TAX POLICY CENTER
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CHALLENGES & OPPORTUNITIES FOR CHARITIES AFTER THE 2017 TAX CUTS AND JOBS ACT

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May 11, 2017

Eugene Steuerle, Richard Fisher Chair at the Urban Institute and co-founder of the Urban-Brookings Tax Policy Center gave this luncheon presentation at the ABA Tax Meetings Exempt Organization.

"A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty." I'd like to refine this idea, probably incorrectly attributed to Winston Churchill, with the wisdom of my teachers, by distinguishing among luck, serendipity, and misfortune. To me, luck—good or bad— results from random factors beyond our control. Serendipity reflects the good things more likely to happen when we put ourselves along a path with a higher-than-average probability of success, while misfortune happens, often unnecessarily, when we bet against a house that has stacked the odds in its favor.

I realize that the lexicographers may not fully agree with my definitions.

> Chauncey M. Depew told the story that Noah's wife one day was caught kissing the cook.
> "'Noah,' she exclaimed, 'I'm surprised!'
> "'Madam,' he replied, 'you have not studied carefully our glorious language. It is I who am surprised. You are astounded.'"

Are charities on a serendipitous path, where a virtuous cycle of improvement is more likely, or a path with greater odds of a vicious cycle of misfortune? I suggest that the treatment of charities in last year's tax reform may reflect a path if not misfortunate at least less serendipitous than possible.

In any case, I want to spend most of this talk discussing why the current tax law is unsustainable and sets in motion forces for further reform. I then set out a bold but difficult agenda worth pursuing as we venture down that still-to-be-determined path.

By Tax Policy Center estimates, the new tax law took away charitable deductions from about 60 percent of those who formerly benefited from it, while reducing subsidies by around $17 billion annually. In percentage terms, the drop was about 30 percent of the amount of tax incentives formerly provided, as the average subsidy rate dropped from about 21 percent to 15 percent.

Unless givers bump up their level of net sacrifice, the burden of that decreased government support will inure not to them but to food bank recipients, students, and museum visitors.

Don't get me wrong. By no means does this tax change destroy what we might call the charitable ship of state. But it was more than a shot across the bow: it was an explosive shot into the bow. Even more threatening than the immediate loss of about 6 cents of subsidy for every dollar of charitable giving was the potential weakening of societal support for charities, both secular and religious, which are mainstays in both the first and fourth estates of a well-functioning, modern society.

This shot into the bow had antecedents. It came about in part because of stories of abuse and corruption, often legal, in charitable organizations. Such stories reduce the support of both the public and elected officials.

As tax experts well know, much of the damage to charities from this tax reform was not direct but collateral to such changes as the increase in the standard deduction. Yet that damage could easily have been avoided by a willingness in the years before this reform got headway, to exchange less valuable subsidies for a more valuable universal deduction—sometimes called an above the line deduction. But charities could not organize together behind that type of proposal.

By 2017 charities had few defenders, either Republican or Democratic. Other actual and threatened changes, such as the enactment of new taxes on college endowments and on high salaries of charity officials, and the earlier (Chairman of Ways and Means Committee) Camp bill attack on donor-advised funds, tell a corollary tale.

Regardless of cause, I predict that the new law will lead to dwindling public support for a charitable deduction confined to about one-tenth of households. I expect the now largely excluded public to look askance at the arbitrary tax distinctions that now favor those who are rich, have individual retirement accounts, bunch their giving in one out of several years, donate property with capital gains, and—excuse the shorthand—forgo payment for labor services rendered. Institutions with endowments and real estate can get an income tax exclusion for returns from those assets, but most individuals who give away their investment returns cannot, while foundations and selective educational institutions get hit with an additional tax on their endowments.

At the end of the day, I don't think this type of system can pass the laugh test for political sustainability.

So, if I am correct that we have an unsustainable law, reconstruction of the charitable ship will almost inevitably occur, though perhaps not in the next year or even next few years. Meanwhile, government budgets are on an unsustainable course, and we will soon be asked what charities will contribute, not receive, to make those budgets sustainable.

And therein lies both opportunity and further threat. The question is not merely how and when future Congresses may react, or even what direction those reactions may take. It is, what responsibilities in the interim lay with us who work for and with charities? How can we help move the sector onto a continual, long-term, serendipitous path?

Though I attempt as a professional to approach these issues with scientific disinterest and dispassion, I am far from uninterested and passive. I worked in Treasury on major tax reform for many years, including serving as the original organizer and economic coordinator of the Treasury's 1984 effort that led to the Tax Reform Act of 1986. I cofounded the Tax Policy Center, the Urban Institute's Center on Nonprofits and Philanthropy, and ACT for Alexandria, a community foundation in Alexandria, Virginia, that depends heavily on extra donations from donor-advised funds for both its community efforts and its own sustainability. I serve or have served on committees of the National Center on

Philanthropy and the Law, Independent Sector, and the Council on Foundations. I know and admire many of the people, like you, with whom I have worked in government, academia, charities, and groups attempting to represent charities.

Perhaps most personal of all, I have asked most of my life about the gains possible from becoming an even more charitable people. Charitable acts do not exist in isolation; they model ways that we can become more humane, welcoming, and inclusive. As only one piece of this puzzle, why can't we, as generations now some eight times richer than our forebears a century ago, jump beyond that 2 percent of income barrier that seems to define the limit on formal private giving? Thinking pie in the sky, if we each gave away a quarter of our income and got nothing in return from the extra charitable services engendered, we'd still personally be six times as well off.

So here is bold agenda that I believe charities could and should undertake at this moment of both opportunity and challenge. It has five related elements, which deserve far more discussion that I can give today:

Eyes on the Prize
Investment
Courageous Leadership
Principled and Evidence-Based Action; and
National Marketing Strategy

Eyes on the Prize. We must focus, first and foremost, on creating a stronger charitable sector that is better able to serve the public. In today's environment, winning an advantage here or there is unlikely to be adequate to move to a more serendipitous path. Worse, it can mask the long-term losses that might accompany the modest gains.

Investment. In life just like in finance, higher returns accrue to long-term investments. The potential loss of perhaps $10 billion or more annually of charitable giving in the 2017 legislation represents only part of what's at risk as we try to find a serendipitous path forward. If individuals would increase their giving by an additional ½ of 1 percent of their income, giving would rise annually by about $100 billion in an economy soon to reach $20 trillion. We need a charitable infrastructure with resources commensurate with what is at stake.

Courageous Leadership. Real reform requires making broad trade-offs both with government policy and within the charitable sector. Any strengthened infrastructure must make that possible. The trade association approach, where fear of offending some charitable organizations means that everybody must agree on what they want, is insufficient, ill-informed, and inefficient.

Principled and Evidence-Based Action. It's time to start choosing policy and practice on the basis, first, of such principles as effectiveness, justice, and non-corruptibility, and, second, on the type of evidence increasingly demanded by private firms and grantor organizations. Charitable advocacy often ignores both, which weakens its credibility.

National Marketing Strategy. Charities have never united behind a national campaign centered on exemplars of good works. Amid today's chaos and increasing tribalism, society desperately needs such messaging. And, the economies of scale available from this more catholic approach to promoting good deeds are huge.

Let me elaborate briefly on each of these five elements.

Eyes on the Prize. If I am right, and the issues at stake are fundamental, then we had best not start out narrowly focused on some tactical, political victory. That's not the prize we seek, even if it may be one input toward attaining that prize. Government tax policy can only reinforce, not define, our chosen path.

We need to turn first to the existential issues: why we are here, what we are about, and how we can best enhance and develop charitable institutions to foster a better society. This goes beyond money to garnering better respect and understanding of the important role nonprofits play in civil society. It is this broader view that can inspire us to make a concerted, but difficult, effort at self-reform, not just trying to convince government to treat charities better.

Each of the next four elements follow from that perspective.

Investment. Tens, if not hundreds of billions of dollars of charitable activity—not just donations, but volunteering, and gains from greater effectiveness—are at stake here. The projected loss in donations from the recent tax act alone—perhaps $10 to $20 billion annually—is merely the most immediately identifiable.

Today we have small bits of an infrastructure that tries to promote goals related to increasing the size and effectiveness of giving. We have representative organizations like the Independent Sector, Council on Foundations and Exponent Philanthropy. Modest support for charitable research, though less than when Harvey Dale and Joel Fleishman made created charitable sector research as a field of study through their efforts at Atlantic Philanthropy. Occasional support for some national efforts like United Way. Tiny support for those groups trying to attack abuses and corruption in the sector. Individual efforts by entrepreneurs like Mario Morino through the Leap of Reason platform for managing for outcomes.

But, at least from my vantage point, the total amount of resources for all these types of efforts is quite small. By contrast, individual charities will often invest 10 or 20 cents or more for each dollar they might raise for themselves, even though some of their gains will be offset by losses to other charities. Yet, somehow, we still have a system in place that implicitly concludes that it's not worth investing even 1 or 2 cents on the dollar to increase aggregate giving and the effectiveness of giving (somehow measured) by tens of billions of dollars.

In economics, we have a term for this type of failure: tragedy of the commons.

To be clear, I am speaking of strengthening the charitable parts of our society in any effective way we can muster, not just lobbying. And this brings me to my third, fourth, and fifth elements,

Courageous Leadership. Success will require courageous leadership by individuals and organizations, to lead when others won't follow, attack abuse and inefficiency even when that offends, and invest when others ride free.

As I have engaged with national charitable organizations over many years, I have watched their leaders hamstrung when the progress to which they aspire requires challenging and at times losing their members. Unfortunately, one consequence is that organized sector activity comes across to many congressional members and their staffs as the actions of another trade association.

But charities will never win more than modestly as a "trade association." They don't—and often can't—threaten voter and campaign contribution consequences, or spread misinformation, in the same way as other special interest groups. And I don't think they should, as it would further weaken public support for charitable causes.

At the same time, donor organizations need to back leaders when they engage drives for internal reform and reforms to government policy that at times go against the interests of some charities.

A simple example would be greatly bolstering institutions that aim to remove corruption and waste from their operations. Some recent publicity dwelt on so-called veterans' organizations that provided little support for veterans. But something is wrong when we've known about this problem for decades and done little about it.

Senators Grassley and Hatch have asked nonprofit hospitals for more evidence on their provision of community goods. I know that such provision may be hard to measure for strict legal dividing-line purposes. Still, their question is legitimate. For reasons I won't go into here, charity officials can effectively withdraw monies intended for charitable beneficiaries in ways that are legal, or apparently legal, though corrupting. Again, none of this is new, but, again, not much has been done about it.

I don't fully know how to tackle all these issues, but it does seem that we need to invest much more in organizations like Charity Navigator, GuideStar, GiveWell, and the Better Business Bureau's Wise Giving Alliance, but going beyond metrics of some limited value toward promotion of standards and efficiency audits (hopefully, more internally sought than externally imposed) of individual organizations.

Principled and Evidence-Based Action. Theories of public finance and public policy have long required that policy be based upon such principles as efficiency or effectiveness, equal justice under the laws, and non-corruptibility. Additionally, policy should be based on evidence, including, to the extent possible, relating benefits to costs and engaging in well-designed experiments.

Over the years, I have used evidence to suggest several tax reforms that would generate significantly more bang per buck out of tax subsidies than the subsidies codified in the former tax law. These reforms include:

- a universal deduction that is backed by a floor, based on evidence that the combination could increase giving at no cost to Treasury without adding significantly to IRS enforcement problems;
- allowance of a deduction for the previous calendar year for any gifts made at tax-filing time, based on evidence both that giving would increase by a multiple of that added revenue cost and that marketing of the subsidy would be among the most salient possible;
- removal of excise taxes on foundations and, now, educational institutions, based on evidence of the taxes' inefficiency and their 1-to-1 loss in charitable output for every dollar of revenue gain to the Treasury; and
- a more rigorous system of reporting to IRS on charitable gifts, based on strong evidence of the significant noncompliance that accompanies weak reporting systems.

I don't necessarily expect you to agree with these proposals, and I apologize for the very brief descriptions given here. However, I do challenge charitable officials to start basing their discussions of better tax policy and charitable practices on principles and evidence, even if those principles work against some of their interests and the evidence contradicts their own intuitions. As I noted, I believe that if charities had been willing in the past to accept evidence on how efficiently to cover the cost of a more universal deduction, they could have avoided the hit they took in last year's tax bill.

A National Marketing Strategy. Finally, based on evidence from marketing more than economics, I have recently suggested the need for a national campaign to promote giving. Charities can gain from the same economies of scale that apply to national marketing campaigns for, say, Major League Baseball and not just the Washington Nationals, pork and not just Bob Jones sausage, milk and not just the Mount Joy Farmers' Cooperative.

To be sure, some groups have made modest attempts at encouraging donations. Giving Tuesday is a great recent example of a drive to encourage charitable contributions that has gained national visibility. Decades ago, Independent Sector urged Americans to "give 5" with the idea that 5 percent is the right percentage of income for the average citizen to donate annually. But whatever their merits, these campaigns have been limited to a specific day or formula for giving; so far, none has been made continuous.

While money and effectiveness are important here, the steady drumbeat of scandal, and the proliferation of quasi-charitable 501(c)(3) organizations undermine faith in the sector. We need to create a positive drumbeat that the public and their elected representatives want to follow.

Though I claim no special expertise in designing a marketing campaign, I cofounded and later chaired the efforts of ACT for Alexandria. There I discovered our advantage of being able to advertise for all Alexandria charities in ways that individual charities could not. For the same advertising effort, people were more likely to contribute to a communitywide effort than an appeal from one organization.

What might be marketed on a national level? Consider the following:

- Tell simple but powerful human-interest stories extolling generous people, an effort that would help meet people's hunger for news stories other than those focused on anger, self-righteousness, and political self-absorption.
- Encourage people to give to charity as a way to mediate disputes over money or compensation.
- Help people understand how their wealth, not just their income, provides great opportunities to give, and organize wealth advisers in communities around the country around that theme. In some ways, this research supports extending efforts like the Giving Pledge to more moderate wealth levels. (If interested, I can share some compelling research here as well.)

SUMMARY

In summary, the likely lack of sustainability of the 2017 tax law provides a strong impetus for reform of the charitable sector. But that law sent out a broader warning that internal reform is needed, not just external reform in the actions of legislators.

Starting with our eyes on the prize of a more generous society, we should consider a bold agenda where all elements relate to each other: investment that empowers courageous leadership, courageous leadership that seeks best practices and policy reform based on principles and evidence, and an efficient and effective marketing campaign that extols generosity so that people and legislators come to believe in that agenda and gain greater respect for the role that nonprofits can play in our society. In that way, the prize we seek may be within our grasp.

ACKNOWLEDGMENTS

The views expressed are those of the authors and should not be attributed to the Urban-Brookings Tax Policy Center, the Urban Institute, the Brookings Institution, their trustees, or their funders.