Congressional Budget Office

Testimony

Statement of
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Options for Changing the Tax Treatment of Charitable Giving

before the
Committee on Finance
United States Senate

October 18, 2011

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Chairman Baucus, Senator Hatch, and Members of the Committee, I appreciate the opportunity to appear before you today to discuss options for changing the tax treatment of charitable giving. My written testimony reprises the Congressional Budget Office's (CBO's) most recent report on that topic, which was published in May 2011.

Summary

Under current law, taxpayers who itemize deductions may deduct the amount they donate to charities from their adjusted gross income (AGI) when determining how much they owe in federal income taxes. That deduction gives people who itemize an incentive to contribute to charities. Like other forms of preferential tax treatment, the deduction also costs the federal government revenues that it might otherwise collect. At current levels of charitable giving, the cost of that deduction—measured as the additional revenues that could be collected if the deduction was eliminated—will total about $230 billion between 2010 and 2014, according to the Joint Committee on Taxation (JCT).[1]

Numerous proposals have been made in recent years to alter the income tax treatment of charitable giving by individual donors. Some proposals aim to reduce the cost to the government by imposing a floor (or minimum level) that a person's charitable giving would have to exceed to qualify for preferential tax treatment. Other proposals would extend the current charitable deduction to taxpayers who do not itemize deductions or would replace the current deduction with a nonrefundable tax credit available to all taxpayers who make charitable contributions.[2]

For this analysis, CBO examined how much taxpayers in various income groups donate to charities and what types of organizations receive those donations. CBO also investigated how changing the structure of tax incentives for giving would affect the tax subsidy (the cost in forgone revenues to the federal government), the overall level of charitable giving, and the extent to which different income groups benefit from the tax preference. Specifically, CBO looked at 11 options for altering the current income tax treatment of charitable giving, which can be grouped into 4 categories:

- Retaining the current deduction for itemizers but adding a floor.
- Allowing all taxpayers to claim the deduction, with or without a floor.
- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 25 percent of a taxpayer's charitable donations, with or without a floor.
- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 15 percent of a taxpayer's charitable donations, with or without a floor.

For each of the four categories, CBO analyzed two potential floors: a fixed dollar amount ($500 for single taxpayers and $1,000 for couples filing a joint return) and a percentage of income (2 percent of AGI). Only contributions in excess of the floor would be deductible or eligible for a credit. The analysis uses data for 2006, the most recent year for which the Internal Revenue Service's public-use sample of individual income tax returns is available. The tax treatment of charitable contributions is generally the same today as it was in 2006; however, because of rising incomes and contribution amounts, the options that include a fixed dollar floor would have a somewhat different impact today than presented here.

Effects of Policy Options on Tax Subsidies and Charitable Donations

According to CBO's modeling, adding a contribution floor to any of the approaches listed above would reduce both the total federal tax subsidy and the total amount donated to charity, relative to the same option without a floor. In each case that CBO examined, the reduction in the subsidy (and thus the increase in revenues) would exceed the reduction in charitable contributions, whether measured in dollars or as a percentage change. The reason is that introducing a floor would continue to provide a tax incentive for additional giving above the level of the floor and at the same time reduce the tax subsidy for

1. A deduction for charitable contributions also exists under the corporate income tax. JCT estimates a much smaller five-year cost for that deduction: about $17 billion. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2010–2014*, JCS-3-10 (December 15, 2010), www.jct.gov/publications.html?func=startdown&id=3718.

2. Taxpayers can use tax credits to reduce their income tax liability (the amount they owe). Nonrefundable credits can lower income tax liability to zero, but excess credits cannot be used to increase tax refunds. In contrast, refundable credits that exceed income tax liability are paid to taxpayers as refunds.

Table 1.

Summary of Total Donations and Tax Subsidies Under Current Law and Eleven Policy Options, 2006

	Floor for Eligible Donations	Total Contributions (Billions of 2006 dollars)	Tax Subsidy (Billions of 2006 dollars)
		Current Law	
Deduction Available Only to Itemizers	No floor	203.0	40.9
		Change from Current Law	
Keep Deduction Available Only to Itemizers but Add Floor			
Option 1	$500/$1,000	-0.5	-5.5
Option 2	2 percent of AGI	-3.0	-15.7
Extend Deduction to All Filers			
Option 3	No floor	2.0	5.2
Option 4	$500/$1,000	0.8	-2.5
Option 5	2 percent of AGI	-1.9	-13.1
Convert Deduction to 25 Percent Nonrefundable Credit for All Filers			
Option 6	No floor	2.7	7.1
Option 7	$500/$1,000	1.5	-2.4
Option 8	2 percent of AGI	-1.0	-11.9
Convert Deduction to 15 Percent Nonrefundable Credit for All Filers			
Option 9	No floor	-7.8	-13.3
Option 10	$500/$1,000	-8.6	-19.0
Option 11	2 percent of AGI	-10.0	-24.6

Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels.

$500/$1,000 = $500 for individual filers and $1,000 for joint filers; AGI = adjusted gross income.

donations that people might have made even without a tax incentive.[3]

Allowing all taxpayers to claim a deduction for charitable giving would have increased donations in 2006 by an estimated $2.0 billion (or 1 percent) and increased the total tax subsidy by $5.2 billion (or 13 percent) from the 2006 amounts. Combining a deduction for all taxpayers with a floor, however, could both increase donations and decrease the tax subsidy. For example, such a deduction combined with a fixed dollar floor of $500/$1,000 would have increased donations by $800 million in 2006 and decreased the tax subsidy by $2.5 billion (see Table 1).

Replacing the current deduction with a 25 percent tax credit would increase donations and also increase the government's forgone revenues. Combining such a credit with certain contribution floors, however, could boost donations while reducing the tax subsidy or could decrease donations by a small percentage while reducing the tax subsidy by a large percentage. Setting the credit at 15 percent would reduce donations but would reduce the tax subsidy by a larger amount (both in dollars and as a percentage change).

3. The fact that some nonitemizers contribute to charities despite receiving no tax benefits for doing so suggests that a substantial amount of charitable giving would still occur in the absence of a tax incentive.

Effects of Policy Options on Various Income Groups

Changing the tax treatment of charitable contributions would have differing effects on taxpayers at different points on the income scale. Adding a contribution floor to the current deduction for itemizers would reduce tax subsidies for all income groups, but for high-income taxpayers, the size of the reduction would vary significantly depending on the type of floor used. For instance, augmenting the deduction with a fixed dollar floor of $500/$1,000 in 2006 would have lowered the tax subsidy for people with AGI over $100,000 by 0.08 percent of their AGI, whereas adding a floor equal to 2 percent of AGI would have lowered the tax subsidy for that income group by 0.30 percent of their AGI.

Making the deduction for charitable contributions available to nonitemizers would benefit lower- and middle-income taxpayers, who tend not to itemize deductions because their deductible expenses (such as mortgage interest and state and local taxes, as well as charitable donations) are not large enough to exceed the standard deduction. Those groups would benefit even more if the current deduction—which tends to help higher-income taxpayers more because they face higher tax rates—was replaced with a nonrefundable credit that gave all income groups the same tax incentives for giving. For example, replacing the deduction with a 25 percent credit in 2006 would have increased the tax subsidy for taxpayers with AGI below $100,000 by 0.27 percent of their AGI, but it would have decreased the tax subsidy for people above that income level by 0.09 percent of AGI. Tax subsidies would be lower for all income groups with a 15 percent credit than with a 25 percent credit.

Caveats About This Analysis

The results of CBO's policy simulations are meant to highlight the general effects of the various approaches. The exact size of those effects, however, would depend on the specific parameters of a policy—such as the level of the floor or the amount of the credit—as well as on the extent to which taxpayers would change the amount of their charitable giving in response to a change in the tax subsidy. In addition, this analysis does not reflect many of the other ways in which taxpayers might respond to a change in their tax subsidy, such as shifting donations between years. (In the appendix of its May 2011 study *Options for Changing the Tax Treatment of Charitable Giving*, CBO examines how sensitive these results are to several different assumptions, including variations in taxpayers' responsiveness to changes in their tax subsidy and the possibility of shifts in the timing of donations.)

Options for Changing the Tax Treatment of Charitable Giving: Introduction

Taxpayers who itemize deductions on their federal income tax returns can reduce their tax liability by deducting their donations to qualified nonprofit organizations—including organizations dedicated to religious, charitable, scientific, literary, or educational purposes. Both monetary contributions and the value of donated financial assets or other property are deductible, subject to certain annual limits (see Box 1). The tax treatment of charitable giving, which has evolved over time, provides various incentives for donations.

Although corporations can also deduct their charitable donations, this testimony focuses on contributions by individual donors. It examines patterns of individual charitable giving and finds that the majority of such giving comes from a small number of taxpayers with high incomes. The testimony also reviews concerns about the current tax treatment of giving and assesses how various changes to that treatment would affect the amount of donations made, the tax subsidies for them, and the distribution of those subsidies by income group.

History of Tax Incentives for Charitable Giving

The deduction for charitable donations is a long-standing feature of the individual income tax: It was created in 1917, just four years after the modern income tax began.[4] The amount of charitable contributions that could be deducted was initially capped at 15 percent of a taxpayer's income. In general, the deduction applied only to high-income people, because they were the only ones required to pay the income tax in its early years.

During World War II, as the income tax expanded to cover three-quarters of the U.S. population, the standard deduction was introduced as an option for taxpayers.[5]

4. The charitable deduction was enacted in the War Revenue Act of 1917.

5. The standard deduction makes tax filing simpler because taxpayers do not need to keep track of all of their itemized expenses. (Besides charitable donations, major expenses that can be deducted include mortgage interest, state and local taxes, and medical costs that exceed a certain percentage of a taxpayer's adjusted gross income.) In addition, the standard deduction lowers the tax burden for taxpayers who have small amounts of itemizable deductions. For 2011, the standard deduction is $5,800 for single filers, $11,600 for joint filers, and $8,500 for heads of households.

Box 1.

Current-Law Limits on the Deduction for Charitable Contributions

Under current law, deductions for cash donations may not exceed 50 percent of a taxpayer's adjusted gross income (AGI). Deductions for donated property that has appreciated in value since it was initially acquired are generally limited to 30 percent of AGI. Although donations of appreciated property are subject to a lower percentage cap, to the extent that they fall below the cap, they receive more-favorable tax treatment than cash contributions do. The reason is that taxpayers do not have to pay income tax on capital gains from appreciated property that they donate, even though they can claim the fully appreciated value as a deduction. Deductions that are limited by those percentage-of-income caps can be claimed in future years (as long as total deductions in those years remain below the caps).

Beginning in 2013, with the expiration of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111-312), high-income taxpayers will be subject to an additional limit on deducting charitable contributions. At that point, if a taxpayer's AGI exceeds a specific threshold, total itemized deductions will be reduced by 3 percent of the income above that threshold (with the total reduction limited to 80 percent of the sum of certain deductions). Because that limit is based on the amount of income above the threshold, not on the amount of itemized deductions, it will not affect a taxpayer's marginal incentive to give an additional dollar to charity.

The deductibility of charitable contributions was then limited to taxpayers who chose to itemize deductions for specific expenses they had incurred rather than claim the standard deduction. (In determining the initial size of the standard deduction, officials took into account a certain typical amount of charitable contributions.)[6]

Nonitemizers were allowed to deduct their charitable contributions for a brief period during the 1980s. The Economic Recovery Tax Act of 1981 created a temporary "above-the-line" charitable deduction, permitting taxpayers who opted for the standard deduction to also deduct charitable contributions.[7] That provision was gradually phased in starting in 1982 and took full effect for 1986, after which it was allowed to expire.

Besides making charitable contributions during their lifetime, people can bequeath donations to charities from their estates upon their death. Such bequests, although not the focus of this analysis, can be deducted when determining estate taxes.[8] Charitable giving during one's lifetime has advantages over bequests, however, because it can decrease individual income taxes now as well as estate taxes later (by reducing the size of the estate that is left) rather than just decreasing estate taxes.[9]

How Tax Incentives Affect Giving

By allowing itemizers to deduct their donations, the government indirectly subsidizes charitable activities. For example, someone in the 25 percent tax bracket faces an after-tax price of only 75 cents when giving a dollar to charity. In other words, a person in that bracket who donates $1 to charity has his or her taxes reduced by 25 cents, so his or her consumption and savings decline by just 75 cents. In general, the deduction lowers the after-tax price per dollar of charitable contributions from $1 to $1 multiplied by the difference between one and the marginal tax rate.

6. See the statement of Congressman Willis A. Robertson, *Congressional Record*, vol. 90, 78th Cong., 2nd sess. (1944), p. 3973.

7. From 1982 to 1984, the deduction was capped at between $50 and $300. For 1985 and 1986, the cap was removed; instead, nonitemizers could deduct 50 percent of their charitable contributions in 1985 and 100 percent of their charitable contributions in 1986.

8. See Congressional Budget Office, *The Estate Tax and Charitable Giving* (July 2004).

9. That statement is based on the assumption that earnings and consumption behavior are not affected by whether donations are made before or after death.

Although the underlying motives for charitable giving are complex and not fully understood by economists, empirical studies generally find that taxpayers respond to the after-tax price of giving to some degree. Such tax incentives are limited, however, to the subset of taxpayers who itemize, and they favor high-income people, who face relatively higher marginal tax rates. That situation raises several questions: Could tax subsidies for charitable giving be extended to more taxpayers without costing the federal government large amounts of forgone revenue? Could the subsidies per dollar of giving be made equal for taxpayers across the income distribution? This analysis examines how policy options to address those questions would affect donations, revenue costs, and the distribution of tax benefits.

Patterns of Individual Charitable Giving

Donations by individuals make up the majority of contributions to U.S. charities. According to the Center on Philanthropy at Indiana University, U.S. charities received a total of $304 billion in contributions in 2009 (equal to 2.2 percent of gross domestic product that year).[10] Of that amount, $227 billion, or approximately 75 percent, was donated by individuals. The other 25 percent came from foundations, corporations, and estates (bequests).

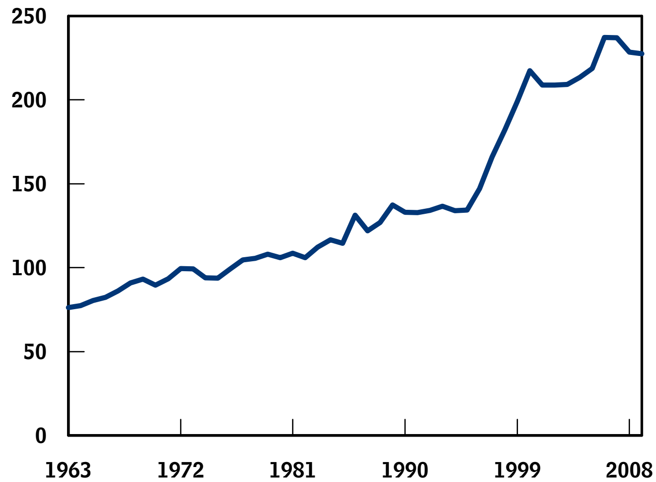
Trends in Donations over Time

From the mid-1960s to the mid-1990s, individual giving rose steadily, even after accounting for inflation. Over the following five years, such giving soared, growing by more than 60 percent between 1995 and 2000 (see Figure 1). That surge was probably tied closely to gains in the stock market. As the stock market declined after 2000, inflation-adjusted individual giving fell by 4 percent in 2001 and stagnated through 2003, before increasing by more than 13 percent between 2003 and 2007. With the recession and renewed decline in the stock market that began in late 2007, inflation-adjusted individual giving declined by almost 4 percent in 2008 and stayed flat in 2009.

Figure 1.

Total Charitable Contributions by Individual Donors, 1963 to 2009

(Billions of 2009 dollars)



Source: Congressional Budget Office based on data from the Center on Philanthropy at Indiana University, *Giving USA 2010: The Annual Report on Philanthropy for Year 2009* (Chicago: Giving USA Foundation, 2010).

Among people who filed tax returns, charitable giving averaged about 2.5 percent of income in 2008 (the latest year for which such information is available). That figure includes itemizers who deducted charitable donations as well as nonitemizers, whose charitable giving was estimated by CBO on the basis of surveys in which people report their contributions to charity. Giving as a share of income was fairly similar for most income groups in 2008, except for the highest-income taxpayers. Among people reporting more than $500,000 in adjusted gross income that year, charitable giving averaged about 3.4 percent of income (see Figure 2).[11]

Higher-income households account for a significant portion of individual giving. People who reported AGI of at least $100,000 in 2008 were responsible for about 58 percent of charitable giving by taxpayers, although they made up less than 13 percent of tax filers (see Table 2). At the top of the income scale, less than 1 percent of taxpayers had AGI over $500,000, but they

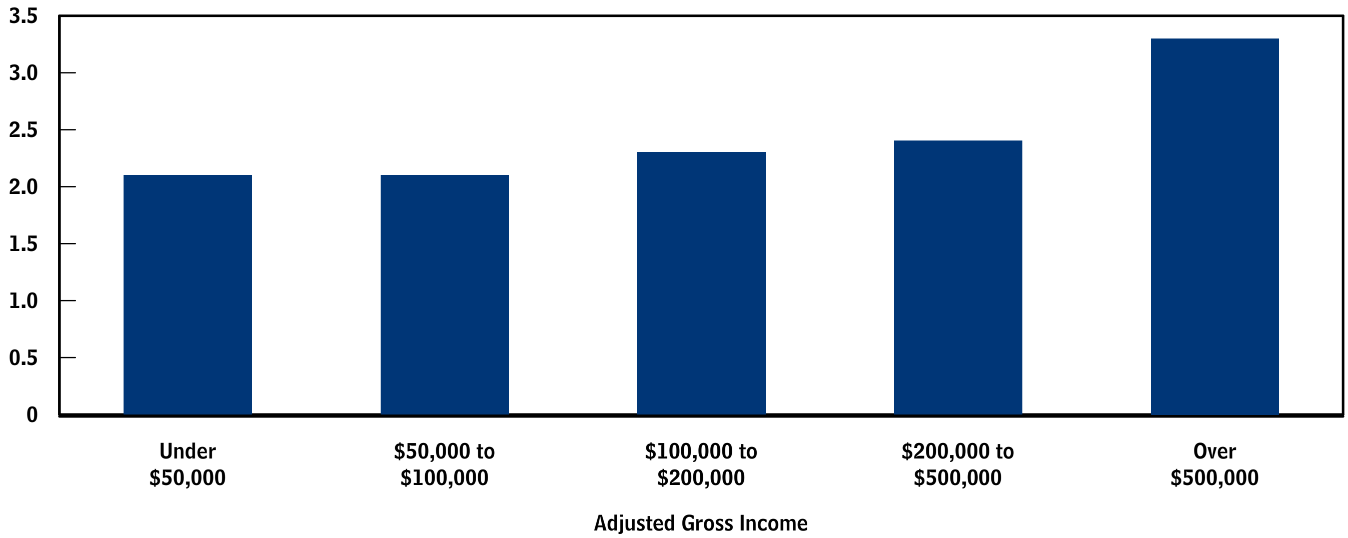
10. See Center on Philanthropy at Indiana University, *Giving USA 2010: The Annual Report on Philanthropy for Year 2009* (Chicago: Giving USA Foundation, 2010).

11. For itemizers, giving as a share of income is U-shaped: The giving rates at both ends of the income distribution are higher than those in the middle.

Figure 2.

Percentage of Income That Tax Filers Contribute to Charity, by Income Group, 2008

(Percentage of adjusted gross income)



Source: Congressional Budget Office based on data from Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns 2008* (revised July 2010); the Federal Reserve Board's 2004 Survey of Consumer Finances; and the Bureau of Labor Statistics' 2002 Consumer Expenditure Survey.

Note: Includes CBO's estimates of charitable contributions by people who filed income tax returns in 2008 but did not itemize deductions.

made 24 percent of the total charitable contributions by taxpayers in that year.

Recipients of Donations

Data from tax returns do not identify the different organizations to which individuals make donations.[12] Instead, researchers in one study examined patterns of household giving using surveys by the University of Michigan and Bank of America.[13] They found that, in general, the higher a household's income, the smaller the share of donations that went to religious causes and the larger the share that went to causes related to health, education, and the arts. For example, among households with AGI below $100,000, 67 percent of giving was directed toward religious organizations, and only 7 percent went to institutions that focus on health, education, or the arts (see Figure 3 on page 8). Among households that reported at least $1 million in income, the situation was reversed: Just 17 percent of donations were made to religious organizations, and 65 percent were made to support health-, education-, or arts-related activities.

12. The recipient organization is sometimes reported for donations by itemizers, but even in those cases, the fact that many organizations serve multiple functions makes it difficult to categorize the contributions by type of recipient.

13. See Center on Philanthropy at Indiana University, *Patterns of Household Charitable Giving by Income Group, 2005* (Indianapolis: Indiana University–Purdue University, 2007). In that study, estimates of giving by households with annual income below $200,000 were based on the Center on Philanthropy Panel Study, a module of the Panel Study of Income Dynamics conducted by the University of Michigan. Estimates for households with annual income above $200,000 were based on data from Bank of America's Study of High Net Worth Philanthropy.

Concerns About the Current Tax Treatment of Charitable Giving

The present income tax treatment of charitable giving subsidizes certain taxpayers' donations to charitable organizations and activities. Although those donations are generally seen as benefiting all of society, concerns have been raised about the current structure of the federal subsidy—in terms of the amount of forgone tax revenues, the incentives for donating, and the degree to which taxpayers respond to those incentives.

Table 2.

Charitable Contributions, by Tax Filers' Itemizing Status and Income Group, 2008

Adjusted Gross Income	Number of Tax Returns (Millions)	Share of Tax Returns (Percent)	Share of Total Income (Percent)	Percentage of Filers with Charitable Contributions[a]	Amount of Charitable Contributions (Billions of dollars)[a]	Share of Charitable Contributions (Percent)[a]
			All Filers			
Under $50,000	93	65	21	53	37	19
$50,000 to $100,000	31	22	27	81	47	24
$100,000 to $200,000	14	10	22	90	43	21
$200,000 to $500,000	3	2	12	93	24	12
Over $500,000	1	1	18	94	49	24
Total	**142**	**100**	**100**	**64**	**199**	**100**
			Itemizers			
Under $50,000	14	29	8	70	20	12
$50,000 to $100,000	18	37	23	82	40	23
$100,000 to $200,000	12	25	28	90	41	23
$200,000 to $500,000	3	7	17	93	24	14
Over $500,000	1	2	25	95	49	28
Total	**48**	**100**	**100**	**81**	**173**	**100**

Source: Congressional Budget Office based on data from Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns 2008* (revised July 2010); the Federal Reserve Board's 2004 Survey of Consumer Finances; and the Bureau of Labor Statistics' 2002 Consumer Expenditure Survey.

a. Includes CBO's estimates of charitable contributions by people who filed income tax returns in 2008 but did not itemize deductions.

Cost to the Government of Subsidizing Charitable Contributions

The revenue cost to the government of the charitable deduction is not obvious from the total dollars donated or deducted because the tax rate that would have applied to the income had it not been donated (the marginal tax rate) varies greatly among individuals. The marginal rate can even vary for the same person depending on how much he or she donates. One way to estimate the revenue loss from charitable contributions is to simulate the change in tax revenues that would result if there were no deduction for charitable contributions and compare that result with actual revenues using a microsimulation model that can calculate the difference in taxes from a representative sample of tax returns. Using that approach, CBO estimates that the tax subsidy associated with the charitable deduction totaled $40.9 billion for 2006.

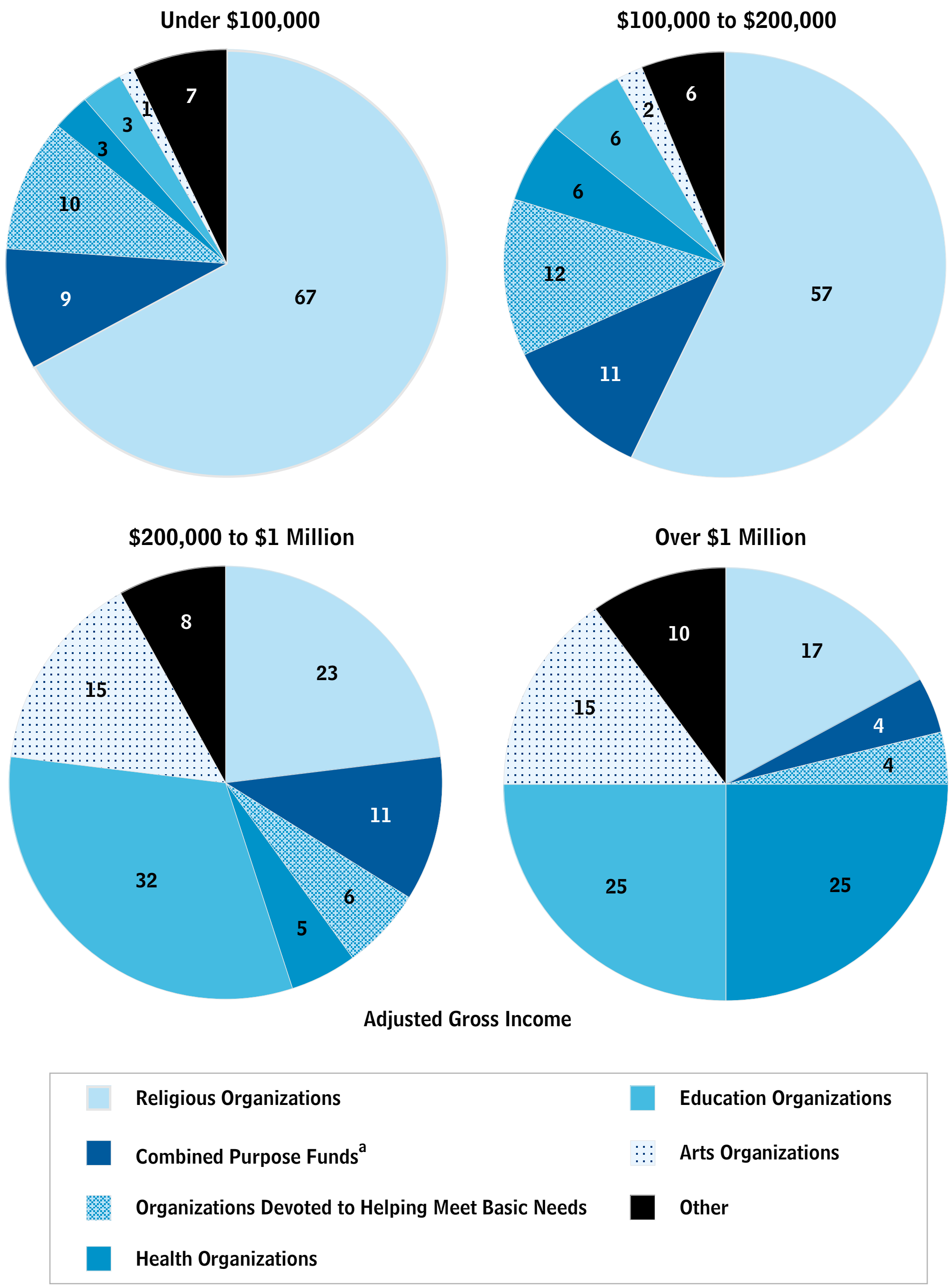
The subsidy for charitable giving is concentrated among high-income taxpayers to an even greater extent than donations are (see Figure 4 on page 9). Although taxpayers reporting adjusted gross income of at least $100,000 accounted for 11 percent of tax returns and 57 percent of charitable contributions in 2006, they received 76 percent of the tax subsidy associated with charitable deductions. In contrast, taxpayers reporting AGI of less than $50,000 filed 66 percent of returns, accounted for 19 percent of charitable donations, and received 5 percent of the tax subsidy for donations.[14] The difference in the tax subsidy occurs because higher-income people are more likely to itemize deductions (and thus to receive a tax subsidy for donations) and because higher-income people generally pay higher marginal tax rates and thus receive a larger subsidy (relative to other itemizers) per dollar of donation.

14. Those numbers include CBO's estimates of charitable contributions by income tax filers who did not itemize deductions.

Figure 3.

How Donors Allocate Their Charitable Contributions, by Income Group and Type of Recipient, 2005

(Percentage of donations)



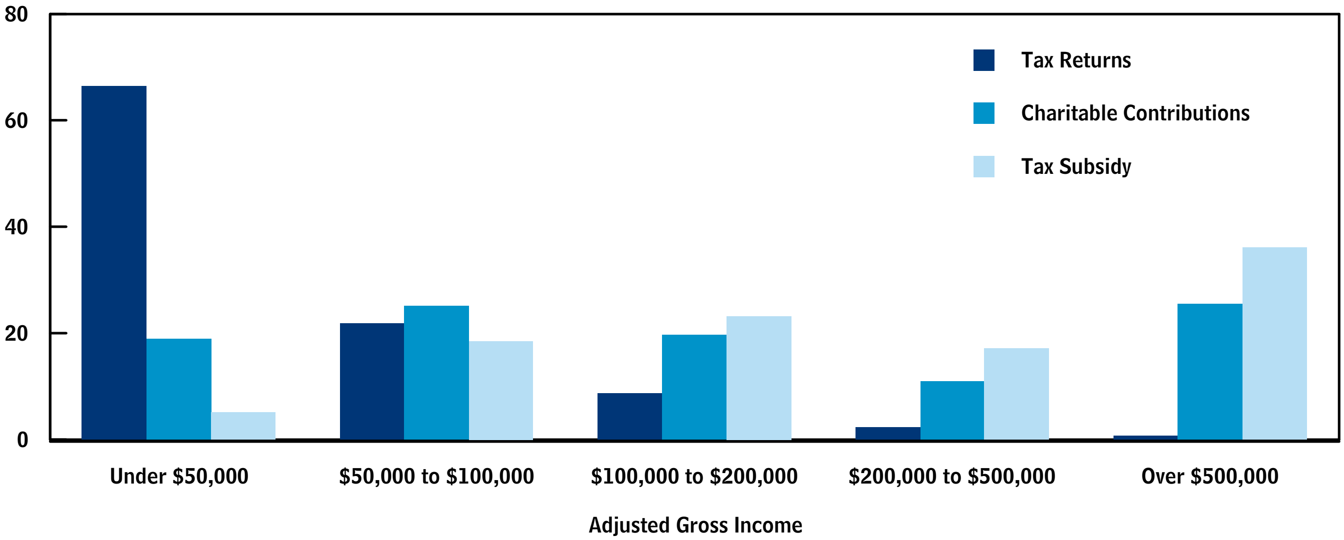
Source: Congressional Budget Office based on data from the Center on Philanthropy at Indiana University, *Patterns of Household Charitable Giving by Income Group,* 2005 (Indianapolis: Indiana University–Purdue University, 2007).

a. Combined purpose funds, such as the United Way, receive contributions and allocate them to many different types of charities.

Figure 4.

Different Income Groups' Shares of Total Contributions and the Total Tax Subsidy, 2006

(Percent)



Source: Congressional Budget Office.

Incentives Created by the Charitable Deduction

By subsidizing charities through individual income tax deductions, the government leaves the choice about which charities are subsidized largely to taxpayers. In doing so, however, it makes no distinction about the extent to which different charitable services would be provided in the absence of the tax subsidy. A sufficiently generous tax incentive can cause even charitable activities with large social benefits to be provided beyond the point at which the benefits to society of allocating more resources to those activities are lower than the benefits of allocating the same resources to other activities.

Subsidizing charitable organizations through income tax deductions also means that the subsidy accrues only to people who have income tax liability and itemize deductions and that the after-tax price of giving decreases with the donor's marginal tax rate. Because people with higher income generally face higher marginal tax rates, they are subsidized at a greater rate than lower-income taxpayers are. In 2008, 25 percent of tax filers (or about 35 million returns) faced a federal income tax rate of zero (see Table 3).[15] For those filers, the deductibility of charitable contributions gave them no tax benefits and hence no tax incentive to donate. At the same time, the 5 percent of filers who were in the 28 percent, 33 percent, or 35 percent tax brackets faced a substantially lower price of giving than the 54 percent of filers who faced tax rates of 10 percent or 15 percent. Because the subsidy for a given amount of charitable donations increases along with income, the deduction for charitable donations reduces the degree to which the average income tax rate (taxes as a percentage of income) rises as income grows. Even so, the federal income tax and overall federal tax system both remain progressive, in that high-income filers pay a much larger share of their income in taxes than lower-income groups do.[16]

15. Another 24 million potential tax filers were not required to file a return that year, generally because their income was below the filing thresholds.

16. For example, CBO estimated that, on average, households that were in the lowest one-fifth of the income distribution in 2007 (as measured by household income) received more in tax credits than they paid in federal individual income taxes, whereas households in the highest one-fifth of the income scale paid federal income taxes that averaged 14 percent of their income. With all types of federal taxes included, households in the lowest one-fifth of the income scale paid less than 5 percent of their income in federal taxes, on average, whereas those in the highest one-fifth of the income scale paid about 25 percent of their income in federal taxes. See Congressional Budget Office, *Average Federal Tax Rates in 2007* (June 2010).

Table 3.

Tax Filers, by Highest Marginal Tax Rate, 2008

Highest Marginal Rate (Percent)	Number of Tax Returns (Millions)	Share of Tax Returns (Percent)
0	35	25
10	26	18
15	50	35
25	23	17
28	4	3
33	2	1
35	1	1
All Tax Rates	142	100

Source: Congressional Budget Office based on Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns 2008* (revised July 2010).

Note: The statutory marginal tax rates shown here may not precisely correspond to the rates that apply to charitable deductions because they do not account for such factors as the alternative minimum tax, the earned income tax credit, or phaseouts for personal exemptions and itemized deductions. These rates reflect only federal income taxes; combined federal and state marginal income tax rates are higher. (Most state income taxes also allow a deduction for charitable contributions.)

Only about one-third of tax filers itemize their deductions. The price of giving for the two-thirds who do not itemize (primarily people in the lower tax brackets) is not subsidized, and thus—like people facing an income tax rate of zero—they have no tax incentive to make donations. Of course, nonitemizers have the option of itemizing their deductions; they do not do so primarily because their total itemized deductions, including charitable donations, are less than the standard deduction. If people's responsiveness to tax incentives increases with income, the approach of providing higher marginal incentives for charitable giving to higher-income taxpayers stimulates more donations; however, there is little evidence that higher-income taxpayers are more responsive to the after-tax price of giving than other taxpayers are.[17] Nonetheless, the fact remains that the current subsidy gives lower-income households less incentive to donate than it gives higher-income households.

Taxpayers' Responses to the Income Tax Treatment of Giving

How taxpayers respond to the tax incentives for charitable giving depends on their underlying motive for making donations. Motivations for giving are complicated and not fully understood. With a purely private good (one whose full benefits accrue to the person bearing the full cost), both the motivation and the behavior it engenders are straightforward: People buy the good because they receive benefits from it, and they keep buying more units of the good until the benefit (the value to them) of the next unit just equals the cost of the next unit. That is also broadly true for charitable giving, but measuring the benefit that donors receive is more complicated.

Some giving is probably motivated by altruism: People receive satisfaction from knowing that others in society are helped. The satisfaction of the donor depends partly on the satisfaction of others, regardless of who is paying for the help that is given. In the altruistic view, a potential donor is just as pleased if a third party steps in and provides the contribution instead. Some giving, however, is motivated not only by pure altruism but also by the "warm glow" that some people feel when giving or helping others—or from receiving public recognition for their good deeds.[18] In that case, the donor's self-satisfaction depends on believing that he or she played a role in (or is being recognized for) helping others. Still other giving is more analogous to a private good, with the benefits directly accruing in proportion to the size of the donation. Examples include gifts to college sports programs (often in exchange for preferential treatment in purchasing tickets to athletic events) and donations to art museums (which sometimes confer special benefits only for donors).

Although those various motivations may prompt different kinds of responses to incentives for charitable giving, empirical studies have generally found that the amount of giving is responsive to changes in the after-tax price of giving. That responsiveness can be measured by the price elasticity of charitable giving—the percentage change in

17. Although the percentage of households that report making charitable contributions rises with income (see Table 2 on page 7), empirical studies offer inconclusive evidence about whether responsiveness to tax incentives differs significantly for households at different income levels.

18. See James Andreoni, "Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving," *Economic Journal*, vol. 100, no. 401 (1990), pp. 464–477.

donations associated with a 1 percent increase in the price of giving.

Policymakers are generally interested in the permanent effects of policy changes, so estimates of how various policy options would alter charitable giving must rely on elasticity estimates that distinguish between transitory shifts in giving and permanent responses to a policy change. For example, a taxpayer who faces a temporary fluctuation in income has an incentive to shift donations to years when income is temporarily high and thus the after-tax price of giving is low. Taxpayers may also change the timing of their donations in response to a preannounced change in tax law. The Tax Reform Act of 1986, which sharply reduced marginal income tax rates for high-income taxpayers, offers a good example. Charitable giving by high-income taxpayers increased steeply in 1986, possibly in anticipation of that law, which was enacted in October 1986 and gradually phased in between 1987 and 1988. Failing to address shifts in giving that result from income fluctuations or preannounced changes in tax law may cause an elasticity estimate to be biased upward (in absolute value).

Most studies that estimate the relationship between charitable giving and tax rates use data from tax returns. Among those studies, ones that distinguish between permanent and transitory responses to price variation have found mixed evidence about the permanent price elasticity of giving. Elasticity estimates vary significantly as a result of differences in the underlying data and time periods studied and the different methods used to derive the estimates. For example, one prominent study that examined a panel data set covering 10 years estimated a permanent price elasticity of giving of -0.5 (meaning that a 1 percent increase in the price of giving would reduce donations by 0.5 percent).[19] Another study that used an expanded version of the same data set but applied a different methodology reported elasticity estimates ranging from -0.8 to -1.3.[20]

Experimental methods offer another approach to estimate the relationship between the price and level of charitable giving. For instance, researchers have studied how people alter the amount of their contributions in response to matching grants (conditional offers to match contributions at a specified rate). Researchers in one study conducted a field experiment on existing donors to a charitable organization and found that announcing the availability of a matching grant increased donations, although the level of contributions was not affected by differences in the matching rate announced.[21] That study estimated an overall price elasticity of -0.3, lower than the estimates from the aforementioned studies that were based on tax data. Because the experiment was framed as a matching grant rather than a change in the after-tax price of giving, however, the result may not be directly applicable to policies involving changes in tax rates.

Effects of Policy Options to Alter the Tax Treatment of Charitable Giving

In recent years, numerous proposals have been made to change the tax incentives for charitable giving. Such changes could take various forms, which would have different impacts on the costs to the federal government, the amount of charitable giving, and the number and types of taxpayers who would benefit. To illustrate the effects of a range of possible changes, CBO has examined 11 stylized policy options. The most important characteristics of the options are whether the tax benefit includes a floor (or minimum amount of donations) below which contributions are not subsidized; whether it is restricted to itemizers or is available to all taxpayers; and whether it takes the form of a tax deduction or a credit. The options can be grouped into 4 sets according to those characteristics:

- Retaining the current deduction for itemizers but adding a floor.
- Allowing all taxpayers to claim the deduction, with or without a floor.

19. See William C. Randolph, "Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions," *Journal of Political Economy*, vol. 103, no. 4 (1995), pp. 709–738.

20. See Gerald E. Auten, Sieg Holger, and Charles T. Clotfelter, "Charitable Giving, Income, and Taxes: An Analysis of Panel Data," *American Economic Review*, vol. 92, no. 1 (2002), pp. 371–382. Also see Jon Bakija and Bradley T. Heim, "How Does Charitable Giving Respond to Incentives and Income? New Estimates from Panel Data," *National Tax Journal* (forthcoming), which assembled the same data set and two others and found similar results.

21. See Dean Karlan and John A. List, "Does Price Matter in Charitable Giving? Evidence from a Large-Scale Natural Field Experiment," *American Economic Review*, vol. 97, no. 5 (2007), pp. 1774–1793.

- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 25 percent of a taxpayer's charitable donations, with or without a floor.

- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 15 percent of a taxpayer's charitable donations, with or without a floor.

In each option with a floor, the minimum contribution level was specified to be either a fixed dollar amount ($500 for people filing individually and $1,000 for couples filing a joint return) or a percentage of income (2 percent of AGI). Only the amount of a taxpayer's total charitable donations that exceeded that floor would be deductible or eligible for a credit.

If the current deduction for itemizers was augmented with a floor, the deduction would continue to provide incentives for charitable giving but at a much lower subsidy cost. The total amount of donations would decline, but the tax subsidy would decline by a much larger amount, CBO estimates. For example, a fixed dollar floor that allowed itemizers to deduct charitable giving in excess of $500 for individuals and $1,000 for joint filers would decrease annual donations by $0.5 billion relative to current law, CBO estimates, but would decrease the federal tax subsidy by $5.5 billion (see Table 4). Both of the reductions would be larger with a higher floor (whether the floor was specified in dollar terms or as a percentage of AGI). Those results would occur because most donations would come from taxpayers who gave amounts above the floor, and although the floor would reduce the subsidy that those taxpayers received, it would maintain their tax incentive to make an additional dollar of donations.

Extending the current deduction to all filers or making a relatively large nonrefundable tax credit available to all filers would have the opposite effect: increasing both donations and the tax subsidy. However, CBO's analysis indicates that if either of those approaches was combined with a contribution floor, it would be possible to raise donations while simultaneously reducing the tax subsidy. For instance, combining a 25 percent tax credit with a $500/$1,000 floor would raise donations by $1.5 billion and boost federal revenues by $2.4 billion. Other floors set sufficiently low could be combined with a deduction or a 25 percent tax credit to achieve a similar result.

If a much smaller credit for all filers, such as 15 percent, was combined with a floor, the effect on total donations and the total tax subsidy would be more like that of adding a floor to the current deduction for itemizers: both lower donations and a lower tax subsidy, regardless of the range of values used for the floor. In proportional terms, the impact on donations would be far smaller than the impact on the tax subsidy. With a 15 percent credit and a $500/$1,000 floor, charitable contributions would decline by 4 percent ($8.6 billion), whereas the tax subsidy would decline by 47 percent ($19.0 billion).

The effects of the policy options on tax subsidies would also vary by income group. Nonitemizers, who are primarily low- and middle-income taxpayers, would clearly gain from the options that extended tax benefits to them. Adding either type of floor to a policy option would reduce tax subsidies across the board (relative to the comparable option without a floor), but the implications for high-income taxpayers would vary significantly between a fixed dollar floor and a percentage-of-income floor. With a floor set at 2 percent of AGI, for instance, high-income taxpayers would find it harder to reach the minimum level of contributions required to obtain the tax benefit than they would with a fixed $500/$1,000 floor.

CBO estimated the impact of the policy options using 2006 tax data and assessed each option relative to the tax rules in effect for that year, which are largely the same as those in effect for 2011.[22] (For details about how CBO produced the estimates, see Box 2 on page 14.) In calculating an option's impact on contributions, CBO assumed that charitable giving has a price elasticity of -0.5, meaning that a 1 percent increase in the after-tax price of giving reduces donations by 0.5 percent. Because empirical evidence about the size of the elasticity is mixed, CBO also analyzed the options assuming a higher degree of responsiveness (an elasticity of -1.0) and assuming that charitable contributions are not affected at all by the after-tax price of giving (an elasticity of 0).

22. Tax law in both 2006 and 2011 contains the major provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003. The major difference between the two years in terms of the tax treatment of charitable giving is that 2006 tax law reduced the total value of certain itemized deductions—including the deduction for charitable contributions—for high-income taxpayers, whereas 2011 law does not have such a reduction.

Table 4.

Total Donations and Tax Subsidies Under Current Law and Eleven Policy Options, 2006

	Floor for Eligible Donations	Total Contributions (Billions of 2006 dollars)	Change in Total Contributions from Current-Law Level: Billions of Dollars	Change in Total Contributions from Current-Law Level: Percent	Tax Subsidy (Billions of 2006 dollars)	Change in Tax Subsidy from Current-Law Level: Billions of Dollars	Change in Tax Subsidy from Current-Law Level: Percent
Current Law							
Deduction Available Only to Itemizers	No floor	203.0	n.a.	n.a.	40.9	n.a.	n.a.
Options to Change Current Law							
Keep Deduction Available Only to Itemizers but Add Floor							
Option 1	$500/$1,000	202.5	-0.5	-0.2	35.4	-5.5	-13.5
Option 2	2 percent of AGI	200.0	-3.0	-1.5	25.2	-15.7	-38.5
Extend Deduction to All Filers							
Option 3	No floor	205.0	2.0	1.0	46.1	5.2	12.8
Option 4	$500/$1,000	203.8	0.8	0.4	38.4	-2.5	-6.1
Option 5	2 percent of AGI	201.1	-1.9	-0.9	27.8	-13.1	-32.1
Convert Deduction to 25 Percent Nonrefundable Credit for All Filers							
Option 6	No floor	205.7	2.7	1.3	48.0	7.1	17.4
Option 7	$500/$1,000	204.5	1.5	0.7	38.5	-2.4	-5.8
Option 8	2 percent of AGI	202.0	-1.0	-0.5	29.0	-11.9	-29.2
Convert Deduction to 15 Percent Nonrefundable Credit for All Filers							
Option 9	No floor	195.2	-7.8	-3.9	27.6	-13.3	-32.6
Option 10	$500/$1,000	194.4	-8.6	-4.2	21.9	-19.0	-46.5
Option 11	2 percent of AGI	193.0	-10.0	-4.9	16.3	-24.6	-60.1

Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels.

n.a. = not applicable; $500/$1,000 = $500 for individual filers and $1,000 for joint filers; AGI = adjusted gross income.

Box 2.

The Basis for CBO's Estimates

The analysis presented in this testimony is based on the Congressional Budget Office's (CBO's) individual income tax model, which uses data for 2006. In the model, a sample representing all households in the United States is constructed by combining information from the Internal Revenue Service's 2006 Statistics of Income public-use sample of individual income tax returns with information from the Census Bureau's March 2007 Current Population Survey. For returns without itemized deductions, CBO estimated charitable contributions using surveys in which people report their charitable giving (the Federal Reserve's 2004 Survey of Consumer Finances for people giving over $500 and the Bureau of Labor Statistics' 2002 Consumer Expenditure Survey for those giving less than $500). Taxes and tax rates were estimated using CBO's tax calculator. All estimates are for tax year 2006 and reflect the extent to which tax subsidies and charitable giving would have been different had a given option been in place in that year.

Calculating the Tax Subsidy for Charitable Contributions

This analysis estimates the cost of the tax preference for charitable donations by focusing on the change in revenues directly attributable to the level of charitable giving. That approach contrasts with the type of revenue estimates that are the responsibility of the staff of the Joint Committee on Taxation. Such estimates would reflect many of the ways in which taxpayers might alter their behavior in response to the existence of the tax preference, such as changing the timing of donations between years and changing their tax compliance. The measure that CBO used does not reflect all of the behavioral assumptions that would be included in a revenue estimate; it accounts only for changes in the amount of charitable giving and any changes in itemization status that would occur if the standard deduction was larger than a taxpayer's noncharitable itemized deductions.

Although CBO's measure incorporates fewer types of responses than a true revenue estimate, it is also less sensitive to the design details of an option. Thus, it is more suited to portraying the costs of highly stylized options such as the ones examined in this analysis. Removing the emphasis on design details makes it possible to identify the salient characteristics of broad approaches to changing the tax treatment of charitable contributions.

In this analysis, taxpayers were modeled as choosing to itemize deductions or claim the standard deduction under each policy option. The calculations assumed that taxpayers would maximize the amount of their total deductions. Thus, for example, if the deduction for charitable contributions was extended to nonitemizers, some taxpayers who had been itemizers would switch to being nonitemizers if that policy change lowered their total tax bill. The cost of subsidizing charitable giving under current law and the policy options was calculated by comparing the amount of income tax owed under a given policy with the amount that would be owed if there was no deduction for charitable contributions.

For options that include a floor, only the portion of a taxpayer's contributions above that minimum level would be eligible for a deduction or a credit. For example, under an option with a fixed dollar floor of $500 for individual filers and $1,000 for joint filers, a couple who itemized their deductions and donated $1,500 to charity would be able to claim only $500 in donations as an itemized deduction on their return, and a couple who itemized and donated $750 would not be able to deduct any of their donations.

Estimating the Effects of Policy Options on Giving

To evaluate the impact of each option, CBO estimated how much taxpayers would change the

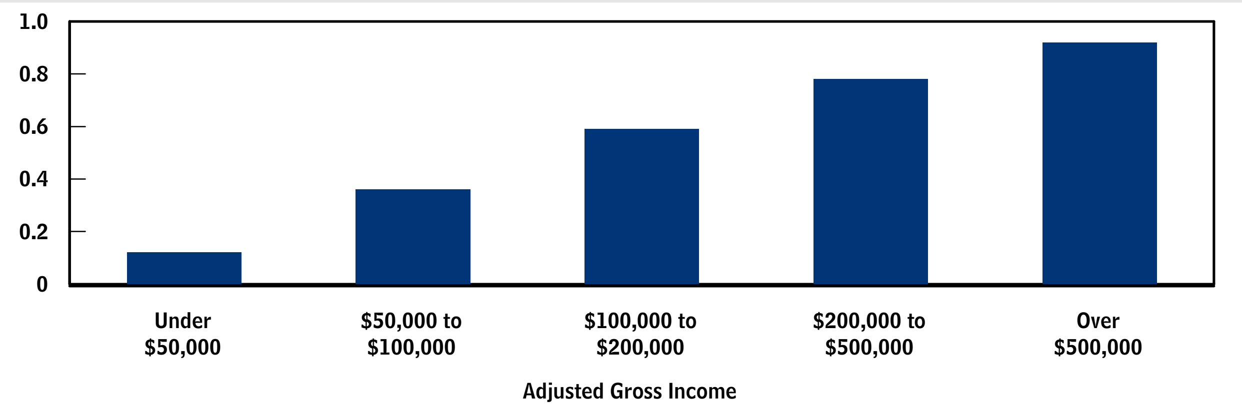
Continued

Box 2. **Continued**

The Basis for CBO's Estimates

Tax Subsidies Under Current Law, by Income Group, 2006

(Percentage of adjusted gross income)



Source: Congressional Budget Office.

amount they donate in response to a change in the after-tax price of giving.[1] The change in contributions was calculated by applying a tax price elasticity to existing contributions using the applicable change in the after-tax price of giving.[2] That price was estimated by calculating marginal tax rates on charitable giving from each individual record in CBO's income tax model under 2006 law and under each policy option. For example, under an option that would extend the deduction for charitable contributions to nonitemizers, a taxpayer in the 25 percent bracket who claimed a standard deduction would see his or her tax price of giving fall from $1 per dollar of giving to 75 cents per dollar of giving, a 25 percent decline.

Because empirical evidence about the responsiveness of taxpayers' charitable contributions to their tax treatment is inconclusive, CBO calculated the results using alternative elasticity values (0 and -1.0) in addition to the main value (-0.5) used in the analysis. In addition, CBO examined the sensitivity of the results to the assumption that a certain amount of contributions—such as regular donations to religious organizations—would be made regardless of changes in their after-tax price. CBO also explored the potential effects of taxpayers' shifting donations into different years to increase the tax subsidies they receive.

Estimating Differences in Effects by Income Level

CBO assessed the distributional implications of the policy options by comparing tax subsidy rates (the tax subsidy divided by adjusted gross income) for various income groups under a given option and under 2006 law. In 2006, subsidy rates ranged from 0.12 percent for taxpayers with adjusted gross income under $50,000 to 0.96 percent for taxpayers with income above $500,000 (see the figure above). Subsidy rates rise with income because higher-income taxpayers are more likely to itemize deductions and because the after-tax price of giving declines as the marginal income tax rate increases with income.

1. This analysis reflects only the change in the relative price of charitable contributions. The change in the income tax treatment of charitable contributions would also affect taxpayers' after-tax income. Those income effects are likely to be small, however, because charitable contributions average only about 2 percent to 3 percent of a taxpayer's income (see Figure 2 on page 6).

2. The tax price elasticity for charitable giving is the ratio of the percentage change in giving to the percentage change in its after-tax price. For example, a price elasticity of -0.5 means that a 1 percent increase in the after-tax price of giving reduces donations by 0.5 percent.

Options 1 and 2: Deduction for Itemizers, With a Floor

The first set of options would keep the current itemized deduction for charitable contributions but allow only contributions in excess of a floor to be deducted. A floor would remove the subsidy for smaller donations—most of which would probably be made even without a tax incentive—but it would maintain the marginal incentive to give for people making larger donations. Imposing a floor would lower contributions to some extent, because some taxpayers who now contribute less than the amount of the floor might reduce their donations. A floor could also make decisionmaking more complex for taxpayers and would provide an incentive for "lumpy" donations, in which people donate more in one year and nothing in other years in order to maximize their deductible contributions.[23]

Options 1 and 2 would maintain the charitable deduction for itemizers but would introduce different types of floors:

- Option 1 would let itemizers deduct the amount of their charitable donations in excess of $500 for individual filers and $1,000 for joint filers.

- Option 2 would let itemizers deduct the amount of their charitable donations in excess of 2 percent of their AGI.

The tax benefits to itemizers would be less generous under Option 1 than under current law; thus, some itemizers would choose to take the standard deduction rather than continue to itemize their deductions.[24] Nonitemizers would be unaffected. For most filers—all nonitemizers plus itemizers who donate more than the amount of the floor—the after-tax price of the last dollar of giving would remain unchanged. However, taxpayers who itemize deductions and donate less than the floor would no longer have a tax incentive for those donations.[25] Overall, donations would be reduced by $0.5 billion (or less than 1 percent), and the tax subsidy would be reduced by $5.5 billion (or 14 percent), from the levels associated with 2006 tax law (see Table 4 on page 13).

Like the fixed dollar floor, the percentage-of-income floor in Option 2 would make benefits to itemizers less generous than under current law and would not affect nonitemizers. Low-income itemizers would be able to reach the minimum contribution level more easily with this type of floor than with the fixed dollar floor. Although more middle- and high-income itemizers would see their after-tax price of giving increase, incentives for large contributors would be virtually unchanged. Under this option, donations would fall by $3.0 billion (or 2 percent) and the tax subsidy would be reduced by $15.7 billion (or 39 percent) from the 2006 levels. Almost all of the added revenues in Options 1 and 2 would come from eliminating the tax subsidy for contributions below the level of the floor by taxpayers who continued to itemize their deductions (see Table 5).

Adding either a fixed dollar floor or a percentage-of-income floor to the current deduction would lower the tax subsidy rate—the total tax subsidy divided by total income—for all income groups. Higher-income taxpayers would face a much higher threshold for deducting donations with the percentage-of-income floor than with the dollar floor. Thus, the change in the tax subsidy for higher-income taxpayers would differ significantly between the two options. For taxpayers with AGI over $500,000, for example, the dollar floor in Option 1 would decrease their tax subsidy by just 0.02 percent of AGI, whereas the percentage-of-income floor in Option 2 would lower their tax subsidy by 0.28 percent of AGI (see Figure 5).

Options 3 to 5: Deduction for All Taxpayers, With or Without a Floor

Another approach that CBO examined would be to allow everyone who files an income tax return to deduct charitable contributions (subject to the rules that now apply to

23. With a $500 floor, for example, a taxpayer who donated $1,000 in each of two years would be allowed to deduct a total of $1,000, whereas a taxpayer who donated $2,000 in one year and nothing the next year could deduct a total of $1,500. The possibility that taxpayers will change the timing of deductions in response to a floor is an important consideration in designing such a policy.

24. In general, the taxpayers who would no longer choose to itemize would be those for whom itemized deductions minus the lesser of their charitable contributions or $500 (for individuals) would be less than the standard deduction.

25. In addition, there may be some itemizers who have no tax liability under current law but would have tax liability under the option and would face a reduction in the after-tax price of giving. Those few itemizers would have an increased incentive to donate.

Table 5.

Sources of Changes in Tax Subsidies Under Eleven Policy Options, 2006

	Floor for Eligible Donations	Source of Change in Tax Subsidy (Billions of dollars)				
		Net Change in Giving	Existing Giving by Nonitemizers	Existing Giving by Itemizers: Who Switch to Being Nonitemizers	Existing Giving by Itemizers: Who Remain Itemizers	Total
Keep Deduction Available Only to Itemizers but Add Floor						
Option 1	$500/$1,000	*	0	-0.1	-5.5	-5.5
Option 2	2 percent of AGI	0.1	0	-0.4	-15.4	-15.7
Extend Deduction to All Filers						
Option 3	No floor	0.5	3.2	1.6	0	5.2
Option 4	$500/$1,000	0.3	1.3	1.0	-5.0	-2.5
Option 5	2 percent of AGI	0.3	0.9	0.3	-14.7	-13.1
Convert Deduction to 25 Percent Nonrefundable Credit for All Filers						
Option 6	No floor	0.8	4.7	2.5	-0.9	7.1
Option 7	$500/$1,000	0.5	1.9	1.7	-6.5	-2.4
Option 8	2 percent of AGI	0.6	1.5	0.9	-14.9	-11.9
Convert Deduction to 15 Percent Nonrefundable Credit for All Filers						
Option 9	No floor	-1.2	2.9	-0.3	-14.8	-13.3
Option 10	$500/$1,000	-1.2	1.1	-0.8	-18.2	-19.0
Option 11	2 percent of AGI	-1.0	0.9	-1.3	-23.2	-24.6

Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels. The total tax subsidy under 2006 law was $40.9 billion.

$500/$1,000 = $500 for individual filers and $1,000 for joint filers; * = between zero and $50 million; AGI = adjusted gross income.

itemizers, as explained in Box 1 on page 4), under three variations:

- Option 3 would have no floor on the amount of donations that could be deducted.[26]
- Option 4 would have the same fixed dollar floor as Option 1 ($500 for single filers and $1,000 for joint filers).
- Option 5 would have the same percentage-of-income floor as Option 2 (2 percent of AGI).

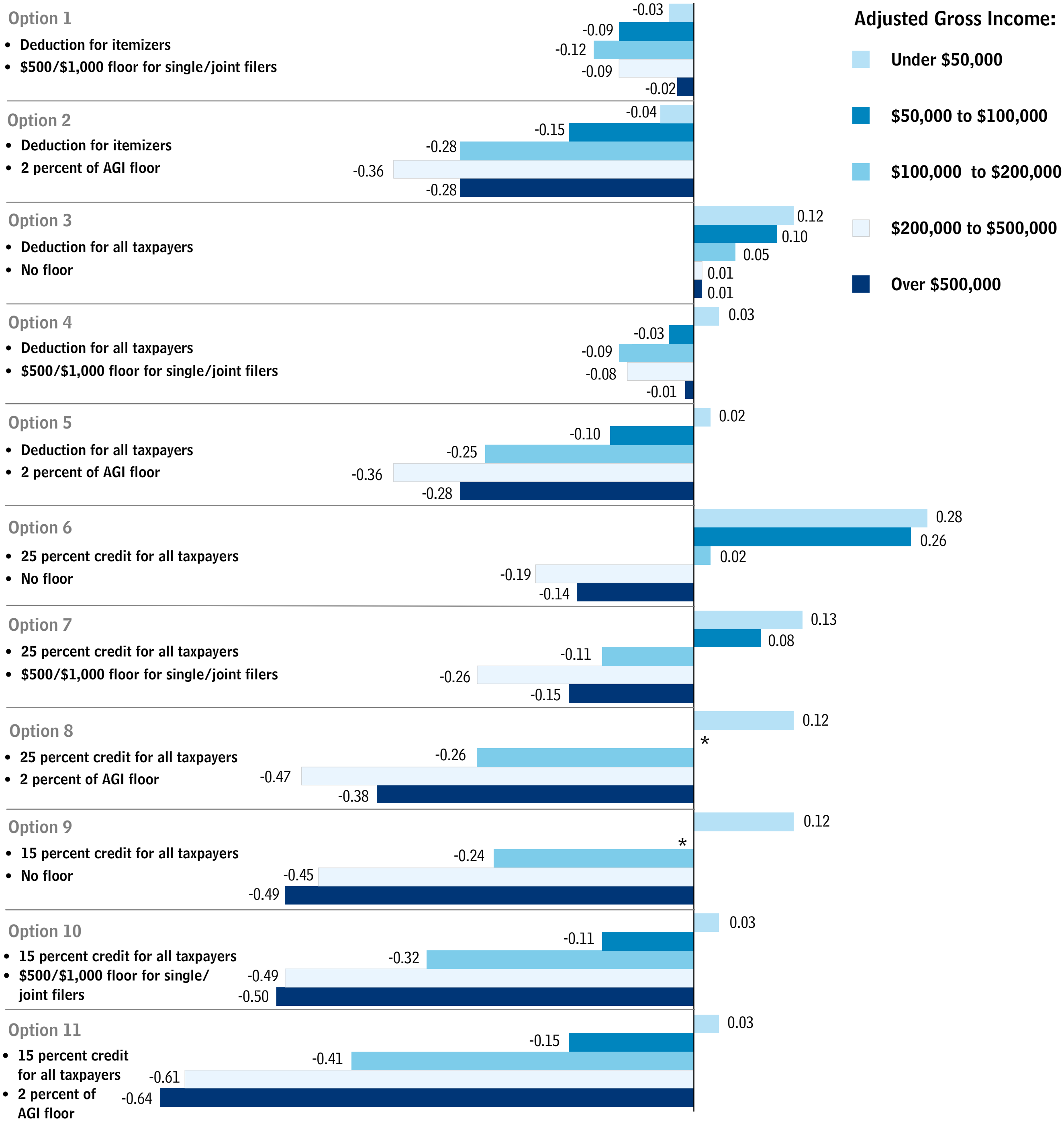
Under those options, some itemizers would be expected to become nonitemizers, because nonitemizers would be treated more favorably than under current law, whereas the tax treatment of itemizers would not change. Itemizers whose other itemized deductions totaled less than the standard deduction would generally benefit from taking the standard deduction and claiming the new non-itemized charitable deduction as well. For those taxpayers, the sum of the standard deduction and the new deduction for charitable contributions would exceed the total itemized deductions they could have claimed under

26. The President's budgetary proposals for fiscal years 2002 through 2005 included a charitable deduction for nonitemizers. Those proposals were more restrictive than the option analyzed here, which would allow nonitemizers to subtract all of their charitable contributions from their AGI (subject to the same restrictions as itemizers) in addition to claiming the standard deduction. See Office of Management and Budget, *Budget of the U.S. Government* for those years; also see Congressional Budget Office, *Budget Options* (February 2007), Revenue Option 11, "Create an Above-the-Line Deduction for Charitable Giving"; and Congressional Budget Office, *Effects of Allowing Nonitemizers to Deduct Charitable Contributions* (December 2002).

Figure 5.

Changes in Tax Subsidies Under Eleven Policy Options, by Income Group, 2006

(Percentage of adjusted gross income)



Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels.

* = between -0.005 percent and 0.005 percent.

2006 law.[27] Taxpayers making that change would not be expected to alter their giving, however, because itemization status would not affect their after-tax price of giving.[28] The only group of taxpayers who would see their after-tax price of giving fall—and would possibly increase their charitable donations as a result—would be nonitemizers with positive tax liability, who could take advantage of the more broadly available deduction.[29]

Extending the charitable deduction to nonitemizers without any contribution floor, as in Option 3, would increase donations by $2 billion (or 1 percent), CBO estimates (see Table 4 on page 13). The tax subsidy would increase by $5.2 billion (or 13 percent), of which $3.2 billion would go to subsidize existing contributions by nonitemizers (see Table 5 on page 17). Another large piece of the increase in the tax subsidy, $1.6 billion, would result from itemizers' choosing to take the standard deduction because it exceeded their noncharitable deductions.[30] The net change in giving would account for only $0.5 billion of the increase in the total tax subsidy.

Combining a floor with a deduction for all taxpayers would produce tax savings for the government while having relatively small effects on total donations. With the fixed dollar floor in Option 4, total contributions would increase by $0.8 billion (or less than 1 percent), whereas the tax subsidy would decline by $2.5 billion (or 6 percent). The subsidy for taxpayers who continued to itemize their deductions would fall by $5.0 billion, but those savings would be partly offset by new tax subsidies of $1.3 billion for existing contributions by nonitemizers, $1.0 billion for former itemizers who claimed the standard deduction instead, and $0.3 billion for the net change in donations.

With a floor set at 2 percent of AGI, as in Option 5, total contributions would decline by $1.9 billion (or nearly 1 percent), and the total tax subsidy would drop by $13.1 billion (or 32 percent). The reduction in the tax subsidy from excluding itemizers' charitable contributions below the floor would amount to $14.7 billion, almost triple the $5 billion in tax savings from the same source under the similar option with the dollar floor (Option 4). Those tax savings would be partly offset by new tax subsidies of $0.9 billion for existing contributions by nonitemizers, $0.3 billion for former itemizers who claimed the standard deduction instead, and $0.3 billion for the net change in giving.

Low- and middle-income taxpayers would be the main beneficiaries of extending the charitable deduction to nonitemizers because they make up the bulk of people who do not itemize deductions. Option 3 would raise the tax subsidy by 0.12 percent of AGI for taxpayers with income below $50,000 and by 0.10 percent of AGI for those with income between $50,000 and $100,000 (see Figure 5 on page 18). Taxpayers with AGI above $100,000 would have a much smaller increase in their tax subsidy rate (0.02 percent for that group as a whole). Adding a floor to the deduction for all filers would still increase the subsidy for taxpayers with income under $50,000 but by a smaller amount: 0.03 percent of AGI under Option 4 and 0.02 percent under Option 5. As in the options to add a floor to the current deduction for itemizers, upper income groups would see a larger reduction in their tax subsidy with a percentage-of-income floor than with a fixed dollar floor.

27. Under the options considered here, the incentive to switch itemization status would not exist for taxpayers paying the individual alternative minimum tax (AMT), because the standard deduction is not allowed for taxpayers paying the AMT. (Fewer than 3 percent of filers were subject to the AMT in 2006.) Also, the existing limit on itemized deductions for high-income taxpayers (those with AGI over $150,500 in 2006) could give some taxpayers an additional incentive to switch itemization status under options that would allow charitable deductions by nonitemizers, if that limit did not apply to deductions by nonitemizers. This analysis assumed that the limit would also apply to charitable deductions claimed by nonitemizers and therefore would not provide an additional incentive to change itemization status.

28. That statement is based on the assumption that behavioral effects resulting from changes in income would be small. It also ignores the fact that a small fraction of taxpayers would move into a lower marginal tax bracket because of the change in itemization status.

29. For that group, the after-tax price per dollar of giving would fall from $1 to [$1 x (1 - their marginal tax rate)]. For most of those taxpayers, the average and marginal price per dollar of giving would be the same. However, deducting charitable donations could move some taxpayers to a lower tax bracket, in which case their marginal price of giving would exceed their average price of giving.

30. Under the options that would extend tax incentives to nonitemizers without adding a floor (Options 3, 6, and 9), roughly 10 percent of itemizers would switch to the standard deduction, CBO estimates.

Options 6 to 8: Nonrefundable 25 Percent Credit for All Taxpayers, With or Without a Floor

An alternative way to extend tax benefits for charitable giving to all filers would be to convert the current deduction into a nonrefundable tax credit equal to a percentage of a taxpayer's contributions.[31] The credit could be various sizes. In this set of options, CBO examined the effects of a credit equal to 25 percent of donations, with the same three variations used earlier:

- Option 6 would have no floor that donations would have to exceed to qualify for the credit.
- Option 7 would have the same fixed dollar floor as Options 1 and 4 ($500 for individuals and $1,000 for joint filers).
- Option 8 would have the same percentage-of-income floor as Options 2 and 5 (2 percent of AGI).

Substituting a nonrefundable credit for the current deduction would provide the same subsidy (per dollar of giving) to all taxpayers who could fully claim the credit, instead of a subsidy rate that increases with a filer's marginal tax rate. A 25 percent nonrefundable credit would tend to benefit lower- and middle-income taxpayers, who generally face marginal tax rates of less than 25 percent. Taxpayers facing tax rates above 25 percent would see a decrease in subsidies under this option. As a result, replacing the current deduction with a 25 percent credit would probably increase the share of total income taxes paid by higher-income people.

Taxpayers would respond in several ways if the itemized deduction for charitable contributions was replaced with a nonrefundable tax credit. Current itemizers whose noncharitable deductions total less than the standard deduction would generally no longer choose to itemize. The after-tax price of giving would rise for itemizers facing marginal tax rates above 25 percent, creating an incentive for them to reduce contributions, whereas the after-tax price would fall for itemizers facing marginal tax rates below 25 percent, creating an incentive for them to increase contributions. Nonitemizers with positive tax liability would generally face a lower after-tax price of giving under this option and thus would also have an incentive to raise their contributions. The overall effect on donations would depend on whether the increased giving by people whose after-tax price of giving fell would exceed the decreased giving by people whose after-tax price rose.

CBO estimates that with a 25 percent credit and no floor (Option 6), total contributions would increase by $2.7 billion (or 1 percent)—about 35 percent more than the increase from extending the charitable deduction to all taxpayers without a floor (Option 3). The tax subsidy for charitable giving would rise by $7.1 billion (or 17 percent), of which only $0.8 billion would result from the net change in donations. Most of the cost increase to the government ($4.7 billion) would come from subsidizing existing contributions by nonitemizers; another $2.5 billion would result from former itemizers who would choose to take the standard deduction (see Table 5 on page 17). Among taxpayers who continued to itemize deductions, the increased tax subsidy for those with marginal tax rates below 25 percent would be slightly less than the reduced subsidy for those with marginal rates above 25 percent, resulting in a net decrease of $0.9 billion in the tax subsidy for that group.

If the credit applied only to contributions above the fixed dollar floor in Option 7, total donations would increase by $1.5 billion (or less than 1 percent), and the total tax subsidy would decline by $2.4 billion (or 6 percent). With the percentage-of-income floor in Option 8, total contributions would decrease by $1.0 billion (or less than 1 percent), and the tax subsidy would drop by $11.9 billion (or 29 percent). Under both of those options, increases in the tax subsidy from existing donations and from the net change in giving would be outweighed by a reduction in the subsidy from excluding tax benefits for contributions below the floor.

A nonrefundable tax credit for charitable giving available to all filers would favor low- and middle-income taxpayers even more than a deduction for all filers would. The reason is that the after-tax price of giving would be the same for all taxpayers rather than being lower for people with higher marginal income tax rates.

Option 6 would increase the tax subsidy for people with income under $100,000 by approximately 0.3 percent of AGI and for people with income between $100,000 and $200,000 by 0.02 percent of AGI (see Figure 5 on page 18). Taxpayers with AGI above $200,000 are likely

31. Nonrefundable tax credits are limited to the amount of a person's tax liability before credits. Refundable credits, such as the earned income tax credit, can exceed tax liability before credits and result in a refund payment from the government to the taxpayer.

to have marginal income tax rates greater than 25 percent. Consequently, their tax subsidy would fall under Option 6—by 0.19 percent of AGI for taxpayers with income between $200,000 and $500,000 and by 0.14 percent of AGI for those with income over $500,000.

Under the options that include a floor, the decrease in tax subsidy rates would be concentrated among taxpayers whose AGI was above $100,000. That decrease would equal 0.16 percent of AGI under Option 7 and 0.35 percent of AGI under Option 8. For taxpayers with income below $100,000, by contrast, the tax subsidy would increase by approximately 0.1 percent of AGI under both options.

Options 9 to 11: Nonrefundable 15 Percent Credit for All Taxpayers, With or Without a Floor

The last three options in CBO's analysis are similar to Options 6 to 8 but with a smaller credit. They would replace the current deduction with a tax credit equal to 15 percent of a taxpayer's donations, with the following differences:

- Option 9 would have no floor.
- Option 10 would have the same fixed dollar floor as Options 1, 4, and 7 ($500 for individuals and $1,000 for joint filers).
- Option 11 would have the same percentage-of-income floor as Options 2, 5, and 8 (2 percent of AGI).

The size of a tax credit for charitable giving affects not just the magnitude but the direction of the effects. A 15 percent credit with no floor would decrease donations relative to 2006 law (by $7.8 billion, or 4 percent), whereas a similar 25 percent credit would increase donations relative to 2006 law (by $2.7 billion, or 1 percent). Adding either type of floor to the 15 percent credit would reduce donations by slightly larger amounts—and, again, would result in fewer contributions than the comparable options with a 25 percent credit. In all three cases, total donations would be about 5 percent lower under the options with a 15 percent credit than under the analogous options with a 25 percent credit because the smaller credit would provide smaller tax incentives for charitable giving.

The same pattern would occur for the total tax subsidy, but the changes would be larger. With a 15 percent credit and no floor (Option 9), the tax subsidy would fall by $13.3 billion (or 33 percent) relative to 2006 law, whereas with a 25 percent credit and no floor, the tax subsidy would rise by $7.1 billion (or 17 percent). Adding the $500/$1,000 floor (Option 10) would reduce the tax subsidy even more, by $19.0 billion (or 47 percent) relative to 2006 law, compared with a $2.4 billion reduction under the same fixed dollar floor and a 25 percent credit. With a floor equal to 2 percent of AGI (Option 11), the 15 percent credit would reduce the tax subsidy by $24.6 billion (or 60 percent), compared with an $11.9 billion decrease under the comparable option with a 25 percent credit. Virtually all of the reduction in the subsidy would come from eliminating tax benefits for charitable contributions below the floor.

Relative to 2006 law, taxpayers with AGI under $50,000 would see a small increase in their subsidy rate under all of the options with a 15 percent credit. That increase would equal 0.12 percent of AGI with the credit alone and 0.03 percent with the credit plus a floor. Taxpayers whose AGI was between $50,000 and $100,000 would see virtually no change in their subsidy rate with the 15 percent credit alone but a decrease equal to 0.11 percent of AGI with the fixed dollar floor or 0.15 percent of AGI with the percentage-of-income floor. All three variants of the 15 percent credit would decrease subsidy rates for income groups above $100,000, with the largest reductions in this analysis coming from combining that credit with a floor of 2 percent of AGI.