Intelligence MEMOS

From: Malcolm Burrows

To: The Honourable Chrystia Freeland, Minister of Finance

Date: October 4, 2023

Re: **AMT and Donations**

Changes to the Alternative Minimum Tax (AMT) rates and rules are scheduled to take effect on January 1 and for the first time AMT will apply to charitable donations from high-income individuals. This is poor tax policy that will produce unintended community harm, as I recently outlined elsewhere.

Current Donation Incentive

Starting in 1996, a series of tax incentives was introduced to encourage Canadians to donate assets, not just income. These tax incentives include contribution limits of up to 75 percent of annual net income during life, and up to 100 percent of net income in the final two lifetime tax returns. There is also a five-year carry forward during life and five-year claim period after death. The 75-percent contribution limit is the charitable version of the AMT as it ensures some tax is paid.

The donation tax credit is the basic tax incentive. It is applicable to all donations made by individuals, but varies by the amount of the donation, income of the donor, and province. For high-income taxpayers, it can be up to the highest marginal tax rate in the province. Another key incentive is available for in-kind donations of public securities, which since 2006 have generated a donation tax credit and nil capital gains.

AMT Basics

Since 1986, AMT has provided a floor tax rate – overriding certain deductions, exemptions, and credits. The underlying policy assumption is that all Canadians should pay a minimum amount of tax.

The current AMT rate is 15 percent. The new rate is 20.5 percent. Previously, AMT started at $40,000 in annual income. Starting in 2024, the new income floor will be $173,000. From a policy perspective, AMT is designed to promote fairness in the tax system. The policy target of AMT is high-income individuals who structure their finances to receive tax efficient income such as dividend or capital gains. It also catches specialized credits and deductions, including tax shelters.

AMT focuses on personal consumption and has never applied to charitable donations. In current tax policy, charitable donations are an alternative to taxation. Donations produce a tax benefit, but they are not personal consumption. They are a self-directed contribution to society.

AMT Donation Impact

The tax benefit from donations will be reduced in two ways on January 1. First, there is a 50-percent reduction in the non-refundable tax credit. Second, for in-kind donations of public securities, there is a 30-percent reduction in the capital gains exemption. These reductions only apply when AMT is triggered. While the changes will catch donations of public securities and reduce tax efficiency of flow-through share donations, even ordinary cash donations will be caught.

Who will be affected?

The donors most affected will be high-income taxpayers who sell a business or other capital asset. They have liquidity and a major tax liability. A donation in the year of the sale will offset a portion of that liability, directing money to charity.

The greatest loser will be charities. Since 1996, tax rules have created a model of private-public support. Donations have become bigger, and charities have become more dependent on them. These new rules will create more unfunded needs and pressure on government, at all levels. Tax policy is social policy. The new rules undermine a complex and successful social support system.

Why the change?

There are a couple of unspoken policy rationales for the new AMT rules. First, reduce the tax effectiveness of public securities donations. The Department of Finance historically viewed the capital gains exemption as too rich, but it has transformed philanthropy in Canada. The fear was donation substitution: Public securities would replace cash donations to produce a better tax outcome. This has occurred.

The second unspoken policy rationale is reducing donations to private foundation and foundations with donor advised funds. Foundation assets have increased by more than 300 percent in the last 15 years. In response, last year the disbursement quota was increased to 5 percent to distribute more money into the community. Now AMT will reduce inflows. While there are good reasons to promote higher outflows, discouraging the use of foundations will hurt charities and communities.

Donation-Killing Complexity

Another problem is rule complexity. I recently spoke to a tax accountant who observed that the rules will create uncertainty and deter donations, even for those who are exempt. The old assumption of reasonably straightforward donation tax incentives will vanish. A chill will descend.

Donations are not tax evasion

In choosing to include donations in AMT, Finance Canada has created a tax policy category error. AMT is about personal consumption. Charitable donations are irrevocable gifts to benefit charity and the community. If Ottawa wants to address minimum taxation levels among high income donors the mechanism to consider is the contribution limit.

Charitable donations and charities are essential tools to provide public good. Charitable giving is self-directed public good and has been supported by key tax incentives since 1996. Donations impoverish the donor and enrich the community. They need to be encouraged.

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