COMPROMISING THE SAFETY NET: HOW LIMITING TAX DEDUCTIONS FOR HIGH-INCOME DONORS COULD UNDERMINE CHARITABLE ORGANIZATIONS

Patrick E. Tolan, Jr.
COMPROMISING THE SAFETY NET: HOW LIMITING TAX DEDUCTIONS FOR HIGH-INCOME DONORS COULD UNDERMINE CHARITABLE ORGANIZATIONS

Patrick E. Tolan, Jr.*

ABSTRACT

President Obama’s recent budget proposals have contemplated reducing the top rate for charitable deductions (and all itemized deductions) to twenty-eight percent. Because America’s largest donors are those in the highest marginal tax brackets, efforts to limit deductibility of charitable donations could have a chilling effect on charitable giving.

In this paper the author looks at motivations for charitable donations and specifically at the impact of tax deductibility as a motivating factor. It takes a historical look at the philanthropic surveys and econometric models and examines empirical data concerning impacts of significant changes to the tax code in the 1980s that could be used as indicators or predictors of what the proposed limitations on deductibility could have on donations. The author also considers impacts of the recent recession on the non-profit sector which has already been burdened by historically high numbers of unemployed individuals and children in poverty.

Because the economic downturn has already stifled charitable giving at a time when the non-profit sector is facing high demands, any further erosion may be the straw that breaks the camel’s back. If tax changes dampen the enthusiasm for charitable giving even further, countless charities may go under and prospective new charities may not be able to get off the ground to pick up the slack. At the end of the day, government welfare programs, which are more costly than a tax subsidy for charitable donations, would be needed to meet the needs of citizens slipping through a crumbling safety net.

* Associate Professor, Barry University School of Law. An earlier version of this Article was presented at the 2012 Southeastern Association of Law Schools’ Economic Challenges and Charitable Organizations Panel. I appreciate the many thoughtful suggestions provided during those conferences. In addition, I wish to thank [****] for their comments and suggestions regarding the ideas and arguments presented here. Any errors are, of course, my own.
COMPROMISING THE SAFETY NET: HOW LIMITING TAX DEDUCTIONS FOR HIGH-INCOME DONORS COULD UNDERMINE CHARITABLE ORGANIZATIONS

TABLE OF CONTENTS

I. INTRODUCTION ........................................................................................................3

II. BACKGROUND ...........................................................................................................5

A. The Charitable Donation Deduction Then and Now ..............................5

   1. INCEPTION OF THE CHARITABLE DONATION DEDUCTION .........5
   2. PRESENT DEDUCTIBILITY...............................................................8
   3. 2013 Budget Proposal Changes.......................................................11

B. Justifications for the Deduction.................................................................13

   1. Ideal Income Tax Excludes Charitable Donations from Income ....15
   2. Efficient Subsidy Theory Income ....................................................18
   3. Equity Theory .................................................................................24
   4. Distributive Justice—Rawls Revisited ...........................................27
   5. The Need for Salience d.................................................................28

C. Charitable Deduction Evolution Over the Years .................................30

   1. Changes to Limit Deductions as a Percentage of Income .............31
   2. Changes to the Pool of Tax-Advantaged Donors .........................32
   3. Tax Rate Changes.............................................................................33

D. How Giving has Changed in Response to Tax Changes ..................38

   1. The early years—up to 1950s .........................................................39
   2. 1950s-1960s ..................................................................................41
   3. 1970s .............................................................................................42
   4. 1980s .............................................................................................47
   5. 1990s-Present ...............................................................................50

III. DONATIONS DROP IN TIME OF SERIOUS RECESSION...............52

IV. ANALYSIS & RECOMMENDATIONS ....................................................54

V. CONCLUSION ........................................................................................................63
COMPROMISING THE SAFETY NET: HOW LIMITING TAX DEDUCTIONS FOR HIGH-INCOME DONORS COULD UNDERMINE CHARITABLE ORGANIZATIONS

Patrick E. Tolan, Jr.*

Charity is thus a blessed act that should suffer no discouragement from something so mean as the tax code.¹

I. INTRODUCTION

More Americans—46 million—are presently living in poverty than at any time in the past fifty years.² Even more disturbing, child poverty rates have climbed to twenty-two percent, up from sixteen percent just ten years ago.³ As demand for social services peaks, many newly

* Associate Professor, Barry University School of Law. An earlier version of this Article was presented at the 2012 Southeastern Association of Law Schools’ Economic Challenges and Charitable Organizations Panel. I appreciate the many thoughtful suggestions provided during and after that presentation. In addition, I wish to thank [****] for their comments and suggestions regarding the ideas and arguments presented here and in earlier drafts. Any errors are, of course, my own.

¹ Ellen P. Aprill, Churches, Politics, and the Charitable Contribution Deduction, 42 B.C. L. REV. 843, 855 quoting Rep. Philip Crane, 147 Cong. Rec. E243-44 (2001). Congressman Crane had the support of 149 members of Congress in an earlier version of the charitable deduction reform bill he was proposing (calling for those taking the standard deduction to also be entitled to a charitable donation deduction). Rep. Philip M. Crane, Testimony in Support of the Charitable Giving Tax relief Act, 147 Cong. Rec. E244 (Feb. 28, 2001). Crane’s remarks explain why many believe that charitable donations are fundamentally different than other personal donations. “Charity benefits both the giver and the receiver in like proportions. The act of giving elevates the heart of the giver. The act of receiving elevates the condition of the recipient.” Id.


unemployed, or others who have never needed social services before, will turn to charities, specifically their churches, for services because they don’t know about public assistance or how to obtain it.4

Despite this unparalleled modern economic hardship, President Obama has proposed reducing the tax relief for wealthy taxpayers who donate to charity.5 To the extent these changes could deter charitable giving, the government could unwittingly undermine the non-profit safety net that insulates the government from being the only provider for the impoverished.6

The charitable donation is different from other personal deductions because the beneficiaries include not only the donor, but the charitable organizations as well as those they serve. Therefore, it should not just be lumped in with restrictions on other itemized deductions. Instead, consequences of a cap on deductions to the charitable sector must be intrinsic to any discussions impacting donations to the charitable sector so that our national leaders don’t make ill-advised decisions, especially in the face of the struggling economy, a time when demands on this sector are at a peak.

This article considers the several rationales for allowing charitable donations and analyzes the potential consequences of implementing the president’s recent budget proposal. Because America’s largest donors are those in the highest marginal tax brackets, efforts to limit the deductibility of their charitable donations could have a chilling effect on charitable giving. This could be especially troublesome in our recent down economy, at a time when donations overall have dropped due to the

low-wage work that we have.” NPR, How America’s Losing the War on Poverty, supra note 2.

4 MacDonald, supra note 3 (quoting Taniesha Woods of Columbia University’s National Center for Children in Poverty). Ms. Woods further noted, “faith-based service programs tend to catch people who fall through the cracks of other safety nets.” Id.


6 Government aid of course takes many forms and is provided by many levels of government to promote the welfare, health and safety of its citizens. Free and reduced price school lunches keep many poor children from going hungry, tax exempt-military subsistence for low ranking soldiers and their families—a significant percentage of whom are below the poverty line—puts food on their table, the Food Distribution Program on Indian Reservations (FDPIR) provides meals for qualifying Native American families; the Supplemental Nutrition Assistance Program (SNAP—formerly food stamps) and Transition Assistance for Needy Families (TANF—formerly welfare payments) are more broadly available for the poor.
recession and have never recovered.⁷ Looming threats of another recession could make matters worse before they get better.⁸

II. BACKGROUND

At the outset, it is appropriate to provide a brief introduction to the general tax scheme concerning deductions for charitable donations. This Section considers what has been done historically and why it was done, but the impacts of changes in the tax scheme are addressed later. This Section also addresses the current tax treatment of charitable donations as a framework for understanding how the proposed changes would depart from the status quo. Finally, the details of the changes in the 2013 budget proposal are discussed.

A. The Charitable Donation Deduction Then and Now

1. Inception of the Charitable Donation Deduction

The tax deduction for charitable donations has been around for almost a hundred years⁹—nearly as long as the Sixteenth Amendment has allowed direct taxation of individual income.¹⁰ It was one of the earliest allowable personal tax deductions.¹¹ Initially it served as a reprieve from

---


⁸ Danielle Kurtzleben, CBO: Fiscal Cliff Effects Now Look Worse (“Updated projections show a contracting economy in 2013, with unemployment moving above 9 percent”); see also Congressional Budget Office (CBO), Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013 (May 2012)[substitute Aug 2012 when released].

⁹ War Revenue Act of 1917, Act of October 3, 1917, ch. 63, tit. XII, § 1201(2), 40 Stat. 330 (codified at I.R.C. § 170); see also Aprill, supra note 1, at 848 (noting an attempt to institute the deduction in 1913 was unsuccessful).

¹⁰ Const. amend. XVI (1913). Prior to the 16th Amendment, direct taxes had to be apportioned according to the populations of the various states in accordance with the census. Pollock v. Farmers' Loan & Trust Company, 157 U.S. 429 (1895), aff'd on reh'g, 158 U.S. 601 (1895). The 1894 corporate income tax held unconstitutional in Pollock actually excluded charitable organizations from the income tax. Peter J. Wiedenbeck, Charitable Contributions: A Policy Perspective, 50 Mo. L. REV. 85, 87 (1985).

¹¹ Exemptions for insurance proceeds payable upon death, gifts, and inherited property were part of the original income tax in 1913. Revenue Act of 1913, Section II, B. 38 Stat. 114, 167 (1913). Personal and business deductions were allowed in computing net income and included relief for taxes and interest paid, business expenses, exhaustion, wear and tear of business assets, casualty losses, and uncollectable debts. Id.
the wartime burden of income taxes on the wealthy in World War I. As originally enacted in the War Income Tax Revenue Act of 1917, the deduction extended to organizations “operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals.”

The chief proponent of the charitable donation deduction was Senator Henry F. Hollis who asked that a series of editorials in favor of the proposal be admitted to the Congressional Record. These arguments have been used to support the efficient subsidy justification embraced by some commentators for such deductibility (the efficient subsidy theory is discussed infra at Section B.2.), but a more comprehensive review of the


The top marginal rate jumped from 15% in 1916 to 67% in 1917 due to an additional 2% “war normal” tax on all incomes and an additional 50% tax on the highest incomes under the 1917 law (the additional tax was above the 2% “normal” and 13% highest additional tax in the 1916 revenue Act). Blakey, supra note 11, at 794, 804.

Title XII amended income taxes in 1916 and 1917 by exempting “gifts for charitable, religious, educational, and scientific purposes, to the extent of 15 per cent of the payer's taxable net income. Id. at 804.

Vada Waters Lindsey, The Charitable Contribution Deduction: A Historical Review and a Look to the Future, 81 Neb. L. Rev. 1056, 1061 (2003) (quoting War Revenue Act of 1917, ch. 63, § 1201(2)). Of course, the statute has become much more complex since that time. Wiedenbeck, supra note 10, at 85-87 (most complexities “were added as anti-abuse measures by the Tax Reform Act of 1969.”). Some tax scholars have criticized the broad reach of current allowable charitable deductions or advocated for reform in limiting charitable donees or affording a preference for charities that serve the needs of the poor, but these arguments are beyond this scope of this article. For articles advocating a smaller universe of charitable donees or preferences for organizations serving the poor, see Shannon Weeks McCormack, Too Close to Home: Limiting the Organizations Subsidized by the Charitable Deduction to Those in Economic Need, 63 Fla. L. Rev. 857, 911-14 (2011) (suggesting priority for underfunded donees); Miranda Perry Fleischer, Equality of Opportunity and the Charitable Tax Subsidies, 91 B.U. L. Rev. 601, 606 n.14 (2011) (suggesting use of equal opportunity theory to prioritize which charities merit subsidies or, in the alternative, require all to support the poor through free or reduced-cost services).


record reveals other concerns that afford additional historic justifications for the deduction. His remarks are introduced here in some detail to put the deduction in its proper historical context, but the implications of his remarks are discussed later, where appropriate, in concert with the various policy justifications for the deduction. A deeper understanding of the full panoply of values motivating the addition to the tax code of charitable donation relief is consistent with the myriad justifications for the donation as well as the mixed motives that stimulate donor behavior. The following remarks demonstrate these plural and incommensurable values:

If the Government takes all, or nearly all, of one's disposable or surplus income, it must undertake the responsibility for spending it, and it must then support all those works of charity and mercy and all the educational and religious works which in this country have heretofore been supported by private benevolence.\textsuperscript{16}

The tax deduction for charity is consistent with the principles of American democracy espoused in the 19th Century by Alexis de Tocqueville that America’s greatness depends on individual and community responsibility, not the federal government.\textsuperscript{17} It’s no surprise that as direct taxes on individual income became constitutional, Congress was mindful of protecting the individual ability and autonomy to donate to charitable organizations to preserve the social support function in private and community hands. Even before taxes became necessary to fund the war effort in 1917, Congress had proposed tax relief for donations to charity.\textsuperscript{18} These efforts were consistent with de Tocqueville’s framework of American greatness: the preference for small central government and an engaged individual and community role in charity.\textsuperscript{19}

Of course these protections were before major social reforms during and after the Great Depression.\textsuperscript{20} While the Great Depression prompted social legislation, and initiatives like the Great Society were “major leaps forward” in formulation of a government safety net, even


\textsuperscript{18} Thomas J. Burmeister, \textit{Burnin’ Down the House—and Deducting it Too: Charitable Contributions of Buildings to Fire Departments Under I.R.C. § 170, 94 MARQ. L. REV. 1013, 1017 (2011).}

\textsuperscript{19} Marshall, \textit{supra} note 17.

after these reforms, “at heart . . . [Americans] favor private charity over the government dole.”21

2. Present Deductibility

Code Section 170 outlines the deductibility of charitable donations. Section 170 allows an itemized deduction for cash and non-cash donations to charity.22 “An important effect of this provision is to lower an individual’s net cost of making gifts.”23 Although the United States has experimented with allowing a deduction for charitable donations for non-itemizers, the non-itemizer deduction was eliminated when the tax laws were comprehensively re-codified in 1986.24 Therefore, the code only currently allows those itemizing deductions to write-off their charitable gifts. The substantial increase in the amount of the standard deduction in 1986 also significantly reduced the number of taxpayers who itemized their deductions.25

If an organization does not qualify for an exemption as described in Code Section 501(c)(3), donors may not deduct contributions under Code Section 170.26 To qualify for exemption under Section 501(c)(3), a tax-exempt organization must demonstrate27 both that it is organized and operated exclusively for exempt purposes28 and that no part of its earnings inure to private individuals.29 These organizations perform a number of diverse functions including “religious, charitable, scientific, testing for

21 Leone, Foreword to PATTERNS OF GENEROSITY, supra note 20.
22 Of course some charitable giving occurs in the form of bequests or devises of property to charity upon the donor’s death or in the form of charitable trusts, however trust and estate tax consequences of such gifts are beyond the scope of this article.
25 Clotfelter, supra note 23, at 4-5, and Table 2, citing IRS Statistics of Income (SOI), SOI Bulletin 8 (Spring 1989) (dropping from 40% of all taxpayers in 1986 to 30% in 1988).
26 I.R.C. § 170(c) (donors could also donate to public schools or other government agencies).
27 American Science Foundation, 52 T.C.M. 1049 (CCH 1986). Gaps in the application and vague or ambiguous assertions are construed against the applicant. La Verdad v. Commissioner, 82 T.C. 215 (CCH 1984); New Dynamics, 70 Fed. Cl. 782, 802 (2006); Share Network Foundation, 78 T.C.M. 6.
29 I.R.C. §§ 170(c)(2)(C), 501(c)(3); TREAS. REG. § 1.501(c)(3)-1(a)(1). An organization’s articles of organization must limit its purposes to one or more exempt purposes, and must not empower the organization to engage in substantial activities which do not further the exempt purposes. TREAS. REG. §§ 1.501(c)(3)-1(b)(1)(i), (iii) and (iv).
public safety, literary, or educational purposes,” preventing cruelty to children or animals or promoting amateur sports.\textsuperscript{30} The I.R.S. scrutinizes applications for Section 501(c)(3) status to ensure organizations, particularly foundations, are not established to benefit the donor/founder.\textsuperscript{31}

Cash contributions follow comparably easy donation rules and limits while non-cash gifts of appreciated property follow more complex rules. For cash donations to a public charity, individuals can deduct up to 50\% of their contribution base (modified/basically AGI)\textsuperscript{32} in the present tax year and donations in excess of this amount may be carried forward as deductions for up to five succeeding tax years.\textsuperscript{33} Gifts to private foundations, on the other hand are limited to 30\% of the taxpayer’s contribution base (with any surplus also being carried forward for up to five tax years).\textsuperscript{34}

Contributions of appreciated capital assets to public charities generally are deductible at fair market value (FMV) at the time of the donation, up to 30 percent of an individual taxpayer’s contribution base.\textsuperscript{35} Note that no income tax is paid on the appreciation in the hands of the taxpayer, yet the taxpayer can deduct the full FMV of the donated asset making the deductibility of such donations doubly blessed by the tax code.\textsuperscript{36} The taxpayer is allowed a five year carry over for any excess donation. Because of the potential for abuse, especially “inflated” real estate values, the taxpayer must get a qualified appraisal to substantiate the FMV of any gift over $5,000 and must attach an appraisal to gifts over $500,000.\textsuperscript{37}

\textsuperscript{30} I.R.C. §§ 170(c), 501(c)(3).
\textsuperscript{32} Contribution base is defined as “adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172).” I.R.C. § 170(b)(1)(G).
\textsuperscript{33} I.R.C. § 170 (b)(1)(a), (d) (in general, public charities are funded by the public at large and are comprised of churches, public entities, etc.).
\textsuperscript{34} I.R.C. § 170 (b) (F) (in general, private foundations are funded by private donors who own or manage the donations).
\textsuperscript{35} I.R.C. § 170. Donations to private foundations are limited to 20\%. I.R.C. § 170(b)(1)(D)(1)(i).
\textsuperscript{36} A donor has the option of reducing the value of the donation by the amount it appreciated if the donor wants to increase the donation ceiling from 30\% to 50\% of AGI, but the donor must elect this approach for all long-term property gifts. I.R.C. §§ 170(b)(1)(C)(iii) and 170(e)(1)(B); see also Treas. Reg. § 1.170A-8(d)(2).
\textsuperscript{37} I.R.C. § 170; Treas. Reg. § 1.170A-13(c). Because substantiation requirements are statutory, they cannot be waived even when there is no dispute over value. See Mohamed v. Commissioner, T.C. Memo, 2012-152, Doc 2012-11529, 2012 TNT 104-8 (certified real estate appraiser’s own appraisal failed to meet independent...
Assets that constitute ordinary income property (inventory, a farmer’s crops, etc.), on the other hand, receive less favorable tax treatment. The donor of such property is allowed to deduct the lesser of cost basis or FMV. The ceiling is 50% of the contribution base and a five year carry forward applies.

Treatment of tangible personal property such as paintings and antiques depends on whether the taxpayer donates it to a charity for a related use (such as an art work to an art museum) or whether the gift is unrelated to the tax exempt purpose of the charitable organization (such as donating a painting to the Salvation Army). When there is a related-use gift, the donor enjoys a deduction for the full FMV of the donation whereas the lower of cost basis or FMV rule applies to unrelated gifts. The ceiling on related use gifts is 30% of contribution base whereas the ceiling on unrelated use gifts is 50% of the contribution base. In both cases excess donations can be carried forward for up to five years.

Most people, of course, can’t afford to donate anywhere near 30-50% of their contribution base; however, for the wealthy it is reported that they often give more than they can deduct. This is due to at least four factors: 1) the fact they have more assets that have appreciated over time (after all the wealthy by definition have more accumulated wealth and if their assets did not appreciate they would no longer be wealthy); 2) they have had the ability to invest and likely have been successful investors so that their income is predominantly capital gains instead of earned income; 3) favorable tax provisions make it more valuable to donate appreciated stocks and bonds to get the benefit of the deduction and escape capital gains taxation; and 4) the wealthy are financially astute and (either on their own or with the advice of financial counselors, accountants, and tax attorneys), are sophisticated about maximizing the tax benefits of their behavior and will look to manage their affairs, even how they give their money away, in the most financially efficient way.

38 I.R.C. § 170(e)(1).
41 Roberton Williams, Income and Taxes of the Very Rich, 136 TAX NOTES 121 (July 2, 2012), available at http://www.taxpolicycenter.org/UploadedPDF/1001624-TN-RW-Income-and-Taxes-of-the-Very-Rich.pdf. Because the most wealthy realize a greater share of their income from investments (taxed at the lower capital gains rate) they pay lower effective tax rates. Id. (“Compared with others making more than $1million, the very rich [top 400] get much less of their income from salary and wages — less than one-tenth in recent years [compared to roughly one-third for other millionaires.”).
42 Trusts and estates and exploiting the excluded amount of gift taxes are examples of analogous tax minimizing behavior outside the charitable donation realm but confirm
In short, the wealthy are in a position to benefit from donation of capital assets that have appreciated on paper but for which they have paid no taxes; this fact, coupled with their relatively heavy share of capital gains revenue compared to earned income from salaries and wages and the lower contribution base for such assets results in a situation that even with carry forwards the value of large donations may not be completely written off.\(^{43}\)

3. 2013 Budget Proposal and Expiring Tax Cuts

The current proposal would reinstate the 36% and 39.6% brackets for high-income taxpayers and limit the value of all itemized deductions (as well as other specified deductions and exclusions) for those in these brackets to 28%.\(^{44}\) A partial reduction of certain itemized deductions (including that for charitable donations) on high-income taxpayers is also reintroduced.\(^{45}\) It is worth noting that this partial reduction and the 35% that the wealthy have (or have access to people who have) the knowledge, skill and ability to do so in the most tax effective manner. After all, if not for the wealthy the whole trust and estate planning industry would dry up.

\(^{43}\) See Jane G. Gravelle & Donald J. Marples, Charitable Contributions: The Itemized Deduction Cap and Other FY2011 Budget Options, CONGRESSIONAL RESEARCH SERVICE REPORT 7-5700, 1 (Mar. 10, 2010) (discussing 2010 and 2011 proposals). Deductions may never be fully enjoyed for very large donations or by donors with large donations year after year. Id. at 5-6.

\(^{44}\) 2013 Budget Proposal, supra note 5, at 67, 74. The proposed limits are very broad-ranging in terms of limiting all itemized deductions (not just the charitable donation deduction) and would similarly limit to 28% the tax value of the following tax preference items:

- Tax-exempt state and local bond interest
- Employer-sponsored health insurance paid by employers
- Employer-sponsored health insurance paid by employees with before-tax dollars
- Contributions to health savings accounts and Archer MSAs
- Health insurance costs of self-employed individuals
- Employee contributions to IRAs & defined contribution retirement plans
- The deduction for income attributable to domestic production activities
- Certain business deductions of employees
- Moving expenses
- Interest on education loans
- Certain higher education expenses

Id. at 74.

\(^{45}\) Before the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) was enacted, itemized deductions (other than casualty losses, investment interest, medical expenses, and gambling losses) "were reduced by 3 percent of the amount by which AGI exceeded a statutory floor that was indexed annually for inflation, but not by more than 80 percent of the otherwise allowable deductions." Id. at 67. “EGTRRA temporarily eliminated the itemized deduction limitation and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA)
maximum marginal tax rates for individuals in existing laws are due to expire at the end of 2012. If allowed to expire, the 36% and 39.6% rates and the partial reduction of certain itemized donations would be restored for these same top-bracket taxpayers in any event.\textsuperscript{46}

The 2013 Budget Proposal will impact only individuals with adjusted gross incomes above $200,000 ($250,000 for married couples).\textsuperscript{47} Because charitable donations are an itemized deduction, the limits will not affect the two-thirds of American taxpayers who take the standard deduction instead of itemizing.\textsuperscript{48} Therefore, this article focuses on charitable giving by those with incomes above $200,000 who itemize their deductions. While the numbers of these taxpayers are small,\textsuperscript{49} the potential impact is considerable since these donors give disproportionately large amounts to the charitable sector.\textsuperscript{50} Such philanthropy is consistent

extended this tax relief for two years, through 2012.” See 2013 Budget Proposal, supra note 5, at 67. Mechanically, the 28\% proposed rate “would apply to itemized deductions after they have been reduced by the statutory limitation on certain itemized deductions for higher income taxpayers.” Id. at 74.

\textsuperscript{46} “Under current law, taxes are scheduled to increase about $450 billion in 2013.” Tax cuts capping the top marginal rate at 35\% were extended through 2012 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 [hereinafter TRUIRJCA], Pub. L. No. 111-312, 124 Stat. 3296, available at http://www.gpo.gov/fdsys/pkg/PLAW-111publ312/pdf/PLAW-111publ312.pdf (Section 101 extended the 2001 cuts and Section 102 extended the 2003 cuts). The Congressional Budget Office has predicted increased taxes plus statutory spending cuts to take effect at January 1, 2013, could send America over a “fiscal cliff” and back into recession. See infra notes 313-19 for a discussion of potential impacts of the fiscal cliff on donations.

\textsuperscript{47} 2013 Budget Proposal, supra note 5, at 67, 74.


\textsuperscript{49} They donate roughly 40\% of itemized donations. IRS SOI, Individual Income Tax Returns 2010, supra note 20 at 89, 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 (those above 200,000 income gave $68 billion of about $170 billion dollars in itemized charitable donations). IRS SOI, Table 2.1,

12
with the idea of giving from surplus that is preserved by the charitable deduction.\textsuperscript{51} Throughout the years, the charitable deduction has been allowed without any rate cap, notwithstanding that the tax relief may flow disproportionately to these major donors. The next section considers these various justifications.

\textbf{B. Justification for the Deduction}

It is undeniable that favorable tax treatment motivates charitable giving, especially for the wealthiest taxpayers.\textsuperscript{52} However, the fact that non-itemizers (those who currently do not receive a tax break for such donations) continue to give shows that tax consequences are only one contributing factor to the decision to donate. As mentioned above, the economy is another factor and in a recession it is tougher for anyone to give. Nevertheless, even though donations may drop in a down economy, they don’t dry up altogether. These facts suggest other, non-financial, factors must explain or motivate some donative behavior.

A litany of non-financial motivators includes altruism, a sense of religious or other moral obligation, a desire to be recognized as generous (perhaps as a role model for children or others), a sense of gratitude or reciprocity from previously enjoyed benefits (either specifically from a targeted charity or generally), and a desire to make a positive difference in the world.\textsuperscript{53} Indeed, the wide range of values and norms at play may undermine somewhat the motivational force of the tax deductibility of the

\textsuperscript{51}This phenomenon is not surprising given the higher tax relief and greater ability to donate enjoyed by those with the most wealth and has been widely studied and documented. See generally Auten, Clotfelter & Schmalbeck, \textit{supra} note 40 (projecting an even greater role in wake of government “devolution” of the mid-1990s and increasing concentrations of income at the top).

\textsuperscript{52}The Center on Philanthropy at Indiana University, \textit{The 2010 Study of High Net Worth Philanthropy}, at 10 (Nov. 2010), \textit{available at} http://www.philanthropy.iupui.edu/Research/docs/2010BAML_HighNetWorthPhilanthropy.pdf [hereinafter “Bank of America Merrill Lynch 2010 Study” in recognition of the study sponsor] (67\% of 800 responding wealthy households “would somewhat or dramatically” reduce charitable contributions if there was no income tax deduction; this number is up from 47\% in a 2008 study). “[S]tudies generally find that taxpayers respond to the after-tax price of giving.” The Center on Philanthropy at Indiana University, Impact of the Obama Administration’s Proposed Tax Policy Changes on Itemized Charitable Giving (Oct. 2011).

\textsuperscript{53}Some pleasure or gratification may obtain from feeling good about the donation.
donative transfer.\textsuperscript{54}

At the same time, however, this breadth and diversity of motivating factors is, at least in part, a fundamental characteristic of these donations, implicating plural and incommensurable values. For lack of a better term, the author will refer to these nonfinancial values as “the essence of charity,” for this cornucopia of motivators explains the considerations pure economics can’t account for. The essence of charity is the desire for doing good that “goes to the core of who we are as a nation.”\textsuperscript{55}

Obviously, the essence of charity is important for many donors, especially those who donate despite little to no tax subsidy. However, one could speculate that such donors might contribute even more if there was a tax subsidy. For example, all other things being equal, a donor in the 15% bracket who itemizes can donate $1.15 to charity with the same after-tax consequence as a nondonor who spends $1 on something else. If the subsidy was 25%, [perhaps in the form of a tax credit, as has been advocated by some to neutralize the “upside down” effect of a heightened advantage to those in higher brackets]\textsuperscript{56} he could increase the donation from $1.15 to $1.25 for the same dollar of income this donor has agreed to forgo in personal consumption. On a more realistic donation level, if he could afford to do without 1,000 after-tax dollars as a sacrifice for charitable purposes, with the credit he theoretically would donate $1,250 versus the $1,150 donated under the existing scheme. This assumes, of course, sufficient cash or other assets on hand to make the higher donation.\textsuperscript{57}

As important as this potential impact could be to lower-income taxpayers (and as a matter of tax reform more broadly), the tax consequences of the President’s proposal are only to the top tier donors. These donors have (perhaps because the tax consequences are higher or perhaps because they are more likely to have professional financial help

\textsuperscript{54} See, e.g., Henry E. Smith, Mind the Gap: The Indirect Relation between Ends and Means in American Property Law, 94 CORNELL L. REV. 959, 960 (2009) (“It is hard to be against human flourishing and a concept that is in one form or another central to Aristotle, Aquinas, Catholic social thought, modern virtue ethics, some forms of natural law, and the capabilities approach … but one can question the degree of consensus required for implementation in a legal regime”).


\textsuperscript{56} Gravelle & Marples, supra note 43, at 24.

\textsuperscript{57} The Center on Philanthropy at Indiana University, Impact of the Obama Administration’s Proposed Tax Policy Changes on Itemized Charitable Giving (Oct. 2011), at 4 (personal consumption a better indicator for predicting charitable giving than personal income). In this example, he could “consume” the larger donation even though income remained constant because the government increased the subsidy.
and hence be aware of tax impacts) responded much more dramatically to changes than lower income taxpayers.

In a 2010 study, two-thirds of wealthy households “would somewhat or dramatically” reduce charitable contributions if there was no income tax deduction;\textsuperscript{58} this number is up from 47% in a 2008 study.\textsuperscript{59} The Center on Philanthropy at Indiana University recently concluded “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.”\textsuperscript{60} Another recent study, comparing the giving behavior across varying states with different tax treatments for charitable donations also found a strong correlation between tax relief and incentives for the wealthy to give.\textsuperscript{61} A number of different arguments over the years have been advanced to support the deductibility of charitable donations and these arguments are analyzed next.

1. Ideal Income Tax Excludes Charitable Donations from Income

Economist Henry Simons defined income as an aggregate of consumption and an increase in the accumulation of wealth\textsuperscript{62} (in more elementary terms, spending plus savings). In a thoughtful law review article, Professor William Andrews proposed to modify Simons conventional formulation to describe an ideal tax base in terms of consumption and accumulation of wealth, but excluding from the consumption component those items that make the taxpayer personally no better off.\textsuperscript{63} From a tax policy perspective, Andrews argued that a personal deduction should be allowed for such items since at the end of the day they were neither consumed for the benefit of the taxpayer nor

\textsuperscript{58} It would have been more pertinent if they had been asked about the proposed 28% limitation instead of “no deduction” since the tenure of the question may have triggered a more negative response.

\textsuperscript{59} Bank of America Merrill Lynch 2010 Study, supra note 52 at 10.

\textsuperscript{60} Center on Philanthropy, supra note 57, at 4.

\textsuperscript{61} Jon Bakij & Bradley T. Heim, How Does Charitable Giving Respond to Incentives and Income? New Estimates from Panel Data, 64 NAT’L. TAX J. 615, 617-19, 647 (June 2011) (“decisions about how much to donate to charity are influenced significantly by tax incentives.”). To measure the tax implications of donations, Bakij and Heim looked at differences in donor behavior for donors in states with different tax rates to compare with similar income individuals in states with no income tax (as a control group). Id. at 615. In this way they were able to compare wealthy donors with wealthy donors instead of comparing high income individuals with moderate income individuals as a control group (which was the practice of most earlier researchers in this field). Id. Bakij and Heim concluded, “[o]ur most convincing estimates are identified by differences in the time-paths of tax incentives across states, and suggest a persistent price elasticity in excess of one in absolute value.” Id. at 615.

\textsuperscript{62} HENRY SIMONS, PERSONAL INCOME TAXATION 50 (1938).

accumulated as wealth. The charitable deduction was one such meritorious deduction, because, aside from the incidental pleasure of making the gift, the benefit derived by the donation was enjoyed either by the public at large or by individuals unrelated to the taxpayer.

Andrews assessed two types of donations, those inuring to the benefit of poor individuals (alms for the poor) and those for more broad philanthropic purposes. Regarding the former, alms to the poor merely reallocate the consumption of personal goods and services from the donors to the donees—the consumption by the donees (part of the traditional definition of income) should be taxable to them at their tax rate. Regarding more general philanthropy (gifts to museums, churches, educational institutions, symphonies, etc.), Andrews reasoned that common goods for shared use by any interested member of the community should be exempted. “[T]heir enjoyment is not limited exclusively or even primarily to those who pay for them [instead] the benefit conferred on others is of the same kind as that enjoyed by the contributor himself.”

Taxing these benefits, if at all, just like in alms to the poor, should be to those who benefit from the charitable services received based on the benefit consumed. However, the benefits are essentially free goods, because one’s enjoyment does not diminish anyone else’s. In addition there would be valuation problems (does a wealthy person consume more from a church sermon than a poor person; can figures be put on the value of a religious message?), difficulties in tracking indirect benefits (a safer community, a medical breakthrough, a more educated population) and a general damper on socially desirable behavior.

“The exact reasons of not taxing the recipients of other charitable services may vary from case to case, but in general they will arise from both the impracticality of measuring individual benefits and the undesirability of thwarting whatever purposes led the charity to make the provision of the services wholly or partly free.” In fact, Andrews notes

\textsuperscript{64} Andrews work also contained detailed justification for the deduction of medical expenses. See Id. at 335-343.

\textsuperscript{65} Id. at 314. Note that Andrews did not approve of the ability to deduct fair market value of appreciated goods. This is a government subsidy of the untaxed unrealized appreciation which for the highest rate taxpayers lead to the illogical result that the taxpayer has more money for private consumption after donating property than if he would have sold it and kept the proceeds. Id. at 371-73. As the tax deduction for charitable donations is considered for change, modifying it to eliminate this windfall seems more justified from a tax policy perspective than imposing a rate limit on deductibility.

\textsuperscript{66} Id. at 347-356.

\textsuperscript{67} Id. at 356-369.

\textsuperscript{68} Id. at 347. Andrews recognizes that recipients’ income may often fall below a taxable level. Id. at 347

\textsuperscript{69} Id. at 357-58.

\textsuperscript{70} Id. at 358.

\textsuperscript{71} Id. at 360.
that the historic justification for creating the deduction in the first place related to the legislative intent to preserve philanthropy in the face of steep taxes on the wealthy.\textsuperscript{72}

Others have justified the deduction on the theory that these common goods would otherwise have to be provided directly by the government.\textsuperscript{73} Andrews agrees insofar as people won’t generally agree to pay voluntarily for common goods at an optimum level, so that taxing the very kind of activity that creates shared common goods may be counterproductive.\textsuperscript{74} Most scholars that consider these common goods of philanthropy, however, prefer to envision the deduction as a government subsidy to motivate this positive social behavior.\textsuperscript{75}

Professor Mark Gergen exhaustively evaluates the subsidy theory concluding that a charitable deduction efficiently subsidizes collective goods provided by social welfare charities.\textsuperscript{76} Andrews does not use the subsidy construct because he argues that such an approach ought to be reserved for looking at deductions as tax expenditures which he feels is inapplicable for the charitable deduction because the amounts donated, in his opinion, never rise to the level of economic income to begin with.\textsuperscript{77} Gergen, on the other hand, views Andrew’s position as “at best, a reformulation of the efficient subsidy theory.”\textsuperscript{78} This efficient subsidy theory and the “equity theory,” espoused originally by tax legend Boris Bittker, deserve more consideration, in part because Gergen finds these theories “valid subject to significant normative and empirical constraints[\textsuperscript{79}] and in part because many recent scholars tend to focus on

\textsuperscript{72} Id. at 362, citing 55 Cong. Rec. 6728 (1917) (statement of Senator H.F. Hollis)
\textsuperscript{73} Aprill, supra note 1, at 864-65 (citing J.S. Seidman, SEIDMAN’S LEGISLATIVE HISTORY OF THE FEDERAL INCOME TAX LAWS 1938-1861, at 945 (1938)).
\textsuperscript{74} Andrews, supra note 63, at 370.
\textsuperscript{77} Andrews at 311-312 (presumptive characterization as a tax expenditure ignores intrinsic matters of tax policy that must be considered before examining extrinsic merits).
\textsuperscript{78} Gergen, supra note 76, at 1394.
\textsuperscript{79} Id. Indeed Gergen goes so far as to dissect different types of charitable donations to compare the relative merits of the competing theories and how each comes to bear on these categories of charitable relief. See id., Part IV, 1433-49. This paper does not examine individual charitable donees for several reasons. First, the focus of the paper is the overall impact of a rate-cap on deductions on charitable incentives for giving. Second, the Congress has chosen a favored set of organizations that qualify for taxpayers to make deductible donations for a variety of reasons, including historic reasons and there simply isn’t time to do them justice. Third, a wide array of donees (currently over a million different qualified organizations) promotes freedom and autonomy for taxpayers to chose the organizations that they feel are most worthy of help. With a million organizations and hundreds of millions of donors there is an equivalent to a free market where the donees compete for taxpayer favor. Fourth, private giving offsets the
the subsidy theory, either exclusively or predominantly, and often ignore other justifications that shape the charitable donation landscape. Other recent scholars have focused on distributive justice and the distinctions between allocative functions of the tax code (encouraging charitable giving) and distributive functions of tax expenditures. Inasmuch as a 28% rate-cap on charitable donations can be justified as a tax policy matter at all, it is important to deliberate on these competing justifications.

2. Efficient Subsidy Theory

The basic premise for the subsidy theory is that charitable organizations provide common goods to the people without cost. A pure public good would include, for example, cancer research, where society could benefit from a technological breakthrough without diminishing the benefits to any beneficiaries. Of course, since a person can benefit from an advance in the medical state of the art without donating to medical research there is a potential for “freeriders,” those who will benefit though they contributed none of the costs. Because of the freerider problem, unless there is a government subsidy, society will tend to under-invest in medical research. Therefore a subsidy is necessary. Other subsidy justifications include: common goods will be undervalued because there is no ready market price to evaluate their benefits; even those who will benefit and who do donate may underfund because they fail to appreciate ancillary benefits to others; and, some may be discouraged from giving altogether because others will receive the same benefit without paying.

Private donations indirectly subsidized by the tax code in the form of deductions for itemizing donors may allow private charities to respond preferences of elected majorities and “so may allocate resources to activities which are presently undervalued but which turn out to be socially beneficial. Gergen, supra note 76, at 1410 (using Salk’s polio vaccine as an example). Finally, religious donations make up the largest subsector of all giving and allowing tax deductions for private donations to fund these activities walks the fine line between the Establishment Clause and the Free Exercise Clause—allowing the government to do indirectly what it can’t do directly. Giving USA 2011 Report, supra note 7, at Executive Summary 11 (32% of all donations went to churches in 2011); Aprill, supra note 1, at 873 (“A tax deduction or credit ingeniously satisfies the values of both the Free Exercise and Establishment Clauses of the First Amendment.”);
better to the demand for collective goods than the government. With a tax subsidy, a high preference minority may fund a good at the level the minority desires; without it, the minority may not be able “to provide the appropriate amount of the good.” Another way of looking at it is that the government subsidy in a sense imposes part of the cost of the collective good on the freeriders in the form of tax revenue foregone. In this way, if society in general benefits, to the extent of the subsidy, society as a whole shares the cost.

Gergen explains that a deduction may be the only way to allow people with a high preference for a good to cover the bulk of the cost, while shifting some of the cost to freeriders. For example, with a 33% tax break, the donor is still funding two-thirds of the cost while the taxpaying public subsidizes the remaining third. Whether the taxpayers are getting their money’s worth, however, is a different story that depends on the value of the collective goods provided by the charities.

Gergen notes that the disinterested or those opposed to a particular charity are being compelled (in the form of foregone tax revenues) to subsidize organizations they don’t care to support; therefore, for a scheme to be efficient the gain to the beneficiaries must be greater than the costs to the disinterested.

---

87 Id. at 1399 (citing Burton Weisbrod, Toward a Theory of a Voluntary Nonprofit Sector in a Three-Sector Economy, in THE ECONOMICS OF NONPROFIT INSTITUTIONS 21 (S. Rose-Ackerman ed. 1986)). The government, of course spends in accordance with majority vote.

88 Id. at 1399.

89 Id. at 1399 (citing Hochman & Rogers, The Optimal Tax Treatment of Charitable Contributions 30 NAT. TAX J. 1 (1977)).

90 Id. at 1400-01 (explaining “tax-free private giving [may] approximate a Lindahl solution” — a situation where no one is worse off and the policy makes some people better off).

91 Id. at 1403.

92 Of course, lower bracket individuals would bear a higher percentage share than high bracket individuals. For example, a taxpayer in the 15% marginal bracket would only earn a deduction of 15%, thereby bearing 85% of the cost of the donation. Because those at the lower end of the income spectrum derive less of a benefit than those in higher brackets, this is sometimes called the “upside-down” effect. Id. at 1405. To avoid this effect, advocates sometimes call for a tax credit for charitable donations instead of a deduction. Limiting the charitable deduction to 28% would not completely cure the upside down effect because those in brackets below 28% would continue to enjoy less of a deduction than those in the higher brackets, but it would put the highest income donors on equal footing with donors in the 28% bracket.

93 Gergen explains that this is why Pareto-optimal standards, which require that no one be worse off, do not apply and efficiency is better measured in Kaldor-Hicks standards (winners benefits outweigh losers costs; the winners in this case are expanded beyond the classic (pure economist) definition of those who enjoy the tax subsidy to also include the beneficiaries of the charitable services that would not be otherwise enabled—in this way improvements to the welfare of the needy weigh heavily in favor of the benefits side of the equation—consistent with reality and what non-economists see as the strong redistributive value of charitable giving. Id. at 1413-14 (“Modifying the subsidy
At the risk of oversimplification, those charities that serve the poor and needy don’t cause much of an “upside down effect” concern because the wealthy save tax dollars directly in exchange for redistribution of their wealth to the impoverished. This “redistributive effect” occurs for itemizers in every tax bracket since donors contribute more to the poor than the subsidy provides. Capping the deduction at 28% would even more effectively leverage the subsidy because donors would bear a higher portion of the total costs; however, to the extent wealthy donors decide not to make contributions to the needy the same “collective action” problems would persist. Under-subsidizing, in other words, could be extremely detrimental to the poor.

It is important to note that a subsidy theory itself does not embrace government funding of charity even though some scholars talk in terms of the government “matching” donations. While talk of a match may be helpful to some in understanding an equivalent government response, there is no affirmative requirement in the subsidy theory for the government to appropriate or administer a matching program. This is crucial because one paramount idea in protecting pluralism is the notion that the deduction mechanism is free from the political process. The inertia of the status quo (merely ignoring revenue that otherwise would be considered spendable by the government) is one reason to favor Andrews’ approach. Once conceptualized as income to begin with, it becomes subject to tax expenditure analysis—precisely the result Andrews sought to avoid.

Much like the distinction between omission and commission, the status quo places all of the payment and collection burden outside the government while a “matching” program would necessitate government verification of donations and a procedure to supplement donor funding. Indeed government grants to nonprofits for research or other purposes already provide a subsidy program where the government decides where to invest its money among competing non-profit opportunities. In this

---

94 Gergen explains that while some may get satisfaction from the pleasures of giving and “overinvest” . . . “[f]or most charities, however, the greater risk is likely to be underfunding because of freeriding.” Id. at 1409.

95 “While the donor receives some tax benefit for donations, the biggest benefit goes to the charity and those who are served.” ACR, Fly In/Speak Out: Preserve Charitable Giving, supra note 55. “The President’s plan will hit those who rely on charities much more than it will hit the wealthy.” Id.

At a 50% bracket the government is matching the donation dollar for dollar since it provided 50 cents of tax relief for each dollar donated giving the taxpayer an after tax cost of 50 cents to make the donation. If the taxpayer did not donate the dollar, the taxpayer would simply keep the 50 cents instead of donating it.

96 Polsky, supra note 81, at 648-49.

97 See id. at Section III, 647-49 (analyzing deduction as allocative tax expenditure).

98 Andrews, supra note 63, at 310-14.
Compromising the Safety Net: How Limiting Tax Deductions for High-Income Donors Could Undermine Charitable Organizations

respect, government grants are not universal like the tax deduction. In addition to picking and choosing winner and loser organizations for grants, the government allocates variable amounts to different organizations and this spending is subject to fiscal constraints (it must be authorized and appropriated in accordance with federal law). This process is subject to the ordinary political process that controls all government spending of revenue—it is mechanically a completely different animal than the government’s decision to simply forgo revenue. Evaluation in political terms of the charitable deduction is especially difficult because politicians, although they “represent the majority” don’t always vote the way their constituents would like and the result of the political process—compromise and change is that the final laws may not be appealing to the general population. The Patient Protection and Affordable Care Act is perhaps the most recent dramatic example.\(^9\) Polling, in June 2012, when the Supreme Court decision on the Act was imminent, revealed that two-thirds of Americans wanted some or all of the law overturned.\(^10\) The results were not particularly surprising because of the strong opposition at the time the law was passed and the vociferous continuing opposition (including widespread legal challenges). This New York Times/CBS Poll showed that two thirds of Republicans thought it should be overturned completely; over seventy percent of Independents wanted it fully or partially repealed and only forty-three percent of Democrats wanted it preserved in its entirety.\(^11\) CBS commented that the results are consistent with all past polling since the legislation was approved—it never garnered more than forty-three percent of popular support.\(^12\)

Americans overwhelmingly support the charitable donation deduction, but it is doubtful they would approve a tax increase to allow the government to spend more to support charities. Such a “subsidy” would be compulsory for taxpayers (substituting government action for donor autonomy and freedom). It would depart from the American tradition of voluntary giving that led President Reagan to remark that Americans “are the most generous people on earth.”\(^13\) Any compulsion\(^14\) may undermine generosity and undermine America’s reputation for generosity abroad.

---


11 Id.


14 See James N. Morgan, Richard F. Dye & Judith H. Hybels, Results from Two National Surveys of Philanthropic Activity, The University of Michigan Institute for
From the Rawlsian perspective of social justice, the distinction is important because the existing system preserves individual autonomy in the donative process while a tax on all citizens to fund government matching of select social programs would be compulsory. Rawls noted, “justice denies that the loss of freedom for some is made right by a greater good shared by others.”

The government plays the distributive justice role—acting like an institutional Robin Hood—through the progressive rate structure. The progressive rate structure cements this redistributive function—taking from the rich and giving to the poor—because the wealthy pay a higher rate of taxes than the poor. Indeed this is the essential feature which makes the tax code progressive. From a tax policy perspective progressivity is defensible because many believe it is “fair” to tax the wealthy more heavily inasmuch as they are able to enjoy all of the fruits of government and have a greater ability to pay for these goods. Such a scheme satisfies Rawls precepts of justice as fairness, because a measure is evaluated as just when the least well-off in society are advanced by implementing the measure.

Unlike the original Robin Hood—who needed to rescue the poor from oppressive taxation—in the United States, because of the progressive nature of the tax code the federal government redistributes wealth in favor of the poor. This redistribution is facilitated by relieving lower-income taxpayers from any tax burden and allowing refundable or partially refundable credits that allow low-income families to receive a refund even if they have no tax liability. The most obvious of these redistributive credits is the aid to the working poor through the Earned Income Tax Credit (EITC) for taxpayers and their families who fall below the poverty line. Ronald Reagan called this credit “the most successful anti-poverty

---

105 JOHN RAWLS, A THEORY OF JUSTICE 3-4, 28 (1971).
107 Rawls does not evaluate these concepts, but ability to pay and the advantage of broader social goods for the betterment of all members of society would be implicit in his construction of justice since all would agree to expand such benefits where everyone’s interests are expanded, but not under circumstances where there was no ability to pay. See e.g. Rawls, supra note 105, at 285-289 (arguing for similar protection for future generations based on a fair share of the burden of realizing and preserving a just society).
108 Rawls second principle of justice requires that social and economic policies, though there might be inequalities, are arranged so that they are “reasonably expected to be to everyone’s advantage.” Id. at 60.
109 I.R.C. § 32.
program in America” and President Obama significantly raised EITC payments in the past few years.\textsuperscript{110}

Of course, the burden of this credit falls on the shoulders of all taxpayers, but disproportionately on the most wealthy.\textsuperscript{111} According to the most recent statistics, forty-one percent of income tax filers (58 million households) paid no income taxes at all in 2010.\textsuperscript{112} “Today, the percentage of tax filers who pay no income taxes due to the generous credits and deductions in the tax code has reached levels not seen since the income tax became a ‘mass tax’ in 1940.”\textsuperscript{113} Obviously, the 60% who are paying are shouldering the full cost of government.\textsuperscript{114}

This concept of negative income tax is troubling to some who feel that every citizen should pay some of the costs of government so they are stakeholders in holding the government accountable for responsible spending instead of merely benefitting from the governments largesse,\textsuperscript{115} but, it is entirely consistent with Rawls notion of justice as fairness because those not in the least favored group have adopted this policy because it advances the needs of the most disadvantaged.\textsuperscript{116}

Approaching the question of limitations on itemized deductions from a Rawlsian perspective, it would only be just to limit those deductions where doing so accrued to the advantage of the least advantaged group (the poor). Here, while the 28% rate limitation for all deductions raises revenue for the government (presumably to the advantage of the least advantaged members of society) the charitable

\textsuperscript{110} ARRA and TRUIRJCA, supra note 46, 15. Those receiving EITC (and many who receive other refundable credits) actually pay “negative taxes” because they receive the EITC as supplemental government support.

\textsuperscript{111} In 2005, for example, the top 2.7% of individual returns paid 51.3% of the income tax. Nat’l Taxpayer Advocate, 2011 Annual Report to Congress, IRS Pub. 2104b (2011), at 7-9, Table 2; available at http://www.irs.gov/pub/irs-pdf/p2104b.pdf.


\textsuperscript{113} Id. The way the code is presently constructed there is an effective “zero” tax rate for any single person earning under the amount of the combined personal exemption ($3,800) and standard deduction ($5,950) which is $9,750. For married taxpayers filing jointly for a family of four, the zero-income threshold is $27,100. ($11,900 standard deduction plus 4 x $3,800). In fact, these families need not even file an income tax return. See e.g. 1040 Form EZ Instructions, p.7, available at http://www.irs.gov/pub/irs-pdf/i1040ez.pdf.

\textsuperscript{114} Although not subject to income tax, all wage earners pay payroll taxes to fund social security and medicare programs. For some taxpayers, refundable credits such as the earned income tax credit can offset this entire liability.

\textsuperscript{115} Freeland & Hodge, supra note 112 (“This trend raises serious concerns about the equity of the U.S. tax system, the fiscal stability of the federal government, and the political implications of disconnecting millions of citizens from the primary means of funding government programs.”).

\textsuperscript{116} See RAWLS, supra note 105, at 302, Second Principle.
donation deduction is differently situated from the others, because the beneficiaries of charitable donations are (at least often) the least advantaged members of society. Unlike the mortgage interest deduction limitation, for example—which benefits only the itemizer, the charitable donation benefits the poor or other socially desirable charitable endeavors. The question boils down to whether the charitable deduction advances the needs of the least advantaged members of society or merely provides opportunities for the wealthy to escape progressive taxation on amounts donated. This is why opponents of the President’s budget proposal emphasize the adverse social impact if the deduction is limited, while proponents focus on revenue generation or eliminating tax breaks for the rich.\footnote{ACR, Fly In/Speak Out: Preserve Charitable Giving, supra note 55.}

3. Equity Theory

“[P]eople who give their resources to charity are thereby made less well-off and so should pay less tax than people who spend their resources on personal consumption.”\footnote{Gergen, supra note 76, at 1426.} This theory is underpinned by two other fundamental tax principals: First giving away a portion of income to charity diminishes ability to pay and income tax should relate to ability to pay (one basic justification for the progressive tax rates); and second, contributions out of a sense of moral obligation (for religious or other secular altruistic reasons) remove the donor’s autonomy to “enjoy” this income in other more selfish ways. In this sense, the donation to charity has an “involuntary” aspect unlike typical consumption choices.\footnote{Boris I. Bittker, Charitable Contributions: Tax Deductions or Matching Grants? 28 TAX L. REV. 37, 59 (1972).}

The principle of horizontal equity requires that those similarly situated should pay the same tax unless there is a tax-related justification. Using ability to pay theory, the argument would be that a donor with $1.8 million after a $200,000 donation is situated similarly to a non-donor with a $1.8 million income. Under moral compulsion theory, a donor compelled, for example by a religious requirement to tithe 10% to the church would only have $1.8 million left after the $200,000 donation.\footnote{Bittker uses, as an extreme example, religious members who have taken a vow of poverty turning over their income to their religious order. Boris I. Bittker, Charitable Contributions: Tax Deductions or Matching Grants? 28 TAX L. REV. 37, 59 (1972).} This donor would be similarly situated to the $1.8 million income non-donor who felt no similar compulsion.

However, both of these justification are a bit of a “glass half-full,” “glass half-empty” conundrum, for if one views the donation as discretionary—regardless of the moral force there was no legal or tax-based requirement to give—then the $2 million taxpayers who make donations are better off than the $1.8 million non-donors because they had
a choice and decided to make the donation. These donors would obtain
great spiritual benefit from the satisfaction of the donation itself (whether
the pure pleasure of giving or whether satisfying a compulsion to give).
These donors also had the ability to pay—indeed more ability to pay—
than the non-donors who earned $200,000 less. Thus the moral
compulsion/voluntary donation argument depends on what priority one
wants to give to the charitable deduction. For legendary tax Professor
Boris Bittker, “charitable contributions represent a claim of such high
priority that in my view, a case can be made for excluding them in
determining the amount of income at the voluntary disposal of the
taxpayer in question.” Bittker’s position is thus consistent with Andrew’s
view of tax equities of the charitable deduction.

Gergen criticizes Andrews’ arguments as nothing more than a
parallel to the efficient subsidy theory, because Andrews makes arguments
to carve charitable donations out of income altogether based on collective
goods concerns; however, Andrews argument just as easily is justified
by the equity arguments (or the equity arguments also support Andrews’
reasoning) that the donations should be carved out of income to begin with
since the person making the donation does not selfishly benefit from the
products of the consumption of the goods purchased through the donation.

It is equitable to treat the deduction as resulting in horizontal
equity either by disregarding its nature as income (as a matter of tax
policy) or equally so by including it in the formulation of income, but
equitably allowing a deduction to restore that horizontal equity. Of
course, either approach ignores the legal discretion not to donate (in the
terms of Glenshaw Glass, the income has been realized because it
represents an accession to wealth over which the taxpayer has complete
dominion—even if the use of that dominion is to give it away). Both
theories also ignore the line of reasoning of Lucas v. Earl and its progeny
that income must be taxable to the income generating source no matter
how clever the arrangements to assign the income to another (in this case,
the code essentially allows the donor to assign the income to the charity—
which pays no taxes).

Gergen concludes that taxing people “according to their relative
well-being is a plausible allocative goal, and the objections to adjusting
income to account for the effect of receipts and expenditures on well-

121 Gergen, supra note 76, at 1426.
123 Bittker’s moral compulsion theory would allow moral relativism to trump
the legal reality of the taxpayer’s unfettered dominion; while these moral fetters are indeed
truths to some segment of the donating populace, to the extent a donor gives because
compelled, for those who choose to give without feeling compelled (as disinterested acts
of generosity), there is still an exercise of discretion. Discretion also inheres in the hearts
of those who feel no compulsion to give and in fact do not give. Thus, equity restores the
balance between these latter groups and those compelled morally to give, but tax relief
affords a windfall under this theory to those donors who feel no similar compulsion.
being are unpersuasive, at least in the case of charitable contributions. If gifts to charity make people [donors] worse off a deduction for them may be defended on grounds of equity. 125 Nevertheless, the same equitable grounds would allow for a categorical exemption of such donations from the definition of income in the first place. As earlier explained, philosophically excluding these donations from income is tantamount to including them in income but allowing a commensurate deduction of like amount—six of one, half dozen of the other.

The equitable arguments support both approaches equally so long as the donor loses the benefit of the contributed donation. Since “charitable contributions” by definition must “not inure to the benefit” of any private individual,126 the benefit that matters for tax policy reasons is financial benefit, not the element of satisfaction or pleasure the donor may derive from the contribution. 127 In this sense, to the extent the benefits are communal, this links back to the efficient subsidy analysis because any donor presumably could enjoy the social welfare benefits as a freerider. From an empirical standpoint, only 13% of donors report giving for personal benefit (satisfaction) compared with 67% who give out of a sense of obligation or for feelings of approval. 128

This information is critical in confirming normative standards—we can use personal experience, models of human behavior and anonymous surveys to show that donors are not selfish or wasteful, but rather are giving out of a sense of doing right that they learned from parents, churches, schools, etc., and that they will donate as part of that human nature, not because they are acting as “egoistic, rational utility maximizers.” 129 Of course, it is precisely because people are human and give for a variety of altruistic reasons that it is impossible to say with any certainty how much a change in the tax incentives will have on donor behavior. One can therefore understand how general consensus easily forms about the nature (or direction) of the impact from tax law changes (lower incentives to donate will erode donations), but at the same time there is no agreement on the magnitude of the expected change.

For example, one who tithes out of a sense of moral obligation is unlikely to be deterred merely because tax incentives diminish (just as nonitemizers continue to donate even in the absence of tax relief); at the same time, one donating from abundance may be much more interested in the nature and timing of donations—especially when one has access to sophisticated tax planners (attorneys and accountants) who can help the

125 Gergen, supra note 76, at 1428.
126 I.R.C. § 170(c).
127 Some discussants of the deduction argue the pleasure, satisfaction, prestige or “warm glow” confer a benefit to the donor as change-agent even above the altruistic value of the donation. Brian Galle, The Role of Charity in a Federal System, 53 Wm. & MARY L. REV. 777, 829-31 (2012); Schizer, supra note 75, at 225-26 (noting warm glow is the term of choice for many scholars).
128 Gergen, supra note 76, at 1430.
129 Id. at 1428-29.
very wealthy (upon whose donations many charities overtly rely). An advisor may suggest accelerating donations to take advantage of the higher rate relief or suggest, donating appreciated assets, earmarking money for future donations to be invested now in stocks or real estate or other capital assets which can be later donated without paying taxes on the appreciation. Tax law changes would, therefore, predictably have a much larger effect on this latter group.

4. Distributive Justice—Rawls Revisited

Professor Miranda Perry Fleischer explains that “the law governing the charitable subsidies is itself confused on the role of distributive justice.” She argues that expanding our understanding of the distributive justice issues will promote better understanding of the efficient subsidy theories, will help combat existing justice-related criticisms of the deduction and will help us allocate societal resources in a more systematic fashion.” To better explore this largely ignored area of tax scholarship, she is writing a series of articles—the second, published in 2011 examines the doctrine of “equality of opportunity” which has received considerable attention outside of the tax community and relates insights from this philosophic literature to the charitable deduction.

Like Rawls, Fleischer finds that justice requires not equality of income, but rather a system which promotes an equal opportunity for all Americans to achieve their income goals. While this concept has previously been ambiguous, the notion is that it promotes freedom of choice and neutrality as core principles. While Fleischer suggests that distributive justice issues mean some donees are more justified recipients of donations supported by tax dollars, a discussion of the worthiness of various charitable organizations along these lines is beyond the scope of this paper. Instead, the author proposes that cumulatively voluntary distributions of income from the wealthiest donors to charitable organizations serves a generic distributive justice function by reallocating resources from personal consumption of the wealthy to broader societal purposes with wide-ranging benefits for society. Such voluntary

---


131 Fleischer, Distributive Justice, id. at 506.

132 The first, published in 2010, explains the merits of such an approach and lays the groundwork for the follow-on articles. Id.


134 Id. at 603 (explaining the open question is “equality of what?”).

135 Id. at 603, 603 n.2 (citing Anne Alstott, Equal Opportunity and Inheritance Taxation, 121 HARV. L. REV. 470, 476-77.).

136 Scholar and Dean David M. Schizer has adopted a similar distributive justice approach (“Since charity tends to be redistributive, we are promoting voluntary
redistribution is arguably more just than compulsory redistribution by collecting the taxes from the wealthy and then applying the proceeds through the government to the very same approved organizations, because voluntary redistribution preserves the autonomy of the donor consistent with the freedoms and equality of opportunity advocated by Rawls and additionally may (and likely do) generate contributions in amounts above those that would be compulsorily provided because the donors prefer this freedom and the ability to favor their own choice organizations.

5. The Need for Salience

Recent scholarship also suggests that an individual’s response to a tax (or a change in taxes) “depends at least in part on the tax’s salience.” Salience refers to the prominence, visibility, awareness or vividness in the mind of the audience. An example would be the introduction of the EZ-Pass which has the effect of reducing awareness of the costs of tolls because auto-pay and not stopping to dig for money to pay the tolls make these costs less salient—even though the amount of the tolls is the same. Although there is healthy debate on the subject, some tax scholars argue to reduce or hide the tax burden of higher taxes to make them less salient and hence less objectionable.

The present author opposes any such “hide the ball” tactics, preferring instead a simple, transparent tax system that would be fully salient, so the merits of various change proposals can be aired and fully considered to better enable taxpayers and policy-makers alike to make informed decisions.

Redistribution, while also placing public burdens on those best able to bear them.”.

Schizer, supra note 75, at 234.


139 See Faulhaber, Id. at 1308 (citing Amy Finkelstein, E-Z Tax: Tax salience and Tax Rates, 2009 Q.J. ECON. 969).

140 Id. at 1308.

141 Goldin, Optimal Tax Salience, supra note 137, at 15 (“governments should typically avoid relying on fully-salient taxes, unless the purpose of the tax is to reduce consumption of the taxed good.”). Goldin contends that creating a distortion is better for the government because it causes taxpayers to make optimization errors increasing social welfare. Id.


143 For detailed background on the rising costs and other problems with tax expenditures, see Patrick E. Tolan, Jr., Questioning Tax Expenditures for Economic Recovery, 127 TAX NOTES NO. 1, 67, at 69-72 (Apr. 5, 2010).
Stanley Surrey, complained about tax expenditures forty years ago because the effects were more hidden and hence more problematic than direct federal spending for the same purposes.144

On the tax expenditure side, those deductions that are well known and understood should be more salient and therefore more important to taxpayers, because the taxpayers are aware of them and can therefore act to maximize their utility. On the other hand, those that are “hidden” or misunderstood could lead to a number of problems: failing to claim a deduction when so entitled, failing to be motivated by the favorable tax treatment to take advantage of the deduction (in this case make a donation), trying to take the deduction when one is not eligible for the deduction, and believing that the deduction is worth more (or less) than it actually is. All of these outcomes impact efficiency—some making the deduction more efficient while others compromise efficiency.

For example, if a person who takes the standard deduction makes a charitable donation because they have heard about the tax break this makes the fact there is a deduction available (albeit not available to this ignorant taxpayer) motivate behavior beyond (but consistent with) the donative behavior which the tax deduction is designed to stimulate.145 Such a mistake would foster social goals served by the charitable donation, which is why some scholars can tolerate or even call for such confusion.146 Both of these may occur because the deduction is hyper-salient to the extent that the donee organizations may solicit goods with the promise of a tax deduction without identifying the pool of those who could benefit from such deduction or the substantiation requirements incident to claiming the deduction.147

At the other extreme, if a taxpayer doesn’t know the value of the deduction they may underperform in terms of the desired behavior.

144 Stanley S. Surrey, Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Expenditures, 83 HARV. L. REV. 705, 734 (arguing tax expenditures be used only as a last resort to avoid “confusion and divided authority in the legislative and administrative processes, difficulties in maintaining budgetary control, confusion in setting and perceiving national priorities, and dangers to the tax structure itself.”). Tax exempt municipal bonds offer one common example of an inefficient tax subsidy which has been well documented in the scholarship. See GAO, Tax Expenditures Deserve More Scrutiny, GAO/GCD/AIMD-94-122, at 26 (1994).

145 In several years of Volunteer Income Tax Assistance (VITA) service to low-income taxpayers the author has frequently encountered taxpayers bringing in receipts for donations that have no bearing whatsoever on their tax liability because they are not even close to having enough total itemized deductions to approach the amount of their standard deduction—although there is no tax advantage whatsoever to these taxpayers, the salience (hypersalience) of the deduction motivates them to track and report donations anyway.

146 Goldin, Optimal Tax Saliency, supra note 137, at 15 (creating a distortion is better for the government because it causes taxpayers to make optimization errors increasing social welfare).

147 At least one commentator has argued that the deduction is hypersalient for precisely this reason. See Faulhaber, supra note 138, at 1307.
Taxpayers in the 28% bracket, for example, that think the deduction is only worth 10% will not be motivated to contribute enough. A 2012 survey shows that numerous taxpayers misunderstand the charitable deduction and that it is not fully salient for these taxpayers.148 For many, the tendency to believe the charitable deduction grants no tax relief or less tax relief than expected produces for these taxpayers a situation where they are not properly incentivized by the subsidy. However, since the subsidy is also hypersalient for other taxpayers who overvalue the deduction, the misunderstanding somewhat cancels out.

In addition, the conclusions of this study cannot really be extended to a wealthy taxpayer because the survey did not “over-represent” this small but significant group.149 The survey authors noted that the higher income itemizers tended to be more aware of the accurate tax consequences and although the observation may not be statistically significant, it is consistent with the intuitive expectation that a wealthy taxpayer would either have more command of their finances or better advice from tax professionals.

C. Charitable Donation Evolution Throughout the Years

The deduction scheme has remained remarkably stable throughout the decades. It has been substantially impacted only by changes in three primary Categories: 1) the maximum percentage of income that could be deducted annually for charitable donations; 2) changes to the pool of taxpayers who are tax-advantaged by the deduction; and 3) changes to the tax rates themselves which change the after-tax “price” or “cost” of a donation. By far the most numerous changes throughout history have been adjustments to the tax rates themselves.

There has never been a limitation on the maximum allowable rate allowed for the deduction analogous to the administration’s proposal. Category one limitations, at present, limit deductibility for charitable donations in any given tax year to 50% of AGI, but that whole 50% is donated at the taxpayers’ marginal rate (currently 35% for the wealthy). Category two changes occurred when the standard deduction was introduced, because before that time all taxpayers had to itemize to enjoy

---

149 Even though the sample size was 887 taxpayers, the top 1% of this representative sample (which would reflect those most affected by the President’s proposal) would only be 9 taxpayers—not a statistically significant group. Even the top 4% (all of those potentially impacted by the 2013 Budget Proposal) would only be 36 individuals which would be of marginal statistical value. In addition, the “top strata” evidenced in the survey report is at $100,000-300,000 which barely captures the bottom of the group affected by the President’s 2013 budget proposal. See Goldin & Listokin, supra note 148, at 1 (“Along several dimensions, CD [charitable deductions] has low salience.”).
any deductions. The pool expanded back to all taxpayers temporarily in the early 1980s when those taking the standard deduction were also allowed a full or partial deduction for charitable donations. Category three changes—rate changes—are most informative concerning the President’s 2013 budget proposal since the strength of the tax inducement to donate changes with the tax rate (in subsidy terminology, the subsidy incentives change). The proposal to limit the deduction rate to 28% will likewise change after-tax “price” or “cost” of a donation.

While only this third dimension—changing the after-tax price of donating—is an issue in the President’s 2013 budget proposal, the other two types of tax changes are also addressed below to connect the historic dots between the original deduction and the present deduction. In addition, the timing and consequences of these other changes should be appreciated as they sometimes interfere with an ability to derive causal connections between changes in the rates themselves and tax effects likely caused by these other factors.

1. Changes to Limit Deductions as a Percentage of Income

Senator Hollis originally proposed a 20% limit on contributions based on net income, but a 15% limit was imposed by the War Revenue Act of 1917. The limit was increased to 15% of Adjusted Gross Income (AGI) in 1944. The change from “net income” to AGI meant the percentage applied to a larger baseline amount including net income plus the other (non-charitable) itemized deductions (such as state income taxes, interest and taxes).

The limit was raised to 20% of AGI in 1952 and increased in 1954 when the 20% AGI cap was increased to 30%. However, this additional 10% was allowed only for donations to hospitals, churches or religious orders, and educational institutions (this preferred group was expanded to all public charities in 1964). Beginning in 1958, any amounts over the limit were allowed to be carried forward to succeeding years.

In the 1960s, unlimited contributions for those who contributed over 90% of the taxpayer’s taxable income for the taxable year and eight of the ten preceding taxable years led to abuse and the modern-day 50% limit on cash contributions to public charities with lower limits on donations of appreciated property and donations to private foundations.

---

151 Id. at 1062.
152 Id. at 1063.
153 Id.
154 Id.
155 Id. at 1064-67, 1071; I.R.C. § 170. Adjusted gross income (AGI) for purposes of code Section 170 is computed without regard to any net operating loss carryback.
2. Changes to the Pool of Tax-Advantaged Donors

The standard deduction was introduced in 1944, the same year the limits on income were changed from net income-based to AGI-based. The changes are related, because in the early years all individual deductions, business and personal, were essentially equal since they were subtracted from gross income in determining net income. In modern parlance they were all “above the line,” because there was no line needed before the option arose to take the standard deduction. All calculation were related to net income which was derived from subtracting all deductions from gross income.

In 1944, AGI was created as a reference point to put business owners on equal footing with wage earners by allowing business-related deductions in computing AGI, so that all taxpayers regardless of profession might enjoy the standard deduction equally. The charitable deduction was demoted to a below the line deduction together with taxes and interest so that a taxpayer would now have to more than offset the standard deduction to enjoy a tax benefit from itemizing. Therefore there were two potential threats to the charitable donation deductions—first, it would be valueless to non-itemizers and a majority of taxpayers were expected to take this simpler approach. Second, the deduction had formerly generated value to anyone with tax liability because every dollar, from the first dollar of charity up to 15% of income was deductible on its own merit. After the standard deduction, an itemizer would need more itemized deductions in total than the standard deduction in order to enjoy an additional tax advantage. While each taxpayer’s circumstances will vary, the cumulative itemized deductions were now effectively offset by an amount up to the amount of the standard deduction. While this undercut all itemized deductions equally, itemizers lost ground to those who could donate nothing at all and claim the standard deduction.

In the 1980s, a temporary deduction for those taking the standard deduction (non-itemizers) was also phased-in from 1981-1986 and then was eliminated after 1986. The deduction was very limited in 1982, 1983 and 1984 because deductions for non-itemizers were limited to 25% of donations and were further limited to a $100 maximum (1982 and 1983) or a $300 maximum deduction (1984). There was no dollar cap in 1985 or 1986 making the deduction much more valuable. In addition, taxpayers who took the standard deduction could deduct 50% of the value

157 See CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING, supra note 103, at 11-12.
158 Lindsey, supra note 13, at 1068.
of their donations in 1985 and 100% of their donations in 1986 as above the line deductions.\textsuperscript{159} In the Tax Reform Act of 1986, Congress again sought to simplify the code and eliminated this deduction for non-itemizers.\textsuperscript{160}

3. Rate Changes Throughout the Years

Other than these structural changes, the principle change in tax incentives affecting charitable contributions has been due to modifications in the tax rates themselves. As tax rates get steeper, those subjected to the higher rates enjoy more tax advantage from a deduction than those subjected to lower rates. This phenomenon is typical of all deductions that aren’t otherwise limited or phased out for higher income individuals and is sometimes referred to as an “upside down” effect.

As explained earlier, concern for high taxes eroding the discretionary funds available to the wealthy to support charities was one factor in the creation of the charitable donation deduction in 1917. The base [“normal”] tax imposed in 1917 was only four percent, but the additional tax scheme was very progressive with a marginal income tax rate as high as 67%. Over the course of history, top marginal rates have varied considerably, but perhaps those garnering the most scholarly attention from the perspective of the impact on charitable donations have been the tax changes of the 1980s. For this reason, additional time is spent reflecting on these rate changes.

a. Early Tax Rates - Wartime Spikes and Progressivity

Tax rates have changed frequently throughout the years, often in fits and spurts, to higher or lower rates. Pursuant to the 1913 Revenue Act, only those earning over $20,000 were subject to taxation and the initial rate was 1% for incomes up to $50,000.\textsuperscript{161} The rates increased a percent at a time to 6% for those earning over $500,000.\textsuperscript{162} Basically, there were six brackets and the rates increased in gradual fashion.

In 1916 a “normal” tax of 2% was introduced along with an additional tax of 1% for the lowest bracket.\textsuperscript{163} The additional tax again increased in gradual fashion, one percent per bracket, but additional brackets were added.\textsuperscript{164} The lowest bracket was adjusted to $20,000-$40,000, so taxes would have tripled for this group compared to the 1% of the earlier years (rising to 2% normal tax plus 1% additional tax).\textsuperscript{165} A

\textsuperscript{159} Id.
\textsuperscript{160} Id. at 1069.
\textsuperscript{161} Blakey, supra note 11, at 794, Table 2.
\textsuperscript{162} Id.
\textsuperscript{163} Id.
\textsuperscript{164} Id.
\textsuperscript{165} Id.
total of 13 brackets replaced the earlier six brackets and established a highest marginal total rate of 15% for those earning over $2 million.\textsuperscript{166}

The jump in the highest rate from 15% to 67% from 1916 to 1917 was previously discussed, but WWI was so expensive taxes were hiked again in 1918, raising the top rate to 77%.\textsuperscript{167} The laws temporarily changed to tax incomes as low as $5,000-$7,000 and additional brackets were added.\textsuperscript{168} One percent increases applied for the lowest brackets but the rates were adjusted in steeper fashion (from 2-5%) for higher brackets.\textsuperscript{169}

In the post war years and through the early years of the great depression the top rates dropped to as low as 25%.\textsuperscript{170} The highest rates rose to 63% in 1932, the year FDR was elected, and climbed to 81.1% in 1940.\textsuperscript{171} Throughout this era, the New Deal brought government involvement into the economy and much more actively into society in general.\textsuperscript{172} The government needed more revenue to run these social programs resulting in a surtax on the wealthy (increasing rates from 63% to 79%) that was imposed in 1936 for those earning over $5,000,000.\textsuperscript{173}

Top Rates rose again in WWII to as much as 94% and the tax base was expanded to cover the majority of Americans, not just the wealthy.\textsuperscript{174} Rates as high as 91% persisted until 1964 and then dropped to a highest marginal rate of 70% (with a couple of minor variations) until major tax reforms in the 1980s.\textsuperscript{175}

b. Major Rate Change Reforms of the 1980s

Two especially significant changes to the tax code occurred in the 1980s. The first, a byproduct of the election of President Ronald Reagan, was meant to stimulate the economy by allowing taxpayers to keep and spend more of their income.\textsuperscript{176} The 1981 Act reduced the top marginal rate from 70% to 50% and imposed corresponding proportional rate

\textsuperscript{166} Id.
\textsuperscript{167} Nat’l Taxpayer Advocate, 2011 Annual Report to Congress, supra note 111, at 7-9, Table 2.
\textsuperscript{168} Blakey, supra note 11, at 794, Table 2.
\textsuperscript{169} Id.
\textsuperscript{170} Id. (except for 24% in 1929).
\textsuperscript{171} Nat’l Taxpayer Advocate, 2011 Annual Report to Congress, supra note 111, at 7-9, Table 2.
\textsuperscript{172} Id. at 12.
\textsuperscript{173} Id. at 7-9, Table 2.
\textsuperscript{174} Id. at 12.
\textsuperscript{175} Id. at 7-9, Table 2 (except in 1968-70, when the rates were 75.25% , 77%, and 71.25% respectively and in 1981 when rates were 69.1%).
reductions for all taxpayers. 177 Because the top marginal rate was reduced, the effective government subsidy for charitable donations was also reduced.

A simplified example will show the impact of this change. A wealthy donor in the highest bracket in 1980 who donated $1,000 would be able to deduct $1,000 from her income. 178 Had she not donated the $1,000 she would have paid tax of $700 on this income and retained the remaining $300. 179 By reducing her income by $1,000 through the charitable donation, she has avoided $700 of tax liability, but she has also foregone the $300 she would have been able to keep or spend for personal consumption. Instead, this $300 has gone to charity, together with the $700 of revenue that the Treasury has forgone due to the charitable deduction. At the end of the day, because charitable organizations are tax exempt, the charity has a net gain of $1,000 while the taxpayer has a net cost of $300 and the government has lost $700 of revenue. Another way to look at it is that the government subsidized her $300 donation by matching it with $700 federal dollars.

The $300 after-tax cost to the taxpayer to make the donation is described by economists as the “price of giving” or simply the “price.” 180 With a reduction in the highest marginal rate from 70% to 50%, the price of giving increases to $500 for the same donation, because the amount of the government’s subsidy effectively drops by 20% ($200) and the net cost of the donation effectively increases by the same 20% ($200).

This deterrent to give caused by the “price effect,” could be of considerable importance to the nonprofit sector if the donor in our example decided to reduce her donation due to the lower effective subsidy, or worse yet, decided not to donate altogether. The net result for the charitable organization, however, would be the same ($1,000) so long as the taxpayer was not deterred from making the donation by the lower tax breaks.

Nonprofits predictably lobbied against these rate reductions claiming the change in the highest marginal rate would have a devastating untoward impact on the willingness of high income individuals to make

---


178 This assumes the donor itemizes and the entire donation would otherwise be subject to the highest marginal rate.

179 $1,000 x 0.70 (the highest marginal rate) =$700.

180 CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING, supra note 103, at 51 (“virtually all of the econometric studies of contributions use as the basic measure of price the after-tax foregone consumption per dollar of giving.”).
donations (since these individuals most needed the tax break).\textsuperscript{181} However, these philanthropic organizations failed to account for the fact that their main donors (the wealthy) would also have considerably more after-tax revenue (disposable income) from which to make donations.\textsuperscript{182} Unlike the price effect in the example above which is a negative influence on donations, the effect of increased disposable income (“income effect”)\textsuperscript{183} is a positive influence, because the donor has more surplus funds available for consumption.

To make the concept more concrete, imagine in the example above that the taxpayer has $100,000 subject to the highest marginal rate. She would have positive cash flow of $20,000 due simply to the change in the tax rate structure.\textsuperscript{184} Her after tax income would escalate by $20,000 because the liability for taxes diminished by $20,000.\textsuperscript{185}

The “income effect” concept should not be hard to understand because it is the perfect corollary to Hollis’s concern that when taxes spiked in WWI (to 67%), the wealthy would not have enough surplus (after-tax disposable income) to donate to charity. As taxes increase, after-tax disposable income decreases. By the same token, income available for consumption or donation increases when tax rates drop.

Therefore both of these consequences are expected of rate changes. If these effects were perfectly opposite in both magnitude and direction they would cancel one and other out and no one would need to worry about rate changes affecting donor behavior; however, these variables are far more complex. Because they tend to constitute the most important tax-related considerations\textsuperscript{186} and they trend in opposite directions,\textsuperscript{187}
economists have developed models to measure the relative strength of these competing effects. As explained later, while there is agreement on the direction of change, the magnitude is far less certain.

It is easy to imagine that a taxpayer may be motivated to give more from their abundance 188 notwithstanding that the tax benefit of giving may be somewhat reduced. Even with a reduced top rate from 70% to 50%, however, the government is matching dollar for dollar every donated dollar. The wealthy might see this match as a great way to leverage their donations.

The 1986 Tax Reform Act had the same two dynamics at play as the 1981 Act, a combination of both rate reductions—a 22% rate reduction reduced the government subsidy to 28% for the highest marginal taxpayers (down from 50%) and also increased after tax wealth (cash flow) by 22%. Using the numbers above, the last $100,000 in income would only generate a tax burden of $28,000 allowing the Taxpayer to keep $72,000=$22,000 more than she had before the rate change.

Because the ability to donate could more than offset the reduced incentive to donate, one might expect that taxpayer charitable behavior might be unchanged or even increase as it did after 1981.189 But because of the complex relationship of these effects, other variables such as timing donations to maximize tax relief, and simultaneous changes to additional variables make simple observations and conclusions difficult.190

b. Post-1980s Rate Changes: Increases, Relief, and Sunsets

The Tax Reform Act of 1986 reduced the progressivity of the code in two major ways, reducing numerous monotonical rates to only two tax rates—a top rate of 28% for high income taxpayers and a 15% bracket for everyone else.191 Top rates crept back up in the 1990s to a higher rate of 39.6 percent.192 As top rates inched their way back up, additional stair-

187 As after-tax income increases the price effect decreases and vice versa.
188 Some studies have shown “the decision to give is influenced by whether individuals have sufficient disposable income.” April, supra note 1, at 870 (citing Independent Sector 1999 Survey of Giving and Volunteering). This premise is what drove the charitable donation deduction to be added to the code in the first place. See Id. at 849 (citing 55 Cong. Rec. 6728-29 (1917)) (people contribute from surplus, what’s left over after they have satisfied other needs and wants).
189 One might assume if donations go up—the cash flow phenomenon outweighs the discouragement from the reduced write off; whereas if donations drop, the deterrent effect of the reduced incentive more than offsets the increased ability to donate.
190 See CLOTFELTER, supra note 103, at 274 (while income tax has a strong effect on giving this is not the only effect and at 111 (whether a taxpayer itemizes, taxes and interest, and other itemized deductions are also significant).
step brackets were also created above the 28% rate to differentiate among higher income taxpayers—reinstalling some of the progressivity that had existed before 1986. At the turn of the century, brackets of 31%, 36% and 39.6% had been introduced.

These top rates were later reduced beginning in 2001 and by 2003 stood at 25% (versus 28%), 28% (versus 31%), 33% (versus 36%), and the 35% top marginal rate (versus 39.6%)—where it stands today. These Bush era tax cuts also created an additional 10% “initial” bracket which was created for the first $7,000 dollars of taxable income for single taxpayers, $10,000 for heads of household, and $14,000 for married taxpayers filing jointly.

Although the 2001-2003 tax cuts included a sunset provision and would have expired at the end of 2010, they were extended through 2012 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Unless there is another change or extension, expiration of these cuts at the end of 2012 will restore the top rate to 39.6%.

D. How Giving has Changed in Response to Tax Changes

“Almost any change in the tax rate schedule . . . will tend to have an impact on giving.” It is undisputed that direct consequences of a change in tax rates are twofold and include both “price” effects (looking at the after-tax cost of giving and “income” effects (looking at the after-tax disposable income and its impact on ability to pay). What’s controversial and unresolved is the relative strength of these competing effects. The salience of the change is another factor that will likely bear on the price effect so this more recent dimension should also be considered in any tax reform proposal. To these three dimensions, the author proposes to add “economic suffering” as a critical consideration. As next discussed, the lessons of the great depression and the recent “great recession” convincingly demonstrate harsh economic times reduce charitable giving and the magnitude of this effect can dwarf both price and income effects of any tax change.

---

194 I.R.C. § 1(i)(2).
195 I.R.C. § 1(i)(1). The amounts of the initial rate are adjusted for inflation. Id.
196 TRUIRJCA, supra note 46, at §§ 101-102.
197 I.R.C. § 1(i)(2).
198 Clotfelter, supra note 23, at 6.
199 A possible avenue of further study could be development of a salience scale to rank various tax changes through history as one way to perhaps reconcile conflicting price elasticities and empirical results of historic tax changes. For example the mass media/education campaign may have elevated tax awareness and salience during WWII.
1. The Early Years—1913-1940

The only relevant changes in the early years were tax rate changes which fluctuated frequently and wildly, predominantly spiking due to WWI, the great depression, and WWII. Unfortunately, there is not much data about overall giving during these turbulent times, and there appears to be no data stratified by donor income or tax rate. However, because only the wealthy generally paid taxes prior to the 1940s, the overall price and income effects of any tax changes likely applied to this top group.

Estimates of overall giving indicate that giving dropped from over a billion dollars in 1929 to a low of 637 million dollars in 1933 during the great depression and rebounded to just over a billion dollars again in 1940. Since donations dropped annually until the low giving point occurred in 1933 (even though the price incentive for giving increased substantially in 1932 when rates rose from 25% to 63%), it is more likely the drop in giving was due to the bad economy than to any tax incentives. [Income effects due to the tax change itself—even if they greatly outweighed the price incentives to give more--would not have been felt until the 1932 rate increase].

In addition, when tax rates held constant from 1933-1935, overall giving improved annually as the economy improved, so tax incentives cannot account for this increase, but economic improvement could. Then, when tax rates increased again in 1936 (from 63% to 79% top marginal rate) donations increased for two years, dropped one year then increased again to 967 million dollars. Increased salience and timing to take advantage of the higher rates could account for some of the increased donations in response to a 1935 tax hike that was notoriously called the “soak the rich” tax. But economic recovery could just as easily account for the increased donations as overall income increased in 1936 and 1937, dipped in 1938 and recovered in 1939, paralleling the overall giving trends.

201 Nat’l Taxpayer Advocate, 2011 Annual Report to Congress, supra note 111, at 10 (top 2.1% in 1925 paid 85.4% of income tax; top 2.6% in 1935 paid 83.7% of income tax—compare with top 2.5% paying 39.3% after taxes were expanded to the masses in WWII).
202 Id. (all dollars were in “current” dollars in 1984-85 when the book was written).
203 Id.
204 Id.
205 Id.
2. 1940s and the Standard Deduction

In 1942, tax liability was extended to the masses in the form of a 3% victory tax on income over $634 and a reduction of the personal exemption to $500. The changes were accompanied by a media campaign to reach the vast newcomers now subjected to the income tax. Unfortunately, the new taxes were confusing and difficult to collect, so withholding was instituted as was a search for other ways to enable taxpayers to comply without going through the “complicated” process of preparing and filing a return.

The Individual Income Tax Act of 1944 was supposed to simplify the tax code by allowing a standard deduction instead of detailed itemization of deductions. But, because the charitable donation deduction was an itemized deduction, any taxpayers using the standard deduction would not be able to enjoy any tax benefit from charitable donations.

Philanthropic organizations feared this would have a devastating impact on donations, but Congress believed simplification of the code was more important. However, a precipitous drop was unlikely as prior to WWII most Americans were not subjected to the income tax to begin with, so the standard deduction would likely be used primarily by lower-income individuals who (because they had much less wealth, especially following the depression) were not as likely able to make substantial donations anyway. Even if these taxpayers had the ability to make donations above the standard deduction and did in fact make such donations, it was probably for other motives, not a byproduct of motivation or encouragement from the tax code due to their lack of familiarity with it and its initial complexity. The mass media campaign promoting taxpaying and the underlying necessity of supporting the war effort likely made tax avoidance or minimization less important for this new group of taxpayers, yet it could still be expected to affect the top end donors who depended on the deduction to enable them to have enough surplus income from which to make donations.

---

207 Nat’t Taxpayer Advocate, 2011 Annual Report to Congress, supra note 111, at 20 (increasing taxpayers to 27% of population).
208 Id.
209 In hindsight it’s almost laughable that the one and a half hours it took to comply on average was seen as so onerous. See id. at 22.
211 The inability of those who don’t itemize to benefit from donations has motivated some scholars to challenge the equity of this deduction.
212 CLOTFELETER, FEDERAL TAX POLICY AND CHARITABLE GIVING, supra note 103, at 32 (citations omitted), 90 Cong. Rec. 3969; http://www.taxhistory.com/1944.html
213 See Id. at 32 (citing Senator Vandenburg, Cong. Rec. Senate, 19 May 1944, p. 4706).
“Although the income tax now affected the masses, in 1945 the richest one percent of households [nevertheless] paid 32 percent of the revenue.”

For this richest one percent, undoubtedly those inclined to make charitable deductions already were doing so in the bygone days when there was no standard deduction, so they were familiar with and undeterred by the necessity of itemization. In addition, the value of the deduction at the highest marginal rate stood at 94% which made it inconceivable that a large, seasoned donor would choose the simpler route of the standard deduction over the more lucrative itemization route.

Estimates of overall giving suggest that the charitable donations were not significantly affected by the introduction of the standard deduction. As a percentage of personal income, the average rate of donation remained remarkably stable (in the roughly 1.6-1.7% range) from 1941 throughout the decade. Because the national economy rebounded during and after WWII, however, charitable donation in terms of constant year dollars actually increased dramatically from 1.5 to 4.8 billion dollars. The ability of the wealthy to benefit from the deduction would have been substantial as their wealth increased and their marginal rates afforded a significant price incentive. Although price and income effects were somewhat offsetting, there was no economic suffering effect to stifle charitable donations.

2. Changes in the 1950s-1960s

With high tax rates as powerful incentives, the ability to donate appreciated property without taxes on the appreciation, the ability to donate charitable property, in some cases, without percentage of AGI limitations in the year of donation, and the ability in other cases to carry forward “excess” donations to the five subsequent tax year, some taxpayers (particularly wealthy taxpayers) began getting too good of a deal on their donations. For cash donations in 1960, for example, the highest marginal bracket of 91% meant that the donor only paid nine cents for every dollar the donor sent to charity and the other 91 cents was

215 In fact, any property that had appreciated more than 6% would be better off donated than liquidated because the tax relief would exceed the amount of gain.
216 CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING, supra note 103, at 17 (citations omitted).
217 Id.
218 Early estimates of overall contributions suggest a trend of increasing contributions from 1.28 percent of personal income in 1929 to 1.96 in 1970. CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING, supra note 103, at 17-18. After 1944, since only itemizers were able to take deductions it is impossible to say what happened with non-itemizers. Id. Giving USA data on overall donations begins in 1955. Id. at 17.
subsidized in the form of tax relief from the federal government. A donor in a state allowing a state tax deduction for charitable donations or basing its state income taxes on federal taxable income could easily make money by donating cash to charity. The donor could make considerably more money by donating appreciated property as each donation of property which had doubled in value (appreciation equal to basis in the property) netted the donor a refund of $1.19 for every dollar of fair market value of the appreciated item (typically stocks and bonds, but could be appreciated real estate or personal property). \(^{219}\)

The most wealthy have a far higher income from capital gains than from wages or salary so they could shelter all their earned income with donations of appreciated assets and some of the most wealthy individuals brought their tax liability to zero in this fashion. \(^{220}\) In 1966, the situation was especially dire with all itemizers claiming $79 billion in charitable donations (of $130 million in total itemized deductions) compared to $112 million of collective AGI. Worried that high income taxpayers were dodging their fair share of tax, Congress acted in 1969 to stop the abuse. “Congress in 1969 attached some significant limitations to such deductions [and] eliminated some abuses, [but] actually left the larger part of the problem intact since donors can still generally deduct gifts of appreciated property to public charities.” \(^{221}\)

The ability to donate appreciated property and claim a tax deduction for 100% of the fair market value at the time it was donated means the donor is never taxed on the appreciation of the asset, yet gets to claim a deduction not only for basis, but also for the appreciation. In the Tax Reform Act of 1986, Congress limited this advantage somewhat by treating the appreciation component as a “tax preference item” so that those affected by the Alternative Minimum Tax (AMT) (predominantly high income taxpayers) would only be able to deduct their basis in the donated property. \(^{222}\) A large gift of appreciated property could give rise to AMT liability for a taxpayer that otherwise would have avoided the AMT.

4. Changes in the 1970s

In the 1970s, tax rates remained stable with a top marginal rate of 70% and there were no changes to the scope of taxpayers’ entitlement to deduct their charitable donations (category 1 changes). \(^{223}\) In addition, the only change to the AGI limitation on deductions (category 2 changes)

\(^{219}\) Auten, Clotfelder & Schmalbeck, supra note 40, at 5.
\(^{220}\) Lindsey, supra note 13, at 1064-65 (for example, 154 taxpayers earning over $200,000 and 21 earning over $1 million paid no taxes in 1966).
\(^{221}\) Auten, Clotfelder & Schmalbeck, supra note 40, at 5.
\(^{222}\) Auten, Clotfelder & Schmalbeck, supra note 40, at 6.
\(^{223}\) Nat’l Taxpayer Advocate, 2011 Annual Report to Congress, supra note 111, at 7-9, Table 2.

42
occurred in 1978 when the unlimited charitable deduction was repealed; but the 1969 Act had already capped the ability to deduct at 50% of AGI, so this was a formality not impacting incentives or taxpayer behavior. As might be expected, there was no action in terms of altered taxpayer behavior because there were no tax changes related to the deduction to motivate such behavior and, despite stagflation at the beginning of the decade, donations remained at a very consistent percentage of personal income—dropping almost imperceptibly from a high of 1.96% in 1970 to a low of 1.87% in 1979 and consistent with the 1.91-1.95% throughout the 1960s.\footnote{CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING, supra note 103, at 17-18.}

However, while there were few tax changes and no perceived impacts due to tax changes in this area, the 1970s are important because the charitable donation deduction began to be seriously studied and the impacts of tax incentives in general and as related to the most wealthy donors started to become more differentiated.

In 1973, John D. Rockefeller, III, and the Chair of the House Ways and Means Committee formed an independent commission to comprehensively study the tax treatment of philanthropy.\footnote{Morgan, Dye & Hybels, Results from Two National Surveys, supra note 104, at 159.} The Commission published Giving in America in 1975 and subsequently published five volumes of research.\footnote{\textit{Id.} at Preface.} Two of these studies, conducted by The University of Michigan’s Institute for Social Research, Survey Research Center were the first “full-scale national surveys of philanthropy” and were conducted in cooperation with the Treasury Department, the Office of Management and Budget, and the U.S. Census Bureau.\footnote{Results from Two National Surveys, supra note 104, at 157-58.} The surveys confirmed the mixed motivations for charitable giving with “tax reasons” (among other factors) identified as a “high priority” reason to increase or decrease giving.\footnote{\textit{Id.} at 318, App. IV, Atch. 2 (other high priority factors are: changed family income; changed family needs; family touched by benefits from a charitable organization; changed participation in an organization; organization changed or donor obtained new and better information about the organization; pressure at work or from the organization; inflation; and, “given enough already.”).} This characterization oversimplifies the findings which are discussed next in more detail.

When asked to explain changes in giving, few mentioned tax reasons, however, empirical data showed those who were able to take advantage of tax incentives by itemizing donations were much more likely to make donations and also gave in larger amounts than those that did not itemize.\footnote{\textit{Id.} at 158, 229.} For those who ceased itemizing, their level of giving dropped

---

\footnote{224 CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING, supra note 103, at 17-18.}
\footnote{225 Morgan, Dye & Hybels, Results from Two National Surveys, supra note 104, at 159.}
\footnote{226 \textit{Id.} at Preface.}
\footnote{227 Results from Two National Surveys, supra note 104, at 157-58.}
\footnote{228 \textit{Id.} at 318, App. IV, Atch. 2 (other high priority factors are: changed family income; changed family needs; family touched by benefits from a charitable organization; changed participation in an organization; organization changed or donor obtained new and better information about the organization; pressure at work or from the organization; inflation; and, “given enough already.”).}
\footnote{229 \textit{Id.} at 158, 229.}
to substantially less than itemizers with similar incomes and almost to levels of those who had never itemized.\textsuperscript{230} The confluence of these factors suggests \textit{people may not be aware of how important tax incentives are to their own behavior even when recognizing that taxes may be significant drivers for their peers who are itemizers.}\textsuperscript{231}

This finding dovetails with the salience of the deduction (discussed above) and related concerns about how to improve the incentive effect by making the deduction more salient. Intuitively one would expect the incentive to be more visible to those that receive a higher reward for using it (the highest marginal rate) and those in that category would be expected to be more informed and better able to take advantage of its full value compared to those who don’t use it (those who take the standard deduction or itemizers who do not give to charity for other reasons). The survey confirmed this perception. Roughly half of the highest one percent in terms of family income would give “a lot less” without the tax credit; the percentages who would give “a lot less” drop to about 10-15\% for those at the lowest income levels.\textsuperscript{232}

Another corroborating statistical measure showed that in fact those who “had run up against the minimum tax provision” (presumably the AMT) had a much lower average rate of giving than others with like income who didn’t face the AMT.\textsuperscript{233} This empirical data seems to reinforce the conclusion based on actual giving patterns that \textit{taxes play a large role in donor behavior even when the donors may not realize it}. The AMT is much more hidden than the ordinary income tax since it only applies to a subset of filers and requires complex reformulation of taxes owed—for this reason, it may not be very salient for most taxpayers. This may in part explain why a deduction thought by some to be hypersalient\textsuperscript{234} may not be revealed to be salient to all by survey results\textsuperscript{235} even when it’s shown to be linked strongly to the incentivized behavior as a factual matter.

\textsuperscript{230} \textit{Id.} at 158, 229.
\textsuperscript{231} See \textit{e.g.} \textit{id.} at 228-29, Figure 13 (showing only 40\% of those at $50,000 income—then the beginning of the top 1 \%—thought changes would reduce their own giving a lot compared to over 60\% who felt it would make others with like incomes donate much less.) Survey data is of course always to be construed cautiously, but the differences in actual donor giving between itemizers and non-itemizers are based on government statistical information concerning actual behavior. See \textit{id.} at 157 (discussing dangers of “iffy” questions).
\textsuperscript{232} \textit{Id.} at 229, Figure 13.
\textsuperscript{233} Results from Two National Surveys, supra note 104, at 229.
\textsuperscript{234} See Faulhaber, supra note 138, at 1307.
\textsuperscript{235} See Goldin & Listokin, supra note 148.
Another important finding is that high income donors give a higher percentage of their income, as well as their time as volunteers. While higher donation amounts may be anticipated as merely a byproduct of increased ability to pay, the donation of service hours suggests nonfinancial factors are also significant. Looking at only the dollar value of gifts (not volunteer time), those in the top 1% of all households by income level gave on average 8% of their pre-tax income to charity. Contrast this generosity with the average of 2-4% of income donated by the lowest 96% of households by income. This phenomenon accounts for the heightened importance of top-end donors as responsible for a large percentage of overall giving.

Overall, the surveys confirmed that lower income itemizers and non-itemizers tend to give predominantly to religious organization or to social services organizations (such as to the United Way) while high end donors give to a wider array of organizations, including scientific, educational and cultural organizations. Therefore, threatening the deduction for high income taxpayers would have a broad impact on the whole charitable sector.

The study estimated that the magnitude of eliminating deductibility across the board would be a reduction of 10-20% of total charitable donations. The estimate was made by reducing the donation rate of itemizers to the donation rate for non-itemizers. This percentage seems reasonable since donations are based on a broad range of motives in

---

\(^{236}\) Results from Two National Surveys, supra note 104, at 159. Interestingly, the total value of all donations in cash and property was virtually the same as the total value of the hours donated to charitable causes. \(^{237}\) Id. at 160.

\(^{237}\) The study identified that having more to give was another high priority reason to increase giving. \(^{238}\) Id. at 318, App. IV, Atch. 2.

\(^{238}\) Percentages are rounded and do not add to 100% to account for the steep rise between most households and the highest income households. \(^{239}\) Id. at 161-62, Tables 1-2 and Figure 1.

\(^{239}\) Study organizers oversampled the top income groups because of the disproportionate importance of their contributions to the charitable sector, otherwise there might be a problem with statistical significance because of small numbers. \(^{240}\) See id. at 157, 161, Figure 1, note.

\(^{240}\) Id. at 232.

\(^{241}\) Results from Two National Surveys, supra note 104, at 160, 232 ($3-5 billion impact on $26 billion in total gifts). The author’s postulated, based on observed distinctions between the itemizers and those who did not itemize, that there was a strong correlation between tax incentives and giving that would be consistent with substantial price elasticity postulated by Martin Feldstein in a small 1973 study by the Treasury, Office of Tax Analysis. \(^{242}\) Id. at 158-59. Economists now recognize a smaller permanent price effect. See Auten, Clotfelter & Schmalbeck, supra note 40, at 31-32.
addition to tax incentives.\textsuperscript{243} Extrapolating to present day giving, based on the most recent IRS statistics reporting $170.2 billion in itemized charitable deductions,\textsuperscript{244} would lead to an estimated reduction of $17 billion to $34 billion if the deduction was eliminated altogether. The drop could be even more extreme if one considers that the survey data indicated 40% or more of high income donors believed that they or others like them “would give a lot less” without the tax deduction.\textsuperscript{245}

Of course, the recent budget proposal only reduces the rate for deductions instead of eliminating it so these surveys cannot be directly related to the recent proposal. A ballpark estimate of the impact could be obtained by multiplying 20% (the ratio of the proposed rate reduction to the present 35% rate) times $25.5 billion (the mid-point of the earlier estimate of the $17-34 billion from totally eliminating the deduction) to establish the lower end of the range at $5.1 billion. The upper end is estimated in similar fashion using 29% (the ratio of the proposed rate reduction to the reinstated 39.6% rate) times the $22.5 billion to yield $7.4 billion.

Furthermore, at the time of the studies, improved public awareness of the value of the tax incentive was expected to enhance charitable donations, especially donations of appreciated property. “Even at upper income levels, there is a substantial need for better knowledge of present tax advantages of giving.” Presumably, such knowledge would translate to greater salience and more tax motivated giving.

It’s likely that the public is now more educated as tax planning becomes more sophisticated, the government becomes more transparent, and computers and the internet have accelerated taxpayer knowledge.\textsuperscript{246} Taxpayer behavior for high income donors now demonstrates awareness of the tax value of donating appreciated assets.\textsuperscript{247} In addition, more recent surveys show that high-end donors are aware of the value of tax incentives

\textsuperscript{243} The lower side of the estimate may be more likely if the top donors’ altruism (as indicated by service hours) really is higher; in the alternative, without a tax advantage they may choose to donate more time instead of more money.

\textsuperscript{244} IRS SOI Table 2.1, Returns with itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Item, by Size of Adjusted Gross Income, Basic tables 2010, p.89, available at http://www.irs.gov/pub/irs-soi/10inalcr.pdf.

\textsuperscript{245} Results from Two National Surveys, supra note 104, at 228-29, Figure 13.

\textsuperscript{246} But see Goldin & Listokin, supra note 148 (showing lower salience than expected). Perhaps the resort of many taxpayers to formerly uncredentialed preparers or tax software where they only introduce factual data that is prompted interferes with greater salience for Joe Everyday Filer explaining the greater obscurity for low-end taxpayers than those with sophisticated tax professionals. See Patrick E. Tolan, Jr., It’s About Time; Registration and Regulation Will Boost Competence and Accountability of Paid Preparers, 31 VA. TAX REV. 471.

\textsuperscript{247} Gravelle & Marples, supra note 43 at 5-6.
and are concerned about losing the deduction.\textsuperscript{248} Although numerous surveys have been conducted over the subsequent decades to evaluate tax incentives and how various changes may impact charitable donations, many of the surveys tend to adopt the same approaches as these original landmark surveys: using IRS data to identify a pool of potential respondents and oversampling the very wealthy. Some recent surveys either continue this trend or exclusively sample the most wealthy.\textsuperscript{249}

5. Tax Reform in the 1980s

Charles Clotfelter, an economist and professor at Duke University’s Institute of Policy Sciences and Public Affairs wrote the book, Federal Tax Policy and Charitable Giving, as a monograph for the National Bureau of Economic Research in 1985.\textsuperscript{250} Tax policy was a hot button issue in the wake of the tax cuts of The Economic Recovery Tax Act of 1981\textsuperscript{251} and the comprehensive tax code reform then pending before Congress.\textsuperscript{252} Clotfelter’s book comprehensively examined the previous research into the relationship between tax incentives and charitable giving and extended the field of applied econometric analysis.\textsuperscript{253} He concluded that federal tax policy has a substantial impact on charitable giving, but observed that it is not possible (except under very special assumptions) to state any simple relationship between the efficiency of tax incentives to motivate giving and the price elasticity of giving.\textsuperscript{254}

Clotfelter also provided unique insight about the nonprofit sector that “plays a more important role in the United States than in any other industrialized economy” where the governments perform the functions

\textsuperscript{248} Bank of America Merrill Lynch 2010 Study, \textit{supra} note 52 at 10.
\textsuperscript{249} \textit{But see} Dunham & Company, \textit{Three-fourths of Americans Favor Charitable Tax Deduction: Survey Indicates any Changes to System Would Face Strong Opposition} (Feb. 7, 2012) (surveying 1,000 random taxpayers to sample public/political consensus more broadly) and Goldin & Listokin, \textit{supra} note 148 (oversampling in states with no income tax but otherwise mimicking the general population).
\textsuperscript{250} \textsc{Clotfelter, Federal Tax Policy and Charitable Giving, supra} note 103, at xi.
\textsuperscript{252} \textsc{Clotfelter, Federal Tax Policy and Charitable Giving, supra} note 103, at xi (an average of one new tax bill enacted every two years since 1976 and “mounting discussion of comprehensive tax reform.”).
\textsuperscript{253} \textsc{Clotfelter, Federal Tax Policy and Charitable Giving, supra} note 103, at xi (he expanding his modeling to use four different data sets for analysis including three new data sets never previously explored).
\textsuperscript{254} \textit{Id.} at 288. At the time, the value of the standard deduction was being eroded due to inflation so more people were itemizing; however, after the tax reform of 1986 the standard deduction was significantly increased and indexed for inflation.
performed by nonprofits in the United States. Because of the enormity of the nonprofit sector (the vast majority of which is comprised of charitable organizations under 501(c)(3)), nonprofits also play a pivotal role in the job market—employing 10% of the labor force—double the number of federal government employees.

Some writers have used a magnitude of price elasticity of more than one as efficient, because the rise in contributions would exceed the revenue lost to the government, but evaluating an elasticity of one as “break even” is mistaken since it fails to account for these comparative social benefits derived from private contributions or the benefits to society of alternatives to government services.

Clotfelter projected that giving overall would increase after the Economic Recovery Tax Act of 1981 due to nonitemizers taking the above the line deduction, but the increases would be slight as tax rates dropped for those in the upper brackets. He also projected bequests would drop as the marginal rate for bequests dropped and the number of taxable estates dropped. This same change could elevate lifetime giving as the comparative value of giving during life versus at death increased.

In a later work, Clotfelter examined both the predicted effects of the tax reforms of the 1980s as well as the tax statistics for tax years 1987 and 1988, after the later reform was fully implemented. Clotfelter’s goal was to compare, with the benefit of hindsight, the actual and apparent effects of the tax cuts with the predicted effects. He used IRS statistical data for itemizers to see how the predicted declines in giving due to the changing prices of giving (due to tax cuts) compared with the models of impacts on giving using a price elasticity of -1.27 and an income elasticity of 0.78.

Acknowledging that data limitations, “plus the conceptual
difficulties regarding non-tax effects . . . make it impossible to devise definitive tests of the efficacy of economic models of contributions,” Clotfelter nevertheless made three principal observations. Actual performance mimics the model. “Especially noteworthy are the actual and predicted declines in average giving for high-income taxpayers.” Income groups facing the biggest price increases in 1981 tended to show relative declines in giving. For most income classes, however, contributions decreased by less than the model predicted. The model predicted an overall drop of 24% based on price effect and an income effect gain of 2% or a predicted decline of 20% compared to an actual decline of 10.5%.

In response to the Tax Reform Act of 1986, amounts contributed by those at the top actually dropped by more than the model predicted. IRS statistics show that the amount of cash donations from itemizers increased while the amount of donations of appreciated property spiked in 1986 and dropped precipitously after 1986. Tax planning (timing to take advantage of the higher relief in 1986) may have contributed to higher than expected numbers in 1986 and correspondingly lower donations in some subsequent years for donations that had been accelerated due to the pending code changes. These timing considerations may have been even more critical to taxpayers facing AMT liability with the change in the rules after 1986 limiting the deduction for appreciated property to the taxpayers basis (what the item cost) when calculating AMT. Since AMT targets the wealthy, it is reasonable to assume this was more of a concern for top income donors.

As an inflation adjusted amount, overall donations actually rebounded to record levels after both of the tax changes in the 1980s, but simultaneously the percentage of contributions by the top quintile dropped. “Relative to their income these taxpayers gave less in 1987 than they did in 1980.” This observation is consistent with the theory that price elasticity matters most for those with the highest marginal rates and that salience of tax changes is highest for this financially astute group.

Econometric models are not perfect for a number of reasons, most notably that looking at the cost of giving (price factor) in isolation as a method of judging the impact of tax law changes ignores other factors that

263 Clotfelter, Id. at 18.
264 Id. at 18.
265 Id. at 21.
266 Id. at 22.
267 Id. at 22.
268 Clotfelter, supra note 23, at Table 5 (artworks donated, for example, dropped from 28,305 in 1985 to 17,035 in 1988); Bakij & Heim, supra note 61, at 618 (large spike in giving in 1986 was precipitated by looming changes in Tax Reform Act of 1986); see also id. at Figure 3 (showing drop in donations from millionaires from over 8% of income in 1986 down to 4% in 1987).
269 Clotfelter, supra note 23, at 27.
270 Clotfelter, supra note 23, at 25.
Compromising the Safety Net: How Limiting Tax Deductions for High-Income Donors Could Undermine Charitable Organizations

motivate taxpayer “giving behavior.” Other researchers note timing considerations to maximize short-term gain and overall after-tax income also significantly impact donor behavior. In addition, the effect of a recession in 1987 and 1988 may have impacted top donors by reducing their surplus from which to give.

Timing effects make the effects of the economy in 1987 less discernible because tax incentives to donate in 1986 instead of 1987 are consistent with dropping donations as are the lower price effects from the reduced tax rate (unlike the depression-era changes where the economic effect was the opposite of the price effect and 2007-2009 when the economic effect took place while taxes remained unchanged). Because all three factors were in the same direction, the comparative magnitude of each is obscured as is the cause and effect connection. However, the combination of a drop due to the price effect, economic drop in the market, and timing to move donations forward to the more beneficial tax year may all explain why these effects outweighed income effects at the top end and also resulted in lower giving than predicted in the model.

6. 1990s-Present

The price of giving corresponds inversely to the top marginal rate for the wealthy. The overall drop in giving for these taxpayers in the 1980s was predicted by the models and was due, at least in part, to the price effect and the corresponding increased costs of giving. The cost of donating cash rose from 30 cents on the dollar before 1981 to 72 cents on the dollar after 1986. The cost of donating appreciated property rose from 20 cents on the dollar to 58 cents on the dollar during the same timeframe.

As top tax rates began to creep up again in the 1990s, one would expect a renewed vigor in the price effect and its influence on donating by the wealthy. This in fact occurred in the 1990s. The top marginal rate hike from 31% to 39.6% was well advertised in 1992, allowing potential

272 Bakij & Heim, supra note 61, at 636. “[E]stimates based purely on federal price variation are rather sensitive to how one controls for income and omitted time-varying influences that differ by income class.” Id. at 638.
273 For the same reasons, even though the drop was most noteworthy for the wealthy, the reason is not obvious. The timing effects were most likely important for this group (which had the most to gain from timing and probably was best advised of the changes—so this was the group where timing was most salient), the price effects were likely most important for this group (those in the 50% bracket had most to lose from not accelerating donations and the greatest drop in price incentive) and the economic effects—lost wealth in the market drop—were also more significant for the wealthy than those with fewer assets.
274 Clotfelter, supra note 23, at Table 3.
275 Id.
276 See generally Auten, Clotfelter & Schmalbeck, supra note 40.
donors to defer their donations for a greater tax advantage in 1993.\textsuperscript{277} The average giving for this group fell from 6% in 1991 to 4.4% in 1992 and rose to 6.3\% in 1993.\textsuperscript{278} The motive to donate appreciated property was restored in the 1990s as well, when Congress first suspended, then repealed, the unfavorable AMT treatment of appreciated property—effectively allowing taxpayers’ cost of giving to drop to 35 cents on the dollar versus 60.4 cents on the dollar for cash donations, so non-cash donations rose.\textsuperscript{279}

Real adjusted gross income and real salaries and wages all rose throughout the 1990s in response to a rise in GDP.\textsuperscript{280} Overall donations also rose annually as adjusted for inflation until 2001.\textsuperscript{281} In 2001, itemized donations dropped by 3.8\% in constant year dollars, and donations from those earning over $200,000 dropped by almost 9 billion dollars.\textsuperscript{282} The most likely reason for the drop was the 2001 recession. The market lost 25\% after September 11th, but had been sliding all year for a total decline of 37.8\%.\textsuperscript{283} Real AGI, salaries, and wages also dropped.\textsuperscript{284}

Drops due to the price effect as tax rates dropped from 2001 to 2002 probably played a role in top donors giving less in 2002 as well (dropping $4 billion as overall donations almost held steady), but giving for top donors inched back to 2001 levels and rebounded to 2000 levels by 2004. The tax rate changes of the 2000s were not as dramatic as those of the 1980s and were introduced incrementally so they were probably less salient and led to less timing effects. Even though the effects were in the same general direction as those in the 1980s (lowering the price effect but increasing the tax-related income effects to donate), they weren’t as noticeable. For this reason, the impact of the economic hardship brought about later in the decade by the “great recession” masks any lingering price or income effects from the earlier rate relief.

\textsuperscript{277} Auten, Clotfelter & Schmalbeck, supra note 40, at 23.
\textsuperscript{278} Id. The wealthy are more likely to pay attention and to have assistance of tax advisors. See id. at 16, 23.
\textsuperscript{279} Auten, Clotfelter & Schmalbeck, supra note 40, at 6, 19, 24. As might be expected, the wealthy tend to give more appreciated property. Id. at 24.
\textsuperscript{280} IRS, Statistics of Income Bulletin, Fall 2011 at 15, Figure J.
\textsuperscript{281} Id. at 18, Figure M.
\textsuperscript{282} Id. at 15, Figure J; see also Appendix 1.
\textsuperscript{284} IRS, Statistics of Income Bulletin, Fall 2011 at 15, Figure J.
III. DONATIONS DROP IN TIME OF SERIOUS RECESSION

In 2008, due to the recession, Giving USA\textsuperscript{285} reported “the largest drop [in charitable giving] since the group has been keeping track of America’s charitable donations.”\textsuperscript{286} Total inflation-adjusted giving was down 5.7 percent.\textsuperscript{287} To make matters worse, in the face of the lingering recession, donations continued to drop in 2009.\textsuperscript{288} “Real charitable contributions decreased by 8.3 percent for 2009.”\textsuperscript{289} The IRS noted a huge impact on itemizers stating “it also marked the lowest amount deducted on individual returns since 1998.”

Even more remarkable, the 2008 plunge was only the second drop since Giving USA started producing annual reports in 1956; the other drop was in 1987 after the tax reforms of 1986 and during another serious recession.\textsuperscript{290} As explained earlier, the devastating impact of the great depression on donations—triggering a drop of one-third of overall donations in the four year period after the depression began—was a clear indicator that rapid loss of economic wealth could trigger devastating drops in donations. Such drops are a byproduct of both the loss of disposable income and the uncertainty concerning the future of the market. It’s psychologically easier to part with your wealth when you not only have plenty, but have every reason to believe you will have as much or more next year. If donors give from their surplus, they need a surplus and no reservations that the surplus will survive current economic hardship.

The “great recession” (2007-????) also hit all Americans hard reducing overall national wealth. Like the stock market crash and run on the banks that precipitated the great depression, many who had investments and “surplus” wealth lost a considerable part of their fortune. While we all know about the impact on the poor and jobless, the wealthiest individuals in the country were also seriously affected economically, because this group receives a disproportionate share of annual income in the form of capital gains.\textsuperscript{291} “Between 2007 and 2009,
average income for the top 400 plunged more than 40 percent with more
than 90 percent of the drop the result of lower capital gains.\footnote{292} Other
millionaires’ average income dropped 18 percent over the same period and
the number of millionaires fell 40 percent.\footnote{293}

In addition, because there was a lower percentage of tax-preferred
capital gains income, the effective tax rate for the highest income tiers
went up.\footnote{294} Higher tax rates on lower overall income no doubt contributed
to constricted disposable income for this most relevant donor group.
Coupled with the loss of appreciated reserves, these factors crippled their
funds from which to make donations. Considering the import of the top
3\% to overall donations, it is no surprise that overall donations also fell
during this period.

In fact, the overall donation drops during the recent recession
could be explained purely in terms of reduced giving by the highest
income donors. Record levels of overall giving in 2007 ($314 billion)
dropped by $7 billion in 2008\footnote{295} while the total deductible donations of
those earning over $200,000 dropped by $17.7 billion.\footnote{296} In 2009, the
overall donations dropped by $3 billion\footnote{297} while deductible donations of
those over $200,000 dropped by $13.6 billion. Table 1, at Appendix 1,
shows the changes in overall donations for donors above $200,000 from
2001 to 2010.

Serious recessions not only impact individual donors, but also have
an even greater effect on the charitable community and those they serve.\footnote{298}
Any drop in giving forces nonprofits to try to make ends meet with fewer
resources.\footnote{299} The situation was exacerbated by heightened demand due to
the great recession. “Compared with 2007, 54 percent of human services
charities saw an increase in need for their services in 2008.”\footnote{300}
Considering the escalating need for services, this sector was squeezed
from both sides—meeting heightened demand with fewer resources.

\footnote{292}{Williams, supra note 41.}
\footnote{293}{Id.}
\footnote{294}{Effective tax rates jumped by one fifth (from 16.6\% to 19.9\%) for the top 400
and by one tenth (from 22.7\% to 25\%) for the others. Id.}
\footnote{295}{Giving USA 2011 Report, supra note 7, at Executive Summary 24.}
\footnote{296}{Cumulated data from IRS SOI, Table 3, Tax Years 2001 to 2009. Internal
Revenue Service, Statistics of Income, Individual Income Tax Returns, Table 3, available
year). Summary provided in Table 1 at Appendix 1.}
\footnote{297}{Giving USA 2011 Report, supra note 7, at Executive Summary 24.}
\footnote{298}{See id. at 20 (the 0.9\% increase from 2010 to 2011 is described by giving USA
as “flat” and other flat years typically occur in recessions). “[Charitable] giving tends to
decline during recessions, after adjusting for inflation.” Bank of America Merrill Lynch
2010 Study, supra note 52 at 10.}
\footnote{299}{Del Martin, Chair of Giving USA, U.S. Charitable Giving Estimated to be
\footnote{300}{Id.}
“For 2009, 60 percent of the surveyed human services organizations were cutting expenses, including cutting services or staff, due to funding shortages.”301 “Among organizations working to meet people’s basic needs (food, shelter, clothing, etc.), more than half (53 percent) said they are underfunded or severely underfunded for 2009.”302

In some localities, circumstances are especially dire. Even though 2009 showed some early signs of economic recovery and the slow positive trend continued in 2010, charitable donations from 2009 to 2010 to the Community Foundation of Central Florida dropped from $5.9 million to $2.5 million.303 Giving was down eleven percent and grant funding slipped fifteen percent.304

Nationwide, the slow economic recovery has turned the tide on diminishing donations and rates of giving are again on the rise, albeit at a snail’s pace. For the past two years, overall gifts have risen 3% and 4% respectively, but only 0.8% and 0.9% in real terms (after accounting for inflation). In fact, the total charitable gifts of $298.42 billion in 2011 are still down from the $307 billion reflected in the 2008 Giving USA Report and are well below the $314 billion high water mark in 2007.305

One additional disturbing data point from the Giving USA results for 2011 is that the total number of 501(c)(3) exempt organizations also dropped substantially in 2011—down to 1.08 million from 1.28 million a year earlier.306 The report characterizes this reduction as a byproduct of a new requirement in 2006 that such organizations, regardless of size, file tax returns starting in 2007 and the loss of status for nonprofits who failed to comply for three years.307 The Giving USA report characterized the 200,000 organizations that lost their charitable status as “small and largely defunct.”308 But this phenomenon would also be consistent with organizations at the margin going under in the face of increased demands while suffering from fewer donations.

---

301 Del Martin, supra note 295.
302 Id.
306 Id.
307 Id.
308 Id.
IV. Analysis & Recommendations

The United States has the most robust charitable sector in the world, and one of the main reasons is our unique system of tax incentives for those who give so generously. The social good the deduction generates far outweighs the money it costs. And things like education of our youth, healthcare, help for the needy, and funding of the arts can’t be measured on a balance sheet.

The historical concerns that prompted the charitable deduction in the first place and the several justifications analyzed above support special treatment of the deduction, because the fruits of the donation accrue not only to the donor, but even more to society in general. Because the deduction for charitable giving is different in this way from other personal deductions, it should not simply be lumped in with all itemized deductions and treated as if all the deductions are homogeneous. For this reason alone, the 2013 budget proposals should not be adopted; at a minimum, the charitable deduction should be carved out of the overall proposed 28% rate limitation for special consideration and treatment.

As explained below, reasonable minds could differ about whether this particular deduction should ever be changed at all and, if so, how best to change it. However, as a priority matter, it should not be changed now; because this consideration is more urgent, it is addressed first.

1. The Charitable Deduction Should Not be Reduced Now

“Social and Human Services are more than a safety net, and are typically used by more than 60% of citizens.”310 In the past few years, many citizens who have never before been in economic trouble have turned to charity.311 At the same time, eroded overall wealth has eroded the assets available for the wealthy to donate and hence tends to restrict consumption. To use Hollis’s terms, “the surplus” from which to donate has been drained already. Further reductions of wealth through tax hikes will reduce this consumption even more and reduced tax incentives to give further threatens generosity.

The nickname “great recession” harkens back to a time of unprecedented national financial struggles and poverty the likes of which

309 Dunham & Company, supra note 250.
311 See e.g. Shaver, supra note 71 (double the number of people seeking free lunches and assistance with utility bills from Bethesda Cares), available at http://www.givingusareports.org/products/GivingUSA_2011_ExecSummary_Print.pdf.
this nation had never seen. By all accounts, both the severity and duration of the present economic hardship has not been seen since the 1930s. And it could get worse before it gets better. The latest report from the Congressional Budget Office predicts looming fiscal changes (the fiscal cliff)\(^{312}\) will result in recession in 2013 characterized by “negative GDP growth . . . with the economy contracting by -0.5 percent.”\(^{313}\) That forecast is “scarier” than earlier projections in January and May of 2012 and envisions unemployment rising to 9.1%.\(^{314}\)

Just the prospect of another recession could prompt wealthy donors to hold rather than give their assets or dollars to charity. This economic uncertainty is not helped by gridlock in Congress and election-year politics. Gloom and doom terms like “fiscal cliff” and “taxmageddon”\(^{315}\) are probably making the issue of tax reform more salient. With a possibility of tax hikes and no changes to deductions,\(^{316}\) prospective donors are encouraged to hold for now.\(^{317}\) Donor fears the market will deteriorate or will be slow to recover could easily stifle giving. Looking strictly at the strong psychological desire for self-preservation (and correspondingly wealth preservation) one would expect donors not to give their money away when economic prospects are still bleak, because this could compromise their standard of living in the future. In other words, donors will probably look at their long-term and short-term interests when

\(^{312}\) Kurtzleben, *CBO: Fiscal Cliff Effects Now Look Worse*, supra note 8 (“Updated projections show a contracting economy in 2013, with unemployment moving above 9 percent”); *see also* Congressional Budget Office (CBO), Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013 (May 2012) [substitute Aug. 2012 when released].

\(^{313}\) Kurtzleben, id.

\(^{314}\) Id.

\(^{315}\) Lori Montgomery, *CBO: Taxmageddon Would Throw U.S. Back into Recession*, WASH. POST (“Anxiety is growing over how the impact of those tax and spending cuts would affect the nation’s economic recovery come January, when what’s been nicknamed “taxmageddon” hits.”)


\(^{317}\) The prospect of higher taxes and no 28% rate-cap on deductions means the price effect will be stronger (39.6% marginal rate vs. 35%) so top income donors would benefit by delaying donations until 2013 after taxes rise ($4,600 benefit from a $100,000 donation on Jan. 1, 2013 vs. Dec. 31, 2012).
making donations, and donor behavior will likely be shaped by their outlook as well as their pocketbook.318

As charitable organizations struggle to meet increasing demands, this is not the time to threaten their cash flow. Tax incentives are necessary to keep donations flowing. Limiting itemized deductions “would reduce the incentive for people to give at a time when Congress should be considering ways to increase charitable donations rather than decrease them.”319

Nonprofit organizations need stable and predictable sources of income.320 However, the reality of non-profit organizations is that they are highly dependent on gifts from donors—which are inherently unpredictable. Recent studies have evaluated consumption321 as a better indicator than income of donor effects and this is logical since only funds available for consumption are available for charitable donation. Economic hardship limits consumption in the same way tax hikes limit consumption, by reducing the surplus from which taxpayers can make charitable donations.

Since disposable income drops with tax increases, the President’s proposed rate increase will have an adverse effect on donations; the tax hike due to the inability to take charitable deductions at the highest marginal rate will also reduce disposable income. Both features of the proposal will therefore dampen charitable giving by the top income Americans. In a sputtering and uncertain economy, such as we have now, preserving tax incentives could be vitally important because the economic effects will be negligible in a flat economy and continued market uncertainty could motivate more cautious donor behavior.

2. Severity of Proposed Tax Reform

With high demand and reduced donations, the charitable sector now faces the perfect storm if the federal government limits or removes incentives and reduces (through higher taxes) the ability of the wealthy to donate. Looking to the specific proposals in the 2013 budget, there are two relevant features: the increase to the 39.6% marginal rate and the 28% cap on all deductions.

Coupling the prospect of a tax hike for the wealthy with the proposed 28% limit on charitable donation deductions means that unlike

318 Timing to exploit short-term advantage is consistent with this theory (looking at consequences over several tax years) as is the disparity between lifetime giving and bequests that cannot be explained by price incentives (donors underfund lifetime gifts and overfund gifts at death in the author’s opinion because people don’t know when they will die and want to make sure they don’t outlast their wealth).

319 Neal Denton, Senior Vice President, American Red Cross, The Hill (Mar. 27, 2011).


321 Bakij & Heim, supra note 61, at 615, 647.
all of the tax changes in the past, there would be less of a price effect and simultaneously less after-tax income. In other words, there is both an adverse price effect and an adverse income effect (instead of the typical situation where these effects are offsetting).

To gauge the impact of the income effect (reduced after-tax income), compare the July 2012 JCT estimates of the cost of extensions of the existing tax cuts for all taxpayers through 2014 (roughly $300 billion) with the cost of the “Middle Class Tax Cut Act” which would only extend the cuts to those earning under $200,000 ($250,000 for married couples) (roughly $273 billion). The difference ($300 billion-$273 billion) reflects the costs saved by not extending tax relief to the same class of taxpayers addressed in the 2013 Budget Proposal. This means high-end taxpayers would see a tax hike of $27 billion over two years.\textsuperscript{322}

Calculating the tax-related change due to the 28% rate limit for deductions is much more complicated and controversial. Because the charitable sector depends on donations, it has a vested interest in studying the effects of tax changes in order to evaluate potential repercussions. Therefore it’s no surprise that nonprofits have invested considerable time and attention in this regard to studying the likely consequences of tax changes over the years. It’s also no surprise that this sector fights to maintain tax incentives for giving.\textsuperscript{323} Complaints from the nonprofit community about the President’s proposal to cap charitable deductions in 2011 were fast and furious, estimating the total drop in donations from such reform at from $4 billion annually\textsuperscript{324} to as much as $7 billion.\textsuperscript{325}

While there is an inherent bias of self-interest that might motivate this sector to inflate projections, the members of this sector are also in a unique position to collect data about actual consequences in response to changes.\textsuperscript{326} Data on repercussions, therefore, may be less slanted than surveys or projected repercussions. Indeed, the data is likely to be more credible because it is subject to at least partial verification by the IRS in its collected tax statistics, misrepresentation could hurt the reputation of those reporting the data, and faulty data would compromise its utility for use within the community.

Even the projections and surveys, however, are useful to the extent that these studies and surveys intimate likely donor behavior. Projections

\textsuperscript{322} Compare Joint Committee on Taxation, Memorandum from Thomas A. Barthold, Revenue Estimate on Hatch Amendment to S.2237 [TaxAnalysts Doc. 2012-15378] Table #12-2 116 (July 18, 2012) with Joint Committee on Taxation, Estimated Revenue Effects of the “Middle Class Tax Cut Act” [TaxAnalysts Doc. 2012-15379] Table #12-2 112 R1 (July 12, 2012).

\textsuperscript{323} Cite 2011 opposition


\textsuperscript{325} Dunham & Company, supra note 250.

\textsuperscript{326} Clotfelter characterizes their challenges to the 1980 reforms as “some of the gloomiest predictions” and notes that doubters accused the sector of “crying wolf.” Clotfelter, supra note 23 at 2.
are even more valuable when they focus on the giving behavior of the wealthy since this group has such a large impact on giving.\textsuperscript{327} “The average taxpayer in the highest income class gives away in a year an amount greater than what 99 percent of households earn in a year.”\textsuperscript{328}

A 2010 survey of 800 wealthy households indicated that eliminating the charitable donation would undermine their giving.\textsuperscript{329} 67\% “would somewhat or dramatically” reduce charitable contributions if there was no income tax deduction; this number is up from 47\% in a 2008 study.\textsuperscript{330} This study did not specifically focus on what should be lesser impacts from reducing versus eliminating the tax benefit altogether. However, it corroborates the conclusions of the earlier econometric studies and the empirical data showing that “existence of taxes and the associated deductions induce people to give more than they would otherwise” and that even though permanent price elasticity may be smaller than it was first perceived, “it is substantial nonetheless.”\textsuperscript{331}

The October 2011 Center on Philanthropy study looked specifically at the projected consequences of the President’s proposed cap on itemized deductions at 28\% and concluded that giving could drop by $2.43 billion.\textsuperscript{332} A 2010 Congressional Research Service study of President Obama’s earlier proposal to cap deductions at 28\% reached consistent results.\textsuperscript{333}

Any multi-billion dollar drop in charitable donations would have a notable impact. To put these numbers in perspective, the combined annual operating budgets of the American Cancer Society, the American Heart Association, Habitat for Humanity, St. Jude’s Children’s Research Hospital and World Vision total under $4 billion.\textsuperscript{334} The top 200 charitable organizations combined received only about $41 billion in donations in 2011.\textsuperscript{335}

\textsuperscript{327} See generally Auten, Clotfelter & Schmalbeck, supra note 40.
\textsuperscript{328} Auten, Clotfelter & Schmalbeck, supra note 40, at 32.
\textsuperscript{329} Bank of America Merrill Lynch 2010 Study, supra note 52, at 10.
\textsuperscript{330} Id.
\textsuperscript{331} Auten, Clotfelter & Schmalbeck, supra note 40, at 33.
\textsuperscript{332} Center on Philanthropy Study, supra note 57, at 5 (note the number is based on both the 28\% limit and the assumption that rates will go up to 39.6\% for the highest marginal bracket following expiration of EGTRRA).
\textsuperscript{333} Gravelle & Marples, supra note 43, at Summary (showing a drop in giving of 1-1.5\%). This equates to a reduction of $3-4.5 billion based on overall giving of 300 billion or $1.5-2.25 billion based on a drop in only itemized deductions.) One thing to be wary of, however, is timing effect—if any change is perceived as temporary the effects may be amplified—for example a wealthy donor may donate before the unfavorable change or hold on to appreciated property later in the hopes of a more favorable tax change.See id. at 10. The Center on Philanthropy Study, supra note 57, at 8, did not consider confounding short-term effects in its analysis.
\textsuperscript{334} ACR, Fly In/Speak Out, supra note 55.
Carving the charitable contribution deduction from the 28% rate cap, but allowing it to apply to all other itemized deductions and tax-preferred items proposed in the 2013 budget would actually be an advantage for charitable donations due to the substitution effect. To the extent other deductions are limited to 28%, but charitable deductions remain at the higher marginal rates, those charitable donations would be favored by the higher relative subsidies and donors could be motivated to shift to increase charitable donations while sacrificing rate-limited deductions (such as tax exempt bonds or contributions to a 401(k)). Since higher marginal rates will reduce the disposable income of the wealthiest donors, positive price effect will offset the reduced income from the after-tax consequences of the higher rate itself. In other words, these donors will have less disposable income, but their incentive to give to charity will be higher.

Under the President’s budget, however, both the price effect and the income effect will hamper donations. Compared to the 2012 tax laws, donors would face a heightened tax burden due to the reinstatement of the 36 and 39.6% brackets and they will have a reduced subsidy for donations (down to 28% from 35%). The combination of both effects will certainly undermine charitable giving by the effected donors and may do so in a non-linear fashion as wealthy donors and their tax planners may search for tax shelters or other tax advantaged possibilities to improve after-tax income.

The critical distinctions between the present proposals and past reforms serve as the major point of debarkation from the conclusions otherwise suggested by the 1980s results. In addition, the weak economy has already burdened the charitable sector potentially amplifying the consequences of cash flow problems that might stem from tax reform.

3. The Need for Continued Study

“Most Americans (73 percent) believe that private nonprofits are better at promoting social goods than the government.”\(^{336}\) One likely explanation is that the government is widely perceived to be an inefficient bureaucracy.\(^{337}\) Perhaps this is because American’s better trust the private non-profit sector to carry out the predominant social services role; or, perhaps because limitations on individual and community support move further away from the Framers’ careful restraint on the role of federal government. Another explanation would likely include the preference

---

\(^{336}\) Dunham & Company, supra note 250. The Dunham study was based on interviews of 1,000 adults and has a margin of error of minus 3.1 percent at the 95% confidence level. Id.

\(^{337}\) Jeffrey M. Jones, Americans Say Federal Gov’t Wastes Over Half of Every Dollar, Gallup Politics, Sept. 19, 2011; http://www.gallup.com/poll/149543/americans-say-federal-gov-wastes-half-every-dollar.aspx (“Americans have become increasingly likely to see all levels of government as being wasteful of tax dollars”).
Americans enjoy in terms of the freedom to donate to organizations they favor as opposed to entrusting that important decision to the government.

In terms of socio-economic theory, the ability to protect minority interests from intransience of the majority is another explanation. Economic Theorist Burton Weisbrod proposed that the voluntary (not for profit) sector forms one leg of a three-sector economy together with the private sector and the public sector (government). Weisbrod explains that the voluntary sector provides services such as aid to the poor and assistance for health, education, and welfare that would typically be public services, but that are underserved by the government because it imperfectly reflects our heterogeneous society. Constraints on government create a situation tantamount to “market failure” for promoting collective goods because government policy imperfectly represents the will of the people—exceeding what some voters demand while disappointing others. This dispersion of preferences results in a political process where many are disappointed with government output and taxation levels. Voluntary charitable donations allow Americans to support their preferences and the tax relief reduces the burden on private donations to allow the charitable sector to complement the collective services afforded by the government. This may be a significant reason 73% of Americans favor retaining the charitable deduction in its present form.

Another explanation for the preference for nonprofit versus federal charitable support is that many charitable organizations are community-based and a federal program is more likely to be detached and impersonal. Although, government grants to local charities largely help alleviate this concern, without strong community-based organizations in place to implement the grants at a local level, the government would have

338 See Andrews, supra note 63, at 369-70; Gergen, supra note 76, at 1409.
340 Weisbrod, supra note 340, at 2, 5.
341 Weisbrod, supra note 340, at 5.
342 Julian Wolpert, What Charity Can and Cannot Do, A Twentieth Century Fund Report 8 (1996) (“Private, nonprofit agencies are the major frontline social service providers in their communities.”).
343 Galle, supra note 128, at 782.
344 See Wolpert, supra note 331, at 9 (37% of funding for charitable nonprofits in the mid-1990s came from such grants). Wolpert notes that federal spending cuts proposed as part of the Contract with America would cut affected federal funding for 108 diverse charitable organizations by 25% leading to higher charges for services, reduced staffing and an increased competitive scramble for donations to make up the gap. Id. at 12-13. Wolpert concludes that charitable organizations are junior partners with government that depend on help from Washington to serve the neediest Americans and that without such help their ability to help America’s poorest will be compromised. Id.
to take on this administrative burden.

Our most recent economic struggles bring the controversy between
government and private safety nets for the poor again to center stage as
unprecedented numbers of Americans suffer financially. The President’s
proposal would continue to shift the safety net toward the government
implicitly if not explicitly by reducing incentives for private charitable
donations. If a minimum safety net is a zero-sum game, the government
will end up filling the gap for any reduction in private support (and there is
no guarantee this could be done as capably, effectively, or efficiently as
the private charitable sector). For the reasons explained above this is
not the time for such a shift, and there may never be a time for it.
Although some may support these moves for any number of reasons,
based on recent survey results, Americans at heart still prefer full
deductibility of donations to charity.

At bottom, the preference for a government safety net versus a
private safety net depends on political and philosophical preferences for or
against big government. Therefore, competing arguments for and against
the proposal may matter less than an individual’s proclivities and sense of
values. Because these competing values underpin this discussion,
consensus is likely difficult and may be impossible, but in the meantime it
is sensible to seek a deeper understanding of these competing philosophies
and values and examine potential opportunities for compromise.

While America waits for the economy to rebound to the point
where charitable donations are restored to their 2007 levels, further study
and debate should ensue about how to modify or eliminate inefficient
rewards for donations of appreciated property while continuing to foster
high levels of donations from the wealthy. Any decisions shaping reform
of this deduction should be based on sound tax policy and not personal
ideas of fairness. In part this will require appropriate salient treatment of
any changes to the code so incentives are fully understood and the tax
motivation of the charitable donation deduction reaches its full potential.

---

345 See Nina J. Crimm, Core Societal Values Deserve Federal Aid: Schools, Tax
Credits, and the Establishment Cause, 34 GA. L. REV. 1, 8 n.8 (1999) (conventional
combined market and social theory believes charitable organizations relieve the
government of burdens the government otherwise would be responsible for undertaking).

346 Decentralization has regressive effects and some communities are far more
successful in their charitable efforts than other resulting in holes in the safety net for the
most vulnerable in less sympathetic or supportive communities. JULIAN WOLPERT,

347 Study Shows Strong Support for Charitable Deduction, Group Says, 2012 TNT

348 Advocates in favor of the proposal note the heightened tax revenue that will be
generated which would be available to sponsor government programs or buy down the
national debt; those opposed protest the loss of autonomy and donor support.
VI. CONCLUSION

This a bad time for the government to do anything that might undermine charitable donations. We have more people living in poverty than any other point in the past fifty years, the wealthy have less disposable income to give to charity, many organizations are already struggling because donations are down, and we need to be encouraging wealthy people to still give to charity even though the proposed changes to the law would lead to just the opposite result. Undermining the tax incentives now could be the straw that broke the camel’s back.

To make matters worse, recent Congressional Budget Office studies report another recession is looming if we go over the fiscal cliff. The risk to the charitable sector is great because empirical data convincingly demonstrates the adverse impact of a down economy on donations from high-wealth donors. The traditionally largest donors are already facing higher taxes and if they are simultaneously afforded less tax benefit from their charitable donations, the flow of donations to charitable organizations will drop instead of recovering at a time when the charities themselves most need the money. If the country does not go over the fiscal cliff, the sputtering nature of our present recovery and the uncertainty of our economic future will lead donors without sufficient surplus or inducement to hold on to their assets instead of donating them to a worthy cause. Even if some portion of the deduction is inefficient, as a practical matter it should be preserved for now to keep the nonprofit sector afloat in these troubling times.

In recovery from a down economy, paradoxically it will be jobs and economic growth that can push donors back into a positive mindset and a positive financial position to make sufficient donations to increase to pre-recessional levels. In the meantime, tax incentives are necessary to keep donations from dropping even further, as charitable organizations struggle to do more with less, the sector risks potential job losses, charities folding, and the prospect of increasing, unmet, social needs.
Appendix 1

<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL AMOUNT OF DONATIONS BY ALL ITEMIZERS*</th>
<th>TOTAL DONATIONS BY ITEMIZERS W/ INCOME OVER $200K*</th>
<th>PERCENT OF DONATIONS BY ITEMIZERS W/ INCOME OVER $200K</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>140,681,631</td>
<td>55,421,387</td>
<td>39.39%</td>
</tr>
<tr>
<td>2001</td>
<td>139,241,476</td>
<td>46,896,063</td>
<td>33.68%</td>
</tr>
<tr>
<td>2002</td>
<td>140,571,365</td>
<td>42,360,302</td>
<td>30.13%</td>
</tr>
<tr>
<td>2003</td>
<td>145,702,137</td>
<td>47,741,469</td>
<td>32.77%</td>
</tr>
<tr>
<td>2004</td>
<td>165,564,388</td>
<td>60,714,733</td>
<td>36.67%</td>
</tr>
<tr>
<td>2005</td>
<td>183,390,686</td>
<td>76,123,864</td>
<td>41.51%</td>
</tr>
<tr>
<td>2006</td>
<td>186,646,644</td>
<td>81,649,167</td>
<td>43.75%</td>
</tr>
<tr>
<td>2007</td>
<td>193,603,968</td>
<td>90,511,607</td>
<td>46.75%</td>
</tr>
<tr>
<td>2008</td>
<td>172,936,002</td>
<td>72,826,976</td>
<td>42.11%</td>
</tr>
<tr>
<td>2009</td>
<td>158,016,526</td>
<td>59,111,650</td>
<td>37.41%</td>
</tr>
<tr>
<td>2010</td>
<td>170,235,681</td>
<td>69,072,447</td>
<td>40.57%</td>
</tr>
</tbody>
</table>

*Money amounts are in thousands of dollars

Table 1: Comparison of Donations by Itemizing Taxpayers from 2000-2010 Showing Contribution Amounts and Percentages for Donors with Incomes over $200,000