Tax Proposals

August 12, 1999 – DRAFT

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed
Eric Liu

SUBJECT: Tax Proposals to Increase Charitable Giving

You asked us for an analysis of recent faith-based proposals and for ideas we could do by executive order or enact this Congressional session. Last week, we gave you an overall comparison of how the proposals made by Governor Bush and the Vice President compare to current law. Below, we analyze the major recent tax proposals intended to encourage charitable giving, including ones included in the Senate-passed tax bill and in Governor Bush's plan, as well as some possible alternatives. Several of these issues could be raised in tax negotiations this fall. Finally, we are working on a detailed analysis of current federal support for faith-based organizations as well as some new ideas, which we plan to submit to you when you return from vacation.

Deductibility of Individual Charitable Contributions

Recent proposals would increase individuals' deductions for charitable gifts, by allowing a deduction for non-itemizers and/or increasing the deduction for those who itemize.

Current Law

Under current law, taxpayers who itemize their deductions can claim a deduction for contributions made to a qualified charitable organization, up to a limit of 50 percent of adjusted gross income (30 percent in the case of gifts of certain capital gains property). Individuals who elect the standard deduction (non-itemizers) may not claim a deduction for charitable contributions, but the amount of the standard deduction includes an allowance for estimated average charitable contributions.

Bush Proposal

Governor Bush has proposed to allow taxpayers who take the standard deduction the opportunity to deduct their charitable donations. He has not released any details of how he

DRAFT

would structure his proposal.

Senate Proposal

The Senate-passed tax bill, S. 1429, included a proposal to allow non-itemizers to deduct charitable contributions, which was not included in the final conference report. The Senate proposal would allow taxpayers who take the standard deduction to also claim a charitable deduction of up to $50 for single filers and $100 for joint filers in the years 2000 and 2001. The Congressional Joint Committee on Taxation (JCT) estimated the proposal would cost $1.3 billion.

Treasury staff say they would likely oppose a tax proposal structured like this. Though we have not had them do official analysis, staff indicated that extending the charitable contribution deduction to non-itemizers in this way would create unnecessary complexity, create a difficult enforcement problem for the IRS, and probably stimulate little additional giving. Moreover, the standard deduction theoretically includes an allowance for charitable giving. Therefore, they argue, non-itemizers should not be allowed to claim both the standard deduction and a deduction for the first $50 or $100 of their charitable contributions.

In addition to the proposal for non-itemizers, the Senate-passed bill increased the amount itemizers could deduct for charitable contributions. The Senate proposal, not included in the conference report, included a provision that would gradually increase the percentage limitations on deductible contributions from 50 percent and 30 percent (in the case of gifts of certain capital gain property) of Adjusted Gross Income (AGI) to 70 percent and 50 percent of AGI respectively. JCT estimated this proposal to cost $3.7 billion over 2002-2009.

An Alternative Approach

Treasury has indicated that a better approach to the Senate-passed provision for non-itemizers would be to allow a deduction for charitable contributions above a set floor. Assuming that the floor is set at a level that exceeds the average charitable contribution by non-itemizers, such a proposal would be more likely to encourage increased charitable giving and to reduce the potential for abuse. For example, non-itemizers could be allowed to deduct aggregate charitable contributions which exceed the greater of $500 or 1 percent (or 2 percent) of a taxpayer's AGI.

Establishing a floor based on a contribution of a fixed dollar amount and a percentage of AGI would serve two purposes. Use of a fixed dollar amount (e.g., $500) would be consistent with the notion that the standard deduction includes an allowance for average charitable contributions, and that a deduction should be available only for charitable contributions above that minimum amount. At the same time, establishing a floor based on the greater of a fixed dollar amount or a percentage of the taxpayer's AGI would raise the threshold for high-income taxpayers, encouraging them to give more to charity. Although any proposal to allow a charitable contribution for non-itemizers would add complexity and some level of administrative burden, the use of the threshold amount would at least increase the possibility that deduction would reward large or increased charitable contributions.

DRAFT

In 1997, JCT estimated that allowing nonitemizers to deduct aggregate annual charitable contributions in excess of a flat floor of $500 for single filers ($1,000 for joint filers) would cost $6-$6.5 billion per year.

Treasury has not raised any objections to the other proposal in the Senate-passed bill, which increased the present-law limitations on deductible charitable contributions for taxpayers who itemize.

Would Any of These Proposals Increase Giving?

A new study published in the June 1999 National Tax Journal indicates that nonitemizers are price responsive, and thus will give more if given a financial incentive to do so. The study found, however, that itemizers are even more price sensitive, implying that increasing incentives for itemizers is a more efficient way to increase giving. The study is based on a demonstration in effect from 1982-86, which allowed non-itemizers first to deduct a capped amount and then, in 1986, to deduct the full amount of charitable contributions. In 1986, 90 percent of itemizers claimed deductions averaging $1,463 and 46 percent of non-itemizers claimed deductions averaging $477. From 1985 when non-itemizers could deduct 50 cents on the dollar to 1986 when they could deduct 100 cents on the dollar, the percent of non-itemizers donating rose from 42 to 46 percent and the average amount increased from $376 to $477.

The article notes that other research has shown that lower-income taxpayers, who tend to be non-itemizers, are more likely to give contributions to religious charities, rather than the museums and schools favored by higher-income taxpayers. It follows, then, that extension of the itemizers-only deduction to non-itemizers would confer the greatest benefit upon religious charities.

Tax-Free Rollovers of IRA Assets to Charity

A second proposal made by Governor Bush would allow people over age 59 to make charitable contributions with IRA funds without paying income tax. Neither the Senate nor the House tax bill contained this proposal.

Treasury staff say Treasury would likely oppose tax-free rollovers of IRA assets to charity because it would provide more favorable tax treatment to individuals who fund their charitable contributions using IRA assets than those who use other income or assets. Thus, these taxpayers would be permitted to avoid present-law restrictions on deductible charitable contributions.

JCT has estimated such a proposal would cost $1.6 billion over 2003-2009.