6. SUMMARY AND RECOMMENDATIONS

1. Forms of the Incentive in Different Countries

IN a number of countries, the activities of charitable organisations are subsidised by the government through a tax incentive. 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 the 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). A partially deductible tax allowance subject to a ceiling is offered as incentive in Japan and the Netherlands. In India, both fully and partially deductible tax allowances are offered, 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, however, is 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. Objectives of the Study

In none of the countries other than the USA adequate empirical work has been adduced to justify modifications, and retention or deletion of the tax incentive for charitable contributions. 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, as 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 current 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 scheme of providing subsidy to the charitable organisations such as direct subsidy and schemes of deduction (tax allowance) and tax credit for charitable contributions.

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 contribution on the volume of such 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 (1975a, 1975b), 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 individuals while Schwartz (1968) focused on the contributions by corporate entities (companies). All these studies show that the tax incentive in the USA has led to an increase in charitable contributions. These studies except those by Tausigs (1967) and

Schwartz (1970) 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.

4. Scope of the Present Study

The scope of the current study is limited to companies. This however covers a major part of the total charitable contributions on which the deductions have been allowed. In India, unlike in 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 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 allowances) and more than 85 per cent of the tax relief allowed. The average rate of tax relief, and per donor deductions and the tax relief are also found to be substantially higher for companies than for non-company taxpayers.

5. Provisions of the Tax Incentive

In India, the basic structure of the tax incentive for charitable contributions has remained unchanged since the mid-seventies. The scope of the incentive has however been widened over time. This has been done by bringing in an increasing number of charitable organisations into the purview of the incentive.

A donor is allowed a deduction in computing his taxable income, equal to 50 per cent of his contributions to approved charitable organisations. However, for contributions to the Prime Minister's National Relief Fund and to organisations involved in promoting family planning, a deduction of 100 per cent of the contributions is allowed. Only contributions in money and not of property, etc. quality for the incentive. Further, if the amount of contributions is less than Rs 250 then the deduction for contributions is denied.

For contributions to some of the charitable organisations, the amount that qualifies for the tax incentive is subject to a ceiling. The ceiling is calculated as a minimum of 10 per cent of gross total income of the donor, and Rs 500,000.

6. **Tax Structure of Corporate Income Tax**

The basic tax rate structure of the corporate income tax in India has remained stable for a fairly long time. During the assessment years 1974-75 to 1983-84, the tax rate schedules applicable to different categories of companies have remained unchanged, though the surcharge on income tax has varied from 0 to 7.5 per cent. The rate of surcharge on income tax was 5 per cent during 1974-75 to 1978-79, 5 to 7.5 per cent during 1980-81, 2.5 per cent in 1982-83 and nil for the assessment years 1979-80, 1981-82 and 1983-84.

The tax rates applicable to a company depend on the category of the company. For foreign companies, different rates are applicable to income from different sources. During 1974-75 to 1983-84, widely held and closely held industrial companies were taxed under the step system. For each of the two categories of companies, two tax rates were applicable depending on the income level. In effect, the two-rate step system was equivalent to a rate schedule of three rates for different income brackets. Recently, the step system was replaced by a single tax rate. The range of variation in the corporate tax rates has been higher during 1974-75 to 1983-84 than that in the later period. It was 45-80 per cent during 1974-75 to 1983-84 which has been reduced to 50-65 per cent in the subsequent years.

7. **The Methodology**

The demand for charitable contributions is taken as function of income and price of charity.

The effect of the alternative tax incentives on the volume of charitable contributions and on the tax yield are estimated in terms of income and price elasticities of such contributions by using plausible specifications of demand for the contributions.

Estimates of efficiency of the alternative tax incentives for charitable contributions are obtained through simulation exercises based on the estimates of income and price elasticities of the contributions.

A price elasticity of —1 would mean that the amount of charitable contributions attributable to the incentive equals the loss in the tax revenue to the exchequer due to the incentive, and a price elasticity of less than —1 (greater than —1) would mean that the charitable contributions due to the tax incentive exceed (fall short of) the loss in tax revenue to the exchequer.

8. The Data

The basic corporate tax rate applicable to different categories of companies had remained unchanged during the assessment years 1974-75 to 1983-84, and variation in rates of taxation between and within the different categories of companies has been greater than that in the later period. So it was thought appropriate to use data on a cross-section of companies relating to a year falling in the period 1974-75 to 1983-84. The latest year in this period for which required data could be compiled is 1978-79.

Regarding the set of data on cross-section of donor companies, we have been able to compile information on 564 donor companies from those companies for whom the assessments were completed in the year 1978-79. These 564 companies account for 26.7 per cent of the donor companies and 21.5 per cent of the deduction availed of by all the donor companies in the year 1978-79.

9. Main Findings and Policy Imperatives

The main findings of the study can be summarised as follows:

(*i*) The scheme of deductions for charitable contributions increased the quantum of such contributions substantially. In the absence of the incentive provisions, the contributions by the companies would have been lower by about 64 per cent of the actual contribution. In the absence of the incentive the contributions in the year 1978-79 would not have been more than Rs 484 lakh as against Rs 1338 lakh with the incentive and in the year 1985-86 these would have been less than Rs 900 lakh as against Rs 2476 lakh with the tax incentive.

(*ii*) The amount of contributions attributable to the scheme of deductions for contributions exceeds the tax revenue forgone by the exchequer due to the incentive. For a one-rupee sacrifice in tax revenue by the Government due to the tax incentive, donations to charitable organisations increased by more than two rupees.

(*iii*) The stimulative effect on charitable contributions that has been achieved through the scheme of deductions for contributions could alternatively be achieved through the scheme of tax credit of 30 per cent of the contributions without any sacrifice in efficiency of the tax incentive. Since a scheme of tax credit, unlike a scheme of deductions, gives equal price incentive to all the companies to make charitable contributions, as under it the price of a unit of charity is the same for all companies, it therefore seems to be preferable to a scheme of deductions.

(*iv*) There seems to be a trade-off between the volume of charitable contributions that can be achieved through a suitably designed scheme of the tax incentive, considered in this study; it has been found that the scheme which results in a higher amount of charitable contributions has the lower efficiency.

(*v*) The amount of charitable contributions under the scheme of tax credit of 40 per cent for contributions could even be more than two times as much as under the scheme of tax credit of 20 per cent, with a little difference in efficiency of the tax incentive under these schemes.

(*vi*) If it is desirable to stimulate the activities of charitable organisations through a subsidy, it is appropriate to do so through suitably designed schemes of deductions or tax credit for contributions rather than through a scheme of block grant to charitable organisations.

(*vii*) In explaining charitable contributions of donor companies, the measure of income defined in terms of post-tax income rather than pre-tax income seems to be the correct one. To the extent the decision on contributions depends on income, the relevant income variable is post-tax income. The argument put forward by Reece (1979) in favour of pre-tax income (i.e., gross income defined somehow) as an appropriate variable in explaining the contributions is a misconception.

10. Limitations of the Study

Various important aspects of the tax incentive under discussion could not be analysed due to non-availability of requisite data, such as, identifying the organisations that benefit most from the current tax treatment of contributions and also those organisations which would suffer most from abolition of the relevant tax provisions. In order to facilitate a more meaningful evaluation of the tax incentive, improvements in the data base are necessary. The suggestions for improving the data base are discussed in Section 11.

The findings of the study about the income and price effects of the tax incentive are based on the usual two assumptions: (*i*) the cost of administration of a subsidy as stimulus to charitable contributions is the same whether the subsidy is given through the tax incentives or directly through a scheme of block grant, and (*ii*) the degree of misuse of the funds of charity and use of undesirable techniques to mobilise more resources by various charitable organisations is also the same whether the subsidy is given through the tax incentive or through a block grant. If these assumptions turn out to be untrue, then our findings need to be qualified.

With regard to the cost of administration, the main finding that it is appropriate to stimulate the activities of charitable organisations through a tax incentive rather than through a block grant will be at stake only if A exceeds B: Where A is the cost of administration of subsidy for charitable contributions through a tax incentive in excess of the cost of administration of the subsidy through a block grant, and B is the amount of charitable contributions attributable to the tax incentive in excess of the tax revenue forgone by the exchequer due to the tax incentive.

The issue of misuse of the funds of charity perhaps is only remotely connected with the mode of subsidy, whereas the extent to which the donor companies indulge in tax evasion through misuse of the tax incentive provisions is an issue important enough to require a separate study.

11. Suggestions for Improving the Data Base

The suggestions for improving the data base can be divided into three broad categories: first, those relating to changes in the assessment forms[1] to provide for collection of requisite information; second, relating to the system of collection of information to ensure complete coverage of the population under consideration; third, relating to the compilation and publication of information at a reasonable level of disaggregation by status and income classes of the taxpayers.

(*a*) *Changes in the ITNS-150C/150E/assessment forms.* Provisions should be made in the ITNS-150C/150E assessment form to collect the following information on income tax payers:

(*i*) Whether a closely held company is industrial or other than industrial. (This would require a change only in the ITNS-150E assessment fort.)

(*ii*) The break-up of charitable contributions or deductions for contributions according to the types of recipient charitable organisations. For this purpose, charitable organisations can be divided into four broad categories according to the differences in the provisions for deductions. The first category (say, category A) should consist of :

(*a*) the National Defence Fund;
(*b*) the Jawaharlal Nehru Memorial Fund;
(*c*) the Prime Minister's Drought Relief Fund;
(*d*) the National Children's Relief Fund, and
(*e*) the Indira Gandhi Memorial Trust.

The Prime Minister's National Relief Fund should form the second category (say, category B). Also, with effect from April 1, 1989, this category should include the rural development fund set up and notified by the Central Government, and a trust or institution of national importance which has as its main objective the undertaking of scientific research or carrying out of any rural development programme or any programme of conservation of natural resources, etc. The third category (say, category C) should include all the other approved charitable organisations except those involved in promoting family planning which should constitute the fourth category (say, category D).

(*b*) *Strengthening the system of information collection.* Upto the assessment year 1983-84, the information on taxpayers was compiled on the basis of assessments completed in a financial year. It is well known[2] by now that the assessment forms sent to the statistician, Directorate of Inspection (Research, Statistics and Public Relations) did not cover all the assessments completed in a financial year. Further, while compiling the requisite information from the available assessment forms, it has come to our notice that adequate care had not been taken to state requisite details in these forms, particularly those concerning rebates and allowances such as depreciation allowances, development rebate and deduction for expenditure on scientific research. As a result, the final statistics compiled from these assessment forms give a distorted picture of the real phenomenon. From the assessment year 1984-85, information on taxpayers is compiled on the basis of returned income relating to an assessment year instead of assessed income relating to the assessment completed in a year. The mode of compilation of information continues to be the assessment forms. The number of assessment forms based on even the returned income, received by the statistician, Directorate of Inspection, continues to be below the expected number. This necessitates strengthening of the system of information collection.

The income tax offices should be instructed and equipped adequately to provide all the detailed information in the ITNS-150C/150E assessment forms and forward these to the statistician within a reasonable time span. The personnel entrusted with this responsibility should be adequately trained to understand and appreciate the importance of these data. This will lead to a substantial improvement in the quality of all those published data that are compiled from these assessment forms.

(*c*) *Compilation and publication of data.* The data on charitable contributions or deductions for contributions should be compiled and published by status and income classes of assessees, separately for the four categories of charitable organisations described above in section 11a(*ii*). These data

TABLE 6.1

Description of Presentation of Data on Donor Companies

Gross income class (Rs '000)	*Number of Donor companies*	*Gross income (Rs '000)*	*Loss set-off (Rs '000)*	*Assessed income (Rs '000)*	*Charitable contributions/deductions*				
					Total (Rs)	*To organisations of category*			
						A (Rs)	*B (Rs)*	*C (Rs)*	*D (Rs)*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
—20									
20—50									
50—100									
100—200									
200—300									
300—400									
400—500									
500 1000									
Above 1000									
TOTAL									

Note : The four categories (A, B, C and D) of charitable organisations are as described in Section 11a(*ii*).

on each of the four categories of companies described above may be presented as shown in Table 6.1.

Notes and References

1. These are statistical summary sheets (ITNS-150C/150E) which are filed by the various income tax offices in the field from the particulars contained in the income-tax returns and annexures.
2. For details of the shortcoming of *All India Income Tax Statistics*, see Government of India (1976); Gupta, Anupam and Aggarwal, Pawan K. (1982), and Bagchi, A. and Aggarwal, Pawan K. (1983).