

TAX REFORM AND THE CHARITABLE DEDUCTION: The Risk to Blue State Philanthropy

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EXECUTIVE SUMMARY

The ongoing debate over tax reform, including efforts to curb itemized deductions taken by individuals to lower their taxable income, could result in changes to the tax code that blunt charitable giving throughout the country. Little understood in the debate is that the most serious consequences to the flow of donations could well occur in the so-called Blue States—notably, New York and much of the rest of the Northeast, along with portions of the Midwest and California.

In those areas, where donation levels are proportionally highest and where many of the largest charitable institutions are based, any cutback in the federal deduction for charitable giving is likely to have a disproportionate impact on contributions. Under the most restrictive scenarios, a change in the deduction could have potentially devastating consequences for some leading universities, medical centers, and cultural organizations.

The U.S. tax code comprises intricate rules and regulations designed to raise revenues for the federal government. At the same time—through deductions, credits, and other technical devices—the code is a vehicle for pursuing social policies that encourage behavior bolstering the general good. Because of the code’s very intricacy, a change in one of its parts can affect others, sometimes intentionally and sometimes with unexpected consequences. The push for tax reform, as well as the effect that it may have on charitable giving, illustrates both those effects. In its broadest reach, the reform effort would simplify the code, lower personal and corporate tax rates, and eliminate or restrict a variety of tax deductions and credits. In curbing deductions and credits, some of the revenue “lost” in cutting tax rates would be reclaimed.

None of the reform plans under discussion have the explicit goal of reducing charitable giving. But in lumping the charitable deduction in with other tax benefits targeted for trimming, some planners have overlooked or underestimated the full effects that a change would have. The effects are likely to vary, depending on the income level of the donor and where the donor lives. Encouraged by tax benefits to make contributions, high-income households give the most. If we reduce the benefits, donations are likely to fall off. The drop-off is likely to be even steeper for high-income households in Blue States, where state and local taxes and mortgage expenses tend to be higher, partly because deductions for those expenses are on the chopping block as well.

Tax-reform plans that ignore this calculus could do great, and unintended, harm to philanthropic efforts. By contrast, one plan among those analyzed by the Congressional Budget Office in 2011 would reduce donations in a minimal way while still saving billions of dollars in tax revenue.

ABOUT THE AUTHOR

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From 1987 through 2006, Husock served as director of case studies in public policy and management at Harvard University’s Kennedy School of Government, where he was also a fellow at the Hauser Center on Nonprofit Organizations. His publications on the nonprofit sector have appeared in *The Wall Street Journal*, *National Affairs*, *Society Magazine*, *The Chronicle of Philanthropy*, *The Public Interest*, and Townhall.com.

In addition, Mr. Husock has written widely on housing and urban policy, including in his book *The Trillion-Dollar Housing Mistake: The Failure of American Housing Policy* (Ivan R. Dee, 2003) and his monograph *Repairing the Ladder: Toward a New Housing Policy Paradigm* (Reason Foundation, 1996). His work has also appeared in the *Journal of Policy Analysis and Management*, *Philanthropy*, and *The Wilson Quarterly*. Husock is a former broadcast journalist and documentary filmmaker whose work at WGBH-TV in Boston won three Emmy awards. He is a graduate of the Boston University School of Public Communication and was a 1981-82 mid-career fellow at Princeton University’s Woodrow Wilson School of Public and International Affairs.

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TAX REFORM AND THE CHARITABLE DEDUCTION: THE RISK TO BLUE STATE PHILANTHROPY

Howark Husock

INTRODUCTION

The tax deduction for charitable contributions, a part of the U.S. tax code since 1917, has greatly influenced the magnitude of the nation's charitable giving. Historically, changes in the code that raise or lower the effective value of the charitable deduction have significantly affected the level of giving. For instance, donations from the nation's wealthiest households, the source of a disproportionate amount of the approximately \$217 billion in total gifts to nonprofit organizations by individual households in 2012, have fallen significantly as a percentage of disposable income since the 1970s—from 8.2 percent to 5.1 percent—as tax rates have dropped, in turn lowering the value of the charitable deduction.¹ Put another way, because the “price” of charitable giving goes up when the value of the deduction goes down, the percentage of income devoted to charity tends to fall. This has been shown to be true at the state level as well, where the value of the deduction also varies, depending on the existence or level of state income tax or on individual state incentives for charitable giving.²

That calculus may soon come into play again, now that Congress is focusing once more on tax reform. Widely understood to encompass the possibility of lower personal and corporate tax rates, along with a simpler tax code that would limit deductions and credits

of various kinds, the effort could significantly blunt the economic incentive to make donations.

The impact of the change could vary dramatically. Potentially, the most adverse effects on contribution levels could occur in New York and other parts of the Northeast as well as sections of the Midwest and California, the so-called Blue States, where state and local income- and property-tax rates are relatively higher and where any decline in the value of the deduction for mortgage interest, another expense that is also relatively higher there, would be felt more keenly than in other states. Funding levels at non-profit organizations based in those states, including many with a national reach, might also be affected in disproportionate ways.

Calls for tax reform have increasingly been in the air as the budget battles in Washington have intensified in recent years.³ Congressional interest in reform (as expressed by leaders of the Senate Finance Committee and the House Ways and Means Committee) coincides with the Obama administration's standing proposal to limit the value of itemized tax deductions, including the charitable deduction.

This paper examines how proposed changes in the tax code could affect charitable giving, particularly by high-net-worth households. It builds on work showing that a lower-valued charitable deduction will reduce giving. It highlights the likelihood that various proposed tax-code changes would have different regional effects tied to differences in state and local tax rates and mortgage-interest costs, with implications for overall giving as well as giving to specific types of organizations that upper-income taxpayers tend to favor.

Finally, this paper reflects upon whether, and how, changes in the tax laws should include the explicit goal of not reducing overall charitable giving.

CURRENT EXTENT OF GIVING

In 2012, some \$317 billion was donated by individual households, corporations, and foundations to the 1.4 million U.S. not-for-profit organizations

approved by the Internal Revenue Service (IRS). Of this total, some \$217 billion was donated by individual households, with the remainder coming from corporations, foundations, and bequests, which are not influenced directly by tax rates affecting individuals. (A foundation is required, for instance, to distribute annually an amount equal to at least 5 percent of the value of its endowment. The earnings of corporations are taxed at a nominal 35 percent rate; thus, their cost of giving is influenced by that figure, in addition to strategic corporate goals.) It is at the level of the individual household that charitable donations are influenced by the individual income-tax rate schedule, which varies by income status. The current top marginal rate is 39.6 percent.

Notably, some 21 percent of the total value of charitable donations was contributed by households that do not itemize deductions to their gross income.⁴ Such households use the "standard deduction" for their income bracket (for example, \$11,500 for married taxpayers, filing jointly, with one dependent) and are not affected by the charitable deduction or potential changes to it because deductions for charity would not further reduce the overall amount of taxes that they owe.

Nonetheless, the tax rate and structure changes of the sort currently being considered would almost certainly affect the donations made by individuals who do itemize their deductions—donations that, in the aggregate, have a substantial impact on federal tax receipts. For instance, in 2009, such individuals contributed some \$59 billion of the \$200 billion in household donations made that year; in 2012, they accounted for a reduction in federal tax revenue of \$38 billion.

Of the charitable gifts made by those who itemize deductions, a disproportionate share is contributed by high-net-worth households—those earning \$200,000 or more. As economist Jon Bakija has stated: "In 2009, only 2.6 percent of households had [adjusted gross income] above \$200,000 but they accounted for 25.1 percent of all income, and their charitable deductions accounted for 29.5 percent of the aggregate value of charitable donations

made by all households.”⁵ Notably, 95 percent of “high net worth donors give to charity in 2011,” compared with “about two-thirds (65.4 percent) of U.S. households in the general population.”⁶ Importantly, higher-income households are far more likely to itemize their tax deductions—and thus be in a position to be affected by the value of the charitable deduction. The tax incentives available to such households and the types of organizations that they tend to support thus take on special significance.

TYPES OF CAUSES SUPPORTED

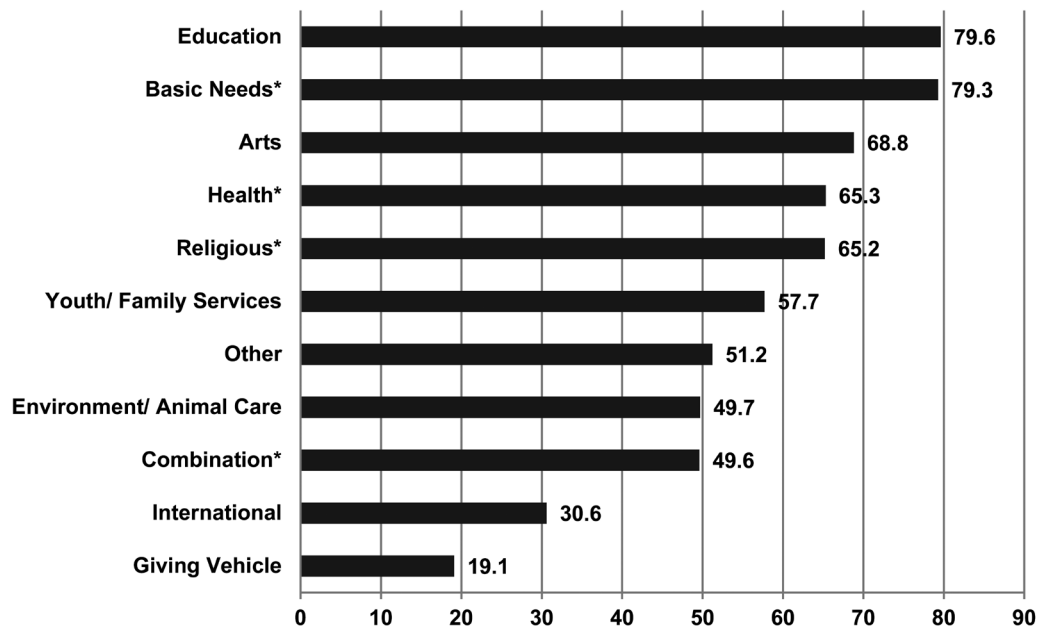
Americans overall direct their philanthropic giving to a wide array of causes and organizations. Indeed, Giving USA, the annual compendium of U.S. charitable giving assembled by the Giving USA Foundation and the Indiana University Lilly Family School of Philanthropy, divides the estimated

1.4 million not-for-profit organizations that receive such financial support into diverse groups. The major categories include: education; human services; health; arts, culture, and humanities; environmental and animal causes; and international affairs. Also in the mix are so-called public-society benefit organizations, such as the United Way, which distribute funds to other organizations.

Just as the magnitude of charitable giving varies by income group, so, too, does the preferred type of cause that the groups support. For instance, households earning less than \$200,000 a year are more likely to support religious institutions than are high-net-worth households. The 2012 Bank of America / Indiana University Study of High Net Worth Philanthropy finds that 65.2 percent of donors in the general population support religious causes, compared with just 41.9 percent of high-net-worth do-

Figure I: High Net Worth Households Reporting Giving to Charitable Categories in 2011[^] (%)

“In 2011, did you or your household make a donation to any of these causes? Please include personal gifts and gifts from your family foundation, donor-advised fund, trust or other charitable giving vehicle.”



[^]Combined organizations include United Way, United Jewish Appeal, and Catholic Charities. “Giving Vehicle” represents gifts to private foundations, charitable trusts, and donor-advised funds.

*2009 and 2011 results are statistically different (2009 data not shown).

Source: 2012 Bank of America Study of High Net Worth Philanthropy (November 2012), Page 15

nors.⁷ So one can say that giving to churches, synagogues, mosques, and other religious institutions may be less sensitive to changes in the tax code and resulting changes in the magnitude of the economic incentive to make donations.

Households of higher income are, for their part, most likely to direct support to educational institutions, to organizations providing for the basic needs of the poor, and to entities involved in the arts or in health care. Religious institutions are only their fifth-highest priority (see Figure 1). Moreover, a survey of high-net-worth households, which was part of the Bank of America study, found that they reported improvements in education (59.5 percent), health care (45.2 percent), and the economy (37.7 percent) as their most important goals for charitable giving. Such areas, in other words, would likely be most at risk of reductions in support, were overall giving to decrease. The effect of a decrease would not, of course, be confined to those sectors. For instance, because such households provide a disproportionate share of overall donations, a higher “price” on giving would lead to reductions in all areas, including donations to religious institutions.

WOULD GIVING BE INFLUENCED BY POLICY CHANGES?

Undoubtedly, tax-policy changes do influence overall charitable giving. For instance, Indiana University’s Center on Philanthropy estimated in 2011 that the reduction in the value of the charitable tax deduction proposed by the Obama administration would have led to an overall national decrease in U.S. charitable giving of \$1 billion to \$2.8 billion over two years.⁸ That study examined the impact when the top marginal tax rate was set at 35 percent, and the administration proposed to limit the tax deductibility of charitable giving to 28 percent. Broadly, the study makes clear that tax-law changes will, without doubt, influence the extent of giving. As Bakija has stated, “Several types of empirical evidence . . . suggest that the donation behavior of high-income people in particular is probably rather responsive to tax incentives.”⁹

Such effects have already been felt at the state level when tax policy affecting charitable gifts has been changed. For instance, after Hawaii in 2011 imposed a cap on itemized deductions for higher-income households—an approach among those now considered “on the table” at the federal level—local charities lost what the National Council of Nonprofits estimates would have been \$50 million in donations.

REGIONAL VARIATION IN CHARITABLE GIVING

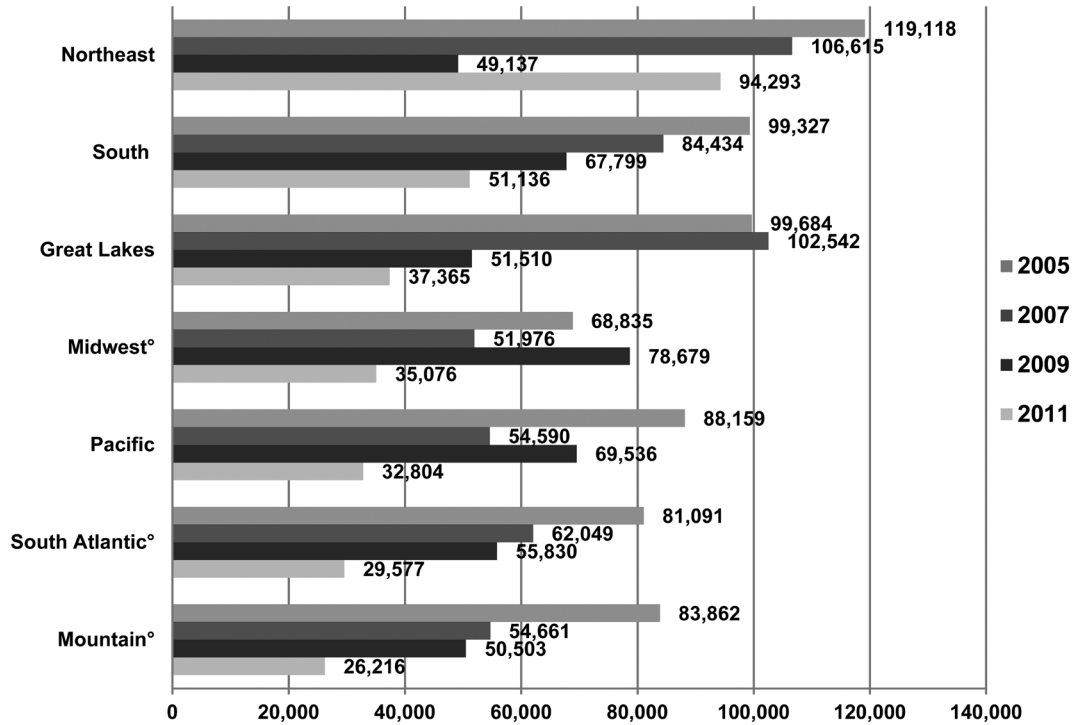
Personal income and wealth levels are not the only important source of variation in U.S. philanthropy. The magnitude of charitable giving varies significantly by state and region, as reflected in Figure 2, from the 2012 Bank of America study on charitable giving by high-net-worth households.¹⁰

Particularly notable is the high rate of giving in the Northeast (with the exception of the period immediately following the 2008 financial crisis).

The underlying reasons for such variation are surely complex and many, and they include the culture and character of different geographic areas. At the same time, states and regions have objectively different public policies that may influence patterns of charitable giving through their interaction with the federal tax code—notably, they have different local and state tax structures. As Bakija puts it: “High-income taxpayers donate more in states where tax incentives for charity are larger.”¹¹ Simply put, some jurisdictions are characterized by much higher state income-tax rates, as well as by higher housing costs, including higher mortgage-interest and local real-estate tax payments. All these costs—state and local taxes and mortgage interest on a principal residence—can now, for federal income-tax purposes, be deducted from taxable income to a large extent, in the same way that charitable gifts can be deducted.

Thus, any tax-law change that limited overall deductibility, for instance, would matter far more in high-tax jurisdictions—and would, by extension, likely matter more for those institutions in such ju-

Figure 2: Average High Net Worth Giving by Region of Primary Residence in 2005, 2007, 2009, and 2011 (\$)



Northeast Connecticut, Maine, Massachusetts, New Hampshire, New York, New Jersey, Pennsylvania, Rhode Island, Vermont
South Atlantic Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, West Virginia
South Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Oklahoma, Tennessee, Texas
Great Lakes Illinois, Indiana, Michigan, Ohio, Wisconsin
Midwest Iowa, Kansas, Nebraska, Minnesota, Missouri, North Dakota, South Dakota
Mountain Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, Wyoming
Pacific Alaska, California, Hawaii, Oregon, Washington

^oMay not be statistically meaningful because, in some years, this group contains fewer than 50 respondents.

Source: 2012 Bank of America Study of High Net Worth Philanthropy (November 2012), Page 28

risdictions that rely on charitable support. Notably, of the 4.5 million high-net-worth itemizers in the United States, 708,000 are in California; 386,000 are in New York; 240,000 are in New Jersey; 180,000 are in Pennsylvania; 167,000 are in Massachusetts; 132,000 are in Maryland; and roughly 100,000 each are in Michigan, Washington, and Connecticut. These are significant dynamics to keep in mind in reviewing the specifics of the various tax-reform proposals.

It is important—indeed, a central point of this paper—that the impact of changes in tax incentives

for charitable giving will vary by state and region. If high-income taxpayers have historically donated more in states where tax incentives for charity are larger, so will they likely donate less if those incentives decrease. Specifically, because the value of the charitable deduction is based on the prospect of a reduced tax burden, households in states and localities where tax-deductible costs, such as mortgage interest and local real-estate taxes, are higher than average have more incentive, at present—when tax law allows deductions to reduce taxable income, dollar for dollar, for those who itemize deductions—to make donations.

For instance, IRS data show that, in New York State, households earning more than \$1 million deduct, on average, a combined \$480,000 in mortgage interest and state and local taxes, compared with a national average for such households of just \$255,000. Such high-net-worth, highly taxed households are, the Bank of America / Indiana University study makes clear, disproportionately located in the Northeast (the New England states and New York, New Jersey, and Pennsylvania), where average giving by high-net-worth households is consistently the nation's highest. It follows, then, that a reduction in the tax incentive to make charitable donations—that is, an increase in the “price” of giving—would affect these states more than others. Logically, regional institutions in this and other high-tax regions, such as California, characterized by a concentration of high-net-worth households that itemize their tax returns and avail themselves of state and local tax and mortgage-interest deductions, would be likely to experience downturns in philanthropic support.

TAX-REFORM PROPOSALS

Although the general topic of tax reform is generating discussion—especially after Senate Finance Committee Chairman Max Baucus (D-Montana) and House Ways and Means Committee Chairman Dave Camp (R-Michigan) solicited no-holds-barred proposals for tax-law revision—only a relatively small group of specific ideas with obvious implications for charitable giving has come to the surface.

The first type would limit the value of the deduction and is best exemplified by the Obama administration proposal to cap all deductions at 28 percent, even for households paying the top marginal tax rate of 39.6 percent. The proposal has consistently failed to be adopted since it was originally put forward in 2009.

A second type of proposal, which first came to public attention as part of the policy ideas advanced by 2012 Republican presidential candidate Mitt Romney, would place a cap on the value of all so-called tax expenditures—deductions taken by businesses as well as individuals that reduce tax

payments and thus can be understood as indirect appropriations of federal revenue. The most fiscally significant examples of such deductions—in terms of how much they “cost” the U.S. Treasury—are the tax exclusion of employer contributions for health insurance (\$180 billion), mortgage interest (\$100.9 billion), state and local taxes (\$68.6 billion), and charitable contributions (\$48.8 billion).¹² The Romney campaign proposed that a cap on such deductions that could be claimed on individual household tax returns might be set as low as \$17,000 (although allowing for the possibility of a higher cap for higher earners).

A different form of this “cap” proposal would scale deduction limits as a fixed percentage of AGI, but exclude charitable deductions from such a ceiling.

A third type of proposal included in the so-called Simpson-Bowles debt reduction plan of 2010, commissioned by the Obama administration. What follows is a review and an analysis of these ideas, with a particular focus on their potential regional impact.

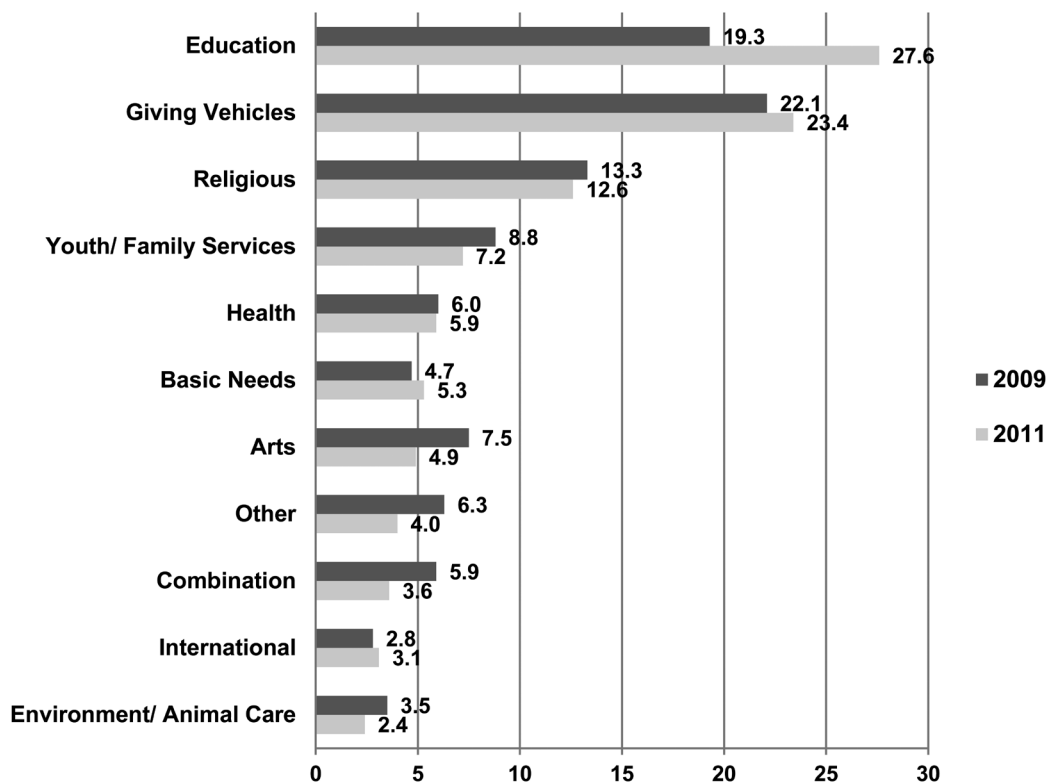
1. The 28/39.6 Option: Capping the Charitable Deduction at 28 Cents on the Dollar. The Obama administration, since taking office, has consistently proposed that the value of the charitable deduction, along with all other itemizable deductions available to joint and individual filers, be set lower than the top marginal tax rate. Thus, from 2009 to 2012, when the top rate was set at 35 percent, the White House proposed that the value of the deduction be capped at 28 percent. As noted above, that spread would likely have led to a reduction in charitable giving of \$2.8 billion in 2010.¹³ The administration continues to propose to limit the value of the deduction to 28 cents on the dollar, even though the top marginal rate increased to 39.6 percent at the beginning of 2013. That rate is paid on earnings above \$500,000 by joint filers, who, as noted earlier, contributed nearly 30 percent, or about \$59 billion, of the \$200 billion donated by all households in 2009. This is a proposal that demands serious and special attention; no other reform idea formally proposed by an elected official is currently under public consideration.

The effects of such a change would be mixed. A higher top tax rate means that more income is at risk—and that high-income taxpayers have more to protect. This aspect would tend to push up charitable giving. At the same time, fixing the deduction rate at 28 percent, rather than continuing to align it with the top tax rate, means that the cost of charitable contributions is higher than it would otherwise be—and that less overall income is available, therefore, for charitable purposes. (It’s worth noting that the effect of the 28 percent cap would be mitigated in cases of those high-income households subject to the Alternative Minimum Tax, which effectively limits the value of tax deductions in reducing overall tax liability. The AMT already imposes a 28 percent ceiling on the value of such deductions and thus would there would not be an

increase in the “price” of charitable giving for those subject to it.)

The administration has made it clear that it is willing to countenance a reduction in the total volume of charitable giving—Treasury Secretary Jack Lew, in testimony at his congressional confirmation hearing, said that the proposed change “would have a modest impact on the incentive to make charitable gifts.”¹⁴ If the priority goal of tax policy is to increase the amount of income taxes paid in total, even at the expense of overall charitable giving by the most affluent households, then this must be considered a potentially effective approach. The impact on such households matters not only in terms of how much additional tax revenue would come from that group, however; it would also affect the types of organiza-

Figure 3: Distribution of High Net Worth Giving by Charitable Category in 2009 and 2011^ (%)



^Combined organizations include United Way, United Jewish Appeal, and Catholic Charities. “Giving Vehicle” represents gifts to private foundations, charitable trusts, and donor-advised funds.

Source: 2012 Bank of America Study of High Net Worth Philanthropy (November 2012)

tions that currently receive their support. (Note that Figure 3 that follows here below reflects the magnitude of high net worth household charitable preferences; that should be understood as distinct from the measurements in Figure 1, above, which reflect the percentage of high net worth households who donate anything at all—even small amounts—to specific types of causes.

One good estimate of the overall reduction in charitable giving that would result from what might be called the 28/39.6 option comes from economist Arthur Brooks, president of the American Enterprise Institute. In a December 2013 paper, Brooks finds that although a higher overall personal income-tax rate will tend to encourage charitable giving, such an increase would be more than offset, negatively, by the limit on deductibility. As Brooks points out, “I find the tax increases to have a moderately stimulative impact but predict the deduction cap will have a large negative impact.”¹⁵ In other words, were the Obama administration proposal to be adopted now, given the 2013 increase in the top marginal rate, its effect would be more pronounced than what was anticipated in 2010 by the Indiana University study.

In sum, limiting tax deductibility to 28 cents on the dollar when the top tax rate is 39.6 percent will make giving more expensive—and lead to significantly less of it, particularly among those high-income households subject to the top rate. Specifically, Brooks finds that the combination of a higher top rate and a lower-valued deduction would lead to a \$9.4 billion reduction in overall giving.¹⁶

Brooks notes that, because the effect of tax-law changes varies by income group, as do charitable preferences, some charities would be more greatly affected than others. He finds that giving to secular organizations would decline much more dramatically (by 7.02 percent) than giving to religious organizations (0.95 percent) (see Figure 4). Brooks notes, further, that because the charitable preferences of top earners differ from those of non-itemizers, the types of causes that high-net-worth people tend to support would be disproportionately affected by a ceiling on the value of deductions. He estimates a

	Percentage Reduction in Giving
All giving	-4.35 percent
Secular giving	-7.02 percent
Religious giving	-0.95 percent
Itemizers Only	-9.30 percent
Top 1 percent of earners	-24.05 percent

24.05 percent reduction in giving from those affected by the 28 percent cap on the value of deductions and observes, pointedly, that “many so-called ‘elite’ nonprofits disproportionately draw from this donor pool—top universities and think tanks, symphony orchestras, some hospitals, and even certain environmental groups, to name a few.... For nonprofits operating largely within this donor base, the results would be serious—maybe catastrophic.”

Regional Impact of 28/39.6 Administration Proposal

Brooks does not go on to examine the variation in regional impact of such a change; but clearly, it would be substantial. As noted above, what the Bank of America study refers to as “average high-net-worth giving”¹⁷ is consistently highest in the Northeast, which the study defines as including Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont. Giving in these states in 2011 (\$94,293) was nearly double the average high-net-worth giving in the next highest region. If one extrapolates the impact on giving in individual states, one finds substantial reductions in donations in high-tax states. New York, for instance, would see a falloff of 16.9 percent, or more than \$1.4 billion (see Figure 5).

Conversely, it is important to note that Brooks also found that maintaining the status quo—keeping an increase in the top marginal tax rate without imposing a ceiling on the deductibility of charitable contributions—would lead to an increase in high-net-worth household giving, which Brooks estimates would be 19.5 percent, or \$3,903, for an itemizing household earning more than \$1 million.

Figure 5: Impact of Obama Administration's 28/39.6 Proposal on Itemized Charitable Giving by Higher-Income Households

	Reduction Amount (\$ Thousands) If Price Elasticity of Giving=1	Reduction as a % of >\$200,000 AGI Itemized Giving If Elasticity=1
UNITED STATES	\$11,068,261	15.18%
CALIFORNIA	\$1,679,080	15.66%
NEW YORK	\$1,420,582	16.90%
TEXAS	\$1,071,137	15.41%
FLORIDA	\$717,160	15.95%
ILLINOIS	\$450,523	15.00%
MASSACHUSETTS	\$405,926	16.28%
PENNSYLVANIA	\$346,486	14.60%
NEW JERSEY	\$321,768	14.44%
GEORGIA	\$301,895	14.37%
VIRGINIA	\$260,533	13.46%
CONNECTICUT	\$258,526	14.26%
OHIO	\$230,269	13.98%
COLORADO	\$228,461	16.37%
MICHIGAN	\$223,377	13.61%
MARYLAND	\$221,086	14.45%
NORTH CAROLINA	\$214,009	15.37%
WASHINGTON	\$203,673	14.47%
TENNESSEE	\$185,695	14.39%
MINNESOTA	\$168,139	14.28%
MISSOURI	\$156,236	14.73%
OKLAHOMA	\$128,078	13.92%
WISCONSIN	\$127,986	13.92%
INDIANA	\$126,738	14.64%
ARIZONA	\$125,939	14.91%
ALABAMA	\$112,106	13.65%
NEVADA	\$110,984	13.74%
UTAH	\$110,129	14.82%
OREGON	\$109,591	14.84%
KANSAS	\$105,083	16.85%
SOUTH CAROLINA	\$85,899	13.10%
LOUISIANA	\$80,183	13.84%
KENTUCKY	\$72,687	13.61%
DISTRICT OF COLUMBIA	\$61,912	13.33%
NEBRASKA	\$61,328	14.81%
IOWA	\$59,339	13.59%
ARKANSAS	\$55,691	16.29%
WYOMING	\$54,785	12.89%
MISSISSIPPI	\$43,611	17.58%

SOUTH DAKOTA	\$41,548	16.67%
MONTANA	\$34,862	14.33%
NEW HAMPSHIRE	\$32,228	15.85%
NEW MEXICO	\$28,267	13.11%
IDAHO	\$28,005	13.32%
HAWAII	\$25,289	14.42%
MAINE	\$22,830	13.91%
RHODE ISLAND	\$22,703	14.25%
WEST VIRGINIA	\$22,434	14.52%
DELAWARE	\$18,603	13.64%
NORTH DAKOTA	\$16,473	14.20%
VERMONT	\$15,488	13.29%
ALASKA	\$14,434	14.64%
Estimates do not control for the effects of Alternative Minimum Tax, a detailed estimate for which would require restricted tax data. This is consistent with earlier work by the Urban Institute (2008).		

So it is that lawmakers, at present, confront a significant policy crossroads. The current tax rate and rules governing charitable deductions should lead to significantly more giving. A limit on deductibility would lead to significantly less.

2a. Deduction Cap. The 2012 Romney campaign proposed, as noted above, a \$17,000 capped total for itemized deductions, leaving the choice of deductions up to the individual filer. There is an attractive political logic to such an approach; it does not eliminate outright any deduction. However, were charitable deductions to be included under the cap—even if, as candidate Romney suggested, the cap were set somewhat higher for higher-income households—the effect would likely be to diminish charitable giving sharply. That is because high-income households, especially those in higher-tax states, typically deduct amounts far in excess of \$17,000—or, for that matter, even \$50,000—for such currently deductible costs as mortgage interest and state and local taxes. In New York, for instance, itemized deductions claimed by those reporting adjusted gross income greater than \$200,000 included a weighted average of about \$19,000 in mortgage interest and about \$83,000 in state and local taxes. In other words, putting charitable deductions under a Romney-style cap could have the effect of raising the cost of chari-

table contributions by 35 or 39.6 cents on the dollar, by effectively eliminating any incremental incentive to make donations. The effect would be similar in California, where the combination of state and local taxes and mortgage interest deducted by high-net-worth households in 2011 totaled over \$80,000. The comparable weighted average figure for Michigan was nearly \$44,000; for Ohio, about \$52,000; and for Minnesota, over \$57,000 (see Figure 6).

Thus a hard cap of less than \$80,000 on the overall value of tax deductions that included charitable donations under its ceiling would be particularly significant. Indeed, it could be said to wipe out any financial incentive for charitable giving for the average household earning more than \$200,000 in such states as New York and California.

2b. Deduction Cap with Charitable Exemption.

A similar effect might well be observed under a related proposal put forward by Martin Feldstein, the Harvard economist and former head of the Council of Economic Advisors. Feldstein has proposed that overall deductions be limited to 2 percent of AGI. Notably, he proposes to exempt charitable contributions from such a cap. This will not, however, guarantee that charitable giving will remain constant. That is because average deductions claimed by high-net-worth households well exceeded (in 2011)

Figure 6: State/Local Taxes Combined with Mortgage-Interest Deductions in Select Blue States

	\$200,000 under \$500,000 (\$ Thousands)	\$500,000 under \$1,000,000 (\$ Thousands)	\$1,000,000 or more (\$ Thousands)	Weighted Average (\$ Thousands)
New York	50.428	111.473	479.973	101.639
California	52.870	103.159	393.587	80.400
Connecticut	45.137	91.008	329.276	78.548
New Jersey	46.086	95.384	313.968	68.286
Oregon	45.677	93.698	288.017	61.502
Minnesota	39.931	75.237	254.033	60.129
Massachusetts	40.200	79.910	265.114	57.442
Rhode Island	39.640	78.265	244.792	55.070
Vermont	40.986	79.928	236.249	54.331
Maine	38.552	79.933	238.082	52.415
Ohio	37.339	75.915	214.526	52.146
Michigan	32.715	62.563	172.133	43.606
New Hampshire	30.213	49.565	127.553	37.047
Washington	30.866	45.322	88.433	35.524

such a 2 percent cap,¹⁸ thus raising the possibility that such households, because they might be called upon to make higher tax payments, would have less disposable income remaining for charitable purposes. Even in a scenario under which tax rates on all households, including those of highest income, were lowered—keeping revenues constant by limiting tax expenditures—charitable giving might well decline. At a lower top tax rate, individuals have less incentive to make donations because of the smaller impact that the contributions have on their tax liability. This, of course, may not be a justification for keeping tax rates high. Indeed, it can be hoped that a simpler tax code with lower top rates may encourage economic growth such that high-net-worth households will have more money available for giving, even if the (economic) incentive to give is lower.

3a. Simpson-Bowles 12% Tax Credit. The Romney tax cap echoed a proposal offered in 2010 by the President’s Commission on Fiscal Responsibility and Reform. The so-called Simpson-Bowles Commission—named for its chairs, former Wyoming senator Alan Simpson and former White House chief of staff Erskine Bowles—took as its mission a combination of debt reduction and tax-code simplification, and it considered the status of the charita-

ble tax deduction part of its extensive work. Specifically, it recommended replacing the deduction with a “nonrefundable” tax credit.

This approach reduces an individual’s actual tax liability because a credit acts as a dollar-for-dollar reduction in the total amount of taxes owed. This differs from a tax deduction, which reduces the gross income on which tax liability is calculated. The worth of a deduction depends on the individual’s top marginal tax rate, so a \$1 deduction would “save” the taxpayer no more than 39.6 cents. (The nonrefundable aspect of this credit means that it could reduce tax liability to zero but would not lead to payments to the taxpayer. This contrasts, for instance, with the Earned Income Tax Credit, which provides payments to low-income households even when they owe no taxes.)

Simpson-Bowles proposed a credit equal to 12 percent of charitable contributions made over and above 2 percent of adjusted gross income (AGI). The goal of the 2 percent AGI floor was to avoid subsidizing the smaller contributions likely to be made with or without tax incentives, while preserving the subsidy for larger (and presumably more incentive-responsive) donations. Indexing the dona-

tion floor to income and making the credit equally available to all taxpayers renders it much more equitable than the current deduction, which is available only to itemizers and which becomes more valuable with each increasing marginal tax bracket.

A Simpson-Bowles approach would likely have a significant negative impact on charitable giving. The price of donating \$1 would rise from 60.4 cents (for those in the 39.6 percent top bracket) to 88 cents (after “earning” a credit for 12 percent of the contributions)—making donations almost half again as expensive for generous high-income donors. Depending on assumptions, total charitable giving would be expected to fall as much as 10 percent.¹⁹ The value of the tax expenditure (forgone tax revenue) would fall dramatically—by more than \$25 billion per year²⁰—but at a significant cost to charity.

3b. Congressional Budget Office Option: 25% Tax Credit. Although it is not a proposal that is currently attracting attention, a variation on the Simpson-Bowles plan discussed above was analyzed in 2011 by the Congressional Budget Office (CBO). Those concerned about maintenance of charitable giving as well as overall tax reform may wish to return to it.

Although similar to Simpson-Bowles, the plan analyzed by the CBO could be considered more generous. It, too, proposed a nonrefundable credit for charitable contributions that would take effect only after the donations exceeded 2 percent of AGI. The CBO option, however, set the subsequent credit at a level more than twice that of the commission’s: at a rate of 25 percent, rather than 12 percent. This slightly raises the price of giving for top-bracket taxpayers, from 60.4 cents to 75 cents but reduces the price for the majority of taxpayers, especially for non-itemizers whose price would fall from 100 cents to 75 cents per dollar given (as a result of the donation becoming a statutory, or “top-line,” credit rather than an itemized deduction). Forgone federal tax revenue would decrease by approximately \$11 billion per year, yet total charitable giving would fall by a mere 0.5 percent.²¹ This approach is successful

because it maintains a reasonable marginal incentive to give, while the 2 percent floor avoids incentivizing smaller donations likely to be made regardless of tax incentives.

REGIONAL EFFECT / REGIONAL CHARACTER OF GIVING

Even if special incentives for charitable giving were to be sharply reduced or eliminated in high-tax, high-home-value regions—a potential side effect of the Romney, Simpson-Bowles, and even the Feldstein plans—it beggars common sense to conclude that all giving would cease.

There is no reason not to conclude, however, that overall giving in high-tax states would fall as a result of a Romney or Feldstein-style cap. It is worth noting, in this context, that disproportionate declines in charitable giving in any one state or region would almost certainly fall heavily not only on certain types of institutions but on institutions located in those regions. This is, of course, clearly true of the Obama 28/39.6 proposal, as well.

For instance, one prominent New York City not-for-profit, the Central Park Conservancy—which raises funds to maintain the world-famous park—reports that 85 percent of its donations come from New York, New Jersey, and Connecticut.²² Colleges and universities, museums, and hospitals almost certainly also rely very heavily on local contributions. Columbia University, for instance, finds that 58 percent of its donors come from New York, New Jersey, and Connecticut; 42 percent of individual donors are from New York alone.²³ So it is that a wide variety of tax-exempt institutions, even those with national recognition, should be considered at risk.

It is difficult to say with empirical certainty that this is the scenario that will play out. But common sense clearly suggests that philanthropic donors are likely to support organizations located in the state or region in which they live. If regional donor preference does matter, the effects of a reduction in philanthropic giving in high-tax Blue States

Figure 7: Selected Top-Ranked New York and California Charities, 2013 Philanthropy 400

Charitable Organization	2013 Private Support
Stanford University	\$1,034,848,797
Silicon Valley Community Foundation	\$990,877,912
Schwab Charitable Fund	\$702,551,521
UNICEF USA	\$498,746,777
University of Southern California	\$491,853,719
Columbia University	\$490,311,000
University of California at Berkeley	\$410,781,035
New York University	\$395,510,000
University of California at Los Angeles	\$344,201,000
Cornell University	\$330,936,000
University of California at San Francisco	\$329,477,127
Mount Sinai Medical Center	\$300,942,761
Direct Relief International	\$299,189,560
American Jewish Joint Distribution Committee	\$298,844,506
Leukemia & Lymphoma Society	\$282,657,104
Jewish Federations of North America	\$266,644,000
Catholic Medical Mission Board	\$257,094,197
New York–Presbyterian Medical Center	\$248,236,105
Memorial Sloan-Kettering Cancer Center	\$238,334,750
California State University system	\$231,538,395
Teach for America	\$214,643,111
National Multiple Sclerosis Society	\$204,999,321
March of Dimes	\$195,402,390
Doctors Without Borders	\$189,249,536
San Francisco Museum of Modern Art	\$180,957,173
ClimateWorks Foundation	\$170,343,410
The Met (NYC)	\$166,544,059
Planned Parenthood	\$155,090,170
ASPCA	\$137,592,110
Metropolitan Opera Association (NYC)	\$136,335,902
University of California at San Diego	\$135,542,556
Children’s Hunger Fund	\$128,694,803
Environmental Defense Fund	\$109,500,000
University of California at Santa Barbara	\$105,394,424
Girl Scouts	\$104,033,552
Energy Foundation	\$103,120,425
California Institute of Technology	\$99,983,000
Museum of Modern Art (NYC)	\$99,797,164
University of California at Davis	\$93,977,000
National Resources Defense Council	\$92,043,375

will be felt by some of the most important not-for-profit organizations in the country. That possibility is suggested by the Philanthropy 400, a list compiled annually by the *Chronicle of Philanthropy*. This list comprises the 400 organizations that received the highest levels of support in the previous year. Notably, a great number of organizations in the Philanthropy 400 are headquartered in New York (72) or California (42).²⁴ Moreover, 41 percent of all high-net-worth households that itemize their returns are in just 12 states, suggesting that philanthropy-dependent organizations in those states will be especially affected.²⁵ The list of such organizations based in New York and California includes a great many household names (see Figure 7 for a partial list).

CONCLUSION: HOLDING CHARITIES HARMLESS

Notwithstanding the effects discussed above, it is not an explicit goal of any of the cited plans to reduce charitable giving in the United States. At worst, such a reduction would be a collateral effect of a policy prescription endorsed for other reasons.

It is worth considering, however, whether it is possible to combine tax reform with the goal of maintaining or increasing the absolute dollar amount of U.S. charitable giving and of limiting the regional impact of any changes. Indeed, an implicit question raised by all the plans reviewed here should be examined.

Is it a good idea for overall donations to charitable institutions in the U.S. to decline? If so, why? One can discuss whether the nonprofit status of some institutions should be revisited—as is occurring in the cases of major health-care and educational institutions—as a question separate from whether overall charitable giving should be reduced. Promoting any plan that would

ACLU	\$91,726,006
Yeshiva University	\$86,032,000
University of Rochester	\$85,415,000
American Museum of Natural History	\$84,437,555
Help the Children	\$82,354,705
State University of New York at Stony Brook	\$82,276,000
New York Public Library	\$77,619,561
University of California at Irvine	\$77,236,000
Rockefeller Philanthropy Advisors	\$74,749,675
Carnegie Hall Corporation	\$74,198,688
Human Rights Watch	\$70,520,001
Syracuse University	\$69,930,824
University at Buffalo (SUNY)	\$68,104,000
Lincoln Center for the Performing Arts	\$65,913,590
National Audubon Society	\$59,940,763
Cedars-Sinai Medical Center	\$55,795,369
Autism Speaks	\$53,046,878
Breast Cancer Research Foundation	\$52,506,843
Source: Adapted from 2013 Philanthropy 400, <i>Chronicle of Philanthropy</i> , http://philanthropy.com/factfile/phil400 (accessed November 2013)	

lead to such a reduction would have to be predicated on the following conclusion: that the federal government can make better use of the funds. This is a difficult proposition to defend. The loss in charitable giving, should it reach into the billions, would amount to a significant portion of overall philanthropy—with disproportionate effects, as noted, in select regions. But the gain in federal revenue would be modest, at best. In contrast, the virtues of philanthropic giving—including the possibility of providing support for innovative approaches to social problems, as well as the oversight of citizens in the use of such funds—have historically been an important aspect of American life.

Simply put, the proponents of any tax-reform plan that might cause a reduction in charitable giving should be called upon to defend the idea that such a reduction is a price worth paying.

We built our estimates from the 2011 IRS Statistics of Income Table 2²⁶ data for each coastal Blue State. Our goal was to present a lower-bound estimate of the change in itemized giving, from the price effect of capping the rate at which deductions reduce AGI to 28 percent, among households earning more than \$200,000.

We maintained several safety margins, reflected in the table below:

1. We assigned tax brackets to the AGI categories on the basis of “Married, Filing Jointly” status. The majority of returns in these categories are indeed joint returns, but the individual filers in these AGI categories will actually be seeing a price increase at least as high as, or higher than, married couples.
2. We assigned tax brackets conservatively, such that some taxpayers in these categories are actually in higher brackets and will be seeing a slightly larger marginal price increase than their assigned rate implies. For example, the entire \$200,000–\$500,000 AGI category—part of which truly faces a top rate of 35 percent—was assigned to the 33 percent bracket.
3. We did not consider the negative income effect resulting from the cap; while this effect is small, the sign is negative and thus provides another margin of safety by excluding it.

AGI Category	Assigned Marginal Tax Bracket	Tax Price @ 28% Cap	%Change in Giving If Elasticity =1	%Change in Giving If Elasticity=2.93
\$200,000 under \$500,000	33.00%	15.15%	15.15%	44.93%
\$500,000 under \$1,000,000	39.60%	19.20%	19.20%	56.26%
\$1,000,000+	39.60%	19.20%	19.20%	56.26%

In each state, we multiplied the amount of itemized charitable deductions in each of these four AGI categories by the estimated percentage change in giving per AGI category. We then summed those amounts to obtain the combined reduction in giving expected in each state. To obtain the percentage change in giving, we divided the sum of the giving reduction by the original sum of itemized giving in all three AGI categories.

ENDNOTES

- ¹ Jon Bakija, "Tax Policy and Philanthropy: A Primer on the Empirical Evidence for the U.S. and Its Implications," *Social Research* 80, no. 2 (summer 2013).
- ² Ibid.
- ³ See, e.g., Bruce Bartlett, "The Real Barrier to Tax Reform," *Economix*, *New York Times*, October 30, 2012.
- ⁴ Bakija, "Tax Policy and Philanthropy," 2.
- ⁵ Ibid.
- ⁶ 2012 Bank of America Study of High Net Worth Philanthropy (November 2012)
- ⁷ Ibid.
- ⁸ "Impact of the Obama Administration's Proposed Tax Policy Changes on Itemized Charitable Giving," Center for Philanthropy at Indiana University (October 2011)
- ⁹ Bakija, "Tax Policy and Philanthropy," 1.
- ¹⁰ Annie Lowrey, "Government Giving Nonprofits Angst," *New York Times*, November 8, 2013.
- ¹¹ Bakija, "Tax Policy and Philanthropy," 9.
- ¹² Bruce Bartlett, *New York Times*, October 30, 2012, citing the federal Office of Management and Budget. The top ten tax expenditures of all kinds result in a reduction of federal tax revenue totaling \$796.1 billion, according to OMB.
- ¹³ "Impact of the Obama Administration's Proposed Tax Policy Changes," Center on Philanthropy at Indiana University.
- ¹⁴ Quoted in Doug Donovan, "Obama May Seek Cap on Charity Deductions—Again," *Chronicle of Philanthropy*, February 28, 2013, <http://philanthropy.com/article/Obama-May-Seek-Cap-on-Charity/137615>.
- ¹⁵ Arthur C. Brooks, "Charitable Giving in America," American Enterprise Institute Conference Series (December 2013).
- ¹⁶ Ibid, citing 2012 Bank of America Study of High Net Worth Philanthropy.
- ¹⁷ "Impact of the Obama Administration's Proposed Tax Policy Changes," Center on Philanthropy at Indiana University, 28.
- ¹⁸ Author's calculations on IRS Statistics of Income data, 2011, Table 2.1.
- ¹⁹ Congressional Budget Office, "Options for Changing the Tax Treatment of Charitable Giving," May 2011, <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/121xx/doc12167/charitablecontributions.pdf>.
- ²⁰ Ibid.
- ²¹ Author's extension of analysis in CBO, "Options for Changing the Tax Treatment of Charitable Giving."
- ²² Response from Central Park Conservancy to author's query.
- ²³ Response Columbia University to author's query.
- ²⁴ Philanthropy 400 Data, *Chronicle of Philanthropy*, 2013, <http://philanthropy.com/factfile/phil400>.
- ²⁵ Author's calculations based on IRS Statistics of Income data, 2011: CA, NY, MA, CT, RI, NJ, ME, OR, WA, VT, DE, and MI.
- ²⁶ IRS SOI Historical Table 2, <http://www.irs.gov/uac/SOI-Tax-Stats—Historic-Table-2>

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