[redacted]

**A FairTax® whitepaper**

# The impact of the FairTax on charitable giving and nonprofit organizations

Many assume that the level of charitable giving in America is driven by the tax code and tax deductions, concluding that if charitable donations were not deductible, then charitable organizations could not exist. Nothing could be further from the truth.

**After the 1986 Tax Reform Act, charitable giving increased rather than decreased, despite the lowering of marginal income and transfer tax rates.** Charitable giving rose by $6.4 billion, or 7.6 percent, in 1987 after the top tax rate fell from 50 to 28 percent (more than doubling the tax price of giving).[1] Likewise, the growth of charitable bequests was most rapid from 1980 to 1987 when estate taxes were coming down.[2]

**The FairTax increases the incentive to give.**
The incentive for giving to charitable organizations is not diminished in any respect by the FairTax. It increases. Under the FairTax, wage earners are taking home their *entire* paychecks – for families of modest means, whose charitable giving is often a very high percentage of their income, this is a substantial increase in available funds. Additionally, these contributions are also made with *pre-tax dollars.* Under the current system, the charitable deduction only offsets a portion of a taxpayer's tax liability. For those generally less affluent taxpayers who do not itemize, *the price of charitable giving actually goes down* under the Fair Tax because they are able to give to their churches or other charitable organizations from *pre-tax dollars*.

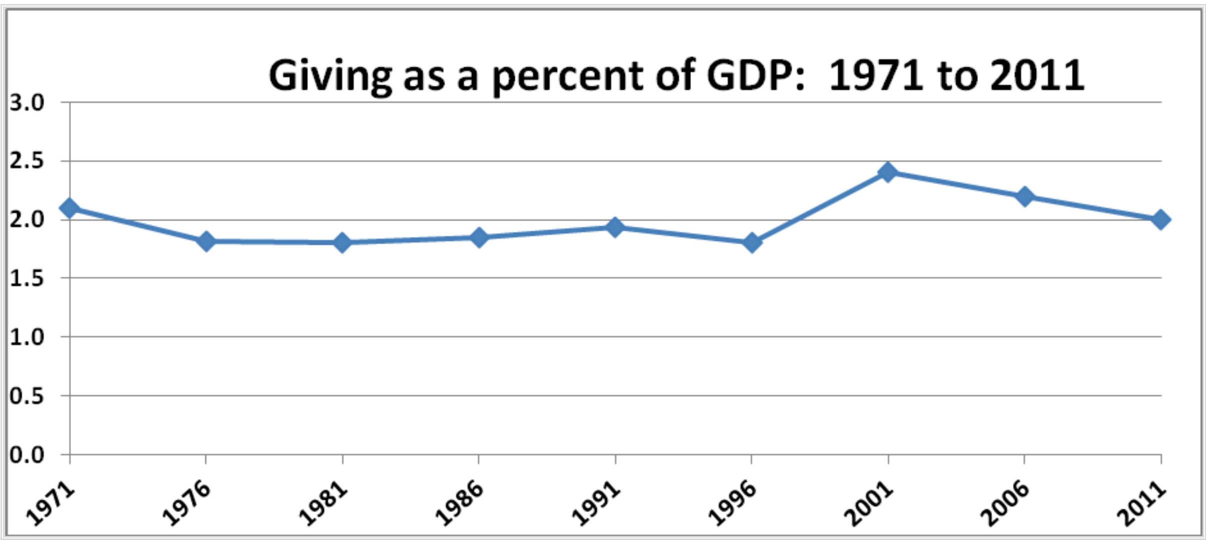
Under the FairTax, the two-out-of-three taxpayers who currently do not itemize deductions are not taxed on charitable contributions, and therefore, for the first time since 1986, the vast majority are actually encouraged to make charitable contributions. It should be noted that percentage ceilings also limit individual contributions today – even if a taxpayer itemizes. For example, all contributions are limited to fifty percent or less of adjusted gross income. This percentage is ten percent for corporations. These ceilings all disappear under the FairTax.

According to *Giving USA*, charitable contributions totaled $290.89 billion in 2010.[3] Of this amount, 58.5 percent or $170.24 billion was claimed by the 33 percent of individual taxpayers who itemized deductions on their 2010 federal tax returns.[4] When the effect of the increase in income from the FairTax is combined with the effect of the change in the price of giving for both itemizers and non-itemizers, recent research by Beacon Hill Institute finds that charitable donations would increase under

[1] Stephen Moore's response in "Republic of Taxes: When Uncle Sam Takes Do Americans Give?" *Philanthropy Magazine,* Spring, 1997.
[2] Based on federal estate tax returns data reported in Reynolds, Alan, "Death, Taxes and Giving: The Conventional Wisdom and Why it is Wrong," *Philanthropy Magazine*, Winter, 1997.
[3] *Giving USA 2011: The Annual Report on Philanthropy for the year 2010*.
[4] Internal Revenue Service Statistics of Income Data, Table 2.1 Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2010.

the FairTax by $2.06 billion. This translates to an 0.89 percent increase in the first year (2007), an increase of 2.40 percent within 10 years of its introduction, and an increase of 4.99 percent after 20 years. These increases are in comparison to a baseline in which the current tax regime continues.[5]

**When do people increase their giving and when do they cut back? It's the economy!**
Charitable giving is more a function of the economy than of the tax code. The common phrase, "It's the economy, stupid!" applies here yet again. Over the past forty years, the level of annual donations almost exactly tracks personal income growth.[6,7]




*Source: Data from Giving USA Annual Reports, various years.*

When the economy is up, along with personal income, Americans give. When the economy falls off a cliff, so does charitable giving. Americans are always generous, but the key to sustaining their giving is a booming economy. Economists have consistently predicted a sustained boom in the American economy once consumption taxes replace income taxation.[8] This will drive charitable giving to new heights.

---

[5] Tuerck, David G., Jonathan Haughton, Alfonso Sanchez-Penalver, Sara Dinwoodie, and Paul Bachman, "The FairTax and Charitable Giving, Beacon Hill Institute, February 2007.

[6] Moore, op. cit.

[7] "The most overwhelming proof that tax incentives have a relatively minor effect on individual charity is the tremendous consistence over time of giving as a percentage of income. Although the tax code has changed frequently and dramatically over the past 23 years, giving as a share of personal income has hovered around 1.83%. This measure reached as high as 1.95% in 1989 and as low as 1.71% in 1985. The narrow range has persisted even though the top marginal tax rate has fluctuated in that period between 28 and 70 percent. It suggests that raising income growth will do more to boost charitable giving than any tax incentive." Quoted from Barry, John S., "Faith, Growth, and Charity," *Policy Review*, March, 1977.

[8] See Kotlikoff, Laurence J.and Sabine Jokisch, "Simulating the Dynamic Macroeconomic and Microeconomic Effects of the FairTax," *National Tax Journal*, June 2007. David G. Tuerck, et.al., "The Economic Effects of the FairTax: Results from the Beacon Hill Institute CGE Model," The Beacon Hill Institute at Suffolk University, February 2007. Arduin, Laffer & Moore Econometrics, A Macroeconomic Analysis of the FairTax Proposal, June, 2006.

**When do the wealthy give? When they *want* to give!**
While serious wealth is only a narrow sector of charitable giving, when compared to the breadth of modest giving, it does command high visibility in the press. Therefore, it is worthwhile addressing here. The highest net worth benefactors, who grant large donations, are primarily and overwhelmingly influenced by their desire to contribute to a cause.[9] Once they make that decision to contribute, they then tailor that contribution to maximize the contribution while minimizing taxes.[10] The reciprocal is very rarely the case. Just as the FairTax allows every American to make their business decisions solely on what is good for their customers and employers, rather than being hamstrung by tax consequences, the FairTax unfetters the wealthy from any tax considerations on their charitable giving.

**What is the effect on religious donations?**
While churches rely on charitable donations, they are somewhat impervious to the tax motivation, as charitable contributions are linked more to church attendance than to tax credits or incentives. "Americans who regularly attend church services contribute 2.2% of their income, a much higher average than non-church-goers who average 1.4%. And the churchgoers' higher level of giving is not confined to [their] own congregations but extends to all types of non-profits . . . Active civic participation, and church attendance in particular, is more important to a healthy non-profit sector than the presence of any tax credit or deduction."[11,12]

**Non-religious charities such as universities and museums, for example, rely little on donative sources of giving.**
The large non-profits (whose assets account for more than three-fourths of the total assets of tax exempt charitable organizations) received only 7.8 percent of their income in 1998 from direct public contributions. Revenues from program services and membership, on the other hand, made up 74.5 percent of total revenues.[13,14]

---

[9] The 2000 National Committee on Planned Giving's updated donor survey results show "unequivocally that the top reason people create a charitable bequest, establish a charitable remainder trust or other planned gift is the desire to support the charitable organization and its mission. Charitable intent as a key motivating factor was much more of a priority than financial or tax considerations." Quoted from Burrill, Janice H., "The Effects of Estate Tax Repeal on Philanthropy," *Trust & Estates*, Oct. 2001, Vol. 140, No. 10.

[10] A 1996 Independent Sector poll of people who made charitable donations found that "keeping taxes down" ranked dead last on a list of seven reasons people gave for giving, and was cited as the second least likely factor to influence giving (even behind "being encouraged by an employer"). See Riley, Tom, "The Final Cut," *Philanthropy Magazine*, March, 1999.

[11] Barry, John S., "Faith, Growth, and Charity," *Policy Review*, March, 1997.

[12] Rose Anne Devlin also found religious giving was not influenced by the fact that charitable donations were tax deductible. See Devlin, Rose Anne, "Charitable Giving and Charitable Gambling: an Empirical Investigation," *National Tax Journal*, March, 2000.

[13] Large non-profits are those 501(c)(3)s with over $50 million in assets. Percentages are calculated from data in Table 1, "Form 990 Returns of Nonprofit Charitable Section 501(c)(3) Organizations: Selected Balance Sheet and Income Statement Items, by Asset Size," IRS Statistics of Income Bulletin, Fall, 2001.

[14] For tax-exempt charitable organizations, as a whole, contributions from direct public support accounted for 11.12 percent of total revenue for reporting year 1998. Revenues from program services and membership accounted for 68 percent of total revenues. Percentages are calculated from data in Table 1, "Form 990 Returns of Nonprofit Charitable Section 501(c)(3) Organizations: Selected Balance Sheet and Income Statement Items, by Asset Size," IRS Statistics of Income Bulletin, Fall, 2001.

## Additional points

Several more points should be mentioned.

- A large source of income for universities, colleges, and other training institutions is tuition payments. Under current law, tuition payments are not deductible, not creditable, and must be paid with after-tax dollars, except for credits available to low income taxpayers. Under the FairTax, all payments for tuition and training are considered investments in human capital and not taxable. Therefore all payments for tuition and training are made from pre-tax earnings.
- Voluntary services provided to non-profits today, under the income tax system, are discouraged because out-of-pocket expenditures are not fully deductible. Under the FairTax, such expenditures are paid from pre-tax earnings.
- Those uncompensated services provided by a charity to that population for which the charity was founded and by which it fulfills its mission do not generate a taxable, retail-delivery event under the FairTax. (This stands in contrast to barter between commercial interests and individuals or between individuals. Such barter does generate a taxable event.)
- Charitable operations, of course, continue to be tax exempt, operating under a sales tax exemption certificate as they do today with most states. The FairTax does not tax purchases made by qualified nonprofits/charitable organizations.
- When charities provide products or services to individuals for compensation, essentially a retail transaction, that transaction is taxed. This is comparable to the current system not allowing the deduction of that portion of a gift for which the donor received some return compensation.

### What is the FairTax Plan?

The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16th Amendment. This nonpartisan legislation (HR25/S13) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

## What is Americans for Fair Taxation® (FairTax.org)?

FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: www.FairTax.org or call 1-800-FAIRTAX.

Karen Walby, Ph.D., Chief Economist, Americans For Fair Taxation, 2007. Updated February, 2013.