

**DESCRIPTION AND ANALYSIS OF PRESENT LAW
AND PROPOSALS TO EXPAND
FEDERAL TAX INCENTIVES FOR CHARITABLE GIVING**

Scheduled for a Hearing
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Prepared by
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INTRODUCTION

The Senate Committee on Finance has scheduled a hearing on issues relating to charitable giving for March 14, 2001.

This document,¹ prepared by the staff of the Joint Committee on Taxation, contains an overview of the present-law rules relating to the Federal tax treatment of charitable contributions, descriptions of various proposals to increase the Federal tax incentives for charitable contributions, and an analysis of the issues relating to Federal tax incentives for charitable giving.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description and Analysis of Present Law and Proposals to Expand the Federal Tax Incentives for Charitable Giving* (JCX-13-01), March 13, 2001.

I. OVERVIEW OF PRESENT-LAW RULES RELATING TO THE TAX TREATMENT OF CHARITABLE CONTRIBUTIONS TO TAX-EXEMPT ORGANIZATIONS

A. Overview of Tax-Exempt Organizations

The nonprofit sector in the United States includes a wide variety of organizations, both charitable and non-charitable, that are recognized as exempt from tax under section 501(a) of the Internal Revenue Code (the “Code”). At present, 25 different types of nonprofit organizations qualify for tax-exempt status. These include certain title and real property holding companies (sec. 501(c)(2)), social welfare organizations (sec. 501(c)(4)), labor, agricultural or horticultural organizations (sec. 501(c)(5)), trade associations (sec. 501(c)(6)), social clubs (sec. 501(c)(7)), cemetery companies (sec. 501(c)(13)), and credit unions (sec. 501(c)(14)).² Only organizations described in section 501(c)(3) of the Code are considered “charitable.”

Tax-exempt organizations described in section 501(c)(3)--generally referred to as charities -- must meet requirements that other section 501(c) organizations do not face. Charities must be organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster international amateur sports competition, or for the prevention of cruelty to children or animals. No part of the net earnings of a charity may inure to the benefit of any private shareholder or individual. In addition, no substantial part of the activities of a charity may consist of carrying on propaganda, or otherwise attempting to influence legislation, and such organization may not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

In exchange for meeting the more stringent requirements under section 501(c)(3), charities are entitled to certain Federal tax (and other) benefits not available to other tax-exempt entities. Within certain limitations, donors to charities are entitled to deduct their contributions for Federal income tax purposes (if they itemize their deductions) and for Federal estate and gift tax purposes. Charities also may use the proceeds of tax-exempt financing (discussed in more detail below) and are granted preferential postal rates. In contrast, contributions to other nongovernmental, tax-exempt organizations generally are not deductible and such organizations are eligible only for the exemption from Federal income tax. Charities and certain other tax-exempt organizations may also qualify for exemption from State and local taxes.

Charities are further classified as either “public charities” or “private foundations.”³ Private foundations are defined under section 509(a) as all organizations described in section 501(c)(3) other than an organization granted public charity status by reason of (1) being a specified type of organization (i.e., churches, educational institutions, hospitals and certain other medical organizations, certain organizations providing assistance to colleges and universities, or

² In addition, other Code sections provide general tax-exempt status for other entities, such as political organizations (sec. 527), qualified pension plans (secs. 401(a) and 501(a)), and certain cooperatives (sec. 521).

³ Sec. 509(a).

a governmental unit); (2) receiving a substantial part of its support from governmental units or direct or indirect contributions from the general public; or (3) providing support to another section 501(c)(3) entity that is not a private foundation. In contrast to public charities, private foundations generally are funded from one or a limited number of sources (an individual, family, or corporation) and are subject to a number of restrictions not applicable to public charities.⁴ In general, more generous charitable contribution deduction rules apply to gifts made to public charities than the rules that apply to gifts made to private foundations.

Donors making contributions to other tax-exempt entities described in section 501(c) (i.e., non-charities) generally are not entitled to a deduction under section 170 for the contribution for Federal income, estate, or gift tax purposes, with the exception of certain gifts made to a veterans' organization or a domestic fraternal society.⁵ Contributions to certain nonprofit cemetery companies are deductible for Federal income tax purposes, but generally are not deductible for Federal estate or gift tax purposes.⁶

Tax-exempt organizations generally are not subject to Federal income tax on dues and contributions the organization receives from its members, nor on income from activities that are substantially related to the purpose of the organization's tax exemption. Tax-exempt organizations generally are not subject to Federal income tax on investment income, although this general rule does not apply to certain organizations (e.g., social clubs described in sec. 501(c)(7), voluntary employees' beneficiary associations described in sec. 501(c)(9), and political organizations described in sec. 527). If a tax-exempt organization engages in business activities unrelated to its exempt purpose, the organization may be subject to unrelated business income tax ("UBIT").⁷

B. Federal Tax Treatment of Contributions to Charities

1. In general

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and the fair market value of property contributed to a charity described in section 501(c)(3) or a Federal, State, or local governmental entity.^{8 9} The amount of

⁴ Secs. 4940-4945.

⁵ Secs. 170(c)(3), 170(c)(4), 2055(a)(3), 2055(a)(4), 2106(a)(2)(A)(iii), 2522(a)(3), and 2522(a)(4).

⁶ Sec. 170(c)(5).

⁷ Secs. 511-514.

⁸ Sec. 170(a). The Economic Recovery Tax Act of 1981 adopted a temporary provision that permitted individual taxpayers who did not itemize income tax deductions to claim a deduction from gross income for a specified percentage of their charitable contributions. The maximum deduction was \$25 for 1982 and 1983, \$75 for 1984, \$150 for 1985, and \$300 for 1986. The nonitemizer deduction terminated after 1986.

the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.¹⁰

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property.¹¹

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of \$250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.¹² In addition, present law requires that any charity that receives a contribution exceeding \$75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services is deductible as a charitable contribution.¹³

2. Contribution limits

Individual taxpayers

Under present law, total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income ("AGI") for a taxable year (disregarding any net operating loss carryback).¹⁴ To

⁹ The deduction is also allowed for purposes of calculating alternative minimum taxable income.

¹⁰ Secs. 170(b) and (e).

¹¹ Sec. 170(e)(1)(B).

¹² Sec. 170(f)(8).

¹³ Sec. 6115.

¹⁴ Sec. 170(b)(1)(A).

the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to private foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.¹⁵

Contributions by individuals in excess of the 50-percent limit may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with AGI in excess of a threshold amount, which is indexed annually for inflation.¹⁶ The threshold amount for 2001 is \$132,950 (\$66,475 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by 3 percent of AGI over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. The effect of this reduction is to limit partially a taxpayer's charitable contributions deduction.

Corporate taxpayers

Under present law, a corporation is allowed to deduct charitable contributions up to 10 percent of the corporation's modified taxable income for the year.¹⁷ For this purpose, taxable income is determined without regard to (1) the charitable contributions deduction, (2) any net operating loss carryback, (3) deductions for dividends received, (4) deductions for dividends paid on certain preferred stock of public utilities, and (5) any capital loss carryback for the taxable year.¹⁸ Any charitable contribution by a corporation that is not currently deductible because of the percentage limitation may be carried over for up to five taxable years.

A transfer of property by a business to a charity might qualify as either a charitable contribution or a deductible business expense, but not both. No deduction is allowed as a business expense under section 162 for any contribution that would be deductible as a charitable gift were it not for the percentage limitations on the charitable contributions deduction.¹⁹ Likewise, a business transfer made with a reasonable expectation of financial return

¹⁵ Sec. 170(b)(1)(B), (C), and (D).

¹⁶ Sec. 68.

¹⁷ The cap on corporate charitable contributions was increased from 5 percent to 10 percent in the Economic Recovery Tax Act of 1981.

¹⁸ Sec. 170(b)(2).

¹⁹ Sec. 162(b).

commensurate with the amount of the transfer is not deductible as a charitable contribution, but may be deductible under section 162.

3. Contributions of food inventory

Under present law, a taxpayer's deduction for charitable contributions of food inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory. However, certain corporations may claim a deduction in excess of basis for certain charitable contributions.²⁰ This augmented deduction is equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., fair market value minus basis) or (2) two times basis. To be eligible for an enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of ongoing disputes between taxpayers and the IRS. In one case, the Tax Court held that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted.²¹

4. Charitable contributions from Individual Retirement Arrangements ("IRAs")

Under present law, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Individuals may also make nondeductible contributions to a Roth IRA. Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59-1/2 are subject to an additional 10-percent early withdrawal tax, unless an exception applies.

If an amount withdrawn from a traditional IRA or a Roth IRA is donated to a charitable organization, the rules relating to the tax treatment of withdrawals from IRAs apply and the charitable contribution is subject to the normally applicable limitations on such contributions.

²⁰ Sec. 170(e).

²¹ *Lucky Stores Inc. v. Commissioner*, 105 T.C. 420 (1995).

II. DESCRIPTION OF PROPOSALS TO EXPAND THE FEDERAL TAX BENEFITS FOR CHARITABLE GIVING

A. President Bush's Proposals

President Bush's budget proposal includes three recommendations relating to the tax treatment of charitable contributions.²² A detailed description of the President's recommendations has not yet been released. However, the President's budget proposal includes the following three recommendations relating to the Federal tax treatment of charitable contributions:

- (1) Expand the Federal charitable deduction to the 70 percent of taxpayers who do not itemize deductions;
- (2) Permit charitable contributions from IRAs without penalty.
- (3) Raise the cap on corporate charitable contributions; and

B. S. 35, the Tax Cut With a Purpose Act of 2001 (Sen. Gramm and others)

In general

Title VI of S. 35 contains proposals similar to the three proposals in the President's budget. S. 35 would (1) permit a deduction for a portion of charitable contributions for individuals who do not itemize deductions, (2) permit tax-free distributions from IRAs for charitable purposes, and (3) raise the percentage limitation on corporate charitable contributions.

Charitable deduction for nonitemizers

Section 601 of S. 35 would phase in a deduction for charitable contributions for individuals who do not itemize their deductions. The amount of the deduction would be subtracted from AGI in the same manner as the standard deduction and the deduction for personal exemptions under present law.

Under the bill, the charitable contribution deduction for nonitemizers could not exceed the amount of the standard deduction for the taxable year and would be subject to the otherwise applicable percentage limitations on charitable contributions under section 170. Thus, the deduction would be available for contributions of cash and property, subject to the present-law rules. As with the present-law charitable contribution deduction, the deduction would be allowed in computing alternative minimum taxable income.

Effective date.--The deduction would apply for taxable years beginning after December 31, 2001, and would be phased in over a five-year period. Thus, in 2002, an individual taxpayer

²² *A Blueprint for New Beginnings, A Responsible Budget for America's Priorities*, U.S. Government Printing Office (February 2001).

could claim 20 percent of the deduction that would otherwise be allowable; in 2003, 40 percent; in 2004, 60 percent; in 2005, 80 percent; and in 2006 and thereafter, 100 percent.

The following example illustrates the operation of the phase in of the deduction. In 2002, a single taxpayer with AGI for the taxable year of \$10,000 contributes \$6,000 of cash to a public charity. The taxpayer does not itemize deductions. For 2002, the taxpayer's charitable contribution deduction is 20 percent of the amount otherwise allowed under section 170 (up to the standard deduction). Under section 170, the taxpayer's charitable contribution deduction is limited to 50 percent of the taxpayer's contribution base (i.e., AGI). Thus, the deduction allowed for the taxable year under section 170 would be \$5,000 (50 percent of \$10,000). The projected standard deduction for 2002 is \$4,650. Under the bill, the taxpayer's charitable contribution deduction for 2002 would be \$930 (20 percent of \$4,650). Under section 170, the taxpayer would be entitled to carry over to the following five taxable years the portion of the charitable contribution that exceeds the taxpayer's contribution base. Thus, the taxpayer would be entitled to carry over \$1,000 to the following five taxable years.

IRA distributions for charitable purposes

Under section 602 of S. 35, an exclusion from gross income would be provided for otherwise taxable withdrawals from a traditional or Roth IRA that are "qualified charitable distributions." A qualified charitable distribution would include any distribution from an IRA made on or after the date the IRA owner attains age 59-1/2 and made directly from the IRA to an organization to which a deductible charitable contribution may be made.

The amount of the charitable deduction to which an individual is entitled during a taxable year is reduced (but not below zero) by the qualified charitable distributions from an IRA during the year.

Effective date.--The proposal would be effective for taxable years beginning after December 31, 2001.

Corporate charitable contributions

Section 603 of S. 35 would increase the percentage limitation on the deduction for corporate charitable contributions from 10 to 15 percent.

Effective date.--The proposal would be effective for taxable years beginning after December 31, 2001.

C. S. 37, the Good Samaritan Hunger Relief Tax Incentive Act (Sen. Lugar and others)

S. 37 would amend the present-law charitable deduction contribution rules of section 170 to (1) expand the class of taxpayers eligible to claim an augmented deduction for charitable contributions of food inventory, and (2) modify and clarify the determination of fair market value for such contributions.

Under the bill, any taxpayer, rather than only a C corporation, engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory under

section 170(e). In addition, the bill would provide that the fair market value of donated food that cannot or will not be sold solely due to internal standards of the taxpayer, lack of market, or similar circumstances, would be determined without regard to such factors and, if applicable, by taking into account the price at which the same or similar food items are sold by the taxpayer at the time of the contribution or in the recent past.

Effective date.--The bill would be effective for taxable years beginning after December 31, 2001.

D. S. 205 (Sen. Hutchison and others)

The proposal would provide an exclusion from gross income for otherwise taxable IRA withdrawals from a traditional or a Roth IRA for qualified charitable distributions made (1) to a charitable organization to which deductible contributions can be made; (2) to a charitable remainder annuity trust or charitable remainder unitrust; (3) to a pooled income fund (as defined in sec. 642(c)(5)); or (4) for the issuance of a charitable gift annuity. The exclusion would apply with respect to distributions described in (2), (3), or (4) only if no person holds an income interest in the trust, fund, or annuity attributable to such distributions other than the IRA owner, his or her spouse, or a charitable organization.

In determining the amount includible in gross income by reason of a payment from a charitable remainder annuity trust or charitable remainder unitrust to which a qualified charitable distribution from an IRA was made, the taxpayer would be required to treat as ordinary income (as described in sec. 664(b)(1)) the portion of the distribution from the IRA to the trust which would have been includible in income but for the proposal. Similarly, in determining the amount includible in gross income by reason of a payment from a charitable gift annuity purchased with a qualified charitable distribution from an IRA, the taxpayer would not be permitted to treat the portion of the distribution from the IRA used to purchase the annuity as an investment in the annuity contract.

A qualified charitable distribution would be treated as any distribution from an IRA which is made on or after the date the IRA owner attains age 59-1/2, and which is made directly to the charitable organization or to a charitable remainder annuity trust, charitable remainder unitrust, or charitable gift annuity (as described above).

The amount otherwise allowable as a deduction to the individual for the year as charitable contributions would be reduced by the amount of qualified charitable distributions.

Effective date.--The bill would be effective for taxable years beginning after the date of enactment.

E. S. 298, the Giving Incentives for Taxpayers Act (Sen. McConnell and others)

S. 298 would provide a charitable contribution deduction for individual taxpayers who do not itemize deductions. Under the bill, up to \$500 of charitable contributions (\$1,000 in the case of a married couple filing a joint return) that would otherwise be deductible contributions under section 170 could be deducted from AGI, in the same manner as the standard deduction and the deduction for personal exemptions under present law.

In addition, the bill would provide that, for purposes of the charitable contributions deduction under section 170, a taxpayer would be deemed to have made a charitable contribution on the last day of the taxable year if the contribution is paid on account of such taxable year and is paid no later than the due date of the return for such taxable year (not including extensions of time to file the return).

Effective date.--The bill would be effective for taxable years beginning after December 31, 2000.

F. S. 312, the Tax Empowerment and Relief for Farmers and Fishermen (“TERFF”) Act (Sen. Grassley and others)

Section 7 of S. 312 would amend the present-law charitable deduction contribution rules of section 170 to (1) expand the class of taxpayers eligible to claim an augmented deduction for charitable contributions of food inventory, and (2) modify and clarify the determination of fair market value for such contributions.

Under the bill, any taxpayer, rather than only a C corporation, engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory under section 170(e)(3). In addition, the bill would provide that the fair market value of donated food that cannot or will not be sold solely due to internal standards of the taxpayer, lack of market, or similar circumstances, would be determined without regard to such factors and, if applicable, by taking into account the price at which the same or similar food items are sold by the taxpayer at the time of the contribution or in the recent past.

Effective date.--The bill would be effective for taxable years beginning after December 31, 2001.

G. S. 393, the Paul Coverdell Medical Research Investment Act of 2001 (Sen. Frist and others)

Sec. 2 of S. 393 would provide a special limitation under section 170(b) with respect to certain contributions for medical research. Under the bill, any medical research contributions would be allowed to the extent that the aggregate amount of such contributions does not exceed the lesser of (1) 80 percent of the taxpayer’s contribution base (as defined under present law) for the taxable year, or (2) the excess of 80 percent of the taxpayer’s contribution base over the amount of charitable contributions (other than contributions of capital gain property) otherwise allowable for the taxable year. Any medical research contributions that are not currently deductible because of the percentage limitation could be carried over for up to 10 taxable years.

Under the bill, a medical research contribution means a charitable contribution that is designated for the use of conducting medical research, to (1) an educational institution,²³ (2) an organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research,²⁴ (3) a governmental unit,²⁵ or (4) a corporation,

²³ Sec. 170(b)(1)(A)(ii).

²⁴ Sec. 170(b)(1)(A)(iii).

trust, or community chest, fund, or foundation organized for charitable purposes that normally receives a substantial part of its support from governments or from direct or indirect public contributions.²⁶

Effective date.--The proposal would be effective for contributions made in taxable years beginning after December 31, 2001, and to contributions made on or before December 31, 2001, if a deduction would be allowed under section 170 for taxable years beginning after December 31, 2000, if the proposal had applied to the contribution when made.

²⁵ Sec. 170(b)(1)(A)(v).

²⁶ Sec. 170(b)(1)(A)(vi).

III. ANALYSIS OF THE EFFECT OF THE CHARITABLE CONTRIBUTION DEDUCTION ON CHARITABLE GIVING

A. Rationale for Tax Deduction for Charitable Donations

In general

Tax deductibility of charitable donations reduces the economic cost to the donor of his or her donation and, therefore, encourages charitable giving (see the discussion, below, concerning the economic effect of the charitable contribution deduction). There are a number of different rationales advanced for the deductibility of donations to charitable organizations. These rationales depend, in part, on differing views about the role of charitable organizations and the benefits they provide to society as a whole.

One rationale for the charitable contribution deduction is that income given to a charity should not be taxed because it does not enrich the giver. Or, stated differently, the charitable contribution reduces the taxpayer's ability to pay income tax. A contrasting view would be that charitable giving is a purely personal expenditure, a deduction for which should be denied under a theoretically pure income tax system.

A second rationale for the deduction for charitable contributions relates to the view that charitable organizations are providing many services at little or no direct cost to taxpayers. It is argued that such services would otherwise have to be provided by the government at full cost to taxpayers. In this view, the tax deduction for voluntary charitable contributions is seen as equivalent to deductions permitted for many State and local taxes. The charitable contribution deduction can be said to provide neutrality in the choice to provide certain services to the public through direct government operation and financing or through the private operation and mixed private and public financing of a charitable organization.

A third rationale for the charitable contribution deduction is that many charitable organizations are public in nature or provide significant spillover benefits to the public at large. For example, some charitable organizations maintain open spaces such as bird refuges. Open space is an example of a public good, that is, a good or service that may be simultaneously enjoyed by all. Other charitable organizations provide benefits that improve the health of specific individuals, such as through the provision of vaccinations, which provide spillover benefits²⁷ to the population in general. Economists generally argue that, in the absence of a subsidy, the private market may provide insufficient levels of public goods or goods that create spillover benefits.²⁸ Thus, it is argued that the tax deduction for charitable contributions under

²⁷ Economists usually refer to such spillover benefits as “positive externalities,” which are benefits that accrue to the individual who consumes the good and also to other individuals who are “external” to the initial consumption of the good.

²⁸ For example, see Musgrave, Richard A. and Musgrave, Peggy B., *Public Finance in Theory and Practice* (New York: McGraw Hill), 1984, and Rosen, Harvey S., *Public Finance* (Homewood, IL: Irwin), 1988.

present law encourages donations to charities that provide public goods or significant spillover benefits and, therefore, promotes the provision of such benefits.

Effect of the standard deduction

The standard deduction provides a minimum exemption from income that many analysts view as providing relief to taxpayers who choose not to itemize their deductions, but who make charitable contributions, pay mortgage interest, or incur other expenses that are otherwise permitted as itemized deductions under the Code. Taxpayers generally will choose to itemize their deductions, rather than claim the standard deduction, if it is in their financial interest to do so.

Under this view, taxpayers who claim the standard deduction do not have total deductions that otherwise could be itemized in excess of the standard deduction amount. Thus, it could be argued that these taxpayers generally receive a tax benefit in excess of their actual expenses that would be deductible. From the perspective of those who see charitable contributions as reducing a taxpayer's ability to pay or providing parity to taxes paid to State and local governments, the standard deduction minimizes administrative burdens while achieving roughly the same results as permitting the taxpayer to itemize deductions. Under this view, the standard deduction more than compensates an individual who makes a charitable contribution for the income that was foregone by the contribution.

However, from the perspective that a specific incentive is required to achieve an efficient level in the provision of public goods or goods that produce spillover benefits, the standard deduction is not a substitute for the itemized deduction for charitable contributions. The taxpayer receives the standard deduction irrespective of any charitable contributions that are made. Thus, to the extent that tax incentives for charitable giving increase charitable contributions, there is no incentive under present law for the 70 percent of taxpayers who do not itemize deductions to make charitable contributions.

Economic effects of tax deductions for charitable contributions

As with any tax deduction or credit, the price to the donor of charitable giving that benefits from a tax incentive is reduced by the value of the tax benefit provided. For example, for a taxpayer who itemizes deductions and is in the 31-percent tax bracket, a \$100 cash gift to charity reduces the taxpayer's taxable income by \$100, and thereby reduces tax liability by \$31. As a consequence, the \$100 cash gift to charity reduces the taxpayer's after-tax income by only \$69. Economists would say that the price of giving \$100 cash to charity is \$69 for this taxpayer. As the preceding example shows, the price of giving is determined as one minus the taxpayer's marginal tax rate. Alternatively stated, the value of the tax deduction is the amount deducted multiplied by the taxpayer's marginal tax rate. Under present law, a taxpayer who does not itemize deductions receives no value from the tax deductibility of charitable contributions and the tax price of giving \$1.00 is \$1.00 of foregone other expenditures.

The charitable contribution deduction is worth more the higher the taxpayer's marginal tax rate. Because higher-income taxpayers generally are in higher marginal tax rate brackets, the charitable contribution deduction under present law is generally more valuable to higher income

taxpayers than to lower income taxpayers. As a result, under present law, higher income taxpayers generally have a lower tax price of giving than do lower income taxpayers. Lower income taxpayers are more likely to claim the standard deduction and, thereby, the tax price of their giving is \$1.00 of foregone other expenditures per \$1.00 of charitable contribution. Proposals to extend the charitable contribution deduction to nonitemizers would reduce the tax price of charitable contributions for this class of taxpayer.

While factors other than tax benefits also motivate charitable giving, the preponderance of evidence suggests that the charitable contribution deduction has been a stimulant to charitable giving, at least for higher income taxpayers. Economic studies generally have established that charitable giving responds to the price of giving. While the economic literature suggests that individuals alter their giving in response to changes in the price of giving, there is less consensus as to how large are the changes in donations induced by the tax deductibility of charitable contributions.²⁹ In addition, most studies rely upon data relating to taxpayers who itemize deductions. Inferences drawn from such studies may be inappropriate when applied to taxpayers who currently claim the standard deduction. Some evidence suggests that higher-income taxpayers are more responsive to the incentives provided by the charitable contribution deduction.³⁰

B. Analysis of Proposals to Expand the Deduction for Charitable Contributions

In general

If taxpayers respond positively to the incentive effect of the tax deduction for charitable contributions, then proposals to expand the charitable contribution deduction should lead to increases in the size of the charitable sector because increased availability of the tax deduction

²⁹ See, Clotfelter, Charles, *Federal Tax Policy and Charitable Giving* (Chicago: University of Chicago Press), 1985, for a review of the literature. Feldstein and Clotfelter argue that the deduction for charitable contributions induces charitable contributions in amounts exceeding the revenue lost to the government from the tax deduction. Feldstein, Martin and Clotfelter, Charles, "Tax Incentives and Charitable Contributions in the United States," *Journal of Political Economics*, 5, 1976. More recently, Randolph argues the opposite. Randolph, William C., "Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions," *Journal of Political Economy*, 103, August 1995, pp. 709-738. Randolph argues that earlier studies inadvertently confused timing effects that may be the result of an individual taxpayer's circumstances in a particular year or the result of changes from one tax regime to another with the permanent effects. Randolph's estimates suggest that, on a permanent basis, charitable contributions are much less responsive to the tax price than previously believed. Clotfelter, Charles T., "The Impact of Tax Reform on Charitable Giving: A 1989 Perspective," in Slemrod, Joel, ed., *Do Taxes Matter? The Impact of the Tax Reform Act of 1986* (Cambridge: MIT Press), 1990, p. 228, points to the surge in giving in 1986 prior to enactment of the Tax Reform Act of 1986 as evidence of the tax-sensitive timing of gifts.

³⁰ See, Clotfelter, Charles, "The Impact of Tax Reform on Charitable Giving: A 1989 Perspective."

would lead to increased contributions to the charitable sector. Depending upon the magnitude of the additional or induced contributions, the increase in the size of the charitable sector may be less than, equal to, or greater than the tax revenue foregone. If the increase in contributions to the charitable sector induced by the increased deduction exceeds the revenue lost to the government, then the tax deduction could be said to be an efficient means of providing public support to such charitable functions.³¹

Opponents of proposals to expand the deduction for charitable contributions argue that many charitable contributions are not tax motivated, but would be made in any event for non-tax reasons. Accordingly, for such contributions, a tax deduction amounts to a windfall reduction in the taxpayer's liability with no change in the taxpayer's behavior.

Recordkeeping and compliance issues

In the past, concerns about the validity of charitable contribution deductions claimed by taxpayers led to legislation to require written substantiation and recordkeeping with respect to certain charitable contributions. Proposals to expand availability of the charitable contribution deduction may lead to increased concerns about whether taxpayers are claiming deductions for charitable contributions legitimately made. See the discussion in III.C., below, concerning studies of the extent to which taxpayers overstate their charitable contributions.

If the proposals to expand the deduction for charitable contributions apply to contributions of property, valuation issues may arise. Many contributions of property to charities do not have a readily ascertainable value and taxpayers may overstate the value of such property in order to increase the tax benefit of the charitable contribution deduction. For example, an increasing number of charities are soliciting donations of used automobiles by individual taxpayers. Absent an expert appraisal, determining the value of a particular used automobile may be difficult both for an individual and the Internal Revenue Service. Certain published guidelines are available as a reference for this purpose, but there is the possibility of a wide variation in valuation even using such published guides. Determining the value of property such as used clothing and appliances presents more difficult valuation issues. Valuation issues place administrative burdens on taxpayers, who are required to maintain records to substantiate their charitable contributions deductions, and the Internal Revenue Service.

It has been noted that one benefit of the present-law standard deduction is that it eliminates the need to itemize and maintain supporting documentation for deductions. Some will note that a substantial increase in the standard deduction was enacted as part of the Tax Reform Act of 1986, in part, because “[t]axpayers who will use the standard deduction rather than itemize their deductions will be freed from much of the recordkeeping, paperwork, and

³¹ In the empirical economics literature, the notion of elasticity is used as a measure of taxpayer response to a change in the “tax price” or value of the tax deduction. An elasticity greater than one in absolute value (that is, a value smaller than negative one or a value greater than positive one) implies that recipients of charitable contributions receive more increased funding than the government loses in foregone revenue. See Clotfelter, *Federal Tax Policy and Charitable Giving*.

computations that were required under prior law.”³² If a separate deduction for charitable contributions of nonitemizers is enacted, then individual taxpayers will be required to keep records to substantiate the deductions claimed. In addition, increased administrative burdens would be imposed on the Internal Revenue Service to ensure that taxpayers only claim deductions for charitable contributions that are actually made.

C. Data on Levels of Charitable Contributions and Charitable Contribution Deductions

The staff of the Joint Committee on Taxation (“Joint Committee staff”) estimates that, for 2001, 37 million individual tax returns will claim more than \$149 billion in charitable contributions prior to application of the present-law limitations on the charitable contribution deduction (such as the percentage of AGI limitations and the overall limitation on itemized deductions (the so-called “Pease” provision). (See Table 1, below.)

Table 1.--Tax Returns Claiming an Itemized Deduction For a Charitable Contribution
(2001 Projections)

Income category ¹	Number of tax returns (thousands)	Dollars claimed (millions) ²
Less than \$10,000	198	\$112
\$10,000 to \$20,000	524	\$588
\$20,000 to \$30,000	1,474	\$1,875
\$30,000 to \$40,000	2,556	\$3,601
\$40,000 to \$50,000	3,217	\$5,841
\$50,000 to \$75,000	8,210	\$17,887
\$75,000 to \$100,000	7,620	\$20,171
\$100,000 to \$200,000	9,913	\$36,537
\$200,000 and over	3,283	\$62,519
Total:	36,995	\$149,131

Source: Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

¹The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: employer contributions for health plans; employer contributions for the purchase of life insurance; employer share of payroll taxes; workers compensation; tax exempt interest; excluded income of U.S. citizens living abroad; nontaxable Social Security benefits; insurance value of Medicare benefits; and alternative minimum tax preference items.

²The dollars claimed include those charitable contributions allowed as a deduction before the application of any present law limitations on the deductibility of charitable contributions, such as the percentage of AGI limitations or the overall limitation on itemized deductions (“Pease”).

A substantial amount of charitable donations made by individuals is not claimed as itemized deductions. However, there are no data that directly measure the magnitude of charitable contributions by non-itemizers. Tables 2 and 3, below, offer some indirect evidence

³² Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987, 11.

on the magnitude of such giving. Table 2 present estimates of the American Association of Fund-Raising Counsel Trust for Philanthropy of the total amount of charitable contributions received by qualifying organizations from individuals. By contrast, Table 3 reports itemized deductions claimed for charitable contributions as reported to the Internal Revenue Service. Comparison of the two tables would suggest that, in 1997, nearly \$24 billion in charitable contributions made by individuals were not claimed as itemized deductions. Unfortunately, differences in the amounts reported in Tables 2 and 3 cannot be interpreted as measures of amounts of contributions made by non-itemizers. Evidence from audits and in taxpayer compliance studies establishes that many taxpayers overstate their actual charitable contributions when claiming itemized deductions.³³ These findings suggest that, if one were to use the difference in the amounts reported in Tables 2 and 3 to estimate the magnitude of charitable donations by non-itemizers, the result would be to underestimate actual charitable contributions by non-itemizers.³⁴ Moreover, experience with taxpayers who itemize suggests that, if non-itemizers were allowed to claim a deduction for their charitable contributions, many non-itemizers would also overstate their actual charitable contributions for the purpose of claiming a tax benefit.

Individual charitable contributions claimed as itemized deductions on individual tax returns have grown in every year since 1984, except from 1986 to 1987.³⁵ Itemized deductions and total individual charitable contributions have grown more rapidly than the rate of inflation over this period.³⁶ However, this real, inflation-adjusted, growth did not occur evenly over the period. Between 1984 and 1990, the real growth in individual charitable contributions claimed as itemized deductions was more modest than was real growth since 1990. There has been little analysis attempting to explain these trends.

³³ Slemrod, Joel, "Are Estimated Tax Elasticities Really Just Tax Evasion Elasticities? The Case of Charitable Contributions," *The Review of Economics and Statistics*, Vol. 71 (August 1989), pp. 517-522.

³⁴ Such a conclusion assumes that the figures reported in Table 1 are accurate estimates of total giving by individuals. Errors in these estimates of total donations could raise or lower estimates of donations by non-itemizers.

³⁵ Most analysts attribute the high level of donations in 1986 followed by the lower level of donations in 1987 to the anticipation and enactment of the Tax Reform Act of 1986 which lowered expected future marginal tax rates for many taxpayers, thereby increasing the expected price of future donations. In addition, certain other modifications to charitable tax deductions as part of the individual alternative minimum tax may have altered the timing of some donations to charities. The increase in the standard deduction provided in the Tax Reform Act of 1986 also reduced the number of taxpayers who chose to itemize deductions.

³⁶ The price level, as measured by changes in the consumer price index, increased by 54.4 percent over the period 1984 through 1997.

**Table 2.--Total Individual Charitable Donations Estimated to Have Been Received
By Charitable Organizations, 1984-1997
(Billions of Dollars)**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Total individual donations	56.46	57.39	67.09	64.53	69.98	79.45	81.04	84.27	87.70	92.00	92.52	95.36	107.65	122.95

Source: *Giving USA* 1999. Data do not include donations from trusts. Tabulations prepared by the staff of the Joint Committee on Taxation.

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**Table 3.--Individual Itemized Charitable Donations Claimed on Tax Returns, 1984-1997
(Billions of Dollars)**

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Itemized deductions claimed for charitable donations	42.12	46.96	53.82	49.62	50.95	55.46	57.24	60.58	63.84	68.35	70.54	74.99	86.16	99.1

Source: Individual itemized deductions taken from Internal Revenue Service Statistics of Income data. Tabulations prepared by the staff of the Joint Committee on Taxation.