# How the 2017 U.S.Tax Reform May Impact Charitable Giving

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Donations from individuals account for nearly three-quarters of all charitable giving in the United States and added up to more than $280 billion in 2016. But will this massive flow persist? Changes to tax policy can influence incentives individuals and households face when making decisions about how much to give to charity. The U.S. tax code has, for some time, used deductions to encourage charitable giving by individuals who itemize their expenses. Although the recently-enacted tax code leaves these charitable deductions in place, changes in their structure and value mean that the new tax code may change how much U.S. charities receive in funding.

## Existing Tax Facts – and How They Have Changed

The U.S. tax deduction for charitable giving is intended to subsidize nonprofit organizations and encourage their socially valuable activities. Nonprofit organizations, the reasoning goes, may supplement or substitute for government activities serving citizens, and may involve citizens more directly. The charitable giving deduction was established shortly after the income tax itself, by the War Revenue Act of 1917. Currently, it is capped at 50 percent of adjusted gross income, and is only available to households that itemize deductions.

About 30 percent of American households have itemized deductions, and they tend to be higher-income households that account for about four-fifths of individual charitable giving. Higher-income households derive greater tax benefits from the charitable tax deduction, because any tax deduction reduces taxable income by the amount deducted; it thus lowers the tax liability by the pertinent tax rate times the deducted amount. Given the highly progressive nature of the tax code, with increasing marginal rates, a deduction is worth more to higher income households. The Congressional Budget Office estimated that over 80 percent of this benefit accrues to households in the top quintile of the income distribution, with over one-third accruing to the top one percent of households. Tax deductions and credits are called “tax expenditures,” because they are functionally equivalent to the government raising and expending revenues. In 2016, the tax expenditure for the charitable giving deduction to all qualifying organizations was $54 billion. Some U.S. states also offer additional tax incentives for charitable giving.

As Congress debated a major tax code overhaul in 2017, various ideas were on the table that differed in their treatment of charitable giving. Some proposed expanding the availability of the deduction to all households, whether they itemize or not. Other proposals aimed to cap or even eliminate the deduction. And still others recommended using a tax credit rather than a deduction – an approach that would give all tax filing units the same benefit from making charitable donations, regardless of their tax bracket.

But in the end, the longstanding charitable deduction for itemizers was left in place, even as the rest of the U.S. tax code was changed in ways that affect its scope. Starting in 2018, the new tax system nearly doubles the value of the standard deduction, which will reduce the number of households that itemize deductions on their returns. The new code also cuts marginal tax rates slightly for top earners – making it less valuable to their bottom lines to use charitable deductions.

## What Tax Treatments of Charitable Giving Mean

America’s high-income households give to all causes, yet they have long provided the majority of donations to organizations that support health, education, and the arts.

- Had tax deductions for charitable giving been eliminated altogether, U.S. tax collections would have increased, with much of the new revenues coming from high-income households. but charitable giving might well have declined substantially. Reductions in tax rates may have increased the income retained by high-income households, offsetting some of this effect.

- On the other hand, expanding the deduction to all households would have likely increased giving somewhat, though the gains would primarily have gone to households that already make donations. Lower-income households face lower marginal tax rates and thus would not be as responsive to changes in deductions.

By keeping the existing deduction in place while reducing its value to high income households, Congress has put the tax system's impact on charities on an uncertain course. Tax policy is extremely complex and the current changes involve numerous factors that will affect individuals' giving patterns and government revenues. Most current projections suggest that the 2017 changes that reduce tax incentives for charitable giving will, in fact, shrink donations – though it is not clear by how much. Policymakers, civic leaders, and especially professionals working in non-profits that rely on charitable giving should keep a close eye on the ongoing implementation and downstream effects of the new tax code. Institutions and groups in the non-profit sector will surely take steps to adapt to the new system – and so will donors, especially the wealthy.

Recent discussions about taxes and charitable giving remind us of the larger practical and normative issues at stake. Does the existence and structure of the tax deduction for charitable giving matter when thinking about how charities benefit society? Setting a precise social value on the activities of nonprofit organizations is difficult and often subjective – and some observers maintain that the largest beneficiaries of the traditional deduction – like elite universities – are not necessarily the most worthy, neediest, or most socially valuable causes. Overall, the charitable deduction is more easily justified if the increase in charitable giving it causes is at least as much as the reduction in tax revenues that occurs because of deductions. Estimates from the economics literature vary, but they suggest that charitable giving in the United States is been quite responsive to tax incentives and that the cost of the incentives has been offset by benefits to society as a whole. Experience with the new tax system will tell whether this remains true.

**Read more in Catherine Eckel, David Herberich, and Jonathan Meer "A Field Experiment on Directed Giving at a Public University" *Journal of Behavioral and Experimental Economics* (Forthcoming).**