Washington Center for Equitable Growth

Should the U.S. tax deduction for charitable contributions be more equitable?

By Nisha Chikhale March 2017

Overview

The U.S. tax system is used as a tool for accomplishing many different policy priorities, one of which is to support charitable organizations and the work that they do by providing a tax deduction for charitable contributions. This particular tax expenditure—so named because it targets federal government spending through the U.S. tax code—is one of the largest in terms of lost government revenue and also one of the most popular because of the many charitable causes these tax deductions support.

Unfortunately, the benefits of this tax expenditure accrue almost exclusively to the wealthy even though many Americans up and down the income ladder give generously to charity, as detailed by several statistical measures in this issue brief. Wealthy taxpayers reap 97 percent of the tax breaks for charitable giving compared to all remaining taxpayers in the country. Research shows that capping the amount of charitable giving eligible for the tax deduction is one way policymakers could make this tax expenditure more equitable while also boosting public spending on social services—all without unduly affecting private charitable giving.

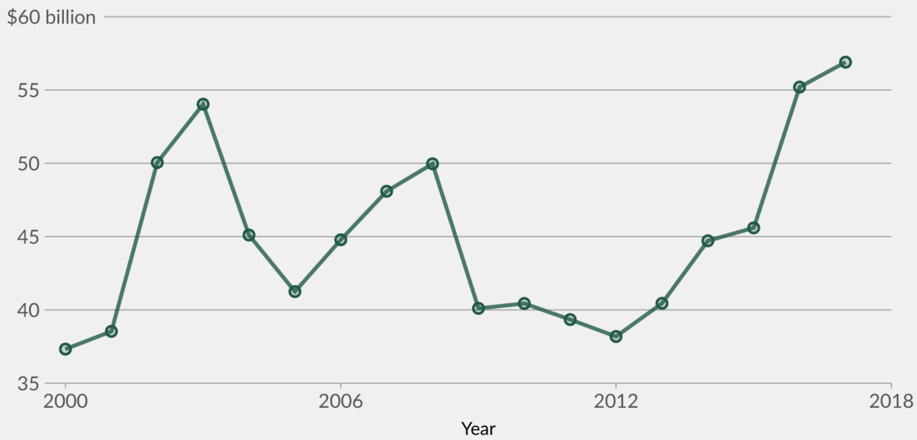
Examining the effects of the charitable tax deduction

The tax deduction for charitable giving is one of the largest in terms of its estimated revenue impact. The Joint Committee on Taxation estimates the five-year revenue cost (from 2016–2020) at $313.4 billion, and the deduction is routinely among the top 10 to 15 federal tax expenditures in terms of its revenue cost.[1] (See Figure 1.)

FIGURE I

A snapshot of the charitable contributions deduction

U.S. government expenditures on charitable contributions deduction in billions of 2015 dollars, by year



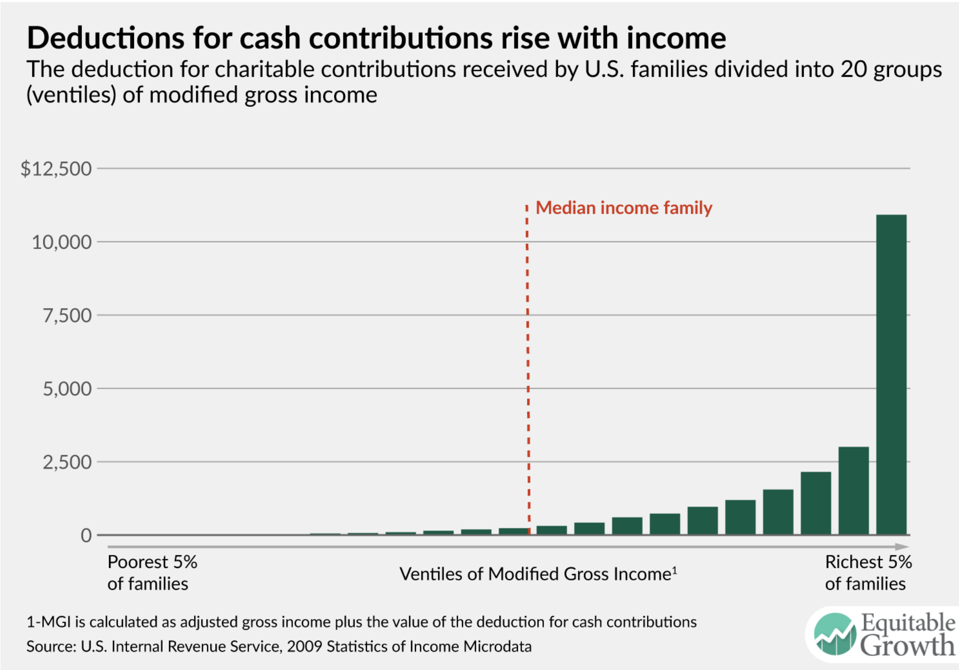
Source: Joint Committee on Taxation: JCS-13-99, JCS-1-01, JCS-1-02, JCS-5-02, JCS-8-03, JCS-1-05, JCS-2-06, JCS-3-07, JCS-2-08, JCS-1-10, JCS-3-10, JCS-1-12, JCS-1-13, JCX-97-14, JCX-141R-15, JCX-3-17

Equitable Growth

The deduction for charitable contributions allows households to deduct the amount of cash contributions to charitable organizations from their taxable income if their tax deductions are itemized. The charitable contributions deduction aims to support the work of nonprofit organizations, but the particular form it takes gives a much larger tax break to the rich than to the rest of taxpayers—and it's not that only the rich give to charities. Charitable giving remains broad based, with nearly 50 percent of households donating to more than one cause annually, according to Giving USA and the Center on Philanthropy at Indiana University.[2] Indeed, giving as a percentage of household income is U-shaped, meaning that low- and high-income households give a larger portion of their income to charity than middle-income households.[3] The problem is, the current structure of the charitable deduction does not allow lower-income households to get the benefit of deducting their charitable contributions because they don't itemize their taxes, whereas higher-income households amply succeed in reducing their tax burden via charitable giving.

The deduction for charitable contributions almost exclusively benefits high-income households, as illustrated by the data examined in this issue brief. The data used in the figures below come from the 2009 public-use version of the Internal Revenue Service's Statistics of Income Microdata. Along the horizontal axis are households divided into 20 groups, or ventiles, of equal size, ordered from lowest to highest modified gross income.[4] By this measure, the median annual income of tax filers was $29,800; the top 5 percent earned between $156,820 and $95,800,000. (See Figure 2.)

FIGURE 2



The relationship between income and the value of the deduction is apparent. The average charitable contribution deduction grows steadily as income rises. In fact, the average deduction received by households in the top 5 percent of earners is more than 30-times larger than the deduction for charitable contributions received by the median-income family. Yet households with incomes between $20,000 and $40,000 give nearly 5 percent of their income to charity, similar to the households that make between $1 million and $5 million and give more than 5 percent of their income.[5] (See Figure 3.)

FIGURE 3

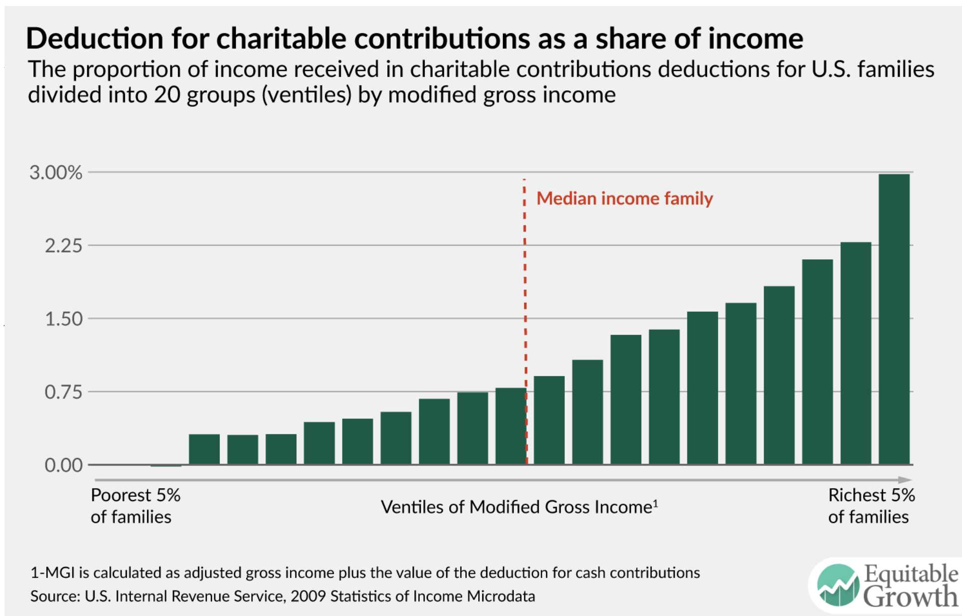
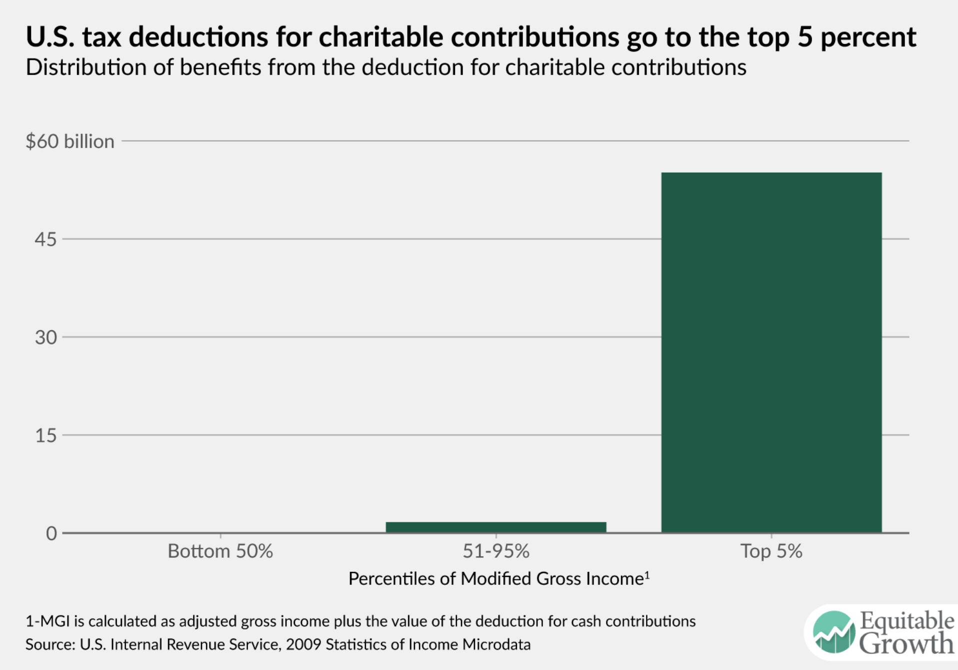


FIGURE 4



Policy options for the charitable deduction

Many of the proposals to eliminate or cap the amount of the deduction for charitable contributions would have both adverse and advantageous implications. There is inherently a trade-off between encouraging charitable contributions and increasing tax revenues. On one hand, capping or eliminating the tax benefit of the charitable contributions deduction may reduce overall charitable contributions and hinder support for the work that the nonprofits do. Politically, this is also tough to do, as the public favors supporting the work that religious, health, educational, and cultural charities conduct. This may result in a multitude of negative effects for the charitable organizations.

On the other hand, this deduction is only accessible to taxpayers who have high enough incomes to itemize their taxes and deduct cash contributions. Eliminating or capping the amount of charitable contributions one can deduct would expand the existing tax base, limiting a key tax expenditure currently available only to the wealthy. These additional funds could make it possible to redirect public spending toward strengthening social safety programs that target those in need.

Adjusting the deduction for charitable contributions can be difficult. The trade-offs between encouraging support for charitable causes and increasing tax revenues in a progressive way should be taken seriously. Former President Barack Obama in 2014 proposed to limit tax subsidies that affluent U.S. taxpayers take for deductible expenses, including the deduction for charitable contributions. Following his proposal, the Tax Policy Center estimated that total charitable contributions would decline only modestly, by an amount between 1.6 percent and 3 percent of total charitable contributions, while helping increase tax revenues.[6] These kinds of limitations to the amount of deductible expenses taken by upper-income U.S. taxpayers such as the deduction for charitable contributions would greatly help reduce government tax expenditures and help preserve the progressive federal tax system.

Endnotes

1 Joint Committee on Taxation, *Estimates Of Federal Tax Expenditures For Fiscal Years 2016–2020* (Government Printing Office, 2017).

2 Giving USA Foundation and the Center on Philanthropy at Indiana University, "2010 Giving USA" (2010).

3 John List, "The Market for Charitable Giving," *Journal of Economic Perspectives* 25 (2) (2011): 157–180.

4 Modified gross income is calculated as adjusted gross income plus the value of the deduction for charitable contributions. This is a measure of income before the deduction for charitable contributions reduces the amount of taxable income for each tax filer.

5 List, "The Market for Charitable Giving."

6 Paul van de Water and Chey-Ching Huang, "Obama Proposal to Limit Tax breaks for High-Income Households Would Reduce Total Charitable Contributions By a Modest 1.6 to 3.0 Percent" (Washington: Center on Budget and Policy Priorities, 2013).

Our Mission

Accelerate cutting-edge analysis into whether and how structural changes in the U.S. economy, particularly related to economic inequality, affect economic growth.

Washington Center for Equitable Growth

1500 K Street, NW, Suite 850, Washington, DC 20005 • Tel: 202-545-6002 • www.equitablegrowth.org • @equitablegrowth