Future of the Charitable Deduction: How, Not if, It will be Limited

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The United States federal government is facing extreme fiscal pressures that will almost certainly lead to limitations on tax benefits for charitable giving. Current US tax and spending policies are projected to result in an accumulated federal debt that will be a multiple of the gross domestic product of the United States by mid-century. The charitable deduction has a sufficiently large impact on federal revenues that limitations to it can play a meaningful role in a larger package to reduce federal budget deficits. Plans to reduce the charitable deduction have found support within both major political parties.

Charities need to understand the various proposals to limit the charitable deduction and how those limitations might affect an organization. The different proposals being considered to limit the charitable deduction will likely impact certain types of organizations more dramatically than other organizations. New types of planning will be required for effective charitable giving under the proposed limitations. When advocating to minimize the impact of the limitations on the charitable deduction, charities will need to develop new arguments rather than the traditional justifications for tax incentives for charitable giving.

A Brief History of the Charitable Deduction

The federal income tax was first instituted in 1913. Although the charitable deduction was not included in the initial tax, it was added quickly thereafter in 1917. Initially, the deduction was limited to 15% of the donor’s adjusted gross income.

The current configuration of the charitable income tax deduction remains principally unchanged since the 1986 Tax Act. Contributions to a public charity of cash or property when the deduction is limited to the taxpayer’s basis may offset up to 50% of the taxpayer’s adjusted gross income. Taxpayers may claim a deduction for the fair market value of appreciated property donated to a public charity and offset up to 30% adjusted gross income. The 1986 Tax Act allowed a significant portion of a taxpayer’s adjusted gross income to be offset with charitable deductions, and the 1986 Tax Act greatly broadened the definition of adjusted gross income. On the other hand, the 1986 Tax Act significantly reduced the top marginal rates (from 50% to 28% [1981 Legislation reduced the top rate from 70% to 50%]), greatly reducing the economic value of an income deduction. For a period of time, the portion of a charitable contribution deduction represented by the appreciation of contributed property was added back into a taxpayer’s income.

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3 I.R.C. §170(b)(1)(B) Contributions to private foundations are treated less favorably).
for purposes of calculating the alternative minimum tax (AMT). This AMT treatment of the charitable deduction was repealed in 1993.

Since the 1986 Tax Act, there have been a number of refinements of the charitable deduction, largely designed to limit perceived abuses including more stringent record keeping requirements, limitations on deductions for gifts of tangible personal property, and limitations on donor advised funds. In response to the Katrina hurricane, Congress briefly allowed taxpayers to offset 100% of their adjusted gross income with a contribution of cash to a public charity. Starting in 2006, taxpayers who are over age 70½ also have been able to directly transfer up to $100,000 from an individual retirement account (IRA) to a public charity without being required to include that amount in their adjusted gross income. This IRA rollover provision has always been passed on a time-limited basis and again sunset at the end of 2011.

In 1944, Congress passed legislation to raise taxes to fund World War II. Since Congress was greatly expanding the number of individuals subject to the income tax, it sought to simplify the tax. As part of the simplification legislation, Congress created the standard deduction. The purpose of the standard deduction was to allow taxpayers with a modest amount of items qualifying for a tax deduction to avoid the record keeping and reporting requirements to take advantage of those deductions. Accordingly, the standard deduction was the estimated amount of charitable deductions as well as other deductions that a typical taxpayer might have. Instead of reporting those amounts, the taxpayer would simply claim the standard deduction. The role of the standard deduction as including a taxpayer’s charitable deductions is widely misunderstood and is discussed further below.

These US tax provisions regarding charitable giving are generally more favorable to taxpayers than incentives provided in other countries. There are a number of reasons for this difference including the fact that charitable organizations provide a number of services in the US that are provided by governments in other countries. The federal government, however, faces fiscal pressures that will result in less favorable treatment of taxpayers who make charitable gifts.

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4 I.R.C. §57(a)(6).
5 I.R.C. §170(f)(8).
6 I.R.C. §170(o).
7 I.R.C. §4969, 4967.
9 I.R.C. §408(d)(8)(A) (reduction is allowed for the gift, however).
11 Alan L. Feld, “Fairness in Rate Cuts in the Individual Income Tax” 68 Cornell. Rev. 426, 433-34 (1983) (Tax grew from applying to 5% of population to 74%).
Exploding Federal Debt

The Congressional Budget Office projects that by 2021, US federal debt will be almost 80% of the US gross domestic product and continuing to grow.\(^\text{14}\) The GAO projects that by mid-century the debt will exceed 300% of US gross domestic product.\(^\text{15}\) It is not likely that foreign countries and other investors in US Treasury Bonds would be willing to buy that amount of debt from the United States.\(^\text{16}\) The interest on that amount of debt would consume the majority of federal revenues at current collection levels as a percentage of gross domestic product. Accordingly, while there may be wide disagreement about how to reduce federal deficits, there is general acceptance that federal deficits must be reduced so that the federal debt does not grow to an unsustainable level. The American general public recognizes that federal deficits must be reduced. The public is as conflicted as the politicians, however, as to the solutions.\(^\text{17}\)

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\text{Federal Debt Held by the Public – 1940 to 2080}
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While the debt ceiling discussion in the summer of 2011 did not result in an agreement by both parties to a combination of spending cuts and tax increases to reduce the federal deficit, it is unlikely that the public will accept a cut’s only solution.\(^\text{18}\) Revenue increases will need to be part of any plan to reduce deficits. The federal tax expenditure for the charitable income tax deduction is more than two times the amount of revenue currently collected for the estate and gift tax. Because the expenditure represents a meaningful amount relative to the deficit and for a variety of other reasons, limitations on the charitable deduction will likely be a source of revenue for deficit reduction.

\(^{14}\) Congressional Budget Office. “The Budget and Economic Outlook: Fiscal Years 2011 to 2021” (January 2011) [hereinafter CBO “Options”].
\(^{16}\) GAO “Citizens Guide” p. _____.
\(^{17}\) Gallop Poll “On Deficits Americans Prefer Spending Cuts, Open to Tax Hikes” (July 13, 2011).
\(^{18}\) Id.
Tax Expenditures

Tax expenditures are provisions of the Code that provide a tax benefit to a taxpayer for engaging in a desired behavior. These provisions are referred to as tax expenditures because they allow a taxpayer to reduce his or her tax liability which means that the government receives less money than it would receive in the absence of these provisions. The decision to not collect money that the government could otherwise collect has the same fiscal effect as an expenditure by the government. Accordingly, these provisions are described as a tax expenditures.

The largest tax expenditures are widely used by middle and upper income taxpayers. These include the deduction for home mortgage interest, and the deduction for or exclusion from income of health insurance costs. The following is a table of the major tax expenditures:

<table>
<thead>
<tr>
<th>Tax Expenditures</th>
<th>Amount</th>
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<tr>
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<td>Deduction of state and local taxes</td>
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At $30 billion a year, the charitable contribution deduction is far from the largest tax expenditure. Over a 10 year period, however, the deduction represents more then $300 billion in revenue. If policy makers were looking to cut $3 trillion from the deficit over a similar time period, then the charitable deduction would represent 10% of their target. Interestingly, the
The cumulative amount of tax expenditures is approximately equal to the current federal deficit. Policy makers appear unlikely to simply eliminate all of the federal tax expenditures, however. The deficit reduction commission appointed by President Obama in 2010 proposed to curtail many of the tax expenditures, but also proposed to lower tax rates to mitigate the impact of the loss of the various deductions for taxpayers. All of the deductions are supported by strong constituencies and have significant policy agreements in their favor. The deduction for the cost of health insurance makes health insurance more affordable which promotes broader coverage throughout the country. The home mortgage deduction makes housing more affordable. Policy makers will obviously be reluctant to take actions that further decrease demand for housing at this time. The deduction for state income taxes arguably can be justified on grounds of defining income. A state income tax is a cost of generating the income in that state. The counter argument to this position is that a taxpayer is getting state services that other states pay for with sales taxes or other non deductable taxes. In the case of the charitable deduction, charitable organizations in the United States provide many services that are funded by governments in other countries.

It is likely that increased revenues for deficit reduction will come from limitations of tax expenditures. There is greater political resistance, particularly in the Republican Party, to increases in tax rates. From a policy perspective, increases in tax rates are problematic as they are a disincentive for productivity. Higher tax rates also increase the benefits of deferring or understating income. Given the popularity of each of the tax expenditures, however, likely only a broad based approach in which every interest group is giving up something can succeed. Accordingly, Congress may need to pair down the charitable deduction simply to make it politically possible to pair down the large tax expenditures.

**Charities are an Essential Part of the US Economy**

In 2010, non-profit organizations represented 5.4% of the US gross domestic product. In 2009, non-profits paid 9% of United States wages and counted for over 10% of US jobs. In some sectors of the economy, charity is the dominate funder. For example, government at all levels represent only 13% of the funding provided for the arts. Contributions from individuals, corporations and foundations represent 43% of the funding for the arts. Remaining 44% of funding for the arts comes from admissions and other revenues and museums and performing arts venues. In 2005, expenditures by non-profits were more than $637 billion in the health

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19 “Moment of Truth” p._____.  
20 A cynical observer might note that congressmen often have two mortgages to deduct and receive a valuable health insurance package.  
21 Urban Institute, “Research Area: Non-Profit Sector”.  
22 Id.  
23 Id.  
24 Id.  
25 Id.
care sector and a $158 billion in the education sector. While charities should continue to emphasize the vital role that the non-profit sector plays in the United States, policy makers are not ignorant of the services that these organizations provide. The policy makers generally believe that federal revenues can be increased by limiting the charitable deduction without causing unacceptable reductions in charitable giving or in the services provided by the non-profit sector.

**Reason for Charitable Deduction: Incentive for Desired Behavior or Part of Definition of Income?**

The evaluation of proposed limitations on the charitable deduction depends in part upon the policy reasons for the charitable deduction. Depending upon the reason for the deduction, the appropriateness of limitations will vary significantly. The deduction is most often described as an incentive for charitable giving. If the deduction is an incentive for desired behavior, then it will be evaluated in the same manor as a deduction for home mortgage interest, the credit for solar panels on people’s homes or any other provision of the Code that is designed to encourage taxpayers to engage in a desired behavior. If the deduction is an incentive, then a proposal to limit the charitable deduction would be evaluated in terms of tax efficiency comparing the revenue raised by the adjustment with the extent to which it reduces the desired activity – charitable giving. The goal of policy makers in structuring an incentive to encourage a behavior is to obtain the greatest amount of the behavior that can be obtained for the least amount of tax expenditure associated with the policy. Accordingly, a policy that results in a tax expenditure of 10 to achieve an amount of the behavior equal to 100 is preferred to a policy that results in a tax expenditure of 20 to achieve an amount of the behavior equal to 100. A significant consideration in evaluating the efficiency of a policy is how much of the desired behavior would occur even if the tax incentive did not exist. Unavoidably, the tax benefit will be conferred on some individuals who would engage in the behavior even in the absence of the policy. Tax benefits given to these individuals are essentially considered to be wasted and decrease the efficiency of the policy. This is a significant consideration for the charitable deduction because it is widely believed that many American’s would make charitable gifts in the absence of any tax benefit.

The Congressional Budget Office, the Congressional Research Service and others who have analyzed the charitable deduction all assume that increases in federal revenue associated with limitations on the charitable deduction will exceed the reduction in charitable giving caused by the reduction in the incentive for the giving. Charitable donations by individuals who do not itemize their deductions also are often cited as proof that taxpayers will make charitable gifts in the absence of a tax incentive to do so. The view of the charitable deduction as an incentive for

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26 Amy Blackwood, Canard T. Wing and Thomas A. Pollak “The Non-Profit Sector in Brief”, facts and figures from the non-profit almanac 2008: Public charities, giving and volunteering. 4
28 For Example, even in a worst case analysis, the CBO assumes a 15% credit with a 2% of AGI floor would reduce charitable giving by $18.6 billion and increase federal revenue by $25.5 billion. CBO “Options” at 23.
charitable giving and the appropriateness of evaluating in terms of the efficiency is generally accepted by most policy makers. So long as this is the framework by which the charitable deduction is evaluated, it is a virtual certainty that policy makers will limit the charitable deduction in connection with any plan to address the fiscal challenges at the federal level. This is because many policy makers view federal spending as a greater public benefit than charitable spending. Even if they don’t hold this view, they know that they can increase federal revenues without losing the same amount in charitable expenditures.

Another way to view the policy reason for the charitable deduction is that funds given to charity are not properly includable in a taxpayer’s income. At its most general level, income includes any ascension to or increase in wealth. Funds given to charity do not increase the taxpayer’s wealth or give the taxpayer any benefit that has monetary value. This position has been advanced by Independent Sector and others, but is not widely accepted by policy makers. Taken to its logical conclusion, this policy would require that taxpayers be allowed to deduct charitable contributions at their highest marginal tax rate without any limitation on the percentage of adjusted gross income that can be offset by the gifts. The only proposal to limit the charitable deduction that would be consistent with the notion that taxpayer’s income should not include charitable contributions would be the elimination of the taxpayer’s ability to claim a deduction for unrealized gain in appreciated property. Given the minimal revenue generated by such a change, it is unlikely that reductions in the charitable deduction would be limited to that change.

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The rejoinder to the argument that funds contributed to charity do not increase wealth is that prior to the contribution, the taxpayer had the opportunity to have an increase of wealth. In most circumstances, the taxpayer has an increase in wealth for a period of time and then reduces his or her wealth by voluntarily making the charitable contribution. Policy makers do not generally view the charitable deduction as a rule for properly defining income. Given that the implications of the position would constrain policy makers’ ability to address overriding fiscal concerns, it is unlikely that this view of the charitable deduction will be embraced by policy makers. In any event, the lack of any financial benefit for a taxpayer in connection with a charitable contribution distinguishes the charitable contribution deduction from all of the other tax expenditures that are associated with economic benefits for taxpayer like the deduction for mortgage interest or health insurance costs.

**The Standard Deduction and the Charitable Deduction**

Most any discussion of modifications to the charitable deduction eventually leads to a discussion of the standard deduction and the fact that taxpayers who use the standard deduction do not separately identify their charitable contributions. In this discussion it is often said that it is unfair

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30 For 2005, such a change would have raised $1.8 billion. Congressional Budget Office, “Restrict Itemized Deductions and Credits under the Income Tax” (March 2000).
that taxpayers who use the standard deduction do not get any tax benefit from their charitable giving while taxpayers who itemize their deduction do get a tax benefit from their charitable giving. This fundamentally misunderstands the standard deduction. As noted above, the standard deduction was enacted as part of tax simplification in the 1940’s. A taxpayer who claims the standard deduction has considered all of his or her deductions, including charitable contributions and determined that those deductions add up to an amount that is less than the standard deduction. Accordingly, when the taxpayer claims the standard deduction, he or she achieves more tax savings than would be achieved by itemizing deductions including the charitable contribution deduction. Indeed it is possible that a taxpayer could have made no charitable contributions and engaged in no other activity that the Code seeks to encourage through deductions and yet the taxpayer would be accorded the benefits as if he or she had engaged in that activity up to the amount of the standard deduction. If Congress decides to allow individuals who take the standard deduction a separate line item for the charitable deduction, the amount of the standard deduction should be reduced by the portion of the standard deduction that represents a typical taxpayer’s charitable contribution deduction. If the reduction in the standard deduction was properly calibrated, the change would be revenue neutral because the revenue lost by allowing individuals who take the standard deduction to claim a charitable deduction would be offset by the revenue gained from the reduction in the standard deduction. This change would have the benefit that some taxpayers who claim the standard deduction are “free loading” by claiming a charitable deduction through the standard deduction for contributions that they did not make while other individuals claiming the standard deduction are in fact making charitable contributions. In any event, taxpayers who itemize their deductions do not receive disproportionate or unfair tax benefits relative to taxpayers who do not itemize their deductions. Indeed, taxpayers who claim the standard deduction are often being given tax benefit without engaging in the behaviors that the Code otherwise would require for the tax benefit.

Different Charities, Different Donors

Most analysis of charitable giving and tax policy look at the overall impact on charitable giving of a proposed tax policy. Donors do not all give proportionately to the same types of organizations. Donors with incomes of up to $100,000 make 67% of their gifts to religious organizations and only 1% to arts organizations. As the donor’s income increases, a greater percentage of the donor’s contributions are to health care organizations, arts organizations and educational organizations. Donors with incomes over $1 million give 17% of their donations to religious organizations, 25% for education, 25% for health care, and 15% for the arts. The various proposals to limit the charitable contribution deduction affect higher or lower income taxpayers differently. In general, because it is the way to generate the most revenue, many of the proposals have a greater impact on giving by higher income taxpayers. If a proposal disproportionately reduces giving by higher income donors or lower income donors, then the proposal will disproportionately impact organizations supported by those donors. Accordingly,

31 CBO “Options” p. 6.
32 Id.
if a proposal had the greatest impact on lower income donors, religious organizations would be the source of most of the reduction in charitable giving. On the other hand, if the proposal mostly reduced giving by higher income taxpayers, most of the reduction in giving would come from health care, educational and arts organizations. In weighing alternatives, policy makers should consider this varied impact when evaluating alternatives for limiting the charitable deduction. Of course, it is possible, that some policy makers may consider it an advantage if a policy disproportionately impacts a particular type of organizations.

Limitations On The Charitable Deduction: Many Options

Politicians from both of the major parties have made various proposals for limiting the charitable deduction over the past few years. These proposals have included limiting the tax rate that is used to compute the amount of deduction, changing the deduction to a credit, and imposing a floor that is expressed as a percentage of adjusted gross income before a taxpayer may claim a charitable deduction or credit.

In the past couple of years, President Obama has included in his proposed budgets a limitation on the rate that a taxpayer would use to calculate a charitable income tax deduction. Obama’s proposal is to cap the rate at 28%. Therefore, even if the taxpayer’s income is subject to a 35% tax rate, taxpayer’s charitable deduction would be taken at a 28% rate. In addition to creating revenue, the argument for this proposal is that higher income taxpayers should not get a greater economic benefit from their charitable contributions than lower income taxpayers. If the charitable deduction is viewed as an incentive for charitable giving which Congress is free to increase or decrease, this proposal fits within that theory. If the basis of the charitable deduction is that it is to accurately reflect the taxpayer’s income then this proposal does not comport with that basis for charitable deduction. Taxpayers may also find the provision confusing and object to being taxed in part on funds that they have given away to charity. Since the provision only impacts taxpayers in the top income tax brackets, to the extent that it reduces charitable giving, it will reduce giving only by high income taxpayers. Charities that rely on high income donors will be most heavily impacted if this proposal is enacted.

The deficit reduction committee appointed by President Obama in 2010 included within its recommendations a proposal to convert the charitable deduction to a nonrefundable credit. The credit would be equal to 12% of the amount of the charitable contribution. For low income taxpayers, particularly ones using the standard deduction, a credit would provide greater benefits for charitable giving than are afforded under current law. The deficit reduction commission also proposed lowering the top marginal income tax rate to 28%. The 12% credit still would mean that higher income taxpayers would not receive a tax benefit sufficient to offset the income tax

35 Id.
on the entire amount of a gift contributed to a charitable organization. The credit may be easier for taxpayers to understand, and although similar in economic effect to the Obama proposal to limit the rate used to compute the deduction, it may be more palatable to high income taxpayers. This is because the credit has the appearance of treating all taxpayers in a similar manner rather than appearing to single out higher income taxpayers for a detriment.

The deficit reduction commission also proposed to limit the charitable deduction by setting a floor of 2% of adjusted gross income that must be exceeded before charitable contributions are subject to the credit. Much of the fiscal impact of such a rule may be blunted by taxpayers bunching their charitable giving and making gifts every two or three years instead of every year to maximize the amount of gifts that would exceed the adjusted gross income floor.\(^36\) Other reform proposals combine the floor with converting the deduction to a credit or limiting the tax rate at which the deduction is used.\(^37\) A floor has appeal as a policy because it insures that if the IRS audits a taxpayer’s charitable deduction, a meaningful amount of tax is in question. The floor also may increase the likelihood that tax benefits are part of taxpayer’s decisions to make gifts in excess of the floor making the policy more efficient. One of the most interesting possibilities for a floor is one that raises federal revenues without reducing charitable giving. On analyst believes that a deduction for all taxpayers for contributions in excess of 1.7% of AGI would generate $10 billion per year of federal revenue without reducing charitable giving.\(^38\)

The ability of taxpayers to take a deduction for unrealized gain in appreciated property is inconsistent with general principals of income taxation. Generally, taxpayers are allowed to claim tax benefit only for basis that they have in property. Accordingly, a taxpayer cannot depreciate more than the taxpayer’s basis in the property.\(^39\) A taxpayer cannot take a loss for the sale or destruction of property in excess of the taxpayer’s basis in the property.\(^40\) When a taxpayer takes a deduction for a gift of property based on a fair market value that exceeds the taxpayer’s basis in the property, the taxpayer is getting a benefit without corresponding basis. Another proposal to limit the charitable deduction would be to limit all charitable contribution deductions to the taxpayer’s basis in the property contributed. Such a limitation would mostly impact wealthier donors who disproportionately make charitable gifts of property.\(^41\) It is possible for a donor with modest assets to have some that are highly appreciated, but it is mostly wealthier donors who benefit from the ability to deduct unrealized gain in appreciated property. Limiting a deduction to a donor’s basis is also one of few proposals that can be justified entirely on the grounds that it makes the charitable deduction more consistent with general principals of general tax law.

\(^{36}\) Congressional Budget Office “Options for Changing Tax Treatment of Charitable Giving” p.23 (May 2011).
\(^{37}\) Id. 9-18.
\(^{39}\) I.R.C. §167(c)
\(^{40}\) I.R.C. §165(b), 1011(a).
taxation. Limiting the deduction to basis also would be consistent with the policy that the charitable deduction is intended to reflect the taxpayer’s income. The limitation also would generally eliminate deductions based upon inflated appraisals of property.

Implications of Reform for IRA Rollover

After more than a decade of asking Congress to pass legislation to make it easier for individuals to fund charitable contributions with assets in individual retirement accounts (“IRA”), Congress finally enacted a limited rule allowing up to $100,000 to be transferred from an IRA directly to a public charity by taxpayers who are over age 72 ½. The legislation allows a taxpayer to avoid having to withdraw the assets from the IRA, include the withdrawal in income and then claim a charitable contribution deduction. For many taxpayers, the income included from the IRA distribution would be offset completely by the deduction for the charitable contribution. For taxpayers who do not itemize their deductions or taxpayers who exceed the limit on adjusted gross income for deductions, however, the deduction would not completely offset the income from the IRA distribution. Virtually all of the reforms being considered by Congress for the charitable contribution will result in a charitable contribution deduction that does not fully offset the taxation of the income that is the source of the contribution. That is, if any of the proposed reforms are adopted, most taxpayers who withdrew funds from an IRA to fund a charitable contribution would find that the contribution deduction did not completely offset the income generated by the IRA distribution. Given that the objective of these reforms is to reduce the extent to which the federal government subsidizes a charitable contribution by a taxpayer, it is unclear why the government would want to afford a larger subsidy to a contribution that is a distribution from an IRA than a contribution funded with other forms of income. If Congress limits charitable contribution deductions in a way that most taxpayers, or at least higher income taxpayers, are subject to tax on a portion of the income used for charitable contributions, it is likely that Congress will eliminate the IRA rollover provision. Congress has never been comfortable encouraging gifts of retirement assets. The IRA rollover provision has been justified to avoid penalizing a few taxpayers for making gifts from IRAs. If the rule becomes in consistent with general tax policy, Congress likely will let it expire.

Across the Board Limitations on Itemized Deductions

Instead of eliminating specific tax expenditures or imposing different limitations on each tax expenditure, Congress could impose a broad base limit on all tax expenditures. In 1992, Congress enacted a phase out of all itemized deductions to the extent that an individual taxpayer’s income exceeded $150,500 (2006 limit). A broad based limit on all deductions spreads the burden of the change across all of the constituencies that take advantage of these tax expenditures. Depending on the nature of the change, it may be more favorable for charities to have a broad limit on all itemized deductions than to face specific limitations on the charitable

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42 I.R.C. §408(d)(8)(A).
43 I.R.C. §68.
deduction. There are certain expenditures that taxpayers have a hard time avoiding that qualify for itemized deductions such as state income taxes, property taxes and mortgage interest. A broad based limit on itemized deductions may be viewed as reducing the benefit of these expenditures, but it may be possible that taxpayers who exceed the limitation imposed by Congress would find that they obtained the full tax benefit of additional itemized deductions above and beyond that floor. Generally, the charitable contributions would be discretionary and above the floor. Accordingly, a taxpayer would enjoy full benefit of the charitable contribution while viewing other deductions as being limited by the general rule. For example, when the phase out of itemized deductions existed, taxpayers in states with significant income or property taxes found that those state taxes exceeded the amount of the phase out of their itemized deductions. Accordingly, when such a taxpayer made charitable contributions, the entire amount of the additional deduction created by the contribution was useable by the taxpayer.

Response of the Charitable Sector

Assuming that policy makers are eventually able to reach an agreement to operate the federal government in a fiscally sustainable manner,44 such an agreement almost certainly will include revenue increases derived from limitations on the charitable contribution deduction. Arguing against any such limitations likely will be ineffective and may limit the opportunity of the charitable sector to shape the nature of the changes. Charities will want to advocate for changes that do not add excessive complexity to the charitable contribution deduction or make it difficult or uncertain for taxpayers to determine the true cost and tax benefits of a contribution. Given the essential role that charitable organizations play in providing services, they should encourage policy makers to select alternatives that generate the greatest amount of revenue with the least reduction in charitable giving. Charities also should advocate for changes that do not disproportionately impact giving to any particular type of organization. Depending on its form, charities may want to advocate for broad limits on all itemized deductions instead of specific limits on the charitable contributions deduction. It is beyond the scope of this discussion to cover the ability of charities to participate in the political process but, charities have a larger range of latitude to advocate on behalf of the charitable deduction than they would on other political issues.45 It is a certainty that the interests behind other tax expenditures will be actively and vigorously advocating to minimize the reduction in those expenditures. The charitable sector will need to mount a vigorous defense of the charitable contribution deduction not to avoid any reduction in the deduction but to insure the inevitable limitations are fairly balanced against other limitations on tax expenditures and have as few negative consequences for the charitable sector as is possible.

44 This is the most speculative and, possibly, most naïve statement in this article.
45 See the Independent Sector website for discussion of permissible advocacy by non-profits. Council on foundations has resources specific to private foundations.
Blunting limits on the charitable deduction may require paid lobbyist and well coordinated actions by charities and their supporters. One hopes convenor organizations like PPP and others can lead the effort that will be required.
Coming Limitations on the Charitable Deduction

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Federal Debt Held by the Public – 1940 to 2080

Source: GAO Citizens Guide FY 2007
Largest Tax Expenditures for Individuals, 2010

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Charities and the Economy

- 5.4% of GDP in 2010
- 9% of wages and 10% of jobs in 2009
- 87% of Arts Funding – All government combined 13%
- In 2005 $637 billion for healthcare
- In 2005 $158 billion for education.

Should donations be taxed?

- Does a person have income if they give up funds or property for no economic benefit?
- If taxpayer has some say over where money goes by picking charity, is the sufficient basis to tax gift?
- Is contribution functionally equivalent to a tax? US charities fill in government services.
How Donors Allocate Their Charitable Contributions 2005

Tale of Two Donors

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<th>Teacher</th>
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Source: Congressional Budget Office based on data from the Center on Philanthropy at Indiana University, Patterns of Household Charitable Giving by Income Group, 2005 (Indianapolis: Indiana University – Purdue University, 2007)
### Current Rules

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<th></th>
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<th>Obama Proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gift</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td>Tax</td>
<td>$28</td>
<td>$40</td>
</tr>
<tr>
<td>Balance</td>
<td>$72</td>
<td>$60</td>
</tr>
<tr>
<td>Cost of Gift</td>
<td>$72</td>
<td>$60</td>
</tr>
<tr>
<td>Retained %</td>
<td>72.00%</td>
<td>60.40%</td>
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### Obama Proposal

<table>
<thead>
<tr>
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<th>Current</th>
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<tbody>
<tr>
<td>Gift</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td>Tax</td>
<td>$28</td>
<td>$51</td>
</tr>
<tr>
<td>Balance</td>
<td>$72</td>
<td>$49</td>
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<tr>
<td>Cost of Gift</td>
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<td>$72</td>
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<tr>
<td>Retained %</td>
<td>72.00%</td>
<td>48.80%</td>
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</table>
Deficit Commission Proposal

<p>| | | |</p>
<table>
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<tr>
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</thead>
<tbody>
<tr>
<td>Gift</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td>Tax Before Credit</td>
<td>$56</td>
<td>$79</td>
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<tr>
<td>Credit</td>
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<tr>
<td>Final Tax</td>
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<tr>
<td>Balance</td>
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<tr>
<td>Cost of Gift</td>
<td>$88</td>
<td>$88</td>
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<tr>
<td>Retained %</td>
<td>56.00%</td>
<td>32.80%</td>
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<tr>
<td>Delta Current</td>
<td>16.00%</td>
<td>27.60%</td>
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Revenue and Giving

<table>
<thead>
<tr>
<th>Policies</th>
<th>Change in Giving</th>
<th>Change in Revenue</th>
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</thead>
<tbody>
<tr>
<td>Extend Deduction to All Filers</td>
<td>2.0</td>
<td>-5.2</td>
</tr>
<tr>
<td>All Filers with 1.7% of AGI Floor</td>
<td>0.0</td>
<td>10.0</td>
</tr>
<tr>
<td>2% of AGI Floor</td>
<td>-3.0</td>
<td>15.7</td>
</tr>
<tr>
<td>15 Percent Credit</td>
<td>-7.8</td>
<td>13.3</td>
</tr>
<tr>
<td>15% Credit and 2% AGI Floor</td>
<td>-10.0</td>
<td>24.6</td>
</tr>
</tbody>
</table>
Deduction for Unrealized Appreciation

- Inconsistent with general rules of tax that require basis for a tax benefit
- Primarily benefits high income taxpayers—50% of gifts for donors with income over $10 million
- In 2005 would have increased receipts by $1.8 billion
- Final Offer Valuation

IRA Rollover

- No income inclusion
- $100,000 limit
- Outright gifts only to public charities
- Over Age 70 ½
- Currently cost about $300 million per year
- Current for benefits non-itemizers and donors hitting AGI limit
- Ended in 2011
Future of IRA Rollover

- More significant benefit if deductions are limited – likely will not be renewed
- Should deferred income gifts be treated more favorably than gifts out of current income?
- Proposals to expand continue to be introduced

Response of Charitable Sector

- Raise the definition of income argument
- Understand we cannot win the efficiency argument
- Consider impact of different limits
- Look for most revenue for least reduction in giving—AGI floor?
- Perhaps support broad limits on all deductions