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Tax Reform and Charitable Contributions Hearing 2/14/2013

To the Members of the Ways and Means Committee:

The deductibility of charitable contributions is crucial to the survival of over 1 million nonprofit organizations in the United States. Although tax revenue is of course of great concern to the proper administration of government, because these charities exist the government does not have to shoulder the burden they carry in every aspect of society –health, welfare, education and culture to name a few general areas.

Every income producer has a certain amount of social capital. Some of this social capital is spent on taxes of every sort to support the general public and the government itself –whether federal, state or local. The rest of this social capital is greatly discretionary; to be used as the individual sees fit to support the causes he or she feels an obligation or attachment to support –whether to address global hunger or a local library. This social capital is exactly that: funding used not to increase one’s own wealth but to assist society in many vital ways.

Even with the charitable tax deduction, it is never cheaper to give money away than it is to keep it. The charitable tax deduction acknowledges the sacrifice the contributor has made to the general good simply by reducing the amount of income that is taxed. Functionally, this deduction only ensures that the taxpayer is not taxed on resources that are in fact used for public good, and not for private gain. There is no private inurement in charitable contributions.

The current limits on the charitable deduction relating to gifts to a 501(c)(3) public charity, in broad stroke terms, are limited to 50% of the taxpayer’s income for cash and 30% for a gift of other property. There is a 5-year carry over provision, but these limits assure the circumstance that a taxpayer will, in fact, have income subject to taxation and thus also funding governmental activities.

Most of the reform proposals discussed in the advance paper for the hearing on February 14, 2013 will have a deeply negative impact on charitable giving. Many charitable gifts are able to be made because the donor will not have to also pay a tax on that contribution. Many of the reforms discussed will greatly increase the cost of a charitable gift, and thus reduce the amount available for charitable giving. This is particularly true of transformational gifts which require a great deal of planning because the donor is not giving out of cash flow but out of assets.

To address each proposed reform in order presented in the advance papers:

Extending the tax benefit of charitable contribution to non-itemizers

This would seem a fair reform to enable non-itemizers to have the same benefit to not be taxed on the funding they apply to the social good.

We support this proposed reform.

Limiting the marginal tax benefit of itemized deductions (including the charitable contribution deduction)

The President has proposed a revenue-raising provision that would limit the tax benefit of certain deductions and exclusions (including the charitable contribution deduction) to 28 percent. (quoted from the advance paper) This will have the effect of increasing the cost of charitable giving, which as mentioned before in this submission, is basically taxing a donor on funds the taxpayer has spent for the general good of society. Any arguments made that since the effect of this is limited to high income donors, it levels the playing ground a bit because the higher income donor receives a higher marginal tax benefit from charitable contributions than a lower income donor would for the same contribution ignore the facts that higher earners pay more taxes in general, and also that with the various tax brackets all taxpayers will have benefits in line with their own tax bracket, unless a flat tax is instituted. Without a full deduction being allowed, a person who spends \$100 on caviar will be treated the same, taxwise, as a person who spent that \$100 feeding orphans if they occupy the same tax bracket.

We oppose this proposed reform.

Putting a contribution-based floor on the tax benefit of charitable contribution

Some advocate for a contribution-based floor on the tax benefit of charitable contributions. The floor could be set at either a fixed-dollar amount or a percentage of AGI. Under this regime, taxpayers would receive no tax benefit for charitable contributions below a threshold contribution level. (quoted from the advance paper)

This reform also would have the effect of decreasing overall giving and also would unfairly adversely affect those giving smaller donations, effectively punishing them for giving to charitable causes without the means to gift enough to exceed the floor. Although proponents maintain that donors who gift at lower levels are less sensitive to marginal tax incentives, these same donors are well aware that losing a charitable deduction means that they are effectively paying taxes on the income they donate, and reinforces the erroneous conclusions that “small gifts don’t matter” and “philanthropy is only for the wealthy.”

Considering that many small charities are able to keep their doors open only through many small donations, this proposed reform would especially adversely affect the causes that lower-income donors tend to support, such as homeless shelters and soup kitchens.

We oppose this proposed reform.

Capping the total allowance for itemized deductions (including the charitable contribution deduction)

Some propose limiting the total deduction allowed under the itemized deduction provisions, either to a fixed-dollar amount or to a specified percentage of AGI. (quoted from advance paper)

Some itemized deductions are discretionary and some are not, so to the extent that a potential donor's nondiscretionary deductions are maximized, potentially, that donor's tax incentive to make a charitable contribution is reduced to zero. Further, a cap would discourage transformational giving where donors gift out of assets rather than cash flow, since these gifts are usually larger and would more quickly exceed the cap and reduce the marginal tax benefit. Gifts of assets are almost always made with the marginal tax benefits in mind, and so would reduce overall charitable giving.

We oppose this proposed reform.

Replacing the charitable contribution deduction with a tax credit

This proposed reform would benefit non-itemizers and enable such taxpayers to receive a benefit for their charitable contributions, so as to non-itemizing taxpayers, such a credit would increase their overall giving by decreasing their cost to do so.

This proposed reform would negatively impact higher-income donors as their after-tax cost of giving would likely increase. Thus, for this set of donors, overall charitable giving would likely decrease. Several states have instituted tax credit incentives for certain charitable contributions, such as scholarship funds, and contributions to these funds seem to be limited to the benefit of the tax credit, regardless of the income of the donor.

We support part of this proposed reform which relates to non-itemizing taxpayers, and oppose this proposed reform in relation to higher-income taxpayers.

Replacing the charitable contribution deduction with a matching grant program

This reform would create extensive administrative costs both for charities and for the government and seems to fly in the face of a purported desire to increase efficiencies on the part of the federal government. Additionally, constitutional issues may arise regarding religious institutions, and causing taxpayers who donate to faith based organizations to divert their donations to secular organizations providing similar services in order to take advantage of the matching grant program. Additionally, since the donor would not receive an actual tax deduction, overall giving would decrease because of the taxpayer being taxed on income given away to benefit society.

We oppose this proposed reform.

Limiting the charitable deduction for contributions of appreciated property

This proposal would decrease charitable contributions of appreciated property. There does not seem to be an exception in this proposed reform for publicly traded appreciated property. For any appreciated property, to restrict the charitable deduction to the basis, as opposed to the FMV, would create a tax disincentive by essentially forcing the donor to sell the property, pay the capital gains tax, contribute whatever funding is left over to the charity, and thus also reduce the amount actually going to the charity. Additionally, long term capital gain property with a difficult to determine basis will increase the out-of-pocket cost of giving. The main impetus for this proposal may well be perceived abuse of valuation, but that is better addressed in other ways.

We oppose this reform.

Other proposals relating to tax compliance and administration

Other reform proposals include (1) eliminating the charitable deduction for contributions of conservation easements on golf courses; (2) allowing deductions for contributions made up until the tax return filing deadline (rather than the end of the taxable year); (3) increasing information reporting requirements and verification efforts; (4) facilitating certain contributions such as those from IRAs or lottery winnings;¹⁸⁵ (5) simplifying and raising the existing charitable contribution deduction limits, including the 10-percent corporate limit; (6) and generally simplifying and restructuring section 170 of the Code. (quoted from advance paper)

Since specific measures relating to these proposed reforms have not been elucidated, we are neutral on these proposed reforms until such time a methodology for implementation is proposed.