Q. How did the TCJA 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) makes major changes that will discourage charitable giving. It lowers individual income tax rates, thus reducing the value of all tax deductions. It increases the standard deduction to $12,000 for singles and $24,000 for couples, caps the state and local tax deduction at $10,000, and eliminates other itemized deductions—steps that will significantly reduce the number of itemizers and hence the number of taxpayers taking a deduction for charitable contributions. The new law also roughly doubles the estate tax exemption to $11 million for singles and $22 million for couples, which will discourage tax-motivated charitable bequests by some very wealthy households.

The Urban-Brookings Tax Policy Center estimates that TCJA will shrink the number of households claiming an itemized deduction for their charitable gifts from about 37 million to about 16 million in 2018, and reduce the federal income tax subsidy for charitable giving by one-third, from about $63 billion to roughly $42 billion. Overall, the TCJA will reduce 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. By lowering tax rates, though only modestly for individuals, the TCJA reduced the tax saving for each dollar donated.

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 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 will

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be to substantially reduce the number of taxpayers who itemize, and thus the number who take a deduction for charitable contributions.

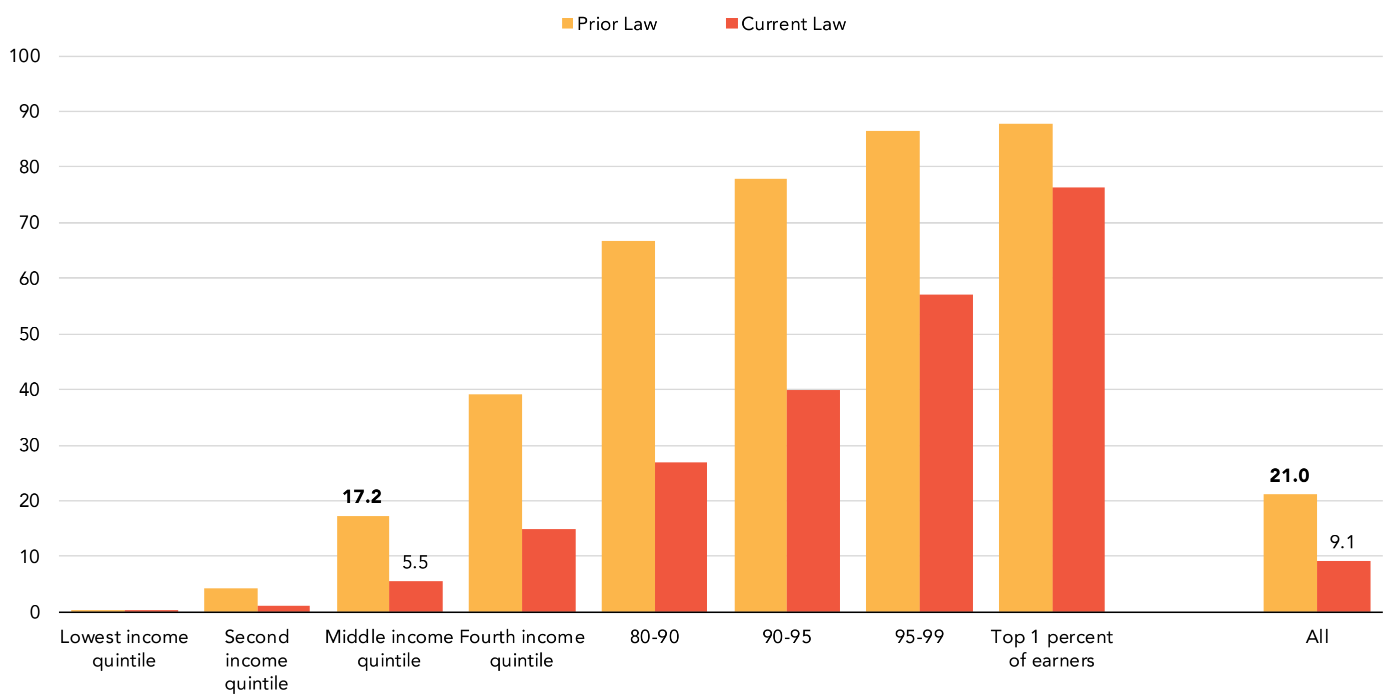
Before accounting for any changes in the amount of charitable giving, TPC estimates that the law will cut the number of those itemizing their charitable contributions by more than half, from 21 percent to about 9 percent of households. The share of middle-income households, defined here as those in the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

The share of households itemizing their charitable contributions will fall 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 will drop 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) will fall 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 would now apply 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 age 70.5 and older 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 reduce both the number of itemizers and tax rates will lower 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 will decline significantly for low- and moderate-income taxpayers, it will hardly change 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) will fall from 8.1 percent to 3.3 percent. By contrast, for those in the top 1 percent, it will fall from 30.5 percent to 28.9 percent (figure 2).

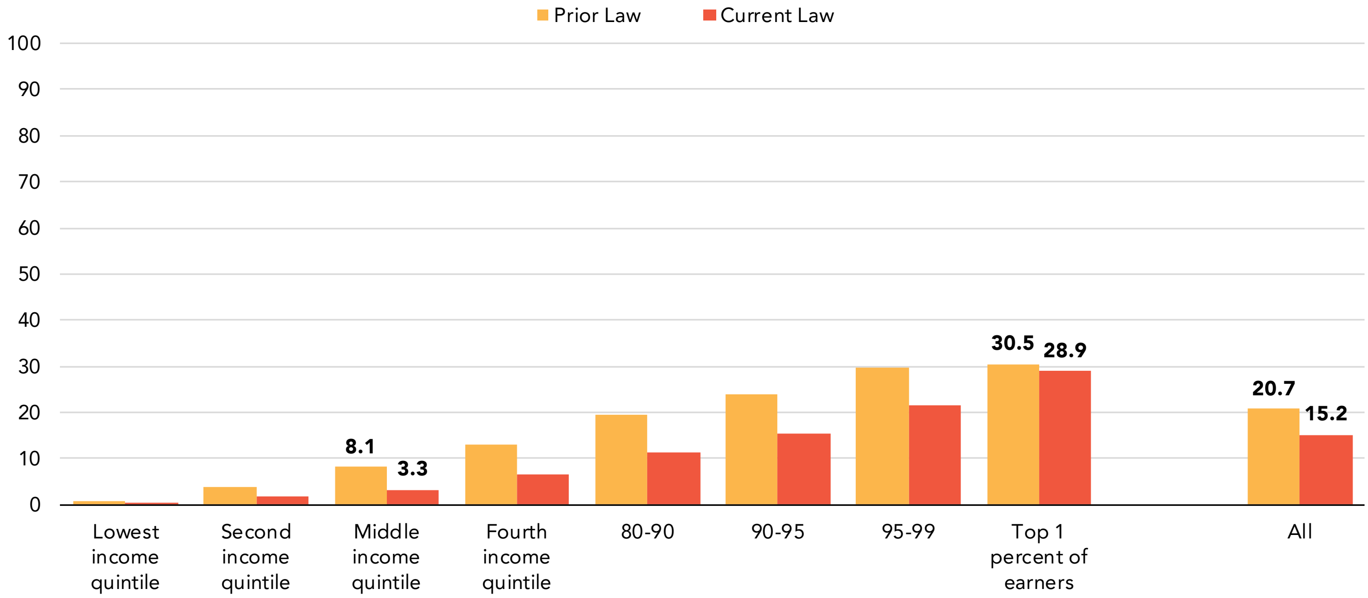
Key Elements of the U.S. Tax System

How did the TCJA affect incentives for charitable giving?

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.

Data Sources

Urban-Brookings Tax Policy Center. "TPC Microsimulation Model, version 0217-1. "