

Should charities receive tax incentives?

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NEW ZEALAND
INSTITUTE OF
CHARTERED
ACCOUNTANTS



Donations



Overview

- Charities Commission and enrolments
- Charities – Is there a market failure?
- Do tax incentives result in more giving?
- What is the future?



Charities Registration

- Commenced receiving registrations on 1 February 2007
- Current registrations
- How many to go?
- How many are there out there?
- What is involved?



Commencement of Registration

The Charities Commission was established in July 2005 and commenced receiving registrations on 1 February 2007.

Current Registrations

Currently (as of 27 November 2007) 1550 organisations had registered with the Charities Commission – this entitles them to either charitable or donee status or both. There are a further 4,000 applications waiting to be considered and the average waiting time is 14 weeks or longer for complex applications.

How many to do?

Previously the IRD had 37,555 organisations registered as charities. The CC has left itself 17 months between 1 February 2007 and 1 July 2008 to have all the organisations registered. We are 60% through the time allowed for registration and we have registered about 4% of the total that IRD had registered.

How many are there out there?

I think that the 37,555 that the IRD had registered are only the tip of the iceberg. John Hopkins University study of the Non-Profit Sector in New Zealand suggests that there could be about 50,000 unincorporated non-profit organisations. Statistics New Zealand believes that there are 96,000 non-for-profit organisations and many more trusts.

What is involved?

Trevor Garrett suggests that this will take 15 minutes to complete a charitable application. Now down to 12 minutes.

How tax incentives work

- Where a taxpayer is allowed a deduction for an incentive, part of the cost is reduced and transferred to other taxpayers.
- The amount transferred is currently 33 cents per dollar.
- The Government expects that if an incentive is introduced, then it will attract additional amounts greater than the cost of tax break to the Government.



Transfer

By allowing a rebate of 33 cents in the dollar, the Government is effectively reducing the amount of tax that a taxpayer would normally pay. This shifts the cost of the private charitable giving onto the rest of society.

The amount paid by the rest of society

Where this is a rebate, it is a constant 33% of the dollars given. In the case of a person on a lower income, a higher percentage of that person's income is sheltered for each dollar given. Where the rebate occurs by way of salary sacrifice, then the tax benefit is determined by the donor's marginal tax rate. Under salary sacrifice, the cost of giving is reduced to persons on higher income.

Price Elasticity of Giving

This measures how responsive giving is to the change in its cost. It assesses the degree to which people give more or less depending on how expensive the donations are. A price elasticity of -1.0 indicates that reducing the cost of giving by 50% raises donations by 50%.

From a tax perspective, if the price elasticity of giving is greater (in absolute terms) than -1, then taxpayers who claim tax deductions for charitable contributions are likely to increase their giving by more than the estimated revenue cost of the subsidy. If it is less than -1 (in absolute terms), then the extra amount that is given to charities is less than what it costs to the Government in terms of a subsidy. If price elasticity of giving is only -0.5 then the govt would be better to give the money directly.

Why give money to charities?

- The case for tax incentives begins with what is called a “market failure”.
- Market failures place a wall between buyers and sellers.
- Are charities supplying a “public good”?
- Caveat – bundling of public goods with others to



Market Failures

There are a number of reasons why markets can fail, lack of information, externalities, market dominance, abuse of monopoly position, and public good. If a market failure exists, economists consider that these market failures are inefficient and recommend government intervention.

Public Good

Proponents of the charitable deduction argue that charities suffer from a particular form of market failure known as “public goods”. To be a public good:

- It is hard to prevent those who don’t pay from using them; and
- One person using them doesn’t reduce the amount left for others.

New Zealand information

Difficult to come to a conclusion on this based on the information that is available in New Zealand. The Institute didn’t raise this matter during its submissions on the legislation, as there is insufficient information to base a case.

In the US there are many organisations that are treated as charities, but they are just the same as profit making businesses. For example, *Ms* magazine, *Nation’s Business*, *Harper’s*. Similarly *National Geographic Society* sells videos, magazines and maps.

New Zealand is not immune to this for example, *Sanitarium*.

Do charitable incentives work

US Experience

- 75% of tax benefits go to 12% of taxpayers
- Size of philanthropic pie in US is the same for last 30 years
- Individual giving is stagnant at less than 2% of personal income
- 79% of giving is planned giving
- Most giving is not redistributive
- Uncertainty as to whether tax breaks work



Regressive Benefits

Most benefits accrue to upper-income taxpayers. 75% of tax benefits go to 12% of the population with incomes of \$100,000 or greater Tax Foundation 2005. In 2000, 400 taxpayers accounted for 7% of individual giving in the US Palgrave Dictionary 2007.

Size of Pie

IRS data show that the size of the philanthropic pie has remained the same over the last 30 or more years (about 2% of GDP). This has continued through the tax cuts during 1981 and 1986 – normally as the price of giving increased, it would suggest that the amount of giving would decrease. (Randolph 1995)

Not Redistributive

The data shows that at an empirical level, non-profit organisations and charitable giving do not serve to redistribute resources. Eikenberry 2003.

Price elasticity

There have been lots of studies into the price elasticity of giving. Up until 1990 most of these found that the price elasticity was greater than -1 i.e. (-1.1 – 1.3). That meant that if a government lost a dollar for the tax incentive, then charities received more than the \$1 lost. In 1995 Randolph did a study on data from 1979-89. This spanned the tax reforms in 1981 and 1986, which contained variation in the price of giving. His methodology allowed him to separate short-run and long-run elasticities. Contrary to prior research this indicated a long-run elasticity of -0.51. Since then Auten have done a similar study which shows an elasticity of -1.26. So the methodology is critical.

Do Charitable Incentives work

UK Experience

- Significant tax incentives in 2000
- Total value & frequency of giving same
- 54% are spontaneous gifts on street
- 20% by way of planned giving
- 7% by way of “Payroll Giving”
- Only half of those giving were aware of the tax deduction.



Giving Changes

Significant changes to incentivise giving in 2000. Government research indicates that there was no change in individual giving from 1998. (Smeaton, Marsh, Rajkumar)

The survey after the measures were introduced indicated that nine out of ten people had given to charity over the previous 12 months.

-The great majority had given in spontaneous ways (street collectors, envelopes, charities lotteries, sponsorship and so on).

-About a fifth had given in planned ways by sending cheques, using credit and debit cards, standing orders.

-Only 7% gave through “Payroll Giving”

-Only half were aware of the tax breaks.

LSE – 2002 (Karen Wright)

83% are spontaneous gifts – 17% are planned. Even where planned donations, only 57% of the persons surveyed did not intend to take advantage of the tax deduction.

Do Charitable incentives work

New Zealand

- 2006 – individual donations \$368M
- Rebates claimed \$122.5M
- Little research on effect of price or sources of individual giving
- Government provides 58% of funding
- AHP indicates tax is not key incentive



2006 Income Year – \$368M

Based on IRD figures for 2005, *Giving New Zealand* estimated that individual donations were \$368M. Individuals claimed \$122.5M in rebates.

This understates the position because, the amount that a person can claim as a donation rebate is capped, you need to have receipt for the amount, you need to file the rebate claims form.

There is also problems with the other major source of data the Household Economic Survey.

Generally tax is not that an important factor in donations

O'Regan & Lynch – Donor Advised Services in New Zealand October 2002.

Choice Determinants of donors giving to charities Fraser Alexander MBA Thesis AUT.

This uses the Analytical Hierarchy Process (AHP) where people indicate what is their key motivation to giving to a charity. Looked at things such as Reputation, Interaction, Personal Values, Empathy, Affordability, Impact. One of the six factors was Affordability and included as a category was tax deductibility. In terms of determinants tax deductibility rates as 23/24.

Summary

New Zealand has an approach to giving that is more like the UK than the US, i.e. there is more spontaneous giving and less concern with tax deductions. Information so far is that tax incentives do not meet the "golden standard". The better course may have been to distribute the \$25million.

What is the future?

- Get the charities registered
- If you can get these registered, there will be issues with the IRD over those that have not filed returns previously.
- If you can get the charities registered there will be increased rebate claims.
- Sort out the relationship between registration (CC) and donee list.



Get the charities registered

There needs to be a major push in the remaining 7 months to get the charities registered. Without that, the IRD should remove them from the donee list and any hope of this measure being effective is nil.

Non-filing charities

There will be a large number of charities that should register which have never been registered with the IRD. What will be the IRD's reaction if these come forward, perhaps there is no tax liability, but there will be a filing liability.

Increase in rebate claims

Provided that you can get increased registration, you can expect increased claims i.e. large gifts and amounts above the current ceiling. This does not mean that the charities are getting an increased amount of money, it just means that more is being paid out.

Relationship between registration (CC) and donee list

IRD will be managing the donee list which determine which what taxpayers can deduct. CC controls the registration process – the relationship needs to be clarified.