April 2013

The Charitable Deduction: Economics versus Politics

Jon Bakija, Joseph Cordes, and Katherine Toran

The ongoing political standoff over the national budget continues to have implications for all sectors of the economy, including the nonprofit sector. Most notably, proposed changes to individual itemized deductions have implications for the charitable deduction and giving to the sector as a whole.

The conference "The Charitable Deduction: A View from the Other Side of the Cliff," hosted by the Urban Institute on February 28, 2013, examined how the recent debate over tax changes has affected nonprofits and charitable giving.

Throughout the conference, a reoccurring theme was the gap between economic analysis and political feasibility. Various speakers proposed ways to increase the efficiency of the charitable deduction, including some proposals that would raise revenue in the least damaging way for nonprofits, as well as other proposals to encourage more charitable giving with a minimal loss of government revenue. However, many presenters noted that the proposals they found most attractive were likely to be less attractive from a political standpoint, partly because of fear as what the total package would look like. Nonprofit organizations feared allowing the government to make any changes to the charitable deduction without confidence that these changes would be efficiently and favorably designed.

The first session, "Looking Back at the Cliff," examined the debate leading up to the "fiscal cliff," including the various proposals that would have affected the charitable deduction, the response of the nonprofit sector, and the effect of the deal that was ultimately reached.

Moderator Gene Steuerle, co-director of the Tax Policy and Charities project at the Urban Institute, began the session by introducing the Tax Policy and Charities project.[1] He pointed out the difficulty in measuring how hypothetical changes to the charitable deduction will affect the sector and asked the first two presenters to discuss what is known about how tax law affects charitable giving and the limits of these measurements.

Joseph Rosenberg, research associate at the Urban-Brookings Tax Policy Center, began by presenting an overview of the charitable deduction:

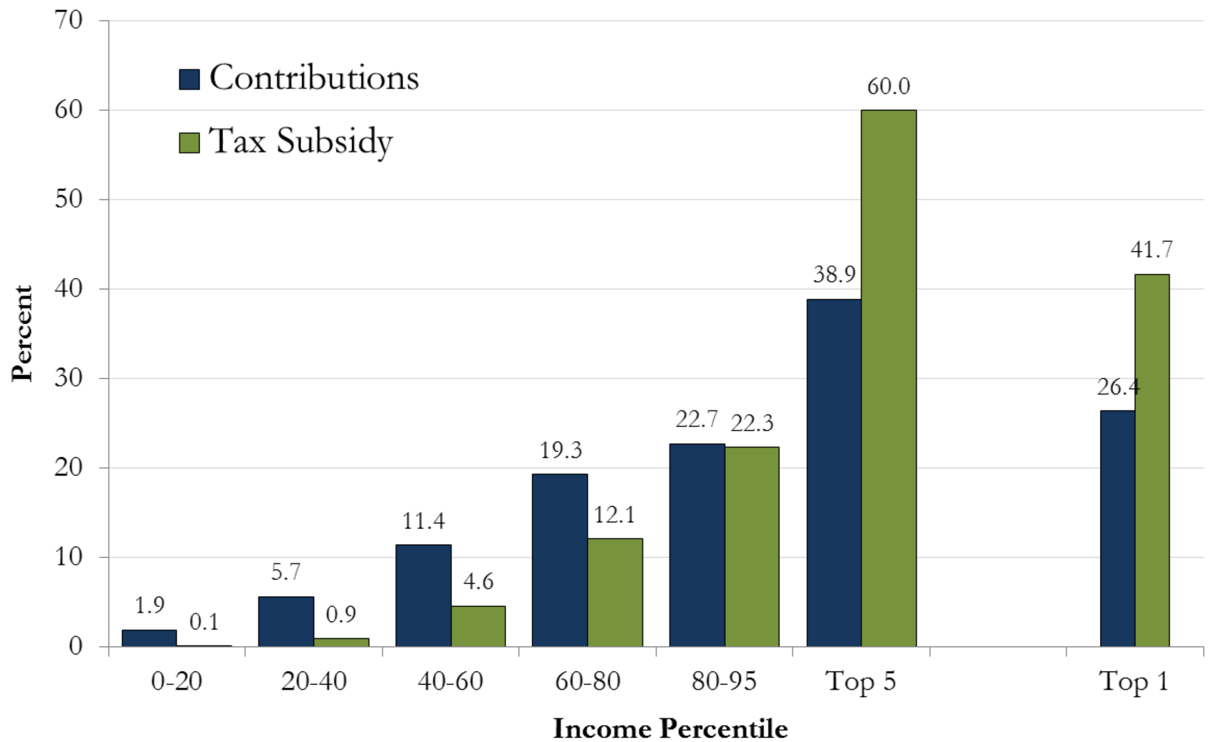
- The charitable income tax deduction costs the federal government about $40 billion in revenue annually ($36 billion in 2012).[2]
- It can only be claimed on itemized tax returns, which includes about 30 percent of taxpayers.
- Like other deductions, the charitable deduction is an upside-down subsidy in the sense that the tax benefit increases for taxpayers with higher incomes and thus higher marginal tax rates.
- The top five percent of households receive 60 percent of the tax subsidy for charitable giving, while making 40 percent of contributions.

Rosenberg then outlined recent tax proposals that would limit the charitable deduction: the 28 percent limit proposed by President Obama, the dollar limits on itemized deductions proposed by the Republican presidential candidate Mitt Romney, and the limitation of the tax benefit of certain tax preferences to 2 percent of AGI in a proposal. All of these proposals, he noted, were

[1] See http://www.urban.org/taxandcharities/.

[2] Joint Committee on Taxation (JCS-1-13).

Shares of Contributions and Tax Subsidies by Income Group, 2013



Joseph Rosenberg. 2013. "The Charitable Deduction: A View from the Other Side of the Cliff," on February 28, 2013, at the Urban Institute.

across-the-board reductions in itemized deductions and other tax preferences, and didn't directly target the charitable deduction.

Rosenberg observed that simple reforms that avoided singling out individual preferences were appealing for political reasons. The other political advantages he saw in across-the-board reforms include the potential to raise revenue and to do so in a progressive manner. However, Rosenberg stressed that political advantages were not the same as economic efficiency. Reducing the subsidy at the margin is the least-effective method of raising government revenue while still encouraging giving. Rosenberg emphasized that the specific design of these across-the-board limits matters enormously in terms of the effects on giving, since proposals like the fixed dollar cap could effectively eliminate the marginal incentive to give for many large donors.

Rosenberg also noted that even if proposals were designed to exclude the charitable deduction, there was the potential for significant indirect effects from limiting other itemized deductions, as fewer people would find it beneficial to itemize at all.

However, despite controversy over the charitable deduction, none of these proposals were passed. Instead, the American Taxpayer Relief Act of 2013 (ATRA) actually had beneficial elements for nonprofits. The Tax Policy Center estimates that ATRA will increase overall individual giving in 2013 by $3.3 billion or 1.5 percent, primarily due to the increased incentive from raising the top

Impact of ATRA on Charitable Giving, 2013

Income Percentile	Tax Units		Change in Contributions under ATRA	
	Number (thousands)	Percent of Total	Amount ($billions)	Percent Change
Lowest Quintile	40,520	25.6	0.0	0.0
Second Quintile	36,208	22.9	0.0	0.0
Middle Quintile	31,370	19.8	0.0	0.0
Fourth Quintile	26,062	16.5	0.0	0.0
Top Quintile	23,189	14.7	3.3	2.5
All	158,260	100.0	3.3	1.5
Addendum				
80-90	11,692	7.4	0.0	0.0
90-95	5,736	3.6	0.0	0.0
95-99	4,615	2.9	-0.1	-0.3
Top 1 Percent	1,147	0.7	3.4	6.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0412-8). Changes are estimated relative to TPC's current policy baseline, which assumes that 2012 tax law is extended (except for the payroll tax cut and health care legislation.)

income tax rate from 35 to 39.6 percent.[3] Also, the rise in the top marginal tax rate on capital gains from 15 to 20 percent increased the tax subsidy for donations of appreciated property to charity. [4]

Several other tax provisions were also beneficial to charities, according to Rosenberg, such as maintaining the estate tax and extending the charitable IRA rollover. Finally, he observed that although the Pease limitation on itemized deductions raised concerns for nonprofits, it has very little impact on giving incentives.

Rosenberg concluded by arguing that the better path forward, if more difficult and more time-consuming, would be to pursue targeted incremental reforms for all itemized deductions. In the case of the charitable deduction, he suggested extending the deduction to all taxpayers, regardless of income or itemizer status. To compensate for the lost revenue from expanding the deduction, he suggested imposing a floor (e.g., 1 percent of AGI) and improving compliance, especially in the area of noncash gifts.

Rosenberg's presentation was to be the first of many that would highlight the difference between economically efficient reforms to the charitable deduction and politically plausible reforms. Although there are political reasons to favor across-the-board changes to all itemized deductions in the form of caps, the charitable deduction illustrates the difficulties in implementing a one-size-fits-all approach.

Jon Bakija, professor at Williams College, explored the question of how the income tax affects incentives to give to charity, and the degree to which people respond to the incentives. He observed that although it is intuitive that exempting charitable gifts from taxation should encourage giving, we also know that tax benefits are not the only reason that people give to charity. In this case, he asked, how do we measure the way reductions in tax benefits for giving may affect donors' behavior?

Bakija explained that the price of giving one dollar to charity is one dollar minus the tax savings from doing so. For example, in 2006, taxpayers with

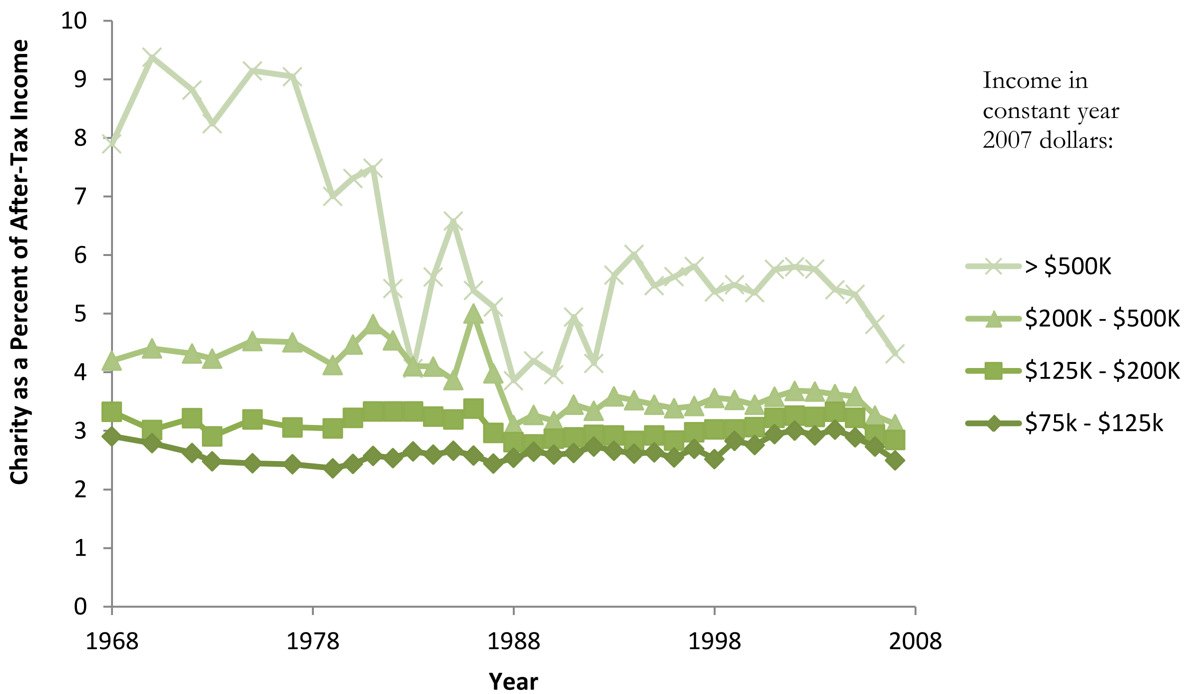
[3] "What Does the Fiscal Cliff Deal Mean for Nonprofits?" by Joseph Rosenberg, C. Eugene Steuerle, Katherine Toran. Washington, DC: The Urban Institute, 2013. See http://www.urban.org/publications/412732.html.
[4] Ibid.

incomes above $500,000 saved about 32 cents in federal and state taxes, on average, for each additional $1 in donations, making their price 68 cents. Economists, he said, summarize the responsiveness of people to the cost of giving with the "price elasticity" of giving—the percentage change in charitable donations caused by one percent increase in price.

Elasticity gives us a means to measure how donors respond to changes in tax incentives, Bakija explained, but it is difficult to distinguish the effects of tax incentives from the effects of other factors, and different types of people might differ in their responsiveness. Economists have debated the magnitude of the price elasticity of charitable giving for years.

Bakija then presented his research into whether an increase in price of giving reduced donors' contributions. First, Bakija looked at aggregate data from 1968 through 2007. From the 1970s to more recent years, changes in tax law increased the price of giving for the highest-income donors while leaving incentives mostly the same for the middle class. He found that the share of after-tax income given to charity decreased for the rich while staying in the same range for other income classes. This occurred despite the fact that over this period, real after-tax incomes increased for the rich compared to the middle class. Although other factors could have affected giving among high-income individuals, he believes that this suggests that charitable giving is responsive to

Charity Declined as a Percentage of After-Tax Income for the Rich Compared to the Middle Class, 1968-2007



Note: Author's tabulations from IRS Statistics of Income public use individual income tax return files. Sample only includes taxpayers with constant dollar itemized deductions for interest and state and local income tax and real estate tax in excess of the largest standard deduction during the sample period in constant dollars.

Source: Jon Bakija. 2013. "Empirical Evidence on the Responsiveness of Charitable Giving to Tax Incentives." Presentation for "The Charitable Deduction: A View from the Other Side of the Cliff," on February 28, 2013 at the Urban Institute.

changes in the tax treatment of contributions.

Bakija then summarized the findings of his empirical research (coauthored with Brad Heim) which used individual-level data following the same taxpayers over time during 1979–2006. They took advantage of the fact that tax incentives for charity changed in different ways over time for people with similar income levels living in different states, because of changes in state income tax laws, and also since changes in federal tax laws had disparate effects across states (for example, he said, people living in states with higher state income taxes are more likely to pay the federal alternative minimum tax).

Bakija and Heim found that charitable giving went down relatively more over time for people living in states where price increased relatively more, controlling for other influences. This evidence suggests a price elasticity in range of -1.1 to -1.5. In practical terms, they believe this implies that a 10 percent increase in the price (e.g., from 68 cents to 75 cents) would results in more than a 10 percent reduction in charitable donations. In effect, this indicates that charities more than donors pay for reductions in the charitable deduction. The policy implication, said Bakija, is that removing incentives to give to charity at the margin may have large negative effects on donations.

Bakija noted that all of these measurements have their limits and there is no one universal elasticity of giving that holds true for all donors.

Measuring the price elasticity of charitable giving continues to be a challenging task for economists. Often economists use a range of elasticities when attempting to measure effects on charitable giving. Others use different elasticities for different income levels.

Rick Cohen, ***Nonprofit Quarterly***, discussed his experience as a journalist following the political debate over the charitable deduction. He first highlighted the increase in media stories concerning the charitable deduction over the last five years. A peak in these stories occurred in the last quarter of 2012, which was double the last quarter of the previous year. Although media coverage has dropped off so far in 2013, the charitable deduction continues to be a policy issue that has not faded away. Cohen noted that the loudest nonprofits in the political debate were not necessarily a perfect sample of all nonprofits, but still represented a broad range of types of charities.

When interviewing various nonprofits involved in the debate, Cohen found that the strongest message was "don't kill the deduction"— these nonprofits feared an end to the charitable deduction more than a limitation. Although this was never an actual proposal, these nonprofits feared a "slippery slope" where any limits to the charitable deduction would lead towards its elimination. Most did not have any opinion on limits to other itemized deductions. Overall, Cohen found that nonprofits were critical of increased enforcement and regulation in the sector, leery of possible effects on their donations.

When asked about the importance of sequestration and other budget cuts, many nonprofits claimed that a dollar of giving to charities was more efficient than a dollar of government spending. Nonprofits avoided entering the discussion concerning federal spending, partly because this was a divisive issue for the sector, whereas the sector agreed on the issue of the charitable deduction.

Cohen also found that the charities he interviewed were somewhat protective of the interests of wealthy, feeling they were being unfairly attacked and demonized in the political sphere. This gave nonprofits a conservative tenor. Nonprofits avoided discussing the issue of the top marginal tax rate (although, as shown in Joseph Rosenberg's presentation, the top marginal tax rate does affect the value of the charitable deduction.) In addition, Cohen found that even charities receiving little from top-tier taxpayers were still afraid of caps on the charitable deduction, even if it was relatively unlikely that their organizations and their donations would be affected. Most charities he interviewed were unaware of the data concerning which sectors of nonprofits would be affected by tax proposals and which would be unlikely to experience much of an impact.

Cohen found that congressmen also had little knowledge of the data concerning how changes in tax law could affect charitable giving, including data presented by government agencies (such as the IRS). In addition, in his experience as a journalist, politicians did not want to talk about the charitable deduction and avoided the topic.

Within the nonprofit sector, Cohen looked for differences in opinion between nonprofit organizations. He found that religious organizations could be critical of secular charities. Faith-based charities desired to be treated differently, perhaps excluded from any changes that affected secular charities. He also found that some nonprofits which did not receive government grants then considered charities that received government money to be less charitable.

Cohen finished by raising two important questions: the question of tax equity, as the charitable deduction gives different incentives to donors of different income levels, and the question of how government social services spending compares in value and interacts with charitable spending on social needs.[5]

Diana Aviv, President of Independent Sector, discussed the strategy of nonprofits in the debate over the charitable deduction from an insider's perspective. Aviv found the White House to be the driving force behind most proposals of limits on itemized deductions, as the result of the overall priorities concerning equity and fairness, which call for revenue increases to be slanted towards the wealthy by limiting itemized deductions, including the charitable deduction.

This was by no means the first time such an argument had been made. In the past, Aviv found that the focus had been more on arguments that wealthy donors mostly gave to "less charitable" sectors such as art, culture, and education. Trying to distinguish among charities on the basis of their worthiness, however, is difficult and opposed by many charities.

Aviv noted one change from the past—charities tried very hard to separate the charitable deduction from other itemized deductions, instead of being content to be considered alongside the housing market and other major players. Also, charities were arguing that not all donations at the top income level went to education institutions and museums, and that many of the benefits even within these institutions went to low or middle income families.

In her experience working with nonprofits during the political debate over tax policy that would affect the charitable deduction, Aviv found nonprofits found the most effective message was simply do "do no harm" to charities. From the government side, she received the message that government may have been hoping that nonprofits would step in to do more, in the place of government cuts. This was perhaps not a realistic expectation, Aviv thinks, given that the government funds the human-needs activities of many charities.

Aviv also responded to Cohen's point that charities should be aware that their own funding was damaged by government cuts, and thus should have an interest in the broader debate over spending cuts and rate increases. According to

[5] This question was the topic of the conference "Charity and Government: Tax Reform and Beyond." See http://www.urban.org/taxandcharities/Charity-and-Government-Event.cfm.

Aviv, the charitable deduction was less controversial among nonprofits and thus became a focus. Aviv also noted that historically charitable organizations had always tried to avoid taking a position on issues of tax rates and government spending, because charities did not want to get caught in that crossfire between Democrats and Republicans. As an example, she described some backlash when Independent Sector released a board statement on fiscal cliff deliberations.[6] The statement said, "Recognizing the serious economic conditions and fiscal challenges facing our country, Independent Sector advocates putting the nation on a sustainable fiscal path through a combination of reasonable spending reductions to both discretionary and mandatory programs, as well as revenue increases that maintain the progressivity of the tax code. […] We favor an approach based on equitable burden sharing, and we believe a plan that includes a modest tax increase on the two percent of Americans who can most afford it offers the best hope of moving forward in a fair and balanced way."

After this statement was published, Aviv received calls from Republicans accusing Independent Sector of taking the president's side. This was reported in the media with headlines such as "Independent Sector Backs Obama Fiscal Cliff Tax Plan"[7] and "Prominent Nonprofit Coalition Supports Obama's Tax Plan"[8] although the actual statement had avoided endorsing any party or specific plan. Instead, Independent Sector described a "balanced" and "bipartisan" solution, while reaffirming support for the charitable deduction, and advised compromise, borrowing language from major bipartisan deficit reduction packages of the past. Aviv suggested that this type of backlash was the reason why nonprofits were reluctant to take sides on political issues outside the charitable deduction.

Aviv then described the battle over the fiscal cliff deal. In the past, she had found much support from congressmen (Democrats and Republicans alike) for the charitable deduction. However, concern over the cliff pushed the charitable deduction down on the political agenda. Aviv also found that proposals to alter the charitable deduction seemed to gain support among Congress over time, which nonprofits believe was driven by budget pressure. Aviv observed a massive outpouring of support from nonprofits for the charitable deduction in response, a unique example of nonprofits of all stripes and political beliefs coming together. The end result was that the charitable deduction was taken off the table, but has not been removed from the White House's future plans, or separated from the fate of other itemized deductions.

Aviv described the current mindset of the nonprofit sector as a "holding position" where they were aware that the recent skirmish had been won, but did not believe that the war was over.

The second panel, "The Road Forward," discussed what lies ahead for the charitable deduction in an environment of continued budget pressure, as well as a look at proposed reforms to the charitable deduction and how these reforms may affect nonprofits, for better or for worse. The panel was moderated by Elizabeth Boris, Director of the Center on Nonprofits and Philanthropy at the Urban Institute.

Joseph Cordes, Associate Director of the School of Public Policy and Public Administration at George Washington University, raised two new issues concerning the charitable deduction: the composition of giving by

[6] "IS Board Statement on Fiscal Cliff Deliberations," Independent Sector, December 12, 2012. See http://www.independentsector.org/is_board_statement_on_fiscal_cliff_deliberations.

[7] See http://www.huffingtonpost.com/2012/12/12/independent-sector-obama-fiscal-cliff_n_2288991.html.

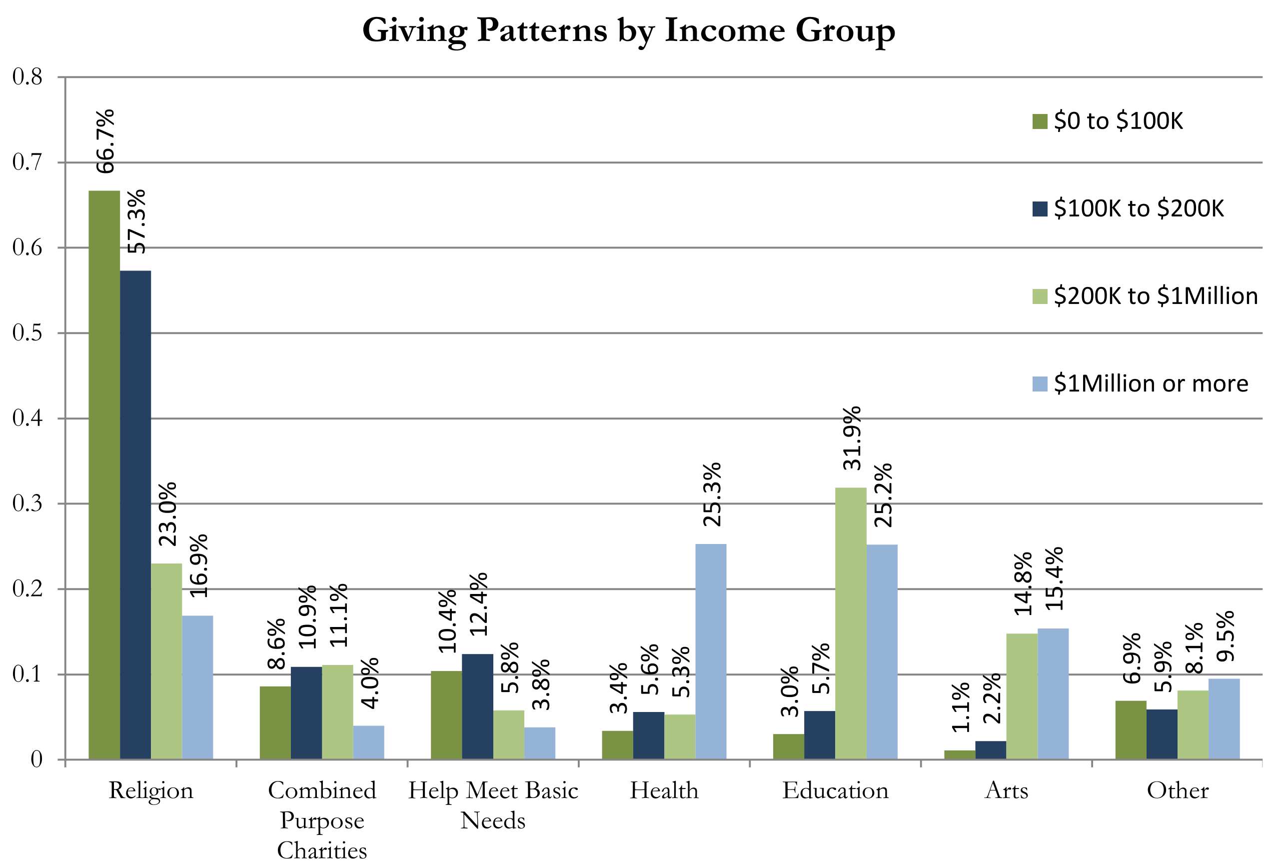
[8] See http://philanthropy.com/article/Prominent-Nonprofit-Coalition/136277/.

income groups, and the relative importance of individual contributions as a source of revenue for different types of nonprofit organizations. Cordes also believes these issues are important because different tax proposals affect different groups of taxpayers, and thus different categories of nonprofit organizations.

The proposal to impose a 28 percent cap on itemized deductions, increasing the after-tax cost of giving for donors in the top income bracket, while the incentives for other donors would be unchanged. The implication Cordes sees is that charities relatively favored by higher income givers (health, education, and arts) would experience proportionately larger declines in individual contributions. The Tax Policy Center ran an analysis of the effects of limiting itemized deductions to 28 percent, and found that the percent decline in individual giving for the top quintile (the only income group affected) would be 3.5–6.7 percent. The percent decline in individual giving for the top one percent was 7.7–14.7 percent, showing the bulk of the change would be at the very top.

Cordes argued that this is significant because, as the chart below shows, higher-income donors give more to health, education, and the arts. These sectors would then have more reason to be concerned about such proposals, since they are more dependent on the continued donations of the wealthy.

The second issue Cordes raised was the relative importance of contributions as a source of nonprofit revenue. He noted that those in favor of limits on the charitable deduction had argued that



Source: Joseph Cordes. 2013. "Effects of Limiting Charitable Deductions on Nonprofit Finances." Presentation for "The Charitable Deduction: A View from the Other Side of the Cliff," on February 28, 2013, at the Urban Institute.

contributions are "not a major source" of nonprofit sector finances. He then proceeded to test that statement, arguing that, for the sector as a whole, the ratio of total contributions to total revenue is on the order of 12 percent. However, he believes this statistic is somewhat deceptive, as for some nonprofits this number may be smaller, while for others it may be much greater. Cordes posited that aggregate statistics mask the wide range of variation in reliance on contributions within the sector. The total number, 12 percent, was decreased by the inclusion of nonprofit hospitals, which mostly rely on patients fees rather than donations. However, the average of individual ratios is on the order of 25 percent of total revenue, a more significant number. For hospitals, contributions average at 2 percent of revenue, while for higher education contributions average 14 percent of total revenue. For human services this increases to 21 percent, and for community improvement, 33 percent. Size also mattered; according to Cordes, smaller organizations were more dependent on contributions.

Cordes suggested that for many nonprofits, the impact of some proposals to limit itemized deductions was perhaps manageable, if painful, although nonprofits themselves might disagree. These proposals included: the 28 percent deduction cap, a deduction floor, and a cap on total itemized deductions (excluding the charitable deduction). However, the impact of other proposals would be more significant: such as a dollar amount cap on all itemized deductions (including charitable). But even in case where total effects on the sector would be modest, Cordes saw that the effect on individual nonprofit organizations would depend on role of contributions at the margin. As he discussed before, some nonprofits are much more reliant on charitable contributions than others.

Finally, Cordes mentioned the impact on nonprofits of reduction in revenue sources from

Relative Importance of Contributions by Size of Nonprofit

		Share of Total Contributions (%)	Contributions as a % of Total Revenue			Percentage Change in Revenue from a 10% Drop in Contributions		
Size (Total Revenue)	Number		Mean	Lower Quartile	Upper Quartile	Mean	Lower Quartile	Upper Quartile
< $25K	14,746	0.1	17.3	7.0	25.7	1.7	0.7	2.6
$25K to $100K	72,069	2.0	28.9	9.1	41.2	2.9	0.9	4.1
$100K to $500K	67,784	8.0	28.7	0.6	43.8	2.9	0.1	4.4
$500K to $1M	22,839	7.4	23.3	4.6	25.8	2.3	0.5	2.6
$1M to $10M	22,741	33.3	22.1	0.1	43.4	2.2	0.0	4.3
> $10M	7,466	49.1	4.5	0.7	14.0	0.4	0.7	1.4

Source: Joseph Cordes 2013. "Effects of Limiting Charitable Deductions on Nonprofit Finances." Presentation for "The Charitable Deduction: A View from the Other Side of the Cliff," on February 28, 2013, at the Urban Institute government grants and contracts. Although less mentioned in the political sphere, for some nonprofits this could make up a greater percent of total revenues than contributions.

Jane Gravelle, senior specialist in economic policy in the Government and Finance Division at the Congressional Research Service, discussed some of the practical issues surrounding the charitable deduction.

Gravelle argued that the extent to which the government subsidizes charitable contributions which would have occurred even without a tax incentive, represents a loss of efficiency, but there is no way to separate out these contributions using a tax deduction.

Gravelle noted that the question of whether a tax subsidy is the best way to support the nonprofit sector depends partly on price elasticity of giving. If the elasticity is less than one, she said, then the revenue lost to the government is greater than the charitable giving induced by the incentive. In this scenario, donors reduce giving without a charitable deduction, but by a lesser amount than the government gained in revenue. Thus, she believes, the government could presumably save money while eliminating the charitable deduction by directly giving money to charities to make up the difference in donations. However, Gravelle noted that regardless of any efficiency advantages, this was not feasible politically.

One argument favoring a charitable deduction to encourage private citizens to give (rather than government directly spending on charities) suggests that private giving has a different mix of recipients. Gravelle posited that this could be used as an argument in favor of or against private giving. Surprisingly moderate amounts of spending by nonprofit organization was spent on the poor, she found: about 25 percent to 30 percent for all organizations; and 22 percent to 26 percent for those with $1 million or over. By this rationale, if the goal of the government through encouraging charitable giving was to help the poor, then Gravelle thought it would be more efficient for the government to directly give to nonprofits focused on human needs.

Furthermore, Gravelle noted that data about the price elasticity of charitable giving was still in doubt. The tax reform act of 1986 showed a brief transitory effect on charitable giving, but no permanent effect, after a large rate reduction that reduced the value of the charitable deduction. Cross section and panel econometric estimates of elasticity of giving have been mixed. Finally, she thought that although not used as sources for economic estimates of elasticity, surveys and field experiments show small or even negligible effects of tax incentives on decisions to donate to charity.

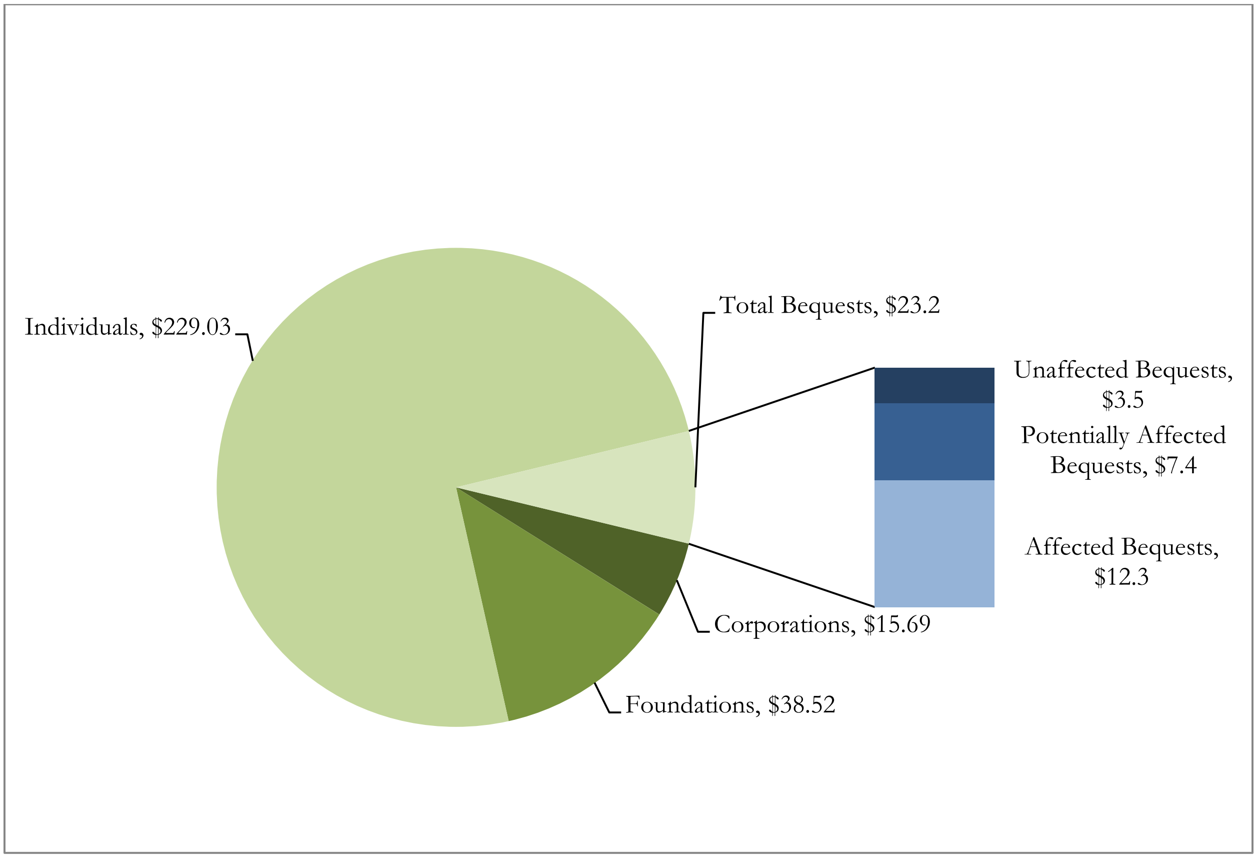
Gravelle concluded that the evidence pointed to a low enough elasticity of giving that there was some inefficiency in the charitable tax subsidy as a mechanism to encourage charitable donations. (She noted that Bakija's estimates were newer, and older estimates of price elasticity tended to be lower.)

Gravelle highlighted that the estate tax has a greater elasticity for charitable giving than the income tax deduction. A report Gravelle coauthored with Donald Marples for the Congressional Research Service[9] found that charitable bequests had an elasticity ranging between 1.2 and 3.0. Using a middle-range elasticity of 2.2, Gravelle's report found that repealing the estate tax would lead to a reduction of over 7.2 percent in total charitable contributions. The effects were stronger for charities receiving more donations from high-income taxpayers.

Next, Gravelle raised the issue of enforcement and regulation of the charitable sector. She noted that donations to donor-advised funds and endowments presented an efficiency problem if these donations received a deduction without actually being spent on charitable causes. She observed that options to address this have included requiring payout rates or

[9] "Charitable Contributions: The Itemized Deduction Cap and Other FY 2011 Budget Options" by Jane G. Gravelle and Donald J. Marples, Congressional Research Service, March 18, 2010. http://phildev.iupui.edu/Research/docs/CRS2010.pdf

Share of Total Charitable Giving Affected by Changes in the Estate Tax Rate, 2007 (in $ billions)



Source: Center on Philanthropy, Giving USA 2008, and IRS and CRS calculations. From "Charitable Contributions: The Itemized Deduction Cap and Other FY 2011 Budget Options" by Jane G. Gravelle and Donald J. Marples, Congressional Research Service, March 18, 2010.

disallowing deductions until funds donated were spent.

In a testimony before the Senate Finance Committee, Gravelle stated, "Endowment assets for 765 institutions summed to $340 billion in the fiscal year ended in June 2006, with earnings of 15.3 percent, amounting to income of $52 billion. The foregone revenue from not taxing these returns probably exceeds the revenue loss from all income tax deductions for charitable contributions to higher education."[10] In addition, Gravelle noted her findings that endowments heavily concentrated in the wealthiest institutions, with the top five institutions accounting for a quarter of all endowment value. For institutions with endowments over $1 billion, the return on endowments for these institutions was 15.2 percent in 2006, while the payout rate was only 4.6 percent, although this is only one year of data. . Gravelle suggested that there remain disputes over whether these endowments should be spent and the value of the tax preference given them.

[10] "Tax Issues and University Endowments" by Jane G. Gravelle, Memorandum to the Senate Committee on Finance, August 20, 2007. See http://www.grassley.senate.gov/releases/2008/01142008.pdf.

As an area with potential for increased enforcement, Gravelle highlighted involved gifts of appreciated property. These donations, she noted, get a double dip, as they are excluded from capital gains tax but are deductible at fair market value, which gives taxpayers an incentive to overvalue. This incentive, she believes, would remain in a more limited form if the capital gains tax was imposed on these donations. It would be eliminated for appreciated assets if only the basis was deductible. She also suggested that cash donations rather than other forms of donations could be more strongly encouraged, given enforcement problems. One unusual method she suggested, designed to lead to honest assessments of noncash property, was the baseball arbitration method: the taxpayer offers an assessment, the IRS offers an assessment, and then the judge can only chose one of them.

Gravelle also noted ongoing concerns about limited charity care by nonprofit hospitals. This was addressed partly by health reform, she said, but continues to be monitored. Finally, Gravelle brought a new question on the table: the charitable deduction for corporations. This has not yet been discussed in the political sphere, but she observed some proposals to eliminate all corporate tax expenditures that would permit a lower rate.

Gravelle echoed the conclusion of other economists at the session, stating that dollar caps are the worst tax reform option for nonprofits, eliminating marginal incentives to charitable giving for high income taxpayers. As caps tend to create inframarginal benefits, she explained that these are only desirable if you want to discourage the activity in question, and it is clear that discouraging charitable activity is not a political goal. If a limit on the charitable deduction is desired, she suggests a floor as a superior option because it reduces the revenue cost without having as much an effect on giving. She believes that floors simplify tax returns and thus reduce cheating. Gravelle suggested the possibility of imposing a floor on the charitable deduction and balancing this out for nonprofits by raising the income limits such as the limitation on deducting contributions greater than 50 percent of AGI.

Brian Flahaven, director of legislative, foundation, and recognition programs for the Council for Advancement and Support of Education (CASE), spoke next on the viewpoint of the education sector. He explained that charitable gifts have become more important to education institutions over time: colleges and universities raised $31 billion in donations in 2012.[11] These donations, he said, help aid to low-income students. He also noted that only a small segment of schools have large endowments—for many private schools, endowments contribute up to a quarter to annual operating budget.

Flahaven concurred with previous speakers that high-income donors give more to education,[12] but noted that this is not "surprising or shocking," since high-income donors have the resources to give more. CASE's position, according to Flahaven, is strongly in support of preserving the charitable deduction, with concerns about proposals to cap the deduction.

Flahaven argued that the wealthy should not be all placed in one group—a cap on the charitable deduction would specifically effect the generous wealthy while not affecting anyone who did not contribute to charity. He noted that limiting deductible donations to 50 percent of AGI already affected the generous. Flahaven argued that the burden of caps was borne by those served by charities, not the wealthy taxpayers.

Furthermore, Flahaven argued that the wealthiest Americans were not necessarily the same as those

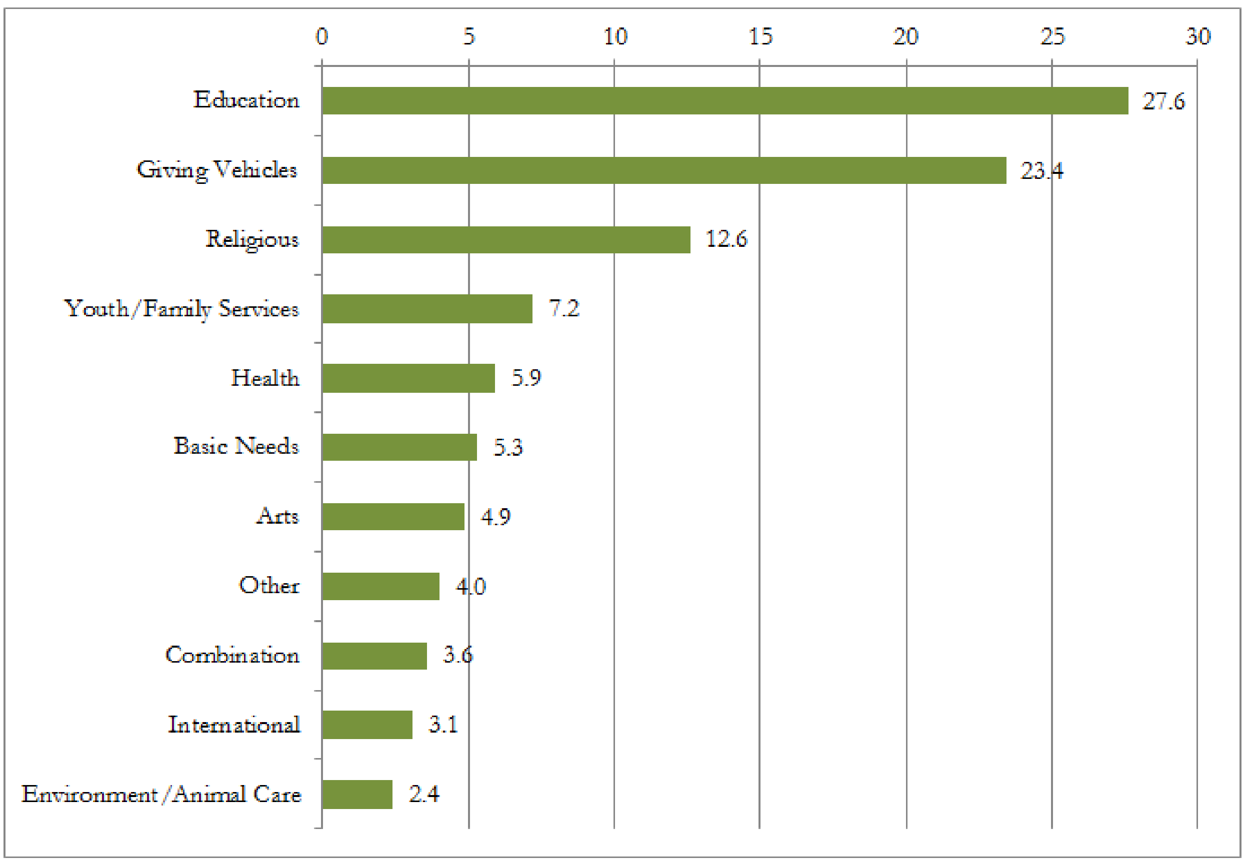
[11] See http://www.cae.org/content/pdf/VSE_2012_Press_Release.pdf.
[12] See http://blog.governmentwedeserve.org/2013/01/17/charitable-giving-and-higher-education/.

who paid the top marginal tax rate (given people who received more investment income or who received a large chunk of income for only one year). He also suggested that it would be better to focus policy on giving and the nonprofit sector rather than on the taxpayers, and to increase incentives for low and middle income donors rather than cutting back on incentives for the wealthy.

In terms of endowments for institutions of higher education, Flahaven argued that flexibility on endowment payouts was needed because of volatility in the financial market. Endowments are meant to be perpetual due to the nature of the investments. College and university endowments are still suffering from the volatility in the stock market. The 2012 National Association of College and University Business Officers-Commonfund survey found that college endowments on average declined 0.3 percent in fiscal year 2012.[13]

Finally, Flahaven noted that institutions are already held accountable for their endowment payouts by stakeholders such as donors, boards, students, and faculty, all of whom have more

Distribution of High Net Worth Giving in 2011



Source: 2012 Bank of America Study of High Net Worth Philanthropy.
Note: High net worth includes households with incomes greater than $200,000 and/or net worth more than $1,000,000 excluding the monetary value of their home. "Giving Vehicles" include gifts to private foundations, charitable trusts, and donor-advised funds.

[13] See http://www.nacubo.org/Research/NACUBO-Commonfund_Study_of_Endowments.html.

pressing reasons than government to monitor endowments and push for higher payout rates. Universities raised $31 billion in donations in 2012.[14] These donations, he said, help aid to low-income students. He also noted that only a small segment of schools have large endowments—for many private schools, endowments contribute up to a quarter to annual operating budget.

Tim Delaney, President and CEO of the National Council of Nonprofits, concluded the session. He broadened the scope of the government/nonprofit relationship by looking a government grants and contracts. Citing a report from the Urban Institute, Delaney noted that when governments turn to nonprofits to supply vital social services through government contracts and grants, these often require nonprofit organizations explicitly share program costs and to match government support through donations and other funding.[15] He explained that more than half of human service organizations in the study reported at least one contract or grant with such a requirement. Of these, 60 percent had to match, on average, a quarter or more of their contracts and grants, and 27 percent had to match, on average, 50 percent or more. In addition, 84 percent of youth development nonprofits, 73 percent of housing and shelter organizations, and 71 percent of community and economic development groups had to match, on average, a quarter or more of their contracts and grants. Finally, three out of four of the smallest groups (those with expenses between $100,000 and $249,999) had to match, on average, 25 percent or more of their contracts and grants. Delaney used these statistics to back the claim that nonprofits subsidize government.

In addition, Delaney explained, in Urban Institute's study, 41 percent of nonprofits reported that government agencies made late payments (beyond contract specifications) in 2009, and 53 percent of nonprofits indicated that late payments from government were a problem for their organization in general. Delaney argued that the tax subsidy for charitable donations should be balanced against the money currently owed to nonprofits by federal and state governments. Also, the benefit of charitable activity to government should be taken into account.

Furthermore, Delaney emphasized that due to the recession, community needs continue to be great. Delaney reported that 2011, 85 percent of nonprofits experienced an increase in demand for their services.[16] Like other speakers from the sector, he shifted the conversation from taxpayers as beneficiaries of the charitable deduction to nonprofit organizations as beneficiaries of the charitable deduction. In addition, he made the argument that nonprofits can meet social needs more efficiently and effectively than the government.

Finally, Delaney turned the discussion to the state and local level. Although thus far no limits on the charitable deduction have passed beyond the proposal stage for the federal government, certain state governments have taken more direct action. In 2011, Hawaii imposed a $25,000 cap on itemized deductions for individuals with AGI above $100,000, and a $50,000 cap for couples with incomes above $200,000.[17] Currently the office of the governor of Hawaii supports a bill which would exclude the charitable deduction

[14]See http://www.cae.org/content/pdf/VSE_2012_Press_Release.pdf.

[15] "Human Service Nonprofits and Government Collaboration: Findings from the 2010 National Survey of Nonprofit Government Contracting and Grants" by Elizabeth T. Boris, Erwin de Leon, Katie L. Roeger, Milena Nikolova. Washington, DC: The Urban Institute, 2010. See http://www.urban.org/publications/412228.html.

[16] See http://nonprofitfinancefund.org/state-of-the-sector-surveys.

[17] See http://www.forbes.com/sites/janetnovack/2011/07/09/hawaii-adopts-obama-style-tax-hike-on-rich/.

from the cap.[18] In Michigan, charitable tax credits were eliminated in 2012.[19] In addition, many states ask nonprofit organizations for Payments in Lieu of Taxes (PILOTs) in place of the nonprofit exemption from property taxes,[20] or work around the exemption in other ways, such as through service fees like the Minneapolis "streetlight fee."[21] Delaney expressed fears that such changes could have a ripple effect among states.

Delaney suggested that the government should adopt an attitude toward nonprofits of "first, do no harm." Delaney noted that the nonprofit sector was concerned about budget deals designed solely to raise revenue with little concern for other effects. He was also uncomfortable with allowing the government to treat different nonprofits differently, given the dangers of allowing the government to control the definition of charity. He supported the idea of making permanent various tax extenders for charitable giving.

But like earlier speakers, Delaney reiterated the idea that the nonprofit sector is concerned about changes to the charitable deduction, even those that might seem beneficial, if it set the precedent for greater, detrimental changes.

The moderator, Elizabeth Boris, concluded the session by describing the struggle of nonprofits and government alike in an "era of desperation," and challenging the audience to continue to work towards solutions.

[18] See http://www.capitol.hawaii.gov/session2013/testimony/HB430_Testimony_FIN_02-13-13_Late.pdf.
[19] See http://www.mlive.com/business/west-michigan/index.ssf/2011/07/state_charitable_tax_credits_e.html.
[20] "The Charitable Property-Tax Exemption and PILOTs," by Evelyn Brody, Mayra Marquez, and Katherine Toran. Washington, DC: The Urban Institute, 2012. See http://www.urban.org/publications/412640.html.
[21] See http://www.minnpost.com/politics-policy/2009/10/nonprofits-object-minneapolis-streetlight-fees-feeling-death-thousand-cuts.

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Acknowledgments

Special thanks go to the presenters who undertook the extensive work summarized here: Diana Aviv, Jon Bakija, Elizabeth Boris, Rick Cohen, Joseph Cordes, Tim Delaney, Brian Flahaven, Jane Gravelle, Joseph Rosenberg, and Eugene Steuerle.

This brief is based on research funded in part by the Bill and Melinda Gates Foundation, the Charles Stewart Mott Foundation, the Wasie Foundation, the Rasmuson Foundation, and other donors through June 2014. The findings and conclusions contained within are those of the authors and do not necessarily reflect positions or policies of either foundation.

This publication is part of the Urban Institute's Tax Policy and Charities project. The purpose of this project is to analyze the many interactions between the tax system and the charitable sector, with special emphasis on the ongoing fiscal debates at both the federal and state levels. For further information and related publications, see our web site at http://www.urban.org/taxandcharities/index.cfm.

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