
OSGOODE HALL LAW SCHOOL

**TAX EXPENDITURES AND PUBLIC POLICY IN
COMPARATIVE PERSPECTIVE**

Toronto – September 11, 2009

Tax

By Ellen Zweibel, University of Ottawa and Karen J. Cooper, LL.B., LL.L., TEP

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Ecological Gifts are a Bargain

Prof. Ellen Zweibel, University of Ottawa, Faculty of Law
Karen J. Cooper, LL.B., LL.L., TEP



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Introduction

- The ITA provides enhanced charitable tax benefits and relief from taxable capital gains for gifts of ecologically sensitive property through the Ecological Gifts Program (“EGP”)
- The EGP was introduced in 1995 as a tool for encouraging the conservation of habitat and biodiversity across Canada

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- Tax expenditure estimates include the expenditures related to ecological gifts in the charitable category
- They are critiqued as part of the general critique of charitable expenditures, with particular negative attention focused on capital gains relief

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- BUT, the EGP is really an environmental expenditure
- The EGP is one of many programs designed to protect Canada's environmental heritage and biodiversity
- It recognizes that conservation measures focused on private lands are essential
- Economic incentive or payment for stewardship - retention and restoration of natural capital

Evaluating a Conservation Tax Policy

- As an environmental expenditure, it should be evaluated based on
 - Environmental effectiveness
 - Economic efficiency
 - Equity (distributional) impacts
 - Flexibility and political feasibility

- Focus on environmental effectiveness by looking at the net benefits of the environmental services provided

Net Environmental Benefits =

Value of Ecological Services Obtained –
Costs

- Costs = tax expenditure
administrative costs
transactional costs

- This analysis
 - Demonstrates that the EGP is a bargain
 - Society receives ecological goods and services worth far more than the compensation paid to private land owners thru the tax expenditure
 - Allows better comparisons with other environmental tools
 - Identifies EGP design weakness
 - Responds to the charitable expenditure based critique

Basic Requirements Of Ecogifts

1. Eligible Recipient:

- Territorial, provincial or federal departments or agencies
- A municipality or quasi-municipality
- An approved registered charity whose main purpose is the conservation and protection of the environment

2. Ecologically Sensitive Land:

- The property must be ecologically sensitive and its conservation and protection important to the preservation of Canada's environmental heritage
- Environment Canada has developed a definition of "ecologically sensitive land," see *The Canadian Ecological Gifts Program Handbook 2005* and the Environment Canada website
- The Minister of the Environment, or his designate, will issue a *Certificate for Donation of Ecologically Sensitive Land* (or, in Quebec, a *Visa pour dons de terrains ou de servitudes ayant une valeur écologique*)

3. Certified Fair Market Value:

- The FMV of the gift must also be certified
- The FMV of an easement, covenant or servitude is determined using the “before and after” method of valuation, e.g. the FMV of the gift is the value of the land before the grant minus the FMV of the land after the grant
- Independent appraisals are submitted to Environment Canada, which is reviewed by the Appraisal Review Panel
- An appeal process is available

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Tax Benefits

- Some of the tax benefits of an ecological gift are the same as for all gifts:
 - Donors receive a non-refundable tax credit or deduction
 - Any unused portion of the donor's ecological gifts may be carried forward for up to five years

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- Ecological gifts also receive tax benefits which are more significant and similar to those available for gifts of publicly listed securities:
 - The taxable capital gain realized on disposition of property is nil
 - The upper donation limit has been removed

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Tax Expenditure Budget Estimates What do they really tell us?

	Estimate			Projection
	2000	2003	2006	2008
Credit – Indiv.	1,495	1,825	2,390	2,640
Deduction – Corp	375 (13)	255 (10)	524(24)	422(12)
Indiv. Capital Gains Exemption	19	6	27	46

Notes:

- Credit & deduction: Combined with all other gifts (ecological and cultural gifts)
- Capital gains: Combined with publicly listed securities (indiv) and cultural property (corp)
- Capital gains extrapolated from EGP data. Assumes ACB value based on undisclosed "historical" values
- Split gifts aren't accounted for at all

Case Study: Jack's farm in Ontario

- Jack is a small farmer who works as a truck driver for additional income
- During the last 5 years, his income from trucking exceeds his gross farm revenue. The annual household income is \$67,000
- He is considering either an outright donation or a conservation easement on his 100 hectares of land in the Credit Valley River watershed

- Although much of this land (50 hectares), which has been in his family for several generations, is in cultivation or used as hay land, 20 hectares are wetlands and 30 hectares are a managed woodlot
- Ducks, geese, and other wildlife are abundant on these lands
- The land has an adjusted cost base of \$150,000 and is now worth \$1,500,000. Although it is zoned agricultural, current zoning allows the severance of a building lot
- With a conservation easement, the land is valued at \$500,000

Natural Capital and Ecosystem Services

Natural Capital: Natural resources, ecosystems, and land that produce a flow of goods and services

Ecosystem Services:

Provisioning	Regulating	Supporting	Cultural
Food	Climate Regulation	Soil Formation	Recreation
Fuel	Disease Regulation	Nutrient Cycling	Aesthetic
Bio-chemicals	Water Regulation & Purification	Primary production	Educational
Genetic	Pollination		Cultural

Ecological Services: Use Value of Wetlands

Direct Use	Indirect Use	Option	Existence
Recreation Hunting Harvest	Water quality Flood control Nutrient retention Groundwater recharge Micro-climate regulation	Potential Future uses	Culture Heritage Biodiversity

Ecological Services: Forest and Agriculture

Forest	Eco-agricultural Practices
Water regulation	Reduced soil erosion
Erosion control	Reduced sediment delivery
Soil formation	Reduced phosphorus
Waste treatment	Species biodiversity
Storm water control	Reduced GHG emission
Genetic resources	
Carbon sequestration	

Valuing Ecological Services

- **Data emerging from a relatively new field**
 - Millennium Ecosystem Assessment
- **Contributes to strategic decision making:**
 - Investing in natural capital
 - Business case for conservation over built capital
 - Choice and design of fiscal instruments
 - Quantifying fines and damage
- **Limitations:** Large data gaps; complex inter-relationships
Best used for comparisons on a relative scale rather than absolute values

Measuring Natural Capital Values

- Valuation Methods are context specific
- Vary with:
 - Scientific knowledge and data available
 - Purpose (designing a PES or Regulation)
 - Level of detailed required
 - Data collection costs
 - Time & resources available
- Wide range of values produced

Economic Valuation Approaches

- **Direct: Stated Preferences** (Contingent value surveys; Choice Modeling)
- **Indirect: Revealed Preferences** (Distance traveled; Hedonic Pricing, Real estate \$)
- **Proxy** (Replacement; Substitution)
- **Benefit Transfer** (estimates from other sites)
- **Total Economic Value:** What are the non-market and market services & what methods to value each

Ecological Gifts: What can be valued?

- Amalgam of mostly non-market services
- Indirect Uses and Option Value
- Some Direct Use (Recreation, Water)
- Value of the total ecosystem services provided free of charge
- Simultaneous benefits

Credit River Valley

Minimum Estimates of Natural Capital Value
\$3,911 / ha / year from preliminary study

Land Cover Types	Ecosystem Services	Annual Value (millions)
Wetlands	Climate Regulation	41.0
Urban Forests	Disturbance Avoidance	16.1
Riparian Forests	Water supply	100.5
Agriculture	Waste treatment	137.1
Meadows	Pollination	4
Water	Habitat	8.6
	Recreation & Cultural	23.1
	Riparian Services	35

Source: Wilson and Kennedy

Range of Values from Different Studies

Studies	Per hectare per year
Credit River Watershed ⁽¹⁾	\$3,911
Lake Simcoe Watershed ⁽³⁾	\$ 2,948
Ontario Greenbelt ⁽¹⁾	\$3,487
Wetland Studies High ⁽²⁾	\$ 24, 330
Wetland Studies Low ⁽²⁾	\$ 5,792
Burns Bog (Fraser Valley) ⁽²⁾	\$ 31,375
Phosphorous and Nitrogen Filter (Wetland) ⁽²⁾	\$425 - \$1,270
Canadian Boreal Initiative (Peat-Wetlands Water filter and flood control) ⁽²⁾	\$77 Billion per annum total area

Notes: (1) Kennedy, M & Wilson, J (2009 Power pt on preliminary report); (2) Olewiler, N (2004) ; (3) Wilson, S. (2008)

Back to Jack
Calculating the Environmental Economic
Flows /Benefit Obtained from the Donation

Study	Per hectare per year x number of hectares from Jack	
Wetlands (30 hectares)	Low	High
Wetlands- phosphorus (1)	\$13,560	\$38,108
Wetlands other studies (1)	\$173,760	\$729,900
Watershed Avg (100 hectares)		
Credit River Valley (2)	\$391,000	
Lake Simcoe (3)	\$294,800	
Notes: (1) Olewiler, N (2004) ; (2) Kennedy, M & Wilson, J (2009 Power pt on preliminary report); (3) Wilson, S. (2008)		

Jack's Tax Picture	
Capital Gain from Transfer	\$1,350,000
Taxable Capital Gain	0
Taxable Income	\$67,000
Income Tax Payable (Fed/Prov)	\$30,820
Eligible amount claimed	\$47,435 – Leaves \$1,452,565
Donation Tax Credit	\$21,820
Other Tax Credits	\$9,000
Net Tax Payable	0

Jack's Tax Incentive & Government's Tax Expenditure	
Relief from Tax on Taxable Capital Gains <i>\$1,350,000 x 50% x 46% (Fed/Prov Tax)</i>	\$310,500
Tax Credit in Year One	\$21,820
Tax Credit for next 5 years @ current income	\$109,000
Total Tax Expenditure over 6 years	\$441,320
Donated value that expires after 6 years	\$1,215,390

Transaction and Administrative Costs

- EGP – roughly 1 million per year
- Individual Transaction costs
 - Appraisals – \$2,000-5000
 - Base line \$2500
 - Surveys \$2000
 - Registration fees
 - Legal fees
 - Stewardship (Request by NGO 10-15% fmv)

Stewardship

- NGOs monitor, maintain, reforest, reseed, control burn, catalogue wildlife, restore vegetation
- Shifts monitoring the volunteer sector and community (another not quantified benefit)
- Donated land is a liability to the NGO not a productive asset
- Underscores the importance of building up endowment funds

Net Economic Environmental Benefit

- Assessing the EGP's Value to Fisc
- Compare the Economic Value of the Ecological Goods and Services Received with the Tax Expenditure Cost
- Ecological Value could be \$391,000 each year
- Ecological Value over 6 years?
- Tax Expenditure over 6 years \$441,420

Responding to the Critique

- Produces demonstrable positive effects

	1995-2005 Pre-capital gains exemption	2006-2008 3 years/no taxable capital gains
Number of gifts	475	217
hectares	44,425	73,031
FMV	139 mil	288 mil

- Payment for ecological value vs Personal and Discretionary expenditure

- Translates into needed public services
- Provides local and regional benefits for broad community
- Environmental organizations receive less support than other charities
- Targets property owned by farmers and individuals with historic attachment to land

Future Directions

- Carryforwards and carrybacks
- Refundability
- Expanding use with agricultural lands
- Inventory lands
- Transferable credits (not so much)

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