

# The complicated issue of tax incentives



**Giedre Lideikyte Huber** is assistant professor of Tax Law at the Faculty of Law and a vice-director at the Institute for Law and Economics, University of St Gallen, Switzerland. [giedre.lideikytehuber@unisg.ch](mailto:giedre.lideikytehuber@unisg.ch)

**Henry Peter** is full professor at the University of Geneva where he is also head of the Centre for Philanthropy. [henry.peter@unige.ch](mailto:henry.peter@unige.ch)

## Are tax incentives a valuable tool to stimulate philanthropy? There are no easy or clear-cut answers

In a 2020 report titled 'Taxation and philanthropy', all 40 countries studied by the Organisation for Economic Cooperation and Development (OECD) and the Geneva Centre for Philanthropy granted tax reliefs associated with philanthropy.

The fact that a portion of public funds continuously flows to this domain raises several questions, notably: Are tax incentives justified? Are they effective? If yes, should we have more? If no, shouldn't they be eliminated?

None of those questions has a straightforward answer.

The overall idea behind tax incentives for philanthropic activities is easily stated – to increase giving to the nonprofit sector. But more delicate discussions arise concerning specific types of tax incentives. These can be classified into





*Are tax incentives justified? Are they effective? If yes, should we have more? If no, shouldn't they be eliminated?*

two broad categories: incentives for donors and incentives for nonprofit entities. The former encompasses different tax reliefs for giving, such as a tax deduction or a tax credit, and the latter is usually an exemption of officially recognised nonprofit entities from various types of tax. This exemption is not controversial unless the entity's activities steer away from nonprofit to business.

However, the justification of tax incentives for donors is a matter of considerable contention. Their aim is rarely explicitly stated in legislation or policy documents, though it can be safely inferred from legal documents on different tax reforms that

governments' main goal is usually to increase the volume of the voluntary redistribution of private resources (and not, for instance, to reward donors). Consequently, if the incentives fail to achieve this objective, they cannot be justified from a policy perspective. Unfortunately, governments rarely evaluate the effectiveness of tax incentives for philanthropy. Such efforts are mostly left to researchers who have a more limited access to relevant data. The efficiency of philanthropic tax incentives is measured through concepts of treasury efficiency and social efficiency.

**Treasury efficiency**

Treasury efficiency is a public finance concept, indicating whether a particular tax relief encouraged an increase in charitable giving. Let's illustrate this with an example: if a donor who is taxed at the marginal rate of 30 percent gives \$100 to a charity and can deduct the entire donation from his taxable income, the donation only costs the donor \$70 ( $100 - 100 \times 30\%$ ) while the state does not collect \$30 of tax revenue. If one can show that without a tax incentive the donor would have given only, for instance, \$20 to a charity, the additional funds that were effectively given by the donor in favour of



public good are \$50, thus higher than the revenue not collected by the state (\$30), so the measure encouraged the increase in giving and is treasury efficient.

### Mixed results

While this is what governments are usually looking for, it is relatively difficult to measure and the research results about the success of tax incentives are mixed. In fact, donors' responses to tax incentives will not only depend on the size of the incentive, but also on many other factors, such as its design and the information available about the incentive, etc. For instance, an income tax deduction – the most popular tax incentive for giving globally – is not the best at producing increased giving, especially in comparison with direct subsidies, such as matches. Overall, as Steinberg puts it in *The Routledge Handbook of Taxation and Philanthropy*, 'the economic case for the favourable tax treatment of donations is quite uneasy.'

### Social efficiency

There are also arguments for 'social efficiency', which amounts to assessing whether a tax relief for charitable donations leads to the production of public goods having a *social value which is greater* than the one that would have been produced by the state had it not granted a tax relief. One contested view is that whenever the nonprofit sector is more efficient than the government in addressing societal questions, the 'investment' in it is justified. In our view, which is also expressed by several authors, a stronger argument for the state to subsidise nonprofits is that of pluralism and complementarity: as individual donors give to diverse nonprofit organisations and goals, donations can help to create and sustain a youthful, sensitive nonprofit sector, which better and more quickly adapts than the state to the social context. As Andreoni and Smith point out, attention should however be paid to large gifts, which, if subsidised with taxes, raise democratic concerns.

Governments might decide to channel such gifts only to specific public purpose goals, and transparency and accountability must in such cases be particularly observed. But the trend of 'for-profit' philanthropy that is described by Reiser and Dean in their 2023 book (*For-Profit Philanthropy*) is a cause for concern.

### Keep or discard?

Without reliable information about their efficiency, should thus tax incentives for philanthropy be eliminated?

Not necessarily. Even though solid evidence on the economic efficiency of tax incentives is lacking, the fact that they are already deeply ingrained in existing tax systems means that if they are taken away suddenly, there is likely to be reaction from donors (as happened in France when wealth taxes were modified), which would result in decreased funding to at least certain sectors. To address this, researchers suggest that governments would need to adopt a long-term approach and compensate the losers. If legislators want to modify the tax framework, the first step might be to make existing incentives more efficient and more egalitarian (for instance, adapting tax credits instead of tax deductions). When it comes to implementing new tax incentives, states should be much more careful, bearing in mind the arguments above.

### Towards effective generosity

One last question worth asking which takes us beyond the realm of taxes is what is philanthropy? The definition provided



**Unfortunately, governments rarely evaluate the effectiveness of tax incentives for philanthropy. Such efforts are left to researchers.**

by the OECD report as 'the act of giving by individuals and corporations, to philanthropic entities with worthy purposes', has been criticised by some scholars as western-centric and ignoring horizontal dimensions of philanthropy, such as long-standing pro-social habits of solidarity and reciprocity that are embedded in many non-western cultures. In addition, if the definition of philanthropy shifts from a pure act of giving to the concept of effective generosity – that is, what the gift costs the donor in relation to their total wealth – the result would be very different from the current concept. As above, the most common tax incentives do not reward such generosity. For instance, a tax deduction in a progressive income tax system rewards donors more bountifully simply because they have higher incomes, irrespective of the size of their donation. In addition, empirical research seems to show that when wealth increases, the generosity of individual givers, defined by the proportion of their wealth given to charity, mostly decreases, through all wealth classes. Paradoxically, therefore, a jurisdiction that has a progressive tax system and incentivises charitable giving through deductions, like Switzerland, awards less generous donors with higher tax reliefs for their gifts.

One way to resolve these tensions might be to redefine the concept of philanthropy and associated tax benefits in light of donors' effective generosity. This could facilitate a more comprehensive and nuanced understanding of this field, provide stronger constitutional justifications for tax incentives and, from a societal perspective, identify the individuals who are the most significant philanthropists.

*The authors of this piece co-wrote the OECD report section on main findings and policy options for Switzerland. ●*