1. INTRODUCTION

THE activities of charitable organisations are subsidised by Government in a number of countries. Charitable contributions have been viewed as a special type of expenditure that deserves government subsidy because of its beneficial social effects[1] that are used to justify government intervention in economic activities.

A subsidy may be given through a direct grant and/or through tax concession.[2] The latter can be provided through full or partial tax allowance or tax credit.[3] Different forms of a subsidy can be considered as alternative means to stimulate charitable contributions.

1. Forms of the Incentive in Different Countries

Forms of the tax incentive for charitable contributions differ among countries. Australia, Greece, Norway and the United Kingdom give a fully deductible tax allowance for such contributions. The incentive in the same form but subject to a ceiling in absolute amount or in terms of a fixed proportion of taxable income of the contributor is given in Belgium, Canada, Denmark, France, Germany, Portugal, Turkey and the United States of America (USA). Japan and the Netherlands have a partially deductible tax allowance subject to a ceiling. In India both fully and partially deductible tax allowances are allowed, depending on the character of the beneficiary charitable organisation.

The incentive in the form of a fully deductible tax credit subject to a ceiling is given in New Zealand, and the form of the incentive in Spain can be characterised as partially deductible tax credit.

The benefit of the tax incentive in some of the abovementioned countries is however subject to certain limitations. For example, in Belgium, Denmark and India, no tax allowance is given unless the contributions exceed a fixed lower limit. Similarly, some of these countries give tax allowance only in respect of the amount of contributions in excess of a fixed amount (e.g., Japan) or in excess of a fixed proportion of taxable income (e.g., the Netherlands).

2. The Issues

Two main issues in the context of charitable contributions are: (*i*) the rationale for charitable contributions and (*ii*) the choice of form of subsidy to stimulate the contributions.

Charitable contributions are primarily philanthropically oriented. Justification for the contributions is given generally in the framework of interdependence of utilities. It is implicit in the hypothesis of interdependence that an individual feels compassion for those who are relatively less well off. The utility of an individual is taken to depend not only on the goods and services personally consumed, but also on the level of utility attained by others.[4] This philanthropic orientation might seem to be inconsistent with the presumed goal of profit maximisation by the corporate entities, but it has been empirically shown by Schwartz (1968) that corporate giving is also philanthropically oriented. A justification for the same is provided in terms of utility functions of the managers. If the utility functions of the managers of corporate entities depend on non-pecuniary elements, business conduct inconsistent with this presumed goal will be generated (Douty, 1972).

The choice of form of subsidy for stimulating charitable contributions gives rise to issues that are complex and wide-ranging. These issues relate mainly to 'visibility' of the subsidy,[5] appropriate definition of income, problems of horizontal and vertical equity, the desirability of decentralised finance for public and quasi-public services, and the effects of the tax incentive provision on both the volume of charitable contributions and the tax yield. Subsidisation through a tax incentive may also raise an issue about the choice of a floor level.[6]

The study aims at analysing the effects of the tax incentive on both the volume of charitable contributions and the tax yield, and evaluation of alternative forms of the tax incentive in terms of efficiency[7] of the different forms.

3. Review of Earlier Studies

There have been a number of attempts in the USA to estimate the effects of the tax incentive for charitable contributions and loss in tax revenue to the exchequer. A variety of data sets based on cross-section and/or time series incorporating low income and/or high income donors have been used. These studies include those of Taussig (1967), Schwartz (1966, 1968 and 1970), Feldstein (1975*a*, 1975*b*), Feldstein and Taylor (1975, 1976), Feldstein and Clotfelter (1976), Boskin and Feldstein (1977), Dye (1977), Fisher (1977), Reece (1979), and Clotfelter (1980). All these studies excepting Schwartz (1968) have focused on the contributions by persons while Schwartz (1968) focused on contributions by corporate entities. All these studies show that the tax incentive in the USA has led to an increase in the charitable contributions. These studies except those by Taussig (1967) and Schwartz (1970)[8] also reveal that the charitable organisations receive more than what is lost in tax revenue by the exchequer due to the incentive, implying that the incentive has been efficient. However, the efficiency of the incentive differs for different categories of charitable contributions like the contributions to educational, religious, and political institutions[9] and with different income-categories of the donors.[10] The findings of the studies conducted in the USA do not necessarily have the same implications for other countries, as especially the economic conditions of the developing countries differ greatly from those of the USA.

4. Objectives of the Study

No study has been attempted to analyse empirically the effects of the tax incentive in developing countries. This study is a step towards filling this gap. It analyses empirically the effects of the tax incentive in a developing country, India.

In India, like in some other countries, the tax incentive to stimulate charitable contributions has been liberalised and extended to contributions to various charitable organisations, over time. These decisions have been based mainly on the belief that the tax incentive leads to a substantial increase in the contributions in relation to the loss in tax revenue rather than on proven facts. Thus the main objectives of the present study are:

(*i*) to provide empirical evidence of the effects of the tax incentive on the volume of charitable contributions and on the tax yield;

(*ii*) to provide an estimate of the efficiency of the incentive; and

(*iii*) to evaluate stimulative effects of the alternative schemes of providing subsidy to the charitable organisations such as direct subsidy and schemes of deduction (tax allowance) and tax credit for charitable contributions.

5. **Scope of the Study**

The scope of the study is limited to corporate entities (hereinafter referred to as companies). The companies account for a major share of the total charitable contributions. In India, unlike the USA, companies played a relatively greater role in supporting the activities of charitable organisations, and availed themselves of most of the tax relief allowed so far in respect of contributions to such organisations. While the donor companies constituted less than 30 per cent of the total number of those donors who availed of the tax relief for charitable contributions, these companies accounted for more than 75 per cent of the total deductions (tax allowance) and more than 85 per cent of the tax relief allowed (columns 10 to 12 in Table 1.1). The average rate of tax relief, and per donor deductions and the tax relief are also found substantially higher for companies than for non-company taxpayers (Table 1.2).

The present study covers only the declared contributions for which tax relief has been availed. However, some amount of contributions might not have been declared. The likelihood of this omission is more in the case of contributions made to religious organisations.

6. **Plan of the Study**

The study is divided into five chapters (in addition to this first and introductory chapter) as follows:

Chapter 2 discusses the provisions of the tax incentive for stimulating charitable contributions in India. Also, it describes the rate structure of the corporation income tax.

The problems relating to availability and quality of the data are discussed in Chapter 3. In doing so, quality of both publish-

TABLE 1.1

Deductions and Tax Relief Allowed for Tax Incentives for Charitable Contributions by Category of Donors

Year	Companies			Non-Companies			All-Donors			Donor companies as percentage of all donors	Deductions of companies as percentage of those of all donors	Tax relief of companies as percentage of that of all donors
	Number of donors	Amount of deductions (Rs. lakh)	Tax relief (Rs. lakh)	Number of donors	Amount of deductions (Rs. lakh)	Tax relief (Rs. lakh)	Number of donors	Amount of deductions (Rs. lakh)	Tax relief (Rs. lakh)			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1969-70	1041	171	99	4529	49	16	5570	220	115	18.69	77.73	86.09
1975-76	1663	504	298	5538	99	32	7201	603	330	23.09	83.58	90.30
1978-79	2109	669	404	5632	102	28	7641	771	432	27.60	86.77	93.52
1985-86	2982	1238	737	49390	1227	292	52372	2465	1029	9.79	46.81	71.62

Note: Figures reported in this table are based on the total number of income tax payers in the books of the Inc ome Tax Department at the end of a year. These have been estimated on the basis of information obtained from the Directorate of Inspection (Research, Statistics and Public Relations), Income Tax Department, Government of India, and information compiled from the *Report of Comptroller and Auditor General of India* (CAG).

TABLE 1.2

Average Rate of Tax Relief, and Per Donor Deductions and Tax Relief Allowed for Incentive for Charitable Contributions by Category of Donors

Year	*Deductions Per Donor (Rs. thousand)*			*Tax Relief Per Donor (Rs. thousand)*			*Average Rate of tax relief on the contributions (%)*		
	Companies	*Non-Companies*	*All Donors*	*Companies*	*Non-Companies*	*All Donors*	*Companies*	*Non-Companies*	*All Donors*
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*
1969-70	16.55	1·09	3.06	9.55	0.33	1.51	28.86	15.31	24.65
1975-76	30.27	1.79	5.72	17.94	0.57	2.97	29.63	15.95	25.95
1978-79	31.72	1.83	7.68	19.25	0.49	4.16	30.45	13.34	27.09
1985-86	41.52	2.48	4.71	24.71	0.59	1.96	29.77	11.90	20.87

Notes: 1. This table is derived from Table 1.1.
2. Charitable contributions are taken to be double the amount of deductions as the contributions to most of the charitable organisations are eligible for a deduction of 50 per cent of the contributions.

ed and unpublished data are examined from the point of view of the objective of this study.

Chapter 4 presents a conceptual framework of the study and gives methodogy for estimating the effects of the tax incentive and for evaluation of the alternative schemes of the incentive. It also discusses the concepts of income and price effects of the tax incentive.

The results of our empirical analysis of the tax incentive are contained in Chapter 5. It gives the estimates of the effects of the incentive in terms of income and price elasticities of the contributions, stimulative effects of the current form of the tax incentive and that of the alternative forms of the incentive on the volume of charitable contributions.

Finally, Chapter 6 presents a summary and policy recommendations of the study. Policy imperatives are also indicated with reference to costs of administration of a subsidy through the tax incentive provisions and through direct grants. Comments on the misuse of tax incentive and on the scope for manipulation of direct grants, and suggestions for improvements in statistical parameters are also included in this chapter.

Notes and References

1. It is interesting to note in this context that in the USA in 1917, the income tax law was amended to allow deductions for charitable contributions when tax rates were sharply increased to finance the war; the introduction of the deduction was intended to offset the effect of higher tax rates on (or prevent the higher tax rates from substantially reducing) charitable contributions (Feldstein, 1975*a*, p. 82).
2. For lucid discussion on the alternative forms of the tax incentive, see McDonel (1972*a* and 1972*b*).
3. Kahn (1960) presents a persuasive argument that a tax credit is a more suitable policy device than a deduction when the purpose is to subsidise some desirable activity rather than to refine the concept of income (pp. 87-91).
4. Reece (1979) points out that this rationalisation was first suggested by Boulding (1962) and Vickrey (1962), subsequently advocated by Schwartz (1970) and later interpreted in a formal model and used to derive some empirical implications of the utility interdependence hypothesis by Becker (1974).
5. A straightforward grant has the merit of 'visibility' and is subjected to periodical scrutiny by the legislature and the public in the

process of preparation of annual budgets. A subsidy through tax provisions is seldom subjected to scrutiny and its revenue effect is not known with certainty. Further, the provisions in the tax laws designed to grant incentives for specific purposes might give rise to considerable administrative as well as enforcement problems. For a lucid exposition of the merits of a direct subsidy, see Surrey (1972). However, it has been argued by some eminent authorities that tax incentives have certain merits to justify their retention in the fiscal armoury while the need for evaluating their cost and benefit is generally accepted. For example, see Bittker (1969) and Feldstein (1976).

6. Goode (1976) presents a case for a floor of 3 per cent of adjusted gross income for the USA (p. 165). The presence of such a floor may affect the contributions significantly as the tax entities cannot enjoy the benefit of tax incentives unless their contributions exceed the specified floor level.
7. A tax incentive for charitable contributions is said to be efficient if the charitable contributions attributable to the incentive exceed the loss in revenue to the exchequer due to the incentive.
8. In the studies of both Taussig (1967) and Schwartz (1970), the explanatory variables employed were not adequately defined, which results in underestimation of the effect of the incentive. For details, see for example, Feldstein (1975*a*).
9. See, for example, Feldstein (1975*b*), and Reece (1979).
10. See, for example, Schwartz (1970).