



## ISSUE PAPER

# Maintain Current Law on Charitable Deduction Rates

**Position:** The Council strongly supports maintaining current law permitting full deductibility of itemized charitable deductions.

Members of Congress who have expressed concerns regarding the administration's proposal include:

### U.S. House of Representatives

Bachmann, Michelle (R-MN6)  
Blunt, Roy (R-MO7)  
Boehner, John (R-OH8)  
Camp, Dave (R-MI4)  
Cantor, Eric (R-VA7)  
Foxx, Virginia (R-NC5)  
Hoyer, Steny (D-MD5)  
McCotter, Thaddeus (R-MI11)  
Mitchell, Harry E. (D-AZ5)  
Rangel, Charles (D-NY15)

### U.S. Senate

Baucus, Max (D-MT)  
Conrad, Kent (D-ND)  
Durbin, Richard (D-IL)  
Ensign, John (R-NV)  
Grassley, Charles (R-IA)  
Menendez, Robert (D-NJ)  
Nelson, Ben (D-NE)  
Schumer, Charles (D-NY)

### Revenue Estimate

28% deduction cap proposal would raise \$269.2 billion (Joint Tax Committee estimate)

35% deduction cap proposal would raise \$90 billion

**Please Note:** This is the Council's issue paper from the 111<sup>th</sup> Congress. The paper has not been updated to reflect activity in the 112<sup>th</sup> Congress as the issue has not changed and the Council's position remains the same.

### Background

Current Law: Charitable contributions are not included as taxable income if taxpayers choose to itemize their deductions. As a consequence, taxpayers generally are not subject to federal income taxes on charitable deductions

### Proposals

President Obama's fiscal 2010 budget included a proposal that would repeal current law, which allows all taxpayers who itemize to deduct charitable contributions from their taxable income. As a result, many contributions currently not included in taxable income would be subject to federal income taxes. Specifically, the administration has proposed disallowing any charitable deduction to the extent such a deduction reduces the income tax liability of the donor by more than 28 percent of the donation. Individuals subject to the two highest tax rates—currently 33 percent and 35 percent, and scheduled to increase to 36 percent and 39.6 percent in 2011—would see the tax benefit of their charitable deductions reduced significantly. The administration's proposed change was presented as a means to raise revenue to help fund health care reform. A more recent legislative proposal offered by Senate Finance Committee member Jay Rockefeller (D-WV), also presented as a means to pay for health care reform, would cap the value of itemized deductions at 35 percent. Neither proposal is yet part of the versions of health care reform legislation reported by the House and Senate committees of jurisdiction.

### Rationale for Opposition to Proposals to Cap Charitable Deductions

Threat to Charitable Giving: The Council on Foundations is concerned that proposals to cap charitable deductions would adversely affect charitable giving. A reduction in the charitable deduction rate would reduce the current incentive for donors to give, likely reducing the amount of money available to support worthy nonprofits across the country. Recent estimates indicate that if the 28 percent cap had been in effect in 2006, between \$4 and \$9 billion in charitable donations would not have occurred. Further, a 2006 study by the Center on Philanthropy at the University of Indiana found that grantmaking foundations were particularly reliant on taxpayers whose donations would be affected by a cap on deductions. The Center reported that, in the period studied, 79.4 percent of gifts to foundations came from households with income above \$200,000 (that is, \$21.8 billion out of \$27.46 billion). Given the current economic downturn and the increased reliance of many on the sector for basic social services, now is not the time to discourage charitable giving.

Tax Policy - Decoupling: For nearly 100 years, the value of the charitable deduction has been tied to an individual's tax rate, ensuring that taxpayers do not pay tax on income that they contribute to charity. By decoupling the deduction rate from the tax rate, the proposals establish a precedent of taxing individuals on income that they redirect to charity. While the current gap between the two rates is fairly narrow, the risk is that, once decoupled, future adjustments to tax rates or the cap could widen the gap and further erode the value of the charitable deduction.

**March 2010 (Over)**

## Rationale for Opposition to Proposals to Cap Charitable Deductions (continued)

Charitable Sector as Revenue Stream: The purpose of the proposals is to raise revenue to pay for broad health care reform. While there is little doubt that health care reform is a critical issue, similar arguments can be made for education reform, climate change, energy policy, and other broad policy initiatives. Changing the formula for calculating the value of the charitable deduction as a “pay for” for new federal programs establishes a troubling precedent.

## Rationale for Support of Proposals to Cap Charitable Deductions

Limited Impact on Giving: A 2008 study of high net worth individuals conducted by Bank of America suggests that the charitable giving by households with income greater than \$200,000, or net worth greater than \$1 million, is not highly sensitive to changes in the tax rate. Because such giving represents between 65 - 75 percent of individual giving, a significant reduction in giving is unlikely.

Response: Though charitable giving would continue even if a cap on deductions was imposed, every independent study, most notably by the University of Indiana, has estimated that a cap would result in a loss of billions to the philanthropic sector and the communities it serves.

Value to the Nonprofit Sector: The nonprofit sector is responsible for funding and running thousands of programs that expand and improve health care coverage for millions of people. Some believe health care reform at the national level will take many of these programs to scale. Others believe that gains from improved coverage and care will alleviate some of the sector’s current employee benefit costs.

Response: Philanthropy works best when providing financial support in innovative ways directly to the needs it identifies, not indirectly through payment of taxes. It is meant to meet the needs of the communities it serves through grantmaking, which would be reduced if a cap on deductions was imposed.

Tax Policy - Equity: Individuals at lower income levels receive less of a tax benefit for the same amount given to charity than high-income taxpayers. Thus, a middle-class taxpayer with a marginal tax rate of 24 percent who gives \$100 to charity receives a tax benefit of \$24. A wealthy taxpayer subject to a marginal rate of 35 percent would receive a tax benefit of \$35 (or \$11 more for the exact same gift).

Response: Each taxpayer receives the same benefit from charitable deductions—itemized deductions are not included in taxable income. The fact that some taxpayers pay taxes at a higher rate is a burden, not a benefit, even if there is a corresponding effect on their tax liabilities if taxable income is reduced. Also, higher income taxpayers already are subject to phased out reductions in the value of their itemized deductions. However, because those phase-outs do not generally reduce the value of marginal dollars donated to charities, they have less effect on donations than a cap would have.

Cost Savings: As employers of one out of every ten Americans, the nonprofit sector has a vested interest in reducing the cost of health care and improving the quality and scope of coverage. Any potential losses from decreased charitable giving may be more than offset by real and immediate cost savings for the benefits nonprofits provide to their employees.

Response: If the nonprofit sector achieves cost savings, those savings are best directed to the communities they serve through philanthropic programs. Those savings should not be redirected to the government by penalizing donors.

## Status of Legislation

None of the health care reform bills that have been approved by the House and Senate committees of jurisdiction include the President’s proposal to cap the charitable deductions rate at 28 percent or any other caps on itemized deductions. However, in light of massive budget deficits, and given the need for massive revenues to fund not only health care reform but other policy initiatives, the Council and its members need to remain vigilant on this issue.

**Requested Action:** Please support philanthropy by urging Congress to protect the full value of the charitable deduction and not cap it at a reduced rate. The decoupling of this rate could have significant consequences in this economic downturn, and in future years.