

## Key Elements of the U.S. Tax System

How did the Tax Cuts and Jobs Act affect incentives for charitable giving?

TAXES AND CHARITABLE GIVING

**Q. How did the Tax Cuts and Jobs Act affect incentives for charitable giving?**

**A. The 2017 Tax Cuts and Jobs Act will discourage charitable giving by reducing the number of taxpayers claiming a deduction for charitable giving and by reducing the tax saving for each dollar donated.**

The Tax Cuts and Jobs Act (TCJA) made major changes that discourage charitable giving relative to under prior tax law. It lowers individual income tax rates, thus reducing the value and incentive effect of all tax deductions. It increased the standard deduction to \$12,000 for singles and \$24,000 for couples, capped the state and local tax deduction at \$10,000, and eliminated other itemized deductions—steps that significantly reduced the number of itemizers and hence the number of taxpayers taking a deduction for charitable contributions. The new law also roughly doubled the estate tax exemption to \$11 million for singles and \$22 million for couples, which discourages tax-motivated charitable bequests by some very wealthy households.

The Urban-Brookings Tax Policy Center estimates that TCJA shrunk the number of households claiming an itemized deduction for their charitable gifts from about 37 million to about 16 million in 2018, and reduced the federal income tax subsidy for charitable giving by one-third—for instance, from about \$63 billion to roughly \$42 billion in 2018.

Overall, the TCJA reduced the marginal tax benefit of giving to charity by more than 30 percent in 2018, raising the after-tax cost of donating by about 7 percent. Unless taxpayers increase their net sacrifice—that is, charitable gifts less tax subsidies—charities and those who benefit from their charitable works, not the taxpayers, will bear the brunt of these changes.

### REDUCING TAX RATES

For taxpayers who itemize their deductions, the tax saving from charitable contributions depends on the donor's marginal tax rate. For instance, a donor in the 30 percent tax bracket pays 30 cents less tax for every dollar donated; that is, an additional dollar of contribution costs the donor on net 70 cents. By lowering tax rates only modestly for individuals, the rate reduction in TCJA reduced the tax saving for each dollar donated much less than other provisions.

### RAISING THE STANDARD DEDUCTION AND LIMITING SOME ITEMIZED DEDUCTIONS

Taxpayers who choose to itemize their deductions on their income tax returns can deduct charitable contributions from income that would otherwise be taxed. This lowers the cost of charitable giving by the amount of taxes saved. Most taxpayers, however, do not itemize but instead claim the standard deduction

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because it is larger than the sum of their potential itemized deductions. Taxpayers who take the standard deduction cannot reduce their taxable income by the amount of their charitable contributions; only itemizers have an incentive to give to charities because it reduces their taxes.

TCJA significantly increased the standard deduction amount. It also capped the deduction for state and local taxes at \$10,000 and eliminated some other itemized deductions. The combined effect of these changes is a substantial reduction in the number of taxpayers who itemize, and thus the number who take a deduction for charitable contributions.

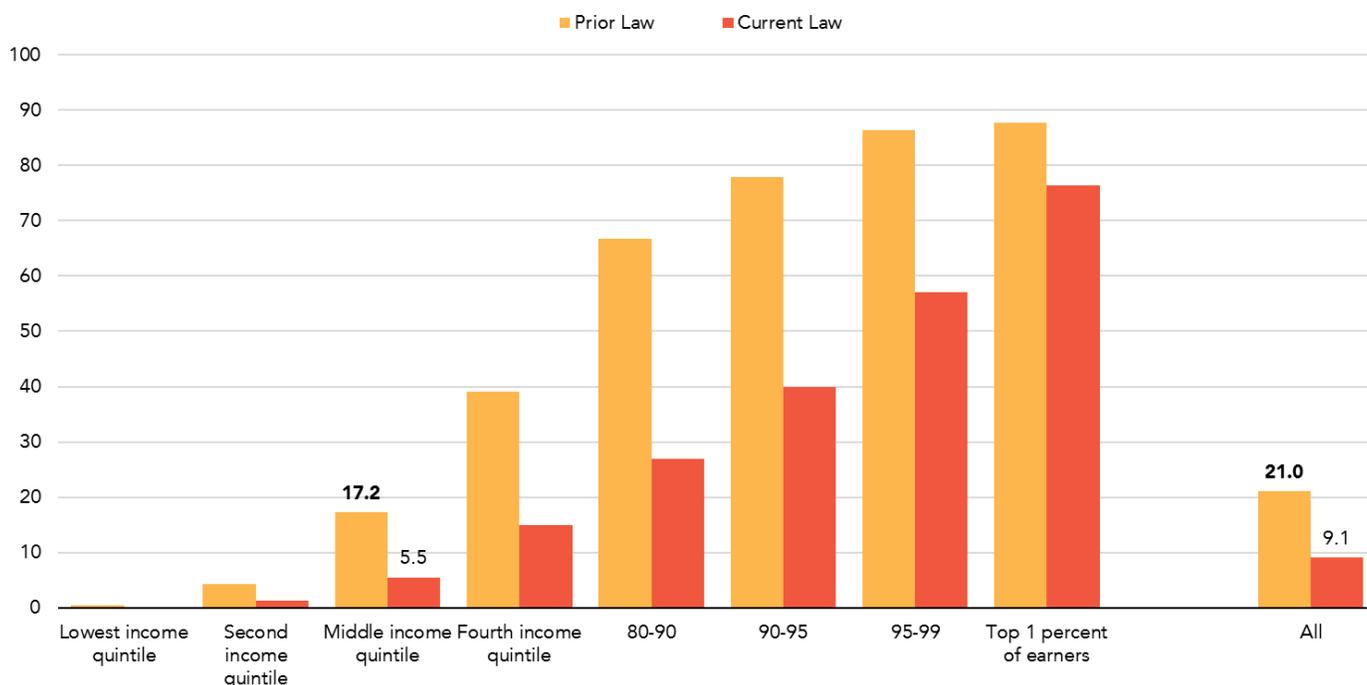
Before accounting for any changes in the amount of charitable giving, TPC estimates that the law cut the number of those itemizing their charitable contributions by more than half, from 21 percent to about 9 percent of households. The share of middle-income households, defined here as those in the middle quintile of the income distribution, claiming the charitable deduction fell by two-thirds, from about 17 percent to just 5.5 percent (figure 1).

The share of households itemizing their charitable contributions fell even among high-income households. The share of households in the 90th–95th percentile (those making between about \$216,800 and \$307,900), taking a deduction for charitable gifts dropped from about 78 to 40 percent, and the share itemizing among households in the 95th–99th percentile (those making between about \$307,900 and \$732,800) fell from 86 to 57 percent (figure 1).

FIGURE 1

### Change in the Share of Taxpayers Taking Itemized Deductions for Charitable Giving under the TCJA

By expanded cash income percentile, under prior law and current law



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1).

Notes: Graph depicts the average marginal tax subsidy for a \$100 donation.

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While nonitemizers do not receive any subsidy for their current level of gifts, the incentive remains for some to make large gifts, even if unused. Thus, a couple filing a joint return with \$280,000 of adjusted gross income and paying state and local taxes in excess of \$10,000 still has an incentive to give more than \$14,000, at which point their total itemized deductions would exceed the standard deduction. However, the tax incentive now applies to excess gifts, that is, giving that raises their total itemized deductions above the \$24,000 amount of the standard deduction. Under prior law, which had a much lower standard deduction and no cap on deductible state and local taxes, the tax incentive for giving might very well have applied to the total amount of their charitable donation.

Some taxpayers can avoid these limitations. An individual retirement account charitable rollover allows people aged 72 and older (before another 2019 reform, the age was 70.5) to make direct transfers from their IRAs totaling up to \$100,000 per year to qualified charities, without having to count the transfers as income for federal income tax purposes. Also, some taxpayers can bunch gifts. For instance, a couple with \$10,000 of state and local taxes would take the standard deduction if the only other itemizable expenses were contributions of \$10,000 a year for each of five years. However, the couple might give away \$50,000 in one year and nothing in the other four—thus gaining the advantages of both the increased standard deduction and a deduction for most of their charitable contributions.

#### AVERAGE SUBSIDY FOR CHARITABLE GIVING

The combination of provisions in TCJA that reduced both the number of itemizers and tax rates lowered the average subsidy for charitable giving (the marginal tax benefit averaged across all charitable gifts) from 20.7 percent to 15.2 percent. While the average subsidy for charitable giving declined significantly for low- and moderate-income taxpayers, it hardly changed for the highest-income taxpayers. For example, the average subsidy for middle-income taxpayers (those whose income places them between the 40th and 60th percentile of the income distribution) fell from 8.1 percent to 3.3 percent. By contrast, for those in the top 1 percent, it fell from 30.5 percent to 28.9 percent (figure 2).

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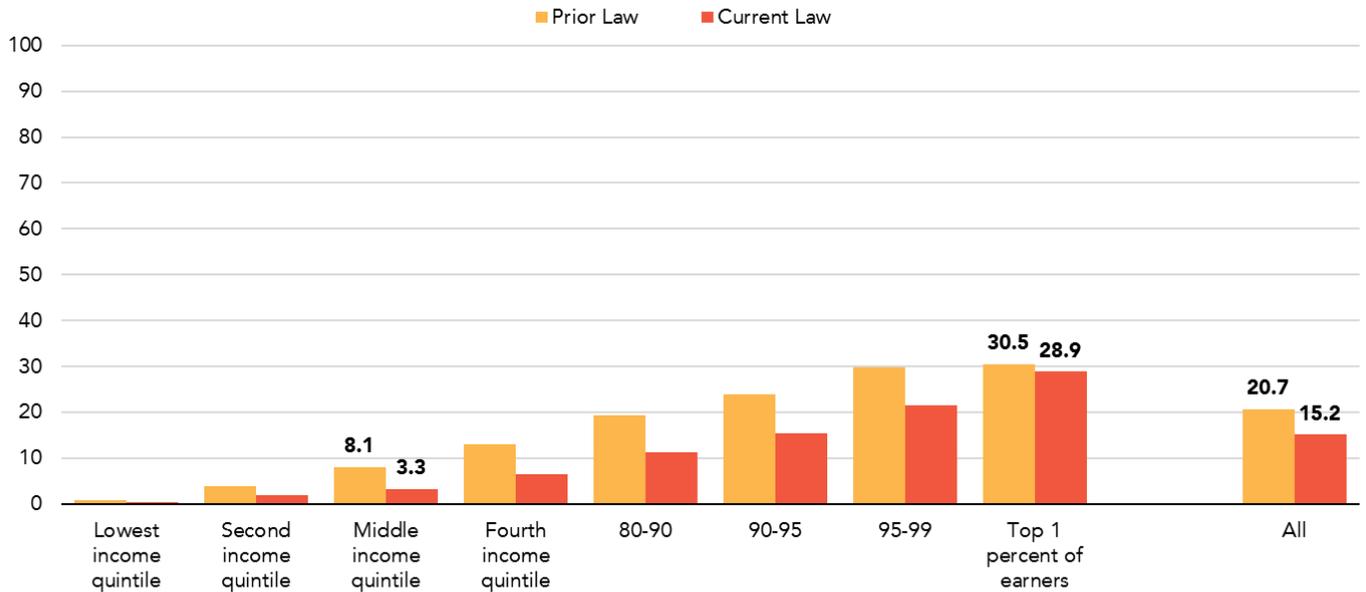
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**FIGURE 2**

## Estimated Effective Marginal Tax Benefit of Charitable Giving, 2018

By expanded cash income percentile, under prior law and current law



**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1).

**Notes:** Graph depicts the average marginal tax subsidy for a \$100 donation.

Updated May 2020

### Data Sources

Urban-Brookings Tax Policy Center. "TPC Microsimulation Model, version 0319-2."

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