Tax incentives for philanthropy

A systematic study of the impact of tax incentives on charitable donations is the need of the hour

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Do people donate money to charity to get a tax rebate? The answer for most donors is 'no'. They donate because they believe in the causes they support, or the quality of work that some NGOs are doing, or because they are committed citizens. Why then are tax incentives needed for the charity sector? Why should the government forgo revenue it can generate from taxing charitable donations? Do tax incentives have any impact on charitable donations? We don't know the answer to the last question, as a study on tax incentives across 12 countries, including India, by the Centre for Social Impact and Philanthropy (CSIP) at Ashoka University, in research partnership with the Centre for Budget and Governance Accountability, highlights. This is because the impact of tax incentives on charitable donations has not been systematically studied in the Indian context. The only publicly accessible study uses data from the 1970s-80s, when tax incentives for philanthropy were more appealing than they are now because the overall tax rates were much higher.

A poorly studied area

Raising taxes is a core attribute of statehood. But remarkably, tax incentives for charity also have a long history. They go all the way back to the 19th century in some of the countries studied, and are also provided in countries such as Brazil which have a restrictive tax incentives regime for civil society. Despite this, the role of tax incentives in supporting civil society is poorly studied in most countries, The best studies are from the U.S. and the U.K. These are primarily econometric studies which measure the increase (or decrease) in charitable donations due to changes in the tax incentives provisions. These studies depend on the availability of tax and donor data to researchers. But in these countries too, the non-monetary impact of tax incentives is not deeply examined. For example, does the legal relationship that tax incentives create between the state and the civil society as a sector impact its financial health and stability?

It does appear that in India, financial flows coming through tax incentives are not the mainstay of civil society (CSIP, 2021). However, given the overall nature of the sector, they may still be very critical. Many NGOs in India are small and operate with budgets of less than ₹15 lakh a year (CSIP, 2019). The distribution of NGOs is also skewed: they are concentrated in States like Uttar Pradesh (MOSPI, 2012). Most NGOs work in the areas of health and education. For small NGOs in remote areas or those working on areas that are less recognised, the tax incentives status may still be important for establishing legal recognition with the community, government entities and donors.

When examined from the perspective of the government, civil society organisations have historically played an irreplaceable role in social development. Many government programmes have emerged due to a harmonious relationship with NGOs that have implemented an innovative idea. Governments have provided the scale and state support while the NGOs have provided the ideational energy and community experience. The activity-based learning approach developed by Rishi Valley in Tamil Nadu during the early 2000s is an example.

The signalling effect

The most important role of tax incentives as the regulatory and legal link between the state and the civil society is that of the 'signalling effect'. It denotes that the state supports philanthropic activity and through its revenue forgone, actively encourages private actors to engage with public problems.

A systematic study of the impact of tax incentives is the need of the hour, particularly one on the various provisions in supporting philanthropic activity which highlight the many ways in which India's tax incentives regime can be made more responsive. For example, countries like France have a credit-based system, which is more equitable than the deduction-based system followed by India which privileges high-income donors. Studies in the U.S. and the U.K. suggest that high-income donors are more sensitive to tax incentives, and a carefully crafted regime can be used to target this category of donors. We also need to take a re-look at reinstating other categories of taxes such as wealth and inheritance tax so that charity-focused tax incentives can benefit the non-profit sector.

Our new tax regime dilutes the state-civil society relationship by giving donors the option to opt out of incentives for lower tax rates. Saving the revenue forgone from tax incentives may not increase the government coffers significantly, but this will impact the perception of the NGO sector for an average donor. And if this gets done, here's hoping that it is supported by research and rationale.

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