The Fiscal Update: A Golden Opportunity to Help Canada’s Charities

Donald K. Johnson

As what has become the near-year-round federal budget process gears up for Finance Minister Bill Morneau’s annual fall fiscal update, officials will be weighing the most efficient methods of serving the needs of as many Canadians as possible. Donald K. Johnson, long a tireless advocate for Canada’s charitable sector, has a suggestion.

Prime Minister Justin Trudeau and his cabinet colleagues have repeatedly stated that their top priority is to support middle-class Canadians. Finance Minister Bill Morneau has a golden opportunity to put those words into action when he delivers his fall economic update sometime in the next few weeks. With a modest tweak to the rules for charitable donations, Morneau could do a huge favour to the many hospitals, universities, cultural groups and social service agencies (among others) that serve the needs of ordinary Canadians.

The minister would open a vast new source of funding for these organizations by allowing proceeds from the sale of private companies or real estate to be exempt from capital gains tax if the money is donated to a recognized charity. As a safeguard, the sale would have to be at arm’s length. In other words, to a party with no connection to the donor, and the donation would have to be made within 30 days of the sale. The recipient organization would be allowed to issue a tax receipt for the donation in the same way it would for a cash gift.

Morneau would simply be continuing along the path that was opened up in 1997, when then-Finance Minister Paul Martin halved the capital gains tax on charitable donations of listed securities. Nine years later, under Jim Flaherty at Finance, the new Conservative government took another step forward by removing the capital gains tax entirely on such gifts. Thanks largely to those moves, the Finance Department estimates that charities across Canada are now receiving about $1 billion a year in stock donations.

The Tories’ final budget in 2015 included a proposal to extend the exemption to donations of private company shares and real estate. But that measure was not passed into law before the election later that year, despite having support from all three parties in the House of Commons. Scott Brison, then the Liberals’ finance critic and now Treasury Board president, spoke out in favour of the change, as did NDP Leader Tom Mulcair.

We estimate that extending the capital gains exemption to gifts from the sale of private businesses and real estate would generate an extra $200 million in charitable donations a year, or about $1 billion over the next five years. That’s not exactly small change, and it could be even more, because the move would put Cana-
dian non-profit groups on an equal footing with their U.S. counterparts when it comes to soliciting donations. South of the border, gifts of appreciated capital assets, a definition that includes listed securities, private company shares and real estate, are currently exempt from capital gains taxes, which is an important reason why U.S. non-profits tend to be far better endowed than Canadian charities.

Some may see our proposal as a tax break for the wealthy. In reality however, it simply removes a barrier to charitable giving by encouraging the wealthy to give back to their communities instead of pocketing the proceeds themselves. The real beneficiaries would be millions of middle-class Canadians served by our vibrant non-profit sector.

I’m confident that, given such a change in the tax laws, many business owners would gladly channel much of their wealth back into society for the greater good, rather than keep it in the hands of a few family members. What’s more, at a time when government funding for social programs is under threat, increased private sector support is more vital than ever. The stipulation that the sale of assets must be at arm’s length should address concerns that buyers and sellers might put an unfair value on the asset to suit their own purposes.

The new exemption would also remove a glaring inequity in the Income Tax Act. At present, entrepreneurs who take a company public can donate some or all of their shares to a charity, free of capital gains tax. Yet those who choose to keep their company private are not entitled to the exemption. The Canadian Federation of Independent Business, which represents 109,000 private companies, strongly supports this proposal. After all, owners of small and mid-sized businesses play a vital role in growing our economy. They are an indispensable source of innovation, new products and competition. We should encourage them in every way we can.

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We estimate that the federal government would forego $50-65 million a year in capital gains tax revenues. The charitable donation tax credit would be the equivalent of $200 million in cash donations, or approximately $60 million for the federal government. The credit is essentially the same as a deduction from taxable income. Two-thirds of the cost would be borne by the federal government and one third by the provinces. There would be no cost to municipalities, because their tax revenues come from property, not income taxes. Every mayor in the country should welcome the exemption because it would provide extra funding to the charities that provide so many vital services in their cities and towns.

Here is a real-life example of how the measure would stimulate charitable giving. A good friend of mine has been a minority shareholder in a private company for more than 20 years. He can sell his shares to the founder and controlling shareholder at any time under an agreement that also determines the fair market value of the shares. If my friend sold his shares today, he would receive $6 million, but would have to pay capital gains tax on whatever profit he made from the deal. Not surprisingly, he has chosen to hang on to his shares and will likely do so indefinitely under the status quo.

However, he has a keen interest in giving back to his community. If the capital gains tax on donations of private company shares was removed, my friend says he would gladly sell his shares immediately and donate the entire $6 million to two charities—Trinity College School, his alma mater, and the Toronto Western Hospital’s Eye Institute. This would be in addition to the $25,000 a year that he already donates in cash to various good causes.

Last, but by no means least, the change we are proposing enjoys strong support among the management, volunteer board members and 2.1 million Canadians employed in the non-profit sector. Their organizations will reap the benefits of more generous private sector donations at a time when governments at all levels are facing budget challenges. They recognize that this proposal is the single most effective action that the government can take to stimulate more private sector funding.

We realize that tax changes are normally unveiled in the annual spring budget rather than the fall fiscal update. But the sooner an expanded capital gains tax exemption takes effect, the sooner the benefits will start flowing to our hospitals, universities and charities. The prime minister and the finance minister, with growing the middle class as their priority, should waste no time getting the job done.

Donald K. Johnson is a philanthropist, former investment banker and an officer of the Order of Canada. He was promoted to the officer level in 2009 “for his key role in changing Canada’s tax laws to eliminate the capital gains tax on gifts of publicly traded securities to registered charities, and for his support of health care research and the arts”.

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