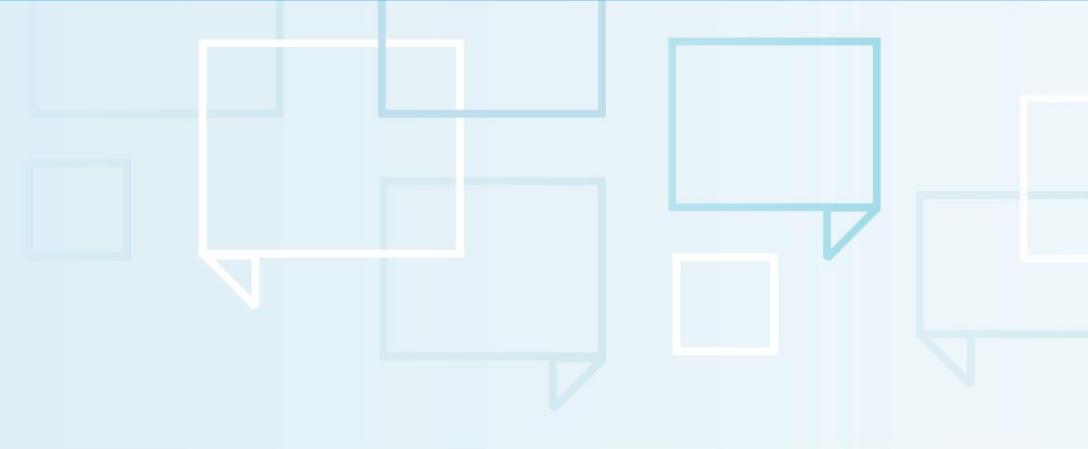


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TAX INCENTIVES FOR CHARITABLE CONTRIBUTIONS

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ABSTRACT

This Chartbook explores the implications of current law income tax incentives for charitable donations along with several alternatives for tax deductions that are more universally available.

Introduction

From the earliest years of the modern income tax system, charitable contributions have been deductible in computing taxable income. And from the earliest years, it was recognized that this deduction provided an incentive for taxpayers to contribute to charities. In 1944, the standard deduction was added to the tax code as an alternative to itemizing deductions. Although this lowered the compliance burden for many taxpayers, it also eliminated the tax incentive to contribute for those who chose it. In 2017, the Tax Cuts and Jobs Act essentially doubled the size of the standard deduction, and the Tax Policy Center estimates that about 88 percent of tax filers will choose the standard deduction for tax year 2019, and only about 9 percent will receive a tax deduction for charitable contributions. This, along with the recognition that a deduction coupled with a progressive tax system provides larger subsidies to higher income taxpayers, has led to renewed interest in alternative tax incentives to contribute to charitable organizations.

The purpose of this chartbook is to briefly examine current law and several alternatives. We examine the predicted change in giving from each alternative and measure the change in federal revenue as the change in the total tax burden. This approach focuses on the change in federal revenue given the existing level of contributions, allowing for simple apples-to-apples comparisons across plans. For simplicity, all analyses are done for calendar year 2020. Some of the proposals provide a tax benefit only for charitable donations greater than a specified amount, in all cases less than the average amount of giving. These specified figures can act as “signals” for suggested levels of giving. Although signals are a potentially important effect, they are not accounted for in this analysis. We also do not examine the comparative difficulty in administering the different plans, though allowing a deduction for taxpayers with only a modest amount of contributions may raise serious issues of administration.

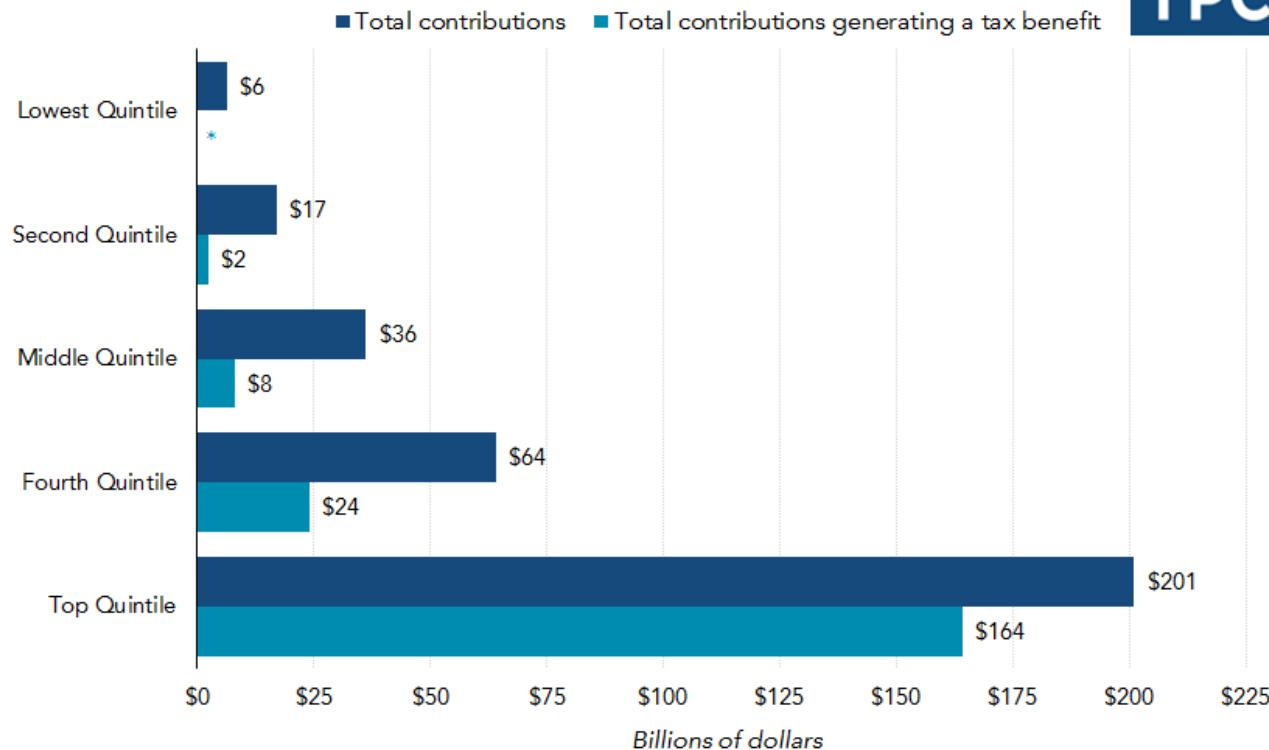
We consider current law and the following alternatives that provide a universal tax benefit for charitable contributions.

- A deduction for all contributions, regardless of whether the tax filer itemizes deductions or uses the standard deduction
- A deduction for all contributions above 1 percent of Adjusted Gross Income (AGI)
- A deduction for all contributions above 1.65 percent of AGI
- A deduction for all contributions above 2 percent of AGI

We first provide a summary of who makes charitable contributions under current law (figure 1). The results are presented by income category and show the amount of contributions and the share of contributions receiving a tax benefit. We then look at the revenue cost associated with four alternatives to the itemized deduction for charitable contributions under current law (figure 2). All these options provide for a universal deduction, whether or not the taxpayer itemizes, but three of the four have a floor and only contributions greater than the specified amount would generate a tax deduction. We then add in the change in contributions that are associated with the alternatives (figure 3). The next figure shows the share of low- and moderate-income households who would benefit from a universal deduction for charitable contributions compared to the current-law itemized deduction (figure 4). We then look at the effect of a floor on deductions by comparing the average tax change by income group for a universal deduction to the change in taxes associated with a 1 percent of AGI floor on a universal charitable deduction (figure 5). Next, we compare the shares of households who benefit from the various options (figure 6). Finally, we show the marginal tax benefit for the various options, compared to current law (figure 7).

FIGURE 1

Contributions by income group, calendar year 2020



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: * Non-zero value rounded to zero. Current law is the itemized deduction for charitable contributions, allowing individuals to deduct up to 60 percent of AGI in a given year, and carry forward any excess for deduction on future tax returns for up to five years. The lowest quintile includes taxpayers with expanded cash income below \$26,300, and the top quintile includes those with income above \$165,900.

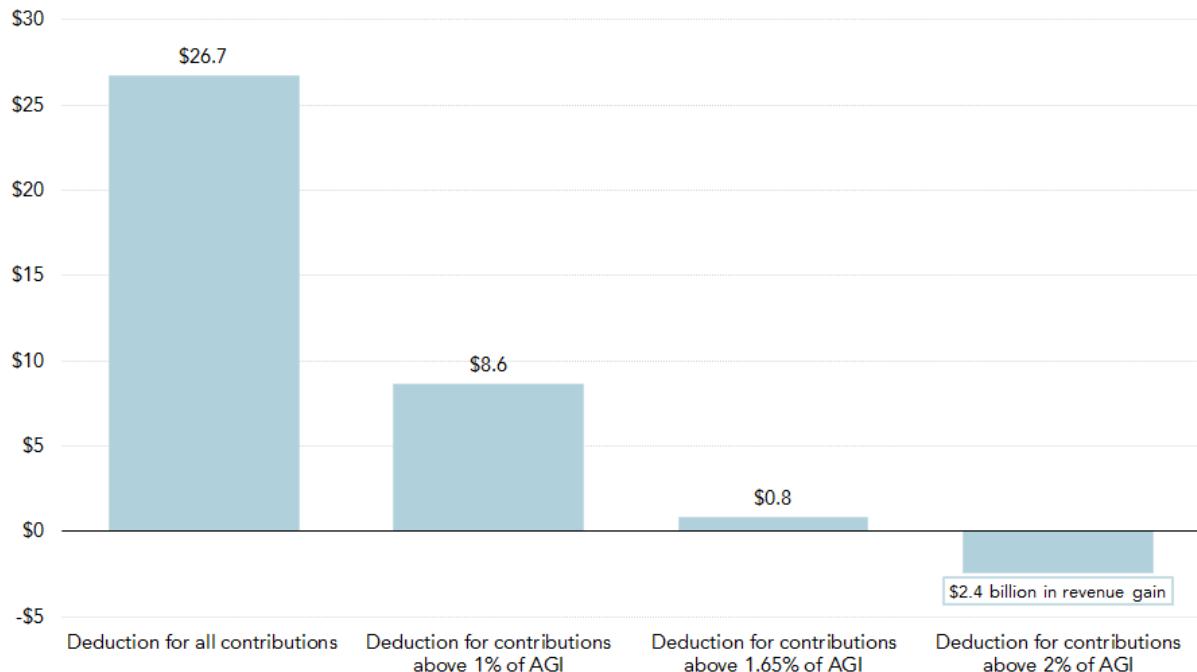
Who makes charitable contributions under current law?

- Although charitable tax benefits are highly concentrated among high-income taxpayers, so are charitable contributions themselves.
- About 12 percent of contributions by those in the second income quintile receive a tax benefit.
- The share of contributions receiving a tax benefit is greater for those in higher income quintiles.

FIGURE 2

Revenue costs by incentive option, calendar year 2020

Billions of dollars



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: All proposals are universal tax incentives.

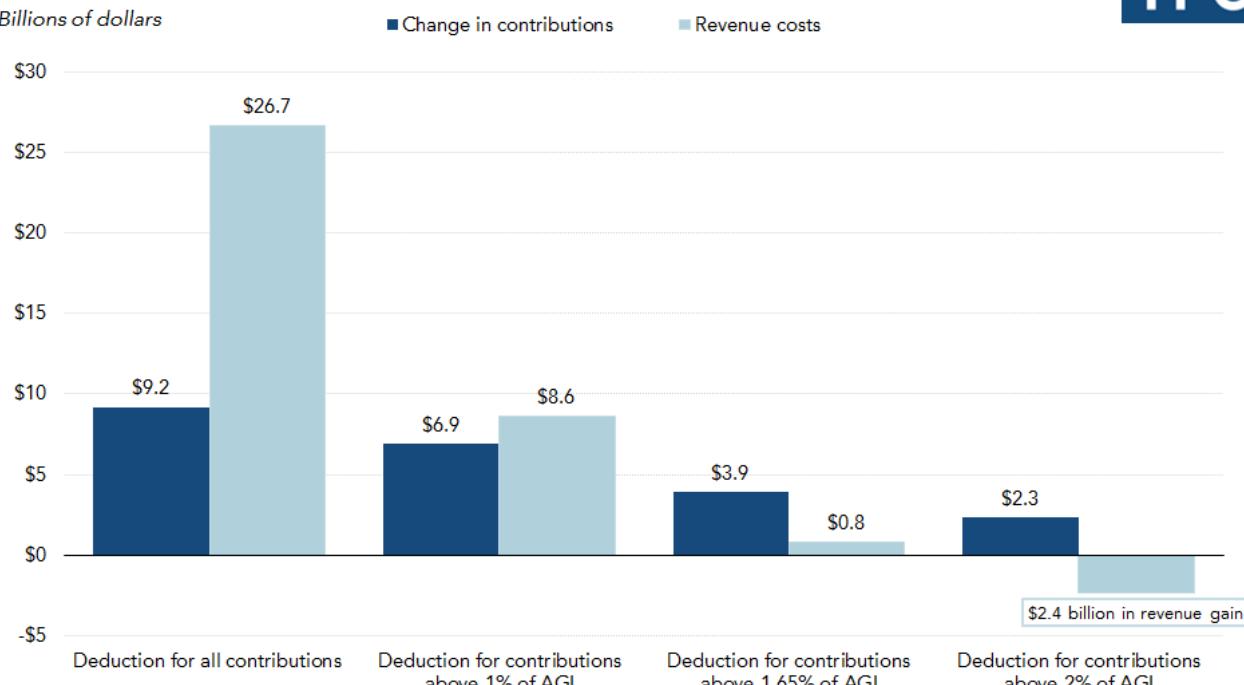


What are the revenue costs for alternative options?

- Revenue costs are highest for the universal deduction because it subsidizes all contributions to charitable organizations. Allowing a deduction only for contributions above a share of AGI reduces the revenue cost while still providing an incentive for contributions above the floor.
- For instance, eliminating deductions for gifts less than 1 percent of AGI reduces revenue costs by about \$18 billion.
- Limiting the deduction to contributions above 2 percent of AGI further reduces the amount of contributions receiving a tax benefit, leading to a revenue pickup.

FIGURE 3

Change in contributions and revenue costs by incentive option, calendar year 2020



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: Change in contributions is estimated using elasticity of -0.5. All proposals are universal tax incentives.

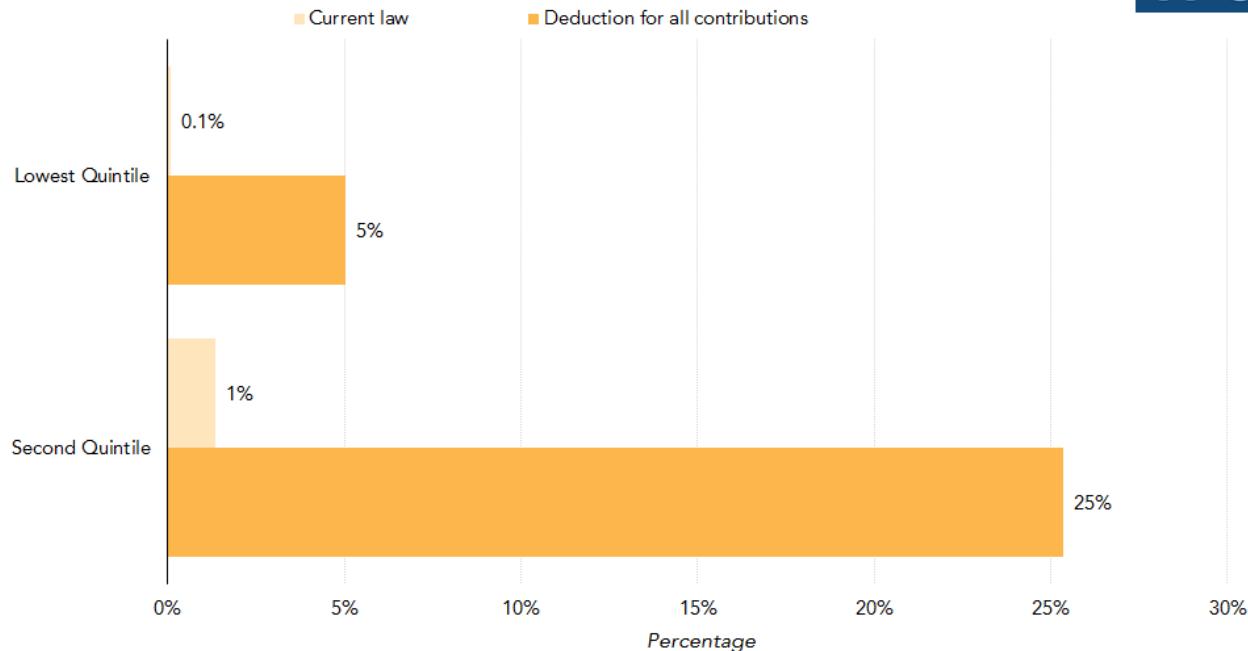


How do revenue costs compare with changes in charitable contributions?

- A tax benefit delivered through a deduction provides an incentive to increase contributions for those taxpayers who can take advantage of the deduction.
- The revenue cost per dollar of contributions generated is steep for the universal deduction because many of the contributions would have been made anyway.
- Changes in revenue and contributions vary among incentive options. For instance, eliminating deductions for donations less than 1 percent of AGI reduces revenue costs by about \$18 billion. But, assuming a modest behavioral response, additional contributions decline only by just over \$2 billion.

FIGURE 4

Share of tax units benefitting under current law versus deduction for all contributions, by income group, calendar year 2020



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: Current law is the itemized deduction for charitable contributions, allowing individuals to deduct up to 60 percent of AGI in a given year, and carry forward any excess for deduction on future tax returns for up to five years; the proposal would replace the itemized deduction with a universal deduction for all charitable contributions.



How many low- and moderate-income tax units with charitable contributions benefit under current law and a universal deduction?

- Looking only at households in the 40 percent of households with lower incomes than the rest, current law provides very few with charitable tax benefits.
- Even a universal deduction, with no floor, would benefit very few in the lowest quintile and about one-quarter of those in the second quintile.
- Most low- and moderate-income tax households owe no income tax against which a deduction could be applied.

FIGURE 5

Change in average tax benefit with deduction for all contributions versus deduction for contributions above 1% of AGI, by income group, calendar year 2020



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: * Non-zero value rounded to zero. Both proposals are universal tax incentives.

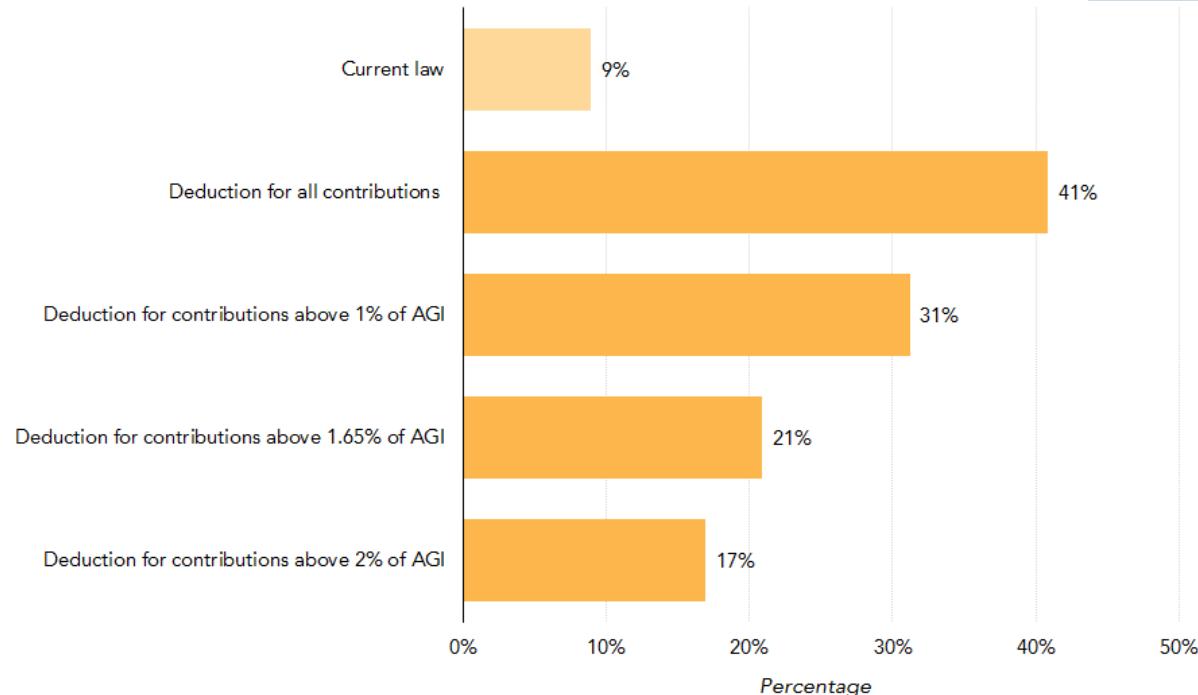


How are average taxes reduced by two alternative charitable contribution tax benefits?

- For a universal deduction, many of the benefits for higher income taxpayers go to those who currently itemize but who would switch to the standard deduction and then claim their charitable contributions as another deduction. These taxpayers get no new marginal incentive from the universal deduction proposal.
- With a floor of 1 percent of AGI, a universal deduction is made more progressive and provides no benefits on average to those in the top quintile.

FIGURE 6

Share of tax units with tax benefit by incentive option, calendar year 2020



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: All proposals are universal tax incentives.

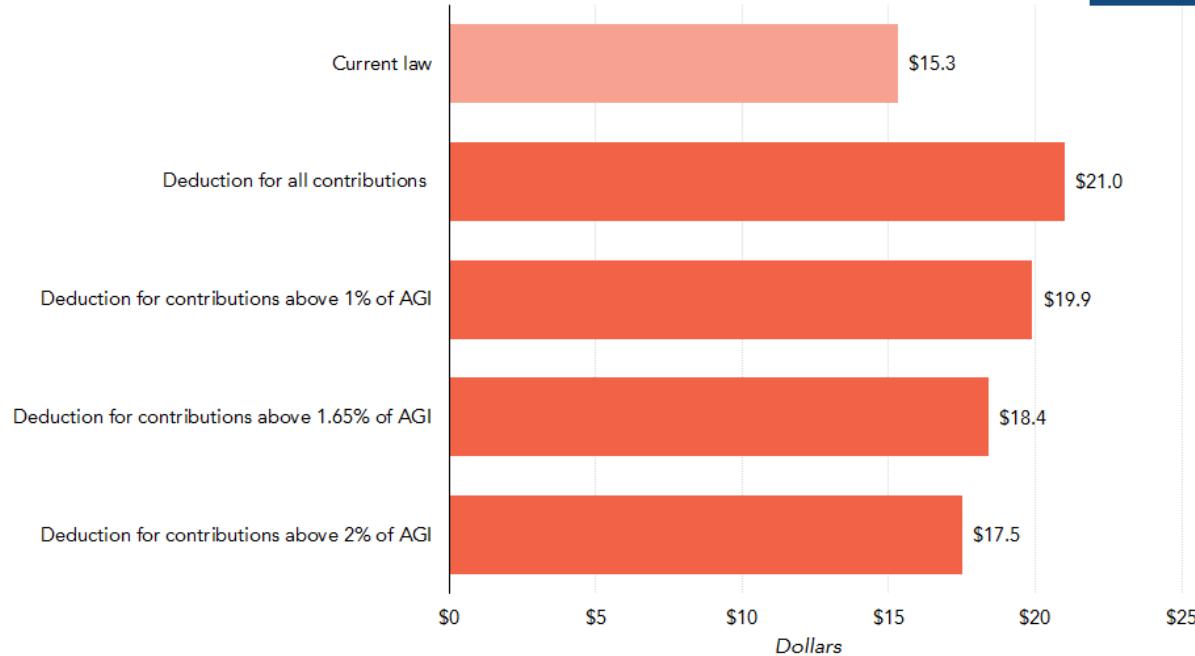
What share of tax units would benefit from charitable contribution tax benefits?

- All four proposals increase the number of tax units receiving a benefit.
- The deduction for all contributions with no AGI floor extends the incentive to about 40 percent of the population. The share is less than 100 percent because many households cannot avail the deduction if they do not have any taxable income, and others may not contribute to charitable organizations.
- A floor provides no benefits for those giving less than the floor amount. So, with a 1 percent floor, taxpayers making \$50,000 in AGI but giving less than \$500 to charity will receive no benefit.
- Higher floors reduce the share of taxpayers who would benefit.



FIGURE 7

Marginal tax benefit per \$100 of additional contributions by incentive option, calendar year 2020



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: All proposals are universal tax incentives. Marginal tax benefit is calculated by increasing each tax unit's baseline charitable contributions by \$100 and recomputing tax liability.

What is the marginal tax benefit per \$100 of additional contributions?

- Under current law, the federal government provides a marginal incentive of about 15 cents for every dollar contributed to charities.
- A universal deduction for all contributions would raise that marginal incentive to about 21 cents.
- The marginal benefit shown here is averaged across all households, including those who don't itemize charitable contributions. Thus, the average benefit for new contributions by those who do itemize would be higher.
- With AGI floors, the incentive will be reduced only slightly, but could significantly reduce revenue costs.

TABLE 1

Baseline Distribution of Charitable Contribution Tax Benefits

Current law, calendar year 2020



Expanded Cash Income Percentile	Total Contributions (\$ billions)	Share of Total Tax Benefit (%)	Marginal Tax Benefit Per \$100 of Contributions (\$)	Share of Tax Units with Benefit (%)
Lowest Quintile	\$6.3	*	\$0.1	0.1%
Second Quintile	\$16.9	0.3%	\$1.4	1.4%
Middle Quintile	\$36.1	1.7%	\$3.2	5.6%
Fourth Quintile	\$63.9	6.5%	\$6.6	14.1%
Top Quintile	\$200.9	91.5%	\$21.8	36.3%
All	\$324.4	100.0%	\$15.3	8.9%
Breakdown of Top Quintile				
80th-90th Percentile	\$43.8	7.6%	\$11.4	25.0%
90th-95th Percentile	\$30.4	8.2%	\$15.5	37.4%
95th-99th Percentile	\$39.6	17.6%	\$22.5	54.8%
Top 1 Percent	\$87.1	58.1%	\$29.0	79.7%
Top 0.1 Percent	\$53.0	35.2%	\$28.0	89.9%

Sources: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: * Non-zero value rounded to zero. Current law is the itemized deduction for charitable contributions, allowing individuals to deduct up to 60 percent of AGI in a given year, and carry forward any excess for deduction on future tax returns for up to five years.

TABLE 2

Distribution of Charitable Contribution Tax Benefits

Universal deduction for all contributions, calendar year 2020



Expanded Cash Income Percentile	Change in Total Contributions (\$ billions) *	Change in After-Tax Income (% points)	Marginal Tax Benefit Per \$100 of Contributions (\$)	Share of Tax Units with Benefit (%)
Lowest Quintile	\$0.1	0.0%	\$2.0	5.0%
Second Quintile	\$0.4	0.1%	\$6.5	25.4%
Middle Quintile	\$1.6	0.2%	\$12.0	50.1%
Fourth Quintile	\$3.0	0.3%	\$16.0	70.1%
Top Quintile	\$4.2	0.2%	\$26.0	86.1%
All	\$9.2	0.2%	\$21.0	40.8%
Breakdown of Top Quintile				
80th-90th Percentile	\$2.0	0.3%	\$20.7	83.1%
90th-95th Percentile	\$1.0	0.3%	\$22.4	87.1%
95th-99th Percentile	\$0.6	0.2%	\$26.2	91.1%
Top 1 Percent	\$0.5	0.1%	\$29.9	93.1%
Top 0.1 Percent	\$0.2	0.0%	\$28.6	91.7%

Sources: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: * Assuming elasticity is -0.5. Proposal would replace the itemized deduction for charitable contributions with a universal deduction.

TABLE 3

Distribution of Charitable Contribution Tax Benefits

Universal deduction for all contributions above 1.0% of AGI, calendar year 2020



Expanded Cash Income Percentile	Change in Total Contributions (\$ billions) *	Change in After-Tax Income (% points)	Marginal Tax Benefit Per \$100 of Contributions (\$)	Share of Tax Units with Benefit (%)
Lowest Quintile	\$0.1	0.0%	\$2.0	4.9%
Second Quintile	\$0.4	0.1%	\$6.5	24.3%
Middle Quintile	\$1.6	0.1%	\$12.0	44.0%
Fourth Quintile	\$2.8	0.2%	\$15.6	51.8%
Top Quintile	\$2.0	0.0%	\$24.4	49.8%
All	\$6.9	0.1%	\$19.9	31.2%
Breakdown of Top Quintile				
80th-90th Percentile	\$1.7	0.2%	\$19.5	50.5%
90th-95th Percentile	\$0.8	0.1%	\$20.9	50.3%
95th-99th Percentile	\$0.1	0.0%	\$24.0	48.4%
Top 1 Percent	-\$0.6	-0.2%	\$28.2	45.7%
Top 0.1 Percent	-\$0.3	-0.2%	\$27.4	41.7%

Sources: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: * Assuming elasticity is -0.5. Proposal would replace the itemized deduction for charitable contributions with a universal deduction for contributions above 1.0 percent of AGI.

TABLE 4

Distribution of Charitable Contribution Tax Benefits

Universal deduction for all contributions above 1.65% of AGI, calendar year 2020



Expanded Cash Income Percentile	Change in Total Contributions (\$ billions) *	Change in After-Tax Income (% points)	Marginal Tax Benefit Per \$100 of Contributions (\$)	Share of Tax Units with Benefit (%)
Lowest Quintile	\$0.1	0.0%	\$2.0	4.2%
Second Quintile	\$0.4	0.0%	\$6.3	15.5%
Middle Quintile	\$1.4	0.1%	\$10.8	27.6%
Fourth Quintile	\$2.3	0.1%	\$14.1	35.5%
Top Quintile	-\$0.3	-0.1%	\$22.6	34.4%
All	\$3.9	0.0%	\$18.4	20.9%
Breakdown of Top Quintile				
80th-90th Percentile	\$1.3	0.1%	\$17.7	35.3%
90th-95th Percentile	\$0.4	0.0%	\$18.9	34.8%
95th-99th Percentile	-\$0.5	-0.1%	\$21.5	32.1%
Top 1 Percent	-\$1.5	-0.3%	\$26.9	31.9%
Top 0.1 Percent	-\$0.5	-0.3%	\$26.9	33.3%

Sources: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: * Assuming elasticity is -0.5. Proposal would replace the itemized deduction for charitable contributions with a universal deduction for contributions above 1.65 percent of AGI.

TABLE 5

Distribution of Charitable Contribution Tax Benefits

Universal deduction for all contributions above 2.0% of AGI, calendar year 2020



Expanded Cash Income Percentile	Change in Total Contributions (\$ billions) *	Change in After-Tax Income (% points)	Marginal Tax Benefit Per \$100 of Contributions (\$)	Share of Tax Units with Benefit (%)
Lowest Quintile	\$0.1	0.0%	\$2.0	2.8%
Second Quintile	\$0.4	0.0%	\$5.7	11.6%
Middle Quintile	\$1.2	0.1%	\$9.9	22.8%
Fourth Quintile	\$2.1	0.1%	\$13.3	29.9%
Top Quintile	-\$1.4	-0.1%	\$21.7	29.0%
All	\$2.3	0.0%	\$17.5	16.9%
Breakdown of Top Quintile				
80th-90th Percentile	\$1.1	0.1%	\$16.7	29.9%
90th-95th Percentile	\$0.2	0.0%	\$17.8	29.1%
95th-99th Percentile	-\$0.8	-0.1%	\$20.4	27.0%
Top 1 Percent	-\$2.0	-0.4%	\$26.3	26.7%
Top 0.1 Percent	-\$0.7	-0.4%	\$26.4	25.0%

Sources: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-1).

Notes: * Assuming elasticity is -0.5. Proposal would replace the itemized deduction for charitable contributions with a universal deduction for contributions above 2.0 percent of AGI.

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