

## Options for Changing the Tax Treatment of Charitable Giving

**U**nder current law, taxpayers who itemize deductions may deduct the amount they donate to charities from their adjusted gross income (AGI) when determining how much they owe in federal income taxes. That deduction gives people who itemize an incentive to contribute to charities. Like other forms of preferential tax treatment, the deduction also costs the federal government revenues that it might otherwise collect. At current levels of charitable giving, the cost of that deduction—measured as the additional revenues that could be collected if the deduction was eliminated—will total about \$230 billion between 2010 and 2014, according to the Joint Committee on Taxation (JCT).<sup>1</sup>

Numerous proposals have been made in recent years to alter the income tax treatment of charitable giving by individual donors. Some proposals aim to reduce the cost to the government by imposing a floor (or minimum level) that a person's charitable giving would have to exceed to qualify for preferential tax treatment. Other proposals would extend the current charitable deduction to taxpayers who do not itemize deductions or would replace the current deduction with a nonrefundable tax credit available to all taxpayers who make charitable contributions.<sup>2</sup>

For this analysis, the Congressional Budget Office (CBO) examined how much taxpayers in various income groups donate to charities and what types of organizations receive those donations. CBO also investigated how changing the structure of tax incentives for giving would affect the tax subsidy (the cost in forgone revenues to the federal government), the overall level of charitable giving, and the extent to which different income groups benefit from the tax preference. Specifically, CBO looked at 11 options for altering the current income tax treatment of charitable giving, which can be grouped into 4 categories:

- Retaining the current deduction for itemizers but adding a floor.
- Allowing all taxpayers to claim the deduction, with or without a floor.
- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 25 percent of a taxpayer's charitable donations, with or without a floor.
- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 15 percent of a taxpayer's charitable donations, with or without a floor.

For each of the four categories, CBO analyzed two potential floors: a fixed dollar amount (\$500 for single taxpayers and \$1,000 for couples filing a joint return) and a percentage of income (2 percent of AGI). Only contributions in excess of the floor would be deductible or eligible for a credit. The analysis uses data for 2006, the most recent year for which the Internal Revenue Service's public-use sample of individual income tax returns is available. The tax treatment of charitable contributions is generally the same today as it was in 2006; however,

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1. A deduction for charitable contributions also exists under the corporate income tax. JCT estimates a much smaller five-year cost for that deduction: about \$17 billion. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2010–2014*, JCS-3-10 (December 15, 2010), [www.jct.gov/publications.html?func=startdown&id=3718](http://www.jct.gov/publications.html?func=startdown&id=3718).

2. Taxpayers can use tax credits to reduce their income tax liability (the amount they owe). Nonrefundable credits can lower income tax liability to zero, but excess credits cannot be used to increase tax refunds. In contrast, refundable credits that exceed income tax liability are paid to taxpayers as refunds.

because of rising incomes and contribution amounts, the options that include a fixed dollar floor would have a somewhat different impact today than presented here.

## Effects of Policy Options on Tax Subsidies and Charitable Donations

According to CBO's modeling, adding a contribution floor to any of the approaches listed above would reduce both the total federal tax subsidy and the total amount donated to charity, relative to the same option without a floor. In each case that CBO examined, the reduction in the subsidy (and thus the increase in revenues) would exceed the reduction in charitable contributions, whether measured in dollars or as a percentage change. The reason is that introducing a floor would continue to provide a tax incentive for additional giving above the level of the floor and at the same time reduce the tax subsidy for donations that people might have made even without a tax incentive.<sup>3</sup>

Allowing all taxpayers to claim a deduction for charitable giving would have increased donations in 2006 by an estimated \$2.0 billion (or 1 percent) and increased the total tax subsidy by \$5.2 billion (or 13 percent) from the 2006 amounts. Combining a deduction for all taxpayers with a floor, however, could both increase donations and decrease the tax subsidy. For example, such a deduction combined with a fixed dollar floor of \$500/\$1,000 would have increased donations by \$800 million in 2006 and decreased the tax subsidy by \$2.5 billion (see Summary Table 1).

Replacing the current deduction with a 25 percent tax credit would increase donations and also increase the government's forgone revenues. Combining such a credit with certain contribution floors, however, could boost donations while reducing the tax subsidy or could decrease donations by a small percentage while reducing the tax subsidy by a large percentage. Setting the credit at 15 percent would reduce donations but would reduce the tax subsidy by a larger amount (both in dollars and as a percentage change).

3. The fact that some nonitemizers contribute to charities despite receiving no tax benefits for doing so suggests that a substantial amount of charitable giving would still occur in the absence of a tax incentive.

## Effects of Policy Options on Various Income Groups

Changing the tax treatment of charitable contributions would have differing effects on taxpayers at different points on the income scale. Adding a contribution floor to the current deduction for itemizers would reduce tax subsidies for all income groups, but for high-income taxpayers, the size of the reduction would vary significantly depending on the type of floor used. For instance, augmenting the deduction with a fixed dollar floor of \$500/\$1,000 in 2006 would have lowered the tax subsidy for people with AGI over \$100,000 by 0.08 percent of their AGI, whereas adding a floor equal to 2 percent of AGI would have lowered the tax subsidy for that income group by 0.30 percent of their AGI.

Making the deduction for charitable contributions available to nonitemizers would benefit lower- and middle-income taxpayers, who tend not to itemize deductions because their deductible expenses (such as mortgage interest and state and local taxes, as well as charitable donations) are not large enough to exceed the standard deduction. Those groups would benefit even more if the current deduction—which tends to help higher-income taxpayers more because they face higher tax rates—was replaced with a nonrefundable credit that gave all income groups the same tax incentives for giving. For example, replacing the deduction with a 25 percent credit in 2006 would have increased the tax subsidy for taxpayers with AGI below \$100,000 by 0.27 percent of their AGI, but it would have decreased the tax subsidy for people above that income level by 0.09 percent of AGI. Tax subsidies would be lower for all income groups with a 15 percent credit than with a 25 percent credit.

## Caveats About This Analysis

The results of CBO's policy simulations are meant to highlight the general effects of the various approaches. The exact size of those effects, however, would depend on the specific parameters of a policy—such as the level of the floor or the amount of the credit—as well as on the extent to which taxpayers would change the amount of their charitable giving in response to a change in the tax subsidy. In addition, this analysis does not reflect many of the other ways in which taxpayers might respond to a change in their tax subsidy, such as shifting donations between years. (In the appendix, CBO examines how sensitive the results of this study are to several different assumptions, including variations in taxpayers' responsiveness to changes in their tax subsidy and the possibility of shifts in the timing of donations.)

**Summary Table 1.****Summary of Total Donations and Tax Subsidies Under Current Law and Eleven Policy Options, 2006**

	Floor for Eligible Donations	Total Contributions (Billions of 2006 dollars)	Tax Subsidy (Billions of 2006 dollars)
<b>Current Law</b>			
Deduction Available Only to Itemizers	No floor	203.0	40.9
<b>Change from Current Law</b>			
Keep Deduction Available Only to Itemizers but Add Floor			
Option 1	\$500/\$1,000	-0.5	-5.5
Option 2	2 percent of AGI	-3.0	-15.7
Extend Deduction to All Filers			
Option 3	No floor	2.0	5.2
Option 4	\$500/\$1,000	0.8	-2.5
Option 5	2 percent of AGI	-1.9	-13.1
Convert Deduction to 25 Percent Nonrefundable Credit for All Filers			
Option 6	No floor	2.7	7.1
Option 7	\$500/\$1,000	1.5	-2.4
Option 8	2 percent of AGI	-1.0	-11.9
Convert Deduction to 15 Percent Nonrefundable Credit for All Filers			
Option 9	No floor	-7.8	-13.3
Option 10	\$500/\$1,000	-8.6	-19.0
Option 11	2 percent of AGI	-10.0	-24.6

Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels.

\$500/\$1,000 = \$500 for individual filers and \$1,000 for joint filers; AGI = adjusted gross income.