

The Charitable Contributions Deduction

A Tax Debate or a Question of Charity versus Government?

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The Charitable Contributions Deduction

There are two senses in which one can conceive of the topic government *versus* charity.

On the one hand, the term versus could be interpreted to mean “as opposed to.” This sense of the term versus suggests that a choice must be made between two options—we must choose between government *versus* charity. Approaching the topic from this angle requires that we form a judgment as to which of government versus charity is the optimal supplier of any given good or service. We are concerned here with identifying the respective advantages and disadvantages of government versus charity, as well as demarcating the respective boundaries of government versus charity. Are charitable purposes a substitute for government, a complement to government, or something else? Are governmental purposes necessarily beyond the purview of charity on the ground that they are non-charitable (or vice versa) or is there an overlap between them? On the other hand, the term versus could be interpreted to mean “in opposition to.” This sense of the term versus contemplates a competition between two things—government *versus* charity in the sense of government against charity. Wrapped up in this sense of the word *versus* is the regulatory relationship between charity and government. What is ideal regulatory posture of the state *vis-à-vis* charities? Should we design and conceive of the legal framework within which charities operate in ways that foster as much as is reasonably possible the autonomy of charities from government (recognizing, of course, the some top-down oversight might be necessary) or alternatively in ways that foster the accountability and subordination of charity to government?

There is a sense in which these questions are insoluble. While some dimensions to the topic can be studied empirically—such as the relative efficiency of charity and government—there is a significant normative dimension to the topic that does not readily avail itself to empirical analysis. Views relating to the ideal regulatory relationship between charity and government are necessarily shaped by views surrounding the respective roles of charity and government, which are in turn informed by policy preferences relating more generally to the proper role and function of government in society. Those who perceive government as the best way to promote the rights of citizenship and to correct for the excesses of free markets will presumably be inclined to favor a small, perhaps even tokenistic, role for charities.¹ Consistent with their state-centered vision of attaining the public good, these persons will presumably also be inclined to support an interventionist state regulatory strategy in relation to the state

supervision of charities. Conversely, those who, for policy reasons, favor a less robust government might be inclined to prefer more privately oriented approaches to solving public ills through private charities and by extension see value in a regulatory strategy yielding a more rather than less autonomous charitable sector. A society, such as the United States, whose national political dialogue is consumed with debating the proper role of government is for this very reason not necessarily going to ever agree upon the proper role of charities vis-à-vis government.

So the goal of this paper is not to even attempt to substantively resolve the topic of government versus charity. For the reasons noted, a substantive argument could go no further than bringing to the table a contestable perspective on how best to achieve the public good as between charity and government. The goal of this paper is to instead reveal the centrality of the government versus charity theme to analyses of charity law and policy. Admittedly, there is a sense in which it is not only true but indeed so obviously true as to possibly be banal to observe that the theme of government versus charity, at least as I have described it above, looms large in debates over charity law. If we define this theme as encompassing analyses of the ideal scope of legal charity and the ideal regulatory framework for charities, then it is by definition true to say that all issues of charity law reduce to these issues. What other issues are there? So it is necessary from the outset to clarify my thesis and its potential value to analyses of charity law.

This paper responds to an observed tendency for debates in charity law to play out at a level that might be obfuscating what is truly differentiating the competing perspectives. Debates over the true rationale behind the charitable contributions deduction supply a timely example and constitute the focus of this paper. These debates play out as though the fundamental point of departure between the two perspectives reduces to a question of income tax logic, namely, whether charitable donations qualify as “income.” The tax base view, most commonly associated with William Andrews, posits that charitable contributions are not income and are thus properly excluded from the normative tax base.² On this view, the deduction is not a tax expenditure but rather a structural income defining feature of tax law. In contrast, the subsidy view posits that charitable contributions are income and that the income tax recognition of such contributions is therefore best understood as a form of state subsidy for charities. The point that I aim to demonstrate is that the debate between these two perspectives might not be a debate about income tax after all, but rather a debate ultimately centered on competing approaches to the theme of government versus charity.

Wrapped up in tax base and subsidy perspectives on the charitable contributions deduction are competing views relating to both the substitutability of income taxes with donations (and by extension government with charity) and the ideal regulatory posture of the state vis-à-vis charities. The tax base perspective appears to accept at some level that charitable donations (and thus charities) are a substitute

for income taxes (and thus government). In contrast, the subsidy perspective is less obviously linked with any particular view of the substitutability of charity and government. Certain claims advanced by subsidy theorists would appear to accept that charitable purposes achieve governmental ends. However, there is also a sense in which the subsidy literature frames charitable giving as something worthy of state support if only because it is a desirable form of private activity. Whatever else might be said of the subsidy perspective, the one thing that seems clear is that it conditions analyses of the charitable contributions deduction in ways that are conducive to regulatory interventions for economizing and safeguarding the state's economic investment in charities. The policy implications are immense, spanning from the definition of charity to the autonomy of charities to self-govern. A recent reform proposal in Canada contemplating a legislatively imposed cap of \$250,000 on the compensation of any individual employee or officer of a charity (discussed below) was expressly premised on the subsidy perspective. The tax base perspective, however, has just the opposite tendency. If it is true that charitable donations are beyond the normative purview of income tax, then the charitable contributions deduction does not amount to a state subsidy. By extension there is no state economic investment implicit in the deduction that needs to be economized and protected through regulatory intervention. This might explain the enduring appeal of the tax base perspective notwithstanding that it has drawn sustained criticism from tax scholars and that it is contradicted by the longstanding practice of including in the tax expenditure budget estimates of revenue losses arising from the charitable contributions deduction.

The value of this paper is that it might better foster meaningful disagreement over the ideal income tax treatment of charitable contributions. Disagreement is only meaningful if we can isolate for reflection what exactly it is that we are arguing about. For this reason alone there is value in considering whether competing perspectives on the charitable contributions deduction do indeed reduce to debates centered on the theme of government versus charity. More specifically, this also helps us to understand why some seeming uncontroversial ideas—such as the claim that treasury efficiency is an appropriate metric for assessing and reforming the charitable contributions deduction—might be met with resistance. As I suggest below, even this seemingly uncontroversial claim draws upon ideas relating to, or at least bodes implications for, the regulatory relationship between charity and state. If contentious ideas relating directly or indirectly to the topic of government versus charity are playing a furtive role in reform discussions, there is value in exposing such ideas for critical reflection to properly focus debate.

Controversial Features of the Income Tax Recognition of Charitable Donations

It has long since been a feature of the income tax codes in the United States, Canada and beyond that qualifying contributions to charities are treated preferentially either via a donations deduction or credit. Given the tenure of charitable donation tax concessions, one might have thought that they would have long since become uncontroversial, that by now there would exist consensus among courts, policymakers and scholars over (1) why charitable donations warrant preferred tax treatment, and (2) the features of an ideal donation incentive. Indeed, in 1972, Boris Bittker observed that the topic had been so extensively argued that he wondered “whether anything new remains to be said.”³ Nevertheless, the debate not only rages on but arguably remains as controversial as ever.

Practically every aspect of the income tax recognition of charitable donations has been contested, including (among other things) the rationale behind recognizing donations, the form (e.g., credit versus deduction) and scope (e.g., floors versus ceilings) of the tax recognition, the ideal evaluative criteria through which to assess the tax rules governing charitable contributions, the range of contributions eligible for income tax recognition (e.g., donations of property versus services), and the identification of eligible donees (e.g., the legal meaning of “charity”).⁴ Notable for purposes of this paper is that debates over these (and other) features of the income tax recognition of donations do not tend to expressly play out as debates centered on competing views relating to the relationship between charity and government.

An exception is the work of Professor Neil Brooks who, writing in the Canadian context, argues that the preferred income tax treatment of charitable donations is “one of the most shameful tax concessions in the Income Tax Act.”⁵ Professor Brooks’ explicitly links his critique of donation tax incentives with the idea that “[t]axes [and thus government] are much more effective at promoting the values of democratic citizenship than are donations [and thus charities].”⁶ His contribution to the scholarly literature is therefore overtly concerned with the relationship between charity and government in the general sense of the respective roles of charity and government in the ideal welfare state. In this respect, Professor Brooks’ contributions to the scholarly literature are, however, the exception rather than the rule.

It is far more commonly the case for debates over the tax treatment of charitable donations to unfold without the point of departure among the competing positions being explicitly linked with rival views surrounding the relationship between charity and government. Instead the debates frequently play out as though they reduce at their most fundamental level to disputes of income tax logic.⁷ The fundamental point of departure between the two dominant theoretical perspectives (tax base versus

subsidy theories) is cast in the literature as a divergence of views over an income tax issue, specifically, whether charitable donations are or are not within the normative income tax base. Tax base theorists maintain that, since charitable donations are outside of the normative tax base, the income tax recognition of donations is appropriately regarded as a structural income-defining feature of tax law rather than an indirect state subsidy or tax expenditure. In contrast, subsidy theorists maintain that, since charitable donations qualify as income the income tax recognition of donations does not serve an income measurement purpose but instead amounts to a state subsidy for charities delivered indirectly through tax law. It is arguable, however, that framing the debate as a contest of income tax logic centered on the scope of the normative tax base has the effect of masking, or at least muting, the considerable extent to which the debate is in reality concerned with the respective roles of charity and government and the ideal regulatory posture of government vis-à-vis charities.

The Tax Base View

In this part I focus on the claim advanced by tax base theorists that charitable donations are outside of the normative tax base. The emphasis will not be on the substantive merit (or lack thereof) of this claim, which has been covered elsewhere,⁸ so much as on the *nature* of the claim. Is this an income tax claim in the sense of a claim buttressed entirely by income tax logic? Or does this claim draw upon considerations pertaining to the charity and its ideal relationship with government. I argue that it is the latter. Specifically, I make two broad points.

The first point, which should prove utterly controversial, is that the income tax concepts relevant to delimiting the scope of the normative tax base, specifically the concept of taxable consumption, are inherently vague. So the argument that charitable donations are not income does not draw upon a rote application of determinate income tax logic so much as it does a policy choice to prefer a definition of income that excludes rather than includes charitable donations. A person could hold just the opposite preference without committing any obvious error of tax logic. The second point following from the first is that those subscribing to a tax base view of the charitable contributions deduction need reasons to prefer a definition of income that excludes charitable donations. I argue that the likely reasons relate specifically to the theme of government versus charity.

The Role of Choice in the Elaboration of the Normative Tax Base

An income tax requires the specification of an income tax base against which income tax can be assessed. This in turn requires a coherent and operational conception of income. It should therefore be no surprise that a longstanding theme in tax policy debates is how income would be defined under an

ideal personal income tax. Indeed, many contentious issues of tax law are either directly concerned with the specification of the normative tax base or, as is the case with charitable contributions, are emanations of this issue.

The principle governing the specification of the normative tax base is the familiar idea that income tax obligations should correspond with taxpaying capacity or, to use the more familiar phrase, “ability to pay.” The process of defining and refining the normative tax base is therefore fundamentally concerned with the identification of appropriate proxies for taxpaying capacity. Notable for present purposes is that these proxies must take account of both sides of the income equation—inclusions and deductions—since both are relevant to discerning a taxpayer’s true taxpaying capacity. Further, they must do so in a way that is attentive to the traditional tax norms of vertical equity (the appropriately different tax treatment of persons with different taxpaying capacities) and horizontal equity (the similar tax treatment of persons with similar taxpaying capacities). That is, income tax law needs to be able to determine when taxpayers are similarly or differently situated not simply based on their receipt of funds from various sources but also based upon their various uses of funds.

The dominant benchmark in analyses of the normative tax base has been the Haig-Simons conception of income—consumption plus gain in net worth over a taxation year.

This formulation has proven particularly influential in relation to the inclusion side of the income equation, specifically in relation to analyses of whether source distinctions should play a controlling role in determining which amounts should be included or excluded from the normative tax base.⁹ It has, however, proven less helpful in terms of identifying which expenditures should be deductible, i.e., excluded from the normative tax base, on the theory that they are not income, i.e., neither consumption nor savings. The focus here is not on the source of funds received (which the Haig-Simons formulation reveals should not matter) but rather on the use of funds. Tim Edgar notes that analyses focusing on the use of funds remain “riddled with difficult distinctions centered on the notion of taxable consumption.”¹⁰ He argues that there is a “lack of any obvious notion of what type of consumption should be taxable as a reflection of ability to pay.”¹¹ He further observes that even Henry Simons’ articulation of the Haig-Simons formulation is notable for its “singular lack of detail in his description of taxable consumption as a fundamental component of his ideal income tax base.”¹² One consequence, according to Edgar, is that “it is not always clear whether, and on what basis, particular individuals should be considered similarly or differently situated in terms of their consumption.”¹³

So the Haig-Simons ideal supplies but a loose reference point for delimiting the scope of taxable consumption and by extension the scope of structural income defining deductions. As one would expect, there exists agreement over the paradigmatic instances of taxable versus non-taxable

consumption. It is accepted that expenses incurred in the income-earning process do not represent taxable consumption and should therefore be excluded from the normative tax base. Conversely, it is accepted that expenses of a purely personal nature unrelated to the income-earning process should be included in the normative tax base. Indeed, it is difficult to conceive of a notion of taxable consumption that categorically excludes such expenses. However, the normative treatment of other expenses, e.g., expenses of a dual character (that is, incurred for both income earning and personal purposes) and charitable donations, is less obvious. Given the malleability of the concept of taxable consumption, it is possible for commentators advancing competing positions regarding the treatment of such expenses under an ideal personal income tax to defend their respective positions with reference to the Haig-Simons formulation. According to Edgar, the fact that “commentators almost universally claim the moral high ground of the Haig-Simons concept of income”¹⁴ reveals that the concept of taxable consumption “can be manipulated.”¹⁵

There is obviously much more that could and should be said to adequately develop the point that the concept of taxable consumption lacks determinacy and that it supplies no more than a highly generalized reference point for delimiting the scope of the normative tax base. But since this point should not prove controversial, let us accept for present purposes its accuracy and move on to consider what insights it yields in connection with the argument that charitable donations are outside of the normative tax base. The most fundamental thing it reveals is that the idea that charitable donations are not income proceeds from a choice. In particular, it proceeds from a choice to embrace an understanding of taxable consumption that excludes charitable donations from the normative tax base over other plausible understandings that support just the opposite conclusion. Exposing the role of choice is important because it reveals that tax base and subsidy perspectives of the income tax recognition of charitable donations share a telling commonality: Both views ultimately reduce to policy preferences or choices, respectively, the choice to exclude charitable donations from the tax base versus the choice to include charitable donations in the tax base but then to subsidize them via tax concessions.

While it might seem unimportant, or perhaps even trite, to emphasize that choice is common to both paradigms, it is a point worth emphasizing if only because the presence of choice tends to be somewhat disguised in the tax base paradigm, at least relative to the subsidy paradigm. Choice is explicit in subsidy theory inasmuch as this theory expressly proceeds from the premise that we *could* subject charitable donations to income tax without contradicting any inviolable principles of income tax but we instead *choose* to allow donors to deduct their contributions as a way of subsidizing charities. One consequence of subsidy theorists expressly framing the preferred tax treatment of charitable donations as a policy choice is that this lays bare the need to identify and articulate reasons in support of this

choice. To expressly acknowledge that a deliberate choice is being made to treat charitable donations preferentially is to acknowledge a need for persuasive reasons to prefer this choice relative to the default position, i.e., taxation of that portion of income donated to charity. Accordingly, the subsidy literature deals overtly and extensively with (1) why the state should choose to subsidize charities, and (2) why an indirect tax subsidy should be chosen in priority to other funding options, e.g., a direct state grant.

In contrast, the very essence of the tax base argument is that deductibility of charitable contributions is less a policy choice than a necessary implication of a tax properly described as a tax on *income*. In fairness, William Andrews, the theorist most commonly associated with the tax base perspective, candidly acknowledges that there are “ambiguities implicit in the concepts of consumption and accumulation.”¹⁶ He observes that “[c]onsumption in particular is not a self-defining term”¹⁷ and that the specification of the normative tax base entails “matters of policy choice and judgment.”¹⁸ There is a sense, though, in which the tax base perspective blesses the deductibility of charitable donations with an apolitical inevitability. If charitable donations are not income, then deductibility is an inevitable and apolitical feature of income tax law rather than a mere policy preference that needs to be justified, evaluated and regulated as a form of state subsidy. To the contrary, deductibility just is, in the sense that it amounts to a structural feature of income tax law necessary to ensure the accurate measurement of taxpaying capacity. On this view, we no more need to explain or justify the deductibility of charitable contributions than we do the choice to tax income as opposed to something else. Somewhat hidden from plain view is the considerable extent to which contestable choices or policy preferences undergird the foundational premise that charitable donations are not taxable consumption and thus not income.

However, once we fully acknowledge the vagueness surrounding the concept of taxable consumption it becomes apparent that choice or policy preference plays a key role in both tax base arguments and subsidy arguments. The distinction between the two approaches is therefore not one of choice versus inevitability, but rather one of choice to support a tax subsidy for charities versus choice to define income in such a way as to exclude charitable donations from the normative tax base. Why does framing the debate in this light matter? What insights are made possible through an acknowledgement of the extent to which choice plays a role in the specification of the normative tax base? One reason this matters is because it enables us to segue to what is ultimately the important question: why do tax base theorists prefer a definition of income that excludes charitable donations in the first place? Interestingly, the likely answers to this question reveal that ideas relating to the relationship between charity and government may well mark the critical point of departure for the tax base perspective. In particular, two ideas relating generally to the relationship between charity and government can be discerned in the policy choice to exclude charitable donations from the normative

tax base. The first idea is that charitable donations (and thus charities) function at some level as a substitute for taxes (and thus government). The second idea is that the optimal regulatory posture of the state vis-à-vis charities would not proceed from a conception of charitable donations as tax expenditures.

Charities as a Substitute for Government

Andrews argues that taxable consumption should be defined consistently with the ultimate purpose of a personal income tax, which he describes as follows:¹⁹

The primary intended effect of a direct, personal tax must be to divert economic resources away from personal consumption and accumulation. Some part of the national output which would otherwise be consumed or accumulated by private individuals is to be devoted to public purposes.

Income tax therefore has the effect of forcibly diverting a portion of what would otherwise have been consumed on non-public purposes, or accumulated for future consumption on non-public purposes, away from such uses so that it can instead be applied toward, and redistributed through, public or collective uses. Income tax is necessary, Andrews observes, because left to their own devices “people acting individually will not tend to pay voluntarily for the provision of public goods or services up to an optimal level.”²⁰

Against this backdrop, Andrews reveals the unique tax policy issues posed by charitable contributions. There is a sense, he argues, in which charitable contributions achieve the very goals that personal income tax is meant to achieve. In the case of alms for the poor, Andrews emphasizes that charitable giving is redistributive in the sense that it “results in the distribution of real goods and services to persons presumably poorer...than the donor.”²¹ Even in the case of philanthropy more broadly defined, Andrews observes that “the goods and services produced do have something of the character of common goods whose enjoyment is not confined to contributors nor apportioned among contributors according to the amounts of their contributions.”²² Charitable contributions therefore represent a unique form of consumption, Andrews argues, in that “the material goods or services purchased with the contributed funds inure entirely to the benefit of persons other than the donor.”²³ The tax policy question for Andrews is whether taxpayers should be required to pay income tax on that portion of income already voluntarily devoted to public or collective purposes through charitable donations. Andrews argues they should not. In particular, he argues that the income tax base should not include consumption “on collective goods whose enjoyment is nonpreclusive or the nonmaterial satisfactions that arise from making [charitable] contributions,” but should instead restrict taxable

consumption to the consumption of “divisible, private goods and services whose consumption by one household precludes enjoyment by others.”²⁴

Andrews articulates a number of income tax oriented reasons to support his position. So, for example, he argues that a progressive marginal rate structure makes it inappropriate to tax donors on their non-preclusive donations to poverty relief charities.²⁵ He argues it is the ultimate recipients of such donations who should in principle be taxed since they are the persons who put the donated funds to private preclusive use.²⁶ If we disallow a deduction to donors, we inappropriately tax the consumption of the poor at marginal tax rates appropriate only for the wealthy.²⁷ Andrews notes that the “probable effect” of this would be a reduction in giving by wealthy donors.²⁸ This is a curious comment as it presupposes that the impact of tax rules on donor behavior is a relevant consideration. Since such considerations have no formal relevance to the goals of income tax, they have no place in a true tax base theory.

Andrews also argues that the charitable contributions deduction ensures equal tax treatment between those who donate cash and those who donate services.²⁹ He reasons that, since those who donate services are not forced to include in their income the value of such services, it follows that it is only appropriate on grounds of horizontal equity to allow a deduction for those who donate cash instead. A deduction for charitable contributions other than services is the only income tax rule capable of ensuring that neither type of donor is taxed on his or her donation. He also cites a number of other income tax-oriented reasons to support his thesis.

Andrews’ tax base argument has been the target of sustained criticism. One critique is that no other deductions have been defended on the ground that they are in respect of non-preclusive expenditures.³⁰ To the contrary, other contexts involving non-preclusive consumption generally result in non-deduction.³¹ This suggests that, if charitable contributions are properly excluded from the normative tax base, it is perhaps not because of their non-preclusive nature. Another critique is that Andrews—notwithstanding his insistence to the contrary—relies upon considerations extrinsic to income tax to justify the deductibility of charitable gifts. On this view, Andrews adds “little to the subsidy justification of the deduction.”³² The essential idea is that the various characteristics of legal charity that Andrews relies upon to justify his conclusion that charitable donations are non-preclusive and thus non-taxable, e.g., charitable purposes are redistributive and collective in nature, are the very characteristics that subsidy theorists point to when arguing that charities are worthy of a state subsidy. Noting the similarity of reasoning, Mark Gergen suggests that “all Andrews really does is to repackage the arguments for subsidizing charities.”³³

A more fundamental objection raised by critics of Andrews' tax base theory is that Andrews overstates the extent to which charitable donations represent a unique form of personal consumption.³⁴ The strong version of this argument posits that, since charitable giving is, for all intents and purposes, of an identical character to every other form of personal consumption, there is no basis for excluding it from the normative tax base. So, for example, John Colombo argues that the decision to "purchase some guilt relief with a donation to the Red Cross" and the decision to purchase "a bag of Ruffles" are indistinguishable in the sense that they are both "designed to maximize personal well-being."³⁵ This reasoning, based as it is on the economic assumption of the utility maximizing rational individual (and what one might call the tautology that, since individuals seek to maximize utility, any given commitment of scarce resources, including charitable giving, can be properly understood as an attempt to maximize personal well-being), is not ideally suited to the study of charitable giving. Indeed, any perspective accepting that the goal of charitable giving is to maximize personal well-being in an identical fashion to the purchase of any and every other good or service supplies a questionable basis on which to truly understand charitable giving. The alleged equivalency exists only if we accept the dubious assumption that the satisfaction associated with altruistic acts is of an identical nature to the self-gratifying satisfaction associated with the consumption of personal goods and services.³⁶ However, the point is probably moot because Andrews' argument does not ultimately rise or fall on whether donating to charity does or does not contribute to a donor's well-being in an identical sense to consuming a bag of Ruffles. We can reject Andrews's tax base argument without accepting the equivalency contemplated by Colombo between these two forms of personal consumption.

It is important for present purposes to isolate the equivalency upon which Andrews' argument does indeed appear to rest. Andrews effectively reasons from the premise that both taxes and charitable contributions fund public or collective goods and services to the conclusion that charitable contributions should therefore not be taxed. If a taxpayer has through his or her charitable contributions voluntarily contributed to the very kind public goods and services that we are concerned would go underfunded without an income tax, then there is no need to tax such contributions.³⁷ Obviously, this reasoning only holds true if we accept that charitable goods and services bear a sufficient resemblance to government supplied goods and services. If they do not, then it is arguably irrelevant, at least from a purely income tax perspective, that charitable goods and services are non-preclusive.

Interestingly, Andrews expressly denies that his theory takes for granted a similarity between charitable and governmental goods and services. After observing that one reason for taxation and government programming is to remedy the underfunding and undersupply of collective goods and services that would otherwise persist, he observes as follows:³⁸

Insofar as that is the reason for taxation, it may well seem counterproductive to lay the tax on that very kind of activity—production of common goods for shared enjoyment—even if the common goods produced by private philanthropic institutions differ substantially from the ones the Government would purchase or produce in the absence of such institutions. (Emphasis added.)

One of the shortcomings with his argument is that Andrews fails to elaborate on this observation notwithstanding that it is foundational to his position. If the common goods produced by charities do indeed differ substantially from the ones produced by government, then it is inaccurate to conceive of charitable giving as, to use Andrews' words, the "very kind of activity" that taxes are meant to coerce. To the contrary, a complimentary purpose is achieved through charitable giving only if charities and governments produce and supply substitutable goods and services. It is ultimately for this reason that Andrews' tax base argument reduces to an assumption that charity is at some level an adequate substitute for government.

The Regulatory Relationship between Charity and State

The second sense in which I contend that the theme of government versus charity can be found in the tax base view derives from the disparate regulatory implications associated with tax base and subsidy perspectives of the charitable contributions deduction. It seems possible, if not likely, that the tax base perspective originates in concerns that characterizing the charitable contributions deduction as a tax expenditure would yield undesirable (from the perspective of adherents to the tax base view) regulatory scrutiny of the deduction. Since this is not an express tenet of the tax base perspective it admittedly cannot be conclusively established. However, it is perhaps very telling that Andrews opens his argument by expressing his unease not with the characterization of the charitable contributions deduction as a tax expenditure per se but rather with the various implications (tax policy, fiscal policy, constitutional, *etc.*) following from this characterization. Of all the possible ways to introduce an argument that Andrews insists is rooted in income tax logic—or, to use Andrews' own words, is concerned with considerations "intrinsic to the elaboration of an ideal personal tax base"³⁹—Andrews somewhat ironically leads off by discussing concerns extraneous to income tax. In particular, he begins by identifying the various ways in which a tax expenditure view of the charitable contributions deduction is bound to attract critiques of and enhanced regulatory scrutiny of the charitable contributions deduction.

The very first sentence of Andrews' paper situates his argument as a response to the frequency with which various features of income tax law are not merely described as but also (and perhaps more of concern to Andrews) evaluated as tax expenditures. He opens with the remark that "[a] variety of provisions in the income tax law are now described as tax expenditures and evaluated as if they

involved direct government expenditures equivalent in amount and distribution to the revenue reduction they produce.”⁴⁰ Developing this point as it relates to the charitable contributions deduction, Andrews goes on to observe that the tax expenditure characterization leaves the deduction vulnerable to critique on equity grounds owing to the upside-down effect of deductibility. Specifically, he observes that “the distribution of matching grants is effectively skewed to favor the charities of the wealthy because of their higher marginal tax rates.”⁴¹ Andrews then goes on to contemplate the possibility that the tax expenditure characterization of the charitable contributions deduction could potentially subject the deduction to constitutional scrutiny. He notes, presumably in reference to constitutional ideals surrounding the separation of church and state, that “we would not permit direct government expenditures to provide matching gifts for churches.”⁴² The implication is that (perhaps) neither should we allow an indirect grant for churches, at least not if the charitable contributions deduction is the functional equivalent of a direct state grant. Andrews then suggests that the subsidy view of the charitable contributions deduction leaves the deduction vulnerable to critique on the basis that it is, to say the least, an unusual way to determine government spending. If the charitable contributions deduction is indeed a tax expenditure, then it effectively affords individual taxpayers with the ability to control through their charitable contributions how and when public monies are allocated. Andrews observes that a system of direct state grants would never be deliberately designed so loosely and so lacking in transparency because “we would insist upon a much more rigorous evaluation of priorities than the tax expenditure mechanism provides.”⁴³

Having identified the various critiques enabled by the subsidy perspective, Andrews candidly concludes that they amount to “devastating criticisms” and that, if valid, they render the charitable contributions deduction “indefensible.”⁴⁴ Of course, he does not go on to recommend the repeal of the deduction based upon the strength of these criticisms. He instead proceeds to deflect these criticisms by arguing that the tax expenditure characterization of the charitable contributions deduction is errant, which, if true, means that any criticism of the deduction following from it being characterized as a tax expenditure is misguided.

What are we to make of the fact that Andrews introduces his tax base argument by first sketching out the policy and regulatory implications of the charitable contributions deduction being characterized as a tax expenditure? On the one hand, we could construe this as reflecting nothing more than an attempt by Andrews to situate his topic into its proper policy context. Even if only for stylistic reasons, it makes sense for Andrews to expressly reveal from the get-go the policy relevance of his argument than for him to leave it to the reader to divine why his argument ultimately matters. On the other hand, we might go further and posit that the manner in which Andrews introduces his argument goes beyond mere stylistic considerations and sheds some light on what might ultimately be driving, or

at least shaping, his tax base argument. For example, one might ask whether Andrews' concerns over the aptness of the tax expenditure characterization ultimately reduce to concerns over the policy and regulatory implications following from this characterization. On this view, Andrews' argument that charitable contributions are not income is as much concerned with inoculating the charitable contributions deduction from tax expenditure oriented critiques and regulatory constraints as it is with anything else.

This interpretation of Andrews falls prey to the obvious criticism that it falsely dichotomizes the tax expenditure view of the charitable contributions deduction and the policy consequences following from this view. If, as Andrews argues, the charitable contributions deduction is not properly viewed as a tax expenditure, then it is obviously correct that it should neither be evaluated nor regulated as though it were a tax expenditure. So the mere fact that Andrews reveals that he is concerned over the charitable contributions deduction being evaluated as a tax expenditure does not in and of itself establish that these concerns are necessarily driving his argument. We do, though, have to keep in mind the point made above that delimiting the normative tax base is not a determinate exercise but rather a process of discretionary line drawing. Inasmuch as choice and policy preferences play a role in the elaboration of the normative tax base they likewise play a role in Andrews' particular prescription of what should and should not qualify as income. It is therefore not a complete answer to simply say that Andrews' objection to the tax expenditure view of the charitable contributions deduction merely reflects his conclusion that charitable donations are outside of the normative tax base. This answer simply obliges us to reflect upon why Andrews, and anyone else subscribing to a tax base view of the deduction, favors a concept of taxable consumption that excludes charitable contributions.

I suspect, though admittedly cannot prove, that the appeal of Andrews' argument (at least to those who espouse it) reflects, at least in part, concerns that the tax expenditure view of the charitable contributions deduction is apt to attract enhanced regulatory scrutiny of legal charity. In saying this I am not by any means suggesting that this is the only consideration underlying the tax base paradigm. Some of the considerations identified by Andrews admittedly raise discrete questions of tax policy that cannot be readily understood as necessarily relating in any discernible way to the regulatory relationship between charity and government, e.g., whether charitable donations should be taxed in the hands of donors or in the hands of the ultimate donees.⁴⁵ Nevertheless, it is instructive to stand back and reflect upon just how fundamental the characterization of the charitable contributions deduction—as an income-defining deduction versus a tax expenditure—might be to the regulatory relationship between charity and government. Once it is seen how pivotal this issue is to the regulation of legal charity it becomes easier to accept that value commitments surrounding the ideal posture that the state should

assume in its regulation of legal charity might indeed play a role in attracting people to accept a tax base view (and by extension to reject a tax expenditure view) of the charitable contributions deduction.

The debate over the correct view of the income tax recognition of charitable donations is important to the regulatory treatment of legal charity because it offers insights into (among other things) the public/private nature of charitable giving, which in turn bodes implications for the proper regulatory posture of the state vis-à-vis charities.⁴⁶ Wrapped up in the debate over the correct view of donation incentives is a debate over the kinds of considerations that should inform the regulation and definition of charity. It is not difficult to see how or why this is the case. A subsidy view of donation incentives supplies a foothold for robust regulatory interventions into the affairs of charities aimed at preserving the state's economic investment in charitable works. A subsidy perspective also lays bare a fiscal dimension to the definition of charity by highlighting the sense in which decisions surrounding the meaning of charity effectively determine which institutions qualify for a state subsidy. In so doing it carries with it the implication that the definition of charity should be approached with a view to economizing the state's subsidization of charities.⁴⁷ In addition, a subsidy perspective is relevant to whether charitable donations should be understood as representing an exclusively private or mixed public/private source of funding for charities. In turn, this bodes implications for whether (and if so, the extent to which) charity regulations should be developed on the basis that charities possess a public character. Having regard to these considerations, it would be fair to say that the only regulatory impact that a tax expenditure view of the charitable contributions deduction could possibly have is in support of a more interventionist state posture vis-à-vis charities. At the end of the day, the tax expenditure view is simply far more conducive than the tax base view to an interventionist approach to regulating charities through measures designed to economize and safeguard the state's economic investment in charities

Given its denial that the deductibility of charitable donations involves any element of state subsidy, the tax base view is consistent with the claim that charitable donations are an exclusively private source of funding for charities. Under this view, it would be difficult to justify regulatory interventions into the affairs of charities on the footing that charities possess a public quality owing to state subsidized charitable donations. Further, it would make little sense under this view for courts and regulators to approach the legal definition of charity as a mechanism for determining which institutions qualify for a state subsidy. To the contrary, the regulation and definition of charity under the tax base view is not in any way complicated by a conception of charities as recipients of public money. The goal of charity regulation under a tax base view is instead to ensure that charities actually "do charity," and, more specifically, do charity based on a conception of charity formally unaffected by tax revenue considerations.

It follows that the regulation and definition of charity under a tax base view is bound to be less restrictive than under a subsidy view in the sense that under a tax base view neither is driven by a concern over economizing the state's economic investment in charities or fixated on whether a given applicant for charitable status is truly worthy of a state subsidy. This, of course, does not mean that the tax base view is by any means opposed to the strict regulation of charity. Under both views of donation incentives there exists a state interest in preserving the public trust inherent in charitable subscriptions through regulatory measures designed to ensure that donated funds are faithfully applied toward charitable purposes.⁴⁸ It is just that the regulatory framework under a tax base view is not premised on the idea that charities receive a state subsidy and should for that reason be regulated as public institutions.

In contrast, the tax expenditure view of the charitable contributions deduction supplies a conceptual basis not only for reporting tax revenue losses resulting from donation incentives as a form of government spending but also for entertaining regulatory models premised on the view that charities are publicly subsidized by the state through income tax law. While it does not automatically follow from the subsidy view that charities should be regulated as though they are public institutions per se, the subsidy view nonetheless exposes an element of publicness that courts and policymakers have for better or for worse concluded should be taken into account to one degree or another at the stage of defining and regulating charity.⁴⁹ The primary, if not singular, way in which the state subsidy for charities is invoked in analyses of charity law is to rationalize constraints on charities either in the form of governmental interventions into the affairs of charities or restrictive interpretations of the legal meaning of charity.

A recent policy debate in Canada regarding executive compensation within the charitable sector illustrates the point. Bill C-470 proposed what was in effect a cap of \$250,000 on the compensation of any individual employee or officer of a charity.⁵⁰ Although the measure was ultimately softened,⁵¹ it is notable that its original form was defended in the House of Commons as a way to safeguard the state's financial support of charities. During debate of the proposal in the House of Commons, Mr. Sukh Dhaliwal, M.P., observed⁵²

Tax receipts were given to over 5.8 million Canadians in the year 2008. The Government of Canada encourages charitable giving through these subsidies... *Thus, we as members of Parliament have every right to scrutinize the salaries of executives that are, to an extent, being partially paid by way of Canadian taxpayers.* (Emphasis added.)

Likewise, Mr. Andrew Kania, M.P., argued that⁵³

The other reason we must support this bill is to protect taxpayers. In the most recent year, the taxpayers of Canada contributed almost \$3 billion in federal tax credits... We

are supporting these executives in their positions. We have a right to know how much they are making and we have a right to set reasonable limits on what that income is.

The appeal to donation incentives reveals the radical regulatory implications of a subsidy view of donation incentives. It would seem that the state's subsidization of charities through donation incentives results in policymakers perceiving themselves as having great latitude to enact regulatory measures in respect of charities that in any other context would seem excessively interventionist.

Even the definition of charity has been shaped, more specifically, constrained, by a subsidy view of donation incentives. The most recent charity decision of the Supreme Court of Canada, *Amateur Youth Soccer Association v. Canada Revenue Agency*,⁵⁴ explicitly referenced tax revenue considerations in reasoning to the conclusion that the common law meaning of charity in Canada should not evolve to include amateur sport. The decision confirmed what many theorists have long since been saying, which is that courts define charity with a view to the income tax subsidy hanging in the balance. That is, the subsidy view of donation incentives encourages constraint in the judicial interpretation of charity as it highlights the sense in which interpretations of charity are tantamount to determinations surrounding what institutions are deserving of a state subsidy. Likewise, it is suspected that a subsidy view of donation incentives is at least in part responsible for the doctrine of political purposes, a rule of law restricting the amount of political advocacy permissible for charities.⁵⁵ Courts have admittedly been reluctant to recognize the role of income tax considerations in the development of this doctrine (as they have generally in charity cases) but the Federal Court of Appeal expressly connected the two in *Human Life International in Canada v. M.N.R.*⁵⁶

An emerging regulatory debate in which a subsidy view of donation incentives is playing a role (in both the cases and scholarly debate) is the extent to which, if at all, discrimination disqualifies an institution as charitable law. The idea that charitableness is incompatible with discrimination is a surprisingly difficult proposition to establish based upon the common law meaning of charity alone. Attempts to restrain discriminatory charity have therefore had to look beyond the common law test for charitable status in order to identify reasons why it is not (or should not be) charitable to discriminate. The idea that charities receive a state subsidy through income tax concessions has factored into this debate. A tax subsidy for charities could be thought to restraint discriminatory charity in three ways. First, it might be said that a tax subsidy is itself a discrete form of state action sufficient to attract constitutional oversight.⁵⁷ Second, it might be said that charities are state actors owing to their benefitting from a tax subsidy. Third, it might be said that a tax subsidy for charities signifies, if nothing else, that charities are public institutions and are appropriately regulated as such. It is the final of these that has had the greatest influence in the cases decided so far.

The leading U.S. decision, *Bob Jones University v. United States*,⁵⁸ dealt with whether two religious schools (Bob Jones University and Goldsboro Christian Schools) could qualify as educational charities under federal income tax law notwithstanding their racially discriminatory admission practices. The case went against the schools. Writing for the majority of the U.S. Supreme Court, Justice Burger adopted what is essentially a tax expenditure based view of the tax treatment of charities. He observed that “[w]hen the Government grants exemptions or allows deductions all taxpayers are affected; the very fact of the exemption or deduction for the donor means that other taxpayers can be said to be indirect and vicarious ‘donors.’”⁵⁹ He did not, however, conclude that the government is constitutionally prohibited from subsidizing discriminatory charities through tax concessions. Instead, Justice Burger reasoned that, given the income tax privileges of charitable status, charities “must serve a public purpose and not be contrary to established public policy.”⁶⁰

The leading Canadian decision, *Canada Trust Co. v. Ontario Human Rights Commission*,⁶¹ was similar. *Canada Trust Co.* dealt with an overtly discriminatory scholarship fund that restricted eligibility for scholarships on the basis of race, gender, nationality, and religion. The recitals in the trust deed stated the settlor’s belief that “the White Race is, as a whole, best qualified by nature to be entrusted with the development of civilization and the general progress of the World,” that the “progress of the World depends in the future, as in the past, on the maintenance of the Christian religion” and that “the advancement of civilization depends very greatly upon the independence, the stability and prosperity of the British Empire.”⁶² The Ontario Court of Appeal unanimously found against the charitableness of the fund.⁶³ Emphasizing that it is the “public nature of charitable trusts that attracts the requirement that they conform to the public policy against discrimination,” Justice Tarnopolsky took note of the privileged legal treatment of charities, specially mentioning the favorable tax treatment of charities, as indicia of this public nature.⁶⁴

The scholarly literature on point has likewise emphasized the idea that a tax subsidy for charities grounds a basis for regulating discriminatory charity. A good example is Nicholas Mirkay, who argues that discrimination is “intrinsically incompatible”⁶⁵ with legal charity and “at odds with the common community conscience and the notion of what constitutes a charity.”⁶⁶ Notable for present purposes is the fact that Mirkay develops this argument with reference to income tax considerations. He argues that “discriminatory policies and practices are fundamentally inconsistent with a tax-exempt status under section 501(c)(3)”⁶⁷ and that “the flow of tax-deductible dollars generated by section 170 should not be used to discriminate against a particular segment of society because the significant cost of providing such tax benefit...is borne by all taxpayers.”⁶⁸ So although he claims that charity and discrimination are “intrinsically incompatible,” his appeal to the income tax treatment of legal charity suggests that his call for greater regulatory scrutiny of discriminatory charity is based more on an

instrumental tax centered view of charity. Be that as it may, the privileged nature of legal charity generally and income tax privileges specifically have also been identified by other authors as a basis upon which to regulate discriminatory charity.⁶⁹

All of these arguments become more difficult to make out if the income tax recognition of charitable donations is not construed as a tax expenditure. If there is no state subsidy to speak of, then the income tax rules relating to charitable donations do not ground a case for classifying and regulating charities as public institutions. Likewise, if there is no state subsidy to speak of, it becomes more difficult to argue that the income tax treatment of charities and charitable donations should be constitutionally scrutinized as though it were a program of direct state grants. It would also become more difficult to argue that charities are themselves state actors directly subject to constitutional oversight. If the charitable contributions deduction is a normative income defining provision, then it could no more make charities state actors than the deductibility of business expenses could have that effect on any private taxpayer.

Numerous other examples could be drawn upon to support the same ultimate point, which is that a subsidy view of the charitable contributions deduction will have a far greater tendency to support regulatory interventions into the affairs of charity than will a tax base view. In fact, it will almost invariably be the case that the only reason why the character of the deduction as a subsidy will arise for discussion will be to justify or help make sense of regulatory practices that might in the ordinary course be viewed as inappropriately interventionist under the circumstances. The tax subsidy characterization allows such practices to be rationalized as, say, attempts to safeguard or economize the state's economic investment in charities or as either a quid pro quo or necessary accompaniment of a state subsidy. The tax base perspective does not assist such arguments. If anything, it refutes them. I believe that this reveals something about why the tax base perspective emerged, or at least why it continues to attract support. For all of its faults it can at least be said to offer an appeal to those who on policy grounds prefer a less rather than more regulated charitable sector.

There is a parallel between the argument advanced here and the sovereignty thesis developed by Evelyn Brody to explain the tax exempt status of charities.⁷⁰ Brody argues that the income tax exemption for charities is best viewed as a policy to promote (within limits) the sovereignty of charities vis-à-vis the state. Explaining the link between tax exemption and sovereignty, she argues that “tax exemption carries with it a sense of leaving the nonprofit sector inviolate”⁷¹ and that “tax exemption keeps government out of the charities’ day-to-day business.”⁷² I have attempted to develop a similar point here by linking the tax base view of the charitable contributions deduction with a policy preference for a more rather than less sovereign charitable sector. Interestingly, Brody argues that her sovereignty thesis is consistent with both tax base and tax subsidy perspectives on the tax exempt status

of charities. This might be thought to conflict with my argument. Can my claim that the ideal of sovereignty is more readily connected to a tax base than a subsidy perspective of the charitable contributions deduction be reconciled with Brody's claim that even a subsidy view of the tax exempt status of charities can be viewed through the lens of sovereignty? I believe that it can.

I do not understand Brody to have argued that a subsidy perspective of the exemption is necessarily equally conducive to the promotion of sovereignty than is a tax base perspective. Her point, as I understand it, is that we should not conceive of sovereignty considerations as corresponding solely with the tax base perspective. So even if we agree that the tax exempt status of charities is best viewed as a form of state subsidy, this simply obliges us to consider why a subsidy delivered in the form of a tax preference should be preferred over a subsidy delivered via a system of direct state grants. Brody's point is that a sovereignty perspective helps explain that choice: since a tax exemption does more to remove the state from the affairs of charities than would a direct state grant, we can rationalize the exemption as a policy tool to promote sovereignty. There is nothing in this reasoning to refute the idea that a tax base defense of either the tax exempt status of charities or the charitable contributions deduction does even more to promote sovereignty relative to a subsidy perspective. The point is simply that we should not think of sovereignty as inhering exclusively in a tax base perspective.

The Subsidy Perspective

The subsidy perspective on the charitable contributions deduction expressly rejects the tax base claim that the deduction can be explained in terms that are intrinsic to income tax, such as the proper measurement of income or taxpaying capacity. Instead, these theories accept as their starting point that the justifications for the deduction lie extrinsic to income tax. As with the tax base view, we find in the subsidy view ideas reflecting an assumed similarity of governmental and charitable purposes and also some normative commitments relating to the ideal regulatory relationship between charity and state. In some instances these commitments are overt, such as the claim that the state should subsidize charities because charities relieve the government of expenses that it would otherwise have to incur.⁷³ This claim could only be true if, and to the extent that, charities supply goods and services dovetailing with the responsibilities of government. In other instances, however, the presence of assumptions relating to charity versus state is far less apparent. The presence of such assumptions, however, helps to explain why seemingly uncontroversial propositions that facially have nothing to do with the relationship between charity and state—such as the idea that the ideal donation incentive is treasury efficient—can become controversial on the basis that they invite reforms tending toward the (further) subordination of charity to state. The analysis in this part will unfold, first, by considering the justifications commonly articulated by subsidy theorists in support of the income tax recognition of charitable donations and,

second, by considering the criteria commonly employed by those sharing a subsidy perspective to evaluate the performance of donation incentives.

Assumed Equivalence of Charitable and Governmental Purposes?

The subsidy perspective accepts as its starting point that charitable goods and services are worthy of state economic support. If charities do not in some way assist government in the pursuit of “the public good” then why subsidize them?⁷⁴ So at some level one might conceive of the subsidy perspective as affirming that charities and government are alike in the very general sense that they share in common a concern for the public good—that they are in the same basic business, so to speak. However, there is a risk of going too far with this reasoning. Practically all tax preferences are meant to induce or reward behavior that is considered by government to be desirable in some way. The mere fact that the state chooses to economically induce certain behavior does not therefore establish that that behavior is governmental in nature. For example, tax concessions in support of home ownership and research and development do not reveal anything inherently governmental about either activity. They simply affirm that some private/nongovernmental behavior is worth promoting because of its socially desirable consequences. Similar reasoning appears in subsidy-oriented analyses of the charitable contributions deduction. For example, one argument is that some public goods, e.g., religion, can’t be provided directly by the state due to constitutional reasons and can therefore only be provided privately and subsidized by the state—if at all—only indirectly.⁷⁵ So the mere fact of a state subsidy delivered in the form of a tax subsidy does not go very far at all in establishing any assumed parallel between charity and government.

There is also a sense, however, in which subsidy theorists draw upon a parallel between charity and government in their defense of the charitable contributions deduction. The standard account for why a state subsidy for charities is both necessary and desirable begins with the idea that charities would be underfunded without a tax subsidy owing to market and governmental failures. Market failure results from the inability of charities to compete with private firms for capital.⁷⁶ Charities are unlike private firms in that they are unable to distribute profits to investors. This removes any pecuniary incentive to “invest” in charities. Underfunding also results from the fact that charities provide “public goods.” Since such goods are non-rival, i.e., no one can be excluded from the goods provided by charities, and non-excludable, i.e., one person’s consumption of these goods does not reduce their availability to others, charities are uniquely vulnerable to free-riding in the sense that people can enjoy the benefits of charitable goods and services without contributing to their cost.⁷⁷ The combination of these factors means that investments in charities are associated with pure risk—risk for which there is no offsetting potential for gain—and thus unattractive to private investors. The government could remedy this

market failure by means of directly supplying the underfunded goods and services but it fails to do so (or at least to completely do so) because government's only supply public goods to the level desired by the median voter.⁷⁸ This means that many public goods for which there is significant public demand are not delivered (and thus not directly funded) by the government.

Having identified government and market failures as the reasons why a funding solution for charities is necessary in the first place, subsidy theorists go on to contemplate why an income tax subsidy in the form of a donation incentive is a defensible policy solution. An alternative policy could entail a system of direct state grants to charities. However, the very reasons why governments do not adequately directly supply the goods and services supplied by charities would presumably likewise complicate the state's ability to implement an adequate system of direct state grants. In any event, a number of arguments have been developed by subsidy theorists in support of why an indirect tax subsidy represents the preferred response. One line of argument emphasizes the efficiency advantages of an indirect state subsidy.⁷⁹ If the tax concessions for charitable donations raise more money for charity than they cost the treasury in foregone revenue, they could be said to be an efficient policy solution to the above described failures of markets and governments.⁸⁰ Another argument is that an indirect subsidy results in a greater quality and diversity of public goods than would a direct state subsidy. The enhanced quality derives from the fact that charities are engaged in an ongoing competition for gifts.⁸¹ The enhanced diversity derives from the fact that charities can provide services for which there exists a public demand sufficient to attract voluntary gifts but insufficient to influence elected legislatures.⁸²

Still yet another argument points to the societal benefits that come from allowing taxpayers to utilize charitable gifts as a means of voting how public funds should be allocated.⁸³ The tax concessions for charitable gifts have been characterized as a "social choice mechanism to determine government spending"⁸⁴ through which the state becomes a "financing partner"⁸⁵ of charitable donors. The benefits associated with this include enhanced pluralism, innovation and civic engagement.⁸⁶ In a similar vein, an indirect state subsidy of charity has been defended on the basis that it better allocates the costs of a given charitable program to the taxpayers who value that program than would a direct government grant.⁸⁷ When a taxpayer makes a charitable gift, the tax concessions reduce the donor's after tax cost of this gift, which essentially results in the cost of the gift being shared among all taxpayers. The tax concessions for donors therefore function in practice as an indirect tax on free-riders. However, even with this cost sharing, the individual donor makes a bigger contribution to the charity than any other single taxpayer. In contrast, a direct grant would allocate the cost of a particular program across all taxpayers without making any adjustment for any individual taxpayer's preferences.⁸⁸

Evident in this reasoning are some very apparent assumptions about the governmental nature of charitable goods and services. The government failure thesis casts the very existence of the charitable sector as a consequence of government failing to supply the full range of public goods that would be supplied by an ideal government. The sector is understood as doing no more than supplying goods and services that in principle would (and perhaps should) be instead supplied by government. On this view there would not even be a need for the charitable sector if the government was providing the optimal level of public goods and services. Under this paradigm charitable goods and services are not even a compliment to governmental goods and services but rather a subset of what the government should be supplying. Even the various advantages that subsidy theorists argue inhere in a tax subsidy are demonstrated by benchmarking against a normative state of affairs in which the government is directly funding or directly supplying charitable goods and services. For example, the idea that donation incentives better allocate the costs of charitable programming to taxpayers who value that programming than would a system of direct state provision only makes sense if accept that charitable programming could be directly supplied by government. Likewise, the idea that donation incentives foster a form of direct democracy whereby taxpayers are permitted to vote (through charitable donations) how public funds are allocated implicitly analogizes between charitable goods and services and the kinds of governmental goods and services that form the basis for democratic votes. Even the idea that donation incentives are a more efficient model of program delivery than direct state provision takes for granted that charitable goods and services could be directly supplied by government.

Treasury Efficiency and Its Regulatory Implications

A necessary implication of the subsidy perspective is that the income tax recognition of charitable donations is intended to function as an incentive to donate. The subsidy theory posits that, rather than directly subsidize charities through direct state grants, the state has instead elected to devote governmental resources to charities by inducing taxpayers to make charitable donations through tax incentives. When viewed in this light it quickly becomes apparent that one of the very purposes of the charitable contributions deduction is to change behavior by inducing taxpayers to make donations they would not otherwise have made. One obvious implication of this view is that it is inefficient to recognize donations that would have been made even in the absence of a donation incentive. The income tax recognition of such donations yields revenue losses to the state with no corresponding increase in revenues for charities. It follows that one evaluative criterion through which to assess the success of the charitable contributions deduction is whether it is efficient at attracting higher levels of charitable giving than would have occurred in the absence of the deduction. The efficiency of the deduction is assessed by estimating the amount of charitable donations the charitable contributions

deduction attracts per dollar of foregone tax revenue. At the risk of oversimplifying, a donation incentive is said to be treasury efficient if the charitable donations it induces are at least equal to the loss of tax revenue it costs.⁸⁹ It is said to be treasury *inefficient* to the extent that it reduces the after tax cost of donations that would have been made even without the tax incentive. In terms familiar to economists, the concept relates to the price elasticity of charitable giving, with treasury efficiency requiring negative price elasticities of 1.0 or more (subject to various adjustments).⁹⁰

It might not be immediately obvious why anyone would object to the concept of treasury efficiency or what this concept has to do with the broader theme of charity versus government. On its face, the concept of treasury efficiency says nothing about either the similarity/dissimilarity of charity and government or the ideal regulatory relationship between charity and state. In a sense the concept of treasury efficiency merely gives concrete expression to the common sense intuition that a donation incentive has to alter donor behavior in order for it to be properly described as an “incentive.” One might have thought it more controversial to argue that the state should subsidize donations unresponsive to incentives than to argue that treasury efficiency is an attribute of the ideal donation incentive. To be clear, no argument is made here that treasury inefficiency is a desirable feature of a donation incentive. It may, however, be a necessary evil that has to be accepted to one degree or another as a public cost of an autonomous charitable sector.

It is instructive to consider the range of potential policy responses that could logically follow from assessments of treasury efficiency. It is through the identification of these policy responses that the controversy potentially inhering in the concept of treasury efficiency may be uncovered. Generally speaking, there are four potential policy responses that could follow from an assessment of treasury efficiency.⁹¹ The first response (the “status quo option”) would be to do nothing because existing incentives are determined to be treasury efficient, or at least sufficiently treasury efficient. The second response (the “repeal option”) would be to repeal existing donation incentives without replacing them with a new model for subsidizing charitable goods and services. The market would be left to fund the supply of charitable goods and services without state support of any sort. The third and fourth policy responses would follow from a determination that existing donation incentives are treasury inefficient, or at least sufficiently treasury inefficient to warrant a change in policy. The third response (the “replacement option”) would be to repeal and replace existing donation incentives. The new funding mechanism would be a system of direct state grants to charities and/or new government programming through which the state would directly supply the goods/services that were previously supplied by charities. The fourth response (the “reform option”) would be to reform existing donation incentives so that they are more efficient. This could be achieved by more selectively targeting donation incentives toward those donors responsive to incentives and away from those donors unresponsive to incentives.

The status quo option is not reflected upon further here. Though it is admittedly to date consistent with the outcome of analyses of treasury efficiency, it is uninteresting for present purposes as doing nothing leaves us with no reforms to reflect upon. Likewise, the repeal option is not reflected upon further here. The repeal option would only make sense if two propositions could be established: (1) donation incentives are either totally inefficient, or at least sufficiently inefficient to warrant their repeal; and (2) the market can be relied upon to adequately supply charitable goods and services.⁹² It is, however, an express tenet of subsidy theory that the market unassisted by government would fail to adequately supply charitable goods and services. Further, the economic literature generally does not support the idea that charitable donations are so inefficient as to warrant their total repeal.⁹³ In any event, if the two propositions—that donation incentives are highly inefficient and that the market unassisted by government would adequately supply charitable goods and services—held true, then this would simply mean that donation incentives were not only ineffective but also unnecessary. The repeal of donation incentives would in this case be immaterial, as it would more or less prove revenue neutral to charities and inconsequential to the supply of charitable goods and services. Again, there is nothing here worthy of further reflection for present purposes.

The policy responses boding implications in relation to the theme of charity versus government are the replacement option and the reform option. These options reveal that the attainment and maintenance of treasury efficiency requires the state to evaluate and continually reevaluate whether donation incentives are functioning efficiently enough to warrant being retained in their current form. Even if only at a very general level, this contributes to an exaggerated sense of charities being in a clearly subordinated role to the state. Charities are left in a position analogous at some level to the precariousness of institutions that must make annual appeals for direct state grants as part of the budgetary appropriations process. In addition, the replacement option makes assumptions about the equivalence of goods and services supplied by governments and charities, respectively. Likewise, the reform option makes assumptions about, or at least bodes implications for, the ideal regulatory relationship between charity and state. It is for these reasons that the seemingly uncontroversial ideal of treasury efficiency might prove controversial from the vantage point of someone who does not accept that governmental goods and services are capable of providing an adequate substitute charitable goods and services or who values a more rather than less sovereign charitable sector.

The Replacement Option

While the comparison of foregone tax revenue with induced donations is transparent in analyses of treasury efficiency, there is another, less overt, sense in which the concept of treasury efficiency draws upon comparative analysis. It is in this additional sense where we find the some potential objections to reforming or replacing donation incentives so as to remedy treasury inefficiency. When charitable tax

concessions are described as being either efficient or inefficient they are ultimately being compared with other ways of funding the provision of the goods and services provided by charities. The reason economists want to know whether each dollar of tax revenue foregone through donation incentives is offset by at least one dollar of induced donations is ultimately because they want to determine whether donation incentives are a comparably more efficient way to fund the same (or at least functionally similar) goods and service.⁹⁴ The comparator funding model assumed in analyses of treasury efficiency is direct state subsidization either through direct state transfers to charities or through the direct provision by the state of the goods and services provided by charities. So in substance, what analyses of treasury efficiency ask is this: could the state directly fund or directly deliver the same (or sufficiently similar) goods and services for less revenue than what is foregone through donation incentives?

If the amount of tax revenue the government loses through tax concessions for charitable donations is greater than the amount of donations induced by those tax concessions, i.e., for each dollar of foregone tax revenue, less than one dollar of new donations are attracted, then direct subsidization is a comparably more efficient funding model, or so it is assumed. That is, a direct-funding model could result in more charitable goods and services being provided for the same level of government spending or alternatively the same amount of charitable goods and services could be provided through a reduced level of government spending. Conversely, if the amount of tax revenue foregone through donation incentives is less than the amount of donations induced, i.e., for each dollar of foregone tax revenue, more than one dollar of new donations are attracted, then indirect subsidization of charities through donation incentives is the comparably more efficient funding model.

An assumption inhering in this analysis is that the goods and services provided to society would essentially remain static regardless of whether (1) charities are funded directly by the state, (2) charities are funded indirectly by the state through a tax subsidy, or (3) the goods and services provided by charities were instead provided directly by the state. In other words, it is assumed that all else would remain equal regardless of which funding model—direct state funding versus indirect state funding through donation incentives—was adopted, such that the preferred funding model is necessarily the more efficient one. The assumed equivalency of goods and services supplied under a direct funding (or direct supply) model versus an indirect funding model is contentious. There is an extensive body of research considering the benefits that come from subsidizing charities indirectly as opposed to directly. These benefits include a greater quality and diversity of public goods, pluralism, innovation, civic engagement, and improved cost allocation between state and citizen. Given these benefits exclusive to an indirect state subsidy, bottom-line cost comparisons with a direct subsidy funding model have the potential to severely mislead policymakers.

It follows that resources consumed through an indirect subsidy might be thought of representing the cost of the specific goods and services that *that* incentive yields. If we value those specific goods and services then the fact that a direct subsidy yielding different (and in some ways inferior) goods and services might draw on less resources is not determinative of anything. Whatever extra costs are associated with a donation incentive could be understood as an expense incurred to secure the unique benefits exclusive to this funding model. One might go so far as to say that, given the different goods and services associated with the two funding models, it is difficult to categorically describe one as being more efficient than the other. The variability of the quality and diversity of the goods and services associated with each funding model frustrate blunt cost comparisons. Treasury inefficiency should not be singularly and reflexively characterized as an absolute vice of a donation incentive because such inefficiency may simply correspond with the cost of securing the uniquely advantageous goods and services fostered by donation incentives.

Further it should not be taken for granted, as analyses of treasury efficiency do, that donation incentives are no more than a vehicle to fund the production and delivery of charitable goods and services. What this ignores is that donation incentives also foster, at least to some extent, other desirable outputs of an intangible nature. To be sure, donation incentives could be defended not only as a public investment in the unique goods and services provided by charities but also as a public investment in the socially desirable phenomenon of charitable giving. Charitable donations represent a voluntary choice to give to strangers. They are unlike gifts between friends and family because charity law, through the public benefit standard, requires that charitable gifts cannot be specifically targeted at persons lacking emotional and obligational closeness to charitable donors. The person's benefiting from charitable gifts must qualify for such benefits as members of the public in the sense that relationship to the settlor (or to anyone identified by the settlor) has nothing to do with it.⁹⁵

So what we are dealing with in charitable giving is a very unique form of giving. The voluntary decision to support strangers brings community benefits that involuntary contributions through income tax and gifts to friends and family do not. Voluntary charitable donations could be said to foster a greater sense of community, empathy, and responsibility to others known only by virtue of their membership in the community, or, as the cases say, an appreciably important segment of the community. While private benevolence follows from affection for a specific person, charitable donations reflect a certain engagement with and investment in the circumstances of remote members of the community. A decision to give to charity is a decision to share with strangers made in circumstances where not sharing would have little to no impact on the donor's personal circumstances and relationships. This unique form of other-centeredness presumably yields benefits in the form of civic engagement and community mindedness that cannot be replicated through income tax or private

benevolence. So even if every dollar of tax revenue foregone through donation incentives is not necessarily offset by induced donations, donation incentives could still be defended as a sound investment in the cultivation and recognition of a socially desirable behavior.

It follows from the preceding that characterizing a donation incentive as treasury inefficient is not a conclusive indictment but rather an invitation to proceed to the next step to consider whether the goods, services, and community-mindedness cultivated through donation incentives are worth the extra costs of this funding model. It is entirely plausible that a donation incentive could be comparably less efficient than a direct funding model but nevertheless still reflect sound tax policy. This would be the case if the unique attributes of the charitable goods and services made possible by donation incentives and the social desirability of charitable giving were determined to be sufficiently advantageous to justify the inefficiency of the incentive.

The only caveat is that a donation incentive would be difficult to defend if it was so inefficient that it failed to attract any donations. This would happen if, for example, demand for charitable donations were perfectly inelastic, i.e., totally unresponsive to tax incentives, or if donations had a positive elasticity of demand, i.e., donations would increase in the absence of tax incentives. If either possibility held true, then most of the benefits of an indirect subsidy would remain with us, even without a donation incentive, by sheer virtue of the fact that donations would not decline in the absence of the incentive. In such a circumstance, the inefficiency of the donation incentive would offer little to no countervailing advantage. Existing economic data does not, however, support either the perfect inelasticity or positive elasticity of demand for charitable giving.⁹⁶

The Reform Option

The replacement option is not the only policy response that could follow from a discovery that donation incentives are sufficiently inefficient to warrant reform. Another potential policy response is the reform option, which would attempt to remedy inefficiency by more selectively targeting donation incentives toward those donors responsive to incentives and away from donors unresponsive to incentives. The goal would be to reduce the cost of the charitable donation tax expenditure program without reducing cumulative charitable giving. Such a reform would transform the charitable contributions deduction from a tax concession generally available to all taxpayers to a more selectively targeted concession aimed at specific kinds of taxpayers only. But it is not simply the characteristics of donors that could matter here. There is always the possibility of the judgment being formed that giving to some charitable causes is too unresponsive to donation incentives to warrant the continued retention of incentives in relation to those causes. The reform option therefore also brings with it the possibility of a narrowed and more specific description of eligible donees. In general, the thrust of the reform

option would be to transform the charitable contributions deduction into a more particularized and possibly more intimate form of state sponsorship. The question is how, if at all, this might impact upon the regulatory relationship between charity and state.

It is difficult to comment in the abstract on the regulatory impact of such a reform without more information about the criteria that would be used to determine eligibility for the reformed donation incentive. However, it could at least be fairly suggested that this might, in at least one respect, tend toward a more-regulated charitable sector. Such a reform could, for example, have the effect of attracting or enhancing constitutional scrutiny of the charitable donations tax expenditure. A live issue under current law is whether tax expenditures should be constitutionally evaluated identically (or at least similarly) to direct transfers.⁹⁷ The issue arises where the state subsidizes through tax preferences an institution that it might be constitutionally restricted from funding through direct transfers. This could be the case if the institution engages in discriminatory practices that would be beyond the constitutional purview of the state or if, say, the religious character of the institution might disqualify it as a constitutionally permissible candidate for a direct state subsidy. The open question is whether the economic equivalence of direct subsidies and tax expenditures should translate into constitutional equivalence.

The U.S. Supreme Court has considered several cases in which the constitutionality of the government subsidizing certain institutions through tax concessions has been reviewed. Summarizing the results of these cases, Edward Zelinsky observes that the court “has equivocated, equating tax benefits and direct spending in some constitutional cases but not in others.”⁹⁸ Similarly, Linda Sugin concludes that the court, despite being “clearly aware of the economic equivalence of tax and direct expenditures” has “resisted the temptation to turn that economic equivalence into constitutional equivalence.”⁹⁹ One lower court decision, *McGlotten v. Connally*, used the equal protection clause to strike down the deductibility of gifts to racially discriminatory fraternal orders based on the economic equivalence of tax and direct expenditures.¹⁰⁰ However, this case is unique in U.S. jurisprudence. Other U.S. cases, while acknowledging that tax concessions for charities entail an economic subsidy, have avoided the constitutional question by finding that some discriminatory institutions do not qualify as charities in the first place.¹⁰¹ Interestingly, U.S. courts have concluded that tax concessions for charities do not even amount to “federal financial assistance” for purposes of civil rights legislation. Since the receipt of such assistance is a precondition to the application of this legislation, U.S. charities have not generally had to comply with these statutes.¹⁰²

So under current law, the economic equivalence of direct subsidies and tax expenditures has not been a controlling consideration. Zelinsky suggests that the design features of a tax expenditure might impact upon the applicability of constitutional considerations with some tax expenditures

perhaps being more likely to attract constitutional scrutiny than others. Consistent with this idea, he argues in favor of a case-by-case approach to determining whether tax expenditures warrant constitutional scrutiny.¹⁰³ His essential point is that the scope and character of state action varies across the various ways in which state subsidies (direct and indirect) can be structured. For constitutional law purposes it is arguably less important to consider whether a subsidy takes the form of a direct subsidy or tax subsidy than it is to consider the intimacy of state sponsorship reflected in the design features of the subsidy.

Using the criteria of permanence, eligibility and quantity (*i.e.*, cost to the fisc), Zelinsky compares two categories of direct expenditures (*paradigmatic expenditures, i.e.*, annual appropriations of specific dollar amounts targeted to specific recipients, and *entitlement-type spending, i.e.*, uncapped funding commitments to social programs, such as social security, available to all who meet the statutory criteria) with two categories of tax expenditures (*classic tax expenditures, i.e.*, permanent tax concessions available to a broad class of taxpayers meeting generalized eligibility criteria, and *rifle shot tax expenditures, i.e.*, time limited tax provisions benefiting a more specifically describe group of taxpayers).¹⁰⁴ He concludes that paradigmatic direct expenditures and rifle-shot tax expenditures are highly similar: neither is permanent, the cost of both is fixed and the legislature more specifically identifies the recipient in both cases. Zelinsky therefore concludes that “[f]rom a constitutional perspective, it is often compelling to view such one-time, targeted tax benefits as akin to direct expenditures rather than as part of the same category occupied by paradigmatic tax benefits.”¹⁰⁵ Also similar under these comparative criteria are entitlement-type spending and classic tax expenditures: both are permanent (they are statutorily provided for without time limit), the cost to the fisc is variable for both of them and, while the state establishes eligibility criteria, it does not in either case select specific recipients.¹⁰⁶ Although Zelinsky doesn’t explicit say so, his reasoning suggests that constitutional law could treat these expenditures the same. In terms of differences, Zelinsky concludes that paradigmatic direct expenditures (and by extension analogous rifle shot tax expenditures) are distinguishable from classic tax benefits (and by extension analogous entitlement spending). Unlike the former, the latter are permanent, the cost to the fisc is variable and the state does not specifically select the specific recipients of the subsidy.¹⁰⁷

Tax expenditure analysis traditionally ignores the differences described above because these differences are not relevant to the primary goal of tax expenditure analysis, which is to provide a more accurate and transparent accounting of government spending. Whether a taxpayer receives \$1 of tax relief through a paradigmatic tax expenditure or through a rifle shot tax expenditure is irrelevant to this concern. In both cases, the state has allocated to the taxpayer \$1 that could have been used in some other capacity. The public interest in having that expenditure disclosed does not vary with the design features of any particular tax expenditure. However, in the context of constitutional law, it is at least

possible that the differences discussed by Zelinsky *could* be relevant.¹⁰⁸ Zelinsky’s ultimate point is that the constitutional question does not simplistically reduce to the economic equivalence of direct subsidies and tax subsidies. Perhaps more important is the intimacy with which any particular subsidy—be it a direct state grant or tax preference—connects the state with the beneficiary of the subsidy. When paradigmatic tax expenditures and rifle shot tax expenditures are viewed from the perspective of the government, it is apparent that the latter, since they are by definition targeted at more specifically described taxpayers, represent a “more particularized, more intimate” state subsidy in comparison with the former, eligibility for which is determined on a far more general basis.¹⁰⁹ A rifle shot tax expenditure might therefore more readily implicate the state in the activities of the institution being subsidized than would hold true of a paradigmatic tax expenditure subsidizing the same institution.

It is in this sense that reforms tending toward the greater particularization of the charitable contributions deduction *could* impact the constitutional scrutiny of the deduction. There is no guarantee that this would happen as much depends upon the criteria that would be employed to more specifically target the deduction. The goal here is not to exhaustively consider the scope of constitutional scrutiny appropriate for tax subsidies so much as to reveal how reforms aimed at improving the treasury efficiency of donation incentives could bring regulatory implications for charities. This is not to say that such reforms would for this reason alone be ill-advised. The point is instead to illustrate the ubiquity of the charity versus government theme in analyses of charity law and policy. It could be said that those who champion treasury efficiency as an attribute of the ideal donation incentive are willing to achieve efficiency at the potential cost of enhanced regulatory scrutiny of charities. Conversely, those more willing to accept a measure of inefficiency might be said to have the exact opposite policy priorities. So even seemingly uncontroversial ideas that on their face have nothing to do with the broader topic of charity versus government—e.g., that donation incentives should be reformed with a view to treasury efficiency—can become controversial in analyses of charity law and policy owing to value commitments surrounding the ideal regulatory relationship between charity and government.

Conclusion

William Andrews said the following of the various criticisms of the charitable contributions deduction emanating from the subsidy perspective: “I do not believe, nor do I think most serious practical students believe, that the charitable contributions deduction is as irrational as this explanation makes it sound.”¹¹⁰ One of the points I have attempted to make in this paper is that I do not believe that the tax base defense of the charitable contributions deduction is necessarily itself any the more rational, at least not in the sense that Andrews portrayed it. This is not by any means to say that the tax base perspective is irrational but rather to observe that it is not necessarily rational in the sense of deriving from

dispassionate, rote income tax logic devoid of policy preference. To the contrary, it may very well be the case that the tax base perspective emerges from (or appeals to) a policy preference against the regulatory implications following from the subsidy perspective. At the very least, it reflects some assumptions about the substitutability of charity and government. Conversely, the subsidy perspective is less easily wed to any particular perspective surrounding the likeness of charity and government. While some versions of the subsidy thesis make assumptions about the similarity of charitable and governmental ends, it would be perfectly consistent with subsidy theory to describe charity as a desirable manifestation of private (non-governmental) behavior. What does seem clear, however, is that the subsidy perspective facilitates regulatory interventions into the affairs of charities to an extent that it is not true of the tax base view. So although the debate between the two perspectives does not transparently play out as a debate expressly centered on the theme of government versus is charity, it could very well be the case that competing views on this very issue are playing a furtive role here. If my reasoning is sound, then I have uncovered a reason why current policy discussions of the deduction are so controversial. These discussions are just as much about the regulatory posture of the state vis-à-vis charities as they are about tax law.

Notes

¹ From this perspective, it has been argued in the Canadian context that the “charitable tax credit is one of the most shameful tax concessions in the Income Tax Act.” See N. Brooks, “The Tax Credit for Charitable Contributions: Giving Credit Where None is Due” in J. Phillips, B. Chapman and D. Stevens, eds., *Between State and Market: Essays on Charities Law and Policy in Canada* (Kingston: McGill-Queen’s University Press, 2001), 457 at 458.

² W. Andrews, “Personal Deductions in an Ideal Income Tax” (1972), vol. 86 *Harvard Law Review* 309-385. See also J.R. Buckles, “The Community Income Theory of the Charitable Contributions Deduction” (2005), vol. 80, no. 4 *Indiana Law Journal* 947-986.

³ Boris Bittker, “Charitable Contributions: Tax Deductions or Matching Grants?” (1972-1973), vol. 28 *Tax Law Review* 37 at 37.

⁴ For a general overview, see D. Duff, “Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform” (2004), vol. 42 *Osgoode Hall Law Journal* 47-98.

⁵ Brooks, *supra* note 1 at 458.

⁶ *Ibid.* at 474.

⁷ For an overview see, for example, C. Kahn, *Personal Deductions in the Federal Income Tax* (Princeton: Princeton University Press, 1960); M. Kelman, “Personal Deductions Revisited: Why They Fit Poorly In an “Ideal” Income Tax and Why They Fit Worse in a Far from Ideal World” (May 1979), vol. 31, no. 5 *Stanford Law Review* 831-884; P. McDaniel, “Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deductions” (1972), vol. 27 *Tax Law Review* 377; and S. Surrey, “Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures” (1970), vol. 83 *Harvard Law Review* 705. See also M. Gergen, “The Case for a Charitable Contributions Deductions” (1988), vol. 74 *Virginia Law Review* 1393-1450; J.D. Colombo, “The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption” (Fall 2001), vol. 36 *Wake Forest Law Review* 657-703; and D. Pozen, “Remapping the Charitable Deduction” (2006-2007), vol. 39 *Connecticut Law Review* 531, at 556.

⁸ See, for example, the works cited in note 7 above.

⁹ If measuring income is concerned with measuring change in economic position either through consumption or savings, then it becomes difficult to conclude that certain receipts should be excluded based upon source alone.

¹⁰ See Tim Edgar, “The Concept of Taxable Consumption and the Deductibility of Expenses Under an Ideal Personal Income Tax Base” in R. Krever, ed., *Tax Conversations: A Guide to the Key Issues in the Tax Reform Debate* (London: Kluwer Law International, 1997) 293 at 295.

¹¹ *Ibid.* at 303.

¹² *Ibid.* at 305.

¹³ *Ibid.* at 304.

¹⁴ *Ibid.* at 305.

¹⁵ *Ibid.* at 309.

¹⁶ Williams, *supra* note 2 at 313.

¹⁷ Williams, *supra* note 2 at 313.

¹⁸ Williams, *supra* note 2 at 315.

¹⁹ Williams, *supra* note 2 at 325/6.

²⁰ Williams, *supra* note 2 at 370.

²¹ Williams, *supra* note 2 at 346.

²² Williams, supra note 2 at 346.

²³ Williams, supra note 2 at 314.

²⁴ Williams, supra note 2 at 314/5.

²⁵ Williams, supra note 2 at 347.

²⁶ Williams, supra note 2 at 347.

²⁷ Williams, supra note 2 347.

²⁸ Williams, supra note 2 at 347.

²⁹ Williams, supra note 2 beginning at 352.

³⁰ See, for example, Edgar, supra note 10 at 341 and Kelman, supra note 7.

³¹ For a discussion, see, for example, Edgar, supra note 10 at 341.

³² See, for example, Gergen, supra note 7 at 1416.

³³ Ibid. at 1416.

³⁴ See, for example, Kelman, supra note 7 at 844-856 and Colombo, supra note 7 at 681 and 667-680, and Duff, supra note 4 at 53. Even Henry Simons, whose conception of income forms the starting point of analysis for most tax base theorists, characterized charitable gifts as taxable consumption. See Henry Simons, *Personal Income Taxation* (Chicago: University of Chicago Press, 1938), at 56-58.

³⁵ Colombo, supra note 7 at 681.

³⁶ Both expenditures yield some form of personal satisfaction but, put simply, the satisfaction that comes from sharing is not the same as that which comes from spending on one's self.

³⁷ See, for example, Andrews, supra note 2 at 370.

³⁸ Andrews, supra note 2 at 370 (emphasis added).

³⁹ Andrews, supra note 2 at 315.

⁴⁰ Andrews, supra note 2 at 309 (emphasis added).

⁴¹ Andrews, supra note 2 at 310

⁴² Andrews, supra note 2 at 310.

⁴³ Andrews, supra note 2 at 311.

⁴⁴ Andrews, supra note 2 at 311.

⁴⁵ Andrews, supra note 2 at 347.

⁴⁶ For a critical analysis of the identification and regulation of charities as “public” institutions, see E. Brody & J. Tyler, “How Public is Private Philanthropy? Separating Reality from Myth” (June 2009), The Philanthropy Roundtable.

⁴⁷ See, for example, A. Parachin, “Legal Privilege As a Defining Characteristic of Charity,” (2009) 48:1 *Canadian Business Law Journal* 36-75.

⁴⁸ The need for this kind of charity regulation long predates the advent of income tax. The 1601 *Statute of Charitable Uses*, the preamble to which has profoundly influenced the modern meaning of charity, was established for the express purpose of ensuring that charitable property is devoted to charitable purposes.

⁴⁹ Brody and Tyler, supra note 46.

⁵⁰ The bill did not impose a hard salary cap but rather conferred on the Minister of National Revenue the discretion to revoke the charitable status of any registered charity paying annual compensation in excess of \$250,000 to any single executive or employee. It would have functioned in practice as a hard salary cap.

⁵¹ The version of Bill C-470 ultimately passed by the House of Commons on March 8, 2011 substituted the salary cap with an obligation to report to the Canada Revenue Agency all employees and executives receiving total annual compensation of \$100,000 or more.

⁵² *House of Commons Debates*, 028, April 19, 2010 at 1631 (Hon. Sukh Dhaliwal).

⁵³ *House of Commons Debates*, 028, April 19, 2010 at 1633 (Hon. Andrew Kania). For similar appeals to the subsidization of charities through income tax incentives in support of Bill C-470, see *House of Commons Debates*, 028, April 19, 2010 at 1632 (Hon. Kelly Block), 1634 (Hon. Paul Szabo) and 1635 (Hon. Albina Guarneri) and *House of Commons Debates*, 009, March 15, 2010 at 420 (Hon. Albina Guarneri).

⁵⁴ [2007] S.C.J. No. 42.

⁵⁵ For commentaries on the significance of income tax considerations to the doctrine of political purposes, see S. Swann, “Justifying the Ban on Politics in Charity” in A. Dunn, ed., *The Voluntary Sector, the State and the Law* (Portland, Hart Publishing, 2000), p. 161 at pp. 166-67; A. Dunn, “Charity Law as a Political Option for the Poor” in C. Mitchell and S. Moody, eds., *Foundations of Charity* (Portland, Hart Publishing, 2000), p. 57 at 75; P. Luxton, “Charitable Status and Political Purpose” (1995), *N.L.J. Annual Charities Rev.* 24 at 28; C.E.F. Rickett, “Charity and Politics” (1982), 10 *N.Z.U.L. Rev.* 169 at 176; and U.K., H.C., “Charities: A Framework for the Future” Cm 694 (1989) at ch. 2.

⁵⁶ [1998] 3 C.T.C. 126 (FCA). In response to the argument that the doctrine of political purposes poses an unconstitutional restraint on freedom of expression, Justice Strayer held at para 18:

The guarantee of freedom of expression in paragraph 2(b) of the Charter is not a guarantee of *public funding through tax exemptions* for the propagation of opinions no matter how good or how sincerely held. (Emphasis added.)

⁵⁷ For a discussion, see part IV(B)(2) below.

⁵⁸ *Bob Jones University v. United States*, 461 U.S. 574 (1983).

⁵⁹ *Ibid.* at 591.

⁶⁰ *Ibid.* at 586.

⁶¹ (1990) 69 D.L.R. (4th) 321 (Ont. C.A.) [*Canada Trust Co.*]. For thorough analyses, see B. Ziff, *Unforeseen Legacies: Reuben Wells Leonard and the Leonard Foundation Trust* (Toronto: University of Toronto Press, 2000); J. Phillips, “Anti-Discrimination, Freedom of Property Disposition, and the Public Policy of Charitable Educational Trusts: A Comment on *Re Canada Trust Company and Ontario Human Rights Commission*” (1990) 9:3 *Philanthropist* 3; and J.C. Shepherd, “When the Common Law Fails” (1988-1989) 9 *E. & T.J.* 117.

⁶² *Canada Trust Co.*, *ibid.* at para. 12.

⁶³ The doctrine of cy pres was applied to remove the eligibility criteria based on race, gender, religion, and nationality.

⁶⁴ *Canada Trust Co.*, *supra* note 61 at para. 100.

⁶⁵ N. Mirkay, “Is It Charitable to Discriminate: The Necessary Transformation of Section 501(c)(3) into the Gold Standard for Charities,” (2007) *Wis. L. Rev.* 45 at 84.

⁶⁶ *Ibid.* at 86.

⁶⁷ *Ibid.* at 84/5.

⁶⁸ *Ibid.* at 85.

⁶⁹ See, for example, P.S.A. Lamek, Case Comment, 4 Osgoode Hall L.J. 113 (1966) at 117. For a more general argument that the legally privileged nature of legal charity attracts an anti-discrimination norms, see J. Colliton, “Race and Sex Discrimination in Charitable Trusts” (2002-03), 12 *Cornell J.L. & Pub. Pol.* 275 at 292/3.

⁷⁰ Evelyn Brody, “Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption,” 23 *Journal of Corporation Law* 585 (1998).

⁷¹ Ibid. at 588.

⁷² Ibid. at 586.

⁷³ See, for example, Pozen, *supra* note 7 at 556 and the authorities cited therein.

⁷⁴ In much of the literature this normative claim is either altogether unacknowledged or acknowledged but left unexplained. Nonetheless, it is foundational to all subsidy theories.

⁷⁵ See, for example, Gergen, *supra* note 7 at 1434-1443 and Pozen, *supra* note 7 at 559. However, not everyone agrees that it is proper for the state to even indirectly subsidize religious activity. See, for example, Brooks, *supra* note 1 at 480.

⁷⁶ See, for example, N.J. Crimm, “An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation” (1998), vol. 50, no. 3 *Florida Law Review* 419-462 and A. Ben-Ner and B. Gui, “The Theory of Nonprofit Organizations Revisited” in H.K. Anheier & A. Ben-Ner, eds., *The Study of Nonprofit Enterprise: Theories and Approaches* (New York: Plenum Publishers, 2003), 3.

⁷⁷ See, for example, Gergen, *supra* note 7 at 1397-98.

⁷⁸ See, for example, Mark Hall and John Colombo, “The Donative Theory of the Charitable Tax Exemption” (1991), vol. 52 *Ohio State Law Journal* 1379-1476, at 1423-25.

⁷⁹ See, for example, D. Pozen, *supra* note 7 at 556.

⁸⁰ See, for example, W. Vickrey, “One Economist’s View of Philanthropy” in F.G. Dickinson, ed., *Philanthropy and Public Policy* (New York: National Bureau of Economic Research, 1962), 31; M. Feldstein, “The Income Tax and Charitable Contributions” (1975), vol. 28 *National Tax Journal* 81; Gergen, *supra* note 134, at 1404; P. Wiedenbeck, “Charitable Contributions: A Policy Perspective” (1985), vol. 50, no.1 *Missouri Law Review* 85-140; Colombo, *supra* note 7 at 683; and Duff, *supra* note 4 at 59-61.

⁸¹ S. Levmore, “Taxes as Ballots” (1998), vol. 65 *University of Chicago Law Review* 387-432, at 411.

⁸² See, for example, B. Weisbrod, “Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy” in E. Phelps, ed., *Altruism, Morality, and Economic Theory* (New York: Russell Sage Foundation, 1975), 171.

⁸³ See Levmore, *supra* note 81.

⁸⁴ Ibid., at 405.

⁸⁵ Ibid., at 388.

⁸⁶ See Duff, *supra* note 3 at 62. Boris Bittker was an early proponent of the view that tax concessions for charitable gifts foster democratic renewal. See Bittker, *supra* note 3 at 61-62.

⁸⁷ Gergen, *supra* note 7 at 1399-1406.

⁸⁸ See *ibid.*, at 1402.

⁸⁹ Other considerations also factor into the efficiency analysis. For example, the direct provision of charitable goods and services by the state would allow for economies of scale that are absent where those goods and services are instead provided by multiple charitable entities indirectly funded through donation incentives. Given the lost economies of scale, donation incentives are presumably inefficient if they merely yield as many donations as they cost in terms of foregone revenue. Efficiency presumably instead requires that they yield more donations than they cost in terms of foregone revenue in order to offset the higher overall operating costs.

⁹⁰ A negative price elasticity of 1.0 or more simply means that as the price of a given commodity drops by a particular amount, say, \$1.00, then at least one additional \$1.00 of that commodity will be demanded as a result. The demand for the commodity is elastic because it varies with price.

⁹¹ Although the four policy responses could be adopted in various combinations, they will be discussed separately for the sake of simplicity.

⁹² I put to the side the possibility that the state might on the basis of efficiency concerns repeal donation incentives only for particular charitable causes, e.g., those least responsive to donation incentives, but retain them for others. However, the same general observations apply here. If donation incentives were sufficiently inefficient to warrant repeal, then it is not clear that this would ultimately make a material difference to the charities removed from the scope of the charitable contributions deduction because charitable giving to these charities would presumably be unaffected.

⁹³ See, for example, J. Pelozo and P. Steel, “The Price Elasticities of Charitable Contributions: A Meta-Analysis,” (2005), 24(2) *Journal of Public Policy and Marketing*, 260.

⁹⁴ This assumes, of course, that we are choosing between two models only, an indirect subsidy delivered through tax law or a direct funding model (either direct state subsidy or direct state provision of goods and services). A third option is no state funding whatsoever. This was discussed above in relation to what I called the repeal option.

⁹⁵ This does not mean that persons at non-arm’s length to the donor or even the donor him or herself are prohibited from directly benefitting from the trust’s goods or services provided they qualify for such benefits *as members of the public*.

⁹⁶ See, for example, Pelozo and Steel, *supra* note 93.

⁹⁷ See, for example, R. Clarke Brown, “State Action Analysis of Tax Expenditures” (1976) 11 *Harr. C.R.-C.L.L. Rev.* 97; Note, “The Judicial Role in Attacking Racial Discrimination in Tax-Exempt Private Schools” (1979-1980) 93 *Harr. L. Rev.* 379; D. Adler, “The Internal Revenue Code, The Constitution, and The Courts: The Use of Tax Expenditure in Judicial Decision Making” (1993) 28 *Wake Forest L. Rev.* 855; L. Sugin, “Tax Expenditure Analysis and Constitutional Decisions” (1998-1999) 50 *Hastings L.J.* 407 at 410; E. Zelinsky, “Are Tax ‘Benefits’ Constitutionally Equivalent to Direct Expenditures?” (1998) 112:2 *Harr. L. Rev.* 380; and David A. Brennan, “Tax Expenditures, Social Justice, and Civil Rights: Expanding the Scope of Civil Rights Laws to Apply to Tax-Exempt Charities” (2001) *B.Y.U.L. Rev.* 167.

⁹⁸ Zelinsky, *supra* note 97 at 380-1.

⁹⁹ Sugin, *supra* note 97 at 464. On a similar note, Robert Brown observes that “[c]ourts seeking to employ the state action doctrine to test the constitutionality of tax expenditure programs have generally encountered difficulty.” See Brown, *supra* note 64.

¹⁰⁰ 338 F. Supp. 448 (D.D.C. 1972).

¹⁰¹ Citing the public policy against discrimination, these cases concluded that discriminatory institutions do not meet the public benefit test for charitable status. See, for example, *Bob Jones University v. United States*, 461 U.S. 574 (1983) and *Coit v. Green*, 404 U.S. 997 (1971). The public policy doctrine is discussed in the next part of the Article.

¹⁰² For a discussion and critique, see David A. Brennan, *supra* note 97.

¹⁰³ Zelinsky, *supra* note 97 at 382–3. Zelinsky’s argument is that owing to (among other things) the differences that can exist between tax and direct expenditures, generalizations regarding their constitutional equivalence are “unpersuasive and often misleading.” See also p. 409 where he observes that “the diverse and overlapping nature of spending and tax programs negates the value of generalized statements about the equivalence *vel non* of tax benefits and direct spending programs.”

¹⁰⁴ *Ibid.* at 400-409.

¹⁰⁵ *Ibid.* at 409.

¹⁰⁶ *Ibid.* at 407.

¹⁰⁷ Zelinsky, *ibid.*, summarizes his analysis as follows at p. 407:

If the direct outlay used for comparison is a classic appropriation, there are indeed important distinctions between that outlay and a paradigmatic tax benefit, distinctions that may be of controlling significance in some constitutional contexts. If, on the other hand, the direct spending used as a baseline for comparison

is an entitlement program, that program is quite similar to classic tax provisions in its permanence, automatic availability to all eligible, and unlimited nature.

¹⁰⁸ Zelinsky, *ibid.*, observes at p. 407 that the “distinctions that may be of controlling significance in some constitutional contexts.”

¹⁰⁹ *Ibid.* at 410-11.

¹¹⁰ Andrews, *supra* note 2 at 345.