THE CHARITABLE DEDUCTION & THE FISCAL CLIFF:

WHY TAKING TAX RATES OFF THE TABLE THREATENS NON-PROFITS & CHARITABLE GIVING

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The Charitable Deduction and the Fiscal Cliff:

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PRESIDENT BARACK OBAMA HELPS PAINT PICTURES OF FRUIT DURING A SERVICE PROJECT IN THE CAFETERIA OF STUART HOBSON MIDDLE SCHOOL IN WASHINGTON, D.C., JANUARY 17, 2011.
(OFFICIAL WHITE HOUSE PHOTO BY PETE SOUZA)

In his Budget, President Obama proposes to raise $1.6 trillion in new revenue over 10 years for deficit reduction, including $1 trillion from the expiration of the Bush high-income and estate tax cuts. Some have suggested that, rather than raising tax rates for the most fortunate, policymakers should make up the revenue by cutting high-income tax expenditures – in particular, by imposing a dollar cap on itemized deductions.

Proposals that take tax rates off the table would threaten donations to universities, non-profit hospitals, and other philanthropic organizations, because – to make the math work – these proposals rely on hundreds of billions of dollars of revenue from drastically cutting or eliminating the charitable deduction. The most prominent dollar cap proposals would effectively eliminate the charitable deduction for up to 13 million households and for as much as 60 percent of currently deductible giving.

Using Congressional Budget Office assumptions, the National Economic Council (NEC) estimates that a $50,000 cap would reduce charitable giving by about $150 billion over 10 years, while a $25,000 cap would reduce giving by about $200 billion. Even a $25,000 cap that applied only to high-income households would reduce giving by at least $10 billion per year.[1]

[1] Specifically, we assume an elasticity of giving with respect to the net-of-tax price of -0.5, following Congressional Budget Office, "Options for Changing the Treatment of Charitable Giving," May 2011, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/121xx/doc12167/charitablecontributions.pdf.

THE IMPACT OF PROPOSED DOLLAR CAPS ON ITEMIZED DEDUCTIONS

The tax code encourages gifts to charity by allowing taxpayers to claim itemized deductions for charitable giving. When taxpayers give to charity, their taxable income is reduced, effectively lowering the cost of giving. The benefit to taxpayers depends on their tax rate; those in higher tax brackets get a larger tax benefit for every dollar donated. For example, a taxpayer in the 35 percent bracket pays 35 cents less in taxes for each dollar donated to charity, while a taxpayer in the 15 percent bracket pays 15 cents less.

The most prominent approach to reducing high-income tax expenditures would do so by capping total itemized deductions at some dollar amount. For example, Senator Corker has endorsed a $50,000 limit on total itemized deductions, while others (including House Republicans, citing a report by the Committee for a Responsible Federal Budget) have floated the idea of a $25,000 limit.[2] Under these proposals, the total amount a household could claim in itemized deductions – including for mortgage interest, state and local taxes, medical expenses, and charitable giving – would be limited to the specified dollar cap. For example, with a $50,000 cap, a household with $90,000 in itemized deductions would lose $40,000 of deductions.

Table 1: Impact of Dollar Caps on Charitable Giving

Cap Level	$25,000 Cap	$50,000 Cap
Number of households losing entire charitable deduction	13 million	3 million
Number of households over the cap – no incentive for additional giving	21 million	6 million
Share of currently deductible giving that would no longer be deductible	About 60%	About 40%
Predicted drop in giving over 10 years	About $200 billion	Above $150 billion

Capping the amount of itemized deductions households can claim means that some taxpayers would no longer get any tax subsidy for giving to charity. As shown in Table 1, this could sharply reduce charitable giving:

- Under an itemized deduction cap, millions of households would effectively lose their entire charitable deduction, since their other deductions (mostly state and local taxes and mortgage interest) already exceed the cap. Under a $25,000 cap, 13 million households would lose the entire charitable deduction; under a $50,000 cap, 3 million would.

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[2] See http://www.corker.senate.gov/public/_cache/files/5eb76323-b7c2-4405-822b-e68890ca3593/Fiscal_Reform_Act_of_2012_Summary.pdf and Jackie Calmes, "Tax Deductions May Trim Benefits, But Not Easily," New York Times, December 4, 2012.

- An even larger number of households would lose any tax incentive for additional charitable giving. As illustrated by the examples on page 6, any household with itemized deductions over the cap gets no tax benefit from increasing their charitable donations. With a $50,000 cap, 6 million households fall into this category; with a $25,000 cap, 21 million do.

- Overall, with a $50,000 cap, about 40 percent of currently deductible giving would effectively lose the tax benefits of the charitable deduction; with a $25,000 cap, about 60 percent would.

- Using Congressional Budget Office assumptions, the NEC estimates that a $50,000 cap would reduce charitable giving by about $150 billion over 10 years, while a $25,000 cap would reduce giving by about $200 billion. Even a $25,000 cap that applied only to high-income households would reduce giving by at least $10 billion per year.[3]

CAPS WOULD AFFECT CHARITIES IN EVERY SECTOR AND ACROSS THE COUNTRY

CHARITABLE GIVING BY THE NUMBERS

HOUSEHOLDS WITH INCOMES OVER $200,000 CONTRIBUTED:

- $42 billion to Educational Institutions.
- $12 billion to Combined Funds that Donate to a Variety of Causes.
- $18 billion to Health Related Charities.
- $21 billion to Arts and Cultural Institutions.
- $7 billion to Organizations that Help Meet Basic Needs Either in the United States or Abroad.

Source: Center on Philanthropy at Indiana University; data are for 2005 (the latest year for which these data are available)

Itemized deduction caps would affect many middle-class families, with 17 million households with incomes below $250,000 seeing tax increases under a $25,000 cap.

But for the large majority of high-income households, these dollar cap proposals would eliminate any tax incentive for additional charitable giving.

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[3] Specifically, we assume an elasticity of giving with respect to the net-of-tax price of -0.5, following Congressional Budget Office, "Options for Changing the Treatment of Charitable Giving," May 2011, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/121xx/doc12167/charitablecontributions.pdf.

Estimates by the Tax Policy Center show that three quarters of households in the top 1 percent of the income distribution currently claim more than $50,000 in itemized deductions, and almost all claim more than $25,000.[4]

As shown in Table 2, households with incomes at these levels make over $100 billion in charitable donations each year.

Table 2: Composition of Giving in 2005

Sector	Amount Given by Households over $200,000 (Billions)	Share of Total Giving in Sector from Households Over $200,000
Religion	30	29%
Combined Purpose	12	55%
Help Meet Basic Needs	7	38%
Health	18	81%
Education	42	92%
Arts	21	94%
Other	12	63%
Total	143	57%

Source: Center on Philanthropy at Indiana University, "Patterns of Charitable Giving by Income Group, 2005," Summer 2007 (http://www.philanthropy.iupui.edu/files/research/giving_focused_on_meeting_needs_of_the_poor_july_2007.pdf).

Likewise, Table 3 shows giving by households with incomes over $200,000 in 2010 in each state.[5] On average, these households accounted for about 40 percent of the charitable giving reported on tax returns. Effectively eliminating the charitable deduction for many or most of these households could have negative impacts on community foundations, colleges and universities, social service providers, arts institutions, and other important local nonprofit organizations throughout the country.

Some have suggested that the problems discussed above could be addressed by just exempting charitable giving from a dollar cap. But according to estimates by the Tax Policy Center, **this approach reduces the revenue generated by an itemized deduction cap by about one third, or hundreds of billions of dollars over 10 years.**[6]

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[4] See Tax Policy Center Table T12-0244, available at http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3549. Because the caps for single filers would be lower than for couples, the share of high-income households over the caps could actually be modestly higher.
[5] Data are from the IRS Statistics of Income tables available at http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2.
[6] See Tax Policy Center Table number T12-0300, available at http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3620.

That means that a cap that protects both middle-class households and charitable giving could raise only about $350-$450 billion over 10 years – far less revenue than is needed for a balanced deficit reduction agreement.[7]

Table 3: Amount and Share of Deductible Giving from Households above $200,000 in 2010

State	Itemized giving by households $200,000 or more (Billions)	Share of itemized giving from above $200,000	State	Itemized giving by households $200,000 or more (Billions)	Share of itemized giving from above $200,000
US TOTAL	$68.7	**40%**	**MISSOURI**	$1.0	34%
ALABAMA	$0.8	27%	**MONTANA**	$0.2	42%
ALASKA	$0.1	33%	**NEBRASKA**	$0.4	41%
ARIZONA	$0.8	31%	**NEVADA**	$0.5	42%
ARKANSAS	$0.4	28%	**NEW HAMPSHIRE**	$0.2	40%
CALIFORNIA	$10.0	47%	**NEW JERSEY**	$2.0	40%
COLORADO	$1.3	42%	**NEW MEXICO**	$0.2	29%
CONNECTICUT	$1.9	63%	**NEW YORK**	$8.7	59%
DELAWARE	$0.1	32%	**NORTH CAROLINA**	$1.4	27%
D.C.	$0.3	50%	**NORTH DAKOTA**	$0.1	41%
FLORIDA	$4.1	44%	**OHIO**	$1.6	33%
GEORGIA	$1.9	31%	**OKLAHOMA**	$0.8	37%
HAWAII	$0.2	29%	**OREGON**	$0.6	30%
IDAHO	$0.2	24%	**PENNSYLVANIA**	$2.2	37%
ILLINOIS	$2.8	41%	**RHODE ISLAND**	$0.2	38%
INDIANA	$0.8	30%	**SOUTH CAROLINA**	$0.6	25%
IOWA	$0.4	30%	**SOUTH DAKOTA**	$0.2	53%
KANSAS	$0.7	40%	**TENNESSEE**	$1.3	38%
KENTUCKY	$0.5	29%	**TEXAS**	$5.7	44%
LOUISIANA	$0.6	32%	**UTAH**	$0.8	27%
MAINE	$0.2	37%	**VERMONT**	$0.1	39%
MARYLAND	$1.5	31%	**VIRGINIA**	$1.9	37%
MASSACHUSETTS	$2.6	60%	**WASHINGTON**	$1.4	38%
MICHIGAN	$1.5	31%	**WEST VIRGINIA**	$0.1	30%
MINNESOTA	$1.1	36%	**WISCONSIN**	$0.8	32%
MISSISSIPPI	$0.3	23%	**WYOMING**	$0.4	71%
MISSOURI	$1.0	34%			
Source: IRS					

[7] See http://www.whitehouse.gov/blog/2012/11/29/limiting-tax-deductions-reality-math.

Examples of Families that Would Lose Tax Benefits for Charitable Giving Under a $25,000 Cap on Itemized Deductions

EXAMPLE 1: A MARRIED COUPLE EARNING $210,000 AND LIVING IN BOSTON

- The couple pays $15,000 a year in mortgage interest, pays $15,000 in state income and local property taxes, and makes a $10,000 gift to a non-profit organization providing after-school activities for local students.

- Because the total of their mortgage and state/local tax deductions ($30,000) already exceeds the $25,000 cap, this couple would effective lose its entire charitable deduction, raising its tax liability by $2,800 ($10,000 x a 28 percent marginal rate).

IMPACT OF A $25,000 CAP:

This family would lose 100% of its charitable deduction.

EXAMPLE 2: A MARRIED COUPLE EARNING $150,000 AND LIVING IN AUGUSTA

- The couple pays $12,000 a year in mortgage interest, pays $12,000 in state income and local property taxes, and makes a $5,000 gift to the endowment of their college alma mater.

- Because the family's mortgage and state/local deductions total $24,000 – just under the cap amount – the family would be able to claim a deduction for only the first $1,000 in charitable giving, while the remaining $4,000 gift would be subject to income taxes, raising the family's tax liability by $1,000 ($4,000 x its 25 percent marginal rate).

- Additionally, even though this couple would retain a portion of its charitable deduction, it would lose any tax incentive for additional giving.

    - Under current law, if the couple decided to increase its gift by $1,000, it would be able to deduct the full amount from taxable income – receiving a tax benefit of $250 ($1,000 x a 25 percent marginal rate).

    - But under a $25,000 cap, the couple would claim no additional deduction and receive no tax benefit for the additional $1,000 gift.

IMPACT OF A $25,000 CAP:

After the first $1,000 of giving, this couple would lose any tax incentive for additional charitable donations.

THE PRESIDENT'S BALANCED APPROACH

The reality of the math means that taking tax rate increases off the table forces a choice between virtually eliminating the charitable deduction for high-income households; raising taxes on middle-class families; or raising too little revenue for deficit reduction and forcing deep cuts to investments in research, education, and infrastructure or to other federal programs important to middle-class or struggling families.

This wholly unnecessary trade-off can be avoided by taking the President's balanced approach. The President would raise $1 trillion by letting the Bush high-income and estate tax cuts expire. He would then raise additional revenue by limiting all high-income tax benefits to 28 percent. Under the President's proposal, every family that currently benefits from the charitable deduction would continue to receive a significant tax incentive for charitable giving. High-income households would receive the same incentive as households with incomes in the range of $200,000, the same incentive they received under President's Reagan's tax reform, and a larger incentive than they would get under Republican proposals to reduce the top tax rate to 25 percent. (See below for the details of the President's 28 percent limit proposal, which was included in the President's Budget.)

Solving the Nation's deficit and debt challenges will require that the highest-income households pay more and will likely require curbing their tax benefits. But under a more balanced approach that includes an increase in tax rates, this can be achieved without imposing major collateral damage on charitable giving and non-profit organizations.

PROPOSED TAX DEDUCTION CAPS VERSUS THE PRESIDENT'S PROPOSED 28 PERCENT LIMIT

The President's Budget would raise over $500 billion from high-income households by limiting the value of all high-income tax benefits – including deductions and exclusions for mortgage interest, municipal bond interest, state and local taxes, health insurance, retirement, and charitable giving – to 28 percent. The value of tax deductions and exclusions depends on the taxpayers' marginal income tax rate. Thus, currently, these tax incentives are worth 35 cents on the dollar for the highest income households, but generally only 28 cents or less for middle-class households. Bringing tax incentives for the highest-income households more in line with tax benefits for middle-class families would raise significant revenue for deficit reduction while also making the tax code more fair.

Under the President's 28 percent limit proposal:

- The 98 percent of households with incomes below $250,000 ($200,000 for singles) would get exactly the same tax benefit for charitable giving as they do today; they would also keep all their other tax benefits.

- All households would still receive significant tax benefits for charitable giving – as large or larger than what middle-class families receive today. High-income households would see at most a 20 percent reduction in the value of the charitable deduction relative to current levels.

- The tax incentive for charitable giving by high-income households would be:

    - The same as the tax incentive for giving by households with incomes in the range of $200,000 (and still greater than the tax benefit for other middle-class households).

    - The same as it was when the top income tax rate was lowered to 28 percent under President Reagan.

    - Large than under the Fiscal Commission tax reform plan, which would replace the charitable deduction with a 12 percent credit.

Independent experts who have evaluated the President's proposal have concluded that it would not significantly reduce charitable giving.[8] Moreover, other features of the President's tax proposals – in particular, his proposal to restore a more robust estate tax for the very wealthiest estates – would increase incentives for charitable giving by high-income households.

Comparing the President's Proposal to Dollar Caps on Itemized Deductions

EXAMPLE 1: THE MARRIED COUPLE (FROM EX. 1 ABOVE) EARNING $210,000

The couple claims $40,000 in itemized deductions including $10,000 in charitable giving

➢ Under the President's plan, this family would continue to deduct its full $10,000 donation from taxable income and would get the same subsidy it does now: $2,800 ($10,000 x the family's 28 percent marginal rate).

IMPACT OF THE PRESIDENT'S PROPOSAL:

This family would see no tax increase on its charitable giving, nor any change to its tax incentive to give to charity.

[8] For example, see Center on Philanthropy at Indiana University, "Impact of the Obama Administration's Proposed Tax Policy Changes on Charitable Giving," October 2011, http://www.philanthropy.iupui.edu/files/research/obamataxchanges2011.pdf.

- By contrast, under a $25,000 cap on itemized deductions this family would lose the entire tax benefit for charitable giving (because the family's non-charitable deductions already exceed that cap).

IMPACT OF A $25,000 CAP:

This family would lose 100% of its charitable deduction as well as any tax incentive to give more to charity.

EXAMPLE 2: ANOTHER BOSTON FAMILY EARNING $500,000

This family has $75,000 in itemized deductions for mortgage interest and state and local taxes and makes a $10,000 donation to charity.

- Under current policy, this family receives a tax benefit of $3,500 for its charitable donation ($10,000 x a 35 percent marginal rate) – a larger tax benefit than the one received by the middle-class family in the previous example ($2,800).

- Under President Obama's proposal, the family would still be able to claim its charitable deduction, but the benefit would be limited to 28 percent. Thus, the total subsidy would be $2,800, the same as for the family above.

IMPACT OF THE PRESIDENT'S PROPOSAL:

This family would continue to receive a tax incentive to give to charity, but would receive the same tax benefit as a middle-class family.

- Under either a $25,000 or $50,000 cap on itemized deductions, this family would lose 100% of its charitable deduction – as well as any tax incentive to give more to charity.

IMPACT OF A $25,000 OR $50,000 CAP:

This family would lose 100% of its charitable deduction as well as any tax incentive to give more to charity.