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The New Debate over a Charitable Deduction for Nonitemizers

Joseph Rosenberg, C. Eugene Steuerle, Joycelyn Ovalle, and Philip Stallworth

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The US tax system provides a deduction for charitable giving, but only for the 25 percent of taxpayers who itemize deductions on their tax returns. Accordingly, advocates for the charitable sector have at times proposed to extend a deduction to itemizers and nonitemizers alike. Today these proposals arise from a desire both to increase charitable giving and protect the incentive from being swept up in reforms that in limiting all deductions, without regard to their purpose or merit, would reduce charitable giving.

If designed well with other features, a nonitemizer deduction could increase giving without decreasing Treasury revenues or adding to IRS burdens. If implemented as a stand-alone proposal, however, the gains in charitable giving would be modest relative to the larger revenue losses, while generating significant problems for an IRS already struggling to enforce charitable laws.

At the same time, separating the charitable deduction from other deductions, such as the one for home mortgage interest, could protect against the larger declines in giving that typically accompany across-the-board restrictions, such as a cap or maximum subsidy rate for all itemized deductions. Even when those restrictions technically exempt the charitable deduction, they can reduce giving by reducing the number of itemizers.

President Obama, recent chair of the Ways and Means Committee David Camp, Hillary Clinton, and Donald Trump have all made proposals that would affect itemizers. This brief analyzes the challenges of implementing a nonitemizer deduction, its possible effects on charitable giving, and ways to make it more effective in terms of cost and IRS enforcement.

The Charitable Deduction and the Standard Deduction

The charitable deduction has been around almost as long as the income tax. After a failed attempt to include it in the original 1913 tax law, policymakers enacted the deduction as part of the War Revenue Act of 1917 because of concerns that a high tax rate might weaken charitable giving.

Legislative history indicates two apparent motives behind the charitable deduction provision: to provide an incentive to give; and to define the tax base in a way that counts taxable income as income less charitable giving, For instance, someone with $50,000 of income and $10,000 of charitable giving would be treated as equal in ability to pay tax as someone with $40,000 of income and no charitable giving (Steuerle and Sullivan 1995).

Over time, Congress has enacted and expanded various provisions to limit the number of taxpayers having to file for small deductions and to deal with other complexities. The current exception, called the standard deduction, equals $6,300 for the single taxpayer and $12,600 for the joint return of a married couple. Almost all taxpayers with itemizable expenses below those totals will claim the standard deduction.

While the standard deduction generally precludes lower-income households and most middle-income households from receiving a charitable incentive, it is considered progressive because it provides more deductions than taxpayers could otherwise claim. Thus, it is generally incorrect to claim that the charitable deduction “unfairly” discriminates against lower- and middle-income taxpayers. Of course, one can obtain the same or even more progressivity with a deduction that is extended to nonitemizers. It largely depends on the structure of an entire tax system put in place of the old one, including how the new tax rates and standard deduction compare with the old ones.

Tax Reforms: 1981, 1986, and More Recent Proposals

The Economic Recovery Act of 1981, sometimes called a “Christmas tree bill” because of the many tax-cutting ornaments attached to President Reagan’s original proposal, included a provision allowing nonitemizers to deduct various amounts of charitable contributions from their adjusted gross income (AGI) for five years. The provision phased out on January 1, 1987, and was not renewed. During the first three years, the amount of giving that nonitemizers could deduct for tax purposes was strictly limited. In 1982 and 1983, nonitemizers were permitted to deduct 25 cents on the dollar for only the first $100 of giving. In 1984, the ceiling on deductible giving was raised to $300. In 1985, the ceiling was removed, and nonitemizers were allowed to deduct 50 cents on the dollar. In 1986, the deduction was fully phased in, and nonitemizer giving was 100 percent deductible (US Department of the Treasury 1984).

Sixty-two million individuals filed nonitemized tax returns in 1986. Forty-five percent of those nonitemizers claimed charitable deductions totaling nearly $13 billion, or close to $29 billion in today’s dollars (table 1). The $13 billion of deductions taken largely represented giving that would have occurred otherwise—not the amount of additional giving, which is difficult to estimate.

TABLE 1

Charitable Deductions Claimed by Nonitemizers, 1982–86

Year	Number of nonitemized returns	Number claiming a charitable deduction	Share claiming a deduction (%)	Amount claimed ($ thousands for year)	Amount claimed (thousands of $2016)
1982	61,904,623	19,284,231	31	430,805	1,074,321
1983	61,091,018	22,512,944	37	506,810	1,224,521
1984	61,235,616	No data	No data	No data	No data
1985	61,812,103	25,359,085	41	4,715,619	10,546,464
1986	62,378,162	28,041,097	45	13,277,865	28,733,275

Source: Statistics of Income Division, Internal Revenue Service.

By 1984, despite the significant amount of tax legislation passed in the first three years of Reagan's presidency, the public remained highly dissatisfied with the Internal Revenue Code. People saw it as too complex and unfair. This dissatisfaction helped lead to the 1986 reform that removed or limited numerous deductions and credits. The Tax Reform Act of 1986 did not renew any charitable deduction to nonitemizers, partly because of limited evidence that the deduction had significantly increased giving (JCT 1987).

At the same time, except for 1986, the nonitemizer deduction was fairly limited, through either dollar caps or percentage-of-giving caps. It shouldn't have been expected to increase giving by much. Incentives take time to work because people typically adjust their behavior gradually. In its 1984 study leading to the Tax Reform Act of 1986, the Reagan administration proposed that the deduction not be renewed, citing both the lack of evidence for increased giving and concern over the IRS's ability to administer the law (JCT 1987).

More recent years have seen various proposals to limit the use of the charitable deduction either for budgetary reasons or as part of broader tax reform. In 2009, in conjunction with his health reform efforts, President Obama first proposed a cap on all itemized deductions at a 28 percent tax rate, limiting the cutback to the highest-income taxpayers with tax rates on their income above that level.[1] In the 2016 presidential campaign, Hillary Clinton has also proposed a 28 percent limit on itemized deductions, although her proposal would exclude the charitable deduction from the limit. While research has found that this particular type of proposal would have fairly modest impacts on charitable giving overall (Cordes 2011), it affects charitable contributions more than other itemized deductions, such as mortgage interest, because giving is more concentrated at higher income levels.[2]

In 2014, former chair of the Ways and Means Committee David Camp released a comprehensive tax reform plan that failed to pass Congress but was considered by many to contain a blueprint for reforms that might later pass Congress. This proposal provides one of the best examples of how provisions can combine in their total effect (table 2).

TABLE 2

Effect of Ways and Means Chairman Camp's Proposals on Charitable Giving

Percentage-point reduction because of provisions related to

Camp tax reform tax plan	Group 1: rate structure	Group 2: standard deduction and other nonitemized deduction provisions	Group 3: itemized deductions other than charity	Group 4: charitable deduction	Residual because of interactions
7.0–14.0	0.9–1.9	0.9–1.8	1.2–2.6	2.2–4.4	1.6–3.1

Source: Rosenberg and colleagues (2014).

Note: Numbers do not total 7.0–14.0 because of rounding.

While the Camp proposal would have reduced charitable giving by about 7 to 14 percentage points, based on various estimates of the influence of tax rates on giving, much of the effect derived indirectly from provisions such as lower tax rates, a higher standard deduction, and the repeal of other itemized deductions (Rosenberg et al. 2014). Less than one-third of the total reduction was attributable to changes in the charitable deduction directly, such as a reduction in the maximum amount of deductible giving to 40 percent rather than 50 percent of AGI and the disallowance of charitable deductions up to 2 percent of AGI by creating a floor below which no deductions would have been allowed.[3]

The net impact of the Camp provisions led to a larger total effect than did the charitable provisions alone. Most contemporary taxpayers would switch from itemizing to not itemizing, regardless of any change in the charitable deduction. Particularly important to the future consideration of extending a deduction to nonitemizers, therefore, are the various ways that subsidies for charitable contributions would be reduced, whether directly from an increase in the standard deduction or indirectly from a reduction in other itemizable expenses.

How Much Do Nonitemizers Give?

Below we provide a rough range of estimates of the impact of a stand-alone nonitemizer deduction on charitable giving based on economic research about the impact of charitable incentives. The effect of a stand-alone provision would differ greatly from how much giving would increase were such a provision added to a law such as the Camp proposal. That is, if Camp had added a nonitemizer deduction, his proposal would have avoided much of the 7 to 14 percentage-point reduction in giving estimated from his proposal, though not the share related to the rate reduction.[4]

To quickly grasp why the impact of a stand-alone proposal would be fairly modest, recognize that nonitemizers are estimated to provide only about 18 percent of total giving and face lower and in many cases no tax incentives because they are in low or zero marginal tax rate brackets. Also, those who give large enough charitable gifts are itemizers in the first place.

TABLE 3

Estimated Charitable Giving by Itemizers and Nonitemizers under 2017 Current Law

Current law baseline	Itemizers	Nonitemizers
Number	45,460	129,220
Percent of total	26	74
Total giving ($billions)	239	53
Percent of total	82	18

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1).

A Stand-Alone Proposal to Provide a Deduction for Nonitemizers

The federal revenue cost of extending the charitable deduction to nonitemizers would be about $13 billion annually or $134 billion over the 10-year budget period (table 4).

TABLE 4

Expanding the Charitable Deduction to All Taxpayers

Impact on tax revenue, fiscal years 2017–26 ($ billions)

	2017	2018	2019	2020	2021	2017–26
Total revenue effect plan	-9.2	-12.6	-12.8	-12.9	-13.2	-133.7

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1).
Notes: Baseline is current year. The proposal would keep the current itemized deduction for charitable contributions while allowing taxpayers taking the standard deduction to deduct all contributions.

Table 5, in turn, shows estimates of the increase in charitable giving for extending a deduction to all taxpayers. If the response to the incentive is modest—in the table, if the elasticity of response is 0.5—the proposal would increase giving by about $5 billion annually. Much of the impact is still in higher income quintiles where tax rates are higher. To the extent that giving is more responsive, the impact could rise to as much as $10 billion.

There are several reasons to expect the impact would be on the lower end of the range. Evidence suggests that lower-income taxpayers are less sensitive than higher-income taxpayers, who have more tax advisers and have more incentive to devote time to figuring out the value of the deduction. Some evidence indicates that many taxpayers underestimate the value of the incentive, for instance, by using an average rather than marginal tax rate to crudely analyze what they get back from the government relative to their contributions. Also, that we are dealing with nonitemizers means that most people with a very high response rate, particularly in the middle and upper income classes, are excluded: they would already be itemizers.

Of course, charitable giving could be affected through other, more indirect, channels. For example, the symbol of a more universally available deduction may provide much more incentive than one confined to itemizers.[5] Also, a universal deduction makes appeals and marketing on behalf of charities more effective because the availability of the incentive is not qualified.

TABLE 5

Expanding the Charitable Deduction to All Taxpayers

Estimated change in charitable giving by expanded cash income percentile, 2017 ($ billions)

Expanded cash income percentile[a]	Total contributions	Elasticity -0.5	Elasticity -0.7	Elasticity -1.0
Lowest quintile	2.7	0.0	0.0	0.0
Second quintile	12.0	0.2	0.2	0.3
Middle quintile	33.4	1.0	1.4	2.0
Fourth quintile	64.5	2.0	2.8	4.0
Top quintile	179.3	1.9	2.7	3.8
Top 1 percent	74.5	0.4	0.5	0.8
Top 0.1 percent	45.1	0.2	0.3	0.5
All	**292.1**	**5.0**	**7.1**	**10.2**

Source: Urban-Brookings Tax Policy Center Microsimulation Model.

Notes: Calendar year 2017. Estimates exclude those that are dependents of other tax units. The proposal would allow taxpayers who claim the standard deduction to deduct eligible charitable contributions.

[a] Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. For a description of expanded cash income, see "Income Measure Used in Distributional Analyses by the Tax Policy Center," Urban-Brookings Tax Policy Center, accessed October 21, 2016, http://www.taxpolicycenter.org/TaxModel/income.cfm. The income percentile classes are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are as follows (in 2016 dollars): 20% $23,800; 40% $46,800; 60% $81,000; 80% $140,900; 90% $204,900; 95% $291,000; 99% $688,900; 99.9% $3,438,600.

The IRS Enforcement Issue

The complication of providing deductions to all taxpayers is not simply one for the tens of millions of taxpayers who would now need to keep track of their charitable deductions. In its 1984 tax reform plan leading to the Tax Reform Act of 1986, the Treasury argued that "extension of this deduction to nonitemizers—taxpayers who on average have only small amounts of deductions—creates unnecessary complexity, while probably stimulating little additional giving and *presenting the IRS with a difficult enforcement problem*" (US Department of the Treasury 1984, emphasis added). The IRS has limited audit resources. In fact, the IRS audits only a tiny fraction of all returns (well less than 1 percent) and puts little effort into enforcing charitable provisions. Even if it audited more returns, the IRS has almost no ability to determine if, say, one really put money in the collection basket or made contributions to people knocking at the door. Spending hundreds or thousands of dollars of IRS personnel time on one return to go after a few dollars of tax for a person donating moderate amounts is not economical.

Increased information reporting might mitigate this problem. Having charities provide electronic or written information to both the IRS and individuals could help significantly reduce noncompliance across the board for current itemizers and potential nonitemizers, thereby regaining likely significant revenues now lost to those who misreport their actual giving. However, some parts of the charitable sector have not favored this type of reform, even though charities already must give individuals paper statements for any single contribution worth more than $250.

Independent Sector and other groups representing the charitable sector have long expressed concern about the inadequate resources devoted to enforcement. The issue is not just fairness; public skepticism stemming from charitable giving abuses could discourage contributions.

Additional Issues in Designing a Nonitemizer Deduction

At least two additional matters deserve attention when designing an extension of the charitable deduction to nonitemizers: avoiding two deductions meant for the same purpose and deciding what to do with the Pease provision that reduces the amount of itemized deductions.

Why a Single Charitable Deduction for All Taxpayers, not Just Nonitemizers

In the 1981 legislation, nonitemizers were given a special deduction calculated separately from the deduction allowed to itemizers. This separation created confusion. Some taxpayers preparing returns were required to compute their tax liability twice, first with a standard deduction and a nonitemizer charitable deduction, and then with charitable gifts included in the itemized deduction schedule. The efficient way administratively to deal with this issue is to provide a single deduction for all taxpayers, not just nonitemizers.

The Pease Provision Limiting Itemized Deductions

Current law includes an overall limit on itemized deductions (known as Pease) that reduces itemized deductions by 3 cents for every dollar of income earned above a certain threshold (single returns with incomes above $259,400 and joint returns above $311,300 in 2016) up to 80 percent of total deductions. Pease has little effect on giving because few taxpayers are affected by the 80 percent limit and therefore Pease is unrelated to the amount of their charitable giving. However, Pease does present a problem for a single nonitemized charitable deduction, because removing charity from the itemized deductions subject to Pease would cost additional revenue and subject more taxpayers to the 80 percent limit. In our simulations, the elimination of the Pease provision for charitable contributions would have added about 10 percent to the revenue cost, mainly benefiting high-income taxpayers without any significant effect on charitable giving. One solution would be to have Pease apply to itemized deductions plus the new nonitemizer deduction. However, the extra complexity of Pease leads us to believe that we should strive for replacing it with an alternative that has a similar distributional impact.

Toward a Better Designed Charitable Tax Incentive

Given the moderate impact on charitable giving relative to revenue cost and concerns over IRS enforcement, is there a way to extend the charitable deduction to all taxpayers more effectively? We believe the best solution involves pairing the expanded charitable deduction with a modest "floor"—that is, restricting the deduction to charitable giving above a dollar amount or percent of income.

Economists find that incentives matter most at the margin. Even without a deduction, a person might naturally give some amounts to a church or to children soliciting for a school, but it is the next or last dollars of giving that are most influenced by an incentive. That is why economists believe that a floor generally has little impact on giving. Thus, if Congress wants to increase giving at limited or no cost, it can target the incentive where it applies more and restrict it where the incentive applies less and is likely to be ineffective.

In a previous analysis, Urban Institute researchers showed how to implement a nonitemizer deduction with a floor in a way that would maintain revenues to the Treasury while increasing giving (Cordes, O'Hare, and Steuerle 2000). If Congress wishes to expand incentives somewhat, it could adopt a lower floor and make other revenue adjustments.

Again, it is not just getting a decent-bang-per-buck that justifies a floor. With a floor, the IRS would no longer need to worry about noncompliance by those who give less than the floor amount. These taxpayers are difficult to monitor and expensive to audit. This reduction in enforcement requirements would mitigate or remove the increase in enforcement required by the allowance of deductions for those currently excluded from any incentive.

Revenue-neutral exchange of extending a deduction to nonitemizers for a floor also turns out to be progressive. The floor applies to all taxpayers and raises revenues from higher-income taxpayers who tend to itemize, while the deduction extends additional tax benefits to nonitemizers who tend to have lower incomes on average.

In summary, the two major complications with the extension of the deduction to nonitemizers—limited bang per buck and IRS enforcement problems—can largely be resolved by adopting a floor under which giving would not be deductible. Even if the goal is simply to protect the threat that charitable incentives would be reduced by being swept up in broader tax reform efforts, the case for dealing with limited bang per buck and IRS enforcement still stands.

Notes

1. Howard Gleckman, "Obama's Plan to Cap Tax Deductions," *TaxVox* (blog) Urban-Brookings Tax Policy Center, February 26, 2009, http://www.taxpolicycenter.org/taxvox/obamas-plan-cap-tax-deductions.
2. See Toder, Rosenberg, and Eng (2013) for an analysis of the incentive effects of various proposals that broadly limit itemized deductions on charitable giving.

3. Average charitable giving represents about 2 percent of income, meaning the 2 percent floor would allow deductions only for amounts above the average.
4. Depending upon design and how many additional taxpayers could now take the charitable deduction, it might also increase the number of taxpayers receiving some charitable incentive.
5. When tax reform eliminated a fairly universal option to take a deduction for individual (non-employer-based) deposits to an individual retirement account, it significantly reduced the extent to which that option was used (even by those who remained eligible).

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About the Authors

Joseph Rosenberg is a senior research associate in the Urban-Brookings Tax Policy Center at the Urban Institute, where his research focuses on federal taxation, including business and corporate taxation, broad-based consumption taxes, tax expenditures, and tax incentives for charitable giving. He also develops and maintains the Tax Policy Center's microsimulation model of the federal tax system, which is regularly used to produce analyses of the revenue and distributional impacts of federal tax policy that are broadly cited by policymakers and the press. Before joining Urban, Rosenberg worked at the Board of Governors of the Federal Reserve System in Washington, DC, and was a PhD candidate in economics at the University of California, Berkeley.

C. Eugene Steuerle is an Institute fellow and the Richard B. Fisher chair at the Urban Institute. Among past positions, he was deputy assistant secretary of the US Department of the Treasury for Tax Analysis (1987–89), president of the National Tax Association (2001–02), codirector of the Urban-Brookings Tax Policy Center, chair of the 1999 Technical Panel advising Social Security on its methods and assumptions, and chair of the 2015–16 National Academy of Sciences Committee on Advancing the Power of Economic Evidence to Inform Investments in Children, Youth, and Families. Between 1984 and 1986, he was the economic coordinator and original organizer of the Treasury's tax reform effort. Among other awards, Steuerle received the first Bruce Davie–Albert Davis Public Service Award from the National Tax Association in 2005, and the 2015 TIAA-CREF Paul Samuelson award for his book *Dead Men Ruling*.

Joycelyn Ovalle is a research associate at the Urban Institute. Ovalle works in multiple subject areas, including tax policy, charity initiatives, and the annual *Kids' Share* publication. She holds a BA in political science from Sam Houston State University and an MPA from the Bush School of Government and Public Service at Texas A&M University.

Philip Stallworth is a research assistant in the Urban-Brookings Tax Policy Center. He primarily works with the Tax Policy Center's federal microsimulation model to estimate the revenue and distributional effects of federal tax policy. He holds a BA in mathematics with a concentration in statistics from Reed College.

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