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The Charitable Deduction for Individuals

The charitable deduction is a long-standing feature of the individual income tax. It is also one of the largest individual income tax provisions in terms of annual forgone revenue, an estimated $58.1 billion in FY2018. However, as a result of various changes implemented by the 2017 tax revision (P.L. 115-97), the tax expenditure for charitable contributions is expected to fall to $45.1 billion for FY2019. This In Focus provides background information on the charitable deduction. Tax provisions for corporate contributions and charitable bequests are not addressed.

The Deduction

Under current law, taxpayers who itemize their deductions can—subject to certain limitations—deduct charitable donations to qualifying organizations. Qualifying organizations are generally "public charities" or "private foundations" with tax-exempt status under Internal Revenue Code (IRC) Section 501(c)(3); federal, state, or local governments; and other less common types of qualifying organizations.

Tax-deductible donations to qualifying organizations can be in the form of cash or property. Property held for more than one year is often referred to as *long-term capital gain property*. Property held for less than a year is often referred to as *short-term capital gain property*. Depending on (1) the type of property donated and (2) the type of qualifying organization that receives the donations, there are limitations on the total dollar amount that can be deducted by the taxpayer in a given tax year. The limitations are defined as a percentage of the taxpayer's adjusted gross income, or AGI (computed without regard to net operating loss carrybacks), as noted in **Table 1**. If the amount deducted exceeds the taxpayer's AGI limitation, the excess can be carried forward and deducted on future years' tax returns for up to five years.

For non-cash donations, there are rules on how to value the property. Depending on the type of property and the recipient organizations, the property is generally valued at its basis (i.e., what the taxpayer originally paid for the property with adjustments) or its fair market value (how much the taxpayer would receive in an open market for the property at the time it is donated), as noted in **Table 1**.

Selected Legislative Background

The charitable deduction was first enacted to offset the potential negative effects of increased income taxes on charitable giving as part of the War Income Tax Revenue Act of 1917 (P.L. 65-50). The overall amount that could be deducted was limited to 15% of net taxable income to prevent taxpayers from eliminating tax liability by claiming the deduction. The deduction has been changed dozens of times since enactment. Key legislative changes relevant to this In Focus are highlighted next.

Table 1. Limitations on Charitable Contributions

Type of Donation	Recipient	Valuation Rules for Property	Limit
Cash or short-term gain capital property	Public charity; private operating foundation; federal, state, local government	Basis of the property	60% of AGI[b]
	Private non-operating foundation; other[a]	Basis of the property	30% of AGI
Long-term capital gain property	Public charity; private operating foundation; federal, state, local government	Fair market value	30% of AGI
	Private non-operating foundation; other[a]	Basis of the property	20% of AGI

Source: Internal Revenue Code (IRC) Section 170.

Note: These are general rules, and there are numerous exceptions.

a. Includes qualifying contributions to veterans' organizations, fraternal societies, and nonprofit cemeteries. Not all non-operating foundations are subject to the 30% limit.

b. Temporarily increased from 50% to 60% through 2025.

Over time, Congress has modified the maximum amount that can be deducted in a given year by changing the income limitation. In 1952, as part P.L. 82-465, Congress raised the limitation to 20% of AGI. In 1954, Congress increased the maximum deduction limit to 30% of AGI (P.L. 83-591) for donations to certain public charities. The Tax Reform Act of 1969 (P.L. 91-172) raised the deduction limit to 50% of AGI for donations to public charities and allowed deductions for contributions to private operating foundations. The 1969 act also imposed a 30% limit for contributions of appreciated property and imposed other restrictions on contributions of long-term capital gain property. The Deficit Reduction Act of 1984 (P.L. 98-369) raised the limitation on the deduction for donations of cash or short-term capital gain property to private non-operating foundations from 20% to 30% of AGI.

There were exceptions to these limits for particularly large gifts. The Revenue Act of 1924 (P.L. 68-176) specified that if a taxpayer made contributions exceeding 90% of net income in the tax year and each of the past 10 years, a full deduction was allowed. A phaseout of the unlimited deduction was included in the Tax Reform Act of 1969.

In the early 1980s, temporary changes provided a charitable deduction to non-itemizers. The Economic Recovery Act of 1981 (P.L. 97-34) allowed taxpayers who took the standard deduction to claim an additional deduction for charitable giving. This temporary provision went into effect in 1982, and was allowed to expire as scheduled at the end of 1986.

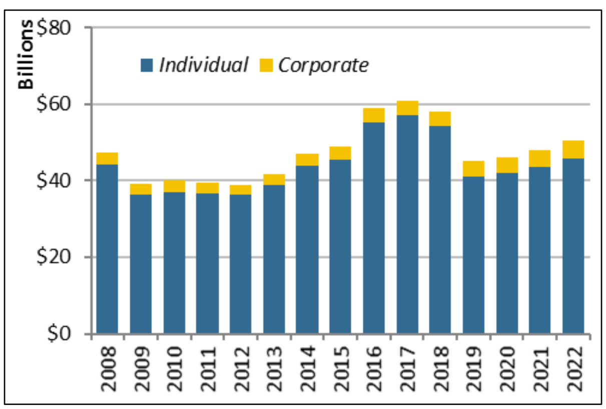
The 2017 tax revision (P.L. 115-97) temporarily increased the AGI limit for cash donations made to public charities to 60%. This change went into effect in 2018, and is set to expire December 31, 2025.

Cost

The charitable deduction is estimated to result in $58.1 billion in forgone revenue in FY2018, $54.1 billion from the individual income tax and $4.0 billion from the corporate income tax (see **Figure 1**). During the past decade, tax expenditures associated with the charitable deduction have fluctuated, largely following patterns in charitable giving. Individual charitable giving fell between 2008 and 2009, as a result of the Great Recession. The post-recession recovery in giving has increased in recent years, and is reflected in the tax expenditure estimates.

Tax expenditures associated with the charitable deduction are also expected to be lower following the 2017 tax revision (P.L. 115-97). P.L. 115-97 approximately doubled the standard deduction and limited or repealed other itemized deductions. As a result, fewer taxpayers are expected to claim itemized tax deductions generally, including the deduction for charitable contributions. Further, lower marginal tax rates also reduce the tax expenditure associated with the deduction for charitable contributions. Both of these factors mean reduced tax incentives for giving following P.L. 115-97.

Figure 1. Charitable Deduction Tax Expenditures
FY2008-FY2022

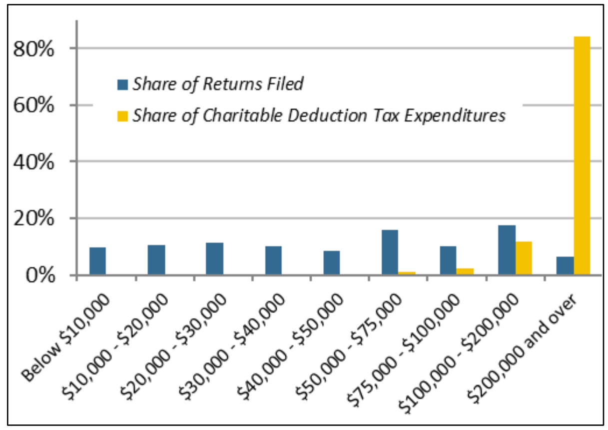


Source: Joint Committee on Taxation.

Distribution of Benefits

Tax expenditures for charitable deductions largely benefit higher-income taxpayers. Higher-income taxpayers tend to (1) have a greater ability to give; and (2) derive a larger tax benefit from each dollar given since they generally face higher marginal tax rates. An estimated 84% of tax expenditures for charitable giving in FY2018 will be claimed by taxpayers in the $200,000-and-above income class (see **Figure 2**). Overall, an estimated 6% of returns fall into this class. In contrast, an estimated 4% of the charitable deduction tax expenditures are associated with tax returns filed in income classes of $100,000 or less (76% of tax returns filed fall into a $100,000 or less income class). Charitable deduction tax expenditures have become even more concentrated in the highest income category following the changes made in P.L. 115-97.

Figure 2. Distribution of Returns Filed and Charitable Deduction Tax Expenditures, by Income Class
2018



Source: Joint Committee on Taxation.

Only taxpayers who itemize deductions can claim a deduction for charitable donations. In 2017, 32% of tax filers itemized deductions. Following P.L. 115-97, for the 2018 tax filing year, it is estimated that 13% will itemize deductions.

Policy Options and Considerations

There tends to be agreement that the tax code should support charitable giving. The 2017 tax revision (P.L. 115-97) retained the charitable deduction. Broadly, however, the higher standard deduction, limitations on other itemized deductions, and lower marginal tax rates reduced charitable giving incentives. The Tax Policy Center has estimated that these changes could result in charitable donations falling by about 5%. Further, the marginal incentive for charitable giving tends to be strongest at the top of the income distribution.

There are various policy options related to charitable giving incentives. For example, the deduction could be modified to allow non-itemizers to receive tax benefits for donations. This would increase the incentive to give for many lower- and middle-income tax filers. Alternatively, a floor could be imposed, restricting deductions for charitable giving to giving above some threshold. There would be no marginal incentive to give small amounts, but there would be a tax incentive to give larger amounts. The deduction could also be converted to a credit, equalizing the subsidy for giving by individuals in different tax brackets. Another way to equalize the value of the deduction for taxpayers in different tax brackets is to cap (or make fixed) the rate of the deduction. Other changes to the deduction might include modified AGI limits or changes related to valuation of non-cash gifts.

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