

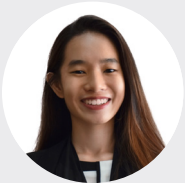
Tax Incentives for Political Donations: Lessons for Malaysia

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Introduction

One of the purposes of regulating political financing is to limit the influence of large donors in the political system and encourage regular citizens to donate to political parties and electoral candidates. However, limiting and regulating donations do not necessarily encourage the public to make political donations. Hence, some countries provide tax incentives for political donations to encourage greater public participation in the financing of political parties and improve transparency, among other purposes.

The conversation on tax incentives for political donations in Malaysia is still limited. As IDEAS is developing a political financing bill with the members of the All-Party Parliamentary Group (APPG) on political financing¹ and consulting the public on the bill, there are questions raised by both the public and politicians on whether Malaysia should provide tax incentives for political donations. This brief aims to provide a snapshot of how tax incentives are practised in some countries, particularly Germany, Canada, Thailand, and Australia, to provide points for consideration should tax incentives be introduced for political donations in Malaysia.



1. Tax incentives for political donations

Tax incentives can be defined as “a reduction in either the tax rate, the tax base, or the tax liability, which is granted if the selected beneficiary takes a specified action” (Sanchez-Ugarte, 1987). For the purposes of this paper, the “specified action” is giving donations to political parties or electoral candidates.

International Institute for Democracy and Electoral Assistance (International IDEA) database on Political Financing, one of the reliable databases on political financing practices worldwide, shows that 61 countries provide tax incentives for political parties and/or donors (Ohman, 2012). However, it does not specify whether these countries provide for both categories or only for one.

International IDEA’s database lumps the two categories together because tax incentives for donors and political parties are forms of indirect public funding to political parties and/or candidates. This means that by relieving donors and political parties from paying certain parts of their tax obligations, the government indirectly provides financial support to the candidates or political parties. In Malaysia, political parties do not receive public funding, but they are exempted from paying taxes, except the Real Property Gains Tax (The Sun Daily, 2021). Hence, political parties already receive some form of indirect public funding. However, such a facility is not currently enjoyed by the donors.

¹The first All-Party Parliamentary Group (APPG) on Political Financing was established by the Dewan Rakyat on 20 April 2022 and was then re-established in 2023. The current APPG is chaired by YB Wong Chen.

This brief provides some insights into how tax incentives could be provided to donors, with reference to examples from Thailand, Canada, Australia, and Germany. These countries provide tax incentives with different models and requirements and will provide insights into factors that should be considered in designing tax incentives for political donations in Malaysia.



2. Why tax incentives for donors?

Tax incentives can be a useful **tool to encourage the broader public to donate to political parties and candidates**. As in charities, people are more likely to donate to political parties if they know the tax incentives available to them. A survey done in Ohio, for example, found that eight per cent of donors indicated that the tax incentive influenced their decision to donate to political parties, with five per cent saying that they would have donated if they had known about the tax incentive (Boatright & Malbin, 2005). In 1979, 5.5% of eligible tax filers in the US utilised the tax credit provided. The percentage rose to more than 7% in the following year but dipped back down and settled at around 5% in 1986 when Congress repealed it (Cmar, 2004).

As tax incentives encourage donors to contribute, it also incentivises political parties to actively seek donations and engage with the public and vice versa. **As a result, tax incentives could be used to increase political participation**. Tax incentives **require political parties to convince voters to donate** to them, which encourages parties to maintain constant connections or relationships with voters if they want donations from the public (Jansen & Young, 2011). Research suggests that political parties would be better funded if tax credits were introduced (Marriott & Rashbrooke, 2023), and it would encourage political parties to engage with their members as well as the broader members of society (Young, 1998; Marziani & Skaggs, 2011).

Finally, as more small donors contribute, **political parties have different sources of income other than relying primarily on large donors**. This allows for financial support to political parties throughout the year and between election periods. In the 1980s, three Canadian federal political parties increased their sources and amount of funding partly because of the tax incentives introduced

by the Canada Elections Act (Jenson, 1991).

3. Tax incentives for political donations in selected countries

This section will provide a snapshot of tax incentives in Australia, Germany, Canada, and Thailand. These countries are chosen due to the different models of tax incentives for political donations that exist within their jurisdictions.



- ◇ Australia only provides an income tax deduction for individual donors, even though it allows corporations to make political donations.² Individuals can donate to political parties, independent candidates, and individual members of political parties.³ Individuals can make monetary or non-monetary contributions valued at \$2 at the very least. If the gifts are property, they should be purchased 12 months or more before donating.
- ◇ The limit for eligible tax deductions is \$1,500 for each category of recipients.⁴ For example, the highest amount that individuals can claim in an income year is \$1,500 for contributions and gifts to political parties and \$1,500 for contributions and gifts to independent candidates or members.
- ◇ The limit also applies to in-kind donations. The value of the in-kind donations is either the market value of the property on the day the donation was made or the amount that the individual paid for the property, whichever is less.
- ◇ Membership subscriptions to a registered political party are also eligible for tax deductions.
- ◇ Conditions to qualify for claiming income tax deduction:
 - An income tax deduction is not claimable if the contribution or gift is made under a will.
 - Income tax deduction is not applicable if the contributions or gifts add to or create a tax loss.
 - Tax deductions only apply to the income year of the contribution or gift made.
- ◇ Tax deductions for political donations in Australia are parked under its income tax legislation (Income Tax Assessment Act 1997).

² Section 30.242(3A) of the Income Tax Assessment Act 1997 Australian Government. (1997). *Income Tax Assessment Act 1997*. Federal Register of Legislation. <https://www.legislation.gov.au/Details/C2023C00306>

³ Section 30.242 of the Income Tax Assessment Act 1997 Australian Government. (1997). *Income Tax Assessment Act 1997*. Federal Register of Legislation. <https://www.legislation.gov.au/Details/C2023C00306>

⁴ Office, A.T. (n.d.). Gifts and donations. [www.ato.gov.au](https://www.ato.gov.au/Individuals/income-deductions-offsets-and-records/deductions-you-can-claim/gifts-and-donations/#:~:text=Political%20party%20and%20independent%20candidate%20donations&text=Your%20gift%20or%20donation%20must). Retrieved October 23, 2023, from <https://www.ato.gov.au/Individuals/income-deductions-offsets-and-records/deductions-you-can-claim/gifts-and-donations/#:~:text=Political%20party%20and%20independent%20candidate%20donations&text=Your%20gift%20or%20donation%20must>

Thailand



- ◇ Individual and corporate donors in Thailand are eligible for tax deductions for their political donations as long as the donations are not more than THB 5,000 and THB 20,000 per year, respectively.⁵
- ◇ In 2018, the deduction eligibility was increased to THB 10,000 for individuals and THB 50,000 for corporations (Bangkok Post, 2023)
- ◇ With regards to corporations, only private corporations are allowed to make donations to political parties; state-owned enterprises of which the state is a major shareholder are not allowed to make donations. Hence, the tax deduction facility only applies to private corporations.
- ◇ If corporations were to donate more than THB 5 million to a political party, the corporation must receive approval or ratification by resolution from the shareholders' meeting.
- ◇ The limit of donation of corporate and individual donors is THB 10 million per year to a particular political party.⁶
- ◇ Tax deductions for political donations in Thailand are parked under its legislation on political parties (Organic Act on Political Parties 2007).

Canada



- ◇ Canada provides a tax credit on income tax for individual political donations.⁷ Unlike a tax deduction, a tax credit deducts the actual amount of tax paid by a taxpayer but not the marginal tax rate.
- ◇ The annual tax credit that an individual can claim in Canada is as follows:
 - 75% of the total contribution if that total does not exceed \$400;
 - \$300 plus 50% of the amount by which the total contribution is between \$400 to \$750
 - \$650 or \$475 plus 33.3% of the amount of the total donation exceeds \$750

⁵ Section 61, Organic Act on Political Parties 2007. Thailand: Organic act on political parties B.E. 2550 [2007] -. (n.d.). https://aceproject.org/ero-en/regions/asia/TH/thailand-organic-act-on-political-parties-b.e./view?set_language=en

⁶ Section 59, Thailand's Organic Act on Political Parties 2007.

⁷ Section 127(3) of the Canada's Income Tax Act. Legislative Services Branch. (2023, June 22). Consolidated federal laws of Canada, Income Tax Act. <https://laws-lois.justice.gc.ca/eng/acts/l-3.3/section-127.html>

- ◇◇ The Canada Elections Act 2000⁸ limits political contributions to \$1,650 but increases the limit by \$25 on 1 January of each subsequent year. This means the tax credit system only applies to relatively small donations.
- ◇◇ The recipients of political donations could be a registered political party, registered association, or candidate. Membership fees of less than \$25 per year in a registered political party are not considered political contributions and are not eligible for tax credits. The recipients can appoint agents to receive these contributions.
- ◇◇ To facilitate tax credit calculation, the recipients of the political donations, including the approved agents, must keep records and books of accounts to verify transaction details such as the monetary contributions received by the agent and expenditures made by the agent. A duplicate of each receipt issued for monetary contributions received by the agent that contains the required information to calculate their income tax must be included.
- ◇◇ The recipients and their agents must record the details of those who contribute more than \$20. The identity of individual donors who contribute to political parties more than \$200 should be published on the Elections Canada website. Only donations below \$20 can be made anonymous, and it is unlikely to be used to circumvent the limit of political donations. The disclosure of details will likely facilitate verification of the tax credit facility.
- ◇◇ The tax credit is claimable if there are official receipts for income tax purposes issued for monetary contributions. It is important to note that official receipts for income tax purposes cannot be issued for services rendered or contributions in kind. The official receipts must contain details such as the amount of monetary contribution and the eligible amount. Nevertheless, only the eligible amount of a monetary contribution will qualify for a tax credit.
- ◇◇ The tax credit for political donations in Canada is parked under its income tax legislation (Income Tax Act 1985).

Germany



- ◇◇ In Germany, political parties are allowed to receive contributions from both individuals and corporations⁹. However, only individual political donations can qualify for tax deduction.
- ◇◇ The rate of the deduction is 50% of the donation amount. However, the total deducted amount should not be more than EUR 1,650 for single persons and EUR 3,300 for married couples who file a joint assessment per calendar year.
- ◇◇ To be eligible for the tax deduction, the individual must provide proof of monetary donations or membership payments. A bank statement is sufficient proof of a donation of less than EUR 200. If

⁸ Section 367(1) of the Canada's Elections Act 2000. Legislative Services Branch. (2023a, June 22). Consolidated federal laws of Canada, Canada Elections Act. <https://laws.justice.gc.ca/eng/acts/e-2.01/page-33.html#h-206931>

⁹ Section 25 of Part V of Germany's Political Parties Act 1967.

the donor is enrolled in online banking, an online account statement is sufficient proof. Donations of more than EUR 10,000 must be disclosed by the political parties in their annual account statement, while those exceeding EUR 50,000 must be immediately reported to the President of the Bundestag, who will then disclose it in a publication and on the website of the Bundestag.

- ◇◇ Individuals can only enjoy tax deduction if they donate to political parties that receive partial state funding. If the political parties are exempt from partial state funding, the donor cannot claim tax deduction.
- ◇◇ Tax deductions for political donations in Germany are parked under its political parties legislation (Political Parties Act 1967).

Key takeaways

The previous section discusses various rules of tax incentives for political donation in four countries. These are the key takeaways:

- » **There are at least two types of tax incentives** practised in the above four countries: tax deduction and tax credit.
 - Tax deduction is an amount that a taxpayer can deduct from their taxable income to lower the amount of taxes that they owe. Tax deduction lowers the amount of a taxpayer's taxable income. Thailand, Australia and Germany use this type of tax incentive.
 - Tax credit refers to the amount of money that taxpayers can subtract directly from the taxes that they owe.

To see how different types of tax incentives benefit taxpayers who give political donations, see Table I.

Table I: How tax deduction and tax credit differs in practice

Tax Deduction	Tax Credit
<p>Jane, an individual taxpayer in Australia with an annual gross income of AUD 50,000, wants to make AUD 1,000 donation to a political party. She is eligible for a tax deduction for this donation.</p> <p>Jane makes her AUD 1,000 donation to the political party through a secure payment method, such as a check, credit card, or bank transfer. She keeps a copy of her donation receipt issued by the political party, which includes the party's name, date of the donation, and the donation amount.</p> <p>When Jane prepares her annual income tax return, she will need to report her total income and calculate her taxable income based on the applicable tax rates and deductions.</p> <p>Jane subtracts the AUD 1,000 political donation from her gross annual income. Given that her gross income for the year was \$50,000, her taxable income after the deduction becomes \$49,000.</p> <p>By deducting her political donation, Jane reduces her taxable income, which, in turn, reduces the amount of income subject to taxation. This means that she will owe less in income tax compared to what she would owe without the deduction.</p>	<p>John, a Canadian taxpayer, has an annual gross income of CAD50,000 and that his tax bracket is 10%, which means that his tax liability is CAD5,000.</p> <p>John donated CAD400 to a political party and kept all the required documents.</p> <p>Since he donates CAD400, John is eligible for a 75% tax credit.</p> <p>John first calculates his tax liability before applying any tax credits. This is based on his total income, deductions, and applicable tax rates.</p> <p>As we have established, his tax liability is CAD5,000. John then applies the tax credit for his CAD400 political donation. In this example, his tax liability is reduced by 75% of the donation amount, which is CAD300 (75% of CAD400). Therefore, his tax liability is now reduced from \$5,000 to \$4,700 (CAD5,000 – CAD 300).</p> <p>Using the tax credit for his political donation, John directly reduces his tax liability by CAD300. This means he owes less in taxes than he would owe without the credit.</p>

Source: Collated by the authors based on research from various sources such as Investopedia

» Rates of incentives differ from country to country, but **there is a limit to the amount that can be reduced from the total tax burden.**

- In Germany, political donations made by individuals can be deducted at a rate of 50% of the donation amount, up to EUR 1,650 for single persons and EUR 3,300 for married couples who file a joint assessment per calendar year.
- In Australia, there is a limit of AUD 1,500 for individuals to claim their political donation for an income tax deduction.
- In Thailand, tax deductions cannot exceed THB 10,000 per year for individuals and THB 50,000 per year for a legal entity (Bangkok Post, 2018).
- In Canada, the annual tax credit that an individual can claim is: (1) 75% of the total contribution if that total does not exceed \$400; (2) \$300 plus 50% of the amount by which the total contribution exceeds \$400 if that total is ranging between \$400 and \$750; or (3) \$650 or \$475 plus 33.3% of the amount by which the total contribution exceeds \$750, whichever is less, if that total exceeds \$750.

- » **In Germany, Canada, and Australia, only individual donors can enjoy tax incentives for their political donations;** corporations do not enjoy the benefits. This is because either only individuals are allowed to make political donations, such as in Canada, or the benefits of tax incentives are restricted to them (in three other countries). Only in Thailand, corporate donors can enjoy tax incentives.
- » In these selected countries, tax incentives for political donations are regulated by income tax or political party legislation.
- » **The tax incentives in the four countries are supported by the requirement of transparency.** Donors would not be able to enjoy the tax incentive if they do not disclose their political donation during tax filing to the authorities through receipts they receive from political parties. Political parties, on the other hand, have certain obligations. For example, they must give donors a receipt for a donation to facilitate tax filing, making disclosure to authorities, and publishing a financial statement. In the interest of transparency, Germany also obligates political parties to publish some form of financial statement or report so members of the public can scrutinise their finances and thus minimise the potential for corruption. **While the requirements of transparency are commendable, small donors may not prefer this as they prefer to remain anonymous, sometimes, for valid reasons.**

Conclusion

- ◊ This brief has identified existing tax incentive mechanisms for political donations in selected countries as a reference for future policymaking on political donations in Malaysia. Legal provisions such as the regulations on political parties or elections and income tax of each country have been referred to as the input of this research. However, this brief does not analyse the effectiveness of tax incentive mechanisms for political donation in selected countries and its impact on the landscapes of political donors, political participation, and financial streams of political parties. Future research can further examine these key components and make appropriate suggestions based on Malaysia's unique political circumstances.
- ◊ Malaysia could consider **tax incentives as a part of the political financing reforms that it is currently undertaking.** Tax incentives, either given as tax deductions or tax credits, are useful policy tools to encourage the public to donate to political parties and candidates and would have a positive impact on political participation since it would encourage political parties to actively engage with the public and convince voters to donate to them. As more small donors contribute, political parties have different sources of income other than relying primarily on large donors. It could be argued that providing tax incentives would have positive implications on political competition and reduce corruption in politics.
- ◊ Should Malaysia adopts tax incentives for political donation, future legislation on political financing, which may include public funding of political parties and transparency requirements for political donations, can provide a general provision for tax incentives on political donations. However, such provisions can be further elaborated in the Income Tax Act.

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- ◊ Tax incentives in the form of tax deduction (donations for charity purposes) or tax credit (zakat payments by individual taxpayers) is not new from a Malaysian income tax perspective. Hence, no major amendments to the Income Tax Act will be required other than including political donations as an approved donation.
 - ◊ Concerns over transparency requirements in Malaysia, however, must be addressed to ensure the positive impacts of tax incentives on increasing political donations.

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