An Option to Increase Charitable Giving and Reduce Current Taxes

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In his list of top priorities President George W. Bush has identified both tax cuts and the enhancement of civil society and charity. Both those goals can be pursued simultaneously, as is indicated by his proposal to try to extend charitable deductions to those who do not currently itemize deductions on their tax return. I have another suggestion (one that I have made in Tax Notes before): extend the charitable deduction to the time of filing a tax return, in much the same way as applies to deposits to individual retirement accounts (IRAs) and to certain pensions of self-employed persons (Keogh plans).

Why is this change likely to enhance giving? People notice most of the impact of charitable giving on their taxes at the time they file a tax return. In theory, of course, some people could adjust withholding of taxes or estimated tax payments during the year to reflect giving during the year, but very few people can or will make such adjustments. At tax filing time, however, people can quickly see that giving money away to charity would reduce taxes by 15 percent or 28 percent of the amount of the giving—and would be reflected immediately in a lower tax payment or a larger refund check from the government. The subsidy would be immediate, and easily recognized.

Do grocery stores advertise the sales they are going to have six months from now or the ones they have this week? The ones they have this week, of course. On April 15 do clothing stores advertise a price break they will pay back a year later? Of course not; they advertise the rebates they will make available immediately. There is no doubt that advertising and marketing have a significant effect on consumers. Why shouldn't the government learn from the private sector and similarly advertise the charitable subsidy it offers? What could fit in better with the president's desire to enhance the charitable sector than for the Treasury Department to proclaim more directly the advantages of the subsidy that it is supposed to administer?

Interestingly enough, the idea of using marketers to enhance the prospects of the charitable sector is only beginning to take off. Charities are forming new alliances with the marketing departments of companies, as well as with advertising companies themselves. Suppose government was to do the same—invite ideas on how to market better the charitable incentive it offers. I am convinced that a plethora of good ideas would be made available, not the least of which would be the allowance of an immediate tax break for additional giving at the time of filing a tax return.

Still other incentives are uniquely present at tax filing time. Many individuals find at that time that they have accidentally violated the requirements to pay estimated taxes close to the value of final taxes owed. The errors arise for a variety of reasons; in particular, many self-employed individuals do not even know their final liability until well after the previous calendar year has ended. Under my proposal, the penalties for not timely paying one's estimated tax, which are already much too steep (another subject), could be mitigated simply by contributing more to charity.

Suppose, for example, that a taxpayer had failed by $500 to pay over an adequate amount of estimated tax in the previous calendar year. If the taxpayer were in the 28 percent tax bracket, she could contribute $1,786 ($500/.28) to charity and avoid a penalty altogether. That is, the charitable contribution would reduce the tax liability by enough that the estimated taxes already paid would be adequate. Sure, the Treasury would lose a little bit of extra money, but the purpose of the penalties should not be to try to catch people accidentally so a little more revenue can be collected. If people want to avoid a penalty by giving more to charity, more power to them. A side benefit perhaps would be slightly less animosity toward the IRS.

My guess is that the various tax filing services and programs would also adjust their programs in ways that would help enhance giving. In effect, they, too, would likely serve as advertising agents for charitable giving largely as a service to their clients. Tax software used to fill out returns could easily pose to individuals the following types of questions: Would you like to contribute more to charity to reduce your tax liability for the previous year? Would you like to avoid the penalty for failure to pay estimated taxes by contributing an extra $X to charity?

The idea has been vetted already before an assembly of tax experts. To be fair to the record, while many were supportive, some were concerned about possible complexity. The most important concern, in my book, was that taxpayers might make errors unless they kept records to make sure that they know whether their April 15 deductions were made for this year or the previous year. Similar concerns arise in the case of IRAs and Keoghs; however, no one suggests that they rise to such a level that these deductions should no longer be made available after December 31 of the previous calendar year.

These concerns have led me to think about adding some limitation on the option that might turn it into a win-win situation that could actually improve compliance. For example, contributions after January 1 for the previous calendar year could only be deductible to the extent they entailed sufficient recordkeeping. For example, a check or money order might have to state that a "deduction for the previous year is being claimed." A charity could also give a statement to an individual for a cash or check gift. A computer-generated transfer might be made through an intermediary such as Guidestar (which, along with the National Center on Charitable Statistics, currently hosts data on charities) if it expands to serve as a platform for a variety of charitable transactions. Similarly, a tax preparer or any tax preparation software company that dealt electronically with its customers could easily generate the necessary receipt if it passed on the contribution to a designated charity. In effect, there is a variety of ways to keep error rates low and even lower than are likely for cash contributions made the previous year by taxpayers who have no records or receipts whatsoever.

Finally, and this is somewhat of a long shot, if it were desired to put money back into the economy immediately, the charitable giving option could be applied even to tax returns for the year 2000. However, congressional action would have to be quick since returns are already being filed, and the IRS should not be put in the position of having to deal with many amended returns.

In sum, the president says he wants to increase charitable giving and reduce taxes. Here is a viable way to do both.

Other Publications by the Authors

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