

It is possible to extend the charitable deduction to non-itemizers and significantly increase charitable giving at little or even no cost in tax revenue while also addressing concerns about administration and compliance

Extending the Charitable Deduction to Nonitemizers: Policy Issues and Options

by Joseph Cordes, John O'Hare, and Eugene Steuerle

On April 15, 2000, more than 30 million taxpayers who itemized deductions on their tax returns were able to claim tax deductions for any contributions made to their favorite charities. The effect of the deduction was to lower the taxpayer's cost of giving one dollar by amounts ranging from 15 cents to almost 40 cents. But many taxpayers who contribute to charities were not eligible for a charitable deduction because they claimed the standard deduction instead of itemizing deductions on their tax returns.¹ Recently, policymakers from both political parties have proposed extending the charitable deduction to taxpayers who do not itemize as one way of expanding the financial resources of charities, helping these organizations to meet a variety of social needs, and, more generally, fostering a more "giving" or "civil" society.²

The idea of allowing a charitable deduction for nonitemizers is not new. For a brief period from 1983 to 1986, such deductions were allowed, but they were then repealed as part of the Tax Reform Act of 1986. Considered in isolation, the notion of extending the charitable deduction to all taxpay-

ers, not just those who itemize, might seem unobjectionable. To the extent that the current charitable deduction is seen as a subsidy for private giving, it might seem somewhat odd to make the subsidy available to some taxpayers but not others.

Yet, repealing the charitable deduction for nonitemizers in 1986 was part of a broad effort to reform the individual income tax, an effort that had tax simplification as one important goal. Enactment of a more generous standard deduction that taxpayers could take in lieu of various itemized deductions, such as charitable contributions, was a centerpiece of these efforts. The standard deduction is large enough to provide most taxpayers with a larger deduction than they would be able to claim by itemizing medical and work expenses, state and local taxes, charitable contributions, and other uses of income. Thus, to some observers, allowing taxpayers who claim the standard deduction to also deduct charitable contributions may be seen as allowing a double deduction for some charitable gifts.

The case for extending the charitable deduction to nonitemizers is thus

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not so much an issue of equity, since these taxpayers are indirectly allowed to deduct charitable contributions as part of the standard deduction. Rather, the question is whether it is good public policy to make tax incentives for charitable giving available to more persons. Almost certainly there would be some gains in terms of additional charitable contributions. But how do those gains stack up against costs, and are there ways to increase the gains relative to the costs? Answering these questions requires addressing the two major issues raised by allowing nonitemizers to claim charitable deductions—revenue cost and administrative complexity.

Concern over revenue cost may seem to be misplaced at a time when both the Congressional Budget Office and the Office of Management and Budget are projecting large budget surpluses, but it remains a real one. There is a large margin of uncertainty about the projections; even if the projected surpluses materialize, there are already many competing political claims on these financial resources, particularly Social Security and Medicare protection, new spending programs, and a host of new tax reduction initiatives (Reischauer 2000). What one *can* afford is not necessarily the same as what one *should* afford.

Associated with this revenue cost are windfalls that would be conferred on some taxpayers. Somewhat paradoxically, one group of taxpayers who could benefit from a deduction for *nonitemizers* would be a subset of *itemizers* who would be able to cut their tax liability without increasing their giving. Suppose that the standard deduction is \$6,000 and that a household has itemized deductions of \$7,000, \$2,000 of which are charitable contributions. If all charitable contributions were deductible by nonitemizers, then the individual could take a \$2,000 charitable deduction and a standard deduction of \$6,000, thus increasing total deductions by \$1,000 to \$8,000. If the taxpayer were in the 28 percent tax bracket, the \$1,000 increase in total deductions would result in tax savings (revenue cost) of just under \$300 without changing the financial incentive to give (except to the extent that the taxpayer had somewhat more after-tax income).

Those who are concerned about tax administration also worry that allowing nonitemizers to deduct charitable contributions may create compliance problems and additional tax return complexity. Again, this was one of the reasons why a standard deduction was created in the first place. When nonitemizers were last allowed to deduct charitable contributions, many reported fairly small amounts. No doubt some of these small gifts were real, but others may simply have been amounts that were “suddenly remembered” at tax time and that would be hard to document if audited. But the IRS simply does not have the resources to audit many returns, much less those reporting only small amounts of deductions. Moreover, when everyone can deduct even the smallest amount, then additional filing and administrative cost is imposed on almost everyone.

The remainder of the brief discusses the implications of these concerns for proposals to expand the charitable deduction to nonitemizers. We show how the concerns about revenue cost and administration or compliance can be addressed in the design of such policies, and we offer an alternative view of the consequences of allowing people who claim the standard deduction to also claim a separate deduction for charitable gifts.

Policy Design: The Role of Contribution Floors

The Urban Institute has developed a charitable giving model that can be used to analyze how different charitable incentives affect both tax revenue and the amount that people give to charities. The model is quite similar to models developed by the Treasury Department, the Joint Committee on Taxation, the National Bureau of Economic Research, and PricewaterhouseCoopers for the Independent Sector. Our focus here is to analyze the broad effects of different policy options rather than provide revenue estimates that might accompany any specific proposals. Thus, we show the effects of alternatives as if they were fully in place for 1995, whereas the effects of formal legislative proposals would be estimated for current and future years.

Our most important conclusion is that it is possible to extend the charitable deduction to nonitemizers and significantly increase charitable giving at little or even no cost in tax revenue while also addressing concerns about administration and compliance. We also show that these results hold even when the responsiveness of giving to changes in the after-tax cost of giving is relatively low.

Table 1 shows the simulated changes in tax revenue and charitable giving that result from four options for extending the charitable deduction to nonitemizers:

- Option 1 would simply allow nonitemizers to deduct charitable gifts beginning with the first dollar given.
- Option 2 would allow nonitemizers to deduct charitable contributions in excess of a floor of \$500 for joint filers and \$250 for single filers.
- Option 3 would allow all taxpayers to claim a charitable deduction in excess of a floor of \$500/\$250 without regard to whether they itemize or not. Such a change would limit charitable deductions for those who itemize under current law to amounts given in excess of the floor, while at the same time allowing those who currently do not itemize to deduct charitable contributions above the floor.³
- Option 4 has the same general features as Option 3, with the floors set at a level that results in no overall loss in tax revenue.

The degree to which any charitable incentive is likely to prompt additional giving depends on how sensitive people are to

changes in the after-tax cost of making charitable contributions. There is general agreement among researchers that people will give more when the cost of giving falls, but some studies estimate that the sensitivity of giving to changes in its price is relatively low, while others find that giving is fairly responsive to such changes. To capture the range of variation in these studies, the effects of each of the four options are simulated for the case in which the price sensitivity of giving is low, moderate, and high.⁴

The first row of table 1 shows the simulated changes in revenue and giving that result from adopting the first option. These results illustrate the concerns about revenue cost mentioned earlier. Even if giving is moderately responsive to changes in the cost of giving, allowing nonitemizers to deduct all charitable contributions, starting with the very first dollar they give, increases charitable giving by a smaller amount than the cost in foregone tax revenue. An important factor is the effect of the policy change on taxes paid by “switchers”—taxpayers who were itemizing deductions before the policy change who would have a financial incentive to switch and become nonitemizers.

The second row shows the effects of adopting Option 2. Limiting deductions to amounts greater than a specified floor has two effects. It reduces the extent to which taxpayers would be able to claim hard-to-document charitable contributions as a means of reducing their tax liability, and it substantially reduces the revenue cost of extending the deduction. Compared with Option 1, if the

TABLE 1: Summary of Revenue Effects and Change in Charitable Giving (Dollar Amounts in Millions), 1995 Income Levels

	PRICE SENSITIVITY IN GIVING					
	Low		Moderate		High	
	Revenue Effects	Change in Giving	Revenue Effects	Change in Giving	Revenue Effects	Change in Giving
Tax Policy Options						
1. Deductions for All Contributions by Nonitemizers	(\$5,570)	\$2,271	(\$6,215)	\$5,513	(\$6,736)	\$8,080
2. Deduction with \$500/\$250 Floor for Nonitemizers Only	(\$3,886)	\$2,166	(\$4,518)	\$5,318	(\$5,032)	\$7,816
3. Deduction with \$500/\$250 Floor for All Taxpayers	(\$1,193)	\$1,904	(\$1,826)	\$4,848	(\$2,340)	\$7,219
4. Revenue-Neutral Floor	\$650/\$325	\$1,681	\$750/\$375	\$3,964	\$800/\$400	\$5,711

Source: Urban Institute calculations based upon its charitable giving model.

responsiveness to changes in the after-tax cost of giving is low, the incentive costs roughly \$1.80 instead of \$2.45 in foregone tax revenue for every extra \$1 of charitable giving, and if the price responsiveness is moderate or high, the incentive encourages more than \$1 of extra giving for each dollar of revenue loss.

It is worth noting that even though limiting deductions to amounts in excess of \$500 or \$250 substantially lowers the revenue cost of extending the deduction, it has only a small effect on the amount of *extra giving* that is encouraged. This reflects the fact that many nonitemizers already give amounts in excess of the floor without any tax subsidy. In effect, the floor has the effect of providing more of the subsidy to extra giving, rather than to giving that would occur without any incentive.

The third option extends the floor to itemizers as well as to nonitemizers. If the tax rate is assumed to be 28 percent, placing a \$500/\$250 floor under charitable deductions would increase the tax bill of an itemizer who files a joint return by about \$150. In the tax model, the overall revenue pickup from a \$500/\$250 floor is over \$2 billion and helps pay for roughly 60 percent of the revenue cost of extending the deduction to nonitemizers, the precise percentage depending upon responsiveness of taxpayers to the overall incentive.⁵ Under this option, even when the responsiveness to changes in the after-tax cost of giving is low, the amount of extra giving from nonitemizers exceeds the net revenue cost. Note how this trade-off essentially exchanges weak to nonexistent incentives for first-dollar giving of itemizers with more powerful incentives more likely to apply to last-dollar giving of nonitemizers.

Option 4 shows what the value of the common floor would have to be in order to extend the deduction to nonitemizers without an overall reduction in tax revenue. The results show that it is possible to craft a charitable deduction for nonitemizers that is revenue neutral and increases total charitable giving. In effect, placing a contribution floor under all givers allows one to shift tax subsidy dollars from ranges of giving where the price sensitivity of giving is effectively zero to margins of choice where giving is sensitive to changes in the price (even if the responsiveness is modest).

Compared with placing a floor under deductions by nonitemizers only, Options 3 and 4 have an additional attraction from the standpoint of administration and compliance. Placing a common floor under all charitable contributions would eliminate the need for tens of millions of taxpayers to keep track of very small contributions and would put less pressure on an IRS that cannot even enforce the current system well for those claiming modest contributions.

Further Issues

Some models of charitable giving predict that higher-income taxpayers might be more responsive to incentives than are lower-income taxpayers.⁶ If this is the case, it changes the previous analysis, though only marginally. Since nonitemizers tend to have low-to-average income, the charitable contributions induced would more likely fall in the range suggested under low-to-moderate price sensitivity to giving. The revenue effects would change little, though the net increase in total giving resulting from the policy options that put a floor under all deductions would be somewhat smaller.⁷

Still another issue not addressed here would be how to deal with complications in the design of the incentive. One layer of complication is added by the hidden tax rates that now permeate the tax code. One rate—the Pease provision, after former Congressman Donald J. Pease (D-Ohio)—reduces itemized deductions as adjusted gross income increases. The net effect for most taxpayers is a separate tax rate for which charitable contributions are not allowed. Moreover, there are a few taxpayers whose deductions are severely limited by the Pease provision. To prevent these taxpayers from gaining large tax reductions through a nonitemizer deduction that is not so limited, complications about when and how to take deductions have been added to some proposals.⁸

Some current proposals also try to limit the revenue losses associated with switchers (noted above) by limiting the charitable deduction for nonitemizers to the size of the standard deduction. But even with this provision, taxpayers whose noncharitable deductions were less than the standard deduction would still unambiguously gain by switching if their charitable deductions were less than or

equal to the standard deduction. Some other taxpayers with charitable deductions in excess of the standard deduction might also still benefit from switching, although their gain would be attenuated by the standard deduction limit, and they would have to forego some of their charitable deductions.

Next, the ability to craft a more efficient charitable incentive leaves unresolved the matter of whether it is equitable to provide a deduction for charitable gifts while also giving taxpayers the option of claiming a standard deduction of the same size as allowed under current tax law. The conventional justification for the standard deduction is that it offers taxpayers an alternative to itemizing deductions. Under this view, allowing taxpayers the option of simultaneously claiming the standard deduction and taking an additional deduction for charitable contributions would allow a taxpayer who takes the standard deduction to deduct the “same” charitable contribution twice. One response to this concern is that limiting deductions to an amount in excess of a floor addresses this issue, at least in part.

More generally, there is no reason why the standard deduction cannot be redefined to apply only to itemized deductions (e.g., state and local taxes, mortgage interest, and medical and other expenses), excluding amounts given to charity. In that case, the only policy question would be the amount of the standard deduction to allow for the remaining items. Redefining the standard deduction in this manner accepts the income tax as an administratively convenient mechanism for subsidizing charitable contributions. Such a shift would be consistent with past legislative justifications for allowing charitable contributions (Brody and Cordes 1999).⁹

Some might also argue that separate treatment of charitable deductions may be justified as a matter of fairness. A common benchmark for defining fair treatment is that taxpayers with the same ability to consume should pay the same amount of taxes. But this broad criterion leaves open the matter of how “consumption” is to be defined.

Suppose that one believed that the tax base should be limited to the ability to consume after charitable gifts were made so that those with equal incomes after charitable contributions would be treated as equals. Under this

benchmark, a generous household with \$30,000 of income and \$5,000 of gifts to charity would be deemed to have the same ability to consume as one with \$25,000 of income and no charitable contributions and would thus be taxed the same. With a standard deduction of \$6,000, however, neither household would itemize and, therefore, the households would be taxed on the basis of their total income, independent of the amount given to charity and available for the household’s own consumption. On the other hand, if both households itemized, then charitable deductions would treat them more as equals on the basis of their after-contribution income. Allowing a deduction for charity without regard to whether a taxpayer claims itemized deductions simply extends the notion that those with equal incomes after contributions should be taxed the same. Since very large givers would become itemizers anyway, and since the ultimate beneficiaries of charitable contributions are not taxed on any consumption received, one shouldn’t stretch this argument too far.

Lastly, extending the deduction to non-itemizers might have a lesser or greater effect on behavior than is traditionally estimated. On the one hand, those attempting to maximize the use of an incentive may bunch contributions over time so that their contributions are limited by a floor only in the years in which the bunched giving occurs rather than one floor every year. This becomes more of a problem when the floor is set very high.¹⁰ On the other hand, the symbolism of a charitable deduction for all could be a powerful one and might induce more giving by those enticed by a social standard as well as reduced price. Some modest givers may also find a floor on deductible contributions to reflect an amount above which they would like to rise so that they fall within that category of taxpayers who meet some minimum generosity standard.

Conclusion

There is now a bipartisan movement, as represented by proposals by both President Clinton and presidential candidate George W. Bush, to extend the charitable deduction to nonitemizers.¹¹ Although these proposals differ in a number of important specifics, a feature that appears to be shared is that any floor placed under contributions would apply only to non-itemizers. The apparent reluctance to consider

combining the extension of the charitable deduction to nonitemizers with the placement of a floor under all contributions may reflect the political wisdom of enacting changes in the individual income tax that are tax “cuts” and do not create losers. While placing a floor under all contributions would raise the tax bills of itemizers, the amount of the increase would be small. Moreover, as a matter of budget and tax accounting, someone always pays for any change in expenditures or taxes, so there are always losers—those who might have otherwise benefited from a different tax cut or expenditure increase than the one enacted, or those who would benefit from additional debt reduction.

Unfortunately, any differential treatment of charitable contributions for itemizers and nonitemizers would increase the complexity of filing an already complicated income tax. Many taxpayers would have to calculate taxes two different ways to decide how they would take their charitable deductions. With a common floor, it is possible to design the charitable incentive so that itemizers would almost always take the deduction in the same way as nonitemizers and avoid this tax filing complexity. A well-designed floor could also further reduce revenue cost and administrative burden on an already overwhelmed IRS. Whether these considerations will be given more attention when and if this issue proceeds to Congress, or is reintroduced in a less intense political environment after an election year, remains to be seen.

Endnotes

1. In recent years, about seven out of ten taxpayers did not itemize deductions on their tax returns.
2. A proposal was made first by George W. Bush, whose economic advisor, Lawrence Lindsey, has written on this subject. In its budget submission for fiscal 2001, the Clinton administration has also come forward with its own proposal to extend charitable deductions to nonitemizers. Thus, the appeal is now bipartisan.
3. Larry Lindsey, an advisor to George W. Bush in the 2000 presidential campaign, has himself written on the use of such floors in extending charitable deductions to nonitemizers. See Lindsey (1989).
4. In the parlance of economics, the sensitivity of giving to changes in its price is summarized by the *price elasticity of giving*, which measures the percentage by which giving changes in response to a given percentage change in the price of giving. For example, a price

elasticity of giving equal to 0.4 in absolute value would mean that a 100 percent decrease (increase) in the price of giving would increase (decrease) the amount of contributions by 40 percent. In this case, giving would be said to be relatively insensitive to changes in its price. A price elasticity of giving equal to 1.0 in absolute value would mean that a 100 percent decrease (increase) in the price of giving would increase (decrease) the amount given by 100 percent, in which case giving would be said to be moderately sensitive to changes in its price. A measured price elasticity of giving greater than 1.0 in absolute value would indicate that giving had a relatively high degree of sensitivity to changes in its price. In table 1, a low responsiveness of giving is captured by assuming that taxpayers have a price elasticity of giving equal to 0.4, a moderate responsiveness by assuming that the elasticity is 1.0, and a high responsiveness by assuming that the elasticity is 1.4.

5. These amounts are calculated from the charitable giving model but are not shown separately in table 1.
6. See, for instance, Clotfelter and Steuerle (1981) and Duquette (1999).
7. If the giving of itemizers were more price sensitive than the giving of nonitemizers, placing a common floor under all contributions while extending the deduction to nonitemizers would shift some dollars of tax subsidy from more price-sensitive to less price-sensitive givers.
8. Various aspects of these complications are discussed in Steuerle (2000a, b, c).
9. Consider a corollary: Suppose that charitable deductions were being designed in the process of a larger reform where the standard deduction and other items remained to be set simultaneously with other tax rules. Then there would not necessarily be a problem with having a charitable deduction that extended to everyone, with the standard deduction set at a slightly lower level than it would be under current law, which limits the deduction to itemizers.
10. One formal analysis of the possible effects of bunching is to be found in Feldstein and Lindsey (1983).
11. For a discussion of the proposal for extending the charitable deduction to nonitemizers that is included in the president’s budget, and other issues related to the charitable deduction, see Steuerle (2000a, b).

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