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Impact of The Obama Administration's Proposed Tax Policy Changes on Itemized Charitable Giving

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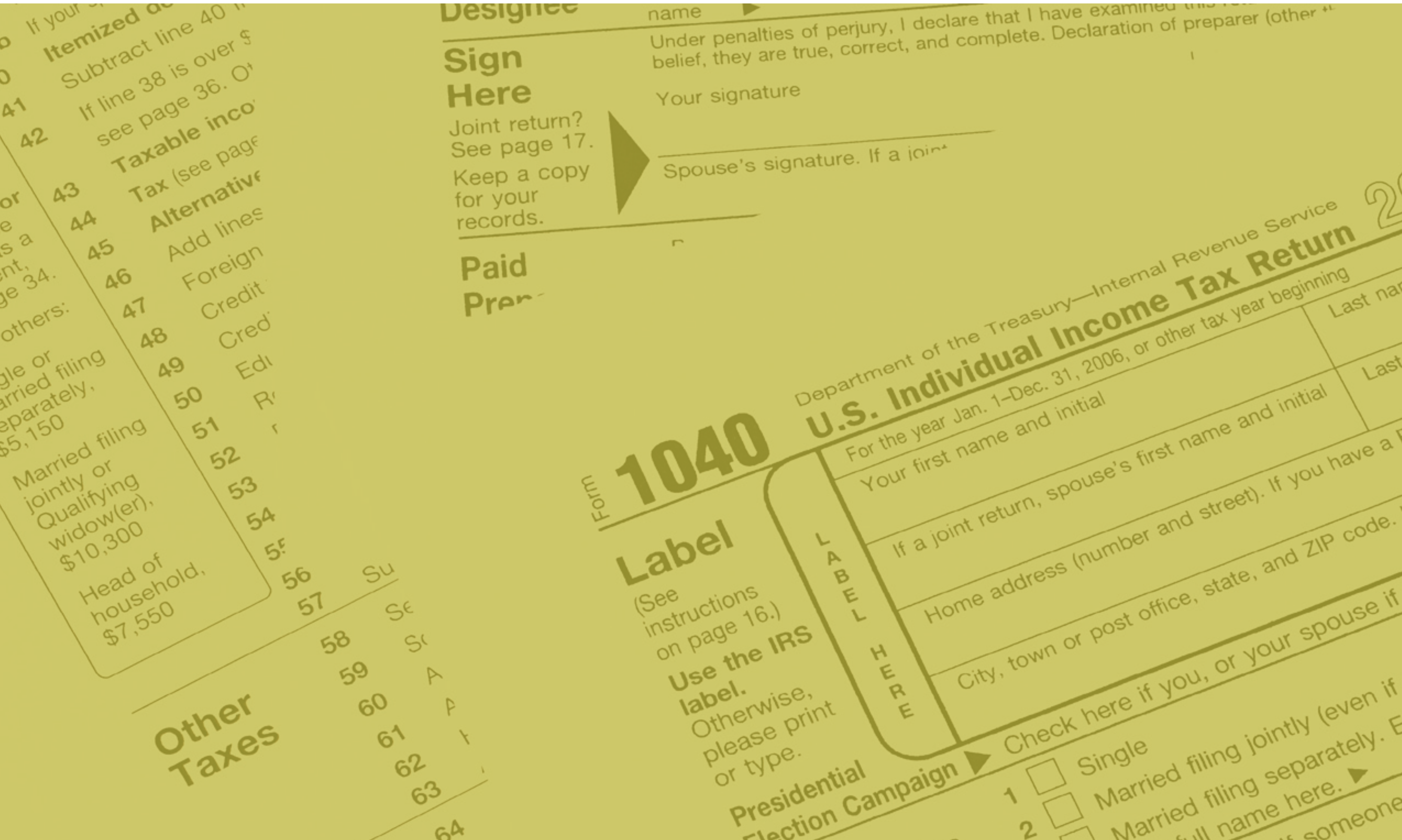

Preface

As the United States addresses economic challenges following a deep recession, both President Obama and Congress are considering new tax policies to stimulate economic growth and reduce the federal government's budget deficit. These measures will impact a wide array of individual economic decisions, including individual decisions regarding what households do with disposable income. One such area where changes in federal tax policy can have a substantial influence on individual decisions is the choice of an individual or household to engage in charitable giving.

In 1917, Congress passed an amendment to the four-year-old federal income tax that allowed individuals to deduct charitable gifts from their taxable incomes. Since that time, considerable research has shown that allowing a charitable deduction for those who itemize their tax returns has been an effective way to increase philanthropic activity. At present, those who itemize their tax return realize a reduction in taxable income equal to the amount of the total of all deductions, including those deductions related to charitable giving. In practice, this means that every dollar deducted generally reduces taxable income by the same amount; the actual value of that deduction depends on a taxpayer's tax bracket. For a household in the highest tax bracket (currently 35 percent), every $100 given to charity saves $35 in taxes.

The Obama administration is proposing a number of modifications to the tax code, one of which would limit the value all deductions in 2012, including those taken for charitable giving, for high-earning households (households with annual adjusted gross incomes exceeding $200,000, or $250,000 for couples). Under this proposal, the Obama administration is seeking to place an upper limit on the value of all itemized deductions to 28 percent, regardless of tax bracket. Therefore, under the administration's plan, a $100 gift to charity will reduce taxes by no more than $28.

Additionally, existing tax breaks in place since 2001 are set to expire at the end of 2012; should that occur as planned, high-income households would be taxed at a higher marginal rate in 2013 (39.6 percent) than they are currently paying. As a result, high income households may have to pay more taxes than they do at present and may have less disposable income for other expenditures, including charitable giving.

In consideration of this plan, the Center on Philanthropy at Indiana University, with sponsorship from Campbell & Company, seeks to forecast whether these changes would negatively impact charitable giving; and if so, to what degree. To that end, this analysis estimates the potential decrease in total giving that could occur with the capping of deductions and allowing existing income tax breaks to expire had the proposals been initiated in 2009 (Year 1) and 2010 (Year 2). Using methods developed in other research, the Center is able to estimate the effect of reducing the value of the tax deduction on charitable giving. The results of our analysis indicate that if the administration's proposals are enacted, a relatively modest decline in charitable giving is likely to occur. Assuming the tax proposals are adopted by Congress, itemized charitable giving could be expected to decline by $0.82 billion in Year 1 when the deduction cap is implemented, and could decline by $2.43 billion in Year 2 when existing tax breaks expire (with the deductions cap remaining in place). In total, this represents a decrease of 1.3 percent in itemized charitable giving in Year 2.

This report gives rise to two general conclusions:

- High-earning households are disproportionately responsible for individual charitable gifts when compared to other taxpayers, and federal tax policy impacts the giving habits of these households. Regardless of one's party affiliation or philosophy on tax and fiscal policy, the Center's forecast suggests that the impact on philanthropy should be considered within the merits of any proposed modifications to US tax policy.

  In the current fiscal environment, charities are realizing reductions in funding from traditional sources including government grants, fees for services, income from investments and other sources. Disincentives for individuals to engage in charitable giving may place additional strain on the nonprofit sector, which could, in turn, curtail the nonprofit sector's ability to meet its social responsibilities in times of increased need.

- Our analysis suggests that reductions in the aggregate disposable income of high-earning households, which increasing the marginal rate paid by high-earning households could cause, is also likely to negatively impact charitable giving. This finding is consistent with previous findings; for example, the Center on Philanthropy's *GIVING USA: The Annual Report on Philanthropy for 2010* showed that 2008 and 2009 saw the largest drops in giving in more than 40 years, largely due to the lingering effects of the recession on donors' personal income and wealth. Our research suggests that the decline in disposable income that would result from an increase in the marginal tax rate paid by high-earning households would lead to declines in charitable giving by those same households. This finding also suggests that regardless of tax policy, restoring growth to the US economy is critical to increasing philanthropic giving.

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Table of Contents

Introduction

For nearly a century, millions of individuals have deducted contributions to charities and nonprofit organizations on their individual income tax returns; in that way, the charitable deduction provides a unique incentive that allows individuals to contribute resources toward the private provision of public goods. This important component of the US tax code demonstrates the high value our society places on philanthropy as well as the important role that charitable organizations play in meeting individual and societal needs. In 2008, the last year for which data are available, approximately 34 percent of individual taxpayers benefitted from itemizing deductions; among those, 80 percent itemized contributions to charity, resulting in $170.4 billion in private giving for the public good (IRS, 2008).[1] Individual charitable contributions represent an important source of revenue for a wide variety of charitable nonprofit organizations. According to *GIVING USA 2011*, nonprofit organizations received a total of $290.89 billion in charitable donations in 2010, an amount that makes up two percent of the nation's gross domestic product (GDP). About 73 percent of that amount, or $211.77 billion, was the result of individual giving (*GIVING USA* Foundation, 2011).

The United States is currently facing severe fiscal and economic challenges. The Obama administration's FY 2012 budget proposes to limit the value of all deductions—including the charitable deduction, as well as the mortgage interest deduction, the federal tax deduction for state and local taxes, and other miscellaneous deductions—to 28 percent for all individual taxpayers with an adjusted gross income exceeding $200,000 (or $250,000 for couples). Further, the administration's proposal would also allow existing tax breaks to expire; the result of which would be an effective increase of the marginal the tax rate on the highest-earning households from 35 percent to 39.6 percent. According to 2008 data from the Internal Revenue Service, the change in the marginal tax rate for the highest earning households would impact nearly 3 percent of all tax filers. These changes could have two impacts on charitable giving: 1) the higher marginal rate on the highest-earning households would reduce these households' disposable income, thereby reducing the amount they have available for charitable giving; and 2) wealthy donors would not realize as much individual tax benefit from their charitable gifts and may face reduced incentives to give. The Congressional Budget Office (CBO) and the Tax Policy Center have conducted several studies to examine the impact of tax provisions in the Obama administration's FY 2012 budget on the nation's fiscal outlook. In this paper, the Center on Philanthropy presents an analysis assessing the effects of the Obama administration's proposed modifications to tax policy on individuals' charitable giving.

According to a report released in August 2011 by the Congressional Research Service, the CBO projects the FY 2011 budget deficit to be almost $1.5 trillion or 9.8 percent of the GDP, up from an average deficit to GDP ratio of 3 percent between 1980 and 2010. Decreased revenue stemming from the 2008 recession and slow economic recovery has significantly contributed to this increase in the deficit relative to GDP in recent years. As policymakers examine ways to reduce the deficit—all tax incentives, including those for individual charitable giving—are expected to be examined.

The Center's analysis looks at how itemized charitable giving would have been affected had the proposals been initiated in 2009 (Year 1) and 2010 (Year 2). Our analysis found that higher marginal tax rates for high-earning households

[1] The percent of taxpayers who itemize deductions is about 34 percent based on data reported in Table 1, Individual Income Tax Returns: 2008, IRS Statistics of Income Bulletin, 2008.

(an increase from 35 percent to 39.6 percent) combined with a 28 percent cap on the value of itemized deductions would result in a reduction of total itemized giving from these households by $0.82 billion in Year 1 and $2.43 billion in Year 2. In Year 1, only the deduction cap would be in effect; whereas in Year 2, both proposals would be in place. In total, this represents a decrease of 1.3 percent in itemized charitable giving in Year 2.

Tax Incentives for Charitable Giving

Tax incentives for charitable giving have existed in the US federal tax code since 1917. The charitable deduction subsidizes charitable giving by effectively lowering the private cost to the donor for supporting charities. The basis for subsidizing private charitable contributions is well-established. Charitable contributions by individuals play a critical role in the private provision of public goods (education, the arts, nonprofits, religious organizations, as well as others) and therefore can be encouraged through reducing the cost of these donations to the donor through a tax-based subsidy. The charitable deduction allows a taxpayer to deduct the amount of a charitable donation from his or her adjusted gross income (AGI) in an amount equal to the donation. The lowered AGI then becomes the base amount on which the donor's income is taxed. In practice, for someone in the highest tax bracket (taxed at 35 percent of AGI), one dollar of charitable contributions will reduce the donor's tax liability by 35 cents; therefore, the price of a one dollar charitable gift is only 65 cents to the donor. In addition to shifting the cost of the provision of public goods to private taxpayers, this approach leaves the choice about which charities are subsidized to individual taxpayers.

Currently, donations to charitable organizations are tax deductible only for taxpayers who have taxable income and itemize their tax returns. Because marginal tax rates increase with taxable income, higher-earning taxpayers receive more tax benefit per dollar deducted, regardless of the type of deduction. Although the underlying motives for charitable giving are complex and have been examined by a number of researchers in economics, sociology and other disciplines, empirical studies generally find that taxpayers respond to the after-tax price of giving (Steinberg, 1990; Bakija and Heim, 2008).

Changes in income and tax benefits are two important drivers of the amount households give to nonprofit organizations—but they are not the only drivers. Changes in wealth and recent giving history also are important in household giving. Additional factors such as volunteering, social connections with other people, and values and beliefs, also play a role in decisions to give to charity (Bekkers & Wiepking, 2007; Andreoni, 1990; Jackson, Bachmeier, Wood, Craft, 1995; Clark, 2002).

President Obama's FY 2012 Budget Proposal

Focusing on deficit reduction and economic growth, the Obama administration released its FY 2012 budget in February 2011. According to an April 2011 report by the CBO, there are several components to the administration's budget proposal that would impact individual income taxes. We study two policy proposals that we believe could impact charitable giving:

» **Tax Rate Increase for Highest Marginal Income Tax Bracket.** The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) set in motion a gradual reduction in individual income tax rates through 2010; this tax relief was then extended for all taxpayers through 2012, by the Job Creation Act of 2010. The Obama administration's FY 2012 budget proposal reflects a permanent extension of the current individual rate reductions for households that report adjusted gross income of less than $200,000 (or $250,000 for couples) and allow the tax breaks for high-earning households to expire. Should those tax cuts be allowed to expire, the highest-earning households would see their marginal tax rate increase from 35 percent to 39.6 in 2013. In effect, the expiration of the current tax breaks would increase the taxes paid by the highest-earning households by 4.6 percent, meaning these households would have an additional tax liability of $46 for every $1,000 in AGI.

» **Limit Itemized Income Deductions to 28 Percent for Taxpayers at the Highest Marginal Income Tax Rates.** Another modification proposed in the Obama administration's FY 2012 budget places a limit on the tax benefit high-earning households realize from itemized deductions. Currently, taxpayers that itemize their tax returns are allowed various deductions, including (with various limitations) medical expenses, state and local taxes, home mortgage interest, and charitable contributions; as noted above, these deductions reduce the amount of a taxpayer's taxable income. The Obama administration has proposed capping the value of these deductions at 28 percent; in practice, this would limit the value of these deductions on households whose income fell to the 33 or 35 percent tax brackets. As with other itemized deductions, the value of the charitable contribution is dependent upon the tax bracket of the taxpayer. For example, a taxpayer in the 35 percent tax bracket who makes a $100 charitable donation currently realizes a $35 tax benefit in reduced liability; capping the limit at 28 percent would reduce this benefit to $28 per $100 deduction.

Impact of Changes in Income Tax Law and Effect on Federal Revenue for 2012 and 2013

The Obama administration's tax reform proposals are occurring within a larger national debate concerning the federal deficit and the role of the federal government in supporting economic growth. Given current law, the CBO projects the federal deficit will reach $1.08 trillion in 2012 (7.2 percent of GDP) and $0.69 trillion in 2013 (4.6 percent of GDP). To address concerns with the growing federal deficit, policymakers are examining policy approaches that would increase revenue and stimulate economic activity.

Within that context, the Obama administration's proposal to reduce the amount of tax benefit high-earning households can obtain from itemizing deductions would increase federal revenue by $3.8 billion in 2012 and $20.3 billion in 2013. This change alone would reduce the federal deficit by less than one percent in 2012 and by 2.9 percent in 2013 (see Table 1). Further, raising the marginal tax rate to 39.6 percent for the highest-earning households—would increase federal revenue by $118.40 billion in 2013, resulting in a 17.1 percent reduction to the projected federal deficit for 2013.

Effects of Policy Options to Alter the Tax Treatment of Charitable Giving, Using Center on Philanthropy Model Predictions

In order to estimate the effects of the administration's budget proposal on charitable giving, the Center on Philanthropy has examined the two proposed changes to the tax code that are most likely to impact charitable giving by high-earning households; those options are represented as options one and two below. We also consider a baseline option (extension of current tax rates and practices) as well as the implementation of both options.

In conducting its analysis, the Center on Philanthropy used the time-series, econometric model that has been used to generate *GIVING USA*'s annual estimates of charitable giving in the United States. This model applies methods developed by scholars, has been subjected to peer-review, and is widely used by practitioners, policymakers, academics, and the media.

The estimated change in itemized individual giving is based on a projection that incorporates historical trends in itemized giving and changes in economic variables related to personal income and wealth; these factors include personal consumption, the Standard & Poor's 500 Index, personal income tax rates, an indicator of whether a year was a recession year or not, and the Consumer Price Index. Our approach incorporates recent findings that show personal consumption to be a better indicator for predicting charitable giving than personal income.[2]

The Center on Philanthropy used estimates from the CBO and Tax Policy Center to determine the ways in which the administration's proposed budget would impact government revenue as well as funds available for private consumption. These data were then incorporated into the economic model to estimate the effect the administration's

[2] For more information on the original model, see: P. Deb, M. Wilhelm, P. Rooney, and M. Brown, Estimating Charitable Deductions in *Giving USA, Nonprofit and Voluntary Sector Quarterly*, Dec. 4, 2003, 548-567.

Table 1: Estimated Effect of the President's 2012 Budget on Baseline Deficits (Billions of Dollars)

	2012	2013
Total deficit as projected in CBO's March 2011 baseline [a]	-$1,080.88	-$691.73
CBO's estimate of the effect of limiting itemized income deductions to 28 percent on budget deficit [a]	+$3.80	+$20.30
COP's estimate using TPC data on the effect on budget deficit of increasing highest marginal tax rate to 39.6 percent [b]		+$118.40

Sources:
[a] The Congressional Budget Office (CBO), with contributions from the staff of the Joint Committee on Taxation, presented a preliminary analysis of the President's budget proposal for fiscal year 2012, which is based on its own economic assumptions and estimating techniques.

[b] Using data from the Tax Policy Center (TPC), a joint venture of the Urban Institute and Brookings Institution, the Center on Philanthropy created estimates for the effect of the tax rate changes on the budget deficit (see Appendix A for COP calculation).

proposals might have on charitable giving. Because the two measures we are examining would be implemented over two years, the Center on Philanthropy uses 2008 final IRS data on itemized deductions for charitable contributions and economic data from 2009 and 2010 to create a baseline year for comparison and for estimating the effects of each option. For both options, we adjusted tax rates and personal consumption following the assumptions outlined in the administration's proposal, holding all other variables constant. To determine the estimated changes in itemized deductions, the Center calculated the difference between each option and the baseline total in current dollars. The full model and the results for these estimates appear in the Appendix.

Given that approach, we find the following:

- <u>**Baseline:**</u> **Tax and spending policies unfold as specified in current law, with the exception that the existing tax breaks remain in effect for all taxpayers.** The Center on Philanthropy created a baseline estimate to compare the estimated impacts of the proposed modifications. The baseline is based on the assumption that tax and spending policies unfold as specified in current law with the exception that the two highest tax brackets—35 and 33 percent—remain in effect. This model includes no cap on any deductions. Based on those criteria, we estimate annual itemized giving to total $197.81 and $185.95 billion in Year 1 and Year 2, respectively. (see Table 2)

- <u>**Option 1:**</u> **Itemized deductions are capped at 28 percent for taxpayers earning more than $250,000 starting in 2012.** Under this option, the Center on Philanthropy found that itemized charitable deductions would decrease by $0.82 billion in Year 1, a decrease of 0.4 percent from the baseline, and decrease by $1.31 billion in Year 2, a decrease of 0.7 percent.

- <u>**Option 2:**</u> **Existing temporary tax breaks expire as scheduled at the end of 2012, thereby increasing the marginal tax rate for taxpayers earning more than $250,000 ($200,000 if single person) from 35 percent to 39.6 percent.** The Center estimates that itemized charitable deductions would decrease by $1.69 billion in Year 2, a decrease of 0.9 percent from the baseline.

- <u>**Total:**</u> **The cumulative impact of both options on charitable giving.** The Center estimates that the two changes combined will reduce total itemized giving by high-earning households by $0.82 billion in Year 1 and $2.43 billion in Year 2, a decrease of 1.3 percent from the baseline. It is important to note that the cumulative impact of Option 1 and 2 is not equal to the sum of the estimates provided for Option 1 and 2 alone. Our estimate of the cumulative impact takes into account that itemized charitable giving decreased in Year 1 as a result of capping deductions.

In summary, the modifications proposed by the administration could impact charitable giving in three ways. First, allowing existing temporary tax breaks to expire would increase the marginal tax rate on highest-earning households, thereby increasing those households' tax burden; one result of the increased tax burden is a reduction in the amount of those households' disposable income, which in turn decreases their capacity to donate to charitable organizations. Second, capping the value of itemized income deductions to 28 percent for high-earning households increases the after-tax price of giving to charitable organizations; as a result, high-earning households would have less of a financial incentive to engage in charitable giving. One additional effect of the adoption of the administration's proposed modifications could be a temporal change in a donor's approach to charitable giving; in effect, donors may choose to donate more under the current laws and less after the modifications go into effect. While this effect is not examined within our model, it is important to note that this could have an additional impact on charitable giving and cause additional uncertainty in the funding environment within which nonprofit organizations operate. These changes could have a negative impact on the nonprofit sector at a time when the nonprofit sector is facing challenges.

The Impact on Nonprofit Organizations

With the slow economic recovery from the 2008 recession, nonprofits are anticipating reductions in their traditional sources of revenue at the same time they are experiencing an increased demand for their services. *GIVING USA* has shown for more than fifty years that three-quarters of charitable donations are made by individuals and households; and, within that, high-earning households provide a disproportionate share of those donations. Several studies examine data from the *Survey of Consumer Finances* and find that high-earning households account for as much as 30 to 70 percent of all individual charitable giving, depending upon the level of income examined (Havens & Schervish, 2001; Havens, O'Herlihy, & Schervish, 2006). Further, Joulfaian (2000) found that charitable giving could exceed claimed income tax deductions by a factor of at least two; that is, very high-earning households gave twice as much as they could deduct on tax returns. Schervish and Havens (2003) estimated that total charitable contributions exceeded claimed deductions in 2001 by as much as $7.4 billion.

Because tax policy changes have the potential to reduce the incentive for individuals and households to engage in charitable giving, the Center estimates the Obama administration's proposed modifications may result in lower levels of giving. As noted above, the Center estimates that capping deductions at 28 percent and allowing existing tax breaks to expire will result in a reduction of charitable giving by highest-earning households; we estimate a reduction of $0.82 billion in Year 1 and $2.43 billion in Year 2 should these policies be adopted. While these reductions are relatively modest—no more than 1.3 percent of itemized charitable giving— the study indicates

Table 2: Estimated change in itemized charitable giving if income tax policy changes are implemented, by type of option

		Baseline	Option 1	Option 2	Combined
Year 1	Estimated Total Itemized Giving (Billions)	$197.81	$196.99	$197.81	$196.99
	Change in Total Itemized Giving from Baseline (Billions)	n.a.	-$0.82	$0.00	-$0.82
	Percent of Baseline Total Itemized Giving	n.a.	-0.4%	0.0%	-0.4%
Year 2	EstimatedTotal Itemized Giving (Billions)	$185.95	$184.64	$184.26	$183.52
	Change in Total Itemized Giving from Baseline (Billions)	n.a.	-$1.31	-$1.69	-$2.43
	Percent of Baseline Total Itemized Giving	n.a.	-0.7%	-0.9%	-1.3%

that the proposed changes in after-tax income as a result of the higher tax rates would have a larger effect on giving than would capping the charitable deduction at 28 percent. In that context, even a modest reduction in charitable giving could place the nonprofit sector under further fiscal strain and render the sector less able to meet growing needs. Because these tax policy changes will adversely impact the nonprofit sector by reducing its fiscal capacity to deliver services and meet social needs, this negative impact of the nonprofit sector's capacity should be considered within the larger discussion of economic, fiscal, and tax policy debates.

Other Estimates of the Impact of Tax Policy Changes on Charitable Giving

Our analysis is intended to add to the national debates on tax policy and economic growth; as such, it is important to compare our analysis to other analyses examining the impact of tax policy on deductions and charitable giving. The CBO and the Congressional Research Service (CRS) have conducted two such analyses. In its analysis, the CBO aggregated the impact of all itemized deductions—including charitable deductions, mortgage interest, state and local taxes, and other eligible expenditures—on the federal deficit. The CBO estimates that the 28 percent cap on deductions will increase tax revenue by $293 billion through 2021. In the short term, the CBO expects the cap to boost revenue by $3.8 billion in 2012 and $20.3 billion in 2013.

The CRS evaluated the proposed modification to cap all deductions at 28 percent and examined the proposal's implications for charitable giving. Estimates by the CRS found that capping deductions at 28 percent would reduce overall giving between 1 and 1.5 percent in 2011, depending on whether the effects of capital gains tax rates on gifts of appreciated property are included.[3] Our findings are similar to the CRS estimates in both its impact and magnitude.

Alternative Policy Options for the Tax Treatment of Charitable Giving

While our analysis examined specific provisions of the Obama administration's FY 2012 budget, there are other policy options likely to be considered by the Joint Select Committee on Deficit Reduction, the bicameral and bipartisan panel formed as a result of the Budget Control Act of 2011 charged with developing strategies for deficit reduction. Policy options related to tax incentives and charitable giving that could be considered include:

- Replacing the current charitable tax deduction with a 12 percent nonrefundable charitable tax credit available to all filers, not only to those who itemize; [4]
- Capping graduated tax rates at a maximum of 28 percent as part of a larger effort to reform itemization rules and taxation of capital gains, dividends, and more (*National Commission on Fiscal Responsibility and Reform*, 2010);
- Implementing a consumption tax, sometimes called the Fair Tax, instead of an income tax (*Fair Tax Act* H.R.25/S.296);
- Creating a national value-added tax (Gale & Harris, 2010); or
- Implementing a flat tax, with one rate for everyone and no deductions (Hoffman &

3 Several studies take into consideration the influence of different price elasticities of giving, income effects, and inter-temporal substitution effects as donors change the timing of their giving before the new policies go into effect (Bakija, 2000; Bakija & Heim, 2008; Bakija & Heim, 2011; Cordes, 2011; Randolph, 1995; Auten, Sieg, & Clotfelter, 2002).

4 Proposed in late 2010 and revived as a proposal in July 2011. The tax credits count only toward taxes owed on income after a standard deduction that is applied for all taxpayers.

Moody, 2003).

The impacts of each of these proposals on charitable giving would vary depending on how they were implemented and the specific tax rates considered. In general, most research finds that if there are no, or lesser, financial incentives for giving, charitable contributions will decline (Auten, Sieg, & Clotfelter, 2002; Peloza & Steel, 2005; Bekkers & Wiepking, 2007).

Strengths and Limitations of This Analysis

Like any estimate, our analysis is sensitive to the particular methods and assumptions used and could reach different conclusions from similar analyses. However, these estimates are consistent with the CRS's 2010 analysis of an earlier version of the Obama administration's proposals.

Our analysis is based on an econometric model that incorporates historical trends in itemized deductions for charitable contributions and changes in economic variables related to personal income and wealth. These estimates were developed using 2008 final IRS data on itemized deductions for charitable contributions and economic variables such as personal consumption, an indicator of whether a year was a recession year or not, and the Standard & Poor's 500 Index from 2009 and 2010. Our predictions are meant to highlight the general effects of various elements of the administration's budget proposal on charitable giving. The exact size of those effects, however, can be challenging to estimate beyond a few years because long-term estimates require a giving history for households covering a long period of time. Further complicating a long-term analysis is the confounding effect of the difference in ways individuals may act if they perceive a tax change as a temporary measure or as a permanent shift. An additional limitation of our approach is that it does not consider changes in the economy's growth rate over time. The administration's budget proposal aims to reduce the federal deficit and boost economic growth. The projected deficits included in the analysis for 2012 and 2013 are much smaller relative to GDP than is the current deficit; under those assumptions—with continued economic expansion—revenue as a share of GDP are projected to rise steadily. Should the projected deficits upon which our analysis is based differ considerably from what actually occurs, our predictions are less likely to be realized.

Other changes in governmental policies and in the economy overall could also impact charitable giving in complex ways (Bakija & Heim, 2008). At the household level, individuals may change their behavior in the short-term in anticipation of changes in tax benefits in the future by shifting donations between years (Barrett, McGuirk, & Steinberg, 1997); such an effect is not considered within our analysis. Additionally, we do not attempt to consider the distributional impact of these changes by subsector, we simply seek to broadly illustrate the effects that changes in tax policy could have on charitable giving.

Our model is based on a reduced form approach to estimate the impact that changes in tax policy may have on charitable giving. The estimation approach assumes an underlying relationship between macroeconomic variables and charitable giving; however, the model itself does not fully specify all of the complex economic and social interactions that influence overall charitable giving. Our model is based on a single estimating equation: an econometric model that relates charitable giving, tax policy, and other macroeconomic variables. Future work to complement this analysis will rely on household level data to better understand the impact across income groups or by subsector (Wilhelm, forthcoming).

Comparison to the Center on Philanthropy's 2009 White Paper

President Obama's budget proposal for 2010 also included changes to the tax deduction that high-earning households could claim for charitable contributions. In 2009, the Center on Philanthropy examined the possible impact of those changes. The Center's white paper *How Changes in Tax Rates Might Affect Itemized Charitable Deductions* estimated $3.87 billion less in charitable giving—a 2.1 percent decrease (using 2006 as a base year)—resulting from both a deductions cap and the expiration of existing tax breaks. The variation between the results in this document and the results of the 2009 white paper reflect the economic differences between 2006 and 2009/2010 as base years as well as the difference in staging the implementation of the cap and the tax rate hikes under the present proposal, rather than having both changes take effect in the same year.

Conclusion

Unlike other tax incentives, the charitable deduction is unique in that it provides an incentive to individuals to give to charities that serve individual and societal needs. The proposed tax policy changes may reduce wealthy households' incentives to give to charities, or to give as much as they might have. According to *GIVING USA 2011*, total giving grew by 2.1 percent in 2010 after adjusting for inflation compared to a combined drop of over 13 percent in 2008 and 2009. The reality is that many nonprofits are still facing increased demand for services, and if giving continues to grow at that rate, it will take five to six more years to return to pre-recession levels. Finding ways to address the nation's economic challenges without curbing the growth of the nonprofit economy will encourage voluntary giving and strengthen the role of civil society organizations.

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Appendix

Table III explains the Center on Philanthropy calculations used to determine the changes in consumption that would occur as a result of the proposed change in the top marginal tax rate from 35 percent to 39.6 percent. Researchers used data from the Tax Policy Center on the number of households and average income of those in three income brackets above $250,000, the threshold at which President Obama's proposed tax rate increase would occur. By calculating the difference in the amount owed as taxes at the two different rates, and multiplying those figures by the number of households affected, researchers were able to determine the total dollar amount in additional taxes that would be paid at the higher rate. This figure directly correlates with a decrease in dollars available for consumption. The final calculation finds an increase in taxes (and thus, a decrease in consumption) of $118.42 billion among households with income greater than $250,000. This is the consumption estimate used as part of the econometric model to predict the impact of tax policy changes on charitable giving.

Table III: Center on Philanthropy Estimates of Impact of Tax Rates on Consumption

Tax Policy Center Data			Center on Philanthropy Estimates			
				Amount over $250,000 taxed at highest rate		Total Increased Taxes ($ billions)
Income Level	**Number of Households**	**Average Income**	**Amount Over $250,000**	**35% Tax Rate**	**39.6% Tax Rate**	**Number of Households* Average Difference**
$200,000 to $499,999	6,329,000	$ 299,437	$ 49,437	$ 17,303	$ 19,577	$ 14.39
$500,000 to $1 million	1,147,000	$ 714,015	$ 464,015	$ 162,405	$ 183,750	$ 24.48
More than $1 million	598,000	$3,141,857	$2,891,857	$1,012,150	$1,145,175	$ 79.55
			More in taxes = Less in consumption ($ billions)			**$ 118.42**

The 2011 estimating model compared with the 2009 model

The Center on Philanthropy uses a macroeconomic model that has been systematically examined and used to generate *Giving USA*'s annual estimates of charitable giving in the United States. The estimated change in itemized individual giving is based on a projection that incorporates historical trends from 1936 through 2000 to estimate itemized giving from 2001 through 2008. These factors include personal consumption, the Standard & Poor's 500 Index, personal income tax rates, and the Consumer Price Index. In spring 2011, Partha Deb, an econometrician at Hunter College at the City University of New York, tested *Giving USA*'s model for estimating giving by individuals and found that personal consumption was a better indicator for predicting giving in recent years than personal income—the variable that had been used in the 2009 model.[1] The 2011 model does not include changes in income, but does include changes in consumption (expenditure). While consumption is linked with income across most households, in the highest income brackets (those likely to be affected by the proposed cap on deductions), the relationship between income and consumption is much weaker.

Data on consumption is important because charitable giving is included as an element of household consumption. Tax policy affects consumption because as taxpayers increase the amount they pay in taxes, they see an equal decrease in the level of disposable income available for, among other things, charitable donations to nonprofit organizations. The Center on Philanthropy uses estimates from the Congressional Budget Office and Tax Policy Center to determine the ways in which the President's budget proposals would change government revenues, thereby affecting funds available for consumption. This calculation is then incorporated into the economic model to estimate the effects of the proposals on charitable giving.

Partha Deb, an econometrician at Hunter College, New York, developed and tested the model used by the Center on Philanthropy to estimate changes in itemized charitable deductions by individuals. The general model is:

$$y_t = \alpha_0 + \alpha_1 y_{t-1} + X_t \beta + \varepsilon_t$$

This means: Changes in giving (y) at one time (t) are a function of a constant (represented by the Greek α) plus changes in giving the year before ($\alpha_1 y_{t-1}$) plus changes in other factors (each labeled X) multiplied by a coefficient (β). The factors labeled X include the Standard & Poor's 500 Index, Personal Consumption Expenditures, and the tax price of giving at the highest marginal tax rate. There is also a term for unknown variables, represented here by the Greek ε.

[1] For more information on the original model, see: P. Deb, M. Wilhelm, P. Rooney, and M. Brown, Estimating Charitable Deductions in Giving USA, Nonprofit and Voluntary Sector Quarterly, Dec. 4, 2003, 548-567.

Examining the effects of the tax policy changes on itemized giving

To analyze the effect of the proposed policy changes in 2012 (Year 1) and 2013 (Year 2) on giving by itemizers, we modeled the effect of these policies if they were implemented in the years 2009 and 2010, the latest years that all necessary economic data are available to inform the prediction. Thus, all proposed changes in 2012 are imposed on 2009 data, and all proposed changes in 2013 are imposed on 2010 data.

Option 1

- We increased the tax price of giving in 2009 from 0.65 to 0.72, to reflect the cap on deductions at 28 percent of adjusted gross income. This cap remains in place for both Year 1 and Year 2.
- We deducted $3.8 billion from consumption expenditures in 2009, because the Congressional Budget Office estimates a $3.8 billion increase in revenue in the first year of implementation of the cap on deductions.
- We deducted $20.3 billion from consumption expenditures in 2010, again because the Congressional Budget Office estimates a $20.3 billion increase in revenue in the second year of implementation of the cap on deductions.

Option 2

- We increased the tax price of giving in 2009 from 0.65 to 0.72, to reflect the cap on deductions at 28 percent of Adjusted Gross Income. This cap remains in place for both Year 1 and Year 2, as shown in Table V.
- We added $3.8 billion to consumption expenditures in 2009, because the Congressional Budget Office estimates a $3.8 billion decrease in revenue in the first year of implementation of the President's budget proposal.
- We added $118.4 billion to consumption expenditures in 2010, again because the Congressional Budget Office estimates a $118.4 billion decrease in revenue in the second year of implementation of the President's budget proposal.

Table IV: Model for predicting change in charitable giving in Year 1 (Note $ in 100 billion [-1.11 = -$111 billion)				
		Values used to predict change in giving in 2009 (Year 1)		
Dependent variable	**Coefficient**	**Baseline**	**Option 1**	**Option 2**
Intercept	0.0176			
Difference in giving the year before (lagged difference in giving)	-0.0152	0.02	0.02	0.02
Difference in consumption expenditures	-0.0211	-1.11	-1.17	-1.11
Squared difference in consumption expenditures	0.0147	1.24	1.31	1.24
Difference in S&P 500 Index	0.0145	1.92	1.92	1.92
Squared difference in S&P 500 Index	-0.0014	3.70	3.70	3.70
Difference in tax price of giving for those at highest marginal tax rate	-0.1068	0	0.07	0
Squared difference in the tax price of giving for those at highest marginal tax rate	-0.3995	0	0.0049	0
Recession (indicator of recession year)	-0.0030	1	1	1

Note: S&P Index as measured on the last day of each calendar year.
All differences indicate change in value compared to the previous year.
Coefficients in this table were calculated by estimating our regression model using data from 1936 to 2007. These estimates were then used to get fitted values for difference in charitable giving for the years 2008 and 2009. Our final estimate for charitable giving in 2009 was calculated by adding the predicted difference in charitable giving in 2008 and 2009 to the actual charitable giving total for the year 2007.

Table V: Model for predicting change in charitable giving in Year 2 (Note $ in 100 billion [-1.11 = -$111 billion)				
		Values used to predict change in giving in 2009 (Year 2)		
Dependent variable	**Coefficient**	**Baseline**	**Option 1**	**Option 2**
Intercept	0.0162			
Difference in giving the year before (lagged difference in giving)	-0.0235	-0.27	-0.27	-0.27
Difference in consumption expenditures	-0.0205	1.60	1.45	.53
Squared difference in consumption expenditures	0.0163	2.56	2.10	.28
Difference in S&P 500 Index	0.0168	1.11	1.11	1.11
Squared difference in S&P 500 Index	-0.0056	1.24	1.24	1.24
Difference in tax price of giving for those at highest marginal tax rate	-0.1016	0	0	0
Squared difference in the tax price of giving for those at highest marginal tax rate	-0.5200	0	0	0
Recession (indicator of recession year)	-0.0012	0	0	0

Note: S&P Index as measured on the last day of each calendar year.
All differences indicate change in value compared to the previous year.
Coefficients in this table were calculated by estimating our regression model using data from 1936 to 2008. These estimates were then used to get fitted values for difference in charitable giving for the years 2009 and 2010. Our final estimate for charitable giving in 2010 was calculated by adding the predicted difference in charitable giving in 2009 and 2010 to the actual charitable giving total for the year 2008.