Q. How would various proposals affect incentives for charitable giving?

A. Proposals include providing more effective or more universal incentives for charitable giving, but often in exchange for some restrictions, such as a floor or a small percentage of income above which incentives would be provided. Many proposals aim to enhance the amount of giving per dollar of revenue loss; some take account of IRS capabilities to monitor taxpayer claims.

Under current law, taxpayers who itemize deductions can deduct most of their charitable contributions, thereby reducing their tax liability. Most taxpayers give up that charitable incentive, along with other itemized deductions, to take a standard deduction of greater value.

A MORE UNIVERSAL DEDUCTION

Until recently, a significant share of taxpayers could claim a deduction for charitable giving, along with other itemizable expenses such as mortgage interest deductions.

The 2017 Tax Cuts and Jobs Act (TCJA), however, went in the opposite direction and reduced tax subsidies for charitable giving to less than 10 percent of all taxpayers. It did so not directly but mainly through several provisions that together substantially increased the share of taxpayers taking a larger standard deduction in lieu of a smaller amount of itemizable expenses, including the charitable deduction. Accordingly, renewed interest has been expressed in a more universal deduction, though advocates often favored such a proposal to expand the reach of the charitable deduction even when a greater share of taxpayers itemized.

A more universal deduction likely would displace the existing deduction for itemizers. Some proposals, however, would create two charitable incentives, one for itemizers and one for everyone else, despite the complexity this would create. A completely universal deduction, almost without restriction, raises two issues: effectiveness and compliance.

First, incentives for the first dollars of giving are considered relatively ineffective because they subsidize giving that taxpayers would take with or without a deduction. Consider a taxpayer who normally gives away $1,000 and, because of an incentive, increases that giving to $1,200. The money spent on the deduction for the first $1,000 is somewhat ineffective; the money spent on the last $200 is where the bang per buck is concentrated.

Second, the Internal Revenue Service (IRS) audits very few people, and the reporting system for charitable contributions is somewhat weak. IRS research clearly indicates that cheating is much more frequent when weak reporting systems are in place.

FLOOR ON DEDUCTIONS

If a more universal deduction were combined with a reasonable floor applied to all taxpayers, much or all the revenue loss would be eliminated, as would many problems with additional noncompliance and complexity.

Taxpayers, for instance, might be allowed to claim charitable deductions greater than 1 or 2 percent of their adjusted gross income, regardless of whether they itemize. A modest floor would leave in place an incentive for all taxpayers, though they must give more than a modest amount to take advantage of it. Meanwhile, the subsidy for some of the first dollars of giving would be eliminated for everyone. Almost no matter how sensitive or insensitive taxpayers are to incentives, a revenue-neutral reform that exchanges fewer subsidies for the first dollars of giving in favor of more subsidies for the last dollars of giving would almost inevitably increase giving.

At the same time, such an approach would address concerns about administration and compliance by eliminating the need for IRS to monitor small givers, which it has not been able to do effectively.

A BETTER REPORING SYSTEM FOR CHARITABLE CONTRIBUTIONS

Expanding reporting requirements for charitable contributions would raise revenues. Congress occasionally has required increased reporting, as when it required charities to track and send letters to donors for contributions greater than $250. Yet no reporting goes directly to IRS, which over the years has increasingly relied upon document matching as perhaps its primary way of enforcing proper reporting of individual's income tax liability. Various options include sending the IRS information already required for the letters to donors, or allowing an April 15 deduction option (see below) only for contributions directly reported to the IRS.

RAISING THE LIMIT ON THE DEDUCTION

The TCJA raised the annual limit on deductible contributions from 50 to 60 percent of adjusted gross income in 2017 legislation. Another option would be to raise the limit even further or to expand the current carryover provision for excess contributions beyond the five years now allowed.

IRA ROLLOVERS

Yet another proposal would expand the charitable individual retirement account (IRA) rollover provision. More generous than an itemized deduction, this provision allows some taxpayers over age 72 years to donate up to $100,000 from traditional IRAs to charity without having to count the distributions as taxable income or separately take an itemized deduction for these contributions. (the RMD, or required minimum distribution, age used to be 70 years and 6 months, but following the passage of the Setting Every Community Up for Retirement Enhancement (SECURE) Act in December 2019, it was raised to 72.) Raising or eliminating the $100,000 annual limit on donations, lowering the age limit to 59 years and 6 months (the age at which IRA owners may withdraw funds without penalty), or allowing taxpayers to deposit such giving in donor advised funds (currently ineligible for such tax treatment) could increase charitable giving.

How would various proposals affect incentives for charitable giving?

FOUNDATION EXCISE TAX

Another option would eliminate or reduce the excise tax on foundation income, which would increase net assets used for charitable purposes. The current excise tax on income from foundation assets was initially intended to cover the IRS's costs of overseeing the tax compliance of charitable organizations, but the monies were never appropriated for that purpose. For tax years beginning on or before Dec. 20, 2019, the excise tax is 2 percent of net investment income, but is reduced to 1 percent in certain cases. For tax years beginning after Dec. 20, 2019, the excise tax is 1.39% of net investment income, and there is no reduced 1 percent tax rate.

At very least, Congress could impose a single tax rate on all such income; this would eliminate the current perverse incentive for foundations to limit current grants today to avoid a higher tax in the future.

ALLOWING CHARITABLE DEDUCTIONS UP TO APRIL 15 OR TIME OF FILING TAX RETURNS

In the America Gives More Act of 2014, the House of Representatives passed a proposal, sometimes called the April 15 option, which would allow individuals to take charitable deductions up to April 15 or the time of filing tax returns. The proposal costs the government almost nothing if there are no increases in giving because it doesn't really change the subsidy value of gifts already available. Thus, in terms of bang per buck, or increased giving per dollar of revenue cost, it ranks very high, because the incentive for the most part only loses revenues when there are additional gifts.

Economic and marketing evidence supports the notion that saliency matters: people would give more because they would be more aware of the size of the incentive, partly through the information tax return preparers and tax software developers provide.

CAPS ON CHARITABLE INCENTIVES

Prior to passage of TCJA, two proposals—a cap on total itemized deductions and a cap on the top rate at which deductions can be made—had been suggested to reduce incentives for charitable giving and raise revenues.

President Trump at one point proposed an overall cap on itemized deductions of $100,000 per single return and $200,000 per joint return. Higher-income taxpayers with mortgage interest, property tax, and other deductions in excess of such amounts would have been left with no tax incentives to give, while others would be left with a subsidy only for their first dollars of giving, up to the point they hit the cap.

A maximum cap on the tax subsidy rate for itemized deductions, proposed by President Obama, could also be reintroduced. Alternatively, in the presence of a universal deduction to nonitemizers and itemizers alike, the maximum cap could be replaced by a cousin, a maximum rate for that subsidy alone. For instance, if the top statutory tax rate is 37 percent but the maximum tax subsidy rate for deductible contributions is set at 27 percent, then the subsidy for those in that 37 percent bracket would be reduced by more than one-quarter. Because the cap applies to all additional giving, as opposed to be concentrated on the first dollars of giving, it would reduce total giving much more than many other types of limitations that raise the same amount of revenues, such as the floor discussed above.

Although the tax deduction likely induces additional giving, estimates of the size of this effect vary. Indeed, there is considerable debate over whether the increase in giving exceeds the loss of government revenue,

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though valuing the deduction on that basis alone treats charitable contributions and government spending simply as substitutes.

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Further Reading

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