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Tax Incentives for Charity: An Overview of Legislative Proposals

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Summary

This reports briefly discusses the tax provisions in the current charitable giving tax incentive bills (S. 1780, H.R. 3908) and in the Senate reconciliation bill, S. 2020. Provisions include charitable deductions for non-itemizers, rollovers of IRAs into charitable uses, an increase in the deductions cap for corporate contributions, and several narrower provisions.

Bills have been introduced in both the House (H.R. 3908, the Charitable Giving Act of 2005) and the Senate (CARE Act of 2005) to provide additional benefits for charitable giving. In addition, S. 2020, the Senate reconciliation bill, includes charitable provisions along with offsetting revenue raisers.

Legislation proposing tax incentives for charity began with H.R. 7 (107th Congress), adopted in 2001 by the House. H.R. 7 had eight new tax provisions designed to benefit charitable giving, including a capped deduction for non-itemizers. The President had proposed three of these provisions in 2001. Senate consideration also began in the 107th Congress with S. 1924, which would have provided a temporary non-itemizers deduction with a higher cap along with other provisions. The bill was reported from committee with a temporary non-itemizers deduction with both a floor and ceiling, but was not considered on the floor. It excluded some provisions of H.R. 7 but contained others. In 2003, a similar bill, S. 476, passed the Senate and a new version of H.R. 7 passed the House. These provisions were included in several 109th Congress bills: H.R. 3908, S. 6, S. 1780, and S. 2020; the latter has passed in the Senate. This report discusses these provisions, focusing on H.R. 3908, S. 1780, and S. 2020.

Deduction for Non-Itemizers

Under current law a taxpayer can either itemize deductions or choose the standard deduction. The standard deduction is advantageous if that amount is larger than total itemized deductions. H.R. 3908 and S. 1780 would allow, on a temporary basis, someone who takes the standard deduction to deduct charitable contributions in addition.

Singles may deduct amounts in excess of $250 but not over $500; joint returns may deduct the excess of $500 not to exceed $1000.[1] In the 108th Congress bills, for which revenue estimates are available, this provision was effective for the years 2004-2006 and accounted for $1.4 billion of the $2.2 billion total cost of the bill in the first full year (FY2005). Over all 10 years (2004-2013) it accounted for $2.9 billion out of $12.7 billion (22%).

While the deduction for non-itemizers may increase giving, its effects would be limited because of the cap, although increased in effectiveness per dollar of revenue by the floor. Even without a cap, the deduction is unlikely to induce additional giving as large as the revenue loss because evidence suggests that the responsiveness of taxpayers, particularly lower and moderate income taxpayers, to incentives is small.[2] The provision would also increase complexity of tax filing by including another line item. A limited deduction for non-itemizers was formerly available for 1981-1986, enacted as part of the Economic Recovery Tax Act of 1981 (P.L. 97-34).

The non-itemizer deduction in S. 2020 would also be temporary, and would have only a floor ($210 for singles and $420 for joint returns), thereby making it more effective per dollar of revenue loss. The cost is paid for by applying the same floor to itemizers. This approach of using a floor should increase charitable contributions, by increasing contributions of non-itemizers. The effect on contributions of current itemizers should be negligible, since 93% of the lost deductions come from returns that are already contributing over the floor and their marginal incentives would not be affected.[3]

IRA Rollover Provision

The largest permanent tax provision in the 108th Congress charitable giving bills and one that is contained in all three current bills (although the provision in S. 2020 is effective for only two years) would allow tax free distributions from individual retirement accounts to charitable organizations by individuals aged 70½ and over, which was 22% of the ten year cost. S. 1780 and S. 2020 would also allow individuals aged 59½ to roll over IRA amounts into a split interest trust (e.g., a charitable remainder trust that pays an annuity and leaves the residual to charity).

Apparently an important motivation is to reduce adjusted gross income which can trigger a variety of phase-outs and phase-ins, including the phase-in of taxation of Social Security benefits. (Another potentially important phase-out effect, that for itemized deductions, is now scheduled to be eliminated.) Floors and ceilings on non-itemizers'

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[1] This provision differs from the 107th Congress House bill which allowed a permanent provision with a cap beginning $25 for singles ($50 for joint returns) for 2002-2003,with the cap rising over time ($50/$100 for 2004-2006, $75/50 for 2007-2009, and $100/$200 thereafter. The President's original proposal and his FY2003 proposal have no cap.

[2] See CRS Report RL31108, *Economic Analysis of the Charitable Contribution Deduction for Non-Itemizers.*

[3] This calculation of the share that is inframarginal was prepared by Max Shvedov using the public use statistics of income micro-data file.

deductions can be avoided as well. There are also income limits on charitable contributions. Since IRAs tend to be held by higher income individuals, the taxpayers might be somewhat more sensitive to the incentive to give; however, it is not clear why this particular group of taxpayers is targeted.

Excise Taxes

Private foundations, whose contributors (or their families) retain the right to direct the distribution of funds, have always been subject to greater scrutiny, in part because of the possibility of the donor (or family) obtaining a private benefit. Foundations are required to distribute 5% of their assets each year (or pay a penalty), but the tax is credited against that distribution. Private foundations are also subject to a variety of excise taxes related to the failure to distribute funds and self-dealing.

An important provision in the earlier House bills was a proposal to reduce excise taxes on foundations. Under current law, there is a 1% tax on investment income of foundations, and an additional 1% if the foundation does not make a certain minimum distribution (based on distributions made in the previous five years), or has been subject to a tax for failure to distribute in the previous five years. The 108th Congress bills would have eliminated the extra 1% tax. This provision accounted for $196 million (9%) in the first year, $270 million (19%) in the last year, and $2,273 (18%) for the 10 year period. These provisions are not included in the current bills, and in fact certain excise taxes on foundations and other entities, addressing issues such as failure to make distributions and self dealing are increased in S. 2020 and H.R. 3908.[4] H.R. 3908, as was the case with the House bill reported in the 108th Congress, limits the counting of administrative costs as part of a foundation's minimum distribution requirement. Foundations are required to make a minimum distribution of 5%, but that 5% can currently include administrative costs (which currently have only to be "reasonable"). As originally introduced earlier in 2003, the provision would have disallowed any administrative costs, but the current proposal as reported allows deductions for most administrative costs, with some exceptions. See CRS Report RS21603, *Minimum Distribution Requirement for Private Foundations: Proposal to Disallow Administrative Costs*, for an analysis.

[4] A provision in H.R. 3908 to increase the general excise tax to 2% may be a drafting error. An argument for reducing the excise taxes was that this tax reduction should be funneled into distributions for minimum distribution foundations, and the moving average discourages a large contribution in a particular year. Proponents also argued that the tax brings in revenue that is in excess of IRS audit costs, which they indicate was the original purpose of the tax (which was introduced in 1969). The legislative history indicates that while the Senate characterized the tax as an audit fee, the House referred more generally to the notion that private foundations should bear part of the cost of government generally because of their ability to pay (as well as viewing it in part as a user fee), and both objectives were cited in the final explanation of the bill. It was reduced twice (in 1978 and 1984) based on the argument regarding costs of audit versus revenue.

Raising the Cap on Charitable Deductions of Corporations

Under current law corporations can deduct charitable contributions of up to 10% of income; H.R. 3908 would increase the cap to 20%.[5] This provision accounted for 4% of the first year cost, 12% of the 10-year cost in earlier bills. Most corporate giving already falls well under the cap; the average giving is less than 2% of income.

There has been some dispute over a corporate charitable deduction, since shareholders could make their own decisions about charitable giving. In some views, charitable giving by corporations is another management perk that might be excessive because of monitoring problems by shareholders (this problem is also called an agency cost problem). Others argue that corporations should be encouraged to give to charity and to be socially responsible. Economists have studied models in which charitable giving is part of the firm's profit maximizing behavior (e.g. by gaining the firm good will). Evidence on the effectiveness of the deduction is mixed, with time series studies showing a positive effect and cross section results not finding an effect.[6]

Deduction for Certain Inventory and Other Property

Under present law, corporations that donate inventory to charity in general get a deduction for the cost (not the market value). A special rule allows businesses paying the corporate tax to also exclude half the appreciation (half the difference between market value and cost of production), if the inventory is given to an organization that directly passes it on to the ill, the needy, or infants, as long as the total deduction is no more than twice the cost. An important category of donations is that of food and there have been disputes between taxpayers and the IRS about how to measure the fair market value of food. Under the bills, unincorporated businesses (or businesses that are incorporated but do not pay the corporate tax) would also be allowed the additional deduction, and the fair market value of wholesome food would be considered the price at which the firm is currently selling the item (or sold it in the past), although this deduction would be limited to the corporate percentage cap on deduction in general. The objective of the provision is to create more equity among types of taxpayers and resolve disputes (largely in the taxpayer's favor). However, one important concern about donated inventory is whether firms might be profiting from charitable contributions for items that they could not otherwise sell.[7]

S. 1780 and S. 2020 would allow the lesser of *full* market value and extend the deduction for corporations to donations of book inventories. S. 1780 would also allow

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[5] This provision is more generous than the 107th Congress version which would have raised the cap to 15%.

[6] See James R. Boatsman and Sanjay Gupta, "Taxes and Corporate Charity: Empirical Evidence from Micro-Level Panel Data, " *National Tax Journal*, Vol. 49, June 1996, pp. 193-213.

[7] See CRS Report RL31097, *Charitable Contributions of Food Inventory: Proposals for Change Under the Community Solutions Act of 2001*.

a deduction for the fair market value of literary, musical, artistic, and scholarly compositions.

Certain special treatment (similar to that for food inventory) is allowed for certain scientific property used for research and for contributions of computer technology and equipment, provided the property is constructed by the taxpayer. In concrete terms, this rule requires that no more than 50% of the cost is due to parts purchased elsewhere. This provision expired in 2003. H.R. 3908 would allow property assembled, as well as constructed, to be eligible and make the provision permanent.

Contributions of capital gain real property are limited to 30% of income. S. 1780 and S. 2020 would increase that limit to 50% for contributions made for conservation purposes (1005 for farmers and ranchers) and S. 1789 would also exclude 25% of the long term gain from the sale of assets for conservation purposes.

Modify the Basis of S Corporation Stock for Certain Charitable Contributions

Under current law, a shareholder in a Subchapter S corporation (a corporation treated as a partnership) is allowed to deduct his or her pro rata share of any corporate contribution. At the same time, the taxpayer must decrease the basis of stock by that amount (which is a way of reflecting the effect on the shareholder's asset position). The bills provide that the taxpayer will not have to reduce basis in the stock to the extent a deduction is taken in excess of adjusted basis of the donated property (e.g. cost). This provision appears to be consistent with allowing a deduction for the market value of appreciated property without including the appreciation in income (a special benefit generally available to taxpayers).

Modify Tax on Unrelated Business Taxable Income of Charitable Remainder Trusts

Current law provides tax deductions for some portion of a trust and income tax exemption on the earnings, if a remainder of the assets is left to charity (while paying income to a non-charitable donee, usually a spouse or other relative during an interim period). The trust's income is, however, no longer exempt from tax if the trust has unrelated business income. This provision, contained in S. 1780 and H.R. 3908, liberalizes the rule by providing for a 100% excise tax on any unrelated business income rather than loss of all tax exemption.

Other Provisions

There are a number of other provisions in the bills that differ and some that are the same. The remaining revenue loser in S. 2020, also included in S. 1780 and H.R. 3908, would exclude certain items (such as rent) received by a subsidiary from a tax on unrelated business income except for the excess over an arms length price. The remaining provisions in S. 2020 are revenue raisers and aimed at preventing potential abuses, including restrictions on the donation of certain types of assets (taxidermy, household items, historical easements), stricter rules regarding self-dealing and minimum distributions (some of which would apply to donor advised funds and certain supporting organizations), stricter requirements for credit counseling organizations, requirements for documentation for cash gifts, changes in excise taxes, and other provisions.

S. 1780 would allow an exclusion for mileage reimbursements for volunteers, liberalize a rule relating to scholarship grants to employees or relatives of employees of charitable organizations, and would liberalize the treatment of indebtedness of certain hospital support organizations. Both S. 1780 and H.R. 3908 would liberalize the treatment of tax exempt bonds for nursing homes and exempt blood collector organizations from excise tax. S. 1780 also has non-tax provisions, including Individual Development Accounts (as does H.R. 3908). The remaining provisions of S. 1780 are largely reporting and disclosure provisions with negligible revenue effects.

H.R. 3908 allows organizations to retain charitable status while making collegiate housing and infrastructure grants, excludes earnings from games of chance (in addition to bingo, which is already eligible) from unrelated business income taxes, allows a longer period of acquiring replacement property for charities to avoid the unrelated business income tax, expands the types of cost sharing payments for conservation that are excluded from income, and contains some other minor tax and spending provisions.