S. HRG. 112–646

TAX REFORM OPTIONS: INCENTIVES FOR CHARITABLE GIVING

HEARING

BEFORE THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

OCTOBER 18, 2011

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

77–208—PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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TAX REFORM OPTIONS: INCENTIVES FOR CHARITABLE GIVING

TUESDAY, OCTOBER 18, 2011

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:06 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Carper, Cardin, Hatch, Grassley, Crapo, Coburn, and Thune.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Lily Batchelder, Chief Tax Counsel; Tiffany Smith, Tax Counsel; Amber Roberts, Tax Exempt Organization Policy Staff Member; Sarah Babcock, Detailee; and Cosimo Thawley, Intern. Republican Staff: Chris Campbell, Staff Director; and Preston Rutledge, Tax and Benefits Counsel.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

Henry David Thoreau wrote, "Goodness is the only investment that never fails."

Nonprofit organizations invest in our communities. They deliver essential services and benefits to those most in need. They play a key role in creating jobs and improving our economy. Nonprofits employ 10 percent of the U.S. workforce. Many are small employers. Nonprofits in my home State employ 40,000 Montanans.

In these tough economic times, the role of nonprofits becomes even more important. Donations are up 4 percent this year compared to 2009, but giving levels are still far below where they were before the 2008 economic downturn.

At the same time, unemployment and increased homelessness are causing more people to rely on these organizations. Nonprofits are being forced to do more with less. These organizations are particularly important in America's rural communities. That is why I worked with Montana nonprofits and foundations in 2006 on a larger long-term effort to diversify support for rural and frontier communities.

Rural philanthropy fuels economic infrastructure and human resource needs by encouraging nonprofit partnerships. Local nonprofits are able to partner with schools, businesses, and government agencies to deliver results. These partners rely on the benefits of the charitable tax deduction, which is why we must ensure the deduction is fair and effective. The foundation of tax-exempt organizations is based on a relationship of trust. Citizens and businesses invest energy and hard-earned money in nonprofits because they believe in their mission.

In return, we ask that they fill a unique space that government and the private sector do not occupy. It is the obligation of this committee to ensure that nonprofits uphold their commitment, and it is our duty to make sure the tax code encourages charitable donations in the most efficient way possible.

Most Americans are not able to receive tax benefits from charitable deductions since they do not itemize. Less than one-third of taxpayers itemized their deductions last year. Of those folks who do itemize, 86 percent claimed a charitable deduction, but only 27 percent of all Americans claimed the deduction.

People at different income levels tend to give to different types of charities. Higher-income households give more often to health organizations; lower-income families statistically donate more to religious or basic need charities.

This results in the tax code giving large subsidies to some charities and smaller subsidies to others. The nonprofit sector predates the U.S. tax code. Our Nation's earliest settlers formed charitable and voluntary associations with their neighbors to get things done. Americans have always valued these traditions of volunteerism, philanthropy, and community, and for these reasons the charitable deduction and nonprofit exemption were incorporated into the tax code.

Today's nonprofit organizations help to carry these values. Their work helps improve all of our communities. One organization that exemplifies these values is the Montana Nonprofit Association, and last month they celebrated their 10th anniversary. Their members have helped improve Montana on so many fronts: education, health and human services, arts and culture, religious and spiritual development, environmental protection, economic and workforce development, and more. This anniversary commemorates years of hard work, civic engagement, and a social contract in the State of Montana. I would like to take a moment to congratulate those members and thank them for their service to the State of Montana.

So let us remember the wisdom of Henry David Thoreau, that "goodness is an investment that never fails." Let us invest in our communities. Let us encourage charitable giving in a way that is fair and efficient, and let us ensure that benefits get to the people who really need them. Let us continue to make sure nonprofits have the resources they need to continue their good work.

[The prepared statement of Chairman Baucus appears in the appendix.]

Senator Hatch?

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Well, thank you, Mr. Chairman. In particular, I want to thank you for the indulgence of an extended opening statement. The issue of our tax code's treatment of charitable contributions is of critical importance to me, to the people of Utah, and to millions of Americans who give every year to their churches and their communities. I am deeply concerned that the current deduction for charitable giving is under quiet assault, and today's testimony does nothing to diminish those concerns.

Mr. Chairman, you have assembled an excellent panel to discuss the issues of our tax code's treatment of charitable giving. I am particularly pleased to have Elder Oaks and Mr. Gallagher testify today. They are uniquely qualified by their lives of service to provide the committee with the insight that we need to understand the importance of maintaining the current charitable deduction.

In advocating for the current deduction, I expect that they will be more diplomatic than I. But from my perspective, the tax reform options being discussed today are options that target charitable giving concocted by those who, hungry for more taxpayer dollars to finance reckless government spending, are now casting their sights on the already-depleted resources of charities and churches. I appreciate the other witnesses here today too and their sincerity, and I want to personally pay tribute to them for being willing to come.

Alexis de Tocqueville wrote in *Democracy in America* of the importance of intermediate associations that stand between the individual and the centralized state. The Catholic Church speaks about subsidiarity, a principle that matters ought to be handled by the least centralized competent authority. To put these insights into constitutional terms, the Federal Government cannot, and should not, do it all. The truth of these moral and legal principles is embodied in the work of America's churches and charities, which have played a critical role in securing the welfare of Americans in the face of our Nation's worst economic disaster since the Great Depression.

In no small measure thanks to the administration's lack of focus on jobs and misguided economic policies, our economy is growing much too slowly, and unemployment remains stuck above 9 percent. Our jobs deficit is enormous, and neither the President's first stimulus bill nor its sequels will get Americans working again. In this economic environment, the charitable community is more important than ever to those in need.

As State and local governments grapple with budget deficits and revenue shortfalls, Americans in crisis are turning for help in ever greater numbers to churches, charities, shelters, and other social welfare groups. Charitable donations are the lifeblood of charities, and the last thing Congress should do is interrupt the blood supply. The administration proposes to cap the itemized deduction at 28 percent, and we know the administration would raise the top marginal tax rate on individuals to 39.6 percent if it could.

One prominent research organization that studied the President's proposal to cap the tax deduction at 28 percent estimated that it would lead to a drop in total charitable giving of $6 billion. Now, that cannot be allowed to happen. The Congressional Budget Office has published a report that analyzes several proposals to place various limits on the charitable deduction. We will hear about that study today from Mr. Sammartino.

However, most of the proposals described in the CBO report would result in less charitable giving, and one would cause a devastating drop of $10 billion per year in donations. Two of the proposals would increase Federal tax expenditures by $5 billion and

$7 billion per year, an unrealistic proposition in today's deficit climate. Two proposals are projected to increase donations and reduce Federal tax expenditures at the same time. Frankly, that sounds too good to be true. As we all know, when something sounds too good to be true, it probably is.

In addition to curbing the charitable deduction, proposals have been made to convert it to a non-refundable tax credit. The Bowles-Simpson Commission proposed a 12-percent tax credit, and the CBO report describes a 15-percent and 25-percent tax credit.

Now, we should make no bones about it, the changes being discussed today are radical ones. There has been a charitable deduction in the tax code for nearly a century, and the proposals on the table would undo it. This is not the area for experimentation by the Federal Government.

Our charitable sector is just recovering from a steep drop in contributions that followed the 2008 stock market meltdown. Charities today face the prospect of enduring another recession that will again put downward pressure on charitable giving. This is not the time to reduce the charitable deduction and further suppress the incentive to give. It is certainly not the time to experiment with the charitable deduction by converting it into a tax credit.

Common sense tells us that a greater charitable tax incentive will result in a greater amount of charitable giving, assuming the capacity to give exists. It seems to me that this point is overlooked by those who criticize the charitable deduction on "fairness" grounds, that is, on the ground that it is unfair that a donor in a higher marginal tax bracket receives a larger deduction than a donor in a lower bracket.

Now, this sort of reasoning misses the point entirely. The tax deduction is not an end unto itself. The goal is not to reward some donors more than others. In fact, it is not really about the donor at all, it is about the charity. It is about directing sufficient resources to charities so that they can carry forward the good works our society so desperately needs them to perform. It makes perfect sense to provide the greatest tax incentive for giving to the donors with the greatest capacity to give.

The upper-income donors, the ones with the high marginal tax brackets, are the very donors who are in a position to give substantial amounts to charity. It should come as no surprise that for nearly 100 years the tax code has provided such an incentive. This is not just an issue for high-income donors, however. It is important to remember that there has never been a floor on the charitable deduction either, nor should there be. The charitable deduction begins with the first dollar given. We should rejoice that we live in a country where people of all income groups give generously to charity.

Studies have actually shown that lower-income Americans, those with fewer dollars to spare, are actually more generous than wealthier Americans, giving away a greater percentage of their income than the higher-income taxpayers. Think about that. Taxpayers who receive little or no additional tax benefit for giving to their church or charity give faithfully anyway.

Economists have a term for this behavior. It is called "inelastic charitable giving." I call it "giving from the heart." But it is this very behavioral prediction that has encouraged some to advocate for curtailing the charitable deduction by placing a floor on the deduction, a minimum amount below which no deduction would be allowed.

Now, one proposal would deny a donor the deduction except to the extent their charitable giving exceeded 2 percent of adjusted gross income. The advocates of this proposal say the following: "An argument in favor of this option is that, even without a deduction, a significant share of charitable donations would probably still be made. Therefore, allowing taxpayers to deduct contributions is economically inefficient because it results in a large loss of Federal revenue for a very small increase in charitable giving."

Now, I have nothing against economists, but please. Economically inefficient? Inelastic giving? I do not believe that Congress should change current law and take away the charitable deduction for modest gifts merely because we can rely on kind and faithful citizens to continue giving their hard-earned money to churches and charities regardless of the tax benefit they might receive. That is just not right.

Harrisburg, PA, the State capitol, declared bankruptcy last week. What do you think will happen to the provision of city services in Harrisburg? Who will step into the breach? Churches and charities will. Poverty in America, including childhood poverty, is reported to be at the highest levels since 1993. These are our neighbors. Who is there for them? Local governments, yes, but churches and charities are there, too. The food banks and shelters are busier than ever and in need of donations, large and small.

I could go on, but we all have heard the stories. We all are aware of the need. I would like to make another point about the charitable deduction that is a very personal one for me, and for many Utahans and Americans across the country.

Too often, including just recently, this administration has taken actions that in my view undermine the mission of our Nation's churches and religious institutions. I am deeply concerned that the effect of these proposals to reduce the tax benefit for charitable deductions would have a similar effect, and I urge those who are considering them to think long and hard before going down this path.

I will just close by saying that the charitable tax deduction is unique. It is the only deduction that encourages you not to spend or invest your income, but to give it away. Every charitable gift has one thing in common: the donor is always left worse off financially, but society is made better. We curtail the charitable tax deduction at our peril.

Now, I look forward to hearing the testimony of these excellent witnesses here today and studying this as thoroughly as we possibly can.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. I am now pleased to welcome our witnesses. First, we will hear from Frank Sammartino, Assistant Director for Tax Analysis at the Congressional Budget Office. Our second witness is Elder Dallin Oaks, a member of The Quorum of the Twelve

Apostles, The Church of Jesus Christ of Latter-day Saints. I think, Senator Hatch, after I introduce the other two witnesses, it is my understanding that you would like to introduce our second witness.

Senator HATCH. Would you let me do that?

The CHAIRMAN. Absolutely. Let me get through the others first.

Our third witness is Dr. Eugene Steuerle, the Richard B. Fisher chair and institute fellow at the Urban Institute. We will also hear from Brian Gallagher, the president and CEO of United Way Worldwide. The final witness is Roger Colinvaux, who was formerly on the Joint Committee on Taxation, and is now an associate professor at Catholic University of America, Columbus School of Law.

Now, let us hear from Senator Hatch.

Senator HATCH. Well, thank you, Mr. Chairman. I am honored to introduce my friend, Elder Dallin H. Oaks from Utah. Elder Oaks is a senior member of The Quorum of the Twelve Apostles and of the leadership of The Church of Jesus Christ of Latter-day Saints, the same church of which I have been a member my entire life.

I asked Chairman Baucus to invite Elder Oaks to testify today not just because of his lifelong involvement in the church, but also because of his extensive experience in all the areas of the charitable world. The churches, social services, education, health care, and the arts all occupy valuable space in the charitable community.

Elder Oaks's life of service has touched all of these areas. Elder Oaks is keenly aware of the importance of the charitable tax deduction. He is the former president of Brigham Young University, one of the largest private institutions in the world, and has served as the chairman of the Board of Public Broadcasting, and chairman of the Board of the Polynesian Cultural Center, just to mention a few.

All of these institutions rely to a great extent on charitable donations. Elder Oaks also has had a distinguished academic and legal career. He holds a BA from Brigham Young University and a J.D. from the University of Chicago Law School. He served as editor-in-chief of the *University of Chicago Law Review,* and after law school he served as law clerk to Chief Justice Earl Warren on the U.S. Supreme Court.

Elder Oaks has also served as a justice on the Utah Supreme Court. Elder Oaks was one of the great law professors at the University of Chicago. He is known by people all over the world, and frankly we are very grateful to welcome you and all of the other witnesses here today, in particular, Mr. Gallagher as well. He is a tremendous leader of a great charitable institution in our society today. I look forward to all of the witnesses today, and I think we are very fortunate to have these folks with us.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Unfortunately, I have to leave to go to another hearing. I hope to make it back, but in the meantime I would like you to chair this hearing.

Senator HATCH. Well, thank you, Mr. Chairman. I would be glad to do it.

The CHAIRMAN. Good. Thanks.

Senator HATCH. Well, we will begin then with you, Mr. Sammartino, and then we will just go right across the table. Is that all right? We would like you to keep your remarks as close to 5 minutes as you can, but we are not going to be fussy about it if you need to go over.

Mr. SAMMARTINO. I will try my best.

STATEMENT OF FRANK SAMMARTINO, ASSISTANT DIRECTOR FOR TAX ANALYSIS, CONGRESSIONAL BUDGET OFFICE, WASHINGTON, DC

Mr. SAMMARTINO. Chairman Baucus, Senator Hatch, and members of the committee, I appreciate the opportunity to appear before you today to discuss options for changing the tax treatment of charitable giving. My written testimony is taken from the Congressional Budget Office's most recent report on that topic which was published last May. My oral testimony summarizes the results from that report.

Under current law, taxpayers who itemize deductions may deduct the amount they donate to charities from their adjusted gross income when determining how much they owe in Federal income taxes. That deduction gives people who itemize an incentive to contribute to charities. Like other forms of preferential tax treatment, the deduction also costs the Federal Government revenues that it might otherwise collect.

At current levels of charitable giving, the cost of that deduction, measured as the additional revenue that could be collected if the deduction was eliminated, will total about $230 billion between 2010 and 2014, according to estimates from the Joint Committee on Taxation.

In its analysis, CBO investigated how changing the structure of tax incentives for giving would affect the tax subsidy; that is, the cost in foregone revenues to the Federal Government, the overall level of charitable giving, and the extent to which different income groups benefit from the tax preference.

In keeping with CBO's policy, the agency makes no recommendations. Specifically, CBO looked at 11 options for altering the current income tax treatment of charitable giving. Those options can be grouped into four categories. The first is retaining the current deduction for itemizers, but adding a floor; the second is allowing all taxpayers to claim the deduction with or without a floor; the third is replacing the deduction with a non-refundable credit for all taxpayers equal to 25 percent of the taxpayer's charitable donations, again, with or without a floor; and the fourth is replacing the deduction with the non-refundable credit for all taxpayers equal to 15 percent of a taxpayer's charitable donations, again, with or without a floor.

For each of the four categories, CBO analyzed two potential floors: a fixed dollar amount, in this case $500 for single taxpayers and $1,000 for couples filing a joint return; and a percentage of income floor, in this case, 2 percent of adjusted gross income. Only contributions in excess of the floor would be deductible or eligible for a credit.

Because the analysis uses data from 2006, the options that include a fixed dollar floor would have a somewhat different impact today than presented here. According to CBO's estimates, adding a contribution floor to any of the approaches listed above would reduce both the total Federal tax subsidy and the total amount donated to charity relative to the same option without a floor.

In each case that CBO examined, however, the reduction in the subsidy, and thus the increase in Federal revenues, would exceed the reduction in charitable contributions, whether measured in dollars or as a percentage change. The reason is that introducing a floor would continue to provide a tax incentive for additional giving above the level of a floor, at the same time reducing the tax subsidy for donations that people might have made even without the tax incentive.

Allowing all taxpayers to claim a deduction for charitable giving would have increased donations in 2006 by an estimated $2 billion, or 1 percent of donations, and increased the tax subsidy by $5.2 billion, or 13 percent, from the 2006 amount.

Combining a deduction for all taxpayers with a floor, however, could both increase donations and decrease the tax subsidy. For example, such a deduction combined with a fixed dollar floor would have increased donations by $800 million in 2006 and decreased the tax subsidy by $2.5 billion, according to CBO's calculations.

Replacing the current deduction with a 25-percent tax credit would increase donations, but also increase the government's foregone revenues. Combining such a credit with a fixed dollar contribution floor, however, could boost donations while reducing the tax subsidy, while a percentage of AGI floor would decrease donations by a small percentage while reducing the tax subsidy by a large percentage.

Setting the credit at 15 percent would reduce donations but would reduce the tax subsidy by a larger amount, both in dollars and as a percentage change. Changing the tax treatment of charitable contributions would have different effects on taxpayers at different points on the income scale.

Adding a contribution floor to the current deduction for itemizers would reduce tax subsidies for all income groups, but for high-income taxpayers the size of the reduction would vary significantly depending on the type of floor used. A fixed dollar floor would have little effect on high-income taxpayers relative to a percentage of AGI floor.

Making the deduction for charitable contributions available to non-itemizers would benefit lower- and middle-income taxpayers who tend not to itemize deductions because their deductible expenses, such as mortgage interest and State and local taxes, as well as charitable donations, are not large enough to exceed the standard deduction.

Those groups would benefit even more if the current deduction, which tends to help higher-income taxpayers more because they face higher tax rates, was replaced with a non-refundable credit that gave all income groups the same tax incentives for giving.

For example, replacing the deduction with a 25-percent credit in 2006 would have increased the tax subsidy for taxpayers with AGI below $100,000, but it would have decreased the tax subsidy for people above that income level. Tax subsidies would be lower for all income groups with a 15-percent credit than with a 25-percent credit.

That concludes my remarks. I would be happy to answer your questions.

Senator HATCH. Well, thank you, Mr. Sammartino.

[The prepared statement of Mr. Sammartino appears in the appendix.]

Senator HATCH. Elder Oaks, we will take your statement now.

STATEMENT OF ELDER DALLIN H. OAKS, THE QUORUM OF THE TWELVE APOSTLES, THE CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS, SALT LAKE CITY, UT

Elder OAKS. Chairman Hatch and distinguished Senators, I am Elder Dallin H. Oaks of The Quorum of the Twelve Apostles of The Church of Jesus Christ of Latter-day Saints. Seated behind me are the Most Reverend Timothy C. Senior, auxiliary to the Roman Catholic Archbishop of Philadelphia, and Russell Moore, dean and professor of christian theology and ethics at the Southern Baptist Theological Seminary. They have authorized me to say that they are in full agreement with the statement I will make.

We appear here to speak not only for churches and their charitable works, but also for the entire private sector of which we and our charitable institutions are only a part. While we are religious leaders, the possible impairment of the charitable deduction in order to enhance tax revenues is not a religious issue, it is not a political issue, it is not even an economic issue. It poses a question about the nature and future of America.

The charitable deduction is vital to the private sector that is unique to America. Astute Alexis de Tocqueville observed, "Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States, you will be sure to find an association."

Today, millions of these private associations, religious and charitable, are responsible for tens of millions of jobs and innumerable services that benefit our citizens at every level. I speak of private educational institutions, hospitals, social welfare agencies, and countless other organizations ministering to the needs of children, youth, the aged, the poor, and citizens generally.

The financial well-being of this private sector is dependent upon private contributions that qualify for the charitable deduction. The impact these private institutions have on those they serve is magnified by the millions of volunteers motivated by the ideals they pursue.

For example, in the aftermath of Katrina and the other 2005 Gulf Coast hurricanes, The Church of Jesus Christ of Latter-day Saints aided the clean-up efforts with almost 3,000 tons of emergency supplies, over $3 million in cash, and use of heavy equipment, and its members gave more than 42,000 man-days of service. Other nonprofit organizations provided over $3.5 billion in cash and in-kind donations to help with the relief efforts.

Another example concerns the unique role of our Nation's churches, synagogues, and other religious organizations. John Adams wrote, "Our Constitution was made only for a moral and religious people. It is wholly inadequate to the government of any other." This wise Founding Father explained, "We have no government armed with power capable of contending with human passions unbridled by morality and religion. Avarice, ambition, revenge, or gallantry would break the strongest cords of our Constitution as a whale goes through a net."

Our Nation is held together not just by law and its enforcement, but by voluntary obedience to the unenforceable and by widespread adherence to norms of right and wrong, such as the vital principle of honesty. For a large proportion of our citizens, these essential norms are grounded in the principles of our religious beliefs taught in our churches and synagogues. There is no need to provide other examples. Throughout your life, each of you Senators and those you love have personally benefitted from a host of private organizations, some church-related, but many not.

The private sector of charitable activity is almost unique and surely uniquely valued in America, and we all understand that its activities are funded by private donations produced or importantly stimulated by a charitable deduction that reduces the donor's taxes. Some economists and other scholars contend that this is in effect a tax expenditure because tax revenues are reduced by the benefit granted.

In other words, because the government could have denied the charitable deduction, there is a government expenditure in its granting the deduction and foregoing the revenue. By that reasoning, the personal income we think is ours is really the government's because of its choice not to take it away by taxation. That is surely an attitude not shared by most Americans.

We are grateful for the charitable deductions which encourage donations to churches and other charities. The effect of this tax benefit is built into the financing of charitable enterprises that are vital to our Nation, and it is a significant and wise support of the private sector. The charitable deduction should remain unimpaired not just for religious institutions and their unique role, but for the benefit of the entire private sector of our Nation.

The private nonprofit, non-government sector has always been an important counterweight to the powers and potentially repressive influence of governments at the local, State, and national level. The private sector is essential to preserving pluralism and freedom in our Nation. Do not reduce the charitable deduction.

Senator HATCH. Well, thank you, Elder Oaks.

[The prepared statement of Elder Oaks appears in the appendix.]

Senator HATCH. Dr. Steuerle?

STATEMENT OF DR. EUGENE STEUERLE, RICHARD B. FISHER CHAIR AND INSTITUTE FELLOW, THE URBAN INSTITUTE, WASHINGTON, DC

Dr. STEUERLE. Thank you, Senator Hatch, members of the committee. It is an honor once again to testify before you today, this time on the tax treatment of charities.

In your deliberations, I strongly hope that you will give attention to a message that I believe I heard from both Senator Baucus and Senator Hatch—that we think strongly about what message Congress is going to convey about the type of society that we want to encourage.

At the same time, I have encouraged many in the charitable sector to give attention to the message they convey about helping us to deal with our huge budgetary shortfalls and the threat that they pose to our people. Our mutual goal should be to enhance the strengths and the capabilities of all sectors of the economy—government, charitable, household, and business. Each has a vital part to play.

The simple message that I hope you take from my testimony, if you remember nothing else, is that it is quite possible to redesign programs of government so that they are more effective. Senator Baucus spoke to this briefly at the beginning when he talked about targeting or making effective the various incentives for charitable giving.

Regardless of the level of revenues or spending upon which you finally decide, it is really possible to undertake a vast range of reforms in many policy areas, not just charitable giving, but homeownership or educational subsidies, by re-targeting those incentives so that they are most effective at doing the very job we want them to do.

Moreover, combining options creates new possibilities. Often when budgetary reform is considered, people pick items one at a time off a laundry list but very seldom consider how they can be combined to do a better job at achieving goals beyond just some simple revenue target. One that I discuss with you today can even increase both revenues and charitable giving—that is right, we can increase both revenues and charitable giving—without adding the IRS cost.

So what are some elements of a legislative package that could be combined and ought to be considered? Well, here are some examples. For a long time you have considered extending a deduction to non-itemizers. I think that such could be done; however, to be done well, I believe you also have to do it with a floor under giving so that you exchange an incentive for the people who do not itemize now, who do not get any incentive, with a floor that is less effective in providing incentives. So I would consider doing both, since a floor does not have as much of a disincentive for giving. Extending the deduction to non-itemizers could increase giving quite substantially.

I would consider providing an improved reporting system to taxpayers on charitable contributions. If we really want to simplify the tax code long-run—and I realize this would be a long-run measure—I think it is time that we start thinking about information reports that IRS can easily monitor. We know in the past we have gotten significant improvements in compliance when we extended information reporting to interest and dividends, as well as when you required Social Security numbers be reported for dependents.

I would think about trying to limit the deductibility for in-kind gifts where a net amount to charity is quite low relative to the revenue cost to government. I would especially give attention to some of the household goods and clothes, where recent IRS data indicate that there are fairly extraordinary amounts of such deductions being taken and where it is well-known anecdotally that there are intermediaries who operate so that charities receive often a very tiny amount of money relative to the amount of deductions that are taken and the revenue cost to government.

To help the public monitor the charitable sector better, I would also require electronic filing by most or all charities. This simple effort could help many, including the State attorneys general and watchdog groups who are trying better to clean up this sector, because they would have information much more quickly.

Now, I have already mentioned one proposal to enhance incentives. That was to extend the deduction to non-itemizers. I also suggest that you strongly consider allowing a deduction up to April 15th or the time of filing. Everyone who wants to promote something knows the best time to advertise it is when people are most cognizant of the issue. The advertisement when you go to the grocery store that you see the day before you go to the grocery store is the most effective. If you would allow an incentive up to April 15th, I believe that you would have substantial increases in giving at modest cost to government.

I would also consider proposals to place less strict limits on charitable contributions. One of those you have considered and have adopted in the past has to do with allowing people to take deductions from their individual retirement accounts without facing a cap on giving. Another example I would give would be with respect to people who win lottery tickets. If they give their lottery ticket away to charity right away, it is essentially fully deductible. But if they give the lottery winnings to charity, they face a 50-percent cap on the amount of such giving that can be given away.

And, as a final example of how you could use some of these revenue-raising items to actually increase incentives for giving, I think I would finally get around to reforming the excise tax on foundations. This badly designed excise tax is now penalizing those very foundations that keep up their giving in the recession. And by the way, every dollar that you collect here is one less dollar that goes to charity.

So in sum, it seems to me that one can think about reform of the charitable incentives to both improve charitable giving and to deal with our budgetary shortfall. Some of the monies derived from a floor under charitable giving, improved compliance measures, greater restrictions on non-cash gifts where abuse is likely or enforcement is next to none, and a better system of information reporting could be spent to enhance charitable incentives, allowing taxpayers to benefit immediately from charitable contributions they make while filing their tax returns, extending the deduction to more taxpayers who do not itemize, raising the ceilings on allowed charitable giving for some types of gifts, and fixing the foundation excise tax.

Thank you.

Senator HATCH. Thank you, Dr. Steuerle.

[The prepared statement of Dr. Steuerle appears in the appendix.]

Senator HATCH. Mr. Gallagher, we will turn to you. You represent one of the largest charitable groups in the country, and we are interested in what you have to say as well.

STATEMENT OF BRIAN A. GALLAGHER, PRESIDENT AND CEO, UNITED WAY WORLDWIDE, ALEXANDRIA, VA

Mr. GALLAGHER. Thank you, Senator Hatch. I would like to say thank you to Chairman Baucus, Senator Hatch, members of the committee. Thanks for inviting me to testify before the committee on this matter of critical importance not just to the nonprofit sector, but to our society in general. I urge the committee to preserve the charitable deduction for all donors.

Let me start by stating that I deeply respect the work of my colleagues on this witness panel. However, I have spent my entire career, now 30-plus years, working with donors in the nonprofit sector. I know why people give, and I believe that limiting the charitable deduction would have a far greater impact on charitable giving than many estimate and would significantly affect our sector's ability to deliver critical services.

In addition to the administration's 28-percent cap, a variety of other proposals to limit the deduction have been circulated this year. Each proposal has two common elements: they limit the value of the deduction for some group of donors, and they will result in reduced giving to charity to the detriment of individuals and families who rely on our help.

The highest estimates of reduced giving are equal to eliminating all the private donations each year to the Red Cross, Goodwill, the YMCA, Habitat for Humanity, the Boys and Girls Clubs, Catholic Charities, and the American Cancer Society combined.

I am not arguing that those organizations would not survive limitations to the charitable deduction. United Way and these major charities would. However, the services charities provide would be reduced at that scale. For United Way, we calculated that a mere 2.5-percent reduction in revenue would result in 1.3 million fewer times that we can provide job training services for an unemployed worker, home care for an elderly citizen, service-supportive housing for a single mother, or a mentor or tutor for an at-risk young person.

At a time when all manner of government-funded social service programs are being cut, decreasing the capacity of charities to provide services is the wrong thing to do. Those at the bottom of the economic spectrum have suffered the most through the recession. They are the ones who would bear the brunt of reduced giving to charity because of a tax policy change.

Americans give for a variety of reasons. I think it is rare that someone gives to charity only because of a tax incentive, but tax incentives are often a factor in how much someone donates. I can tell you from my experience, large donors are very sensitive to the tax code. If Congress reduces the charitable deduction, you should expect that donors will simply withhold from their donations the difference necessary to cover the tax.

The real impact would be felt by the people we serve. Within American culture, innovation is prized. It is most noted as an achievement in the American business sector. But the nonprofit sector is the cradle of innovation in providing services and solving social problems. We are dynamic and responsive to the needs of the people we serve. We are always finding new ways to do things more efficiently and with many fewer resources than government.

We are the source of much of the social innovation you have seen in our country for decades. This is possible because of generous private giving in America. The point is that our charitable sector is the envy of the world. We have an effective and efficient system. That is in part due to the historic treatment of charitable donations. The deductions simply track with the donor's tax rate.

The effect of that is that income donated to charity is not taxed. This connection to the tax rate is the strength and the simplicity of the charitable deduction. Perhaps my biggest concern about limiting the deduction is it would, for the first time, decouple the deduction from the tax rate. Once you have done that, then it is a simple matter of repeatedly returning to the deduction as a source of more revenue.

Even when tax reform is not on the table, perhaps future well-meaning Senators will see this as an offset for their own priority programs: a cap can be lowered another fraction of a percent, a floor can be raised a few hundred dollars, an arbitrary tax credit can be reduced, until there is little left to resemble a tax policy that reflects our Nation's philanthropic heritage.

This would just be the beginning of a whittling away of the charitable sector. The charitable deduction is perhaps unique among tax deductions. No personal gain or benefit is conferred to a donor by donating to charity. By allowing donors to deduct the deductions at the same rate as their tax rate, you are simply not penalizing them for giving away income. Every cent of their donation is going back into their community.

In other words, while the Federal Government may be losing some revenue from that dollar, the entire dollar is going to advance the common good. What could be a better use of that dollar? We have to create more private investment and incentives to address our Nation's growing human need.

Getting people involved through the nonprofit sector is how you change society. Think about it: Mothers Against Drunk Driving, which led to tougher laws; Girls in Sports, which led to title IX; bans on smoking in public places; breast cancer awareness. It is not just about providing services, it is how our sector leads the way in movements that improve society.

The loss of social movements like these, coupled with proposed reductions in Federal social service programs, could negatively impact individuals and families for years to come. Dramatic cuts by Congress began last year, and more are coming. The so-called Super Committee will likely make even more dramatic cuts, where automatic reductions to social services will occur. At the same time, States are in budget crises and making deep cuts in State-funded programs. But the need is not going away.

Many, many government programs are facing cuts, but people will still need help paying their heating bills this winter, single moms will still need help with child care so they can work, and unemployed workers will still need training to return to work. We can help these folks pay their utilities, get child care, and get job training, but we can help fewer of them if our donations are reduced because of limitations on the deduction.

Finally, our Nation is enduring a drawn-out jobless recovery which has been especially hard on the poor and middle-class. In the short term, you could help ease the economic suffering of millions of Americans by enabling charities to do more. Over the long term, investments in social services or human success can help our Nation recover and prosper. There can be no sustained economic success without human success. There never has been. We in the nonprofit sector are investing in human success, and we need the help of this committee and Congress to make that investment.

Thank you.

Senator HATCH. Well, thank you, Mr. Gallagher.

[The prepared statement of Mr. Gallagher appears in the appendix.]

Senator HATCH. Mr. Colinvaux, we will finish with you.

STATEMENT OF ROGER COLINVAUX, ASSOCIATE PROFESSOR, THE CATHOLIC UNIVERSITY OF AMERICA, COLUMBUS SCHOOL OF LAW, WASHINGTON, DC

Mr. COLINVAUX. Thank you, Senator Hatch, members of the committee. Thank you for holding this hearing today and for inviting me to testify.

Broadly speaking, there are two ways you can approach changing the charitable deduction. One is to raise revenue in a cost-effective way but not reform the deduction. Another is to reform the deduction with or without revenue goals.

First, I want to talk about the harder of the two, which is to reform the deduction. Now, here you need to have some idea of what the deduction is right now and also what you want the deduction to look like. One window on reform for me comes back to a decision made long ago at the outset of the charitable deduction to link the two benefits, so the deduction is linked to tax-exemption.

What this means is that the charitable deduction is not independent, rather it is dependent on tax-exemption to define its scope, to define its cost, and also its purpose. You have two different tax benefits, but really one foundational body of law.

What it means is that the charitable deduction is really a support for the section 501(c)(3) sector which, if you are going to reform the deduction, means you have to care about the section 501(c)(3) sector and exemption law itself.

So you need to know what organizations are a part of the sector, how many there are, what their purposes are, how easy it is to become a 501(c)(3) organization, how the organizations are overseen, and whether or not all of their activities further deductible purposes.

Now, if you are content with the law at the exemption level, then really there is not an issue in terms of reforming it. But if you are not content with the law at the exemption level, then reform of the deduction also means reform of the exemption as well. What is the state of the law at the exemption level? Well, in my own personal view, the exemption law is, to a certain extent, overwhelmed. It is operated in part on an important principle of trust, and it is difficult to verify much of what occurs in the section 501(c)(3) sector.

Now, when I say "trust," I am thinking of trust not only that an organization is not being abusive, but also trust that the organization is in fact serving a public benefit. Now, this may seem an odd view, but I do not think it is just my view. I think also Congress itself has shown increasing frustration with the breadth of the exemption law, as evidenced by recent reform legislation in 2006 and also in the Affordable Care Act, where new exemption standards were imposed on hospitals.

So one suggestion I have to think about reform is to de-link the deduction from tax-exemption. Now, I have no illusions that this would be easy. It would be hard, because we have been working under this regime for a long time. But I think there would be certain benefits to de-linking the two.

One is, that it would force more directly a conversation about what the charitable deduction is for. Is it for pluralism? Is the intent of it to foster a dynamic, growing, and broad section 501(c)(3) sector, or is it to produce more particular public benefits, or something more concrete than pluralism? We would ask questions, such as whether all parts of the sector are equally worthy of support, or whether the deduction should be supporting the unrelated activities of 501(c)(3) organizations.

Now, these are important and difficult questions, but it is hard to have this discussion when you are talking about both exemption and deductibility at the same time, because right now all of the decisions are made at the exemption level.

Nevertheless, what this suggests is that reforming the deduction is a heavy lift, if you will. There are a lot of issues involved. I think it is a longer-term project, and, if the Congress decides that it needs to act more quickly to make changes to the deduction, then I suggest perhaps a different model. This is to raise revenue without reform, that is, while trying to retain the current structure of the deduction as much as possible and doing the least amount of harm to charitable organizations.

Now, here I would just offer a few observations about the different proposals that are on the table. The first is, in my view, the best fit with overall current policy, which is a floor underneath the charitable deduction, an income-based floor. This would preserve the incentive effect of the deduction. It might even make it stronger in some cases, and it would also have, I think, considerable administrative benefits.

The next closest to the revenue-without-reform model, I think, is the administration proposal to cap the value of itemized deductions. It is fairly narrowly targeted to the top rate payers, and some studies have indicated that the effect on overall giving would be modest, though not of course insignificant.

However, I echo Mr. Gallagher's remarks that I think there is a significant reform-based element to the administration proposal, mainly that the policy explanation for it broadly is that it reduces the unfairness of the deduction. I think even after that proposal, were it enacted, that unfairness would continue to reside within the deduction through the rate structure.

What you would see would be increasing future pressure, either for revenue concerns or for fairness reasons, to further reduce the value of the itemized deduction, which I think would leave you with something looking very similar to a credit.

I think a credit would be a dramatic change from present law. There may be good reasons to move toward a credit, but my own view is that it should not happen without a broader discussion about what the public benefit of the charitable deduction is or should be, and without a wide consultation of stakeholders.

And, finally, the proposal to provide direct grants to charities in lieu of a deduction would be a very dramatic change to the deduction and could undermine the independence of organizations.

I see I am over my time. Thank you very much for inviting me to testify today.

Senator HATCH. Well, we thank all of you for testifying. It has been a very interesting discussion, as far as I am concerned.

[The prepared statement of Mr. Colinvaux appears in the appendix.]

Senator HATCH. My first question will be for the entire panel, and we will start with you, Mr. Sammartino, and just go across the table. The President proposes to cap itemized tax deductions at 28 percent and thereby reduce the charitable tax deduction for upper-income taxpayers. Upper-income individuals are the largest givers to charity.

Estimates vary as to how much charitable donations will drop. I have seen estimates that range all the way up to $6 billion per year, but all the estimates point to a drop in donations. In addition, the charitable sector has not yet recovered from the drop in donations following the 2008 market meltdown, yet demand for charitable services has increased dramatically and remains high.

I have two questions I would like to ask each of you to address. First, do you agree that reducing the charitable deduction will cause a drop in charitable donations? And two, with charitable donations not fully recovered from the recession and demand for charitable services remaining high, do each of you agree that this is not the time for Congress to consider adopting policies that will reduce charitable donations?

So, we will start with you, Mr. Sammartino.

Mr. SAMMARTINO. So, as to your first question, if there is a cap, just a cap or a limit on itemized deductions at 28 percent with no other changes, it is likely that people at high incomes would contribute less. We do not have estimates for really how much that would change.

As to the second question, I do not know that I can really give you an answer to that. I mean, I know Congress is going to have to make a lot of difficult choices about what the appropriate timing is for lots of changes, and so perhaps consideration of the changes in the charitable deduction is just one among many.

Senator HATCH. Elder Oaks?

Elder OAKS. I believe it would result in a significant drop in charitable deductions. Second, I believe this is not the time for that.

Senator HATCH. Thank you.

Dr. Steuerle?

Dr. STEUERLE. Senator Hatch, in my testimony I provide a variety of numbers that we have generated from the Urban-Brookings tax model simulations. We estimate that, for instance, a 28-percent cap on charitable deductions alone—that is not quite the President's proposal because he has the cap on all deductions—would cost about $1.7 to $3.1 billion in charitable contributions. That is, you would have a decline.

The question about timing is more complex. If we were having a hearing on budget, I would be giving you numbers like, the government is now spending $31,000 a household. That is total spending by the number of households. And it is collecting $19,000 in taxes. That gap is causing huge, huge problems that I think we cannot avoid.

So, in terms of the timing of dealing with our budget issues, I think we have to deal with them now. I do not know that I can solve the problem of the fact that there is a transition—for affected groups—that will take place. So the timing, I do not know. I personally, as I say, would end up trying to do something that would actually increase charitable giving rather than decrease it; that would be my ultimate goal. But as to the timing, I do not think there is any better time for dealing with this budgetary shortfall than right now.

Senator HATCH. Mr. Gallagher?

Mr. GALLAGHER. There is no question in my mind that a 28-percent cap would drive charitable giving down. There are 26,000 people who give $10,000 a year or more to their local United Way. We surveyed that group. Twenty-three percent of them said any change to that tax rate would have a major impact on their giving. There is no question that it would drive giving down.

Second, I would say the timing is bad not just on financial terms, but, at a time when local communities are going to have to find new solutions to more difficult social problems, if we start reducing the capacity of nonprofits and communities to do that work, it is just not a dollars-and-cents issue, it means that we will stop innovating in the way that really drives us to new solutions to the issues we face in communities.

Senator HATCH. Mr. Colinvaux?

Mr. COLINVAUX. Certainly all the studies indicate that there would be a decline in giving. I think what I can add to that is that one question is which types of gifts would decline, or which sorts of organizations would decline or see a reduction in their gifts? That might well depend on what the proposal is. So the proposal to cap the value of the deduction means that the more wealthy might give less, but then the charities favored by the more wealthy would probably also receive less, so you would want to know which charities would be affected.

Senator HATCH. Well, thank you. My time is up.

Senator Cardin, we will turn to you.

Senator CARDIN. Thank you, Mr. Chairman. Let me thank the witnesses for their testimony. This is a subject that we really do need to deal with. Whether we are doing it in the most effective way now, a large part of this will depend upon what happens with tax reform, and we all understand that.

But charitable giving and the incentives in the tax code are an important partnership with the private sector to further our mutual goals, and we need to make sure that, whatever we do on tax reform, we do not jeopardize that partnership, so I am sensitive to that. I think there are some areas that are, today, inconsistent with other areas in the code.

For example, for medical expenses, we can adjust the per-mileage deduction that is available on the medical side. We do not have that same authority on the charitable giving, so the use of transportation costs are not treated the same. Whenever you have inconsistencies in the tax code, it causes resentment. Now, we are hopeful we have bipartisan support for changing that, and we hope we will be able to change that.

My question, though, deals with one part of the charitable deductions where I think neighbors think they are not being treated the same as neighbors, and that is on the valuations of gifts that are given. We made some modifications to that a few years back on valuations of gifts that are property gifts rather than cash gifts.

I am wondering whether you have any recommendations as to additional changes that should be made that would add to the integrity of the system without jeopardizing the effectiveness of those deductions for people partnering with the private sector. Who wants to go?

Mr. GALLAGHER. I will take a shot at it. One of the things, when the 990 was reformed a couple of years ago, maybe 3 years ago, one of the things that we are advocating really strongly on is putting the evaluation of the organizations up front and in concrete terms, that is, in addition to the financial disclosures that are in the 990. So I would not be an advocate of trying to parse what is a more effective nonprofit than the other. I think the market takes care of that if you let the market look directly into it.

Senator CARDIN. I guess my question is this: that, when you make gifts of clothing or you make gifts of furniture, you generally get a receipt that you fill in, and you use your own self-evaluation, which is fine. I understand that, and most people, I believe, are treating that with the degree of integrity that it should be treated. But my question is, is that good enough?

Are there ways that we can improve on the consistency, maybe give better guidance to the taxpayer as to what they can fill in so that we can at least assure that two people are being treated similarly in the tax code? I am not sure that is true today. At least, I think the perception is that it is not true.

Dr. STEUERLE. Senator Cardin, in my testimony I testified that I think that there is a serious compliance problem in the non-cash contribution area. The complication I have in giving you details is that I do not think IRS conducts its studies in ways that give you the information you need to solve these problems. For instance, the blank check or the blank slip you get when you donate clothes, it seems to me, invites abuse. And actually, in the long run these types of——

Senator CARDIN. What is the alternative? We do not want to create a huge bureaucracy. These are relatively small dollars.

Dr. STEUERLE. I am not sure. For clothing and household goods, they add up to well more than $10 billion of deductions a year. The average clothing deduction is well in excess of $1,000 by people taking it. The amount of money being deducted here is quite large. So, I mean, I just have some real concerns. In some areas on non-cash gifts, I would actually think about requiring more reporting by the charities. With clothing, that is simply not possible, but there may have to be some severe limits.

One thing I suggest is also going after some of these intermediary organizations. In the clothing area, we all know that we get these calls on the phone, we get these profit-making organizations out there that go to a charity and say, give me your name and I will give you 10 bucks and I will go off to the people. The people go off and give them whatever, hundreds of dollars' worth of clothing that goes to a profit-making thrift store, and the charity gets very little money relative to the revenue cost of government. I think we need some serious studies in this area.

The question of how to get better reporting there, I do not know. There is even a question, I think, of whether you want to fully allow some of these deductions—particularly large deductions, even for things like clothing and household goods—without a statement from the charity if the abuse is that large.

Elder OAKS. Senator, I would like to add, since I urged no modification in the charitable deduction, that I do not feel at all—and I am sure that my fellows do not feel at all—hostile to ideas that would be targeted to improve the administration of the charitable deduction. There are circumstances like my fellow spokesmen have spoken to where undoubtedly we could improve the efficiency of administration of the law and the fairness of the administration of the law in a relative way among taxpayers that would surely not be hostile to the objectives and impact of the charitable deduction.

Senator CARDIN. Thank you.

Thank you, Mr. Chairman.

Senator HATCH. Thank you, Senator Cardin.

Senator Grassley, you are next.

OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Yes. I am going to make a statement instead of asking questions. The purpose of the statement is to set a background for a request of you and Senator Baucus to maybe have a hearing on some nonprofit problems that started maybe 10—well, not 10 years ago, probably 5, 6 years ago.

President Bush's Tax Reform Advisory Panel recommended expanding the charitable deduction to all taxpayers with a 1-percent floor. The Simpson-Bowles Commission also recommended a floor and made it available to all taxpayers, but converted it to a credit. Thus, the various tax reform proposals preserve the incentives for charitable giving in some form.

The President's proposal to cap itemized deductions is not a tax reform proposal. It is a cap on itemized deductions but does not close any loopholes. It just discriminates against higher-income taxpayers. Studies measuring the elasticity of giving indicate that higher-income taxpayers are more sensitive to changes in tax rules. Simply put, the tax increase resulting from limiting itemized deductions, including the deduction for charitable giving, will result just in less money for charity.

Separately, in the context of tax reform, this committee should examine the type of organizations that benefit from incentives for charitable giving regardless of how the incentive is structured. Specifically, we should consider whether it makes sense for donors to receive the same tax benefit for giving, even though the standards for charitable status are very vague.

Mr. Colinvaux proposed severing the ties between charitable deductions and the requirements for tax-exemption. Let me provide an example that might make the case for this proposal. During our tenure as chair and ranking member, Senator Baucus and I worked together to curb the abuses of tax-exempt status and charitable deductions. This ranged from limiting abusive deductions for contributions of vehicles and clothing to applying private foundation rules to certifying certain supporting organizations and donor-advised funds.

However, we did not close all the loopholes regarding supporting organizations, as we were waiting on a study by the Treasury Department. That study is now 4 years overdue, and I wish the Treasury Department would get on the ball and finish that study, or start it if they have not. In the meantime, the recent Solyndra scandal highlights the need for further tax reforms in this area. So I wrote the Treasury Secretary and the IRS Commissioner about the George Kaiser Family Foundation, a key investor in the now-bankrupt Solyndra Solar Energy Company.

Mr. Chairman, I request that this letter be placed in the record.

Senator HATCH. Without objection.

[The letter appears in the appendix on p. 67.]

Senator GRASSLEY. The George Kaiser Family Foundation Organization converted from private foundation status to a supporting organization about 10 years ago. If it had remained a private foundation, it likely would not have been able to invest as much as it did in Solyndra or other private equity and hedge funds it invested in. It also would have been subject to strong restrictions on self-dealing and excise taxes on its investment income.

Most relevant to today's conversation, the donors to the Kaiser Foundation who contributed $1 billion in cash and securities, including non-publicly traded securities over the past 3 years, would have been subject to lower limits for deductibility if it had remained a private foundation.

As some of the testimony today highlights, deductions for donations of cash and publicly traded securities to public charities are limited to 50 percent of adjusted gross income, 30 percent for other non-cash donations. These percentages drop to 30 and 20 percent if the donations are to a private foundation. So with Solyndra, the government did not just lose out on its investment through the $535-million loan guarantee, it also lost out on the tremendous subsidy it provided the George Kaiser Family Foundation through charitable deductions.

Separately, our review of yesteryears of donors' advice funds and university endowments showed that, since the last major overhaul of tax-exemption rules in 1969, there has been an explosion in asset accumulating public charities that are not subject to payout requirements or other private foundation rules.

So as a result, Mr. Chairman and Senator Hatch, as you continue to schedule tax reform hearings, I would ask that you schedule one to examine the standards for tax-exemption and the increasingly blurred line between public charities and private foundations.

I do not expect an answer on that now, but I would like to have both of you give it serious consideration.

Senator HATCH. We surely will.

Senator Carper?

Senator CARPER. Thank you, Senator Hatch.

Gentlemen, welcome. Thanks for joining us today. Thanks for your testimony. As you know, a number of proposals have been suggested for reforming our tax code, including the charitable deduction. In particular, I want to focus on two of those as they pertain to your testimony today.

One of the recommendations comes from the President's Fiscal Commission, co-chaired by Erskine Bowles and former Senator Alan Simpson, and they recommended replacing the deduction with a 12-percent non-refundable tax credit, provided that the taxpayer donated, I believe, more than 2 percent of their income.

The President proposed a different approach in his budget for the current fiscal year. In his proposal, he proposed limiting the itemized deductions, I believe, to something like 28 percent, not 35 percent, for couples earning more than $250,000.

My colleagues have heard me say this here a couple of times. Whenever I look at proposed changes in the tax code, I look at them through a prism of four questions, and I am just going to mention those questions briefly. I am going to ask you, using those four questions, or prism, if you will, how would you evaluate the two proposals, one from the Fiscal Commission and the other from the President's budget?

The first of the four questions that I ask is, will a particular reform proposal encourage economic growth and provide a more nurturing environment for job creation? The second question is, will it be fiscally responsible and provide for certainty and predictability that families and businesses can use and need to plan? The third one is, is the proposal fair? And the last one is, does the proposal make the tax code simpler or more complex? Those are the four questions that I ask.

The changes to charitable deductions touch on, I think, several of those issues on the basis of the questions that I have just outlined. I would like to ask each of you to compare for us, if you could, the Fiscal Commission's proposals and the President's fiscal year 2012 budget proposal.

And, if each of you is making a recommendation to the Joint Select Committee on Deficit Reduction, which plan would you be more likely to recommend given the prism of those four questions? All right. That is a pretty long question. I do not know if you all want to take a shot at it. If you do, that would be great. If you do not, we will bring a new panel in. [Laughter.]

Would you go first, please, sir?

Mr. SAMMARTINO. I am afraid I will have to sidestep the recommendations.

Senator CARPER. All right. That is fine.

Mr. SAMMARTINO. CBO is not in that business.

In looking at the options we considered, we did look at the possibility of converting the deduction to a 15-percent credit with a 2-percent-of-AGI floor, which is close to the 12-percent proposal.

I mean, we did find that it would lower both contributions and the tax subsidy, so as far as the effect on the economy, you have two offsetting—you have less money going to the charitable sector, but you also have reduced government tax expenditures that reduce the deficit, so you sort of have competing horses there.

In terms of fairness, I think there are a couple of things to consider in moving from the current deduction to some kind of uniform credit. In the current deduction, the higher-income taxpayers receive a larger subsidy per dollar of giving because it is based on the marginal tax rate. There are just a couple of issues to consider there.

One is, if you do think that higher-income taxpayers are more responsive to changes in the price of charitable contributions, then it could be efficient to have a higher subsidy for them, although I have to say the evidence we looked at on that is inconclusive that they are actually more responsive. Not in terms of giving more, I mean, obviously they give more, but a lot of that is related to having higher income.

But it is just whether they respond more to the price incentive than other taxpayers. If you think that is true, then you could be more efficient in giving a greater subsidy to high-income people. You are leveraging the tax dollars you are granting more.

But, if you do not know or you are not sure that it is true, then maybe a uniform credit, where it is either 12 percent or 25 percent or whatever, is the more efficient way to do it because, if you do not know that higher-income people are more responsive to changing the after-tax price of giving, then you are not sure that you want to do that.

The other question about fairness is, as we point out in our study, because higher-income people have higher tax rates and they get a greater benefit for each dollar deducted, more of the benefits from the charitable deduction go to them. But, in the overall question of whether or how that affects tax progressivity, I think you would really have to look at the whole tax system.

So you should be cognizant of what different pieces are doing, but if you thought, well, this benefit to higher-income people is lowering their taxes, there are other pieces of the tax code that can sort of undo that so you get the desired amount of progressivity that you are after. So it is not very dispositive that, just because they benefit more from this in some way, it affects the overall progressivity of the tax system.

Senator CARPER. All right.

Mr. Chairman, my time has expired. If you would like, I can ask the other panelists to respond in writing. Would that be your preference?

Senator HATCH. That would be fine.

Senator CARPER. All right. Thank you very much.

Mr. SAMMARTINO. Sorry.

Senator CARPER. That is all right. Thanks.

Senator HATCH. In fact, we will open it up to all panelists. If you care to add to your statements and care to add to this issue, we would love to receive your writings, because this is an important issue, or set of issues, I think would be a better way of saying it. We would love to have your expertise.

Senator Thune, you are next.

Senator THUNE. Thank you, Mr. Chairman.

Senator HATCH. I am going to return. I will be right back.

Senator THUNE. All right. It is an important subject, and there is no question in my mind that the current tax deduction for charitable giving is one of the most important, if not the most important, incentive that we have in the tax code today.

So I am someone who believes we certainly ought to look at and examine various reforms that may be proposed to the charitable deduction in the context of comprehensive tax reform, but I am hopeful that, when we do that, we remain mindful of how incredibly important charitable contributions are to religious organizations and other organizations out there who are caring for people in need all across the country.

In my State of South Dakota, we have had record flooding this summer. It has affected thousands of individuals. As a result, we have seen neighbors helping neighbors, we have seen churches and charitable groups playing an essential role. These are the very groups that could be negatively impacted by efforts to lessen incentives for charitable giving.

I do not believe that we should consider proposals to limit the charitable deduction outside of a comprehensive tax reform effort and simply as a means to raise revenue to pay for more spending. That appears to me to be what this administration has proposed. They believe that if you eliminate the deduction for Americans in the 33- and 35-percent tax brackets, that that somehow is a good thing.

My fear, of course, is that charities are going to bear the brunt of the collateral damage that is created by a lot of these new taxes, and that seems to be something that has been missed by those who are advancing these proposals. I think the large majority of my colleagues agree with me that—none of them are here, obviously, at the moment. [Laughter.]

But they agree with me that it is important that we not impair the ability of charities to do the things that they are doing out there. I offered an amendment to the 2010 budget resolution to protect the charitable deduction, and it passed by a vote of 94:3. Yet in spite of that, we see these repeated attempts by the administration to try to put these deductions in play, and I think we ought to be looking at ways that we can provide incentives for charitable giving and make it more effective in the context of tax reform, if we ever get to that point.

Just a couple of questions, if I might. This would be for any and all panelists here today. The Joint Committee on Taxation report on charitable giving prepared in advance of this hearing indicates that charitable organizations provide goods and services that the government would otherwise provide.

In the absence of charitable gifts, such goods and services would have to be provided by the government at full cost to the taxpayers. Have any of the proposals to alter the charitable deduction taken into consideration the added cost to taxpayers of providing the programs and services that nonprofits would no longer be able to afford to provide because of the reduced charitable giving? Does anybody care to take a shot at that one? Perhaps from CBO?

Mr. GALLAGHER. No, go ahead.

Mr. SAMMARTINO. We did not look at that in our review.

Mr. GALLAGHER. But I think it is fair to say that every proposal that has been floated the last couple of years is going to make the system more complex. It is going to make it more complex to administer. There have been lots of studies done in terms of the efficiency and the cost difference between providing services at a local level privately versus centrally, and you need both. But everything that we have seen adds complexity. All the proposals, in our view, add complexity to the system.

Dr. STEUERLE. Senator, part of the problem is that the charitable sector and the government sector are not exactly the same, even though they both are aimed at serving the public good. Sometimes they are substitutes.

Senator THUNE. Right.

Dr. STEUERLE. Sometimes they are complements. I mean, a great many charitable activities are financed by government, and a great many of the things government does have come about because of advocacy by the charitable sector. At times, they are adversaries. So they fill all these roles.

The only thing I would say, again, in the context of the much broader budget reforms taking place, is that all the other changes that are going to be taking place in these next few years, as we try to tackle these very large deficits, are going to have large impacts on charities. In fact, the grants to charities probably are an even bigger area than are the deductions. So we have to, in some way or another, try to figure out how to think holistically about these issues, and not just one at a time.

Elder OAKS. As we think holistically about them, I urge that we remember that this is not just a financial issue, but, as I noted in my earlier testimony, the role of the volunteer whose efforts are not measured on financial reports is very important. If we cut into the charitable deduction and cut into the activities of charitable organizations, the role of the volunteer who is scooping soup at the soup kitchen or going to help recover neighborhoods in the Gulf Coast is going to be decreased.

I think we can anticipate that the government, whatever functions it presumes to provide in lieu of the charitable sector, is going to call forth a great deal less from volunteers than the charitable organizations would call forth.

Mr. GALLAGHER. And, Senator, if I could add to that, there are United Ways now in 41 countries around the world. We are directly counseling the Chinese government, the British government, the French government, in terms of, what could you put in your tax code to create this kind of private initiative, not just money, but people getting involved.

A couple of months ago I was with Nick Hurd, who is the Minister of Civil Society for the U.K., and one of the proposals that we have looked at here in the U.S. is a 15-percent tax credit that would go to the charity. It is in play in the U.K. right now. So, Minister Hurd is saying to us, it is not working for us. It is too complex. People do not know how to use it. We are trying to get more private citizens involved in trying to deal with social issues, so it is not just an economic issue.

This is a part of keeping private initiative in our communities to make sure that we have folks working together with government, with business, and trying to solve their own problems. That the rest of the world is trying to put this into their tax code, and we are considering how to roll it out, is incredibly ironic.

Senator THUNE. Yes. Well, I think you would never want to get to where you just say, we will let the government do it. I mean, I think you want to have people who are motivated to help other people. I think these incentives have played an important role in encouraging that kind of behavior.

May I ask one more question, Mr. Chairman?

Senator HATCH. Sure. Go ahead.

Senator THUNE. All right. I am interested, too. There is a group called The Independent Sector, and they have indicated that there are nonprofit organizations out there that employ literally 1 in 10 workers in the United States and pay $670 billion in annual wages and benefits. In South Dakota, we have, believe it or not, over 7,000 nonprofit organizations that employ nearly 40,000 workers. So I believe that we are concerned about a near-record unemployment rate, and we want to enact policies that help create jobs and not create even higher unemployment.

So given that, has there been any analysis conducted as to how the administration's itemized deduction limitation might impact the 13 million jobs currently provided by the nonprofit sector? Has anybody done any analysis on that? Has CBO looked at that side of it? No? All right. Well, it seems to me, at least, that would be something you would want to take into consideration as well.

So you have a lot of people who are employed. My guess is, if we were to make this change in tax policy and you saw a reduction in the amount that people are giving to charitable organizations and nonprofit organizations, that it would certainly impact employment in those organizations as well.

Mr. GALLAGHER. Let me just say, in the area of social services, daycare services, shelters, and so forth, the vast majority of the budget is people. You know, you are not selling cars, you are not selling widgets, you are selling human services, and so there is a direct correlation between reduced funding or increased funding and more product, and product is people. So anecdotally, we are the largest private funder of human services in the country, at $3.9 billion. As our revenue goes down, our allocation to nonprofit agencies goes down, and where they get their cost is people. That is where you take cost out of a nonprofit.

Senator THUNE. Thank you all very much.

Thank you, Mr. Chairman.

Senator HATCH. Well, thank you, Senator Thune.

Elder Oaks, you have your two colleagues here as well. As I understand it, in humanitarian assistance all over the world, The Church of Jesus Christ of Latter-day Saints and Catholic Charities in particular combine to help countries all over the world that have disasters, natural disasters. Am I right about that?

Elder OAKS. Oh, you certainly are. I think that would be an appropriate question for Bishop Senior to respond to further, as he has had an intimate role in Catholic Charities, if I could hand the microphone to him.

Senator HATCH. That would be fine. Bishop, we are glad to have you here and would love to hear your viewpoint on this.

Bishop SENIOR. Thank you very much, Senator, and Senator Thune as well. It is an honor to be here with Elder Oaks as well.

Yes, Catholic Relief Services from the United States, from the Catholic Church in the United States, does serve countries and people who have been victims of disasters all over the world. Here in the United States, it is predominantly through Catholic Charities agencies and the Catholic community in each diocese throughout our country.

Ourselves, in southeastern Pennsylvania, the Archdiocese of Philadelphia, the five counties of southeastern Pennsylvania, including the city of Philadelphia, we are an integral part of the social service, health care, and also educational system in our region, particularly in the city, providing services to literally tens of thousands of people without regard to faith, and that is certainly true in our services in other parts of the world as well.

But the municipalities, particularly in Philadelphia, are dependent upon the church as a partner and in some cases would not be able to absorb the cost, particularly in education, were we to close all of our 150 Catholic elementary schools in the Archdiocese of Philadelphia, or our 17 secondary schools. And we fund that almost completely with charitable dollars and provide a cost-effective, very, very high-quality service of education with charitable funding.

We are dependent upon also—as was noted in your remarks and several others'—the smaller donor, the Catholic family or people of all faiths who assist us and support that, support those who are not itemizers. While the Catholic Conference of Bishops has not really gotten involved too much in tax code issues, we certainly want to speak out when there could be a change in the tax code that could affect our ability to continue to provide the services that our mission requires of us.

So this is an instance where we really do believe that a significant change which would reduce the incentives to contribute, could affect the mission and would affect cities like Philadelphia because it would impede the Catholic Church's ability to assist the community, especially those most in need, in education, in health care, and in social services. Thank you so much, Senator.

Senator HATCH. Well, you are the largest denomination in our country. The LDS church, The Church of Jesus Christ of Latter-day Saints, is the fourth-largest. I have seen the two faiths all over the world, irregardless of membership, help with major disasters everywhere. Elder Oaks mentioned helping in Katrina, regardless of different things, or denominations, or no faith at all. I think we ought to continue to do that.

Elder Oaks, do you have anything to add to that?

Elder OAKS. No. I think the Bishop has spoken eloquently to an individual example of a general principle that reaches into every community in our country and across our borders in many places. I know that our own charitable work is smaller than that of the Catholic Church, but nevertheless significant. We are typically cooperative with organizations overseas as we say, such as Catholic Charities or Red Crescent, the local equivalent of the Red Cross, and so on. It is a worldwide ministry that is affected by the tax code in the United States.

Senator HATCH. Well, Elder Oaks, many people do not realize that the religious community does more than just perform worship services. Religious organizations provide food, they provide shelter for the homeless, they support the unemployed, give relief for victims of natural disasters, and many other services. Now, you have had many years of experience working within your faith, the LDS church.

Now, you have also worked extensively with people of other denominations and faiths. Just give us your insights into the charitable works of religious organizations generally, not just the LDS church, and please explain the importance of the individual donor to the continuation of these policies. Now, you have done that to a degree, but give us a little bit more if you can.

Elder OAKS. The individual donor, even below a floor of donation, is immensely important not just for the money that is funneled into a charitable organization, but for the commitment that an individual makes of their personal time when they have sent their dollars on to a particular effort. The work of volunteers is immensely important in my church, and I know from our cooperative efforts that it is very important in others.

I urge, just as I did earlier in response to Senator Thune's question, that we not overlook the impact on the individual and those off-balance-sheet figures which do not get considered in connection with financial calculations but are immensely important to the individual who is being helped in ways that my fellow panelists have identified. That is a very important part of this picture, and yet it is one that is very hard to quantify.

The law is not only an enforcement mechanism, it is a teaching instrument. If the charitable deduction is modified in substance, not in refinement of details such as valuation and so on, but if it is modified in substance, that will be understood as a teaching message by the Government of the United States to its citizens generally that the private sector and charitable works are less important in our picture, and that the government is assuming this function. It is that message that I speak against.

Senator HATCH. Well, thank you.

Mr. Gallagher, in your testimony you said that 46 million Americans are living in poverty. In my own home State of Utah, the Gospel Rescue Mission of Salt Lake City wrote to me and said, "The demand for food and clothing has increased 30 percent." They are serving 14,000 meals each month. That is an all-time high for this one small organization. They are seeing more homeless families and homeless single women with children. On top of all this, fundraising has declined.

The Gospel Rescue Mission receives no government money and relies entirely on individual donations. Now, you said in your testimony that a mere 2.5-percent reduction in charitable donations would result in 1.3 million fewer times that a United Way could provide services to people in need.

Now, we hear about the reduction in donations in dollar terms, but these reductions mean that millions of people in need will lose assistance. Now, has the experience of your local United Way affiliates been similar to that of the Gospel Rescue Mission in my home State of Utah?

Mr. GALLAGHER. It has, Senator. We run a 3-digit phone service, 211, that allows people to call for assistance in their communities, and it is all across America. Last year there were over 16 million calls, and the call volume was up 15 percent. The calls are for exactly what you just cited. It is food, it is heating oil, it is shelter, it is basic need.

As the poverty rate went up—and it is not just people technically living in poverty; it is people living on the edge of poverty and working a couple of jobs, but still struggling with food, clothing, daycare. The numbers are up dramatically all across the country.

Senator HATCH. In your testimony you said that the United Way receives gifts of all sizes, from $10 to $10,000 and more. Now, the charitable deduction is an important incentive for all givers, and the deduction is based on every dollar given.

Now, there are proposals to cap, as you can see, the charitable deduction. There also are proposals to place a floor on the deduction. Now, these proposals would not allow a deduction for charitable giving until annual giving exceeds either a fixed amount, such as $1,000, or 2 percent of income. Now, all of these proposals, according to the experts, would cause a drop in charitable donations.

Now, in your experience, how much of an incentive is the charitable deduction for donors who give large amounts, and how much of an incentive is the charitable deduction for donors who give small amounts?

Mr. GALLAGHER. Let me put it in context. Again, there are 10 million individual donors to United Way in the U.S. Five hundred have given $1 million or more, 26,000 a year give $10,000 or more, but 93 percent of the 10 million, their average contribution is $290 a year. Clearly, the cap at 28 percent is going to affect the high-end donor.

One of the myths that is being, I think, bantered about in this is that wealthy people give to only the symphony and art museums and so forth. Those 26,000 people give $500 million a year to United Way, and that is going to human services. So a top-end cap would definitely affect it. The floor—our estimate would be that is where you would feel that most, and I kind of think we are being a little cavalier about the floor as well because it is going to affect giving.

If you are in lower cost of living communities like Utah, like South Dakota, like places I have worked, Reading, PA, Winston-Salem, NC, and let us say you are making $40,000 a year as a household, you own a home, you are itemizing. You decide to give 2 percent of your income to charity. That is $800. You are below the floor, and you do not get that anymore.

The other thing that concerns us about the floor is that it puts the charitable incentive into political play as it relates to revenue. It is going to be much easier to raise the floor in years out, much easier to bring the cap down a little more. It puts it into political play. But there is no question in our mind that a floor would have an impact negatively on giving to that average donor.

Senator HATCH. Elder Oaks, in my faith, we are asked to give 10 percent of our gross income for tithing.

Mr. GALLAGHER. Right.

Senator HATCH. In addition, we have other donations: perpetual education fund, we have a welfare fund, we have all kinds of opportunities to give and to participate.

The Church of Jesus Christ of Latter-day Saints is, to my knowledge, just about the only church that has a completely unpaid ministry and missionary system on the base level. So people volunteer to serve, are called to serve in various positions, which of course helps that particular—our particular—religion to be able to do even more from a charitable standpoint.

But let me just ask this of both you and Elder Oaks. I will start with you. I have a question. I have been sitting here thinking about charitable donations to the arts. We hear criticism of the charitable deduction for donations to the arts, like museums and the opera, symphonies, et cetera.

But current law allows entities organized in the United States with an educational, religious, scientific, social welfare, animal welfare, or health-focused mission to receive tax-deductible contributions. Now, this broad definition of charitable purpose allows people to form a wide variety of groups based on a common goal with the intent to serve a public good.

Now, as a result, educational institutions—museums, orchestras, and many others—may receive tax-deductible donations. Congress wisely has chosen not to prefer one charitable activity over another. The *New York Times* recently published a story about a program for Alzheimer's patients at the Metropolitan Museum of Art that is helping patients to cope with that sad and debilitating disease. There are numerous stories about the importance of arts and music in helping the under-privileged, for instance.

I, myself, as a young kid growing up in a not very well-to-do family, was helped in these areas. Of course, music has always been very important to me personally. But not just that, all of these have been. I would like you both to share with the committee your experience with the importance of the arts and the significance of the charitable deduction in funding the arts.

In your case, Elder Oaks, you were president of Brigham Young University, one of the largest private institutions in this country, or at least colleges or universities in this country. How would it be affected? But if you would cover the arts and any other matters you care to cover, I would appreciate that.

I am not trying to foreclose the other witnesses from weighing in either, if you feel like you should. So I would be glad to have you comment.

Mr. GALLAGHER. Let me say, Senator Hatch, that it would be my view that a tax incentive that incents the common good makes the most sense, and that I find it at times a slippery slope when we start trying to parse too directly the differences between nonprofits.

To take your example, as long as everyone is operating within the letter of the law and there is compliance and you are operating as a nonprofit, then the arts have been a huge part of community development and the common good, as have museums. The direct examples I have seen, when you are trying to get to a young person who does not have the advantages of, say, others with more wealth, more income in their family, the way you get to that child is through his or her interest.

Sometimes it is sports, sometimes it is art, sometimes it is music. I have seen some incredible arts organizations not just deliver their mission, I think appropriately in a nonprofit way, in a tax-exempt way just in the arts specifically, but I have seen it in human development. I have seen the cross-over between arts and human services.

The other thing that I would say—and I cannot make this point more strongly—is that the beauty of our system, in terms of a tax incentive for charitable giving, is that it is simple, it is concrete, it is easily understood. As soon as we start putting more and more layers into it in terms of definition and floors and separating donors from each other, you get more complex. What governments around the world have found is, the more complexity they have in their systems, the less private initiative there is.

A last point on volunteers. The reason that charitable giving and private sector delivery of service is so efficient is that volunteers follow the money, and so you are leveraging somebody's contribution. To your point, you are not paying folks who are delivering service along with charitable contributions. We need government, there is no question, but private sector initiatives are an efficient way to do it, and arts organizations are, I think in my view, a big part of community development.

Senator HATCH. Elder Oaks?

Elder OAKS. Thank you. I endorse what Mr. Gallagher has said wholeheartedly. I simply add that, on the basis of my experience at Brigham Young University and in public broadcasting, I know that, without the charitable donations, arts organizations would suffer disproportionately in the charitable sector. Another point to be made is, let us not get government into the decision of which charitable organizations are to be promoted and which are not. That ought to be made in what has been referred to as "the marketplace of donations."

Finally, I would like to invite Dean Moore to add to this point, if he would. He is dean of the Southern Baptist Theological Seminary.

Senator HATCH. We would be happy to hear from you, Dean.

Dean MOORE. Thank you, Elder Oaks.

I would reiterate what Elder Oaks and Mr. Gallagher and others said earlier as it relates to giving to arts and giving to charitable organizations. This is not simply about economic impact, it has to do with what it means to form a citizenry that understands what persons are for, that we are not simply economic units.

So giving to the arts, giving to religious organizations, giving to charitable organizations, really can serve as a workshop of compassion in demonstrating to our fellow citizens that this is not simply a matter of raw power, but that we have obligations to one another, not simply at the bureaucratic level of government, but as members of a civil society.

So, when a person is either directed in giving to the arts and empowering a disadvantaged young person to sense something transcendent in art, or when someone is giving to charities that take care of orphans or widows or clean up after hurricanes, that is not simply about the impact on those situations themselves, it also is a signal and a building block of the fabric for the next generation that teaches and shows that there are things more important than simply the abundance of our possessions. I think that is critical, whatever our political differences, whatever our religious differences, to the common good as people of the United States of America.

Senator HATCH. Thank you so much.

Dr. STEUERLE. Senator, may I just add a footnote here?

Senator HATCH. Yes, sir.

Dr. STEUERLE. In my testimony—I did not read all of it—I also talked about government funding of acts of generosity. It promotes many good things: a general spirit of giving and a development of mediating institutions that goes beyond just the recipient. So I strongly agree with these comments of your last three speakers as to the importance of the signal that Congress sends.

The only footnote I would add, when we start talking about floors and ceilings, is that we already have a lot of them. We have a lot of ceilings. We have a 50-percent ceiling, we have a 30-percent ceiling, we have a 20-percent ceiling. You can play with those to try to find ways to send a better signal. As to a floor, we already have a major floor that applies to most taxpayers, which is the standard deduction.

So most taxpayers—including the $40,000-a-year household that Mr. Gallagher talked about that probably is taking the standard deduction—do not have any incentive. So one can think about changing one floor for the other, one ceiling for the other, in ways that strengthen the signal. So I just encourage you to think that, yes, the signal is very important, but the status quo may not be necessarily the best way of providing that signal.

Senator HATCH. Mr. Gallagher?

Mr. GALLAGHER. I would just say that, again, having worked in communities where you can earn $40,000 as a household and buy a home, it means that you are itemizing. Many folks are not just taking the standard deduction. There is, I think——

Dr. STEUERLE. I am suggesting exchanging one floor for another. You can think about a floor, like a 1-percent floor under giving, as an exchange for a non-itemizer deduction. That I think, would increase giving at all levels.

Mr. COLINVAUX. Could I add a couple of quick thoughts, Senator?

Senator HATCH. Sure.

Mr. COLINVAUX. One thing I wanted to emphasize, because I do not know that I have heard it said yet, is that, when thinking about the charitable deduction, I think it is important to put it into context as one source of support for the section 501(c)(3) sector. It is by no means the most significant source of support, so, when you look at hospitals, when you look at universities and colleges, they get most of their support from program service revenue, that is, fees for tuition or for health care. Private giving represents a fairly small portion of that support. Also, for——

Senator HATCH. I would bet a lot of them would not do very well if they did not have the private giving.

Mr. COLINVAUX. That may be right, Senator. I think the point I am trying to make is that, when we talk about changes to the charitable deduction, and we talk about our concern of the impact it would have on the section 501(c)(3) sector, I think we also need to be mindful of the other supports, including direct government spending through grants. So, many of the basic needs organizations that we have talked about rely more on direct grants from government than they do on private contribution. So there is a mix of funding going on there.

May I just make one other—sorry.

Senator HATCH. Sure. Go ahead.

Mr. COLINVAUX. The other point I wanted to raise, because I believe it is an important one, is that I echo much of what I have heard, that the point of the charitable deduction in supporting the section 501(c)(3) sector is to generate government policy encouraging altruism, encouraging pluralism, encouraging evolution of ideas of what it means to be a charity.

That is, to a certain extent, what our current system is, and those are all very positive symbols. But on the other hand, there is, I think, a risk of negative symbols that also we need to be mindful of, which can occur at the exemption level.

So, when you have a large and growing sector that may not be effectively overseen or when you have the public questioning the public benefit of some charitable organizations, that can have negative spill-over effects that affect the image and the symbols of continuing the deduction and of continuing with exemption law as it is today.

Senator HATCH. Well, at least for that organization.

Elder Oaks?

Elder OAKS. What Mr. Colinvaux says about the other support of the private sector from government is of course very true and very significant, but we need to remember that the support that comes as charitable deduction comes without strings and controls, and it is, therefore, immensely and uniquely important to the charitable sector, whereas the government support is necessarily accompanied by restrictions and controls.

Senator HATCH. Well, this has been a really interesting panel as far as I am concerned, and I think others as well. I hope we can work our way through this so that we do not damage the charities throughout this country, especially religious freedom and all the good that religious entities do for our society.

But I personally have appreciated all the testimony of each and every one of you. I am sorry I have kept it going so long, but I just want you to know this is a very important hearing in my eyes, and I think in yours as well. So I want to personally express my gratitude on behalf of this committee to each and every one of you, and with that we will recess until further notice.

[Whereupon, at 11:54 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding Nonprofits and Charitable Giving

Henry David Thoreau wrote, "Goodness is the only investment that never fails."

Nonprofit organizations invest in our communities. They deliver essential services and benefits to those most in need. And they play a key role creating jobs and improving our economy. Nonprofits employ ten percent of the U.S. workforce. Many are small employers. Nonprofits in my home state employ 40,000 Montanans.

And in these tough economic times, the role of nonprofits becomes even more important. Donations are up four percent this year compared to 2009, but giving levels are still far below where they were before the 2008 economic downturn.

At the same time, unemployment and increased homelessness are causing more people to rely on these organizations. Nonprofits are being forced to do more with less.

These organizations are particularly important to America's rural communities. That's why I worked with Montana nonprofits and foundations in 2006 on a larger, long-term effort to diversify support for rural and frontier communities.

Rural philanthropy fuels economic, infrastructure and human resource needs by encouraging nonprofit partnerships. Local nonprofits are able to partner with schools, businesses, and government agencies to deliver results.

These partners rely on the benefits of the charitable tax deduction, which is why we must ensure the deduction is fair and effective.

The foundation of tax-exempt organizations is based on a relationship of trust. Citizens and businesses invest energy and hard-earned money in nonprofits because they believe in their mission. In return, we ask that they fill a unique space that government and the private sector do not occupy.

It is the obligation of this Committee to ensure that nonprofits uphold their commitment, and it is our duty to make sure the tax code encourages charitable donations in the most efficient way possible.

Most Americans aren't able to receive tax benefits from the charitable deduction since they don't itemize. Less than one-third of taxpayers itemized their deductions last year. Out of these folks who do itemize, 86 percent claimed the charitable deduction, but only 27 percent of all Americans claimed the deduction.

People with different income levels tend to give to different types of charities. Higher-income households give more often to health organizations, while lower-income families statistically donate more to religious or basic-need charities. This results in the tax code giving large subsidies to some charities and smaller subsidies to others.

The nonprofit sector predates the U.S. tax code. Our nation's early settlers formed charitable and voluntary associations with their neighbors to get things done.

Americans have always valued these traditions of volunteerism, philanthropy and community. For these reasons, the charitable deduction and nonprofit exemption were incorporated into our tax code. Today's nonprofit organizations help to carry on these values. Their work helps improve all of our communities.

One organization that exemplifies these values is the Montana Nonprofit Association. Last month they celebrated their 10th anniversary.

Their members have helped improve Montana on so many fronts – education, health and human services, arts and culture, religious and spiritual development, environmental protection, economic and workforce development and more.

This anniversary commemorates years of hard work, civic engagement and a social contract in the state of Montana. I would like to take a moment to congratulate those members and thank them for their service to Montana.

So let us remember the wisdom of Henry David Thoreau: That goodness is an investment that never fails. Let us invest in our communities. Let us encourage charitable giving in a way that is fair and efficient. Let us ensure benefits get to the folks in need. And let us continue to make sure nonprofits have the resources they need to continue their good work.

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Testimony Before the Senate Finance Committee

"Tax Reform Options: Incentives for Charitable Giving"

October 18, 2011

Statement of Roger Colinvaux[1]

Mr. Chairman, Mr. Ranking Member, Members of the Committee, thank you for inviting me to testify before you today about the charitable deduction. Thank you also for holding this hearing. The relationship between government and the nonprofit sector is in need of a critical look, and I commend your ongoing efforts to focus on this issue, among the many others that you face.

As you know, the charitable contribution deduction is a longstanding feature of the federal tax law. Enacted in 1917, four years after the income tax, it has become an embedded part of tax policy and of the landscape for many nonprofit organizations and the giving public. It is also one of the principal tax expenditures. The Joint Committee on Taxation estimates the five-year cost of the tax expenditure as $246.1 billion.[2] Of that number $25.3 billion is for health, $33.3 billion is for education, and the remaining $187.5 billion covers other purposes.[3]

My testimony is intended to provide a framework for thinking about the role of the charitable deduction in the federal income tax. As you decide whether to make changes to the deduction, I think it is important that you consider the following questions. (1) What are the existing characteristics and policy tenets of the charitable deduction? (2) In practical terms, how are the benefits of the charitable deduction allocated? (3) In more theoretical or policy terms, what is the charitable deduction for and is the theory of the deduction consistent with our expectations? And finally, (4) how do existing proposals to change the deduction fit into the current law framework?

A. Existing Structure and Policy Tenets of the Charitable Deduction.

As you know, the charitable deduction is an itemized deduction. As such, it is not used by the roughly 70 percent of taxpayers who claim the standard deduction, many of whom nonetheless make charitable contributions.

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[1] Associate Professor, Columbus School of Law, The Catholic University of America.

[2] Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014, Dec. 15, 2010.

[3] It should be noted as well that the charitable deduction is but one of several governmental supports for the nonprofit sector. Tax exemption under section 501(c)(3) of the Code and eligibility to receive tax-exempt financing are two other federal tax benefits. In addition, many local and State tax benefits flow from preferred federal tax status, as well as some nontax benefits. A charitable deduction also exists for estate and gift tax purposes.

The charitable deduction is subject to a cap, but the cap is based on a high percentage of adjusted gross income (e.g., 50 percent of AGI for cash gifts to a public charity)[4] and so does not affect most taxpayers.

The charitable deduction is available for the first dollar of charitable contributions, meaning it is not subject to a floor before the deduction is allowed. As a general matter, the absence of a floor is consistent with some itemized deductions (e.g., the deductions for mortgage interest, and state and local taxes) but unlike others (e.g., the deductions for casualty losses, medical expenses, and miscellaneous itemized deductions).

The charitable deduction generally is allowed at fair market value for contributions of cash or property. Cash gifts present little difficulty, either as a matter of policy or practice (apart from substantiation). The deduction rules for property, however, are complex, difficult to administer, prone to abuse (especially on valuation questions), and allow taxpayers with appreciated assets to avoid taxation on the appreciation.

The charitable deduction requires a qualified organization as a recipient, i.e., gifts to individuals, even if charitable in nature, are not eligible.[5]

The charitable deduction is closely linked to, and generally follows the standards for, tax-exempt status under section 501(c)(3). As a practical and legal matter, this means that two different tax benefits – income tax exemption and eligibility to receive deductible contributions – are subject to the same definitional standard, notwithstanding that the policy basis underlying the two benefits may not be identical. It also means that the scope (and cost) of the benefit for deductible contributions is dependent on the scope of the benefit for tax-exemption. Thus, a broad definition of tax exemption under section 501(c)(3) means a broad pool of organizations eligible to receive deductible contributions.

The definition of a section 501(c)(3) organization is based on an organization's purposes, and is broad. Section 501(c)(3) describes a qualifying organization as one organized and operated for charitable, religious, educational, scientific, and other purposes. The law does not require outcomes or base continuing exemption on quantifiable measures. Typically, organizations apply for section 501(c)(3) status at the outset of existence, secure the status based on promises about the future, and are subsequently evaluated (if at all) for exemption purposes on a vague purpose-based inquiry and not on the effectiveness of the organization.

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[4] The cap is lower for gifts to private foundations (30 percent of AGI) and for gifts of capital gain property (30 percent of AGI if to a public charity, 20 percent of AGI if to a private foundation). Charitable contributions by corporations are subject to a cap roughly equal to 10 percent of the corporation's taxable income.

[5] Although an organization requirement is sensible, even essential for administrative reasons, it means that government-supported charitable giving is dependent upon the presence of organizations.

The charitable deduction, following section 501(c)(3), generally does not distinguish among qualifying purposes. In other words, all section 501(c)(3) purposes are equally eligible for government support through the charitable deduction.[6]

Although section 501(c)(3) purposes generally are treated equally for charitable deduction purposes, not all section 501(c)(3) organizations are on equal footing. Rather, the charitable deduction disfavors private foundations, and now certain "hybrid" organizations such as donor-advised funds and supporting organizations, relative to other section 501(c)(3) organizations.[7]

Summing up, the charitable deduction is an itemized deduction, with a high cap and no floor, is allowed for contributions of cash and noncash property, disfavors some organizations relative to others (but not on purpose grounds), and relies on standards for tax-exempt status under section 501(c)(3) to define its scope.

B. Who Benefits From the Deduction?

(i) <u>The Section 501(c)(3) sector</u>. Section 501(c)(3) organizations are the main recipients of deductible contributions.[8] Variously referred to as the "nonprofit sector," the "independent sector," or the "charitable sector," none of these names are apt. "Nonprofit sector" is too broad – there are many nonprofit tax-exempt organizations other than section 501(c)(3) organizations. "Independent sector" denotes an independence or separateness from government that is an important trait, but also belies the dependence of the sector on government support. "Charitable sector" is too narrow – section 501(c)(3) confers status on religious, educational, scientific, and other generally noncharitable organizations. Thus, the technical but accurate "section 501(c)(3) sector" is a better label, if only because it forces us to ask more directly what it is we are talking about when we talk about the charitable deduction.

The section 501(c)(3) sector includes over 1.1 million organizations, with revenues of approximately $1.4 trillion.[9] The value of assets held by section 501(c)(3)

[6] That said, the charitable deduction rules do favor certain types of property, for example, food inventory, for use by the donee organization in performance of its exempt function. Exempt-use property as a category also is favored.
[7] For example, gifts to private foundations are subject to a lower percentage limitation than gifts to public charities. In addition, gifts to donor-advised funds, supporting organizations, and private foundations are not eligible for the special rule allowing tax-free transfers from individual retirement accounts notwithstanding the percentage limitations.
[8] Other eligible recipients include government entities (if the gift is exclusively for public purposes), certain veterans organizations, fraternal organizations, and cemetery companies.
[9] Molly F. Sherlock & Jane G. Gravelle, Cong. Research Serv., R40919, An Overview of the Nonprofit and Charitable Sector 3, 9-12 (2009) (reporting as of July 2009). This figure does not include organizations that do not file an exemption application with the IRS, which could number in the hundreds of thousands (e.g., churches, other qualifying religious organizations, and very small organizations). Approximately 116,000 million organizations are private foundations. *Id.* at 9-12. The revenue number does not include organizations that do not report to the IRS on the annual information return (Form 990 series) such as churches and small organizations; $181 billion is revenue of private foundations.

organizations is approximately $2.6 trillion.[10] Comparable numbers from the mid-1970s demonstrate the significant recent growth of charities. In 1976, for example, there were 259,523 charitable organizations and in 1975 (using constant 2001 dollars) revenues were approximately $155 billion and assets were approximately $361 billion.[11] Thus, since the mid-seventies, the section 501(c)(3) sector has grown by about 324 percent in terms of the number of organizations, 918 percent in terms of revenues, and 786 percent in terms of assets. Entire classes of organizations continue to be recognized – churches, hospitals, colleges and universities – though such organizations look much different today than 100 years ago. Indeed, two subsectors, hospitals and colleges and universities, account for over half of the sector's revenues and assets.[12] The example of hospitals also highlights the ongoing tension within parts of the section 501(c)(3) sector of distinguishing nonprofit and for profit activity.

(ii) Deductible contributions as a source of support. It is important to put the charitable deduction in perspective as a revenue source for the section 501(c)(3) sector. Data indicate that private giving is but one means of support. For example in the year 2005, in the aggregate, section 501(c)(3) organizations relied on deductible contributions for roughly less than nine percent of total support.[13] Although this aggregate number hides the importance of the deduction to particular organizations, it highlights the fact that as a general matter, deductible contributions are a supplementary source of revenue for most section 501(c)(3) organizations.

Of course, some broad types of section 501(c)(3) organization rely on deductible contributions more than others. For example, data from the same year shows a breakdown of support based on organizational purpose:[14]

[10] *Id.* at 11-12 (reporting as of July 2009, not including non-filing organizations). Of this amount, $621 billion is held by private foundations.
[11] Staff of the Joint Committee on Taxation, 109th Cong., Historical Development and Present Law of the Federal Tax Exemption for Charities and Other Tax-Exempt Organizations, 20, 24 (Joint Comm. Print 2005).
[12] Hospitals account for 41.25 percent of revenues and 29.13 percent of assets; colleges and universities account for 11.36 percent of revenues and 21.21 percent of assets. Molly F. Sherlock & Jane G. Gravelle, Cong. Research Serv., R 40919, An Overview of the Nonprofit and Charitable Sector 10 (2009). This is notwithstanding the fact that hospitals are just .65 percent of organizations and colleges and universities just .42 percent of organizations. *Id.*
[13] *Id.*, Figure 4, 17. The CRS study shows that in 2005 private contributions in the aggregate constituted 12 percent of support. However, private contributions includes not only deductible individual contributions, but also corporate giving, bequests, foundation giving, and gifts by nonitemizers. Given that about 25 percent of all private contributions were from corporate giving, bequests and foundations, support from deductible contributions is closer to 9 percent; and then gifts from nonitemizers should also be taken into account. The aggregate support number does not include private giving to private foundations or to organizations such as churches that are not required to file a Form 990.
[14] *Id.*, Figure 5, 19.

	Private Contributions	Private payment	Government grants/payments	Investment Income	Other revenue
Arts, Culture, Humanities	43%	29%	12%	9%	7%
Education	13%	56%	12%	17%	2%
Environment/Animals	48%	24%	12%	7%	9%
Healthcare	2%	56%	37%	3%	2%
Human Services	16%	41%	36%	3%	4%

Accordingly, hypothetically, if the charitable deduction were eliminated, and if giving as a result significantly decreased, based on this data snapshot, the most adversely affected organization types likely would be those that benefit arts, culture, and humanities, and the environment and animals. Also likely to be most adversely affected are smaller organizations. Such organization types might well find it difficult to find alternative revenue sources and might be forced to curtail programs substantially or to cease operations.

By contrast, the education and healthcare subsectors rely for a majority of support on program service revenue, e.g., tuition, and payments for healthcare, and much less on private contributions. Also noteworthy is that as a class, human services organizations rely more on fees and direct government grants for support than private contributions.

In any event, even in the absence of the deduction, support from private giving would not disappear. Rather, the extent of any reduction in private contributions would depend upon the extent to which donors give because of the tax incentive, or whether donors give without regard to the tax benefit.

In addition, however, although it is important to put the importance of private contributions as a revenue source in the proper context, it is also important not to view private contributions completely in isolation of possible cutbacks to revenue from other sources. Thus, although cuts to the deduction alone might not have an unmanageable impact on finances for many organizations, if deduction changes are combined with cuts to direct government support, this could create the "perfect storm" for many section 501(c)(3) organizations of various types and sizes.

(iii) Distribution of giving and the deduction. Total giving is reported each year by Giving USA and shows how gifts are distributed among organization types. The numbers for 2010 are shown in the following Table:

Religion	$100.63 billion (35%)
Education	$41.67 billion (14%)
Foundations	$33 billion (11%)
Human Services	$26.49 billion (9%)
Public-society benefit	$24.24 billion (8%)
Health	$22.83 billion (8%)
International Affairs	$15.77 billion (5%)

Arts, culture, and humanities	$13.28 billion (5%)
Environment/animals	$6.66 billion (2%)
To individuals	$4.2 billion (2%)
Unallocated	$2.12 billion (1%)

The total giving numbers are not limited to individual deductible contributions, however, but include giving by nonitemizers, corporate giving, bequests, and private foundations.

In any event, as an itemized deduction, the charitable contribution deduction is claimed by the more affluent, with the wealthiest generally giving the most. In 2008, for example, taxpayers with adjusted gross income of $200,000 or more gave 42 percent of deductible contributions and represented just 10 percent of returns. The very wealthiest, taxpayers with AGI of $10 million or more, gave 11.73 percent of deductible contributions, and were just .03 percent of returns.[15] Charitable contributions at this income level consisted in large part of noncash property – about 50 percent of contributions for this income group and 24 percent of the total noncash property contributions for the year.

The wealthiest of taxpayers fund a variety of organization types. One study of giving by high net worth taxpayers[16] found the following distribution:

Education (27.1 %)
Giving Vehicle (16.5%) (e.g., donor advised fund, trust, foundation)
Religious (14.6%)
Health (10.4%)
Combination Funds (6.8%) (e.g., United Way)
Youth/family (6.3%)
Art (4.2%)
Basic needs/food and shelter (3.7%)
Environment/animal care (2%)
International (1.5%)
Other (6.9%)

As the Table indicates, over half of giving by high net worth taxpayers was for education, private giving vehicles (which may take many years to pay out funds), and health. Organization types receiving less support from high-income givers were those that serve basic needs, the environment and animal care, and international causes.

[15] Tax Policy Center, 2008 Individual Income Tax Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income. Percentage calculations by author.

[16] 2008 Study of High Net Worth Philanthropy, The Center on Philanthropy at Indiana University, March 2009, Figure 14. High Net Worth individuals were defined as survey respondents with household income greater than $200,000 and/or net worth (excluding the value of their residence) of at least $1 million.

The above snapshot of the charitable deduction shows that it is designed to be a support of the section 501(c)(3) sector, that it is more important as a source of support to some organizations than to others, and that the giving choices of the more affluent are important dictates of which types of section 501(c)(3) organization benefit.

C. The Purpose of the Charitable Deduction

Given the above as a model, the question becomes one of matching the charitable deduction in practice with the charitable deduction in theory. This of course raises important questions of what the charitable deduction is for. What is it intended to accomplish? What should it be for? There is no single or simple answer.

One place to start is with rhetorical arguments that often accompany discussions about the charitable deduction. For example, a common (and often effective) response to proposals that impinge on the charitable deduction is to stress that this would hurt charity. The argument is often effective because it appears to rely upon an idea of charity that reflects our better instincts – to help those in need. And the argument is accurate, at least to the extent that many section 501(c)(3) organizations do help those in need and rely on the deduction.

Such reflexive support for the charitable deduction raises questions, however, because, as the discussion above should indicate, the charitable deduction supports not "charity" as it is commonly understood, but rather the entire section 501(c)(3) sector, of which basic needs or traditional charitable organizations are just one of many supported types.[17] Thus, to the extent the rhetorical view reflects a traditional idea of charity (it is after all the "charitable deduction" and not the "section 501(c)(3) sector" deduction), then significant change to present law is suggested, namely, by weakening the link between section 501(c)(3) exemption and the charitable deduction and to redefine "charity" for deduction purposes.

There are, however, other explanations for the charitable deduction than the rhetorical view. Broadly speaking, there are two strands of thought. One largely discounted but still important rationale for the deduction is rooted in the definition of income for tax purposes. Under this theory, income simply does not include amounts paid to charity. Charitable expenses are not like other nondeductible personal expenses (i.e., consumption) but rather have a public benefit. Therefore, such amounts should not form a part of the tax base.

The other, and principal, rationale for the deduction is that it is an incentive or subsidy. Again, roughly speaking, by paying for a portion of charitable contributions, the government encourages such contributions and does so because the gifts will help

[17] Further, as a general matter, many basic needs or traditional charitable organizations would be more adversely impacted by cuts to direct government spending than by changes to the charitable deduction – so if the goal is to protect basic needs organizations from harm, the charitable deduction is but one small piece of a broader policy issue.

produce important public goods, or goods that would not be provided independently by the market. Or, further, that the benefited organizations perform functions that would otherwise be performed by government and therefore should be supported by government.

Importantly, either rationale depends to a certain extent upon what we mean by public benefit. In particular, the subsidy rationale invites a critical question for policymakers, namely a subsidy for what? Given the large, diverse, and growing section 501(c)(3) sector, and the open-ended nature of the section 501(c)(3) exemption, it is difficult to pinpoint with particularity what is being subsidized under the current system or, perhaps more importantly, what is intended to be subsidized. Accordingly, if the reason for the deduction is to support the public benefits provided by the section 501(c)(3) sector, but the particulars of the subsidy are not known, it may be time for policymakers to reexamine the sector, and the rules that regulate it, to provide a clearer policy of public benefit.

Some will disagree with this and argue that a reassessment of the charitable deduction can and should be avoided by reliance on perhaps the best, in the sense of most accurate, explanation of current law: namely, that the public benefit served by the charitable deduction is not to produce any particular public good or goods but rather is to support the values of pluralism and private choice. Under this view, the point of the deduction is to foster broad based and generic altruism, without the government picking winners and losers (as the government does in direct spending programs). The government offers support, and individual donors and the section 501(c)(3) sector decide how the support is spent. An expansive view of qualifying section 501(c)(3) purposes and organizations fits well with this theory, because the government stands back and lets the sector evolve and grow consistent with social norms.

Although this view of the charitable deduction is appealing and reinforces current law, even here, as with a more concretized view of the public good, some change is warranted. As noted above, because of the tight link between the deduction and exemption, the main control on the charitable deduction is tax exemption law. But tax exemption law is largely bereft of bright lines or enforcement mechanisms, a condition that led recently to a spate of scandals and new legislation.[18] Accordingly, if the support of the section 501(c)(3) sector as such is the rationale for the charitable deduction, then it is important also to be mindful of the negative symbols that can result when the sector is or is perceived to be either underperforming or prone to abuse of public trust – a condition that seems also to be part of the pluralistic model.

In short, the broad issue before you is to a certain extent a decision about what the charitable deduction is for – is it a subsidy, and if so for what? For a section 501(c)(3) sector like the one we have? Or for something else? And who should decide? Congress,

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[18] For a discussion of the recent reform legislation and the scandals that preceded it, *see* Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FLORIDA TAX REV. 1 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1809171.

or individual donors and the exempt sector? Further, what leverage should government have over the section 501(c)(3) sector through its support, direct or indirect?

Perhaps one way to crystallize the issue is to consider whether the charitable deduction should continue to be linked to section 501(c)(3) tax-exemption. Congress linked the two benefits in 1917, a linkage that arguably made sense at the time. The understanding of "charity" writ large was arguably closer to the statutory definition for exemption purposes, and Congress was concerned about the basic question of the proper tax base. The charitable deduction may well have been less of a subsidy then than an income measurement issue. Today, however, with the deduction viewed as a government subsidy, and a vastly different section 501(c)(3) sector, there is to a certain extent a policy disconnect between the charitable deduction and the sector it supports. Arguably lost with the passage of time is a strong sense of the public benefit, or of charity in the charitable deduction.

D. Budget Pressure and the Charitable Deduction

That said, the immediate task for policymakers is not necessarily to rethink from first principles the role of the charitable deduction in the federal income tax, or the overall relationship of government and the section 501(c)(3) sector. Rather, major changes to the charitable deduction have been proposed, often in the context of deficit reduction, and their merits or demerits must be considered.

In general, the proposals fall into four categories: a cap on the value of the deduction, a floor underneath the deduction, conversion of the deduction to a credit, and replacing the deduction with matching grants paid directly by the government to the section 501(c)(3) organization.

An initial question is whether the charitable deduction is exceptional and should be considered separately from other itemized deductions. My view is that ideally, yes, the reasons for the charitable deduction are somewhat unique, the deduction is but one of many government supports for the section 501(c)(3) sector, and so better overall policy might follow if the deduction is tackled as part of a comprehensive review of the sector and all sources of support – that is, including direct government spending, as well as tax policy regarding charitable giving, exemption, and tax-exempt financing.

Nevertheless, if Congress determines that under present circumstances any cuts to tax expenditures should be broadly distributed, the charitable deduction could be changed and probably in a manner with limited impact on the section 501(c)(3) sector or the overall current policy of the deduction. Accordingly, one way to assess the various proposals is from the perspective of maximizing revenue gain while minimizing reform-oriented change.

Of the proposals, an income-based floor on charitable deductions appears best to fit within current policy tenets. A floor would improve the incentive aspect of the deduction by encouraging contributions at the margin. In other words, a floor would reduce the windfall that many taxpayers receive for charitable contributions they would have made with or without a tax benefit, and so could make the deduction more cost effective. A floor would also have administrative benefits, by taking away opportunities to cheat on low-value contributions, and reducing the need to oversee many small dollar contributions, especially of noncash property. That said, however, some might argue that the floor would not be fair to those taxpayers who currently give at or below the floor. Such taxpayers might see their tax benefit eliminated, while others with more capacity to give, would continue to get tax benefits for giving.

The Administration's proposal to cap the value of all itemized deductions at less than the top rate of tax would be next on the scale of revenue raising changes with only modest immediate effects to the current structure. Unlike a floor, the impact of the Administration's proposal is more targeted in that it would only affect taxpayers in the highest rate bracket. The studies that have estimated its likely impact on giving suggest a small percentage decrease in giving. The section 501(c)(3) organizations affected would likely be those favored by the more affluent; data suggest this would tend to have less impact on basic needs charities.

However, there is a reform-based element to the Administration's proposal. By reducing the value of the deduction only for top rate payers, the proposal would have the effect of embracing as a matter of policy the argument that the current deduction is unfair. The unfairness argument stems from the progressive rate structure, which means that those in higher brackets get more value from a deduction, making charitable giving cheaper (and so providing a larger incentive) for those with higher incomes.

In my view, if the value of the charitable deduction does not automatically follow the rate structure, as under the Administration proposal, the most likely outcome over time is that the deduction will be converted to a credit. This is because any pretense of an income measurement rationale for the deduction will have disappeared, placing increased pressure on continued unfairness that would still be represented by the rate structure. In addition, once the value of the deduction becomes a policy choice distinct from the rate structure, future revenue needs will likely lead to calls for additional reductions to the value of the deduction, leading eventually to one or two rates – leaving the deduction looking increasingly like a credit.

A credit would be a clear break with current law. Although there may be good reasons to move to a credit, such a move might best be accomplished after considerable consultation with stakeholders. A credit (perhaps combined with a floor, as recommended by the Bowles-Simpson Commission) seems fairer than present law, in that all taxpayers, including nonitemizers, would have an equal incentive to give. However, depending upon its design, a credit might not be cost-effective. For example, a credit without a floor generally would be available to every dollar of contribution by nonitemizers, thereby to a certain extent unnecessarily rewarding existing giving patterns. In any event, in my view, conversion to a credit should be part of a broader discussion about the nature of the subsidy, and whether some parts of the section 501(c)(3) sector should have bigger dollar incentives than others, perhaps through variable credit rates depending upon the recipient organization.

Of all the proposals currently under consideration, moving to a direct payment or grant system would be the most dramatic change from present law. Apart from requiring a new administrative apparatus to make payments and report contributions, a grant system likely would alter the character of the section 501(c)(3) sector. Many organizations that enjoy receiving deductible contributions and maintaining independence from government, might chafe at the idea of direct government support. In turn, government might demand more in terms of outputs because of the directness of the subsidy. This most certainly would affect the general independence of the section 501(c)(3) sector that the indirect subsidy allows.

E. Conclusion

By way of summary, the charitable deduction, and the rules governing tax exemption are in need of a critical examination. The focus of any such examination should be on whether existing rules are maximizing the public benefit at the lowest cost to taxpayers, including not only the charitable deduction, but tax exemption, direct grants, and other supports. Key to all of this is a better understanding of what we mean by public benefit, the role of the charitable deduction in the broader picture, and whether it should continue to be linked to standards for tax-exemption. Congress may of course decide to address the charitable deduction as part of its assessment of tax expenditures more broadly. If so, or if change is otherwise wanted without a broader reform effort, of the several proposals under consideration, a floor based on adjusted gross income appears to allow for cost-effective change within the existing policy structure.

Thank you for inviting me to testify and I welcome any questions.

Senate Finance Committee Hearing
"Tax Reform Options: Incentives For Charitable Giving"
October 18th, 2011
Questions for the Record
Answers of Professor Roger Colinvaux

Question 1. Some believe that the charitable deduction is not a tax expenditure because the donor has given the money away – they don't have the money donated anymore so shouldn't be taxed on it. Others believe it is a tax expenditure because, for example, someone who has $20,000 and decides to give $1,000 to charity is better off than someone who only has $19,000.

- What do you think about whether the charitable deduction is a tax benefit?
- If it is not a tax benefit, does it make sense to deny the deduction to non-itemizers?

Answer to Question 1.

In my opinion, the charitable deduction of present law is a tax benefit, and generally is considered as such by those who give, those who receive, and by the government. However, whether the charitable deduction is properly construed as a tax "benefit" is less important than deciding what it is we want to accomplish with respect to charitable giving. So we should focus on who should benefit from the charitable deduction, which section 501(c)(3) organizations most rely on the deduction, the extent to which noncash contributions should be encouraged, and the administrability of the deduction.

The question about whether non-itemizers should be allowed a charitable deduction is best answered in terms of the potentially large cost, the incentive effects, and administrability. Setting these issues aside, however, in my view, the standard deduction in effect allows a deduction for charitable contributions, without the substantiation requirements. So nonitemizers generally do receive a benefit from their charitable contributions, albeit an indirect one.

Question 2. The Finance Committee has spent many hours examining our tax code out of a belief that by modernizing our tax laws we can enhance our ability to successfully compete in the 21st century global economy. This study has convinced many of us on the panel that our nation's ability to compete with China and other emerging economies depends, in part, on a tax code that is competitive with other countries.

- Do you have any data or views on the value and importance of the charitable deduction as it pertains to the ability of tax-exempt organizations to contribute to our nation's economic competitiveness?
- If we make changes to the charitable deduction that result in a loss of some private support for the tax-exempt community at a time of diminished and diminishing government support for many of the activities of the tax-exempt community, do we put at risk the ability of tax-exempt organizations to, for

instance, help meet a rising demand for basic needs, or to educate young people to ensure our long-term economic growth?

Answer to Question 2.

With respect to the first part of the question, organizations that are eligible to receive deductible contributions are not organized for economic or business purposes. So support for section 501(c)(3) organizations generally is not like supporting an organization or industry that competes economically with other countries. Of course, aiding the success of educational organizations in educating our citizens, scientific organizations in fostering research, and other section 501(c)(3) organizations, can be a crucial way to invest in economic growth.

Whether or not changes to the charitable deduction will adversely affect basic needs or educational organizations depends on the type of change, but also more importantly on the extent to which the organization depends on deductible contributions for support. As indicated in my written testimony, data suggest that the primary source of support for educational organizations is program service revenue, with charitable contributions constituting a much smaller percentage of total support. So even if the charitable deduction were eliminated, and voluntary contributions as a result were greatly reduced, the reduction in support might not be unmanageable.

To the extent that basic needs organizations are the concern, the charitable deduction, again though an important source of support, is far less important than direct government grants and program service revenue. In addition, it is in my view important to realize that if policymakers believe that the policy of the charitable deduction is or should be principally to support basic needs organizations, then present law should become much more targeted. As indicated in my written testimony, this is because the charitable deduction of present law primarily is a government support for private choice of a (broadly construed) public good, as represented by the section 501(c)(3) sector, and not for any particular organization type.

Question 3. The code is complex, and many folks agree that its language should be precise. Many of us use words like, "nonprofit" and "charitable" interchangeably when discussing tax-exempt organizations.

- Can you discuss the differences between traditional "charity" and the entire 501(c)(3) sector?
- Can you discuss the link between exemption and the deduction and whether you think it needs to be changed in any way?

Answer to Question 3.

As your question suggests, there are many terms used to describe tax-exempt organizations, and unfortunately, it is rarely clear what people mean when using terms like "charity," "non-profit," or "tax-exempt." As you know, under the Internal Revenue

Code, a tax-exempt organization includes a wide variety of organizations – trade associations, advocacy groups, football leagues, charities, noncharitable section 501(c)(3) organizations, title-holding companies, agricultural organizations, among others. The reasons for exemption from federal income taxes are quirky, and have developed piecemeal over time. The staff of the Joint Committee on Taxation (during my time on staff) prepared a document looking into the bases of tax-exemption of the various types of tax-exempt organizations. See Staff of the Joint Committee on Taxation, Historical Development and Present Law of the Federal Tax Exemption for Charities and Other Tax-Exempt Organizations, JCX-29-05, pages 159-193 (Apr. 19, 2005).

This same document also discussed the meaning of charity over time. In broad brush, there are two approaches. A narrower "ordinary" definition confines charity more to helping those in need. A broader definition, defined largely in terms of public benefit, is supported by the common law. Although the broader definition has been embraced by the federal tax law, the narrower view of charity retains a firm hold on the popular imagination. This can often lead to a mismatch between rhetoric and reality, as references to the "charitable sector" often are used to mean those organizations that meet basic needs, and not the entire section 501(c)(3) sector. Regardless, the important question today is what should the definition be – what types of organizations should receive or need tax benefits? The answer to the question should also be informed by our expectations of administrative capability.

This leads to the last part of your question. Tax exemption of course is one tax benefit. Eligibility to receive deductible contributions is another. Historically, the two have been linked through section 501(c)(3), that is, qualification for exemption under section 501(c)(3) results in being eligible to receive deductible contributions under section 170. This means that much of the law of "charity" occurs at the tax-exemption level, and many of the strengths or weaknesses of tax-exemption law flow through to affect the deduction. For example, if charity or the scope of section 501(c)(3) is defined broadly, then charity for charitable deduction purposes also will be broad. If an abuse occurs at a section 501(c)(3) organization, sanctions are thought of at the exemption level – often in terms of loss of tax-exempt status – a mostly inadministrable sanction. Because tax-exempt status is generally considered as a lifetime benefit, so is the charitable deduction.

But the policy of the two tax benefits need not be the same. One might want a broad definition for exemption purposes (e.g., administrative convenience, or because the income generally is put to non-profit and public use, so why tax it), but a narrower one for deduction purposes (to benefit basic needs organizations, or organizations that satisfy certain criteria). Or it might make sense to tailor sanctions based on recapture of the deduction or loss of deductibility status, apart from tax-exemption. Further, the charitable deduction does not have to exist along with tax exemption, but could be tied to other standards. However, because exemption and deductibility are linked, it becomes harder to differentiate a policy for the two tax benefits.

Question 4. Research has shown that folks donate to different charities for different reasons. Some folks are more inclined to support their church with small tithes, regularly. Some folks are more inclined to make large one-time donations to their alma mater.

- What differences and similarities have you noticed amongst donors?
- Which donors respond to incentives for charitable giving?
- Does the form of the incentive matter?

Answer to Question 4.

As noted in my written testimony (and the testimony of others), wealthier donors have more to give, give the most, and give to a different mix of section 501(c)(3) organizations than do less affluent donors. There is also some evidence that wealthy donors are more sensitive to the cost of giving. We also know that many give generously even without a tax incentive. The form of the tax incentive matters to measure the value of the incentive to donors, and generally to determine who may claim the incentive.

Question 5. The charitable deduction was adopted into the tax code in 1917. While it has gone through various changes, including an above the line deduction for non-itemizers in the 80s, it has remained a deduction. This provision is one of the largest tax expenditures.

- What has been your view of the charitable deduction over the years?
- Would another form for charitable giving encourage more giving?
- Is there another way to encourage just as much giving, but more efficiently?

Answer to Question 5.

The charitable deduction was introduced four years after the income tax, and linked to tax exemption. At that time, the sector was smaller and eligible organizations (churches, hospitals, schools, others) did not resemble their modern-day counterparts. In addition, the charitable deduction may not have been viewed so much as a subsidy or a giving incentive (there was no "planned giving" industry) than a reasonable adjustment to the tax base. As the sector grew, the charitable deduction became viewed more clearly as a subsidy, an "incentive," and a tax expenditure. As such, the expectation that the government should get something for its money also (reasonably) took hold, as did the view that the government should, as a matter of course, reduce the cost of private giving. Today, the charitable deduction is largely viewed uncritically, as is the sector it supports; but this "halo effect" can inhibit reasonable discussion about what the charitable deduction is for, who should benefit from it, and whether changes should be made.

In my view, the policy goal should not necessarily be to encourage more giving as such. The year-by-year giving totals show that as a nation we already give generously. Rather, the question in my mind is whether we should attempt to change the allocation of current giving, or direct new giving initiatives toward particular causes. A related issue is whether section 501(c)(3) organizations, particularly private foundations, are doing enough with their resources. In other words, government could look for ways to encourage "more giving" by section 501(c)(3) organizations, and not just the giving public. I do believe that an income-based floor likely would make giving more cost-effective, whether paired with a deduction or a credit, and likely need not have a significant impact on current giving levels.

Question 6. Five years ago, I challenged large foundations and grant-makers to double their investment in rural America. So far, the challenge has not been met. I encouraged funders to partner with government, invest in local community foundations, invest in rural nonprofit infrastructure and to tailor more grants to meet the needs of rural states.

- How can policymakers work with tax-exempt organizations to meet identified needs, after we've provided an incentive to encourage folks to donate

Answer to Question 6.

The charitable deduction is an awkward tool for this purpose. It is not designed, nor arguably intended, to give the government leverage over spending decisions or priorities of private organizations. This is largely because the deduction is not a direct grant to the charity, but a tax benefit to a private individual (or corporation), administered through the tax system. The federal government could take a more active role in setting funding priorities through additional direct spending, by modifying the charitable deduction to favor some contributions relative to others, or by establishing a distinct benefit for activities that benefit rural areas.

Questions from Senator Wyden

Mr. Sammartino testifies that replacing the current deduction with a nonrefundable tax credit made available to all tax filers would – if it's combined with a contribution floor – increase the total value of donations and reduce the cost of the federal tax subsidy.

For example, he said that a 25 percent nonrefundable tax credit (with a floor of $500 per individual and $1,000 per couple) would increase donations by $1.5 billion and boost federal revenues by $2.4 billion.

In contrast to the current deduction, a nonrefundable credit would provide the same tax subsidy (per dollar of giving) to all taxpayers who could fully claim the credit, instead of a subsidy that benefits the highest income taxpayers more.

- **Wouldn't this approach** – setting a floor and replacing the deduction with a refundable tax credit – be more equitable than the current deduction?
- Is there any reason not to pursue this route if it saves the government money and will increase the total value of charitable giving?

Answer to Questions from Senator Wyden

A nonrefundable credit for charitable contributions combined with a floor has some appeal. As the CBO analysis suggests, a credit could be designed (and adjusted as necessary) to produce the same amount of giving as under present law, and extended to additional taxpayers.

One argument against a credit is that if the tax benefit is severed from the rate structure, future revenue needs will encourage reductions to the credit rate, resulting in decreases to charitable giving. Put another way, as a credit, the charitable deduction might become a regular target in revenue-raising discussions. However, I tend to partially discount such arguments, given that there likely will always be a strong policy and lobby in support of charitable giving incentives – making reductions to the credit rate an uphill battle. Further, there could be a benefit to periodically adjusting the credit rate (up or down): experience with one rate or another might show the optimal rate at which a true incentive is provided. This would provide additional flexibility, as it is difficult if not impossible under a deduction model to change the rate structure just to account for the optimal level of charitable giving (though of course changes to the rate structure occur, and so have an effect on the cost and amount of giving).

Another argument against a credit is based on horizontal equity. For example, assume the credit rate is 25% and the highest marginal rate is 35%. Also assume two taxpayers, "A" and "B", both in the 35% rate bracket. Taxpayer "A" has income of $200,000 (that is subject to the 35% bracket); taxpayer "B" has income of $190,000 (that is also so subject). Taxpayer "A" gives $10,000 to a section 501(c)(3) organization. Taxpayer "B" does not give to a section 501(c)(3) organization. Forgetting other deductions, Taxpayer "B" pays tax on $190,000 at 35% ($66,500). Taxpayer "A" pays tax on $200,000 at 35% offset with a credit of $2,500 ($67,500). In other words, taxpayer "A" is worse off net of charitable giving relative to taxpayer "B." Both have $190,000 with which to pay taxes, but A's tax bill is $1,000 higher than B's because A's gift is not fully offset with a deduction. Whether this difference is troubling as a matter of equity depends in large part on one's view of the section 501(c)(3) expense. To the extent there is an element of personal consumption and benefit in the expense, which I believe there often is, then a difference in treatment between "A" and "B" seems reasonable.

Relatedly, a credit might lead to greater emphasis on the outputs of section 501(c)(3) organizations. This is because as shown above, a credit, unlike a deduction, has no pretensions to income measurement. As such, it does not matter that a taxpayer in a marginal rate bracket higher than the credit rate will pay tax on a portion of income in respect of the charitable contribution. With the income measurement aspect of the deduction gone, there might be increased focus on what specifically the charitable credit is subsidizing – a pluralistic section 501(c)(3) sector or something more tangible. However, in my view, this could be a positive development, and indeed should inform discussions about conversion to a credit.

Of less central importance, a credit versus a deduction also could have effects on decisions by some whether to work in order to give away any extra money earned to section 501(c)(3) organizations. Because a deduction fully offsets income, income from such additional work is not taxed. But if the deduction is converted to a credit and the credit rate is lower than the taxpayer's highest marginal rate, a taxpayer who worked to give away extra money would also have to pay tax with respect to a portion of the extra money, thus influencing the decision, and potentially discouraging such efforts.

Finally, as a general matter, equity can be viewed both on a provision-by-provision basis, and under the tax code as a whole. Viewed in isolation, the charitable deduction appears unfair because wealthier taxpayers receive a larger benefit. (Yet even here, as an incentive, one could argue that, equity aside, wealthier taxpayers are more responsive to tax incentives than the less well off and so might require a larger incentive.) However, as Dr. Steuerle testified, in the context of broader tax reform, whether replacing a deduction with a credit makes the entire tax system more or less equitable depends on whether there have been other changes to the rate structure or other benefits or preferences.

Testimony of Brian A. Gallagher
President and CEO, United Way Worldwide
United States Senate Committee on Finance
October 18, 2011

Chairman Baucus, Senator Hatch, and Members of the Committee, thank you for inviting me to testify before the Committee on this matter of critical importance to the non-profit sector and our society in general, the charitable deduction.

I urge the Committee to preserve the charitable deduction for all donors.

With specific regard to the impact of policy changes on donors, let me start by stating that I deeply respect the work of my colleagues on this witness panel. However, I've spent my entire career, now 30-plus years, working with donors in the nonprofit sector. I know why people give and believe that limiting the charitable deduction would have a far greater impact on charitable giving than many estimate, and would significantly affect our sector's ability to deliver social services.

Recent studies indicate that a cap on the deduction could result in loss of charitable giving of between $2.9 billion and $5.6 billion each year. A variety of other proposals to limit the deduction have been circulated this year. Each proposal has two common elements: 1) they limit the value of the deduction for some group of donors, and 2) they will result in reduced giving to charity to the detriment of individuals and families who rely on our help.

If the $5.6 billion number is correct, and I believe that it is, that equates to eliminating all of the private donations each year to the Red Cross, Goodwill, the YMCA, Habitat for Humanity, the Boys and Girls Clubs, Catholic Charities, and the American Cancer Society combined. I am not arguing that those organizations would not survive limitations to the charitable deduction; United Way and these other major charities would. However, the services charities provide would be reduced at that scale.

For United Way, we calculated that a mere 2.5% reduction in revenue would result in 1.3 million fewer times that we can provide job training services for an unemployed worker, home care for an elderly citizen, service supportive housing for a single mother, or a mentor or tutor for an at-risk young person.

I know the Members of this Committee are well aware of the Census Bureau's recent report that 46.2 million Americans are living in poverty. And the unemployment rate is hovering around 9%. At a time when all manner of government funded social service programs are being cut, decreasing the capacity of charities to provide services is the wrong thing to do. Those at the bottom of the economic spectrum have suffered the most through the recession. They are also the ones who would bear the brunt of reduced giving to charity because of a tax policy change.

In my view, the Committee should be considering ways to provide additional incentives for charitable giving. You cannot solve our nation's deficit by the relatively small amount of revenue to the government garnered by limiting the charitable deduction.

I have spent literally thousands of hours getting to know people who donate to charity and why they donate. I've come to know the motives and financial limitations of all sorts of donors. We get contributions from Union workers who sacrifice to give $10 or $20 from each paycheck. We have 26,000 donors who give $10,000 per year or more, and 500 Americans that have donated a million or more to United Way.

Americans give for a variety of reasons. I think it is rare that someone gives to charity only because of a tax incentive. But tax incentives are often a factor in how much someone donates. I can tell you from my experience, large donors are very sensitive to the tax code. In a recent study we conducted, 23% of high net-worth individuals indicated that receiving tax benefits for their charitable contributions was a "major" motivation for giving.

If this Committee reduces the charitable deduction, you should expect that donors will simply withhold the difference necessary to cover the tax from their donations. A limitation on the deductibility of charitable donations isn't really an increase in tax on the wealthy so much as it is a transfer to the government of money that would otherwise go to charities. The real impact will be felt by the people we serve.

Americans from all backgrounds are generous by nature and are willing to give back to their communities. And Americans give to many causes. Arts and education are critical to our society and they merit equal support in the tax code. But United Way, at $3.9 billion last year, is the largest non-government funder of human services in the United States. We rely heavily on large donations from upper-income individuals. I hope my appearance here today helps dispel any presumption that large donors only give to the symphony or the museum; that simply isn't true. Each year, United Way receives a half billion dollars from high-income individuals who give $10,000 or more.

I have been traveling extensively during the last few years as United Way's work continues to expand to communities throughout the world. I've talked to many foreign civic and charitable sector leaders from China to France to South Korea. It's clear they seek two uniquely American exports: One is of course the American imagination that fosters business innovation and job creation; the other is our charitable spirit, which Alexis de Tocqueville wrote about in the 19th Century. It's our private sector initiative applied to solving social problems. I'm regularly asked how our system can be replicated abroad.

I found it ironic that one of the proposals for reforming charitable giving incentives in the tax code here in the U.S. was based on the U.K. model, which funnels a tax credit to charities through the government. Around the time the Domenici-Rivlin proposal was released (Nov. 2010), I was advising leaders in the United Kingdom who were looking for new ways to stimulate charitable giving.

Within American culture, innovation is prized. It is most noted as an achievement in the American business sector. But the nonprofit sector is the cradle of innovation in providing social services and solving social problems. We are dynamic and responsive to the needs of the people we serve. We are always finding new ways to do things more efficiently, and with many fewer resources than government. This initiative, for which our business sector is known, permeates the charitable sector too. We are the source of much of the social innovation you have seen in our country for decades. This is possible because of generous private giving in America.

The point is that our charitable sector is the envy of the world. We have an effective and efficient system. That is in part due to the historic tax treatment of charitable donations. The deduction rate simply tracks with the donor's tax rate. The effect of that is that income donated to charity is not taxed.

This connection to the tax rates is the strength and simplicity of the charitable deduction. Perhaps my biggest concern about the deduction is that it would for the first time "decouple" the deduction from the tax rate. Once you have done that, then it is a simple matter to repeatedly return to the deduction as a source of more revenue. Even when tax reform is not on the table, perhaps well-meaning Senators will see this as an offset for their own priority programs. A cap can be lowered another fraction of a percent, a floor can be raised a few hundred dollars, an arbitrary tax credit can be reduced; until there is little left to resemble a tax policy that reflects our nation's philanthropic heritage. This would just be the beginning of a whittling-away at our charitable sector.

Of course, many tax incentives are designed to stimulate certain types of activities. In most cases, the conduct the tax code incentivizes is also beneficial to the individual tax payer. The conventional wisdom in our nation is that homeownership is good. So the tax code incentivizes homeownership. But of course, the taxpayer who gets the incentive also receives a benefit of owning a home.

The charitable deduction is perhaps unique among tax deductions. No personal gain or benefit is conferred to a donor by donating to charity. By allowing donors to deduct the donations at the same rate as their tax rate, you are simply not penalizing them for giving away income. And every cent of their donation is going back into their community. In other words, while the federal government may be losing some revenue from that dollar, the entire dollar is going to advance the common good. What could be a better use of that dollar?

We have to create more private investment incentives to address our nation's growing human need. It not only allows for vital resources, it also encourages an active and engaged citizenry. Simply put, people, not institutions, solve problems.

A good example is the parents and families of drunk-driving victims advocating and saying: *We won't let it happen again*. They worked together and they changed conditions. Today, organizations like Mothers Against Drunk Driving and others are strengthening these laws and achieving sustainable results.

As a father of two daughters, an issue close to my heart is girls in sports. Leaders at high schools and colleges weren't just sitting around one day thinking, "You know, we could use more womens' athletic programs." It took young women, parents, and coaches making it an issue and working with their institutions to provide greater opportunities.

The loss of social movements like these coupled with proposed reductions in federal social services programs could negatively impact individuals and families for years to come. Dramatic cuts by Congress began last year, and more are coming. The so-called "super committee" will likely make even more dramatic cuts, or automatic reductions to social services will occur. At the same time, states are in budget crises and are making deep cuts in state-funded programs. But the need is not going away.

The Low Income Heating Energy Assistance Program (LIHEAP) is being cut, but people will still need help paying their heating bills this winter. Child Care and Development Block Grants will be cut, but single moms will still need help with child care so they can work. Workforce training programs will be cut, but unemployed workers will still need training to return to work. We can help these people pay their utilities, get child care, and get job training. But we can help fewer of them if our donations are reduced because of limitations on the deduction.

Our nation is enduring a drawn-out, jobless recovery, which has been especially hard on the poor and middle class. In the short term, you could help ease the economic suffering of millions of Americans by enabling charities to do more.

Over the long-term, investments in social services or "human success" can help our nation recover and prosper. There can be no sustained economic success without human success; there never has been. We in the nonprofit sector are investing in human success. And we need the help of this Committee and Congress to make that investment.

Thank you.

# # #

Senate Finance Committee Hearing
"Tax Reform Options: Incentives For Charitable Giving"
October 18th, 2011
Questions for the Record
Submitted December 5, 2011 by
United Way Worldwide President and CEO
Brian Gallagher

Questions from Chairman Baucus

1. Some believe that the charitable deduction is not tax expenditure because the donor has given the money away – they don't have the money donated anymore so shouldn't be taxed on it. Others believe it is tax expenditure because, for example, someone who has $20,000 and decides to give $1,000 to charity is better off than someone who only has $19,000.

- **What do you think about whether the charitable deduction is a tax benefit?**

  Answer: I understand that that since the 1960s, tax policy experts have characterized tax deductions as government expenditures. I'll leave those definitions to tax experts. I think there is common sense to the notion that if someone gives some of their income to charity, then they should not have to pay tax on that income.

  The beauty of the current deduction is that the deduction rate simply tracks with the tax rate. Whatever the taxpayer's rate, the current system allows the taxpayer to "break-even". Taxpayers who itemize in fact do not pay tax on income they give away.

  This is especially sensible given that taxpayers do not gain any financial benefit from the charitable deduction, unlike other deductions.

- **If it is not a tax benefit, does it make sense to deny the deduction to non-itemizers?**

  Answer: My view is that given the current economic situation and cuts to government funded social programs, Congress should be looking for ways to expand incentives for giving to charities. Extending the deduction to non-itemizers, perhaps by creating an "above the line" deduction, would provide a material incentive for additional giving.

  To the extent there are questions about fairness of the current system, expanding the deduction to non-itemizers is far preferable to creating "fairness" by limiting the deduction for itemizers.

2. The Finance Committee has spent many hours examining our tax code out of a belief that by modernizing our tax laws we can enhance our ability to successfully compete in the

21st century global economy. This study has convinced many of us on the panel that our nation's ability to compete with China and other emerging economies depends, in part, on a tax code that is competitive with other countries.

- **Do you have any data or views on the value and importance of the charitable deduction as it pertains to the ability of tax-exempt organizations to contribute to our nation's economic competitiveness?**

  Answer: I can say from first hand experience that while the Senate Finance Committee is looking at modernizing the American tax code, your counter-parts in many other countries are looking to emulate parts of our tax law. I have been asked by leaders in places like China, France, and England specifically about the United States' tax incentives for charitable giving. They are looking for ways to enhance and build their nonprofit sector. They correctly see our deduction as key to their efforts to stimulate a charitable spirit in their countries.

- **If we make changes to the charitable deduction that result in a loss of some private support for the tax-exempt community at a time of diminished and diminishing government support for many of the activities of the tax-exempt community, do we put at risk the ability of tax-exempt organizations to, for instance, help meet a rising demand for basic needs, or to educate young people to ensure our long-term economic growth?**

  Answer: The fundamental danger of changing the deduction is that it will reduce giving to charities at a time when the need for help is the greatest we've seen in decades. This is not a taxpayer/donor issue, nor is it really about charities; this is about people at the bottom of the economic spectrum who desperately need help. All the proposals discussed at the Committee's hearing would reduce giving to charities and the result of such changes would mean fewer people would get help from charities. At a time when federal and state governments are reducing aid for basic needs and education, our nation cannot afford to reduce the capacity of private charity.

3. Research has shown that folks donate to different charities for different reasons. Some folks are more inclined to support their church with small tithes, regularly. Some folks are more inclined to make large one-time donations to their alma mater.

- **Over the course of your years of experience, what differences and similarities have you noticed amongst donors?**

  Answer: Americans are fundamentally generous by nature. I have observed that the vast majority of individuals who have had economic success in this country are happily willing to give back to their communities. United Way has 28,000 donors who give $10,000 or more each year, totaling a half billion dollars.

In large numbers, Americans of all means give to charity. Over 9 million individuals give to United Way every year. Among those donors, the average gift is $213. Generosity is the commonality among Americans.

In places like Montana, these smaller donors are the bread and butter of United Way and other charities. And because the cost of housing is lower, these families of more modest means are also itemizers. It is these donors in middle-America who would be harmed by a proposed "floor" on the deduction.

I have observed that there are differences among donors. Because there are many reasons donors give, the tax incentive being one, it is difficult to generalize. I think to some degree donors are influenced by factors such as the relationships they may have to various non-profits or their view about where there donations may do the most good.

- **Which donors respond to incentives for charitable giving?**

Answer: My experience is that all donors will respond to incentives for charitable giving in the tax code. The broad influence of the tax code is the reason Congress should consider expanding the charitable deduction to non-itemizers.

Despite mixed evidence among academics, it is absolutely clear to me that high-income individuals are the most responsive to tax incentives. While there could be an exception for the super-wealthy, a vast majority of the well-off plan their gifts carefully, including tax implications in their planning.

- **Does the form of the incentive matter?**

Answer: An above-the-line deduction that tracked with the tax rates would probably provide the greatest incentive for charitable giving.

I would be very concerned about a tax credit that was fixed at an arbitrary amount or rate. On the other hand, a tax credit that tracked with the tax rates and, at a minimum, preserved the current incentive for all current itemizers could be acceptable.

4. The charitable deduction was adopted into the tax code in 1917. While it has gone through various changes, including an above the line deduction for non-itemizers in the 80s, it has remained a deduction. This provision is one of the largest tax expenditures.

- **What has been your view of the charitable deduction over the years?**

Answer: The modern deduction has always tracked with the various tax rates. I believe this is a key to the success of the deduction in incentivizing charitable giving.

If you accept the premise that the deduction is a government expenditure, then it is an enormously efficient and effective expenditure. At the highest individual tax rate, the federal government may be losing as much as $.35 on the $1.00. However, that entire dollar is going to the benefit of the donor's community. I am not aware of any other provision in the tax code that generates that kind of return on investment.

- **Would another form for charitable giving encourage more giving?**

Answer: Generally, private giving, in which individual donors decide where to direct their donations is very effective. If there were some sort of regulation that favored one-sort of giving over another, I am confident that you would see reduced giving overall. In the end, the current system requires non-profits to be transparent and accountable, which leads to educated decisions by donors. There will always be a few bad-actors, but regulation should not be based on a few exceptions, which will be weeded out by the market and existing laws.

- **Is there a way to encourage just as much giving, but more efficiently?**

Answer: My view is that the system is very efficient. Expansion of incentives would produce additional giving, which would in turn provide an effective return on investment.

5. Five years ago, I challenged large foundations and grant-makers to double their investment in rural America. So far, the challenge has not been met. I encouraged funders to partner with government, invest in local community foundations, invest in rural non-profit infrastructure and to tailor more grants to meet the needs of rural states.

- **How can policymakers work with tax-exempt organizations to meet identified needs, after we've provided an incentive to encourage folks to donate?**

Answer: While I cannot speak on behalf of foundations, they are close partners and United Ways in communities of all sizes across the U.S. benefit from foundation support. My understanding is that many foundations across the country and specifically those in rural communities have undertaken initiatives to grow and sustain rural philanthropy. The Council on Foundations or Independent Sector may be able to provide you with more details.

For my part, I can pledge to work closely with you, Chairman Baucus, and the Finance Committee to help ensure that the needs of rural states are met by the non-profit sector and United Way in particular. I know the United Ways in Montana are committed to and are doing a great job of serving the needs of Montanans.

Questions from Senator Wyden

Mr. Sammartino testifies that replacing the current deduction with a nonrefundable tax credit made available to all tax filers would– if it's combined with a contribution floor – increase the total value of donations and reduce the cost of the federal tax subsidy.

For example, he said that a 25 percent nonrefundable tax credit (with a floor of $500 per individual and $1,000 per couple) would increase donations by $1.5 billion and boost federal revenues by $2.4 billion.

In contrast to the current deduction, a nonrefundable credit would provide the same tax subsidy (per dollar of giving) to all taxpayers who could fully claim the credit, instead of a subsidy that benefits the highest income taxpayers more.

- **Wouldn't this approach – setting a floor and replacing the deduction with a refundable tax credit – be more equitable than the current deduction?**

Answer: While I am not a tax policy analyst, my understanding is that academic tax policy experts who have reviewed the CBO report, which forms the basis for Mr. Sammartino's testimony, are critical of the elasticity basis used in the CBO study.

A 25 percent tax credit would reduce the incentive for families and individuals in the top tax brackets. The elasticity used by CBO causes an underestimate of the negative impact on charitable giving by higher income donors. A more appropriate higher elasticity basis would result in a net-reduction in charitable giving by changing the current deduction to a 25% non-refundable credit.

The higher elasticity cited by other experts is consistent with my personal experience with a life-time career in charity: high income donors are very sensitive to tax policy related to charitable giving.

I am also very concerned that a floor on deductions would discourage donations from millions of individuals who make small donations to charities every year. In large sections of the U.S., where housing prices are still within the reach of much of the middle-class, middle-income families are itemizers. They make modest contributions to local charities, which cumulatively have tremendous impact.

United Way, for example, has 9 million donors. Setting aside our small percentage of "major donors" ($10,000 or more per year), the average donation to a local United Way is $213. A floor on deductions could have a devastating impact on charities located in small communities and rural areas that rely most heavily on smaller donations.

- **Is there any reason not to pursue this route if it saves the government money and will increase the total value of charitable giving?**

  Answer: While I appreciate the Finance Committee's efforts in finding a win-win scenario for generating government revenue and increased donations, none of the CBO proposals would actually create the win-win you are seeking.

  There is not an easy answer here. My view is that, during these challenging economic times, Congress must protect those at the bottom of the economic spectrum. It appears that automatic sequestration will disproportionately impact low-income families, as discretionary social programs will be cut. Any changes to tax policy that would reduce the capacity of private sector charities to help people would be a double hit on those low-income families.

  I hope Congress will find a way to increase incentives for giving, rather than reduce them. In that spirit, my recommendation is that the Finance Committee make the charitable giving incentive more equitable by expanding the incentive to non-itemizers. This would create more equity in the tax code and help charities meet increased demands.

Questions from Senator Carper

Whenever I look to proposed changes in the tax code, I look at them through a prism of 4 questions.

Using the four questions, how would you evaluate two of the recommendations that have been put forward, 1) the President's 28 percent cap on deductions contained in his Budget proposal, and 2) the Simpson/Bowles Fiscal Commission proposal to replace the deduction with a 12 percent non-refundable tax credit?

- **Will the particular proposal encourage economic growth and provide a more nurturing environment for job creation?**

  Answer: Both proposals would reduce giving to charities. This would reduce the capacity of charities to help people in need. My primary concern is the impact both proposals would have on the families and individuals at the bottom of the economic spectrum. On that basis alone, I would urge the Committee to reject both proposals.

With that said, approximately 10% of the Nation's workforce is employed in the non-profit sector. Reductions in charitable giving caused by the two proposals you mention would cause job loss in our sector.

- **Is the proposal fiscally responsible and does it provide certainty and predictability for families and businesses that need to plan?**

  Answer: The charitable deduction has been a feature in the tax code for nearly one hundred years. Unlike other provisions in the tax code, which may have made planning challenging for some families and businesses, the permanency of the charitable deduction has lent itself to the certainty and predictability sought by taxpayers. Maintenance of the current deduction is the best way to ensure predictability for a component of the tax code that has proven effective.

- **Is the proposal fair?**

  Answer: The current deduction is fairer than both the proposals at issue in this question. The current charitable deduction rate tracks with the taxpayer's tax rate. The impact of that policy is that income that is donated to charity is treated as if it hadn't been earned in the first place. Whatever the tax rate, the deduction allows the taxpayer to "break-even" on donations to charity.

  Both the proposals reduce the relative incentive for some taxpayers, potentially making the tax code less fair.

  I won't state an opinion as to whether the current tax rates are fair or sufficiently progressive; however, I agree with Dr. Steuerle that progressivity is contained in the underlying tax rates, not in the deductions.

- **Does the proposal make the tax code simpler or more complex?**

  Answer: Currently, the charitable deduction rate is equal to the individual's tax rate. This is simple. Both the 12% credit and the 28% cap would make the tax code more complex.

- **Which plan would you be more likely to recommend to the Joint Select Committee on Deficit Reduction, given the 4 questions?**

  Answer: I would not recommend the 12% credit or the 28% cap to the Joint Select Committee on Deficit Reduction. In fact, United Way has urged the Committee to preserve the current charitable deduction.

I would like to add a comment, however, related to the Joint Select Committee on Deficit Reduction. In November 2011, as the deadline for a Committee agreement approached, there were news reports about a proposal that had been circulated by Democrats on the Committee. That proposal suggested partial deficit reduction by fast-track tax reform to generate revenue. The proposal included a trigger to incentivize tax reform by 2013. That trigger included "Feldstein-type limitation on itemized deductions for higher income taxpayers."

The Feldstein reference is to a proposal by Harvard Economist Martin Feldstein. While not expressly mentioned in the Democrat's proposal, it is important to note that Professor Feldstein has expressly suggested exempting changes to the charitable deduction from his proposal. To the extent the Finance Committee looks to the Feldstein proposal in the future, I recommend inclusion of his suggestion regarding the charitable deduction.

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October 17, 2011

The Honorable Timothy F. Geithner
Secretary
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The Honorable Douglas L. Shulman
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Washington, DC 20224

Dear Secretary Geithner and Commissioner Shulman:

I appreciate the letter from Acting Assistant Secretary (Tax Policy), Emily McMahon, regarding my August 11, 2011 letter to the President on the definition of loopholes. Further to that discussion, I am writing to inform you of a loophole that I have been concerned about for many years now. That is the exploitation of the supporting organization status in the Internal Revenue Code.

Enclosed please find a copy of the February 3, 2005, letter that then-Ranking Member Baucus and I sent to Treasury Secretary John Snow. At the time, abuse of Type III supporting organizations was our primary focus. However, I had also asked my staff to review Type I and Type II supporting organizations, including those mentioned in the 1998 ***Wall Street Journal*** article titled "Gimme Shelter: The SO Trend: How To Succeed in Charity Without Really Giving" as well as the George Kaiser Family Foundation (GKFF).

In March, 2005, my staff reviewed GKFF's Form 990 available at that time and noted the following:

- George Kaiser Family Foundation is a supporting organization that, according to its 990, supports the Tulsa Community Foundation.
- GKFF has $364 million of assets which include $215 million of stocks and $64 million in partnership interests and natural gas swap contracts.
- In 2002, it distributed $776, 000 (.2% of assets) including $500,000 to the Tulsa Community Foundation $300,000 of which went to the Kaiser Fund at Tulsa Community Foundation.
- If subjected to the private foundation minimum distribution requirements, the Foundation would have been required to distribute close to $18 million.

The *New York Times* specifically profiled the GKFF in its April 25, 2005, front-page story titled "Big Tax Break Often Bypasses Idea of Charity". This piece highlighted that GKFF had been a private foundation before converting to a supporting organization. Private foundations are subject to several rules that aren't applicable to public charities such as supporting organizations. These rules include 1) restrictions on ownership of business interests, 2) excise taxes on investment income, 3) payout requirements and 4) lower limits on the deductibility of contributions by individuals.

In light of GKFF's investment in Solyndra, I asked my staff to review GKFF's most recent Forms 990. Their analysis is attached. The numbers are very troublesome. GKFF's basis for the more favorable public charity status is that it supports the Tulsa Community Foundation (TCF). While its assets have grown to over $4 billion since 2005, its grants for the most recent three year period is less than 2% of its total assets – about $215.4 million. Of this amount, less than 5% was allocated to the TCF, or $10,464,012. Of those funds, it is unclear how much was allocated to the Kaiser family funds at the TCF as was done in 2002.

During this same time, GKFF received over $1 billion in contributions – over one-third of which were non-cash contributions. On page 2 of GKFF's 2009 Form 990, Schedule O, GKFF states that "George Kaiser is a substantial contributor to the George Kaiser Family Foundation." Given that the foundation is named after Mr. Kaiser, this is to be expected. Assuming that he was the only contributor, Mr. Kaiser was eligible to deduct the $1 billion of contributions up to 50% of his adjusted gross income (AGI) for contributions of cash and publicly-traded securities and 30% of his AGI for contributions of non-publicly traded securities. If GKFF had remained a private foundation, those limits would have been 30% and 20% respectively.

Moreover, if GKFF had remained a private foundation, GKFF would have been required to pay-out more than an additional estimated $230 million to charities in those three years and to pay excise taxes on its investment income. In addition, GKFF likely would not have been able to hold investments in the private equity and venture funds such as Argonaut, which was a key investor in Solyndra.

Separately, during the same time, the TCF received $462,801,083 in contributions. Thus, the $10,464,012 allocated to the TCF represents less than 2% of its total contributions for those years. GKFF's low pay-out to the TCF combined with the low level of support this amount represents to the TCF raises serious questions about GKFF's status as a supporting organization and thus its status as a public charity. This is well within the power of the Internal Revenue Service to review.

In the Pension Protection Act of 2006, Chairman Baucus and I shut down abuses by certain supporting organizations by applying private foundation rules to these organizations. However, as we stated in our 2005 letter to Secretary Snow, the Tax Reform Act of 1969 established supporting organizations as a limited exception to the private foundation definition. Recognizing this, we required the Treasury Department to submit a report to the Senate Finance Committee and House Ways & Means Committees on supporting organizations and donor-advised funds. This study was due to these Committees on August 17, 2007 <u>so it is now four years overdue.</u>

The study was supposed to address the following:

(1) whether the deductions allowed for the income, gift, or estate taxes for charitable contributions to sponsoring organizations of donor advised funds or to supporting organizations are appropriate in consideration of—

(A) the use of contributed assets (including the type, extent, and timing of such use),

or

(B) the use of the assets of such organizations for the benefit of the person making the charitable contribution (or a person related to such person),

(2) whether donor advised funds should be required to distribute for charitable purposes a specified amount (whether based on the income or assets of the fund) in order to ensure that the sponsoring organization with respect to such donor advised fund is operating consistent with the purposes or functions constituting the basis for its exemption under section 501, or its status as an organization described in section 509(a), of such Code,

(3) whether the retention by donors to organizations described in paragraph (1) of rights or privileges with respect to amounts transferred to such organizations (including advisory rights or privileges with respect to the making of grants or the investment of assets) is consistent with the treatment of such transfers as completed gifts that qualify for a deduction for income, gift, or estate taxes, and,

(4) whether the issues raised by paragraphs (1), (2), and (3) are also issues with respect to other forms of charities or charitable donations.

In the summer of 2009, my office was informed that the study was awaiting review by the incoming Assistant Secretary for Tax Policy. This person was confirmed and has since resigned. Now, the position is again vacant and occupied by Ms. McMahon in an Acting capacity.

Separately, five years since the enactment of the 2006 legislation, a key component of the reforms has yet to take effect – the pay-out requirement. The study was intended to inform the Treasury as to what was an appropriate pay-out level. The idea was that the pay-out requirement should be no less than what is required of private foundations since these supporting organizations were clearly formed to skirt the private foundation rules.

If the Administration is serious about closing loopholes, it should prioritize the completion of the study and the finalization of the pay-out rules for those supporting organizations Congress deemed to be exploiting the tax code. Both of these will be helpful as Congress continues to consider tax reform. I request that my staff be briefed on the status of both of these projects as soon as possible.

Sincerely,

Chuck Grassley

Charles E. Grassley
United States Senator

CEG/tp
enclosure

February 3, 2005

The Honorable John Snow
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Mr. Secretary:

We are writing to express our continued concern regarding the inappropriate use of charitable organizations for purposes of tax avoidance and evasion. While we are supportive of President Bush's efforts to encourage charitable giving, we would like to ensure that charitable contributions translate into actual additional assistance to those in need.

We are particularly concerned about section 501(c)(3) charitable organizations avoiding private foundation rules by claiming public charity status as a Type III supporting organization (SO) under section 509(a)(3) of the Code and section 1.509(a)-4(i) of the Treasury regulations. As a result of its own review as well as various newspaper articles, the Finance Committee is aware of the following abusive situations in which a taxpayer donates assets to a Type III SO and likely takes a charitable deduction for the claimed fair market value of the contribution:

1) The donated assets remain under the effective control of the donor while generating very little income for the charity. (The charity may be controlled by the taxpayer, such as a donor advised fund.) In one case, an SO with over $300 million in assets distributed in one year less than $1 million to the supported organization, a significant portion of which was to the donor advised fund controlled by the donor, and the SO had no other activities. This equates to a payout of approximately .3%. In contrast, a private foundation is generally required to payout 5% of the value of its non charitable use assets annually or, in this case, $15 million to charity.

2) The SO engages in offshore investment activities and, through several transactions, effectively returns the money to the taxpayer. It is our understanding that this scheme also allows the taxpayer to take a deduction and avoids tax on capital gains.

3) Soon after the donation, the taxpayer receives a loan back from the Type III SO up to the amount donated.

The common objective in these schemes involving supporting organizations is a very large charitable deduction for the donor with little charitable purpose served. The Finance Committee believes that often the "donation" is of assets that are difficult to value or are essentially illiquid such as stock in closely-held corporations or antiques which if donated to a private foundation and not to an SO would generate a deduction of the donor's basis and not a fair market value deduction. Such donations also raise concerns about inflated valuations which go hand-in-hand with tax evasion and avoidance. Moreover, the supported charity that does finally receive funds from the Type III SO is often effectively controlled by the donor so that both the SO and the supported organization become vehicles to hold the assets in perpetuity. Another situation of concern to the Finance Committee is one where an SO is established to support a foreign organization. Although to our knowledge, there have not been reported abuses involving SOs and foreign organizations, the Type III form of SO could be abused to generate improper deductions for contributions to foreign organizations.

We are aware the Internal Revenue Service is currently auditing a sample of supporting organizations. We would appreciate a status report on this initiative. The report should address the situations and issues described above as well as inform us of any other abuses the IRS may have uncovered. The report should also highlight organizations that may be abiding by the letter of exempt organizations law but are violating the spirit of our laws that encourage charitable giving. We are particularly interested in any efficiencies that can be gained through the use of non-routine enforcement techniques as well as impediments that may hinder the use of such techniques.

We are troubled that even though abuses in this area were reported by the Wall Street Journal over six years ago there still has not been effective action taken in this area. These abuses cannot continue. Type III supporting organizations are primarily a creature of Treasury Regulations. To that end, we ask: what combination of changes to the Regulations, IRS guidance and enforcement activities and legislation is needed to curb these abuses quickly?

We strongly encourage the Department of Treasury to revisit the regulations that have created the Type III supporting organizations. The Tax Reform Act of 1969 established supporting organizations as a limited exception to the private foundation definition. As stated in the General Explanation of that Act, "religious organizations other than churches, the Hershey Trust (which is organized and operated for the benefit of a specific school for orphaned boys and is controlled by or operated in connection with that school), university presses, and similar organizations are examples of organizations expected to qualify [as supporting organizations]." Even apart from abusive situations, the use of supporting organizations under present Treasury regulations appears to have departed from the original Congressional intent. It is difficult to believe that Congress intended for the strict regulation on private foundations contained in the 1969Act be eviscerated by the Treasury Department regulations governing Type III supporting organization.

Thank you for your time and attention to this matter. We ask for a response within thirty days given that the Finance Committee hopes to consider the President's proposals regarding charitable contributions in the near future.

Cordially yours,

Charles E. Grassley
Chairman

Max Baucus
Ranking Member

STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER U.S. SENATE COMMITTEE ON FINANCE HEARING OF OCTOBER 18, 2011 TAX REFORM OPTIONS: INCENTIVES FOR CHARITABLE GIVING

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining the effectiveness of tax incentives for charitable giving:

In particular, thank you for the indulgence of an extended opening statement. The issue of our tax code's treatment of charitable contributions is of critical importance to me, to the people of Utah, and to millions of Americans who give every year to their churches and their communities. I am deeply concerned that the current deduction for charitable giving is under quiet assault, and today's testimony does nothing to diminish those concerns.

Mr. Chairman, you have assembled an excellent panel to discuss the issue of our tax code's treatment of charitable giving. I am particularly pleased to have Elder Oaks and Mr. Gallagher testify today. They are uniquely qualified by their lives of service to provide the Committee with the insight we need to understand the importance of maintaining the current charitable deduction.

In advocating for the current deduction, I expect that they will be more diplomatic than I. But from my perspective the tax reform options being discussed today are options that target charitable giving concocted by those who, hungry for more taxpayer dollars to finance reckless government spending, are now casting their sights on the already depleted resources of charities and churches.

Alexis de Tocqueville wrote in *Democracy in America* of the importance of intermediate associations that stand between the individual and a centralized state. The Catholic Church speaks about *subsidiarity*, the principle that matters ought to be handled by the least centralized competent authority. To put these insights into constitutional terms, the federal government cannot — and should not — do it all. The truth of these moral and legal principles is embodied in the work of America's churches and charities, which have played a critical role in securing the welfare of Americans in the face of our nation's worst economic disaster since the Great Depression.

In no small measure thanks to the Administration's lack of focus on jobs and misguided economic policies, our economy is growing much too slowly and unemployment remains stuck above 9 percent. Our jobs deficit is enormous, and neither the President's first stimulus bill, nor its sequels, will get Americans working again. In this economic environment, the charitable community is more important than ever to those in need. As state and local governments grapple with budget deficits and revenue shortfalls, Americans in crisis are turning for help in ever greater numbers to churches, charities, shelters, and other social welfare groups. Charitable donations are the lifeblood of charities and the last thing Congress should do is interrupt the blood supply.

The Administration proposes to cap the itemized deduction at 28 percent, and we know the Administration would raise the top marginal tax rate on individuals to 39.6 percent if it could. One prominent research organization that studied the President's proposal to cap the tax deduction at 28 percent estimated that it would lead to a drop in total charitable giving of $6 billion. That cannot be allowed to happen.

The Congressional Budget Office has published a report that analyzes several proposals to place various limits on the charitable deduction. We will hear about that study today from Dr. Sammartino. However, most of the proposals described in the CBO report would result in less charitable giving, and one would cause a devastating drop of $10 billion per year in donations. Two of the proposals would increase federal tax expenditures by $5 billion and $7 billion per year, an unrealistic proposition in today's deficit climate. And two proposals are projected to increase donations and reduce federal tax expenditures at the same time. Frankly, that sounds too good to be true. And as we all know, when something sounds too good to be true, it probably is.

In addition to curbing the charitable deduction, proposals have been made to convert it to a non-refundable tax credit. The Bowles-Simpson Commission proposed a 12 percent tax credit and the CBO report describes a 15 percent and 25 percent tax credit.

We should make no bones about it. The changes being discussed today are radical ones. There has been a charitable deduction in the tax code for nearly a century, and the proposals on the table would undo it. This is not the area for experimentation by the federal government. Our charitable sector is just recovering from the steep drop in contributions that followed the 2008 stock market meltdown. Charities today face the prospect of enduring another recession that will again put downward pressure on charitable giving. This is not the time to reduce the charitable deduction and further suppress the incentive to give. And it is certainly not the time to experiment with the charitable deduction by converting it to a tax credit.

Commonsense tells us that a greater charitable tax incentive will result in a greater amount of charitable giving; assuming the capacity to give exists. It seems to me that this point is overlooked by those who criticize the charitable tax deduction on "fairness" grounds; that is, on the ground that it is unfair for a donor in a higher marginal tax bracket to receive a larger deduction than a donor in a lower bracket.

This sort of reasoning misses the point entirely. The tax deduction is not an end unto itself. The goal is not to reward some donors more than others. In fact, it's not really about the donor at all.

It's about the charity.

It's about directing sufficient resources to charities so they can carry forward the good works our society so desperately needs them to perform. It makes perfect sense to provide the greatest tax incentive for giving to the donors with the greatest capacity to give. The upper income donors, the ones in the high marginal tax brackets, are the very donors that are in a position to give substantial amounts to charity. It should come as no surprise that for nearly one hundred years the tax code has provided such an incentive.

This is not just an issue for high income donors, however.

It is important to remember that there has never been a floor on the charitable deduction either.

Nor should there be.

The charitable deduction begins with the first dollar given. We should rejoice that we live in a country where people of all income groups give generously to charity. Studies have actually shown that lower-income Americans, those with fewer dollars to spare, are actually more generous than wealthier Americans, giving away a greater percentage of their income than higher-income taxpayers.

Think about that. Taxpayers who receive little or no additional tax benefit for giving to their church or charity give faithfully anyway. Economists have a term for this behavior. It's called *inelastic charitable giving*. I call it *giving from the heart*. But it is this very behavioral prediction that has encouraged some to advocate for curtailing the charitable deduction by placing a floor on the deduction: a minimum amount below which no deduction would be allowed. One proposal would deny a donor the deduction except to the extent their charitable giving exceeded 2 percent of Adjusted Gross Income. The advocates of this proposal say the following:

> "An argument in favor of this option is that, even without a deduction, a significant share of charitable donations would probably still be made. Therefore, allowing taxpayers to deduct contributions is economically inefficient because it results in a large loss of federal revenue for a very small increase in charitable giving."

I have nothing against economists, but please.

Economically inefficient?

Inelastic giving?

I do not believe that Congress should change current law and take away the charitable deduction for modest gifts merely because we can rely on kind and faithful citizens to continue giving their hard-earned money to churches and charities regardless of the tax benefit they receive. That is just not right.

Harrisburg, Pennsylvania, the state capital, declared bankruptcy last week. What do you think will happen to the provision of city services in Harrisburg? Who will step into the breach? Churches and charities will. Poverty in America, including childhood poverty, is reported to be at the highest levels since 1993. These are our neighbors.

Who is there for them?

Local governments, yes.

But churches and charities are there too. The food banks and shelters are busier than ever and in need of donations large and small. I could go on, but we all have heard the stories. We all are aware of the need.

I would like to make another point about the charitable deduction that is a very personal one for me and for many Utahns and Americans across the country. Too often, including just recently, this Administration has taken actions that in my view undermine the mission of our nation's churches and religious institutions. I am deeply concerned that the effect of these proposals to reduce the tax benefit for charitable deductions would have a similar effect, and I urge those who are considering them to think long and hard before going down this path.

I'll just close by saying that the charitable tax deduction is unique. It is the only deduction that encourages you not to spend or invest your income, but to give it away. Every charitable gift has one thing in common: the donor is always left worse off financially. But society is made better. We curtail the charitable tax deduction at our peril.

I look forward to hearing the testimony of all of the witnesses. Thank you, Mr. Chairman.

###

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 446474

Mr. Kurt Micka
[redacted]

Email: [redacted]

Phone(s): (H) [redacted]

Activity Created: 10/14/2011
File Location: 1042869
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/14/2011 10:30:28 AM
Topic/Subject Desc: Taxes
Senator Hatch,

Thank you for your support of charitable giving, and your continued support of the Utah Family Foundation.

Kurt Micka
Utah Partners for Health
Executive Director

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 807424

Ms. Sarah Trescott
[redacted]

Email: [redacted]

Activity Created: 10/14/2011
File Location: 1042865
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/14/2011 11:11:51 AM
Topic/Subject Desc: Taxes
As a United Way supporter, I want to thank you for being a great defender of charitable deductions and for inviting Brian Gallagher, CEO of United Way Worldwide, to testify in defense of charitable deductions.

As you know, the ability of donors to deduct contributions to charity from their taxes is a cornerstone of the success of America's charitable tradition.

There are so many challenges facing nonprofits already and this economic downturn has left nonprofits with more demands and less funding. In a time when the need of average American's is so great, it is our nonprofit community that trying desperately to meet the demand for critical community services. Please do all you can to ensure that charitable donations are protected.

Thank you so much!
Sarah

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 807423

Ms. Linda Zimmermann
[redacted]

Email: [redacted]

Activity Created: 10/14/2011
File Location: 1042864
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/14/2011 11:33:53 AM
Topic/Subject Desc: Taxes

- As a United Way supporter, I want to thank you for being a great defender of charitable deductions and for inviting Brian Gallagher, CEO of United Way Worldwide, to testify in defense of charitable deductions.
- As you know, the ability of donors to deduct contributions to charity from their taxes is a cornerstone of the success of America's charitable tradition.
- As demands on nonprofits continue to increase over the next few years, we must ensure that charitable deduction continues to help enable charities to meet the demand for critical community-based services.

Thank you.

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 772614

Mrs. Marilyn Albertson
[redacted]

Email: [redacted]

Phone(s): (H) [redacted]

Activity Created: 10/14/2011
File Location: 1042850
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/14/2011 12:00:01 PM
Topic/Subject Desc: Human Services
Thank you for your support for charitable deductions. As a strong supporter of local programs such as United Way and other agencies that provide critical community based services,I see on a weekly basis the benefits to individuals of these services. When our economic situation is so challenging, more households are having to resort to assistance from others. Please don't penalize those of us who are trying to lessen their struggles.

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 807400

Mr. Michael Anglin
[redacted]

Email: [redacted]

Activity Created: 10/14/2011
File Location: 1042841
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/14/2011 3:15:00 PM
Topic/Subject Desc: Human Services
As a United Way supporter, I want to thank you for being a great defender of charitable deductions and for inviting Brian Gallagher, CEO of United Way Worldwide, to testify in defense of charitable deductions.

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 523714

Mrs. Shauna Brown
[redacted]

Email: [redacted]

Phone(s): (H) [redacted]

Activity Created: 10/14/2011
File Location: 1042839
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/14/2011 3:42:07 PM
Topic/Subject Desc: Other
As a United Way supporter, I want to thank you for being a great defender of charitable deductions and for inviting Brian Gallagher, CEO of United Way Worldwide, to testify in defense of charitable deductions.

As you know, the ability of donors to deduct contributions to charity from their taxes is a cornerstone of the success of America's charitable tradition.

As demands on nonprofits continue to increase over the next few years, we must ensure that charitable deduction continues to help enable charities to meet the demand for critical community-based services.

Thanks again,
Shauna K. Brown

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 414427

Chris Bray
[redacted]

Email: [redacted]

Phone(s): (H) [redacted]

Activity Created: 10/14/2011
File Location: 1042866
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/14/2011 11:03:29 AM
Topic/Subject Desc: Other
I want to thank you for being a great defender of charitable deductions and for inviting Brian Gallagher, CEO of United Way Worldwide, to testify in defense of charitable deductions.
As you know, the ability of donors to deduct contributions to charity from their taxes is a cornerstone of the success of America's charitable tradition.
As demands on nonprofits continue to increase over the next few years, we must ensure that charitable deduction continues to help enable charities to meet the demand for critical community-based services.

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 807773

Ms. Amanda Hewlett
[redacted]

Email: [redacted]

Phone(s): (H) [redacted]

Activity Created: 10/17/2011
File Location: 1043238
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/17/2011 1:05:04 PM
Topic/Subject Desc: Other
Dear Senator Hatch,
I want to personally thank you for defending charitable deductions.
As an organization that receives limited funding, we depend on contributions from donors to be able to accomplish many of our most important and innovative projects, including Head Start's Central Kitchen Job Training program where we prepare Head Start parents for a career in the food industry.
As demands on the economy and nonprofits continue to increase over the next few years, we must ensure that charitable deduction continues to assist organizations like Salt Lake Community Action Program meet the changing needs of the community.

With appreciation,
Amanda Hewlett
Grants and Resource Development Coordinator Salt Lake CAP Head Start

iawrmsg
Capitol Correspond
Incoming Email Message

Constituent ID: 807671

Shu Cheng, Ph.D.
[redacted]

Email: [redacted]

Phone(s): (H) [redacted]

Activity Created: 10/17/2011
File Location: 1043120
Interest Code(s): TAXES

Incoming Message:

RSP: Yes.

Date Received: 10/17/2011 6:02:13 PM
Topic/Subject Desc: Taxes
Senator Hatch,
Thank you for your support in preserving tax deduction for charitable donations. In this economic tough time, financial support for charitable causes has decreased dramatically. Keeping the charitable donation as a tax credit will minimize further decrease of donations. Your effort and effort is greatly appreciated.
Sincerely,
Shu Cheng, PhD
Asian Association of Utah

Testimony Submitted by Elder Dallin H. Oaks
Senate Finance Committee Hearing
October 18, 2011

I am Elder Dallin H. Oaks of the Quorum of the Twelve Apostles of The Church of Jesus Christ of Latter-day Saints.

I appear here to speak not only for churches and their charitable works, but also for the entire private sector, of which our churches and other charitable institutions are only a part.

While I appear here as a religious leader, the possible impairment of the charitable deduction in order to enhance tax revenues is not a religious issue. It is not a political issue. It is not even an economic issue. It poses a question about the nature and future of America.

The charitable deduction is vital to the private sector that is unique to America. Alexis de Tocqueville, one of the most astute observers of our nation in its infancy, wrote:

> "The Americans make associations to give entertainment, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the antipodes; and in this manner they found hospitals, prisons, and schools. If it is proposed to inculcate some truth or to foster some feeling by the encouragement of a great example, they form a society. Wherever at the head of some new undertaking you see the government in

France, or a man of rank in England, in the United States you will be sure to find an association."[1]

Today millions of these private "associations"—religious and charitable—are responsible for tens of millions of jobs and innumerable services that benefit our citizens at every level. I speak of private educational institutions, hospitals, social welfare agencies, and innumerable other organizations ministering to the needs of children, youth, the aged, the poor, and citizens generally. The financial well-being of this private sector is dependent upon private contributions that qualify for the charitable deduction. And the impact these private institutions have on those they serve is magnified by the millions of volunteers motivated by the ideals they pursue.

For example, in the aftermath of Katrina and the other 2005 Gulf Coast hurricanes, The Church of Jesus Christ of Latter-day Saints aided the cleanup efforts with almost 3,000 tons of emergency supplies, over $13 million in cash and use of heavy equipment, and its members gave more than 42,000 man-days of service. Other non-profit organizations provided over $3.5 billion in cash and in-kind donations to help with relief efforts.[2]

Another example concerns the unique role of our nation's churches, synagogues, and other religious organizations.

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[1] Alexis de Tocqueville, *Democracy in America*, Vol. 2, p. 114 (New York, Vintage Books, 1955).
[2] See Appendix for sources and details.

John Adams wrote: "Our constitution was made only for a moral and religious people. It is wholly inadequate to the government of any other." This wise Founding Father explained:

> "[We] have no government armed with power capable of contending with human passions unbridled by morality and religion. Avarice, ambition, revenge, or gallantry, would break the strongest cords of our Constitution as a whale goes through a net."[3]

Our nation is held together not just by law and its enforcement, but by voluntary obedience to the unenforceable and by widespread adherence to norms of right and wrong, such as the vital principle of honesty. For a large proportion of our citizens these essential norms are grounded in the principles of our religious beliefs, taught in our churches and synagogues.

There is no need to provide other examples. Throughout your life, each of you Senators and those you love have personally benefitted from a host of private organizations—some Church-related, but many not.

The private sector of charitable activity is almost unique and surely uniquely valued in America. And we all understand that its activities are funded by private donations produced or importantly stimulated by a charitable deduction that reduces the donor's taxes.

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[3] Charles Francis Adams, *The Works of John Adams,* Second President of the United States, 228-29 (Books for Libraries Press, 1969).

Some economists and other scholars contend that this is, in effect, a tax expenditure because tax revenues are reduced by the benefit granted. In other words, because the government could have denied the charitable deduction there is a government expenditure in its granting the deduction and forgoing the revenue. By that reasoning the personal income we think is ours is really the government's because of its choice not to take it away by taxation. That is surely an attitude not shared by most Americans.

Some also assert that reductions in the charitable deduction would not cause charitable organizations to suffer financial losses from decreased private gifts since the government would make up some of these losses by additional appropriations. Again, I submit that most Americans would not have us relinquish the freedom and diversity of our vigorous private sector of charities in exchange for the assurance that the government would select and manage their functions.

We are grateful for charitable deductions, which encourage donations to churches and other charities. The effect of this tax benefit is built into the financing of charitable enterprises that are vital to our nation, and it is a significant and wise support of the private sector. The charitable deduction should remain unimpaired, not just for religions and their unique role but for the benefit of the entire private sector of our nation.

I close with a quote from an 1830 debate in the United States Senate on a matter of great national importance. These words provide an appropriate reminder during the current discussion of the advisability of modifying the charitable deduction. We have heard arguments pro and con, with complex and competing analyses. So it was in Senator Daniel Webster's day, when he offered this suggestion:

> "When the mariner has been tossed for many days in thick weather, and on an unknown sea, he naturally avails himself of the first pause in the storm, the earliest glance of the sun, to take his latitude, and ascertain how far the elements have driven him from his true course. Let us imitate this prudence, and, before we float farther on the waves of this debate, refer to the point from which we departed, that we may at least be able to conjecture where we now are."[4]

"Where we now are" is midway in a discussion of whether the charitable deduction—so essential to maintaining the private sector of American life—is to be retained intact. That private, non-profit sector has always been an important counterweight to the powers and potentially repressive influence of governments. The private sector is essential to preserving pluralism and freedom in our nation.

In behalf of countless churches and other charities, and in behalf of the tens of millions who are benefited by their services and by the services of the millions of volunteers who are motivated by them, I say, don't impair the charitable deduction!

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[4] *The Works of Daniel Webster*, 10th ed., vol. 3, p. 270.

Appendix

PRIVATE CHARITABLE RESPONSES TO THE GULF COAST HURRICANES IN 2005

The Church of Jesus Christ of Latter-day Saints

Before Hurricane Katrina hit land, fourteen truckloads of supplies from The Church of Jesus Christ of Latter-day Saints were being moved into position to distribute food, water, and emergency equipment to people in storm devastated areas. Over the next few months, a total of 140 semi-trucks carrying 2,800 tons of donated supplies arrived in the Gulf Coast. Thousands of LDS volunteers, from every state in the Union, spent their own time and money to travel to the coast and help in the cleanup efforts; they donated more than 42,000 man-days of service. Some wielded chainsaws or drove dump trucks, Bobcats, or back hoes, removing heavy debris. Others handed out food and clothing, hygiene kits, generators, tents, sleeping bags, and tarps. Trained social workers and counselors offered their expertise. At least ten meetinghouses were opened to provide temporary housing, and LDS computer programmers set up a system to connect people who needed housing with those offering places to stay. During the next year, members provided the labor to help repair and rebuild 200 homes. Members served however they were needed, as part of an organized army or as individuals providing one-on-one charity.[5]

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[5] Records of The Church of Jesus Christ of Latter-day Saints.

Other Faith-Based and Community Organizations and Disaster Relief Agencies

Over $3.5 billion dollars were contributed to relief and recovery operations after the Gulf Coast hurricanes. This number includes $3,378,185,879 cash donations, and $166,624,000 in-kind donations including water, food, drinks, clothing, medical equipment and supplies, housing, transportation, equipment, and volunteer services. For example, Catholic Charities donated over $154,000,000 to relief efforts. The American Red Cross reported $2.1 billion in cash donations for hurricane relief in 2005. Over 200,000 Red Cross volunteers made sure that survivors had a safe place to stay, food, and the means to provide essential items for themselves and their families. They provided more than 3.4 million overnight stays in nearly 1,200 Red Cross shelters, more than 34 million meals and snacks, and emergency financial assistance to more than 4 million people. Hundreds of organizations stepped up to provide funding or manpower to rebuild lives, homes and businesses.[6]

[6] The Center on Philanthropy at Indiana University, "Disaster Giving 2005: Size, Scope, and Effects on the Nonprofit Sector," Nov. 16, 2006, and spreadsheet published 20 Feb. 2006; The Foundation Center, "Snapshot of Philanthropy's Response to the Gulf Coast Hurricanes," Feb. 2006; Congressional Budget Office, "Progress Made: A 6-Month Update on Hurricane Relief, Recovery and Rebuilding," 28 Feb. 2006.

THE CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS
THE QUORUM OF THE TWELVE APOSTLES
47 EAST SOUTH TEMPLE STREET, SALT LAKE CITY, UTAH 84150-1200

November 15, 2011

Senator Max Baucus
United States Senate
Committee on Finance
Washington DC 20510-6200

Dear Senator Baucus:

Thank you for your letter, dated October 27, 2011, and the written questions that accompanied it, which are a follow-on to my testimony before the Senate Finance Committee on October 18, 2011, regarding "Tax Reform Options: Incentives for Charitable Giving." It was an honor to testify before the Committee and I appreciate the courtesy of these additional questions.

As I hope my testimony made clear, I believe that the charitable deduction is essential as an incentive to charitable giving. Laws, including tax laws, often teach or shape societal values. Personal charity is just such a value that should be encouraged. By contrast, forced "charity" through government exactions to support the portion of nonprofit sector chosen by government would be destructive of such values.

As a matter of public policy, volunteer charities should be encouraged across all economic classes. Consequently, a charitable deduction or other incentive should be allowed for non-itemizers. The standard deduction could be adjusted to make this revenue-neutral.

In my experience, donor motivation in making a charitable gift proceeds principally from true charity, as it should. But undervaluing that motivation and the associated tax deduction by treating it as a "tax benefit" or a "tax expenditure"—or, worse eliminating the deduction altogether—would almost certainly result in a marked disincentive for such giving.

I urge Congress to retain the charitable deduction and avoid changes that would undercut the donor motivations that serve us so well.

Kindest regards.

Sincerely,

Dallin H. Oaks

Dallin H. Oaks

Tax Reform Options: Incentives for Charitable Giving
United States Senate Committee on Finance
October 18, 2011

Statement for the Record
Senator Pat Roberts

Mr. Chairman, thank you for holding this hearing on the incentives for charitable contributions. I am pleased we are looking into this issue as we consider reform of the tax code.

The not-for-profit sector in our economy plays a significant and growing role in providing a vast array of services. These services range from providing health care, to education, to helping our military veterans', our elderly population, and people suffering from the economic downturn. There's a lot more out there that these folks do, but the list of how they help us all is too long to recite.

In many cases, these are services that cannot be effectively offered by the government or are things that the federal, state, and local government can no longer afford to provide. Yet the demand for these services is growing every day. We are truly lucky we have a committed, innovative and effective pool of charitable organizations in the country. They are instrumental in building communities, educating our children, and caring for the sick, the aged or disadvantaged. They are, in fact, critical to the health of our nation and its economy, employing millions, but helping many more millions, improving things for us all in innumerable ways.

As we consider reforming the tax code, it's important to keep these facts in mind. But we also need to be mindful of how the not-for-profit sector funds the vital services it provides. More than 70 percent of all charitable giving in the US is done by individuals. In the last 4 years, however, donations have dropped by about 20 percent. In fact, recent studies indicate that charitable giving would decrease by billions of dollars if limits are placed on the deduction. Since the nonprofit sector employs almost 10 percent of the workforce nationwide, I would call such a proposal a job killer.

In Kansas, I am proud to say we have a robust not-for-profit sector, which employs 85,000 people and provide millions of dollars in services to Kansans every year. It's certainly misguided in this economy to consider proposals that would make the operations of these charities more difficult.

I am afraid that limiting the itemized deduction will lead to a decrease in charitable contributions. This would be disastrous in the current economy, and would lead to a reduction in services, less investment in communities, and job losses in the organizations at the exact time when the assistance these organizations provide is most needed.

I know we will discuss alternatives to the current deduction for charitable contributions, either fundamental revisions, additional limits, or an outright repeal.

There also may be consideration of changes to the types of organizations eligible for tax exempt treatment under the code. In considering the eligibility rules for exempt organizations, we need to tread carefully. For example, there are unique and important not-for-profit structures, such as fraternal benefit organizations and farmland conservation easement trusts, which contribute greatly to the public good.

According to a recent Georgetown University study, the public investment in the fraternal model network is leveraged 68-fold in terms of benefits to society. Fraternal organizations, which have existed for more than a century, as well as their member-volunteers across the country, are on-the-ground positioned for impact to meet needs and work to build valuable social capital in communities in a way that would be impossible to replace. The incentives for farmland easements, likewise, play a critical role in communities by allowing private landowners to protect farmland from development.

As we consider revisions to the tax code that would impact the not-for-profit sector, i urge my colleagues on the committee to keep in mind the vibrant, diverse and increasingly vital role these organizations play in our nation – and how we must preserve and encourage their work, not stifle it. We must keep in mind the importance of the various structures eligible for tax exempt status and the role they play in this sector. We also must keep in mind the importance of proper incentives for people to donate to these worthy organizations.

Thank you, Mr. Chairman.

Congressional Budget Office

Testimony

Statement of
Frank J. Sammartino
Assistant Director for Tax Analysis

Options for Changing the Tax Treatment of Charitable Giving

before the
Committee on Finance
United States Senate

October 18, 2011

This document is embargoed until it is delivered at 10:00 a.m. (EDT) on Tuesday, October 18, 2011. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Chairman Baucus, Senator Hatch, and Members of the Committee, I appreciate the opportunity to appear before you today to discuss options for changing the tax treatment of charitable giving. My written testimony reprises the Congressional Budget Office's (CBO's) most recent report on that topic, which was published in May 2011.

Summary

Under current law, taxpayers who itemize deductions may deduct the amount they donate to charities from their adjusted gross income (AGI) when determining how much they owe in federal income taxes. That deduction gives people who itemize an incentive to contribute to charities. Like other forms of preferential tax treatment, the deduction also costs the federal government revenues that it might otherwise collect. At current levels of charitable giving, the cost of that deduction—measured as the additional revenues that could be collected if the deduction was eliminated—will total about $230 billion between 2010 and 2014, according to the Joint Committee on Taxation (JCT).[1]

Numerous proposals have been made in recent years to alter the income tax treatment of charitable giving by individual donors. Some proposals aim to reduce the cost to the government by imposing a floor (or minimum level) that a person's charitable giving would have to exceed to qualify for preferential tax treatment. Other proposals would extend the current charitable deduction to taxpayers who do not itemize deductions or would replace the current deduction with a nonrefundable tax credit available to all taxpayers who make charitable contributions.[2]

For this analysis, CBO examined how much taxpayers in various income groups donate to charities and what types of organizations receive those donations. CBO also investigated how changing the structure of tax incentives for giving would affect the tax subsidy (the cost in forgone revenues to the federal government), the overall level of charitable giving, and the extent to which different income groups benefit from the tax preference. Specifically, CBO looked at 11 options for altering the current income tax treatment of charitable giving, which can be grouped into 4 categories:

- Retaining the current deduction for itemizers but adding a floor.
- Allowing all taxpayers to claim the deduction, with or without a floor.
- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 25 percent of a taxpayer's charitable donations, with or without a floor.
- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 15 percent of a taxpayer's charitable donations, with or without a floor.

For each of the four categories, CBO analyzed two potential floors: a fixed dollar amount ($500 for single taxpayers and $1,000 for couples filing a joint return) and a percentage of income (2 percent of AGI). Only contributions in excess of the floor would be deductible or eligible for a credit. The analysis uses data for 2006, the most recent year for which the Internal Revenue Service's public-use sample of individual income tax returns is available. The tax treatment of charitable contributions is generally the same today as it was in 2006; however, because of rising incomes and contribution amounts, the options that include a fixed dollar floor would have a somewhat different impact today than presented here.

Effects of Policy Options on Tax Subsidies and Charitable Donations

According to CBO's modeling, adding a contribution floor to any of the approaches listed above would reduce both the total federal tax subsidy and the total amount donated to charity, relative to the same option without a floor. In each case that CBO examined, the reduction in the subsidy (and thus the increase in revenues) would exceed the reduction in charitable contributions, whether measured in dollars or as a percentage change. The reason is that introducing a floor would continue to provide a tax incentive for additional giving above the level of the floor and at the same time reduce the tax subsidy for

1. A deduction for charitable contributions also exists under the corporate income tax. JCT estimates a much smaller five-year cost for that deduction: about $17 billion. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2010–2014*, JCS-3-10 (December 15, 2010), www.jct.gov/publications.html?func=startdown&id=3718.

2. Taxpayers can use tax credits to reduce their income tax liability (the amount they owe). Nonrefundable credits can lower income tax liability to zero, but excess credits cannot be used to increase tax refunds. In contrast, refundable credits that exceed income tax liability are paid to taxpayers as refunds.

Table 1.

Summary of Total Donations and Tax Subsidies Under Current Law and Eleven Policy Options, 2006

	Floor for Eligible Donations	Total Contributions (Billions of 2006 dollars)	Tax Subsidy (Billions of 2006 dollars)
		Current Law	
Deduction Available Only to Itemizers	No floor	203.0	40.9
		Change from Current Law	
Keep Deduction Available Only to Itemizers but Add Floor			
Option 1	$500/$1,000	-0.5	-5.5
Option 2	2 percent of AGI	-3.0	-15.7
Extend Deduction to All Filers			
Option 3	No floor	2.0	5.2
Option 4	$500/$1,000	0.8	-2.5
Option 5	2 percent of AGI	-1.9	-13.1
Convert Deduction to 25 Percent Nonrefundable Credit for All Filers			
Option 6	No floor	2.7	7.1
Option 7	$500/$1,000	1.5	-2.4
Option 8	2 percent of AGI	-1.0	-11.9
Convert Deduction to 15 Percent Nonrefundable Credit for All Filers			
Option 9	No floor	-7.8	-13.3
Option 10	$500/$1,000	-8.6	-19.0
Option 11	2 percent of AGI	-10.0	-24.6

Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels.

$500/$1,000 = $500 for individual filers and $1,000 for joint filers; AGI = adjusted gross income.

donations that people might have made even without a tax incentive.[3]

Allowing all taxpayers to claim a deduction for charitable giving would have increased donations in 2006 by an estimated $2.0 billion (or 1 percent) and increased the total tax subsidy by $5.2 billion (or 13 percent) from the 2006 amounts. Combining a deduction for all taxpayers with a floor, however, could both increase donations and decrease the tax subsidy. For example, such a deduction combined with a fixed dollar floor of $500/$1,000 would have increased donations by $800 million in 2006 and decreased the tax subsidy by $2.5 billion (see Table 1).

Replacing the current deduction with a 25 percent tax credit would increase donations and also increase the government's forgone revenues. Combining such a credit with certain contribution floors, however, could boost donations while reducing the tax subsidy or could decrease donations by a small percentage while reducing the tax subsidy by a large percentage. Setting the credit at 15 percent would reduce donations but would reduce the tax subsidy by a larger amount (both in dollars and as a percentage change).

3. The fact that some nonitemizers contribute to charities despite receiving no tax benefits for doing so suggests that a substantial amount of charitable giving would still occur in the absence of a tax incentive.

Effects of Policy Options on Various Income Groups

Changing the tax treatment of charitable contributions would have differing effects on taxpayers at different points on the income scale. Adding a contribution floor to the current deduction for itemizers would reduce tax subsidies for all income groups, but for high-income taxpayers, the size of the reduction would vary significantly depending on the type of floor used. For instance, augmenting the deduction with a fixed dollar floor of \$500/\$1,000 in 2006 would have lowered the tax subsidy for people with AGI over \$100,000 by 0.08 percent of their AGI, whereas adding a floor equal to 2 percent of AGI would have lowered the tax subsidy for that income group by 0.30 percent of their AGI.

Making the deduction for charitable contributions available to nonitemizers would benefit lower- and middle-income taxpayers, who tend not to itemize deductions because their deductible expenses (such as mortgage interest and state and local taxes, as well as charitable donations) are not large enough to exceed the standard deduction. Those groups would benefit even more if the current deduction—which tends to help higher-income taxpayers more because they face higher tax rates—was replaced with a nonrefundable credit that gave all income groups the same tax incentives for giving. For example, replacing the deduction with a 25 percent credit in 2006 would have increased the tax subsidy for taxpayers with AGI below \$100,000 by 0.27 percent of their AGI, but it would have decreased the tax subsidy for people above that income level by 0.09 percent of AGI. Tax subsidies would be lower for all income groups with a 15 percent credit than with a 25 percent credit.

Caveats About This Analysis

The results of CBO's policy simulations are meant to highlight the general effects of the various approaches. The exact size of those effects, however, would depend on the specific parameters of a policy—such as the level of the floor or the amount of the credit—as well as on the extent to which taxpayers would change the amount of their charitable giving in response to a change in the tax subsidy. In addition, this analysis does not reflect many of the other ways in which taxpayers might respond to a change in their tax subsidy, such as shifting donations between years. (In the appendix of its May 2011 study *Options for Changing the Tax Treatment of Charitable Giving,* CBO examines how sensitive these results are to several different assumptions, including variations in taxpayers' responsiveness to changes in their tax subsidy and the possibility of shifts in the timing of donations.)

Options for Changing the Tax Treatment of Charitable Giving: Introduction

Taxpayers who itemize deductions on their federal income tax returns can reduce their tax liability by deducting their donations to qualified nonprofit organizations—including organizations dedicated to religious, charitable, scientific, literary, or educational purposes. Both monetary contributions and the value of donated financial assets or other property are deductible, subject to certain annual limits (see Box 1). The tax treatment of charitable giving, which has evolved over time, provides various incentives for donations.

Although corporations can also deduct their charitable donations, this testimony focuses on contributions by individual donors. It examines patterns of individual charitable giving and finds that the majority of such giving comes from a small number of taxpayers with high incomes. The testimony also reviews concerns about the current tax treatment of giving and assesses how various changes to that treatment would affect the amount of donations made, the tax subsidies for them, and the distribution of those subsidies by income group.

History of Tax Incentives for Charitable Giving

The deduction for charitable donations is a long-standing feature of the individual income tax: It was created in 1917, just four years after the modern income tax began.[4] The amount of charitable contributions that could be deducted was initially capped at 15 percent of a taxpayer's income. In general, the deduction applied only to high-income people, because they were the only ones required to pay the income tax in its early years.

During World War II, as the income tax expanded to cover three-quarters of the U.S. population, the standard deduction was introduced as an option for taxpayers.[5]

4. The charitable deduction was enacted in the War Revenue Act of 1917.

5. The standard deduction makes tax filing simpler because taxpayers do not need to keep track of all of their itemized expenses. (Besides charitable donations, major expenses that can be deducted include mortgage interest, state and local taxes, and medical costs that exceed a certain percentage of a taxpayer's adjusted gross income.) In addition, the standard deduction lowers the tax burden for taxpayers who have small amounts of itemizable deductions. For 2011, the standard deduction is \$5,800 for single filers, \$11,600 for joint filers, and \$8,500 for heads of households.

Box 1.

Current-Law Limits on the Deduction for Charitable Contributions

Under current law, deductions for cash donations may not exceed 50 percent of a taxpayer's adjusted gross income (AGI). Deductions for donated property that has appreciated in value since it was initially acquired are generally limited to 30 percent of AGI. Although donations of appreciated property are subject to a lower percentage cap, to the extent that they fall below the cap, they receive more-favorable tax treatment than cash contributions do. The reason is that taxpayers do not have to pay income tax on capital gains from appreciated property that they donate, even though they can claim the fully appreciated value as a deduction. Deductions that are limited by those percentage-of-income caps can be claimed in future years (as long as total deductions in those years remain below the caps).

Beginning in 2013, with the expiration of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111-312), high-income taxpayers will be subject to an additional limit on deducting charitable contributions. At that point, if a taxpayer's AGI exceeds a specific threshold, total itemized deductions will be reduced by 3 percent of the income above that threshold (with the total reduction limited to 80 percent of the sum of certain deductions). Because that limit is based on the amount of income above the threshold, not on the amount of itemized deductions, it will not affect a taxpayer's marginal incentive to give an additional dollar to charity.

The deductibility of charitable contributions was then limited to taxpayers who chose to itemize deductions for specific expenses they had incurred rather than claim the standard deduction. (In determining the initial size of the standard deduction, officials took into account a certain typical amount of charitable contributions.)[6]

Nonitemizers were allowed to deduct their charitable contributions for a brief period during the 1980s. The Economic Recovery Tax Act of 1981 created a temporary "above-the-line" charitable deduction, permitting taxpayers who opted for the standard deduction to also deduct charitable contributions.[7] That provision was gradually phased in starting in 1982 and took full effect for 1986, after which it was allowed to expire.

Besides making charitable contributions during their lifetime, people can bequeath donations to charities from their estates upon their death. Such bequests, although not the focus of this analysis, can be deducted when determining estate taxes.[8] Charitable giving during one's lifetime has advantages over bequests, however, because it can decrease individual income taxes now as well as estate taxes later (by reducing the size of the estate that is left) rather than just decreasing estate taxes.[9]

How Tax Incentives Affect Giving

By allowing itemizers to deduct their donations, the government indirectly subsidizes charitable activities. For example, someone in the 25 percent tax bracket faces an after-tax price of only 75 cents when giving a dollar to charity. In other words, a person in that bracket who donates $1 to charity has his or her taxes reduced by 25 cents, so his or her consumption and savings decline by just 75 cents. In general, the deduction lowers the after-tax price per dollar of charitable contributions from $1 to $1 multiplied by the difference between one and the marginal tax rate.

6. See the statement of Congressman Willis A. Robertson, *Congressional Record*, vol. 90, 78th Cong., 2nd sess. (1944), p. 3973.

7. From 1982 to 1984, the deduction was capped at between $50 and $300. For 1985 and 1986, the cap was removed; instead, nonitemizers could deduct 50 percent of their charitable contributions in 1985 and 100 percent of their charitable contributions in 1986.

8. See Congressional Budget Office, *The Estate Tax and Charitable Giving* (July 2004).

9. That statement is based on the assumption that earnings and consumption behavior are not affected by whether donations are made before or after death.

Although the underlying motives for charitable giving are complex and not fully understood by economists, empirical studies generally find that taxpayers respond to the after-tax price of giving to some degree. Such tax incentives are limited, however, to the subset of taxpayers who itemize, and they favor high-income people, who face relatively higher marginal tax rates. That situation raises several questions: Could tax subsidies for charitable giving be extended to more taxpayers without costing the federal government large amounts of forgone revenue? Could the subsidies per dollar of giving be made equal for taxpayers across the income distribution? This analysis examines how policy options to address those questions would affect donations, revenue costs, and the distribution of tax benefits.

Patterns of Individual Charitable Giving

Donations by individuals make up the majority of contributions to U.S. charities. According to the Center on Philanthropy at Indiana University, U.S. charities received a total of $304 billion in contributions in 2009 (equal to 2.2 percent of gross domestic product that year).[10] Of that amount, $227 billion, or approximately 75 percent, was donated by individuals. The other 25 percent came from foundations, corporations, and estates (bequests).

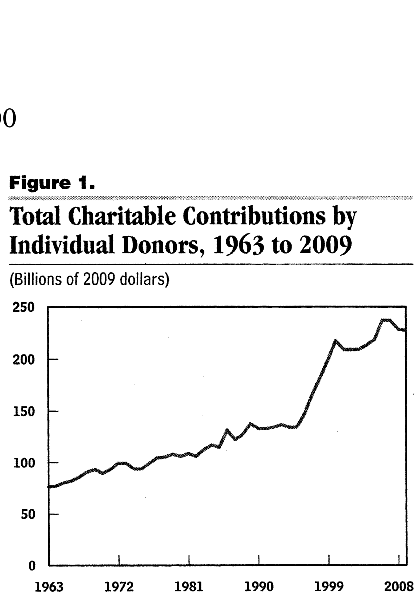
Trends in Donations over Time

From the mid-1960s to the mid-1990s, individual giving rose steadily, even after accounting for inflation. Over the following five years, such giving soared, growing by more than 60 percent between 1995 and 2000 (see Figure 1). That surge was probably tied closely to gains in the stock market. As the stock market declined after 2000, inflation-adjusted individual giving fell by 4 percent in 2001 and stagnated through 2003, before increasing by more than 13 percent between 2003 and 2007. With the recession and renewed decline in the stock market that began in late 2007, inflation-adjusted individual giving declined by almost 4 percent in 2008 and stayed flat in 2009.

Figure 1.

Total Charitable Contributions by Individual Donors, 1963 to 2009

(Billions of 2009 dollars)



Source: Congressional Budget Office based on data from the Center on Philanthropy at Indiana University, *Giving USA 2010: The Annual Report on Philanthropy for Year 2009* (Chicago: Giving USA Foundation, 2010).

Among people who filed tax returns, charitable giving averaged about 2.5 percent of income in 2008 (the latest year for which such information is available). That figure includes itemizers who deducted charitable donations as well as nonitemizers, whose charitable giving was estimated by CBO on the basis of surveys in which people report their contributions to charity. Giving as a share of income was fairly similar for most income groups in 2008, except for the highest-income taxpayers. Among people reporting more than $500,000 in adjusted gross income that year, charitable giving averaged about 3.4 percent of income (see Figure 2).[11]

Higher-income households account for a significant portion of individual giving. People who reported AGI of at least $100,000 in 2008 were responsible for about 58 percent of charitable giving by taxpayers, although they made up less than 13 percent of tax filers (see Table 2). At the top of the income scale, less than 1 percent of taxpayers had AGI over $500,000, but they

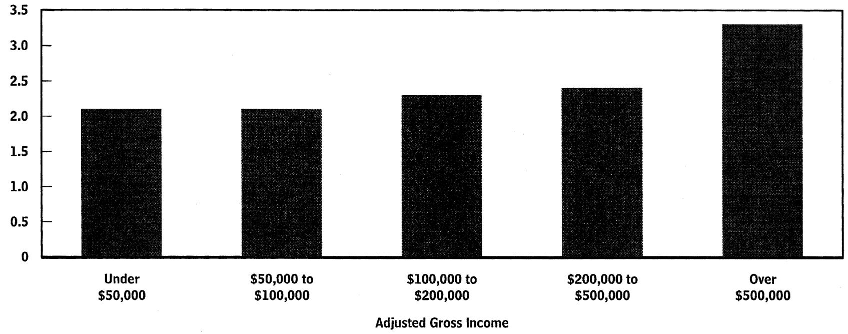
10. See Center on Philanthropy at Indiana University, *Giving USA 2010: The Annual Report on Philanthropy for Year 2009* (Chicago: Giving USA Foundation, 2010).

11. For itemizers, giving as a share of income is U-shaped: The giving rates at both ends of the income distribution are higher than those in the middle.

Figure 2.

Percentage of Income That Tax Filers Contribute to Charity, by Income Group, 2008

(Percentage of adjusted gross income)



Source: Congressional Budget Office based on data from Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns 2008* (revised July 2010); the Federal Reserve Board's 2004 Survey of Consumer Finances; and the Bureau of Labor Statistics' 2002 Consumer Expenditure Survey.

Note: Includes CBO's estimates of charitable contributions by people who filed income tax returns in 2008 but did not itemize deductions.

made 24 percent of the total charitable contributions by taxpayers in that year.

Recipients of Donations

Data from tax returns do not identify the different organizations to which individuals make donations.[12] Instead, researchers in one study examined patterns of household giving using surveys by the University of Michigan and Bank of America.[13] They found that, in general, the higher a household's income, the smaller the share of donations that went to religious causes and the larger the share that went to causes related to health, education, and the arts. For example, among households with AGI below $100,000, 67 percent of giving was directed toward religious organizations, and only 7 percent went to institutions that focus on health, education, or the arts (see Figure 3 on page 8). Among households that reported at least $1 million in income, the situation was reversed: Just 17 percent of donations were made to religious organizations, and 65 percent were made to support health-, education-, or arts-related activities.

Concerns About the Current Tax Treatment of Charitable Giving

The present income tax treatment of charitable giving subsidizes certain taxpayers' donations to charitable organizations and activities. Although those donations are generally seen as benefiting all of society, concerns have been raised about the current structure of the federal subsidy—in terms of the amount of forgone tax revenues, the incentives for donating, and the degree to which taxpayers respond to those incentives.

12. The recipient organization is sometimes reported for donations by itemizers, but even in those cases, the fact that many organizations serve multiple functions makes it difficult to categorize the contributions by type of recipient.

13. See Center on Philanthropy at Indiana University, *Patterns of Household Charitable Giving by Income Group, 2005* (Indianapolis: Indiana University–Purdue University, 2007). In that study, estimates of giving by households with annual income below $200,000 were based on the Center on Philanthropy Panel Study, a module of the Panel Study of Income Dynamics conducted by the University of Michigan. Estimates for households with annual income above $200,000 were based on data from Bank of America's Study of High Net Worth Philanthropy.

Table 2.

Charitable Contributions, by Tax Filers' Itemizing Status and Income Group, 2008

Adjusted Gross Income	Number of Tax Returns (Millions)	Share of Tax Returns (Percent)	Share of Total Income (Percent)	Percentage of Filers with Charitable Contributions[a]	Amount of Charitable Contributions (Billions of dollars)[a]	Share of Charitable Contributions (Percent)[a]
			All Filers			
Under $50,000	93	65	21	53	37	19
$50,000 to $100,000	31	22	27	81	47	24
$100,000 to $200,000	14	10	22	90	43	21
$200,000 to $500,000	3	2	12	93	24	12
Over $500,000	1	1	18	94	49	24
Total	**142**	**100**	**100**	**64**	**199**	**100**
			Itemizers			
Under $50,000	14	29	8	70	20	12
$50,000 to $100,000	18	37	23	82	40	23
$100,000 to $200,000	12	25	28	90	41	23
$200,000 to $500,000	3	7	17	93	24	14
Over $500,000	1	2	25	95	49	28
Total	**48**	**100**	**100**	**81**	**173**	**100**

Source: Congressional Budget Office based on data from Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns 2008* (revised July 2010); the Federal Reserve Board's 2004 Survey of Consumer Finances; and the Bureau of Labor Statistics' 2002 Consumer Expenditure Survey.

a. Includes CBO's estimates of charitable contributions by people who filed income tax returns in 2008 but did not itemize deductions.

Cost to the Government of Subsidizing Charitable Contributions

The revenue cost to the government of the charitable deduction is not obvious from the total dollars donated or deducted because the tax rate that would have applied to the income had it not been donated (the marginal tax rate) varies greatly among individuals. The marginal rate can even vary for the same person depending on how much he or she donates. One way to estimate the revenue loss from charitable contributions is to simulate the change in tax revenues that would result if there were no deduction for charitable contributions and compare that result with actual revenues using a microsimulation model that can calculate the difference in taxes from a representative sample of tax returns. Using that approach, CBO estimates that the tax subsidy associated with the charitable deduction totaled $40.9 billion for 2006.

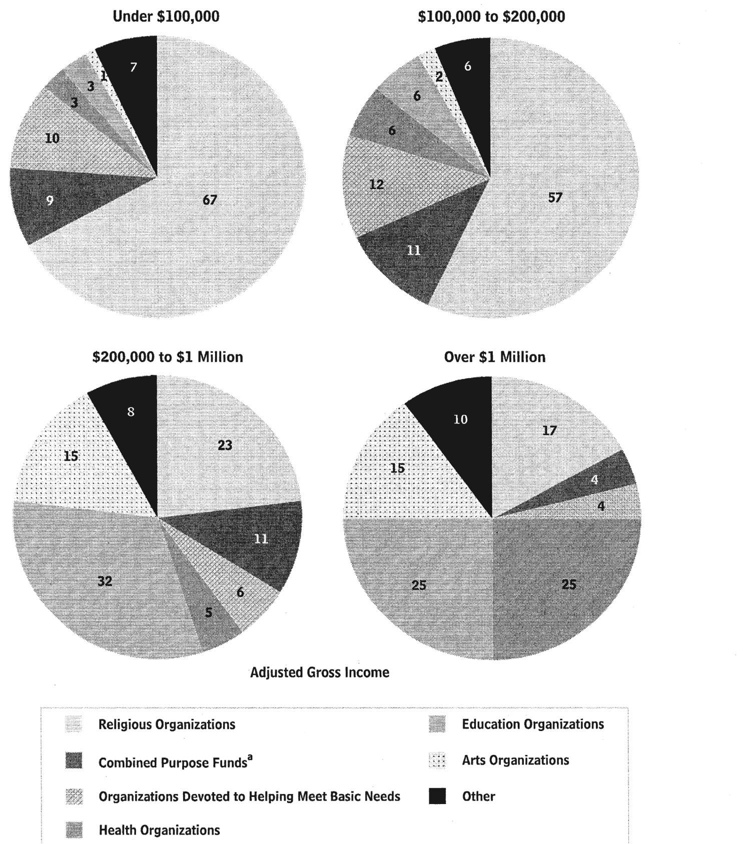
The subsidy for charitable giving is concentrated among high-income taxpayers to an even greater extent than donations are (see Figure 4 on page 9). Although taxpayers reporting adjusted gross income of at least $100,000 accounted for 11 percent of tax returns and 57 percent of charitable contributions in 2006, they received 76 percent of the tax subsidy associated with charitable deductions. In contrast, taxpayers reporting AGI of less than $50,000 filed 66 percent of returns, accounted for 19 percent of charitable donations, and received 5 percent of the tax subsidy for donations.[14] The difference in the tax subsidy occurs because higher-income people are more likely to itemize deductions (and thus to receive a tax subsidy for donations) and because higher-income people generally pay higher marginal tax rates and thus receive a larger subsidy (relative to other itemizers) per dollar of donation.

14. Those numbers include CBO's estimates of charitable contributions by income tax filers who did not itemize deductions.

Figure 3.

How Donors Allocate Their Charitable Contributions, by Income Group and Type of Recipient, 2005

(Percentage of donations)

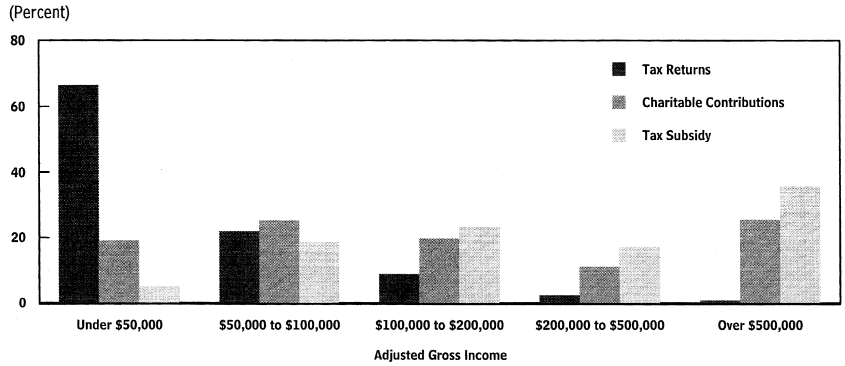


Source: Congressional Budget Office based on data from the Center on Philanthropy at Indiana University, *Patterns of Household Charitable Giving by Income Group,* 2005 (Indianapolis: Indiana University–Purdue University, 2007).

a. Combined purpose funds, such as the United Way, receive contributions and allocate them to many different types of charities.

Figure 4.

Different Income Groups' Shares of Total Contributions and the Total Tax Subsidy, 2006



Source: Congressional Budget Office.

Incentives Created by the Charitable Deduction

By subsidizing charities through individual income tax deductions, the government leaves the choice about which charities are subsidized largely to taxpayers. In doing so, however, it makes no distinction about the extent to which different charitable services would be provided in the absence of the tax subsidy. A sufficiently generous tax incentive can cause even charitable activities with large social benefits to be provided beyond the point at which the benefits to society of allocating more resources to those activities are lower than the benefits of allocating the same resources to other activities.

Subsidizing charitable organizations through income tax deductions also means that the subsidy accrues only to people who have income tax liability and itemize deductions and that the after-tax price of giving decreases with the donor's marginal tax rate. Because people with higher income generally face higher marginal tax rates, they are subsidized at a greater rate than lower-income taxpayers are. In 2008, 25 percent of tax filers (or about 35 million returns) faced a federal income tax rate of zero (see Table 3).[15] For those filers, the deductibility of charitable contributions gave them no tax benefits and hence no tax incentive to donate. At the same time, the 5 percent of filers who were in the 28 percent, 33 percent, or 35 percent tax brackets faced a substantially lower price of giving than the 54 percent of filers who faced tax rates of 10 percent or 15 percent. Because the subsidy for a given amount of charitable donations increases along with income, the deduction for charitable donations reduces the degree to which the average income tax rate (taxes as a percentage of income) rises as income grows. Even so, the federal income tax and overall federal tax system both remain progressive, in that high-income filers pay a much larger share of their income in taxes than lower-income groups do.[16]

15. Another 24 million potential tax filers were not required to file a return that year, generally because their income was below the filing thresholds.

16. For example, CBO estimated that, on average, households that were in the lowest one-fifth of the income distribution in 2007 (as measured by household income) received more in tax credits than they paid in federal individual income taxes, whereas households in the highest one-fifth of the income scale paid federal income taxes that averaged 14 percent of their income. With all types of federal taxes included, households in the lowest one-fifth of the income scale paid less than 5 percent of their income in federal taxes, on average, whereas those in the highest one-fifth of the income scale paid about 25 percent of their income in federal taxes. See Congressional Budget Office, *Average Federal Tax Rates in 2007* (June 2010).

Table 3.

Tax Filers, by Highest Marginal Tax Rate, 2008

Highest Marginal Rate (Percent)	Number of Tax Returns (Millions)	Share of Tax Returns (Percent)
0	35	25
10	26	18
15	50	35
25	23	17
28	4	3
33	2	1
35	1	1
All Tax Rates	142	100

Source: Congressional Budget Office based on Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns 2008* (revised July 2010).

Note: The statutory marginal tax rates shown here may not precisely correspond to the rates that apply to charitable deductions because they do not account for such factors as the alternative minimum tax, the earned income tax credit, or phaseouts for personal exemptions and itemized deductions. These rates reflect only federal income taxes; combined federal and state marginal income tax rates are higher. (Most state income taxes also allow a deduction for charitable contributions.)

Only about one-third of tax filers itemize their deductions. The price of giving for the two-thirds who do not itemize (primarily people in the lower tax brackets) is not subsidized, and thus—like people facing an income tax rate of zero—they have no tax incentive to make donations. Of course, nonitemizers have the option of itemizing their deductions; they do not do so primarily because their total itemized deductions, including charitable donations, are less than the standard deduction. If people's responsiveness to tax incentives increases with income, the approach of providing higher marginal incentives for charitable giving to higher-income taxpayers stimulates more donations; however, there is little evidence that higher-income taxpayers are more responsive to the after-tax price of giving than other taxpayers are.[17] Nonetheless, the fact remains that the current subsidy gives lower-income households less incentive to donate than it gives higher-income households.

Taxpayers' Responses to the Income Tax Treatment of Giving

How taxpayers respond to the tax incentives for charitable giving depends on their underlying motive for making donations. Motivations for giving are complicated and not fully understood. With a purely private good (one whose full benefits accrue to the person bearing the full cost), both the motivation and the behavior it engenders are straightforward: People buy the good because they receive benefits from it, and they keep buying more units of the good until the benefit (the value to them) of the next unit just equals the cost of the next unit. That is also broadly true for charitable giving, but measuring the benefit that donors receive is more complicated.

Some giving is probably motivated by altruism: People receive satisfaction from knowing that others in society are helped. The satisfaction of the donor depends partly on the satisfaction of others, regardless of who is paying for the help that is given. In the altruistic view, a potential donor is just as pleased if a third party steps in and provides the contribution instead. Some giving, however, is motivated not only by pure altruism but also by the "warm glow" that some people feel when giving or helping others—or from receiving public recognition for their good deeds.[18] In that case, the donor's self-satisfaction depends on believing that he or she played a role in (or is being recognized for) helping others. Still other giving is more analogous to a private good, with the benefits directly accruing in proportion to the size of the donation. Examples include gifts to college sports programs (often in exchange for preferential treatment in purchasing tickets to athletic events) and donations to art museums (which sometimes confer special benefits only for donors).

Although those various motivations may prompt different kinds of responses to incentives for charitable giving, empirical studies have generally found that the amount of giving is responsive to changes in the after-tax price of giving. That responsiveness can be measured by the price elasticity of charitable giving—the percentage change in

17. Although the percentage of households that report making charitable contributions rises with income (see Table 2 on page 7), empirical studies offer inconclusive evidence about whether responsiveness to tax incentives differs significantly for households at different income levels.

18. See James Andreoni, "Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving," *Economic Journal*, vol. 100, no. 401 (1990), pp. 464–477.

donations associated with a 1 percent increase in the price of giving.

Policymakers are generally interested in the permanent effects of policy changes, so estimates of how various policy options would alter charitable giving must rely on elasticity estimates that distinguish between transitory shifts in giving and permanent responses to a policy change. For example, a taxpayer who faces a temporary fluctuation in income has an incentive to shift donations to years when income is temporarily high and thus the after-tax price of giving is low. Taxpayers may also change the timing of their donations in response to a pre-announced change in tax law. The Tax Reform Act of 1986, which sharply reduced marginal income tax rates for high-income taxpayers, offers a good example. Charitable giving by high-income taxpayers increased steeply in 1986, possibly in anticipation of that law, which was enacted in October 1986 and gradually phased in between 1987 and 1988. Failing to address shifts in giving that result from income fluctuations or preannounced changes in tax law may cause an elasticity estimate to be biased upward (in absolute value).

Most studies that estimate the relationship between charitable giving and tax rates use data from tax returns. Among those studies, ones that distinguish between permanent and transitory responses to price variation have found mixed evidence about the permanent price elasticity of giving. Elasticity estimates vary significantly as a result of differences in the underlying data and time periods studied and the different methods used to derive the estimates. For example, one prominent study that examined a panel data set covering 10 years estimated a permanent price elasticity of giving of -0.5 (meaning that a 1 percent increase in the price of giving would reduce donations by 0.5 percent).[19] Another study that used an expanded version of the same data set but applied a different methodology reported elasticity estimates ranging from -0.8 to -1.3.[20]

Experimental methods offer another approach to estimate the relationship between the price and level of charitable giving. For instance, researchers have studied how people alter the amount of their contributions in response to matching grants (conditional offers to match contributions at a specified rate). Researchers in one study conducted a field experiment on existing donors to a charitable organization and found that announcing the availability of a matching grant increased donations, although the level of contributions was not affected by differences in the matching rate announced.[21] That study estimated an overall price elasticity of -0.3, lower than the estimates from the aforementioned studies that were based on tax data. Because the experiment was framed as a matching grant rather than a change in the after-tax price of giving, however, the result may not be directly applicable to policies involving changes in tax rates.

Effects of Policy Options to Alter the Tax Treatment of Charitable Giving

In recent years, numerous proposals have been made to change the tax incentives for charitable giving. Such changes could take various forms, which would have different impacts on the costs to the federal government, the amount of charitable giving, and the number and types of taxpayers who would benefit. To illustrate the effects of a range of possible changes, CBO has examined 11 stylized policy options. The most important characteristics of the options are whether the tax benefit includes a floor (or minimum amount of donations) below which contributions are not subsidized; whether it is restricted to itemizers or is available to all taxpayers; and whether it takes the form of a tax deduction or a credit. The options can be grouped into 4 sets according to those characteristics:

- Retaining the current deduction for itemizers but adding a floor.
- Allowing all taxpayers to claim the deduction, with or without a floor.

19. See William C. Randolph, "Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions," *Journal of Political Economy*, vol. 103, no. 4 (1995), pp. 709–738.

20. See Gerald E. Auten, Sieg Holger, and Charles T. Clotfelter, "Charitable Giving, Income, and Taxes: An Analysis of Panel Data," *American Economic Review*, vol. 92, no. 1 (2002), pp. 371–382. Also see Jon Bakija and Bradley T. Heim, "How Does Charitable Giving Respond to Incentives and Income? New Estimates from Panel Data," *National Tax Journal* (forthcoming), which assembled the same data set and two others and found similar results.

21. See Dean Karlan and John A. List, "Does Price Matter in Charitable Giving? Evidence from a Large-Scale Natural Field Experiment," *American Economic Review*, vol. 97, no. 5 (2007), pp. 1774–1793.

- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 25 percent of a taxpayer's charitable donations, with or without a floor.

- Replacing the deduction with a nonrefundable credit for all taxpayers, equal to 15 percent of a taxpayer's charitable donations, with or without a floor.

In each option with a floor, the minimum contribution level was specified to be either a fixed dollar amount ($500 for people filing individually and $1,000 for couples filing a joint return) or a percentage of income (2 percent of AGI). Only the amount of a taxpayer's total charitable donations that exceeded that floor would be deductible or eligible for a credit.

If the current deduction for itemizers was augmented with a floor, the deduction would continue to provide incentives for charitable giving but at a much lower subsidy cost. The total amount of donations would decline, but the tax subsidy would decline by a much larger amount, CBO estimates. For example, a fixed dollar floor that allowed itemizers to deduct charitable giving in excess of $500 for individuals and $1,000 for joint filers would decrease annual donations by $0.5 billion relative to current law, CBO estimates, but would decrease the federal tax subsidy by $5.5 billion (see Table 4). Both of the reductions would be larger with a higher floor (whether the floor was specified in dollar terms or as a percentage of AGI). Those results would occur because most donations would come from taxpayers who gave amounts above the floor, and although the floor would reduce the subsidy that those taxpayers received, it would maintain their tax incentive to make an additional dollar of donations.

Extending the current deduction to all filers or making a relatively large nonrefundable tax credit available to all filers would have the opposite effect: increasing both donations and the tax subsidy. However, CBO's analysis indicates that if either of those approaches was combined with a contribution floor, it would be possible to raise donations while simultaneously reducing the tax subsidy. For instance, combining a 25 percent tax credit with a $500/$1,000 floor would raise donations by $1.5 billion and boost federal revenues by $2.4 billion. Other floors set sufficiently low could be combined with a deduction or a 25 percent tax credit to achieve a similar result.

If a much smaller credit for all filers, such as 15 percent, was combined with a floor, the effect on total donations and the total tax subsidy would be more like that of adding a floor to the current deduction for itemizers: both lower donations and a lower tax subsidy, regardless of the range of values used for the floor. In proportional terms, the impact on donations would be far smaller than the impact on the tax subsidy. With a 15 percent credit and a $500/$1,000 floor, charitable contributions would decline by 4 percent ($8.6 billion), whereas the tax subsidy would decline by 47 percent ($19.0 billion).

The effects of the policy options on tax subsidies would also vary by income group. Nonitemizers, who are primarily low- and middle-income taxpayers, would clearly gain from the options that extended tax benefits to them. Adding either type of floor to a policy option would reduce tax subsidies across the board (relative to the comparable option without a floor), but the implications for high-income taxpayers would vary significantly between a fixed dollar floor and a percentage-of-income floor. With a floor set at 2 percent of AGI, for instance, high-income taxpayers would find it harder to reach the minimum level of contributions required to obtain the tax benefit than they would with a fixed $500/$1,000 floor.

CBO estimated the impact of the policy options using 2006 tax data and assessed each option relative to the tax rules in effect for that year, which are largely the same as those in effect for 2011.[22] (For details about how CBO produced the estimates, see Box 2 on page 14.) In calculating an option's impact on contributions, CBO assumed that charitable giving has a price elasticity of -0.5, meaning that a 1 percent increase in the after-tax price of giving reduces donations by 0.5 percent. Because empirical evidence about the size of the elasticity is mixed, CBO also analyzed the options assuming a higher degree of responsiveness (an elasticity of -1.0) and assuming that charitable contributions are not affected at all by the after-tax price of giving (an elasticity of 0).

22. Tax law in both 2006 and 2011 contains the major provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003. The major difference between the two years in terms of the tax treatment of charitable giving is that 2006 tax law reduced the total value of certain itemized deductions—including the deduction for charitable contributions—for high-income taxpayers, whereas 2011 law does not have such a reduction.

Table 4.

Total Donations and Tax Subsidies Under Current Law and Eleven Policy Options, 2006

	Floor for Eligible Donations	Total Contributions (Billions of 2006 dollars)	Change in Total Contributions from Current-Law Level		Tax Subsidy (Billions of 2006 dollars)	Change in Tax Subsidy from Current-Law Level	
			Billions of Dollars	Percent		Billions of Dollars	Percent
Current Law							
Deduction Available Only to Itemizers	No floor	203.0	n.a.	n.a.	40.9	n.a.	n.a.
Options to Change Current Law							
Keep Deduction Available Only to Itemizers but Add Floor							
Option 1	$500/$1,000	202.5	-0.5	-0.2	35.4	-5.5	-13.5
Option 2	2 percent of AGI	200.0	-3.0	-1.5	25.2	-15.7	-38.5
Extend Deduction to All Filers							
Option 3	No floor	205.0	2.0	1.0	46.1	5.2	12.8
Option 4	$500/$1,000	203.8	0.8	0.4	38.4	-2.5	-6.1
Option 5	2 percent of AGI	201.1	-1.9	-0.9	27.8	-13.1	-32.1
Convert Deduction to 25 Percent Nonrefundable Credit for All Filers							
Option 6	No floor	205.7	2.7	1.3	48.0	7.1	17.4
Option 7	$500/$1,000	204.5	1.5	0.7	38.5	-2.4	-5.8
Option 8	2 percent of AGI	202.0	-1.0	-0.5	29.0	-11.9	-29.2
Convert Deduction to 15 Percent Nonrefundable Credit for All Filers							
Option 9	No floor	195.2	-7.8	-3.9	27.6	-13.3	-32.6
Option 10	$500/$1,000	194.4	-8.6	-4.2	21.9	-19.0	-46.5
Option 11	2 percent of AGI	193.0	-10.0	-4.9	16.3	-24.6	-60.1

Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels.

n.a. = not applicable; $500/$1,000 = $500 for individual filers and $1,000 for joint filers; AGI = adjusted gross income.

Box 2.

The Basis for CBO's Estimates

The analysis presented in this testimony is based on the Congressional Budget Office's (CBO's) individual income tax model, which uses data for 2006. In the model, a sample representing all households in the United States is constructed by combining information from the Internal Revenue Service's 2006 Statistics of Income public-use sample of individual income tax returns with information from the Census Bureau's March 2007 Current Population Survey. For returns without itemized deductions, CBO estimated charitable contributions using surveys in which people report their charitable giving (the Federal Reserve's 2004 Survey of Consumer Finances for people giving over $500 and the Bureau of Labor Statistics' 2002 Consumer Expenditure Survey for those giving less than $500). Taxes and tax rates were estimated using CBO's tax calculator. All estimates are for tax year 2006 and reflect the extent to which tax subsidies and charitable giving would have been different had a given option been in place in that year.

Calculating the Tax Subsidy for Charitable Contributions

This analysis estimates the cost of the tax preference for charitable donations by focusing on the change in revenues directly attributable to the level of charitable giving. That approach contrasts with the type of revenue estimates that are the responsibility of the staff of the Joint Committee on Taxation. Such estimates would reflect many of the ways in which taxpayers might alter their behavior in response to the existence of the tax preference, such as changing the timing of donations between years and changing their tax compliance. The measure that CBO used does not reflect all of the behavioral assumptions that would be included in a revenue estimate; it accounts only for changes in the amount of charitable giving and any changes in itemization status that would occur if the standard deduction was larger than a taxpayer's noncharitable itemized deductions.

Although CBO's measure incorporates fewer types of responses than a true revenue estimate, it is also less sensitive to the design details of an option. Thus, it is more suited to portraying the costs of highly stylized options such as the ones examined in this analysis. Removing the emphasis on design details makes it possible to identify the salient characteristics of broad approaches to changing the tax treatment of charitable contributions.

In this analysis, taxpayers were modeled as choosing to itemize deductions or claim the standard deduction under each policy option. The calculations assumed that taxpayers would maximize the amount of their total deductions. Thus, for example, if the deduction for charitable contributions was extended to nonitemizers, some taxpayers who had been itemizers would switch to being nonitemizers if that policy change lowered their total tax bill. The cost of subsidizing charitable giving under current law and the policy options was calculated by comparing the amount of income tax owed under a given policy with the amount that would be owed if there was no deduction for charitable contributions.

For options that include a floor, only the portion of a taxpayer's contributions above that minimum level would be eligible for a deduction or a credit. For example, under an option with a fixed dollar floor of $500 for individual filers and $1,000 for joint filers, a couple who itemized their deductions and donated $1,500 to charity would be able to claim only $500 in donations as an itemized deduction on their return, and a couple who itemized and donated $750 would not be able to deduct any of their donations.

Estimating the Effects of Policy Options on Giving

To evaluate the impact of each option, CBO estimated how much taxpayers would change the

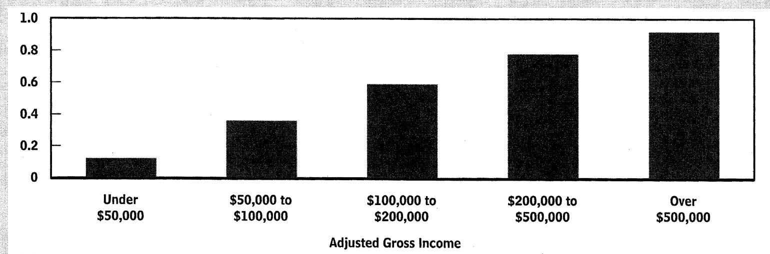
Continued

Box 2. **Continued**

The Basis for CBO's Estimates

Tax Subsidies Under Current Law, by Income Group, 2006

(Percentage of adjusted gross income)



Source: Congressional Budget Office.

amount they donate in response to a change in the after-tax price of giving.[1] The change in contributions was calculated by applying a tax price elasticity to existing contributions using the applicable change in the after-tax price of giving.[2] That price was estimated by calculating marginal tax rates on charitable giving from each individual record in CBO's income tax model under 2006 law and under each policy option. For example, under an option that would extend the deduction for charitable contributions to nonitemizers, a taxpayer in the 25 percent bracket who claimed a standard deduction would see his or her tax price of giving fall from $1 per dollar of giving to 75 cents per dollar of giving, a 25 percent decline.

1. This analysis reflects only the change in the relative price of charitable contributions. The change in the income tax treatment of charitable contributions would also affect taxpayers' after-tax income. Those income effects are likely to be small, however, because charitable contributions average only about 2 percent to 3 percent of a taxpayer's income (see Figure 2 on page 6).

2. The tax price elasticity for charitable giving is the ratio of the percentage change in giving to the percentage change in its after-tax price. For example, a price elasticity of -0.5 means that a 1 percent increase in the after-tax price of giving reduces donations by 0.5 percent.

Because empirical evidence about the responsiveness of taxpayers' charitable contributions to their tax treatment is inconclusive, CBO calculated the results using alternative elasticity values (0 and -1.0) in addition to the main value (-0.5) used in the analysis. In addition, CBO examined the sensitivity of the results to the assumption that a certain amount of contributions—such as regular donations to religious organizations—would be made regardless of changes in their after-tax price. CBO also explored the potential effects of taxpayers' shifting donations into different years to increase the tax subsidies they receive.

Estimating Differences in Effects by Income Level

CBO assessed the distributional implications of the policy options by comparing tax subsidy rates (the tax subsidy divided by adjusted gross income) for various income groups under a given option and under 2006 law. In 2006, subsidy rates ranged from 0.12 percent for taxpayers with adjusted gross income under $50,000 to 0.96 percent for taxpayers with income above $500,000 (see the figure above). Subsidy rates rise with income because higher-income taxpayers are more likely to itemize deductions and because the after-tax price of giving declines as the marginal income tax rate increases with income.

Options 1 and 2: Deduction for Itemizers, With a Floor

The first set of options would keep the current itemized deduction for charitable contributions but allow only contributions in excess of a floor to be deducted. A floor would remove the subsidy for smaller donations—most of which would probably be made even without a tax incentive—but it would maintain the marginal incentive to give for people making larger donations. Imposing a floor would lower contributions to some extent, because some taxpayers who now contribute less than the amount of the floor might reduce their donations. A floor could also make decisionmaking more complex for taxpayers and would provide an incentive for "lumpy" donations, in which people donate more in one year and nothing in other years in order to maximize their deductible contributions.[23]

Options 1 and 2 would maintain the charitable deduction for itemizers but would introduce different types of floors:

- Option 1 would let itemizers deduct the amount of their charitable donations in excess of $500 for individual filers and $1,000 for joint filers.
- Option 2 would let itemizers deduct the amount of their charitable donations in excess of 2 percent of their AGI.

The tax benefits to itemizers would be less generous under Option 1 than under current law; thus, some itemizers would choose to take the standard deduction rather than continue to itemize their deductions.[24] Nonitemizers would be unaffected. For most filers—all nonitemizers plus itemizers who donate more than the amount of the floor—the after-tax price of the last dollar of giving would remain unchanged. However, taxpayers who itemize deductions and donate less than the floor would no longer have a tax incentive for those donations.[25] Overall, donations would be reduced by $0.5 billion (or less than 1 percent), and the tax subsidy would be reduced by $5.5 billion (or 14 percent), from the levels associated with 2006 tax law (see Table 4 on page 13).

Like the fixed dollar floor, the percentage-of-income floor in Option 2 would make benefits to itemizers less generous than under current law and would not affect nonitemizers. Low-income itemizers would be able to reach the minimum contribution level more easily with this type of floor than with the fixed dollar floor. Although more middle- and high-income itemizers would see their after-tax price of giving increase, incentives for large contributors would be virtually unchanged. Under this option, donations would fall by $3.0 billion (or 2 percent) and the tax subsidy would be reduced by $15.7 billion (or 39 percent) from the 2006 levels. Almost all of the added revenues in Options 1 and 2 would come from eliminating the tax subsidy for contributions below the level of the floor by taxpayers who continued to itemize their deductions (see Table 5).

Adding either a fixed dollar floor or a percentage-of-income floor to the current deduction would lower the tax subsidy rate—the total tax subsidy divided by total income—for all income groups. Higher-income taxpayers would face a much higher threshold for deducting donations with the percentage-of-income floor than with the dollar floor. Thus, the change in the tax subsidy for higher-income taxpayers would differ significantly between the two options. For taxpayers with AGI over $500,000, for example, the dollar floor in Option 1 would decrease their tax subsidy by just 0.02 percent of AGI, whereas the percentage-of-income floor in Option 2 would lower their tax subsidy by 0.28 percent of AGI (see Figure 5).

Options 3 to 5: Deduction for All Taxpayers, With or Without a Floor

Another approach that CBO examined would be to allow everyone who files an income tax return to deduct charitable contributions (subject to the rules that now apply to

23. With a $500 floor, for example, a taxpayer who donated $1,000 in each of two years would be allowed to deduct a total of $1,000, whereas a taxpayer who donated $2,000 in one year and nothing the next year could deduct a total of $1,500. The possibility that taxpayers will change the timing of deductions in response to a floor is an important consideration in designing such a policy.

24. In general, the taxpayers who would no longer choose to itemize would be those for whom itemized deductions minus the lesser of their charitable contributions or $500 (for individuals) would be less than the standard deduction.

25. In addition, there may be some itemizers who have no tax liability under current law but would have tax liability under the option and would face a reduction in the after-tax price of giving. Those few itemizers would have an increased incentive to donate.

Table 5.

Sources of Changes in Tax Subsidies Under Eleven Policy Options, 2006

	Floor for Eligible Donations	Source of Change in Tax Subsidy (Billions of dollars): Net Change in Giving	Existing Giving by Nonitemizers	Existing Giving by Itemizers: Who Switch to Being Nonitemizers	Existing Giving by Itemizers: Who Remain Itemizers	Total
Keep Deduction Available Only to Itemizers but Add Floor						
Option 1	$500/$1,000	*	0	-0.1	-5.5	-5.5
Option 2	2 percent of AGI	0.1	0	-0.4	-15.4	-15.7
Extend Deduction to All Filers						
Option 3	No floor	0.5	3.2	1.6	0	5.2
Option 4	$500/$1,000	0.3	1.3	1.0	-5.0	-2.5
Option 5	2 percent of AGI	0.3	0.9	0.3	-14.7	-13.1
Convert Deduction to 25 Percent Nonrefundable Credit for All Filers						
Option 6	No floor	0.8	4.7	2.5	-0.9	7.1
Option 7	$500/$1,000	0.5	1.9	1.7	-6.5	-2.4
Option 8	2 percent of AGI	0.6	1.5	0.9	-14.9	-11.9
Convert Deduction to 15 Percent Nonrefundable Credit for All Filers						
Option 9	No floor	-1.2	2.9	-0.3	-14.8	-13.3
Option 10	$500/$1,000	-1.2	1.1	-0.8	-18.2	-19.0
Option 11	2 percent of AGI	-1.0	0.9	-1.3	-23.2	-24.6

Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels. The total tax subsidy under 2006 law was $40.9 billion. $500/$1,000 = $500 for individual filers and $1,000 for joint filers; * = between zero and $50 million; AGI = adjusted gross income.

itemizers, as explained in Box 1 on page 4), under three variations:

- Option 3 would have no floor on the amount of donations that could be deducted.[26]
- Option 4 would have the same fixed dollar floor as Option 1 ($500 for single filers and $1,000 for joint filers).
- Option 5 would have the same percentage-of-income floor as Option 2 (2 percent of AGI).

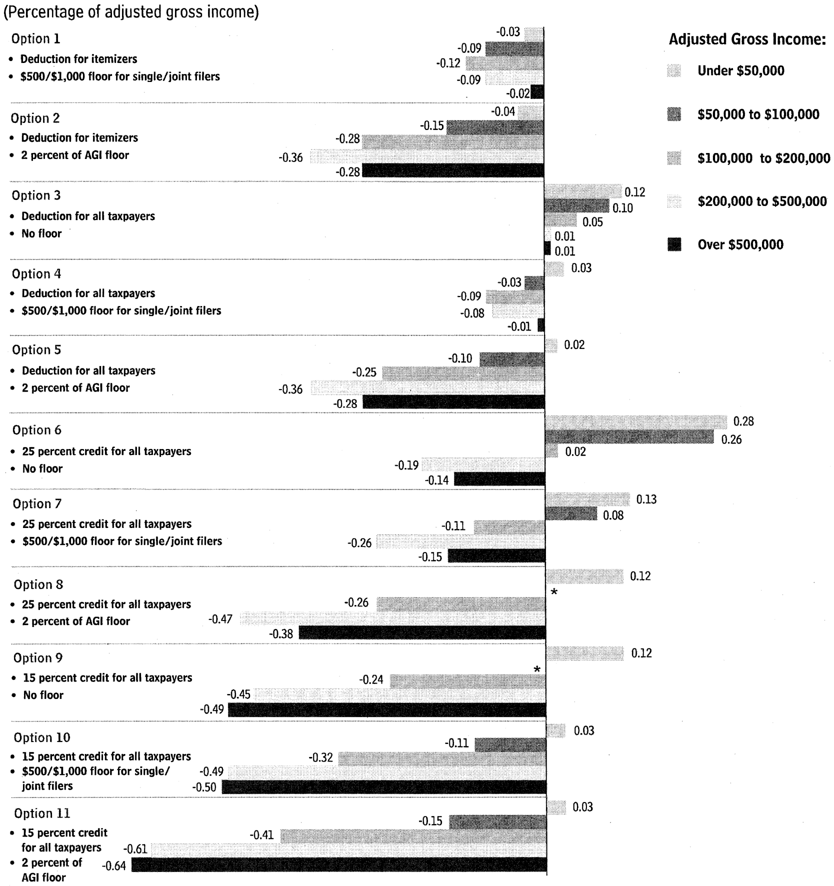
Under those options, some itemizers would be expected to become nonitemizers, because nonitemizers would be treated more favorably than under current law, whereas the tax treatment of itemizers would not change. Itemizers whose other itemized deductions totaled less than the standard deduction would generally benefit from taking the standard deduction and claiming the new non-itemized charitable deduction as well. For those taxpayers, the sum of the standard deduction and the new deduction for charitable contributions would exceed the total itemized deductions they could have claimed under

26. The President's budgetary proposals for fiscal years 2002 through 2005 included a charitable deduction for nonitemizers. Those proposals were more restrictive than the option analyzed here, which would allow nonitemizers to subtract all of their charitable contributions from their AGI (subject to the same restrictions as itemizers) in addition to claiming the standard deduction. See Office of Management and Budget, *Budget of the U.S. Government* for those years; also see Congressional Budget Office, *Budget Options* (February 2007), Revenue Option 11, "Create an Above-the-Line Deduction for Charitable Giving"; and Congressional Budget Office, *Effects of Allowing Nonitemizers to Deduct Charitable Contributions* (December 2002).

Figure 5.

Changes in Tax Subsidies Under Eleven Policy Options, by Income Group, 2006

(Percentage of adjusted gross income)



Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels.

* = between -0.005 percent and 0.005 percent.

2006 law.[27] Taxpayers making that change would not be expected to alter their giving, however, because itemization status would not affect their after-tax price of giving.[28] The only group of taxpayers who would see their after-tax price of giving fall—and would possibly increase their charitable donations as a result—would be nonitemizers with positive tax liability, who could take advantage of the more broadly available deduction.[29]

Extending the charitable deduction to nonitemizers without any contribution floor, as in Option 3, would increase donations by $2 billion (or 1 percent), CBO estimates (see Table 4 on page 13). The tax subsidy would increase by $5.2 billion (or 13 percent), of which $3.2 billion would go to subsidize existing contributions by nonitemizers (see Table 5 on page 17). Another large piece of the increase in the tax subsidy, $1.6 billion, would result from itemizers' choosing to take the standard deduction because it exceeded their noncharitable deductions.[30] The net change in giving would account for only $0.5 billion of the increase in the total tax subsidy.

27. Under the options considered here, the incentive to switch itemization status would not exist for taxpayers paying the individual alternative minimum tax (AMT), because the standard deduction is not allowed for taxpayers paying the AMT. (Fewer than 3 percent of filers were subject to the AMT in 2006.) Also, the existing limit on itemized deductions for high-income taxpayers (those with AGI over $150,500 in 2006) could give some taxpayers an additional incentive to switch itemization status under options that would allow charitable deductions by nonitemizers, if that limit did not apply to deductions by nonitemizers. This analysis assumed that the limit would also apply to charitable deductions claimed by nonitemizers and therefore would not provide an additional incentive to change itemization status.

28. That statement is based on the assumption that behavioral effects resulting from changes in income would be small. It also ignores the fact that a small fraction of taxpayers would move into a lower marginal tax bracket because of the change in itemization status.

29. For that group, the after-tax price per dollar of giving would fall from $1 to [$1 x (1 - their marginal tax rate)]. For most of those taxpayers, the average and marginal price per dollar of giving would be the same. However, deducting charitable donations could move some taxpayers to a lower tax bracket, in which case their marginal price of giving would exceed their average price of giving.

30. Under the options that would extend tax incentives to nonitemizers without adding a floor (Options 3, 6, and 9), roughly 10 percent of itemizers would switch to the standard deduction, CBO estimates.

Combining a floor with a deduction for all taxpayers would produce tax savings for the government while having relatively small effects on total donations. With the fixed dollar floor in Option 4, total contributions would increase by $0.8 billion (or less than 1 percent), whereas the tax subsidy would decline by $2.5 billion (or 6 percent). The subsidy for taxpayers who continued to itemize their deductions would fall by $5.0 billion, but those savings would be partly offset by new tax subsidies of $1.3 billion for existing contributions by nonitemizers, $1.0 billion for former itemizers who claimed the standard deduction instead, and $0.3 billion for the net change in donations.

With a floor set at 2 percent of AGI, as in Option 5, total contributions would decline by $1.9 billion (or nearly 1 percent), and the total tax subsidy would drop by $13.1 billion (or 32 percent). The reduction in the tax subsidy from excluding itemizers' charitable contributions below the floor would amount to $14.7 billion, almost triple the $5 billion in tax savings from the same source under the similar option with the dollar floor (Option 4). Those tax savings would be partly offset by new tax subsidies of $0.9 billion for existing contributions by nonitemizers, $0.3 billion for former itemizers who claimed the standard deduction instead, and $0.3 billion for the net change in giving.

Low- and middle-income taxpayers would be the main beneficiaries of extending the charitable deduction to nonitemizers because they make up the bulk of people who do not itemize deductions. Option 3 would raise the tax subsidy by 0.12 percent of AGI for taxpayers with income below $50,000 and by 0.10 percent of AGI for those with income between $50,000 and $100,000 (see Figure 5 on page 18). Taxpayers with AGI above $100,000 would have a much smaller increase in their tax subsidy rate (0.02 percent for that group as a whole). Adding a floor to the deduction for all filers would still increase the subsidy for taxpayers with income under $50,000 but by a smaller amount: 0.03 percent of AGI under Option 4 and 0.02 percent under Option 5. As in the options to add a floor to the current deduction for itemizers, upper income groups would see a larger reduction in their tax subsidy with a percentage-of-income floor than with a fixed dollar floor.

Options 6 to 8: Nonrefundable 25 Percent Credit for All Taxpayers, With or Without a Floor

An alternative way to extend tax benefits for charitable giving to all filers would be to convert the current deduction into a nonrefundable tax credit equal to a percentage of a taxpayer's contributions.[31] The credit could be various sizes. In this set of options, CBO examined the effects of a credit equal to 25 percent of donations, with the same three variations used earlier:

- Option 6 would have no floor that donations would have to exceed to qualify for the credit.
- Option 7 would have the same fixed dollar floor as Options 1 and 4 ($500 for individuals and $1,000 for joint filers).
- Option 8 would have the same percentage-of-income floor as Options 2 and 5 (2 percent of AGI).

Substituting a nonrefundable credit for the current deduction would provide the same subsidy (per dollar of giving) to all taxpayers who could fully claim the credit, instead of a subsidy rate that increases with a filer's marginal tax rate. A 25 percent nonrefundable credit would tend to benefit lower- and middle-income taxpayers, who generally face marginal tax rates of less than 25 percent. Taxpayers facing tax rates above 25 percent would see a decrease in subsidies under this option. As a result, replacing the current deduction with a 25 percent credit would probably increase the share of total income taxes paid by higher-income people.

Taxpayers would respond in several ways if the itemized deduction for charitable contributions was replaced with a nonrefundable tax credit. Current itemizers whose noncharitable deductions total less than the standard deduction would generally no longer choose to itemize. The after-tax price of giving would rise for itemizers facing marginal tax rates above 25 percent, creating an incentive for them to reduce contributions, whereas the after-tax price would fall for itemizers facing marginal tax rates below 25 percent, creating an incentive for them to increase contributions. Nonitemizers with positive tax liability would generally face a lower after-tax price of giving under this option and thus would also have an incentive to raise their contributions. The overall effect on donations would depend on whether the increased giving by people whose after-tax price of giving fell would exceed the decreased giving by people whose after-tax price rose.

CBO estimates that with a 25 percent credit and no floor (Option 6), total contributions would increase by $2.7 billion (or 1 percent)—about 35 percent more than the increase from extending the charitable deduction to all taxpayers without a floor (Option 3). The tax subsidy for charitable giving would rise by $7.1 billion (or 17 percent), of which only $0.8 billion would result from the net change in donations. Most of the cost increase to the government ($4.7 billion) would come from subsidizing existing contributions by nonitemizers; another $2.5 billion would result from former itemizers who would choose to take the standard deduction (see Table 5 on page 17). Among taxpayers who continued to itemize deductions, the increased tax subsidy for those with marginal tax rates below 25 percent would be slightly less than the reduced subsidy for those with marginal rates above 25 percent, resulting in a net decrease of $0.9 billion in the tax subsidy for that group.

If the credit applied only to contributions above the fixed dollar floor in Option 7, total donations would increase by $1.5 billion (or less than 1 percent), and the total tax subsidy would decline by $2.4 billion (or 6 percent). With the percentage-of-income floor in Option 8, total contributions would decrease by $1.0 billion (or less than 1 percent), and the tax subsidy would drop by $11.9 billion (or 29 percent). Under both of those options, increases in the tax subsidy from existing donations and from the net change in giving would be outweighed by a reduction in the subsidy from excluding tax benefits for contributions below the floor.

A nonrefundable tax credit for charitable giving available to all filers would favor low- and middle-income taxpayers even more than a deduction for all filers would. The reason is that the after-tax price of giving would be the same for all taxpayers rather than being lower for people with higher marginal income tax rates.

Option 6 would increase the tax subsidy for people with income under $100,000 by approximately 0.3 percent of AGI and for people with income between $100,000 and $200,000 by 0.02 percent of AGI (see Figure 5 on page 18). Taxpayers with AGI above $200,000 are likely

31. Nonrefundable tax credits are limited to the amount of a person's tax liability before credits. Refundable credits, such as the earned income tax credit, can exceed tax liability before credits and result in a refund payment from the government to the taxpayer.

to have marginal income tax rates greater than 25 percent. Consequently, their tax subsidy would fall under Option 6—by 0.19 percent of AGI for taxpayers with income between $200,000 and $500,000 and by 0.14 percent of AGI for those with income over $500,000.

Under the options that include a floor, the decrease in tax subsidy rates would be concentrated among taxpayers whose AGI was above $100,000. That decrease would equal 0.16 percent of AGI under Option 7 and 0.35 percent of AGI under Option 8. For taxpayers with income below $100,000, by contrast, the tax subsidy would increase by approximately 0.1 percent of AGI under both options.

Options 9 to 11: Nonrefundable 15 Percent Credit for All Taxpayers, With or Without a Floor

The last three options in CBO's analysis are similar to Options 6 to 8 but with a smaller credit. They would replace the current deduction with a tax credit equal to 15 percent of a taxpayer's donations, with the following differences:

- Option 9 would have no floor.
- Option 10 would have the same fixed dollar floor as Options 1, 4, and 7 ($500 for individuals and $1,000 for joint filers).
- Option 11 would have the same percentage-of-income floor as Options 2, 5, and 8 (2 percent of AGI).

The size of a tax credit for charitable giving affects not just the magnitude but the direction of the effects. A 15 percent credit with no floor would decrease donations relative to 2006 law (by $7.8 billion, or 4 percent), whereas a similar 25 percent credit would increase donations relative to 2006 law (by $2.7 billion, or 1 percent). Adding either type of floor to the 15 percent credit would reduce donations by slightly larger amounts—and, again, would result in fewer contributions than the comparable options with a 25 percent credit. In all three cases, total donations would be about 5 percent lower under the options with a 15 percent credit than under the analogous options with a 25 percent credit because the smaller credit would provide smaller tax incentives for charitable giving.

The same pattern would occur for the total tax subsidy, but the changes would be larger. With a 15 percent credit and no floor (Option 9), the tax subsidy would fall by $13.3 billion (or 33 percent) relative to 2006 law, whereas with a 25 percent credit and no floor, the tax subsidy would rise by $7.1 billion (or 17 percent). Adding the $500/$1,000 floor (Option 10) would reduce the tax subsidy even more, by $19.0 billion (or 47 percent) relative to 2006 law, compared with a $2.4 billion reduction under the same fixed dollar floor and a 25 percent credit. With a floor equal to 2 percent of AGI (Option 11), the 15 percent credit would reduce the tax subsidy by $24.6 billion (or 60 percent), compared with an $11.9 billion decrease under the comparable option with a 25 percent credit. Virtually all of the reduction in the subsidy would come from eliminating tax benefits for charitable contributions below the floor.

Relative to 2006 law, taxpayers with AGI under $50,000 would see a small increase in their subsidy rate under all of the options with a 15 percent credit. That increase would equal 0.12 percent of AGI with the credit alone and 0.03 percent with the credit plus a floor. Taxpayers whose AGI was between $50,000 and $100,000 would see virtually no change in their subsidy rate with the 15 percent credit alone but a decrease equal to 0.11 percent of AGI with the fixed dollar floor or 0.15 percent of AGI with the percentage-of-income floor. All three variants of the 15 percent credit would decrease subsidy rates for income groups above $100,000, with the largest reductions in this analysis coming from combining that credit with a floor of 2 percent of AGI.

Senate Finance Committee Hearing
"Tax Reform Options: Incentives for Charitable Giving"
October 18th, 2011
Questions for the Record
Frank Sammartino, Congressional Budget Office

Questions from Chairman Baucus

1. Some believe that the charitable deduction is not a tax expenditure because the donor has given the money away – they don't have the money donated anymore so shouldn't be taxed on it. Others believe it is a tax expenditure because, for example, someone who has $20,000 and decides to give $1,000 to charity is better off than someone who only has $19,000.

- **What do you think about whether the charitable deduction is a tax benefit?**
- **If it is not a tax benefit, does it make sense to deny the deduction to nonitemizers?**

Answer: CBO thinks that the charitable deduction is best viewed as a tax benefit rather than as an adjustment to a taxpayer's ability to pay. Taxpayers receive something of value for their charitable contributions, including the satisfaction of helping others and, in some cases, more-tangible benefits as donors to particular organizations. Under current law, taxpayers who itemize deductions on their federal income tax returns can reduce their tax liability by deducting their donations to qualified nonprofit organizations. Like other forms of preferential tax treatment, this deduction reduces federal government revenues.

While the deduction is only available to taxpayers who choose to itemize their deductions, taxpayers who do not itemize can claim a standard deduction, the size of which was initially determined to account for a typical amount of charitable contributions.

2. The Finance Committee has spent many hours examining our tax code out of a belief that by modernizing our tax laws we can enhance our ability to successfully compete in the 21st century global economy. This study has convinced many of us on the panel that our nation's ability to compete with China and other emerging economies depends, in part, on a tax code that is competitive with other countries.

- **Do you have any data or views on the value and importance of the charitable deduction as it pertains to the ability of tax-exempt organizations to contribute to our nation's economic competitiveness?**
- **If we make changes to the charitable deduction that result in a loss of some private support for the tax-exempt community at a time of diminished and diminishing government support for many of the activities of the tax-exempt community, do we put at risk the ability of tax-**

exempt organizations to, for instance, help meet a rising demand for basic needs, or to educate young people to ensure our long-term economic growth?

Answer: The nonprofit sector plays an important role in the U.S. economy. A 2009 report by the Congressional Research Service estimated that nearly 10 percent of the nation's workforce was employed in the nonprofit sector and that the nonprofit sector generated about 5 percent of the country's economic output, although both are uncertain estimates subject to certain qualifications.[1]

It is not clear how much changes to the charitable deduction would affect the finances of the nonprofit sector. First, private contributions account for a small portion of total revenues in the nonprofit sector. Private contributions accounted for about 14 percent of total revenues among all public charities that filed a financial return with the IRS in 2009.[2] The largest sources of revenue for public charities in that year were fees for goods and services (such as tuition and payments for medical care), which were 52 percent of total revenue, and government sources (such as Medicare and Medicaid), which were 23 percent of the total. Moreover, not all private contributions were eligible for the charitable deduction. Second, as shown in the May 2011 CBO report, many options for changing the current charitable deduction would either increase charitable giving or reduce giving by only a small amount.

3. The Congressional Budget Office issued a May 2011 report on options for charitable giving.

- **Could you explain which options had the most "bang for the buck" in terms of stimulating charitable giving?**
- **If we were to take the whole cost of the charitable deduction and could spend it on any kind of tax incentive for charitable giving, what kind, if any, would generate the largest increase charitable giving?**

Answer: CBO examined 11 stylized policy options in the May 2011 report. The most important characteristics of those options are whether the tax benefit includes a floor (or minimum amount of donations) below which contributions are not subsidized; whether the tax benefit is restricted to itemizers or is available to all taxpayers; and whether the tax benefit takes the form of a tax deduction or a credit.

Among these 11 policy options, CBO's analysis indicates that extending the deduction to all filers or making a relatively large nonrefundable credit available to all filers would increase donations by the largest amount. Those increases in donations, however, would come at a cost of relatively large increases in the tax subsidy. For example, allowing nonitemizers to deduct charitable contributions would increase donations by $2 billion (about 1 percent) and would increase the tax subsidy by $5.2

[1] Molly F. Sherlock and Jane G. Gravelle, *An Overview of the Nonprofit and Charitable Sector*, CRS Report for Congress R40919, Congressional Research Service, November 17, 2009.
[2] Katie L. Roeger, Amy Blackwood, and Sarah L. Pettijohn, *The Nonprofit Sector in Brief: Public Charities, Giving, and Volunteering in 2011*, The Urban Institute, 2011.

billion (about 13 percent). Replacing the current deduction with a 25 percent nonrefundable credit for all taxpayers would increase total contributions by $2.7 billion (just over 1 percent) and would raise the tax subsidy by $7.1 billion (about 17 percent).

However if either of these approaches was combined with a contribution floor, it would be possible to raise donations while simultaneously reducing the tax subsidy. For instance, combining a deduction for all taxpayers with a minimum contribution floor of $500 for individual filers and $1000 for joint filers would raise donations by $0.8 billion (just under ½ percent) and reduce the tax subsidy by $2.5 billion (about 6 percent). Combining a 25 percent tax credit with a $500/$1000 floor would raise donations by $1.5 billion (just over ½ percent) and reduce the tax subsidy by $2.4 billion (again, about 6 percent).

4. Research has shown that folks donate to different charities for different reasons. Some folks are more inclined to support their church with small tithes, regularly. Some folks are more inclined to make large one-time donations to their alma mater.

- **Over the course of your years of experience, what differences and similarities have you noticed amongst donors?**
- **Which donors respond to incentives for charitable giving?**
- **Does the form of the incentive matter?**

Answer: Researchers at the Center on Philanthropy at Indiana University have examined patterns of household giving using surveys conducted by the University of Michigan and the Bank of America.[3] They found that, in general, the higher a household's income, the smaller the share of donations that went to religious causes and the larger the share that went to causes related to health, education and the arts. For instance, among households with income below $100,000, 67 percent of giving was directed toward religious organizations, and only 7 percent went to institutions that focus on health, education, or the arts. Among households that reported at least $1 million in income, the situation was reversed: just 17 percent of donations were made to religious organizations, and 65 percent were made to support health-, education-, or arts-related activities.

Types of non-cash donations also vary with income. Tax return data suggest that, in general, the higher a household's income, the higher is their share of non-cash donations in the form corporate stock. For example, in 2008, among households with income below $100,000, about 11 percent of non-cash donations were made in the form of corporate stock. On the other hand, those with income above $1 million made approximately 78 percent of their non-cash donations in the form of corporate stocks. The donated corporate stock was likely to have appreciated in value since it was initially acquired. Donations of appreciated property are subject to a lower percentage cap than cash donations, but they receive more favorable tax treatments because taxpayers do not have to pay income tax on capital gains from the appreciated property that they donate.

[3] Center on Philanthropy at Indiana University, *Patterns of Household Charitable Giving by Income Group, 2005* (Indianapolis: Indiana University-Purdue University, 2007).

The current deduction for charitable contributions lowers the after-tax price of giving for taxpayers claiming the deduction. The after-tax price of giving is the amount of current consumption or saving that a person forgoes by contributing $1. Taxpayers who claim the charitable deduction lower their after-tax price of giving from $1 to $1 multiplied by the difference between one and their marginal tax rate. Thus a taxpayer in the 25 percent tax bracket who claims the deduction faces an after-tax price of giving of $0.75, while a taxpayer in the 35 percent tax bracket who claims the deduction faces an after-tax price of giving of $0.65. Empirical studies find evidence that taxpayers are responsive to changes in the after-tax price of giving.[4] They do not find strong evidence, however, that the responsiveness of households differs significantly among households at different income levels.

5. The charitable deduction was adopted into the tax code in 1917. While it has gone through various changes, including an above the line deduction for non-itemizers in the 80s, it has remained a deduction. This provision is one of the largest tax expenditures.

- **What has been your view of the charitable deduction over the years?**
- **Would another form for charitable giving encourage more giving?**
- **Is there a way to encourage just as much giving, but more efficiently?**

Answer: Under the current tax treatment, the deductibility of charitable contributions is limited to taxpayers who choose to itemize deductions on their federal returns. CBO's May 2011 report indicates that extending the charitable deduction to all taxpayers would increase donations by $2 billion. Alternatively, replacing the current deduction with a relatively large tax credit such as a 25 percent tax credit for all taxpayers would increase donations by $2.7 billion.

The CBO report also examined the effects on donations and the size of the tax subsidy of augmenting each policy option with a minimum contribution floor. With the minimum contribution floor in place, only the amount of a taxpayer's total donations exceeding that floor would be eligible for the tax benefit.

The report finds that if the current deduction for itemizers was augmented with a floor, the deduction would continue to provide incentives for charitable giving but at a much lower subsidy cost. The total amount of donations would decline, but the tax subsidy would decline by a much larger amount. For example, a fixed dollar floor that allowed itemizers to deduct charitable giving in excess of $500 for individuals and $1,000 for joint filers would decrease annual donations by $0.5 billion relative to current law, but would decrease the federal tax subsidy by $5.5 billion. Both of the reductions would be larger with a higher floor (whether the floor was specified in dollar terms or as a percentage of adjusted gross income). Those results would occur because most donations would come from taxpayers who gave amounts above the floor, and although the floor would reduce the total subsidy

[4] See, for example, Jon Bakija and Bradley T. Heim, "How Does Charitable Giving Respond to Incentives and Income? New Estimates from Panel Data," *National Tax Journal*, vol. 64 (2011)

that those taxpayers received, it would maintain their tax incentive to make an additional dollar of donations.

6. Five years ago, I challenged large foundations and grant-makers to double their investment in rural America. So far, the challenge has not been met. I encouraged funders to partner with government, invest in local community foundations, invest in rural non-profit infrastructure and to tailor more grants to meet the needs of rural states.

- **How can policymakers work with tax-exempt organizations to meet identified needs, after we've provided an incentive to encourage folks to donate?**

Answer: Unfortunately, CBO has not examined the issue of how to provide incentives for tax-exempt organizations to invest in rural America.

Questions from Senator Wyden

You testified that replacing the current deduction with a nonrefundable tax credit made available to all tax filers would – if it's combined with a contribution floor – increase the total value of donations and reduce the cost of the federal tax subsidy.

For example, you said that a 25 percent nonrefundable tax credit (with a floor of $500 per individual and $1,000 per couple) would increase donations by $1.5 billion and boost federal revenues by $2.4 billion.

In contrast to the current deduction, a nonrefundable credit would provide the same tax subsidy (per dollar of giving) to all taxpayers who could fully claim the credit, instead of a subsidy that benefits the highest income taxpayers more.

- **Wouldn't this approach – setting a floor and replacing the deduction with a refundable tax credit – be more equitable than the current deduction?**
- **Is there any reason not to pursue this route if it saves the government money and will increase the total value of charitable giving?**

Answer: The tax subsidy per dollar of giving from the current income tax deduction for charitable contributions increases with the donor's marginal income tax rate. For example, a taxpayer in the 25 percent tax bracket who claims the deduction generally receives a tax benefit of $0.25 for each dollar of giving, while a taxpayer in the 35 percent tax bracket receives a tax benefit of $0.35 for each dollar of giving. Because people with higher income typically face higher marginal tax rates, they receive a larger subsidy (per dollar of giving) than lower-income taxpayers.

Substituting a nonrefundable credit for the current deduction would provide the same tax subsidy for charitable contributions (per dollar of giving) to all taxpayers who could fully claim the credit; how the amount of the subsidy would compare with that received under current law by taxpayers at different income levels would depend on the size of the credit. CBO's May 2011 report indicates that replacing the current deduction with a 25 percent nonrefundable credit (with a floor of $500 per individual and $1,000 per couple) would increase the average tax subsidy by approximately 0.1 percent of adjusted gross income (AGI) for people with income under $100,000 but reduce the average tax subsidy by 0.16 percent for people with income over $100,000.

The Congress could consider various factors when comparing a 25 percent credit to the current itemized deduction. The CBO report indicates that combining a 25 percent tax credit with a $500/$1000 floor would raise donations by $1.5 billion (just over ½ percent) and reduce the tax subsidy by $2.4 billion (about 6 percent). The net increase in donations reflects a decrease in donations by some taxpayers and an increase by others. Because a 25 percent tax credit would reduce the tax subsidy for higher income taxpayers, their donations would decline to some degree, and that could have a disproportionate effect on charitable organizations that depend on donations from higher-income households.

In addition, policy options that involve a minimum contribution floor create an incentive for taxpayers to retime their giving by bunching donations into fewer years. In its May 2011 report, CBO examined the sensitivity of the estimated changes in charitable giving and the tax subsidy to retiming of donations. Assuming taxpayers bunch contributions in alternate years, CBO found that although the bunching significantly reduces the tax savings from the options involving a floor, the conclusion that a floor can noticeably reduce the total tax subsidy with relatively modest effects on giving still holds.

SENATE COMMITTEE ON FINANCE
Tax Reform Options: Incentives for Charitable Giving
Senator Olympia J. Snowe
October 18, 2011

Mr. Chairman, thank you for continuing this series of hearings on tax reform to educate and illuminate the Committee and the public regarding the tax system, particularly as we consider potentially fundamental changes to its structure. I appreciate the opportunity these hearings afford us to prepare ourselves for what portends to be an arduous task of reforming the tax system.

The issue before us today of charitable tax incentives is a welcome one and one with which I am intimately familiar. We have a vibrant philanthropic culture in Maine, where the vigilance of the Maine people encourages them to look out for each other and those most in need. This is not just a matter of personal pride in their communities but also a matter of good sense and ensuring that precious financial resources are being deployed in the best manner possible.

My experiences with the philanthropies in my own state have been deeply instructive. In Maine, there are 326 foundations reporting $1.8 billion in assets and $133 million in grants. In 2005, those figures were 289 Maine foundations, with $1.5 billion in assets, and awarded $91 million in grants, demonstrating that there has been great growth in Maine's philanthropic sector, even during our recently turbulent years. One area in which Maine surpasses national numbers is charitable bequests—contributions by will or trust. In 2005, 27 percent of Maine estates over $1.5 million that were settled that year included a charitable bequest versus 20 percent nationally. According to the IRS, Mainers donated an estimated $35 million in charitable bequests that year. I am proud of the commitment Mainers make to philanthropy.

I know today's discussion will focus principally on the charitable tax deduction, and it should, since it is a major tax expenditure of the current code. The Joint Committee on Taxation (JCT) estimates that this deduction ranks among the Top 10 tax expenditures on the books, costing $182 billion over 5 years.

It is a very popular provision, as well. An April 2011 Gallup poll showed that, even among those who do not claim the deduction, 62 percent of Americans oppose cutting the charitable deduction, even if those savings would be used directly for deficit reduction or to cut taxes. Gallup also found that support for the charitable deduction is entirely bipartisan, with both Republicans and Democrats agreeing overwhelmingly that the charitable deduction should not be eliminated. Since the JCT also tells us that there are more than $10 trillion in total tax expenditures over a 10 year period, my hope is that we can achieve tax reform while maintaining a tax incentive for philanthropic giving such as the current deduction, and it seems the American people agree with this goal.

Some say that the charitable tax deduction benefits only the wealthy, since only taxpayers who itemize their taxes are able to take advantage of it. But a JCT report in December 2010 found that almost half, 45 percent, of the benefit of the charitable deduction goes to taxpayers under the $200,000 income threshold, which is an encouraging and important data point. Still, it is certainly true that the charitable deduction cannot help everyone, and that is why it is not and cannot be the only policy prescription we have with which to help our fellow citizens through the wide variety of philanthropic enterprises.

The charitable deduction is not the only tax issue of critical importance to philanthropies. I am proud to join with my fellow Finance Committee Members, including Senators Schumer and Burr, on two bills of critical importance to the charitable sector. The Public Good IRA Rollover Act, S. 557, would permanently extend the Individual Retirement Account (IRA) charitable rollover option and expand it to allow increased charitable giving. The current law is set to expire at the end of 2011 and we need to act to prevent this potential disruption in giving. And we have also introduced S. 676, which would simplify the excise tax imposed on private foundations. This revenue-neutral bill would replace the current two-tiered system with a simple, flat rate, and in so doing eliminate an existing and unfortunate disincentive to giving. We need to encourage more giving, especially in these difficult times.

As our economy continues to struggle, the need for a vital and thriving philanthropic community could not be more apparent. These are the organizations that are most directly in touch with the people and have the passion and skills to best serve the needs of their community. Because their ability to deliver services to our fellow citizens is generally far better than that of any federal bureaucracy, with the possible exception of Social Security, it has been an on-going goal of mine throughout my congressional career to champion the philanthropies.

As an original Member of the Senate Philanthropy Caucus, it is my special duty and privilege to carry the message and mantle of philanthropic legislative priorities. I cannot let this opportunity go by without calling to action all those who today profess their support for charities in general and for charitable tax provisions in particular. I urge you to join me and the other Finance Members including Senators Schumer and Burr on the Senate Philanthropy Caucus.

Mr. Chairman, the process of reforming the tax law in 1986 was largely possible only through bipartisan work in the Senate Finance Committee, and I urge us as a Committee to undertake this endeavor with care and deliberate speed because our economy needs a strong platform and Americans deserve a competitive, world class tax system.

The Tax Treatment of Charities & Major Budget Reform

Statement of

C. Eugene Steuerle

Testimony Before the
Committee on Finance
United States Senate
Hearing on Tax Reform Options: Incentives for Charitable Giving

October 18, 2011

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Mr. Chairman and members of the Committee:

It is an honor once again to testify before you, this time on the relationship among budget reform, tax reform, and the tax incentives for charities. Like almost everyone, I am involved with the charitable sector in many ways—in my case, as researcher or analyst, donor, chair of a community foundation, and employee. You have asked me here in my first role, and I will strive, as I always have, to try to present you the best information in as objective a way as possible.

Almost no person or institution can fail but be intimately involved and affected by the huge tasks before this Congress—getting our long-run budget in order, reducing unemployment, and simply making government work. You sit, I believe, at the beginning of one of the major fiscal turnings in our history. By fiscal turning, I refer to a period where government must gain or regain the fiscal space, give, or slack to be able to move forward confidently to meet the needs and demands of an unknown future. That we must go through this turning is unavoidable; that it will be done well is yet to be determined. And the stakes are huge.

Our mutual goal in the midst of this uncertainty should be to enhance the strength and capabilities of all sectors of our economy. Each has a vital part to play. With regard to budget or tax policy and charities, both public and private sector have clear responsibilities:

> The foundation community and charitable sector should provide leadership to help us face up to our duties, make tough choices, and move beyond narrow interest considerations that can pull us down together.
>
> Those deciding or influencing government policy, in turn, should be seeking policy solutions that strengthen the budget, develop a fairer and more efficient tax system, and strengthen all the sectors of the economy, including business, household, and nonprofit.

These goals are compatible.

Let me also be clear. *Reforming budgets so that they have fewer long-term deficits only creates net losses in the political, not economic, sense.* Real budget reform simply means moving to a system where we pay our bills, or incur fewer of them, rather than shift ever more of them off to unidentified taxpayers in the distant future. In that sense reform merely makes visible the hidden parts of a balance sheet. Done well, it creates the net winnings that come from a more vibrant economy, which can benefit all sectors.

In most of my testimony, I compare and contrast various proposals according to their effect on charitable giving and revenues. Before proceeding, however, I wish to lay aside three issues:

- A charitable incentive may be desired for reasons that go well beyond any incentive effects we can measure, including sending a positive signal about the type of society we seek and our duties to one another.
- Progressivity is best assessed by the overall structure of the tax system, or, more precisely, of taxes and spending, not by each individual provision.
- Government interacts with charities in many ways, and what it does through direct spending or tax rates generally will have more impact than changes in tax incentives.

Promoting Altruism and a Civil Society

Government funding of acts of generosity encourages many good things in society that go beyond a mere transfer of resources. It promotes a general spirit of giving and the development of mediating institutions. This type of signaling effect is measured poorly by the types of statistical analysis we normally perform, which generally try to determine how much modest differences in tax incentives affect giving.

Promotion of charity is also viewed as a way that a capitalistic society reduces the tensions that arise from the unequal distribution of power and wealth. If the charitable deduction also promotes a more altruistic society, the gains to society relate not just to benefits transferred to ultimate donees, but to the behavior of the donors.

In your deliberations over budget and tax reform, therefore, I strongly encourage you to give attention to the message you convey about the type of society you wish to encourage.

Progressivity

To measure progressivity, one has to define the base by which it is measured. We could measure it along a scale of income by itself or income available to consume after taking into account certain transfers such as alimony or gifts to charity. In the latter case, charitable deductions do not reduce progressivity any more than do deductible payments of alimony. Unlike alimony, on the other hand, charitable giving is seldom taxable to the ultimate beneficiaries of the transfer, so it still provides a subsidy, but by this standard, to the recipients.

For the moment, however, let's measure progressivity along a scale of income alone. Even then, a charitable deduction need not reduce progressivity.

To see this, imagine a tax system with four taxpayers. Taxpayers A and B each have $100,000 in income and have a higher tax rate than taxpayers C & D, each with $40,000 in income. Suppose only taxpayers A and C give money away to charity. In Figure 1 below, I show that a tax regime with a charitable deduction and one without a deduction can be made equally progressive.

This is not just a hypothetical issue; it has real world applications. When I served as the economic coordinator of the Treasury project that led to the Tax Reform Act of 1986, some Treasury staff initially produced draft explanations of proposed reforms of particular tax subsidies. They wanted to argue that reforming some of these programs would make the tax system more progressive. However, the reform was designed so as to leave the distribution of taxes the same among those in different income classes, as measured on an income (pre-deduction) basis. Accordingly, any change in deductions, credits, preferences, and adjustments to the tax base was immediately offset by a change in the tax rate schedule to produce the same degree of progressivity.

Figure 1

Two Equally Progressive Tax Systems				
Taxpayer	Income	Charity	Tax	
			Regime 1	Regime 2
A	$100,000	$10,000	$18,000	$19,000
B	$100,000	$0	$20,000	$19,000
Total A + B			$38,000	$38,000
C	$40,000	$4,000	$3,600	$3,800
D	$40,000	$0	$4,000	$3,800
Total C + D			$7,600	$7,600

The Government-Nonprofit Relationship

The government interacts with charities and nonprofit institutions on a variety of fronts. Many of its payments flow through charities and provide health, education, and other forms of social welfare. Indeed, more money flows to charities from government fees and contracts than from individual and corporate contributions. Also, the setting of tax rates largely must be determined by considerations that stretch well beyond the charitable sector, yet they may have as much or greater effect on the sector as reforms made to the deduction itself.

When Congress allows an incentive like the current deduction, it permits taxpayers to choose how to allocate subsidies, but only within a set of boundaries surrounding what it deems to be charitable. However, Congress still picks winners and losers more directly through its direct grants and subsidies: for example, nonprofit hospitals over education for the young. There is no doubt as to whether Congress will pick winners; the question is whether it wants to maintain as part of its overall system a portion where it encourages individuals to give and, through their giving, pick the recipient organizations for some government money, as well.

Reforming Charitable Incentives

One of the practical difficulties with broad-scale budget reform is that it very big decisions often are made quickly, with officials often picking items off of a list to achieve some fiscal goal. When general limitations are made to apply across programs, such as a simple limitation on all itemized deductions (but not exclusions), they often don't end up providing the fairest or most efficient way of achieving the objectives of each particular program, even if, as a composite, the reformed law from a budget perspective might still be better than the status quo.

I also recognize the power of the status quo and the fundamental difficulty of all policy reform: that it creates losers as well as winners even if the net gains to society would be quite positive.

Still, I would like to lay out for you how a detailed reform of charitable tax law can be pulled together in a way that might achieve several of your longer-term objectives in ways superior to the shortcut method. In fact, it is quite possible to undertake reform that both cuts back on the cost of the charitable deduction and raises revenues.

In Figure 2 below I rank different tax reform options that raise revenue by the relative size of their negative impact on giving relative to amount of revenue gained. I include the failure to take certain actions—not allowing giving through April 15, and not allowing a deduction for non-itemizers—in this list since they, too, effectively "raise" revenues relative to their adoption.

The bottom line is that some actions, such as a floor under giving (say, only allowing deductions for giving above 1 percent), tend to raise substantial revenues with minimal impact on giving. Other options, such as not allowing people to continue to make deductions up until they file their returns on April 15, probably loses at least $3 of charitable giving for every $1 of revenue gained by denying this privilege. Capping the deduction or converting the deduction to a credit likely creates a greater loss of charitable giving than do some limitations on the deduction because they affect taxpayers who are considered by some researchers to be more sensitive to tax incentives.

Figure 2

A Preliminary Ranking of Restrictions on Giving by Loss in Charitable Giving Per Dollar Pick-Up in Revenue

--Rough Ranking from Highest to Lowest--

- Undertaking greater compliance efforts
  - It is even possible for improved compliance to increase charitable giving
- Not allowing giving until April 15
  - Perhaps $3 to $6 dollars of giving lost per dollar of revenue pick up
- Capping the deduction or converting to a revenue-raising credit
  - Greater loss of charitable giving if higher-income givers more "price" sensitive
  - Result for a credit sensitive to the credit rate
- Excise tax on foundations
  - $1 loss in giving per $1 pick-up in revenues
- Not allowing a non-itemizer deduction
  - Less loss of charitable giving if lower-income givers less "price" sensitive
- A floor under charitable giving
  - Very limited loss of charitable giving per dollar of revenue pick up

Figure 3, summarized in the chart in Figure 4, shows you several types of changes to charitable tax law standardized to produce approximately $10 billion in revenues each. Though my reading of the literature implies a higher response rate for proposals that tend to affect those with higher incomes (because they have more at stake), there is no consensus on the matter, and through the Urban-Brookings Tax Policy Center we present results two ways that have been used by such agencies as the Congressional Budget Office[1]:

[1] The "low response" category uses a price elasticity of charitable giving of -0.5, and the "high response" category uses an elasticity of -1.0.

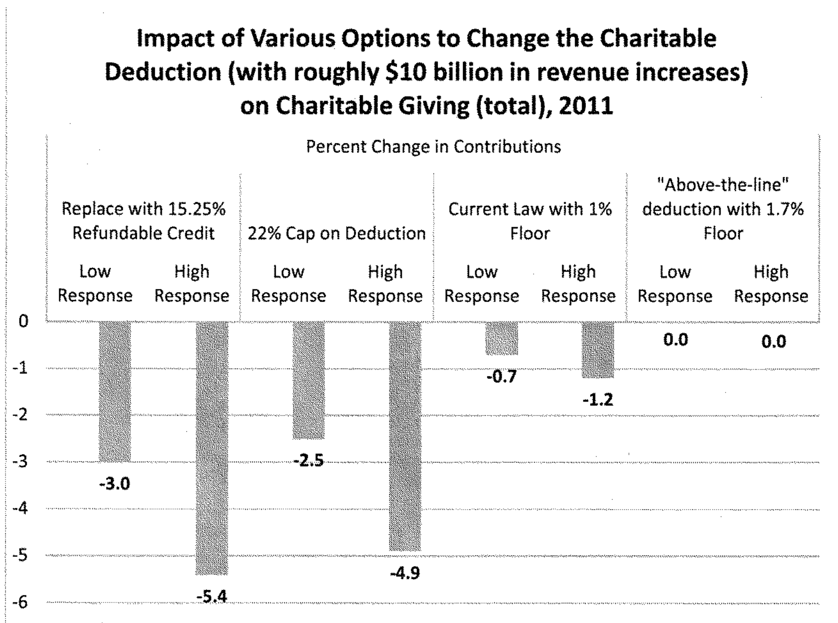
Figure 3

Impact of Various Options to Change the Charitable Deduction on Charitable Giving, 2011

Cash Income Percentile	Baseline Contributions ($ millions)	Percent Change in Contributions							
		Replace with 15.25% Refundable Credit		22% Cap on Deduction		Current Law with 1% Floor		"Above-the-line" deduction with 1.7% Floor	
		Low Response	High Response	Low Response	High Response	Low Response	High Response	Low Response	High Response
Lowest Quintile	**3,048**	8.6	18.5	0.0	0.0	0.1	0.7	0.6	1.5
Second Quintile	**9,480**	7.3	15.2	0.0	0.0	0.0	-0.1	3.6	4.2
Middle Quintile	**21,118**	4.7	9.8	-0.1	-0.1	-0.2	-0.4	2.9	3.9
Fourth Quintile	**40,221**	1.1	2.4	-0.4	-0.7	-0.5	-0.9	1.2	3.0
Top Quintile	**126,428**	-6.6	-12.6	-3.8	-7.5	-0.9	-1.6	-1.1	-2.0
All	**200,323**	-3.0	-5.4	-2.5	-4.9	-0.7	-1.2	0.0	0.0
Addendum									
80-90	**31,135**	-3.0	-5.7	-1.4	-2.7	-0.7	-1.3	0.3	0.4
90-95	**21,420**	-5.7	-10.9	-2.5	-4.8	-1.0	-1.8	-0.7	-1.0
95-99	**27,560**	-9.5	-17.9	-6.2	-12.1	-1.2	-2.2	-2.5	-4.4
Top 1 Percent	**46,314**	-7.8	-14.8	-4.7	-9.3	-0.8	-1.4	-1.5	-2.7
Memo: Revenue Effect ($ billions)		***9.7***	***10.4***	***9.4***	***10.4***	***10.5***	***10.4***	***11.0***	***10.4***
Memo: Total Change in Contributions ($ billions)		***-6.0***	***-10.8***	***-5.0***	***-9.8***	***-1.4***	***-2.4***	***0.0***	***0.0***

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2).

Figure 4



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0411-2).

Of the $10 billion revenue options shown in these two figures, the "above-the-line" deduction with the 1.7% floor has approximately a neutral effect on giving. The floor reduces giving very modestly, and the extension of a deduction to non-itemizers increases giving by about the same amount. In these examples, the strongest loss in giving comes from replacing the deduction with a refundable 15.25% credit. This option leads to about the same revenue gain but a decline in giving of 3.0% if givers are less responsive, and a decline of 5.4% for $10.4 billion in revenue if donors are more responsive.

Obviously, these numbers are only projections, not exact representations of the effects of each of these laws; the variation in responsiveness of donors demonstrates this uncertainty. However, what this simulation does reveal is that a floor on the charitable deduction could raise as much revenue as a cap or a credit, while decreasing giving by considerably less. Also, depending on the method of raising revenue, the effects on charitable giving vary greatly.

To compare these options to the 28% cap on itemized deductions proposed in the American Jobs Act: the Urban-Brookings Tax Policy Center Microsimulation Model projects that at 28% cap would decrease contributions by $1.7 billion if donors are less responsive and $3.2 billion if donors are more responsive, although the revenue pick up is only $3.1 billion in the less responsive case and $3.5 billion in the more responsive case.[2] This option generates less than half of the $10 billion of revenue pick-up shown in the figures.[3]

Note how combining options creates new possibilities. For instance, extending a deduction to non-itemizers might initially be considered poor tax policy since it is believed to cost significant revenues per dollar of charitable pick-up. And it could add significantly to IRS compliance costs. But if combined with a floor on giving, the package could easily be designed to increase both revenue and charitable giving without adding to those IRS costs.

Several other options presented in Figure 2 deserve strong consideration. One way of increasing revenues without losing contributions would be to increase compliance by giving the IRS better tools to monitor charitable deductions, reduce opportunities to overvalue gifts, and remove opportunities for taxpayers to declare deductions for giving that never took place. The net result would be better tax policy, better tax administration, and a stronger charitable sector—and perhaps most important, an intangible: a sector with improved integrity, one that better represents the public it claims to serve.

Some compliance efforts, of course, could place some additional burden on some charities. Still, the net amount for charitable purposes is clearly a far more important consideration than the gross amount flowing through any particular charity. For instance, suppose a provision forces a loss of $100 of contributions, but only $25 of that amount ever really gets to charitable recipients. Intermediaries along the way walk away with the other $75. Suppose additionally that Congress offers charities, as whole, subsidies likely to increase giving to charitable beneficiaries by $30. Then, the net amount of real charitable activity is larger ($30 less $25). Not only is there more money available to ultimate beneficiaries, but the economy as a whole is also now more efficient and wastes fewer resources along the way.

These various revenue pick-up items could be used to support a number of other items that likely would increase charitable giving, such as allowing giving until April 15, relaxing some rules on maximum amounts that can be given away, and reducing and simplifying the excise tax on foundations.

I cannot give you precise estimates for some of the options that I suggest you consider—for instance, allowing people to take deductions on last year's return up to the time of filing their return or increasing compliance efforts. Numbers from the Joint Committee on Taxation would have to be obtained before the exact parameters of a combined package can be determined.

What are some elements of a legislative package that might be considered? Here are some examples:

Some Potential Elements of a Combination Legislative Package

Revenue Increasing But With Minimal Impact on Charitable Giving

1. **Place a floor under charitable contributions so that only amounts in excess of the floor are deductible.** Economists generally believe that some base amounts of contributions would be given regardless of any incentive (e.g., the first $500 for someone giving away $1,000). Two additional trade-offs, however, must be considered. First, a

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[2] The baseline contributions in this analysis are slightly different compared to those in Figures 3 and 4, because this simulation excluded dependent tax filers.

[3] This estimate analyzes only the effect of a 28% cap on charitable giving relative to current law, not the potential effect of the American Jobs Act as a whole. Because the estimate does not consider the concurrent impact of other reform proposals, caution must be used in drawing a comparison with the options mentioned in Figures 3 and 4.

percentage floor might be defined relative to some average amount of giving, so that taxpayers might actually respond positively to show that they want to provide at least some average amount. However, a percentage floor does operate as a slight increase in marginal tax rates (e.g., someone in a 28 percent tax bracket might end up paying 28.28 percent on an additional dollar of earnings).

2. **Provide an improved reporting system to taxpayers for charitable contributions.** This would involve expansion of information reporting to the IRS by charities on some, most, or all donations received (starting with gifts greater than $250, where such reports already must be made to taxpayers). Further consideration ought to be given to requiring that charities verify or place valuations on many, most, or all types of in-kind gifts, and, for the most part, that the taxpayer use that valuation when reporting charitable donations.

   For most charities, in truth, the net additional cost would be small because most already have a system in place to keep track of their donors and how much they have given. Even most churches now give taxpayers a statement at the end of the year as to the cash contributions they stick in envelopes. Still, some software would probably need to be developed that would integrate current systems of reporting with any new system of reporting to the IRS, and there would be some transition costs.

   Historically, reporting of Social Security numbers for children or of interest and dividends appears to have led to very high improvements in compliance. Also, a well-developed information system is an important step empowering the IRS in an area where compliance efforts, by being minimal, encourage cheating.

   A viable trade-off here, as well as transition method, might be to require an information reporting system for those charities wanting to opt into the April 15 deduction proposal below.

3. **Limit deductibility for in-kind gifts where the net amount to the charity is so low (because of payments to intermediaries) that the revenue cost to government is greater than the value of the gift made.** Alternatively, at least improve the information that donors receive. For instance, require that the charity must report to the taxpayer on the net amount received after payment to intermediaries, including advertisers, if this amount is less than, say, 50 percent of the value of the gift.

   For household goods alone, Congress ought to consider the Joint Committee option to remove the deduction. Recent IRS data on donations of clothes, for instance, implies some fairly extraordinary amounts of such deductions, and it is well known that many intermediaries operate so that charities often get very little relative to the amount of revenue loss to the government.

   At a minimum, require full and transparent public disclosure by fundraising intermediaries of the amount of the gifts raised for *each* charity; the amount they, the intermediaries, received; the amount paid to other intermediaries, including for advertising; and the net amount turned over to the charity. These returns should be publicly available, just like the 990 returns of charities.

4. **To help the public monitor the charitable sector, require electronic filing by most or all charities.** Today, a large confluence of charitable sector groups, researchers, state attorneys general, and private-sector information firms unite in trying to clean up the charitable sector. One step that would help them greatly would be to require the electronic filing of tax forms, such as the 990 and 990 PF, for most or all charities. Electronic filing will (1) improve compliance by charities, (2) lead to better monitoring of the sector by the public, (3) help state attorneys general catch non-tax abuses, and (4)

reduce the paperwork exchange among charities (e.g., by foundations needing information on grantees). It also makes the IRS's job easier, allowing it to devote more resources to compliance efforts that raise revenues. Congressional backing here for electronic filing and for making existing electronic files available as quickly as possible to the public could add to the momentum toward producing a more vibrant nonprofit sector.

Proposals to Enhance Incentives

5. **Allow deductions to be given until April 15 or the filing of a tax return.** This is the same rule that applies to IRAs and Keogh plans. If the tax system is to encourage giving, then the best time to advertise is when people are filling out their tax returns or their tax preparers are looking for additional ways to save them taxes. The long-term cost of this extension would be only a fraction of whatever increase in charitable giving might result since there is almost no cost unless giving goes up. Therefore, it would be one of the most effective measures that could be adopted in terms of induced charitable giving per dollar of revenue cost.

   To deal with some enforcement issues, however, this April 15 allowance might be allowed only for contributions accompanied by an improved reporting system, as is the case with IRA contributions. Otherwise, Treasury fears that some taxpayers would take the deduction twice, on April 15 of the year of deduction and then when filing the tax return for the next year. With IRAs, the issue is solved by the recipient charity working with the taxpayer to provide a 1099 indicating the year to which the deduction applies.

6. **Adopt a deduction that is the same for non-itemizers and itemizers alike.** Charitable bills in the past often offered an extension of deductions to non-itemizers, but generally failed to deal with either the costs per dollar of pick up or with increased IRS enforcement problems. Combining a new deduction with a floor can neatly solve both problems. For some complicated but very important reasons, it is crucial that any resulting deduction and floor be the same for itemizers and non-itemizers alike.

7. **Consider proposals to place less strict limits on charitable contributions, such as the proposal to allow contributions to be made from individual retirement accounts (IRAs) and allowing lottery winnings to be given to charity without facing tax.** Various versions of this proposal would allow money to be paid directly out of IRA accounts without having to be declared first as income subject to tax and then deducted. I have suggested that lottery winners ought to be given a brief period when they can give away as much as 100 percent of their winnings in the same manner. (Right now they are penalized for not engaging in a legal commitment to share their lottery winnings at the time the ticket is purchased but before they have won—an almost impossible condition given the odds of winning and the cost of such a legal transaction relative to the cost of a ticket.)

   The simplification aspects of these proposals almost surely would increase charitable giving and would likely lead both mutual funds and state lotteries to advertise the availability of these options. Whatever rule is adopted, there should be at least one line on the individual tax return reporting gifts made in any exceptional way, as well as a box on the 1099 sent to taxpayers and the IRS by retirement plans. Only in that way will the IRS and Congress be able to monitor well exactly what is happening over time. This selective approach does grant some individuals an exception to the limit on giving of 50 percent of adjusted gross income, an issue that must be admitted. On net, however, I believe that the simplification gains would enhance giving enough to make the proposal worthwhile.

8. **Raise and simplify the various limits on charitable contributions that can be made as a percentage of income.** There seems to be no significant reason for limiting corporate giving to 10 percent of income. For moderate- and middle-income individual taxpayers, in addition, one could consider removing the various individual limits (50 percent for all giving, lesser amounts for giving to foundations and for giving appreciated property). The goal here is both to simplify and to enhance charitable giving. The limit on giving to foundations ought simply to be folded into whatever overall limit applies to giving in general; this separate limit for foundations has a tortuous history that has little to do with the present circumstances of foundations.
9. **Reduce and dramatically simplify the excise tax on foundations.** Whatever Congress gives back here will automatically be paid out to the public in the form of greater charitable activity—thus meeting the primary test for effectiveness outlined above. This tax also raises far more than is needed to meet its intended Congressional purpose—to support IRS costs of monitoring the nonprofit sector. The current design discourages payouts today because they can increase future excise taxes (which are higher when giving tomorrow does not exceed giving today).
10. **Change the foundation payout rule so that it does not encourage giving in a pro-cyclical manner.** Stock market bubbles can cause grants to rise dramatically for a few years, but then a later recession and a bursting bubble tends to lead at least some foundations to reduce grants. It is counterproductive to require private foundations to pay out more money when times are good and to induce them to pay out less when times are bad. For instance, those foundations that kept up giving during the recent Great Recession will soon be penalized with a higher excise tax. Revisions to the payout formula that would reduce this pro-cyclical effect need to be considered. Whether the average rate of payout needs to be lower over time is a separate issue and is discussed in item 9, above.

In many cases, charities that might be reluctant to take on some of these suggested limits or reporting requirements, considered in isolation, would find that they are much better off with the broader legislative package than without it. For instance, a floor under itemized deductions would have little effect on itemizers since it would have little effect on their marginal giving, but it would increase the amount of revenues that could be spent on expanding the deduction to non-itemizers. The additional reporting requirements make it easier to allow giving until April 15, which likely would increase giving significantly because it markets the tax incentive at the time the tax return is filed.

Conclusion

As I have indicated, I believe we are I the midst of a radical fiscal turning, one that is going to require us to look through a whole slew of spending and tax subsidy programs and decide which ones to keep, which ones to get rid of, and, in many cases, how best to pursue objectives that Congress decides remain worthwhile for the government to undertake. I have tried to show that in the case of tax law toward charitable contributions, there is a lot we can do to make our subsidy system more effective from both a fiscal and a charitable sector standpoint.

Here, then, is an ideal trade-off. The monies derived from a floor under charitable giving, several improved compliance measures, greater restrictions on non-cash gifts where abuse is likely or enforcement is next-to-none, and a better system of information reporting could be spent to enhance charitable incentives: allowing taxpayers to benefit immediately from the charitable contributions they make while filing their tax returns, extending the deduction to more taxpayers who don't itemize, raising the ceiling on allowed charitable giving for some types of gifts, and fixing the foundation excise tax that has been under consideration for some time.

Senate Finance Committee Hearing
"Tax Reform Options: Incentives for Charitable Giving"
October 18, 2011
Questions for the Record
Dr. Steuerle

Questions from Chairman Baucus

1. Some believe that the charitable deduction is not tax expenditure because the donor has given the money away – they don't have the money donated anymore so shouldn't be taxed on it. Others believe it is a tax expenditure because, for example, someone who has \$20,000 and decides to give \$1,000 to charity is better off than someone who only has \$19,000.

- **What do you think about whether the charitable deduction is a tax benefit?**
- **If it is not a tax benefit, does it make sense to deny the deduction to non-itemizers?**

A: There is a legitimate debate among policy makers and scholars as to whether the charitable deduction should be considered as an incentive or as an adjustment to the tax base for ability to pay. In the latter case, for instance, someone who has \$20,000 and gives \$1,000 to charity would be treated equivalently to someone who has \$19.000 and gives nothing to charity. (For this purpose, I am ignoring other issues such as a standard deduction that might be given in lieu of a charitable deduction.)

In my view, the deduction serves both purposes, and there is no contradiction is saying that Congress wanted both to provide an incentive and make an adjustment for ability to pay.

Either way, however, it is appropriate to consider the deduction an "income tax expenditure" in the sense that the deduction provides an exception to the rule that income would be subject to tax. Tax expenditures are not "bad" or "good" per se. Note also that under an ability to pay argument, even if we do think that it is appropriate to provide an adjustment to the donor, there is still income received (usually as services or goods by the ultimate beneficiaries) that is not subject to tax.

2. The Finance Committee has spent many hours examining our tax code out of a belief that by modernizing our tax laws we can enhance our ability to successfully compete in the 21st century global economy. This study has convinced many of us on the panel that our nation's ability to compete with China and other emerging economies depends, in part, on a tax code that is competitive with other countries.

- **Do you have any data or views on the value and importance of the charitable deduction as it pertains to the ability of tax-exempt organizations to contribute to our nation's economic competitiveness?**
- **If we make changes to the charitable deduction that result in a loss of some private support for the tax-exempt community at a time of diminished and diminishing**

government support for many of the activities of the tax-exempt community, do we put at risk the ability of tax-exempt organizations to, for instance, help meet a rising demand for basic needs, or to educate young people to ensure our long-term economic growth?

A: Research generally has shown that the charitable and philanthropic community in the United States is among the strongest in any nation in the world, especially when considering donations of money and time. At the same time, the social welfare function of the government is about ten times larger than the charitable contributions of individuals, so we should not think that one is easily a substitute for the other. While both sectors are organized to promote the public good, they each have roles to play that are also complementary (many charities get large amounts of service fees and contracts from government) and adversary (e.g., prodding each other to do better).

It is hard to prove empirically how much this charitable spirit is enhanced by the deduction. Moreover, the risks to the economy from not dealing well with our budget must be matched up against the risks to those sectors of the economy that are going to be affected by spending cuts and tax increases that will bring our budget back into balance.

The safest course is to try to strengthen both sectors at the same time—strengthen government by reducing the cost of incentives that are not working well and not well targeted and, at the same time, strengthen the charitable sector by improving on incentives where more can be obtained per dollar of revenue cost. Improvements in areas of compliance also strengthen both sectors.

3. Research has shown that folks donate to different charities for different reasons. Some folks are more inclined to support their church with small tithes, regularly. Some folks are more inclined to make large one-time donations to their alma mater.

- **Over the course of your years of experience, what differences and similarities have you noticed amongst donors?**
- **Which donors respond to incentives for charitable giving?**
- **Does the form of the incentive matter?**

A. My research has shown that people are all over the map in terms of their donative behavior. Some people who give in their estates do little when alive, and vice-versa. A significant share give little or nothing, others are quite generous from year to year. Older individuals are more likely to reach a stage in their lives where they start to think more about what to do with their remaining resources, especially after many of the other needs of the family are met. By the same token, the presence of children and active engagement in volunteer and church activities tends to be associated with higher levels of giving, as well.

Generally, the best incentive is that which is best marketed, which is one reason why I have suggested letting individuals take deductions for the previous year up until April 15 or the filing of their tax returns, whichever comes first. There is some slight evidence that higher income individuals are more responsive to incentives, which may simply reflect that they have more at stake and that planning is more profitable.

Granting deductions for the first dollars of giving—those that are likely to take place no matter what the incentive—are generally believed to be of little effectiveness. That is one reason why I suggest replacing the inclusion of the charitable deduction under the standard deduction floor with a separate floor under charitable giving (e.g., allowing everyone to take deductions for gifts in excess of some figure like 1 percent of AGI). Done the right way, this likely would both reduce costs of the government subsidy and raise charitable contributions.

4. The charitable deduction was adopted into the tax code in 1917. While it has gone through various changes, including an above the line deduction for non-itemizers in the 80s, it has remained a deduction. This provision is one of the largest tax expenditures.

- **What has been your view of the charitable deduction over the years?**
- **Would another form for charitable giving encourage more giving?**
- **Is there a way to encourage just as much giving, but more efficiently?**

A. Many tax expenditures encourage excessive behavior (e.g., higher medical costs) we do not want. The charitable deduction, on the other hand, favors behavior we want to encourage—not simply for the good of the recipient but for the character development of individuals and society. Generally speaking, a deduction provides more incentive than does a credit or a deduction with a cap (e.g., at a rate lower than the taxpayer's marginal tax rate). Again, however, a floor under the charitable deduction, combined with a deduction for all (not just itemizers) could be designed to encourage more giving at no cost or reduced cost for government.

5. Five years ago, I challenged large foundations and grant-makers to double their investment in rural America. So far, the challenge has not been met. I encouraged funders to partner with government, invest in local community foundations, invest in rural non-profit infrastructure and to tailor more grants to meet the needs of rural states.

- **How can policymakers work with tax-exempt organizations to meet identified needs, after we've provided an incentive to encourage folks to donate?**

A: I believe we could do a much better job in "marketing" the value of charities to our society. The government could, as I suggested in my testimony, offer the option to allows deductions up until April 15 or the filing of a tax return, exchange the standard deduction floor for charitable giving with a more efficient floor that would apply to everyone, provide certain exceptions to the maximum allowable contribution—as for the lottery winner who wants to donate the winnings to charity, and simplify and reduce the excise tax on foundations. Other suggestions along these lines are in my testimony, and I have also suggested that there are ways to combine these options so that the cost to government would be the same or less.

At the same time, the charitable sector could do a lot better and more scrupulous job of monitoring noncompliance, activities likely to lead to corruption, and even legal activities that test borders and are not very efficient or fair (e.g., donations of non-cash gifts that cost the government far more than any amount that ultimately benefits charitable recipients). Monitoring these activities would both provide greater public support for charities in general and increase the net amount of giving that actually benefits the intended beneficiaries of the donations.

<u>Questions from Senator Wyden</u>

Mr. Sammartino testifies that replacing the current deduction with a nonrefundable tax credit made available to all tax filers would– if it's combined with a contribution floor – increase the total value of donations and reduce the cost of the federal tax subsidy.

For example, he said that a 25 percent nonrefundable tax credit (with a floor of $500 per individual and $1,000 per couple) would increase donations by $1.5 billion and boost federal revenues by $2.4 billion.

In contrast to the current deduction, a nonrefundable credit would provide the same tax subsidy (per dollar of giving) to all taxpayers who could fully claim the credit, instead of a subsidy that benefits the highest income taxpayers more.

- **Wouldn't this approach – setting a floor and replacing the deduction with a refundable tax credit – be more equitable than the current deduction?**

A: As you suggest, a floor allows one to allocate the charitable incentive in such a way that the government can both raise revenues and increase charitable giving. Some economists believe that a subsidy provides greater charitable giving for higher income taxpayers than a credit of equal cost simply because they are more sensitive to the incentive. As for the fairness issue, a case can be made either way. Yes, higher income taxpayers have more of an incentive to give, but in some ways that counteracts their cost of earning another dollar from work. In other words, a deduction is neutral between a higher income taxpayer working to give money to charity and a lower income taxpayer doing likewise. I discuss these issues in my testimony, as well. Bottom line, however, whether a credit or deduction is used, it is possible in get more "bang per buck" out of the existing law.

- **Is there any reason not to pursue this route if it saves the government money and will increase the total value of charitable giving?**

A. As indicated in my testimony, I consider these type of trade-offs the type we should be examining in depth. I mentioned several others, as well. Indeed, as we move forward in many other areas of tax, expenditure, and budget reform in the coming years, it is my fear that these issues of efficiency and fairness will be put to the side. The goal of sustainable government may be defined by deficits, but the goal of good government is much a much broader concept for which sustainability and limited long-term deficits are only subsets.

COMMUNICATIONS

ALLIANCE FOR CHARITABLE REFORM
A Project of The Philanthropy Roundtable

Alliance for Charitable Reform
Sandra Swirski, Executive Director
1455 Pennsylvania Avenue NW, Suite 800
Washington, DC 20004

Tuesday, October 18, 2011
Senate Finance Committee Hearing
Tax Reform Options: Incentives for Charitable Giving

Statement for the Record:

As a group dedicated to educating legislators on the contributions of private American philanthropy, its longstanding tradition and the role it plays in their communities, we urge you not to alter the charitable deduction from its current state.

The charitable deduction supports the notion that private philanthropy is an independent and innovative investment improving our nation's communities. Donors commit private resources for the public good, affecting change in diverse ways. The charitable deduction is unique in that it encourages individuals to give away a portion of their income, not for personal gain, making it different from other incentives within the tax code.

Therefore, now is simply not the time to lessen the incentive to give. According to the 2010 census, the number of Americans living below poverty level has risen by 2.6% since 2007, generating tremendous demand for charitable services. During this same time, charitable giving dropped by about 20% from 2007 to 2009 by donors who use the charitable deduction, according to the IRS.

Even with this decline in giving over previous years, donors still gave $290 billion in 2010; however, any change to the charitable deduction would drive down donations. Earlier this month, the Tax Policy Center estimated that capping the charitable deduction at 28% for individuals earning more than $200,000 a year, which the President has proposed more than three times in two years, would reduce charitable giving by up to $5.6 billion a year. That is more than the annual operating budgets of Red Cross, Goodwill, the YMCA, Habitat for Humanity, the Boys and Girls Clubs, Catholic Charities, and the American Cancer Society combined.

This reduction in giving, coupled with drastically reduced federal funding due to deep spending cuts, would substantially hinder charitable services throughout the country. And while many are claiming that this deduction would only affect the "wealthy," the real burden would be placed on those who rely on charities. As previously stated, the charitable deduction is unique. The donor receives some tax benefit, but the homeless, victims of disaster, hungry children, and the others who are less fortunate derive the real benefit.

We stand with more than 15 other colleagues in the nonprofit sector who are urging you to protect this provision (see attached letter). Together, we gladly welcome any questions you may have and encourage you to consider us as a resource on this subject as tax reform continues to take shape. But for now, please maintain the status quo for charitable giving; the country cannot afford to do otherwise.

September 21, 2011

The Honorable Max Baucus
United States Senate
511 Hart Senate Office Building
Washington, DC 20510-2602

Dear Chairman Baucus,

As a coalition representing a broad cross-section of nonprofit organizations across the country, we urge you to protect the value of the charitable deduction by opposing efforts to reduce or cap the value of itemized deductions for charitable contributions as part of the President's American Jobs Act. Proposals to cap itemized deductions at 28 percent would have long-lasting negative consequences for the charitable organizations that millions of Americans rely on for vital programs and services.

The charitable deduction is different than other provisions in the tax code in that it encourages individuals to give away a portion of their income to those in need. During his speech introducing the American Jobs Act, President Obama said, we are "a nation with responsibilities to ourselves and with responsibilities with one another." This notion is the embodiment of American philanthropy. To limit the charitable deduction would be to limit our spirit of philanthropy in a time where the demand for charitable services is at its peak, and would adversely affect the less fortunate in our society in deep and direct ways.

The past few years have been incredibly challenging for our nation's charities. According to the Internal Revenue Service, charitable giving by American donors who itemize their tax returns dropped by about 20 percent from 2007 through 2009. Although the Giving USA Foundation and its research partner, the Center on Philanthropy at Indiana University, found that "giving by individuals rose an estimated 2.7 percent in 2010 (1.1 percent adjusted for inflation)," these modest gains will do little to offset the low levels of giving during previous years. In fact, it is estimated that it will take five to six years for giving to return to its pre-recession levels. And with questions surrounding the economy again, we cannot assume that charitable giving will continue to rise.

It is true that high-income earners are more sensitive to changes in tax incentives. Given this sensitivity, reducing the charitable deduction for higher income earners will negatively impact the amount these donors give to charitable organizations. And indeed higher income taxpayers account for the majority of individual giving. According to the recent CBO report on the tax treatment of charitable giving, tax filers who reported AGI of at least $100,000 in 2008 were responsible for well over half (about 58 percent) of all charitable giving by taxpayers.

And yet in the face of such tough financial conditions, charities continue to do more with less. When the economy stagnates, charities bridge the gap by serving those in need and our communities as budgetary constraints hinder state and federal governments from providing similar services. These charity-provided services are critical, and reducing charitable giving does not just harm the nonprofit sector, it also hurts the lowest income brackets that rely heavily upon these services. Despite how the proposal looks on paper, wealthy Americans will not bear the brunt of a cap or reduction in the value of itemized deductions—America's poor will.

As charities struggle to meet increased demands for their services and raise additional funds, we need to encourage all individuals, regardless of income and wealth, to give more to charitable organizations. Therefore, now is not the time to diminish incentives to give. In fact, data suggests that for every dollar a donor gets in tax relief for his or her donation, the public typically gets three dollars of benefit. Reducing the value of the charitable deduction does the exact opposite and would fundamentally change a tax structure that has contributed to a cherished tradition of charitable giving that is unmatched in the world.

Again, we urge you to oppose efforts to reduce or cap the value of itemized deductions for charitable contributions. We look forward to working with you and your staff on this issue and on any other issues affecting the charitable sector.

Sincerely,

Neal Denton
Senior Vice President
Government Relations and
Strategic Partnerships
American Red Cross

John Ashmen
President and CEO
Association of Gospel Rescue Missions

Steven S. Taylor
Vice President & Counsel for Public Policy
United Way World Wide

Adam Meyerson
President
The Philanthropy Roundtable

Jeffrey Clarke
Interim President and CEO
Council on Foundations

Dan Busby
President
Evangelical Council for Financial Accountability

William C. McGinly, Ph.D., CAE
President, Chief Executive Officer
Association for Healthcare Philanthropy

John Lippincott
President
Council for Advancement and Support of Education

John H. Graham IV, CAE
President and CEO
American Society of Association Executives

William C. Daroff
Vice President for Public Policy & Director of the Washington Office
Jewish Federations of North America

Mike Novak
President and CEO
Education Media Foundation

Jesse Rosen
President and CEO
League of American Orchestras

Senny Boone, Esq.
SVP, Corporate and Social Responsibility
DMA & DMA Nonprofit Federation

Tanya Howe Johnson
President and CEO
Partnership for Philanthropic Planning

Sr. Georgette Lehmuth, OSF
President and CEO
National Catholic Development Conference

Andrew Watt
President & CEO
Association of Fundraising Professionals

Sandra Swirski
Executive Director
Alliance for Charitable Reform

Ford W. Bell
President
American Association of Museums

Kelly Browning
Executive Vice President & Chief Operating Officer
American Institute for Cancer Research

cc: Members of the Joint Select Committee on Deficit Reduction

Testimony for the Record
Submitted to the
U.S. Senate Committee on Finance
for the October 18, 2011 Hearing on
Tax Reform Options: Incentives for Charitable Giving

On behalf of:

American Council on Education
One Dupont Circle, NW
Washington, DC 20036

American Association of Community Colleges
One Dupont Circle, NW
Washington, DC 20036

American Association of State Colleges and Universities
1307 New York Ave, NW
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Association of American Universities
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Association of Public and Land-grant Universities
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National Association of Independent Colleges and Universities
1025 Connecticut Avenue, NW, Suite 700
Washington, DC 20036

Council for Advancement and Support of Education (CASE)
1307 New York Avenue NW, Suite 1000
Washington, DC 20005-4701

October 26, 2011

On behalf of the higher education associations listed above representing approximately 4,300 two- and four-year public and private colleges and universities, we are submitting this written testimony on charitable giving incentives for the October 18, 2011, hearing record. We appreciate the opportunity to submit our views regarding the testimony received by the Finance Committee on the efficacy of tax incentives for charitable giving, in particular the federal income tax deduction for charitable contributions and potential proposals to change current giving incentives.

We know that there are a number of proposals which would significantly change the current federal income tax deduction for charitable donations as a means of increasing tax revenues. While we recognize the need to reduce the federal deficit and address the rising national debt, we urge the committee to proceed very cautiously in making changes to the current federal charitable income tax deduction, which helps generate needed private support for colleges and universities.

The federal income tax deduction has long served as an important and effective incentive for charitable giving which benefits both higher education as well as society in general. While donors make charitable gifts for many reasons, it is well established that the charitable tax deduction helps generate and sustain charitable donations. In fact, the charitable deduction is unique in tax policy in that it encourages and rewards private behavior which advances the common good. The benefit to society of a charitable donation far exceeds the financial benefit received by a donor. For every dollar a typical donor receives in tax relief for his or her gift, the public gains approximately three dollars of benefit.[1]

The teaching, research, and public service missions of colleges and universities are all supported by charitable giving. As nonprofit charitable tax-exempt entities, public and private colleges, universities, and the foundations that support them are among the beneficiaries of charitable giving. According to the Council on Aid to Education, colleges and universities in 2010 received $28 billion in charitable gifts to support their educational missions of teaching, research, and public service. These charitable gifts were used to support student financial aid, scholarships, and faculty salaries.

In this challenging economic climate, charitable gifts are an increasingly critical source of support for colleges and universities. The Great Recession has exacerbated a 20-year trend of declining state support for public higher education. Unfortunately, the major funding reductions for public higher education in many states will result in another round of higher-than-average tuition rate increases at public colleges and universities around the country, as these institutions struggle to offset the losses in state revenue. Public and private institutions experienced historic declines in the value of their endowments during the height of the recession and thus, payout amounts also suffered.

Today's struggling economy has reinforced the importance of obtaining a college education. During this time of slow economic growth, the employment divide between college-educated and non-college-educated workers has widened. At the same time, many families are under financial stress, creating greater demand for student financial aid. Without significant charitable contributions, many colleges and universities cannot accomplish their goal of access to their institutions regardless of income. Charitable gifts colleges and universities receive help to minimize tuition increases and support student financial aid programs.

Private charitable donations work in concert with federal investment to ensure access to higher education through student financial aid and support of groundbreaking research and technological innovation. This partnership has delivered enormous economic benefits to our society, but unfortunately, it is a partnership undergoing severe stress. Recent federal budget deals have already cut $30 billion from student financial aid programs, sacrificing some students' benefits to pay for others. The Fiscal Year 2012 appropriations bills contain further cuts to investments in higher education, including a $3.6 billion cut to the Pell Grant Program in the House Labor-HHS appropriations bill. Diminished support for student financial aid undermines access to higher education and ultimately, the country's ability to produce enough well trained workers essential to our economy. Work force projections show that by 2018, there will be jobs for as many as 22

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[1] Stephanie Strom, *Big Gifts, Tax Breaks and a Debate on Charity*, New York Times, September 6, 2007.

million new workers with college degrees. But on our current trajectory, we will not make that goal—in fact, we will miss it by 3 million workers.[2]

To ensure the United States' long-term economic growth, we need to expand access to education and continue to invest in critical scientific research and innovation. In light of the federal deficit, it will be difficult to sustain current federal investment in student financial aid and scientific research. Consequently, we should be taking steps that continue to encourage charitable giving to colleges and universities to support student financial aid, research, and other academic programs.

For all of these reasons, we strongly urge the Finance Committee to preserve the value of the federal income tax deduction for charitable contributions. Now is not the time to make changes in the charitable deduction that would result in a loss of charitable support. We thank the committee for this opportunity to submit this statement for the hearing record and for considering our views.

2

Anthony P. Carnevale, Nicole Smith, and Jeff Strohl, *Help Wanted: Projections of Jobs and Education Requirements Through 2018*, Center on Education and the Workforce, Georgetown University, 18 (June 2010).

United States Senate Finance Committee

Statement for the Record

October 18, 2011 Hearing: Tax Reform Options — Incentives for Charitable Giving

Submitted by: The American Council on Gift Annuities, 1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546, Phone: (770) 874-3355, Fax: (770) 433-2907, e-mail: acga@acga-web.org.

The American Council on Gift Annuities (ACGA) (formerly the Committee on Gift Annuities) was formed in 1927, is an IRC §501(c)(3) organization described in IRC §170(b)(1)(A)(vi). ACGA's officers, board of directors and its legal counsel are all unpaid volunteers. **ACGA is sponsored by over 1,000 social welfare charities, health organizations, environmental organizations, colleges, universities, religious organizations and other charities.** The Mission of ACGA is to "actively promote responsible philanthropy through actuarially sound charitable gift annuity rate recommendations, quality training opportunities and the advocacy of appropriate consumer protection."

Prepared by: Conrad Teitell, volunteer counsel to American Council on Gift Annuities, (Chairman, National Charitable Planning Group, Cummings & Lockwood, Six Landmark Square, Stamford, CT 06901. Phone: (203) 351-4164; Fax: (203) 708-3840; e-mail: cteitell@cl-law.com).

Summary of Statement

Preface. In 1973, I testified before a Congressional Committee at a hearing on the charitable deduction on behalf of a coalition of tax-exempt health organizations. Testifying with me was Dr. Jonas Salk who told the committee that a major part of the funding for the development of his polio vaccine came from charitable gifts by individuals to the University of Pittsburgh School of Medicine and the National Foundation for Infantile Paralysis (now known as the March of Dimes Birth Defects Foundation).

1. Curtailing the tax incentives to charitable giving would adversely affect the people served by America's charities. Doing this slice by slice — salami tactics — could result in little or no tax incentives for private philanthropy.

2. The current important incentive that allows tax-free IRA rollovers for direct (outright) transfers to specified categories of charitable organizations expires on December 31, 2011 and should be made permanent. The IRA/charitable rollover is an important source of charitable support. Being off-again-on-again-off-again is confusing and decreases the number of new donors and repeat annual donors.

3. Chairman Baucus, at the October 18, 2011 hearing, stated: "Most Americans aren't able to receive tax benefits from the charitable deductions since they don't itemize. Less than one-third of taxpayers itemized their deductions last year."

The IRA/charitable rollover is unique in that it does give tax incentives to the two-thirds of the taxpayers who don't itemize, but take the standard deduction. Although no charitable deduction is allowable for IRA/charitable rollovers, the rollovers aren't taxable. Not being taxable on income that would otherwise be taxable is the equivalent of a charitable deduction.

4. The tax-free IRA/charitable rollover should be expanded to include life-income charitable gifts — gifts that pay income to the donor for life, with a remainder to a qualified charity. This would be at no revenue loss to the government because annual payments to the donor would be fully taxable at ordinary income tax rates.

5. With decreased federal, state and local government support and the increased burdens on charities to serve our people, now is the time to increase, not decrease, the long-established and successful tax incentives for private support for the public good.

STATEMENT

1. Beware of salami tactics. Proposals discussed at the October 18, 2011 hearing included those that would place a 28% or other tax-bracket cap on the charitable deduction, impose an adjusted gross income floor before charitable gifts could be deducted and substitute a low credit for the current deduction.

> If your opponent has a salami and you want it for your very own, you must not grab it — because he will defend it. Instead take for yourself a small slice and he will not notice it. Or, if he does, he will not mind very much. And then you take another slice, and then another slice. And slowly but surely, that salami will pass from his possession into yours. — *Matyas Rakosi*, Hungarian politician in the 1950s, coined the term "salami tactics."

So it could be with the charitable tax incentives — a slice here and a slice there. Caps can be lowered, floors raised and credits reduced. And before you know it, our nation's unique tax encouragement to charitable giving would disappear. And some of the proposals would take big chunks at the outset — all to the detriment of the countless millions who rely on our nation's charities.

ACGA echoes the testimony of the five witnesses who testified at the hearing that limiting the charitable deduction would significantly decrease charitable support. And we also echo the statement of each Committee member who spoke at the hearing that this is not the time to limit tax incentives to charitable giving. The options being considered would decrease the ability of our nation's charities to serve their constituents in these troubled economic times and increased needs.

2. The current law that allows tax-free IRA rollovers for direct (outright) transfers to specified categories of charitable organizations should be made permanent. The law, enacted in 2006, has expired a few times, but has been extended (sometimes retroactively) and expires again on December 31, 2011. The IRA/charitable rollover is an important source of charitable support. Being off-again-on-again-off-again is confusing and reduces the number of new donors and repeat annual donors. The law should be made permanent.

The expiring 2011 law (and the law from 2006 through 2010) in a nutshell. An individual age 70½ or older can make outright (direct) charitable gifts from an IRA — including required minimum distributions — of up to $100,000 to public charities (other than donor-advised funds and supporting organizations) and not have to report the IRA distributions as taxable income on his or her federal income tax return. Most private foundations are not eligible donees, but private operating and pass-through (conduit) foundations are. The tax-free rollover is for outright gifts only, not life-income gifts. A charitable deduction is not allowable for the amount transferred to charity from an IRA, but the donor is not taxable on the amount transferred — up to $100,000. Not being taxable on income that would otherwise be taxable is the equivalent of a charitable deduction.

3. The IRA/charitable rollover is unique in that it gives tax incentives to the two-thirds of the taxpayers who don't itemize but take the standard deduction. Although no charitable deduction is allowable for IRA/charitable rollovers, the rollovers aren't taxable. Not being taxable on income that would otherwise be taxable is the equivalent of a charitable deduction.

Chairman Baucus, at the October 18, 2011 hearing, stated: "Most Americans aren't able to receive tax benefits from the charitable deductions since they don't itemize. Less than one-third of taxpayers itemized their deductions last year."

Making the current IRA/charitable rollover law permanent would continue to provide charitable tax incentives for nonitemizers.

4. The tax-free IRA/charitable rollover should be expanded to include life-income charitable gifts — gifts that pay income to the donor for life, with a remainder to a

qualified charity. This would be at no revenue loss to the government because annual payments to the donor would be fully taxable at ordinary income tax rates.

The Senate now has before it a bipartisan bill co-sponsored by three Senate Finance Committee members that would make the IRA/charitable rollover permanent <u>and</u> expand it to include life-income charitable gifts.

The Public Good IRA Rollover Act of 2011 was introduced by Senator Charles Schumer (D-NY) and Senator Olympia Snowe (R-ME) on March 10, 2011 with co-sponsors: Sherrod Brown (D-OH), Richard Burr (R-NC), Kirsten Gillibrand (D-NY), Tim Johnson (D-SD), John Kerry (D-MA), Patrick Leahy (D-VT), Carl Levin (D-MI), Mark Pryor (D-AR).

The Public Good IRA Rollover Act has been introduced in every Congress over a number of years. The original co-sponsors were Senator Byron Dorgan (D-ND) and Senator Olympia Snowe (R-ME).

The Public Good IRA Rollover Act — in a nutshell. It would allow tax-free IRA rollovers for both outright and life-income gifts and with no annual ceiling. And it includes rollovers to *all* public charities and *all* private foundations.

If it is deemed that the absence of annual ceilings on the amount that can be rolled over outright annually would make this bill too costly at this time and if there are concerns about including donor advised funds, supporting organization and private foundations as qualified donees, we ask the Senate Finance Committee to report out ACGA's proposed All-American Charitable IRA Rollover.

The All-American Charitable IRA Rollover Act would:
(draft language is at the end of this statement)

- Make permanent current law (for years 2006 through 2011) that allows individuals age 70½ or older to make direct (outright) gifts from an IRA of up to $100,000 per year to public charities (other than donor advised funds and supporting organizations) and to private operating and pass-through (conduit) foundations without having to report the IRA distributions as taxable income on their federal income tax returns.

- **Expand current law to authorize tax-free IRA rollovers for gifts that benefit charities and provide taxable retirement income for the donors.** The qualified charities would be the same donees authorized under current law for direct rollovers. There would be a $500,000 annual ceiling for life-income rollovers and donors must be age 59½ or older.

- The types of life-income plans assure that the annual taxable payments will be equal to (or greater than) what an individual would receive under the required minimum distribution rules had he or she kept the funds in the IRA instead of rolling them over for a life-income plan. The life income paid from the rollover cannot be assigned.

- Under the authorized life-income plans, the IRA owner will be taxable on income received at ordinary income tax rates. Because the payouts are 5% or more, there will be more income paid with the charitable plans than under the normal payouts of the minimum required distribution rules. The higher payout amounts will produce greater tax revenue for the Treasury.

The current outright (direct) IRA/charitable rollover has resulted in millions of dollars of charitable gifts that would not otherwise have been made. It helps the Americans served by our nation's charities — provides for housing assistance, feeding the hungry, education, medical services and thousands of other services that American citizens need. The life-income rollover would greatly increase those gifts.

Why would IRA owners not just give outright to charity (a direct gift) from an IRA as provided under current law? Many IRA owners want to make charitable gifts, but also need retirement income. The life-income IRA rollover is an excellent way for donors of average resources to combine a charitable gift with retirement income. Many charities have donors who are "standing by" and wish to make life-income charitable gifts from their IRAs.

This is an All-American Charitable IRA Rollover. It allows all Americans with IRAs — not just those with large stock portfolios — who meet the minimum age requirements, to benefit charities. And since it encourages non-itemizers (over 65% of taxpayers) as well as itemizers, it is truly All-American.

Senate Finance Committee member Snowe was the original co-sponsor of the Public Good IRA Rollover Act. On November 14, 2007, the Senate Finance Committee held a hearing titled: "Federal Estate Tax—Uncertainty in Planning Under the Current Law." I was one of the four invited witnesses.

Among the written questions asked of me by Committee members after the hearing, was this question from Senator Snowe and my response:

> **Senator Snowe**
> Mr. Teitell, thank you so much for your reference in your written testimony to the Public Good IRA Rollover Act of 2007 (S. 819) that I introduced with Senator Byron Dorgan earlier this year. I agree with you that it is a critical incentive for both donors and charities.

Mr. Teitell, focusing on the planned-giving component of this legislation through which an individual could donate to a charity and receive life income that is taxable, could you please comment on how this provision would promote charitable donations while simultaneously reducing individuals' present-law estate tax liabilities and addressing Congress' concern that individuals do not outlive their retirement savings?

Conrad Teitell

Senator Snowe, many individuals would like to give part or all of their IRAs outright to charity, but they need the retirement income from their IRAs. Allowing them to roll over their IRAs at age 59½ or older to a life-income plan that would pay the individual (and a spouse, if desired) income for life (through a charitable gift annuity, charitable remainder unitrust or annuity trust, pooled income fund gift) would enable them to provide retirement income for life <u>and</u> make a charitable commitment. The charities could plan on receiving the gift after the life interest terminates.

A life-income rollover is truly an All-American IRA/Charitable Rollover. It would encourage philanthropy by <u>all</u> Americans—not just those who can afford to part with their assets now <u>and</u> not just those who itemize their deductions on their tax returns.

The ability to roll over an IRA to charity directly—or for a life-income plan—gives charitable tax incentives to the approximately two-thirds of taxpayers who take the standard deduction. Not being taxed on income that would otherwise be taxed (withdrawal from an IRA) is the equivalent of a charitable deduction.

The IRA assets rolled over for a life-income plan would not be included in the taxpayer's estate at death. However, the vast majority of the rollover gifts would come from individuals who have no estate tax concerns.

The life-income rollover shouldn't cost the government anything because the payments received from the life-income plans would be fully taxable—just as if the payments were received from the original IRA custodian or administrator. The big difference is that the nation's charities and the people they serve will be greatly benefitted.

Rolling over an IRA for a charity's life-income plan is not giving away the assets in the plan. The individual continues to receive income for life—just as if she or he had kept the IRA assets with the current custodian or administrator.

Senator Snowe, as you know the IRA/charitable rollover law that allowed tax-free rollovers for direct (outright) rollovers to charity for 2006 and 2007 wasn't in an extenders' bill at the end of 2007. When the Senate this year (soon, I hope) considers extending the just-expired IRA/charitable rollover provision, I hope that it will add the life-income component of the Public Good IRA Rollover Act of 2007 (S. 819).

As volunteer legal counsel to the American Council on Gift Annuities (an organization of over 1200 charities receiving support through life-income plans), I convey ACGA's thanks for your being an initial co-sponsor of S. 819 with Senator Byron Dorgan—not only in this Congress, but also several years ago in an earlier Congress.

The bill that you and Senator Dorgan initiated now has wide bipartisan co-sponsorship in both the Senate and the House—including many members of the Finance and Ways and Means Committees.

To sum up: The IRA/charitable life-income rollover is not a revenue drainer and it doesn't decrease retirement savings—just puts an IRA in a different container. I hope that Congress agrees that passage should be a no-brainer.

5. With decreased federal, state and local government support and the increased burdens on charities to serve our people, now is the time to increase, not decrease, the long-established and successful tax incentives for private support for the public good.

General William Booth, the founder of The Salvation Army, spoke these words on May 9, 1912 at Royal Albert Hall in London:

> While women weep, as they do now — I'll fight. While little children go hungry as they do now — I'll fight. While men go to prison — in and out, in and out, as they do now — I'll fight. While there is one lost little girl upon the street, While there is one soul without the light of God — I'll fight. I'll fight. I'll fight until the very end.

With all our nation's problems, ours is still a most wonderful country. But the societal ills that General Booth spoke about almost 100 years ago are still with us today.

Continuing the current tax incentives to charitable giving, making the IRA/charitable rollover permanent and allowing IRA rollovers to charitable life-income gifts will better enable America's charities to do the job of eliminating the evils that General Booth spoke about. And, it will provide better education, further the arts, and expand the other laudable activities in our country.

All-American Charitable IRA Rollover Act of 2012 — Draft Bill

To amend the Internal Revenue Code of 1986 to expand tax-free distributions from individual retirement accounts to include rollovers for charitable life-income plans for charitable purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "All-American Charitable IRA Rollover Act of 2012."

SEC. 2. TAX-FREE DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT ACCOUNTS FOR CHARITABLE PURPOSES.

(a) In General -- Paragraph (8) of section 408(d) of the Internal Revenue Code of 1986 (relating to tax treatment of distributions) is amended to read as follows:

(8) DISTRIBUTIONS FOR CHARITABLE PURPOSES

(A) IN GENERAL

For purposes of this paragraph, so much of the aggregate amount of qualified charitable distributions with respect to a taxpayer made during any taxable year –

(i) which is made directly by the trustee to an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and does not exceed $100,000, shall not be includable in gross income of such taxpayer for such taxable year, or

(ii) which is made directly by the trustee to a qualified split-interest entity for the benefit of an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and does not exceed $500,000, shall not be includable in gross income of such taxpayer for such taxable year.

(B) QUALIFIED CHARITABLE DISTRIBUTION

For purposes of this paragraph, the term "qualified charitable distribution" means any distribution from an individual retirement plan (other than a plan described in subsection (k) or (p)) --

(i) which is made directly by the trustee to an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and which is made on or after the date that the individual for whose benefit the plan is maintained has attained age 70½, or

(ii) which is made directly by the trustee to a qualified split-interest entity for the benefit of one or more organizations described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and which is made on or after the date that the individual for whose benefit the plan is maintained has attained age 59½.

A distribution shall be treated as a qualified charitable distribution only to the extent that the distribution would be includable in gross income without regard to subparagraph (A).

(C) CONTRIBUTIONS MUST BE OTHERWISE DEDUCTIBLE

For purposes of this paragraph --

(i) a distribution to an organization described in subparagraph (B)(i) shall be treated as a qualified charitable distribution only if a deduction for the entire distribution would be allowable under section 170 (determined without regard to subsection (b) thereof and this paragraph), or

(ii) a distribution to a split-interest entity described in subparagraph (B)(ii) shall be treated as a qualified charitable distribution only if a deduction for the entire value of the interest in the distribution for the benefit of an organization described in subparagraph (B)(ii) would be allowable under section 170 (determined without regard to subsection (b) thereof and this paragraph).

(D) APPLICATION OF SECTION 72

Notwithstanding section 72, in determining the extent to which a distribution is a qualified charitable distribution, the entire amount of the distribution shall be treated as includable in gross income without regard to subparagraph (A) to the extent that such amount does not exceed the aggregate amount which would have been so includable if all amounts in all individual retirement plans of the individual were distributed during such taxable year and all such plans were treated as one contract for purposes of determining under section 72 the aggregate amount which would have been so includable. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

(E) SPLIT-INTEREST ENTITY DEFINED

For purposes of this paragraph, the term "split-interest entity" shall include --

(i) a charitable remainder annuity trust as defined in section 664(d)(1) which must be funded exclusively by a qualified charitable distribution, or

(ii) a charitable remainder unitrust as defined in section 664(d)(2)) which must be funded exclusively by one or more qualified charitable distributions, or

(iii) a charitable gift annuity as defined in section 501(m)(5) which must be funded exclusively by a qualified charitable distribution, and shall commence fixed payments of 5% or greater not later than one year from date of funding.

(iv) No person may hold an income interest in a charitable remainder annuity trust, a charitable remainder unitrust or a charitable gift annuity funded by a qualified charitable distribution other than one or both of the following: the individual for whose benefit the individual retirement plan is maintained and the spouse of such individual. Income interests in split-interest entities funded by qualified charitable distributions shall not be assignable.

(F) SPLIT-INTEREST ENTITY DISTRIBUTIONS

For purposes of this paragraph --

(i) notwithstanding section 664(b), distributions made from a trust described in subparagraph (E)(i) or subparagraph (E)(ii) shall be treated as ordinary income in the hands of the beneficiary to whom is paid the annuity described in section 664(d)(1)(A) or the payment described in section 664(d)(2)(A), and

(ii) qualified charitable distributions made for the purpose of funding a charitable gift annuity shall not be treated as an investment in the contract under section 72(c).

(G) DETERMINING DEDUCTION UNDER SECTION 170

Qualified charitable distributions shall not be taken into account in determining the deduction under section 170.

Association of Art Museum Directors

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Statement Submitted to the United States Senate
Committee on Finance
on behalf of the Association of Art Museum Directors

Hearing on Tax Reform Options: Incentives for Charitable Giving,
October 18, 2011

The Association of Art Museum Directors (AAMD) is composed of the directors of approximately 200 of the leading art museums in the United States, with additional members in Canada and Mexico. We are grateful for the opportunity to submit written testimony for the record regarding incentives for charitable giving and addressing how museums serve their communities.

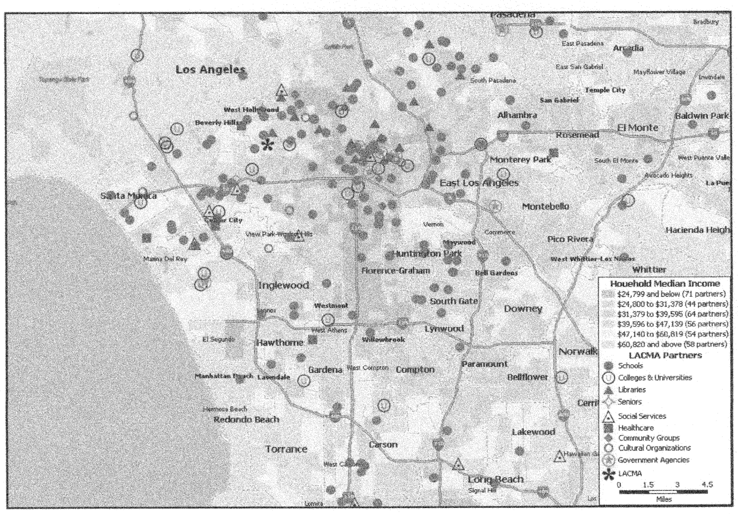
Museums reflect creativity, history, culture, ideas, innovation, exploration, discovery, diversity, freedom of expression and the ideals of democracy. They are repositories for collections that encompass the cultural, religious, secular and spiritual expression of humankind from prehistory to the present day; their staffs are highly trained and capable; and their mission is to share these resources, which they hold in the public trust, with as broad a public as possible.

America's museums were founded in many cases by generous individuals who believed that art should belong to the people. For example, the Smithsonian was established "for the increase and diffusion of knowledge among men." The Metropolitan Museum of Art's founding document states that it was established for the purpose "of encouraging and developing the study of the fine arts, and the application of arts to manufacture and practical life, of advancing the general knowledge of kindred subjects, and, to that end, of furnishing popular instruction." In Boston, Isabella Stewart Gardner ensured that the museum would remain "for the education and enrichment of the public forever." Perhaps it is worth noting that Mrs. Gardner's will also provided for the Massachusetts Society for the Prevention of Cruelty to Children, Industrial School for Crippled and Deformed

Children, Animal Rescue League, and Massachusetts Society for the Prevention of Cruelty to Animals.

The public-spirited generosity of American donors is a living tradition that has enabled museums to offer affordable access to unique collections. For example, at the Cincinnati Art Museum, free admission stretches back to 1906, when Mary Emery established a fund to make Saturday admission free to all; a generous gift from The Richard and Lois Rosenthal Foundation subsequently established free general admission for everyone at all times. A single individual's gift has allowed the Baltimore Museum of Art to offer free admission since 2006. Indeed, fully one third of AAMD member museums offer free admission to all, all the time, and two thirds offer free admission for children under 12. Those with admission fees nearly always offer some form of free admission (for example, free days or free hours) and discounts for seniors and students. Taking all of this into account, we estimate the average cost of admission at AAMD museums to be about five dollars or less. At the same time, the cost to museums per visitor is about $85. Clearly, donations subsidize a great deal of the difference.

Some people believe that museums chiefly serve "the rich." AAMD research, which disproves this theory, shows that the average AAMD museum serves approximately 200 schools annually. Collectively, AAMD members reach approximately 40,000 K-12 schools nationwide through on-site and off-site programs, including direct work with students and teachers. (This total does not include schools reached online.) The research indicates that museums serve broadly across all income levels, as exemplified by the map below, which shows organizations in greater Los Angeles served by the Los Angeles County Museum of Art, with shading that indicates the income level by U.S. Census Tract.



Museums are creative about expanding their reach. In Pittsburgh, for example, the Carnegie Museums offer reduced admission fees to holders of Pennsylvania ACCESS cards, which are given to families on welfare, food stamps, or medical assistance. Whereas normal admission costs $15 for adults, ACCESS families may visit for $1 per person. In 2007, the program's first year, 171 people took advantage of it. By 2010, usage had climbed to over 10,000 people. Similarly, when the Baltimore Museum of Art initiated free admission, attendance at family programs grew by over 80 percent.

Another myth is that art museums only celebrate Western European art. In fact, large and small art museums alike show a wide range of cultures and periods. They are committed to using their collections, which range over ten thousand years and are drawn from every known civilization in every part of the world, to speak eloquently to diverse audiences. Museum collections are a primary resource for people who wish to learn more about their own heritage as well as the heritage of others, regardless of race, religion, ethnicity, or economic resources. America's non-profit system ensures that these collections are held in trust for the public – not just part of the public, but all of it, and not just for today's audiences, but for those of the future as well.

Art museums are sometimes the primary source of exposure to visual art instruction and appreciation for many at-risk children and youth, given that formal arts education barely exists in many urban school systems. We are proud that 100 percent of AAMD museums offer programs for schools. Their programs for teachers – showing how to connect works of art to school curriculum in every academic subject – are irreplaceable. Over 90 percent offer programs for universities, and more than 70 percent have preschool programs. More than a third have programs for Alzheimer's patients and caregivers, while nearly half have programs for nursing home residents. Smaller numbers have offerings for seniors at home, children in the juvenile justice system, and incarcerated adults. Thirty-one percent offer art instruction for medical, nursing, and pharmacy students, which is clinically proven to sharpen observation skills and hence improve the ability to make correct diagnoses.

All AAMD members share a commitment to serving the public, partnering with their community institutions, including health, human service, and education organizations, and applying the unique resources of the arts to serving a wide variety of purposes. Museums are anchors in their communities, often serving as the centerpiece of new or revitalized neighborhoods, providing jobs, attracting tourists as well as residents, and in a less literal sense, helping to form the community's identity – its sense of self.

Another argument that has been circulated holds that capping the value of the charitable deduction will not change the behavior of donors. Art museums know this argument to be untrue. The tax treatment of gifts of art has been altered several times since 1969, and donors' behavior has responded directly, immediately and always negatively. In 1969, Congress restricted the ability of artists to take a fair-market value deduction for gifts of their own art; as a result, artist gifts have been relatively rare ever since. In 1986, the Tax Reform Act made gifts of appreciated property a preference item under the Alternative Minimum Tax; gifts of art plummeted by 90 percent by 1989, causing Congress to reverse itself and restore full deductibility in 1990, upon which giving resumed. Most recently, the Pension Protection Act so tightly restricted the deductibility of fractional gifts of art that such gifts have practically ceased. In sum, we have a long history of experience with tax deductibility. We understand that donors give for altruistic reasons, but the tax code influences the size, timing, and form of gifts.

In conclusion, we suggest that discouraging gifts to the arts by reducing their tax deductibility would have a counter-productive effect. It would lessen institutions' growing ability to serve the very populations whom Members of Congress most wish charities to serve, and would deprive those populations of the chance to participate fully in civil society and to have access to collections and programs that speak to their specific needs and interests. The social safety net has many strands; weakening any single strand only diminishes the safety net's overall integrity. Supporting the needy and supporting the arts are not mutually exclusive enterprises.

With this testimony we are submitting summaries of published articles that document the unique and sometimes surprising ways in which art museums serve the public. Thank you again for the opportunity to provide testimony on this important issue.

Reduced admission for public assistance recipients
Carnegie Museum of Art / Pittsburgh, PA
The Carnegie Museums of Pittsburgh offer $1 admission to holders of Pennsylvania state ACCESS EBT cards, which are given to families on welfare, food stamps or medical assistance. Beneficiaries can bring themselves and up to 3 family members to the museum for one dollar each. Offered in partnership with the Allegheny County Department of Human Services (DHS), the program has seen a staggering 600 percent increase since December 2008, counting more than 36,000 individual visits. Of these visitors, 84 percent were visiting with their children.
http://www.pittsburghlive.com/x/pittsburghtrib/news/s_716233.html

Alternative sentencing for juvenile offenders
Sterling and Francine Clark Art Institute / Williamstown, MA
The Responding to Art Involves Self Expression (RAISE) program is a collaboration between the Berkshire County Juvenile Court (BCJC) and the Clark. This alternative sentencing model shifts the sentencing paradigm from punishment to education, fostering self-awareness and self-esteem. Through this program, adjudicated youth participate in group meetings, writing and self awareness exercises, and gallery talks. Since its inception in 2006, RAISE has served more than 75 boys and girls ages 12 to 17. The program is being replicated at other museums in America and France. It has been recognized by the International Council of Museums, the French American Museum Exchange, the Annenberg Foundation, the United States Department of State, and the American Association of Museums.
http://www.clarkart.edu/about/raise.cfm

Academic and emotional support for girls at risk
Samuel P. Harn Museum / Gainesville, FL
In 2010, a collaboration was created between the Harn Museum of Art and the PACE Center for Girls in Gainesville, Florida. The mission of PACE is to prevent school withdrawal, juvenile delinquency, teen pregnancy, substance abuse and welfare dependency among adolescent girls considered "at-risk." Through the collaboration with the Harn, the girls regularly meet with museum educators to observe, analyze, discuss, write about and create art. The partnership gives participants an opportunity to interact with positive role models and builds their confidence, visual awareness, critical thinking, and social skills. The program has received grants from the Division of Cultural Affairs and the National Endowment for the Arts.
http://www.gainesville.com/article/20100428/ARTICLES/4281012
http://www.harn.ufl.edu/press/e104.php

Building observation skills in medical and nursing students
The McNay Museum of Art / San Antonio, TX
The McNay Art Museum offers a program designed to help medical and nursing students improve their observation and communication skills. The Art Rounds program was developed in 2010 in conjunction with the University of Texas Health Science Center San Antonio. Originally offered as a three week workshop, the program was offered as a full-credit course in the 2011-2012 school year. By learning to carefully observe and evaluate artwork at the museum, students are also honing their skills in making accurate diagnoses, devising treatment plans and interacting with patients and colleagues.
http://www.mysanantonio.com/news/local_news/article/Art-for-medicine-s-sake-992864.php

Art museum helps recovering addicts
Herbert F. Johnson Museum / Ithaca, NY
Educators from the Herbert F. Johnson Museum at Cornell University knew that the museum could play a significant role in the treatment of recovering addicts. They contacted two local treatment centers with their idea, and within four years the program they created had served over 1,700 people. As part of their treatment, participants visit the museum to learn about artists who have also struggled with addiction, the role that art making can play in their recovery, and how the museum can become a place for meditation, reflection, and to reconnect with loved ones.
http://pqasb.pqarchiver.com/ithacajournal/access/2228922261.html?FMT=ABS&FMTS=ABS:FT&type=current&date=Dec+30%2C+2010&author=Rachel+Stern&pub=The+Ithaca+Journal&edition=&startpage=n%2Fa&desc=Art+program+at+Johnson+Museum+helps+addiction+recovery+effort

Museum collaboration with Native American tribe separates fact from fiction
Seattle Art Museum / Seattle, WA
The popular 'Twilight' series of movies has thrust the Quileute Nation of La Push, Washington, into an international spotlight. But the werewolves portrayed in the film and novels bear little resemblance to actual Native Americans, either historical or contemporary. A curator from the Seattle Art Museum spent over a year working with

tribal members to design an exhibition that would counteract the fictional depiction and celebrate Quileute culture for tribal members, 'Twilight' fans and the general public.
http://seattletimes.nwsource.com/html/localnews/2012589090_quileute11m.html

Museum aims to help Alzheimer's patients
Walker Art Center / Minneapolis, MN

The Walker Art Center has partnered with the Alzheimer's Association of Minnesota/North Dakota to offer programming for early-stage dementia patients. Modeled after a similar program at the Museum of Modern Art in New York, the Walker's 'Contemporary Journeys' program helps Alzheimer's patients build a support network and connect with their caregivers via a memory, an experience or an emotion evoked by the artwork. Studies conducted by New York University and George Washington University have shown that patients who take part in this type of program show an overall improvement in their mood, cognitive function, and social interaction.
http://ww2.postbulletin.com/newsmanager/templates/localnews_story.asp?z=10&a=485596

Museum offers sculpture tours for the visually impaired
Des Moines Art Center / Des Moines, IA

Docents at the Des Moines Art Center have been specially trained to offer art tours of the Pappajohn Sculpture Garden in downtown Des Moines to the blind and visually impaired. Participants are able to touch sculptures with gloved hands while docents describe the artwork and discuss the artwork and the artist. The program allows a new level of access to the museum's collection for those who cannot see. Docents are trained by the Iowa Department for the blind.
http://www.kcci.com/video/23754397/detail.html

Art museum partners with jail to bring art education to inmates
Aspen Art Museum / Aspen, CO

A partnership between the Aspen Art Museum and Pitkin County Jail helps counteract the idleness of prison life with an educational opportunity. Museum educators visit the facility twice a month with books, art supplies, and images of the museum's exhibits. Following a lesson and discussion, participants learn to create their own artwork using a variety of media. Studies have shown that prison inmates who participated in creative art programs exhibited higher levels of positive coping skills, decreased anger levels, and spent fewer days in punitive confinement.
http://museumpublicity.com/2011/04/14/aspen-art-museum-partners-with-pitkin-county-jail-to-bring-art-education-to-inmates/

Philanthropist's gift enables free admission for all
Baltimore Museum of Art / Baltimore, MD

In 2006, philanthropist Suzanne F. Cohen donated $1 million to the Baltimore Museum of Art in order to provide free admission for all visitors. Cohen's gift was endowed to encourage other potential donors to step forward. The initiative resulted in increases in visitorship, increased donations, and a more diverse audience.

http://articles.baltimoresun.com/2006-09-11/features/0609110014_1_museum-free-admission-cohen

Kwanzaa family festival celebrates African heritage
Crocker Art Museum / Sacramento, CA
Nearly 2,000 people showed up to participate in the Crocker Art Museum's Kwanzaa Family Festival in December 2010. The festival featured African art from the collection, as well as African music, dance, stories, food, fashion, and crafts.The event was sponsored by Target corporation and organized with the assistance of the Sojourner Truth Multicultural Art Museum, the Kuumba Collective Art Gallery, and Wo'Se Community Church.
http://www.sacramentopress.com/headline/42717/Kwanzaa_Family_Festival_at_the_Crocker

Ruby Bridges visits museum to discuss desegregation and racism
Tacoma Art Museum / Tacoma, WA
Ruby Bridges became an icon of the civil rights movement as a little girl in 1960, when she was photographed walking into the newly desegregated William Frantz Elementary in New Orleans. Bridges' famous walk -- escorted by federal marshals -- also became the inspiration for Norman Rockwell's painting entitled "The Problem we all Live With." In May 2011, the painting appeared as part of a Rockwell exhibit at the Tacoma Art Museum. Ms. Bridges also appeared at the museum to tell her story and discuss the history of racism in America.
http://www.thenewstribune.com/2011/05/15/1665907/inspiring-rockwell-educating-a.html

Senate Committee on Finance

October 28, 2011

Tax Reform Options: Incentives for Charitable Giving

Written Comments and

Statement for the Record

of the

Association of Fundraising Professionals (AFP)
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October 28, 2011

Senate Committee on Finance
Attn. Editorial and Document Section
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Washington, DC 20510-6200

Re: Comments regarding the Senate Committee on Finance's hearing titled "Tax Reform Options: Incentives for Charitable Giving"

On behalf of the Association of Fundraising Professionals (AFP), I am pleased to provide a written statement regarding tax reform options and incentives for charitable giving. AFP represents the individuals responsible for generating philanthropic funds, so we have a unique understanding of the impact of charitable giving and giving incentives.

We hope our thoughts and perspective will prove helpful to the Senate Committee on Finance as it continues its examination of issues related to the nonprofit sector.

Organizational Background

AFP is the largest nonprofit association in the U.S. that represents fundraisers in all 50 states. Fundraising serves as the engine that drives the charitable sector by developing and maintaining relationships with donors and philanthropists who provide the necessary funding for education, social services, healthcare, medical research and the many other altruistic functions provided by the sector. Fundraising complements governmental support for charities and ensures the survival of the charitable sector when state, local and federal governments lack the budgetary means to help. AFP fosters development and growth of fundraising professionals through training and education and promotes high ethical standards in the fundraising profession.

Preserve the Charitable Deduction

We strongly urge you to preserve the charitable giving incentive found in itemized deductions that ensures that our nation's charities receive the funds necessary to fulfill their essential philanthropic missions. Proposals that would impede charitable giving by modifying current itemized deductions would have long-lasting negative consequences for the charitable organizations that millions of Americans rely on for vital programs and services.

During the hearing, a number of proposals were raised—including the Obama Administration's proposed 28 percent cap on itemized deductions, the replacement of itemized deductions with a tax credit and the creation of a deduction floor that would only allow a tax break for charitable contributions that exceed 2 percent of adjusted gross income.

We have concerns about the proposals because each of them, as discussed, appears to have a negative impact on giving. A recently released Center on Philanthropy study found that charitable giving would decrease by $0.82 billion in the first year but would jump to a loss of $2.43 billion the following year if a 28 percent cap were imposed on itemized deductions. In comparison, the Tax Policy Center estimated that charitable giving would decrease between $1.7 billion and $3.2 billion a year under this plan. These figures are conservative compared to the study done by Joseph Cordes, an economics professor at George Washington University, that estimated a loss in charitable contributions between $2.9 billion and $5.6 billion per year. Regardless of the various estimates, it is clear that a cap would result in a loss of vital charitable dollars.

In its testimony during last week's hearing, the Congressional Budget Office (CBO) estimated that a deduction floor of 2 percent of adjusted gross income would result in the loss of $3 billion per year in charitable contributions. The CBO also estimated a loss of almost $8 billion in contributions a year if the current deduction were replaced with a 15 percent nonrefundable tax credit.

These billions of dollars are critical because charities need these funds to fuel their philanthropic missions, which include social services, healthcare, education, housing and other essential programs and services that assist those in need. The loss of these charitable dollars will have a direct impact on the nation's poorest and most disadvantaged.

It is worth noting that high-income earners are more sensitive to changes in tax incentives. Given this sensitivity, reducing the charitable deduction for higher income earners will negatively impact the amount these donors give to charitable organizations, particularly since higher income taxpayers account for the majority of individual giving. According to the recent CBO report on the tax treatment of charitable giving, tax filers who reported AGI of at least $100,000 in 2008 were responsible for well over half (about 58 percent) of all charitable giving by taxpayers. This fact was reiterated during a recent conference on the charitable deduction held by the Urban Institute's Center on Nonprofits and Philanthropy.

The charitable deduction is different than other itemized deductions in that it encourages individuals to give away a portion of their income to those in need. To limit the charitable deduction or replace it with a less effective tax provision would be to limit our spirit of philanthropy in a time where the demand for charitable services is at its peak, and would adversely affect the less fortunate in our society in deep and direct ways.

Charities leverage charitable contributions to bridge the gap by serving those in need and our communities as budgetary constraints hinder state and federal governments from providing similar services. These charity-provided services are critical, and reducing charitable giving does not just harm the nonprofit sector, it also hurts the lowest income brackets that rely heavily upon these services. Despite how the proposals may look on paper, wealthy Americans will not bear the brunt of any changes made to itemized deductions that negatively impact charitable giving—America's poor will.

Also, do not underestimate the positive impact that charities have on the economy. The Urban Institute found that "[i]n 2006, nonprofits contributed $666 billion to the economy and accounted for 5 percent of GDP, 8 percent of the economy's wages, and nearly 10 percent of jobs." The fact remains that the charitable sector represents a significant cog that drives economic recovery. Nonprofits create jobs and leverage economic gains.

To truly jumpstart the economy, the federal government should remove barriers that limit charitable giving, not construct more of them.

Tax Incentives Bolster Charitable Giving

Studies indicate that donors give for many reasons—incentives such as tax deductions being among them. In many fundraising campaigns, the vast majority of donors give their charitable contributions at the end of the year prior to the Dec. 31 cutoff, which indicates that the tax implications of their gifts do affect donors. A simple internet search reveals numerous year-end charitable contributions tips and guides drafted for taxpayers by financial planners and other entities, which indicates the wide array of tax counseling that taxpayers receive regarding charitable deductions. While Americans do not make charitable gifts only for tax reasons, tax incentives make more and larger gifts possible.

History and the actions of the federal government indicate that tax incentives do, in fact, affect charitable giving. During times of crisis, such as the natural disasters like Hurricane Katrina, the 2008 Midwest flooding and the 2010 Haiti earthquake, Congress regularly passes charitable giving incentives to make it easier for Americans to give donations and support to the nonprofits serving individuals, families and communities in need.

Extend the IRA Rollover Provision

One easy way for Congress to leverage tax incentives to enhance charitable giving is by extending the IRA Charitable Rollover provision beyond the end of this year. This provision, a part of the Middle Class Tax Relief Act of 2010, allows donors age 70½ to exclude from their taxable income any IRA funds up to $100,000 that have been withdrawn and transferred to a charity when filing a tax return. The provision was made retroactive to include the 2010 tax year, but it will expire on Dec. 31, 2011.

Tax incentives such as the IRA Charitable Rollover provision play a vital role in encouraging donors to make gifts, especially as the contribution amounts become larger. The rollover provision is a powerful and unique way that donors can support charitable causes in their communities.

The IRA Charitable Rollover has worked very successfully over the last few years, but it would be far more effective if it were extended for a longer period of time, as opposed to a retroactive period encompassing two years. We believe that the provision's impact could reach billions of dollars annually once the public becomes more familiar with it.

Again, we urge the Committee to consider tax incentives that can enhance charitable giving, and we strongly urge you to oppose any proposal that would alter the charitable deduction in any way that would negatively impact charitable giving.

We look forward to working with you and your staff on this issue and on any other issues affecting the charitable sector.

Sincerely,

Andrew Watt, FInstF
President & CEO
Association of Fundraising Professionals

Statement for the Record by John Ashmen
President, Association of Gospel Rescue Missions
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Senate Committee on Finance
Hearing on "Tax Reform Options: Incentives for Charitable Giving"
October 18, 2011

I want to thank Senators Baucus and Hatch for making charitable giving a priority of the Senate Committee on Finance. Strengthening private giving and the incentives to give are critically important to our member organizations across the United States. The Association of Gospel Rescue Missions (AGRM) is the nation's oldest and largest network of independent crisis shelters and addiction recovery programs. Last year, our members served nearly 42 million meals, provided more than 15 million nights of lodging, bandaged the emotional wounds of thousands of abuse victims, and graduated 18,000-plus individuals from addiction recovery programs. The ramification of their work positively influences surrounding communities in countless ways.

The first rescue missions were founded in the U.S. with private funding in the 1870s. Today, the overwhelming majority of rescue missions remain almost 100-percent reliant on private giving to help the hungry, homeless, abused, and addicted. That means that the declines in charitable giving since 2008 have had a direct impact on programs and services. Rescue missions have cut administrative and overhead costs to divert as much funding and other resources as possible to helping the growing number of poor and homeless in America. The Union Rescue Mission in Los Angeles, CA – one of the largest recue missions in the country – last year reported a 21 percent drop in donations and a 35 percent increase in the number of people seeking its basic services. Most rescue missions are experiencing a similar trend.

America's economic recession and slow, jobless recovery have had a devastating impact on the poorest Americans. The U.S. Census Bureau reported last month that the number of Americans living in poverty increased to 46.2 million in 2010 – or one in six people. As a result, rescue missions across the country have seen a spike in the number of men, women, and children seeking emergency shelter, affordable housing, food, clothing, and other basic services. The needs are especially great among single women with children and intact families that are experiencing homelessness for the first time as a result of the poor economy. To make conditions worse, delays and cuts to federal and state funding for human services continue to push more people to seek help at rescue missions and other private, charitable organizations.

All of AGRM's 120 members represented by senators on the Senate Committee on Finance (see attachment) have seen the negative impact of this human and economic crisis. For example, the Montana Rescue Mission in Billings has been responding to a noticeable increase in the number of homeless individuals since the recession began, especially people from outside the state that traveled to Montana looking for work but failed to find employment or housing. Demand for food and clothing at the Salt Lake City Mission has increased 30 percent and they are serving 14,000 meals each month – an all-time high. At the Rescue Mission of Salt Lake, 20 percent of the people staying in their emergency shelter over the past two years are displaced because of the economy and demand for the mission's prepared meals is up another 26 percent over last year. Yet despite the increased demand for services, donations have declined at rescue missions in Montana and Utah.

Our members' heavy reliance on private funding combined with depressed private donations, high numbers of poor and first-time homeless, greater food insecurity and demand for basic needs, and retreating government-funded human services makes rescue missions especially vulnerable to even small drops in giving. The Urban Institute reported earlier this month that the president's proposal to cap charitable deductions from higher-income donors at 28 percent would reduce annual giving by up to $5.6 billion annually. This may seem like a relatively small figure when compared to America's $14.9 trillion debt, but the impact of this additional loss of giving at the community level would be an immediate and lasting setback for individuals and families fighting to escape poverty and homelessness.

Every donor and every donated dollar are critically important to the daily work of rescue missions. AGRM's members receive large numbers of small donations each year. That generosity is buttressed by the faithful giving of higher-income donors that are able to give larger donations. Any rescue mission chief executive will tell you that their reliance on those cash gifts are critical to paying employees' salaries and benefits, expanding facilities and affordable housing for the high number of homeless families, and providing ongoing basic services for a growing number of poor across America. This sober reality puts a sharp point on the fact that any tax reform that intentionally or unintentionally decreases incentives for any income group to give to charity will be accompanied by an unacceptable human cost.

AGRM and its nearly 300 member organizations encourage the committee to evaluate each tax reform proposal through the lens of how it will impact the most vulnerable Americans and the nonprofit organizations that exist to help them. Adopting an overriding philosophy of "do no harm" toward rescue missions and the homeless will ensure that the U.S. Senate achieves what we believe is the proper balance between necessary tax reform and protecting the poor, as well as the invaluable work of the charitable sector. In the end, the human and economic crisis that faces rescue missions everyday across America should compel Congress to reject any limits on giving and find ways to increase the incentive for charitable giving to meet the current and future needs of poor men, women, and children.

ASSOCIATION OF GOSPEL rescuemissions

Rescue Missions in States Represented by Senators on the Senate Committee on Finance

1. Missoula 3:16 Rescue Mission, Missoula, MT
2. Montana Rescue Mission, Billings, MT
3. Huntington City Mission, WV
4. Union Mission Ministries, Charleston, WV
5. West Virginia Rescue Mission, Fairmont, WV
6. New Life Center, Fargo, ND
7. Northlands Rescue Mission, Grand Forks, ND
8. Albuquerque Rescue Mission, Albuquerque, NM
9. Joy Junction, Albuquerque, NM
10. La Cruces Gospel Rescue Mission, La Cruces, NM
11. Springfield Rescue Mission, Springfield, MA
12. Eugene Mission, Eugene, OR
13. Klamath Falls Gospel Mission, Klamath Falls, OR
14. Medford Gospel Mission, Medford, OR
15. Portland Rescue Mission, Portland, OR
16. Roseburg Rescue Mission, Roseburg, OR
17. The Dalles Freedom House, The Dalles, OR
18. Union Gospel Mission, Portland, OR
19. Union Gospel Mission, Salem, OR
20. Yamhill County Gospel Rescue Mission, McMinnville, OR
21. Capitol City Rescue Mission, Albany, NY
22. City Mission of Schenectady, Schenectady, NY
23. Niagara Gospel Rescue Mission, Niagara Falls, NY
24. Open Door Mission, Rochester, NY
25. Rescue Mission Alliance of Syracuse, Syracuse, NY
26. Rescue Mission of Utica, Utica, NY
27. The Bowery Mission, New York, NY
28. Union Gospel Mission, Jamestown, NY
29. United Christian Advocacy Network, Lakewood, NY
30. Carriage Town Ministries, Flint, MI
31. City Rescue Mission of Lansing, Lansing, MI
32. City Rescue Mission of Saginaw, Saginaw, MI
33. Detroit Rescue Mission Ministries, Detroit, MI
34. Guiding Light Mission, Grand Rapids, MI
35. Holland Rescue Mission, Holland, MI

36. Kalamazoo Gospel Mission, Kalamazoo, MI
37. Lenawee County Mission, Adrian, MI
38. Mel Trotter Ministries, Grand Rapids, MI
39. Muskegon Rescue Mission, Muskegon, MI
40. Sunrise Mission, Alpena, MI
41. Bread of Life Mission, Seattle, WA
42. Bremerton Rescue Mission, Bremerton, WA
43. Christian Aid Center, Walla Walla, WA
44. Everett Gospel Mission, Everett, WA
45. Lighthouse Mission Ministries, Bellingham, WA
46. Olympia Union Gospel Mission, Olympia, WA
47. Rescue Israel, Lacy, WA
48. Seattle's Union Gospel Mission, Seattle, WA
49. Spokane Union Gospel Mission, Spokane, WA
50. The Rescue Mission Tacoma, Tacoma, WA
51. TriCity Union Gospel Mission, Pasco, WA
52. Union Gospel Mission of Grays Harbor, Aberdeen, WA
53. Yakima Union Gospel Mission, Yakima, WA
54. Faith Farms Ministries, Boynton Beach, FL
55. Jericho Road Ministries, Brooksville, FL
56. Lighthouse Ministries, Lakeland, FL
57. Manna on Wheels, Dover, FL
58. Miami Rescue Mission, Miami, FL
59. Orlando Union Rescue Mission, Orlando, FL
60. Panama City Rescue Mission, Panama City, FL
61. The Rescue Mission, Jacksonville, FL
62. The Mission, Winter Haven, FL
63. The Path of Citrus County, Beverly Hills, FL
64. Waterfront Rescue Mission, Pensacola, FL
65. Americas Keswick Colony of Mercy, Whiting, NJ
66. Atlantic City Rescue Mission, Atlantic City, NJ
67. Goodwill Rescue Mission, Newark, NJ
68. Market Street Mission, Morristown, NJ
69. The Streetlight Mission, Elizabeth, NJ
70. Sunday Breakfast Mission, Wilmington, DE
71. Helping Up Mission, Baltimore, MD
72. Hope and Life Outreach, Salisbury, MD
73. Hope Center at Hagerstown Rescue Mission, Hagerstown, MD
74. Southern Maryland Rescue Ministries, Lexington Park, MD
75. Westminster Rescue Mission, Westminster, MD
76. Rescue Mission of Salt Lake, Salt Lake City, UT
77. Salt Lake City Mission, Salt Lake City, UT
78. Beacon of Hope Shelter, Fort Dodge, IA
79. Hope Ministries, Des Moines, IA
80. The Gospel Mission, Sioux City, IA
81. Bread of Life Mission, Holbrook, AZ

82. Crossroads Nogales Mission, Nogales, AZ
83. Crossroads Rescue Mission, Yuma, AZ
84. Gospel Rescue Mission, Tucson, AZ
85. Phoenix Rescue Mission, Phoenix, AZ
86. Sunshine Rescue Mission, Flagstaff, AZ
87. Boise Rescue Mission Ministries, Boise, ID
88. Idaho Falls Rescue Mission, Idaho Falls, ID
89. Emporia Rescue Mission, Emporia, KS
90. Salina Rescue Mission, Salina, KS
91. Topeka Rescue Mission, Topeka, KS
92. Union Rescue Mission of Wichita, Wichita, KS
93. Central Wyoming Rescue Mission, Casper, WY
94. Good Samaritan Mission, Jackson, WY
95. Dallas LIFE, Dallas, TX
96. Door of Hope Mission, Odessa, TX
97. Faith City Ministries, Amarillo, TX
98. Highway 80 Rescue Mission, Longview, TX
99. Open Door Mission Foundation, Houston, TX
100. Rescue Mission of El Paso, El Paso, TX
101. Star of Hope Mission, Houston, TX
102. Twin City Mission, Bryan, TX
103. Tyler Rescue Ministries, Tyler, TX
104. Union Gospel Mission, Dallas, TX
105. Union Gospel Mission of Tarrant County, Fort Worth, TX
106. Wichita Falls Faith Mission, Wichita Falls, TX
107. City Rescue Mission, Oklahoma City, OK
108. Jesus House, Oklahoma City, OK
109. John 3:16 Mission, Tulsa, OK
110. The Gospel Rescue Mission, Muskogee, OK
111. Cornerstone Rescue Mission, Rapid City, SD
112. Union Gospel Mission, Sioux Falls, SD
113. Charlotte Rescue Mission, Charlotte, NC
114. Hendersonville Rescue Mission, Hendersonville, NC
115. Raleigh Rescue Mission, Raleigh, NC
116. Safe Harbor Rescue Mission, Hickory, NC
117. The Potter's House Rescue Mission, Waynesville, NC
118. Union Mission of Roanoke Rapids, Roanoke Rapids, NC
119. Western Carolina Rescue Mission, Asheville, NC
120. Winston-Salem Rescue Mission, Winston Salem, NC

Comments for the Record

United States Senate Committee on Finance

Tax Reform Options: Incentives for Charitable Giving
Tuesday, October 18, 2011, 10:00 AM
215 Dirksen Senate Office Building

By Michael Bindner
Center for Fiscal Equity
4 Canterbury Square, Suite 302
Alexandria, Virginia 22304

Chairman Baucus and Ranking Member Hatch, thank you for the opportunity to address this topics. In our comments, we will describe how our tax plan relates to this issue, discussing the incentives for charitable contributions in the income tax generally and how contributions to charity might work with our proposal for a VAT-like Net Business Receipts Tax (NBRT). This proposal is not the same as the charitable tax credit proposed by Len Burman and by the Bipartisan Policy Center for a charitable tax credit included as part of automatic income tax filing, although conceivable that feature could be included as part of the NBRT.

As you know, the Center for Fiscal Equity has a four part proposal for long term tax and health care reform. The key elements are

- a Value Added Tax (VAT) that everyone pays, except exporters,
- a VAT-like Net Business Receipts Tax (NBRT) that is paid by employers but, because it has offsets for providing health care, education benefits and family support, does not show up on the receipt and is not avoidable at the border,
- a payroll tax to for Old Age and Survivors Insurance (OASI) (unless, of course, we move from an income based contribution to an equal contribution for all seniors), and
- an income and inheritance surtax on high income individuals so that in the short term they are not paying less of a tax burden because they are more likely to save than spend – and thus avoid the VAT and indirect payment of the NBRT.

The amount the income tax impacts charity is inversely proportional to the tax rate. Higher marginal tax rates provide more an incentive to giving than lower marginal tax rates, which is why since the 2001 and 2003 tax cuts, charitable giving is down while need is up because dividend rate cuts make labor savings productivity increases more attractive, therefore increasing the need for charitable services.

Many opponents of governmental charitable action maintain that lower tax rates leave more money for private charitable donations and work toward job creation. Recent experience shows that this is not the case. One of the saddest examples of this was last thanksgiving, where it took media reports of empty food banks with no turkeys to move the public to donate. If conservative beliefs on how low taxes lead to jobs and charitable giving were true, food pantries would have been overflowing, the coffers of charitable institutions would have been full and there would have been no need for such services because everyone would be employed, given how low taxation is on a historic basis.

There is also an allocation problem with private donations. Donor sovereignty does not always put such donations where most agree they do the most good. Food banks go empty while The Heritage Foundation, The Tax Policy Center and efforts by the Bill and Melinda Gates Foundation and Warren Buffett to fund birth control in developing nations (which amounts to population eugenics) get funded. I challenge conservative members to justify that result to their pro-life constituents when making the argument that funders know better than voters.

That being said, our plan does include provisions for a charitable deduction against the income surtax. Because the surtax is graduated with rates ranging from 4% to 28%, the incentive to give to charity will be low for lower income heirs and income earners and higher for those with higher incomes, whose donations will make more of an impact.

Corporate giving will be impacted by our proposal, as the Corporate Income Tax will be replaced by a VAT-like Net Business Receipts Tax (NBRT). We suggest that charitable contributions be limited to a series of credits rather than an open ended deduction that can be maximized to give according to donor preference. Unlike a straight up-VAT, however, some form of giving is still possible. Indeed, providing a vehicle for tax expenditures now distributed through the corporate income tax and personal income tax is the entire reason for proposing both a VAT (which provides tax visibility) and an NBRT.

The expanded refundable Child Tax Credit will replace much of the need for private charity, as it will be paid both to workers and paid participants in adult literacy and education programs, with payments at the same levels. Offsetting the credit with ending the child tax exemption, mortgage interest deduction and property tax deduction allows a federal credit of $520 per month per child. If this is matched, even in part, by a state level credit, the question of the need for private charity to feed people will moot.

Assistance at this level, especially if matched by state governments may very well trigger another baby boom, especially since adding children will add the additional income now added by buying a bigger house. Such a baby boom is the only real long term solution to the demographic problems facing Social Security, Medicare and Medicaid, which are more demographic than fiscal. Fixing that problem in the right way definitely adds value to tax reform.

This is not to say that private charitable organizations can be dispensed with. The experience of using Catholic Charities Family Services in lieu of public adoption services, although not without controversy regarding who can adopt, shows the promise of how charitable organizations can outperform government. This would likely also be true in the area of adult education.

One feature of the NBRT is that it allows employers (either on their own choice or responding to the preferences of their employees) to designate alternative providers without forcing qualified providers to compete in a public procurement process – although maintaining the requirement of accreditation and review is still essential. This is a feature that is impossible with the FairTax or a VAT alone. This feature can also be used, mostly at the local level, to fund public and private charter schools, including religious charter schools, although some jurisdictions could require that such schools allow union organization as a condition of participation (a compromise which would likely reverse resistance the National Education Association).

To extract health care cost savings under the NBRT, allow companies to offer services privately to both employees and retirees in exchange for a substantial tax benefit, provided that services are at least as generous as the current programs. Employers who fund catastrophic care would get an even higher benefit, with the proviso that any care so provided be superior to the care available through Medicaid. Making employers responsible for most costs and for all cost savings allows them to use some market power to get lower rates, but not so much that the free market is destroyed. This could also allow senior citizens in need of full time care to avoid selling off all of their property and becoming objects of public charity in order to get such care.

Enacting the NBRT is probably the most promising way to decrease health care costs from their current upward spiral – as employers who would be financially responsible for this care through taxes would have a real incentive to limit spending in a way that individual taxpayers simply do not have the means or incentive to exercise. While not all employers would participate, those who do would dramatically alter the market. In addition, a kind of beneficiary exchange could be established so that participating employers might trade credits for the funding of former employees who retired elsewhere, so that no one must pay unduly for the medical costs of workers who spent the majority of their careers in the service of other employers.

Conceivably, NBRT offsets could exceed revenue. In this case, employers would receive a VAT credit.

In testimony before the Senate Budget Committee, Lawrence B. Lindsey explored the possibility of including high income taxation as a component of a Net Business Receipts Tax. The tax form could have a line on it to report income to highly paid employees and investors and pay surtaxes on that income.

The Center for Fiscal Equity considered and rejected a similar option in a plan submitted to President Bush's Tax Reform Task Force, largely because you could not guarantee that the right people pay taxes. If only large dividend payments are reported, then diversified investment income might be under-taxed, as would employment income from individuals with high investment income. Under collection could, of course, be overcome by forcing high income individuals to disclose their income to their employers and investment sources – however this may make some inheritors unemployable if the employer is in charge of paying a higher tax rate. For the sake of privacy, it is preferable to leave filing responsibilities with high income individuals.

Finally, keeping a separate income and inheritance surtax also allows the maintenance of direct charitable giving in the tax code, as well as the ESOP exclusion which facilitates the tax-free sale of companies to their employees.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

CHIRA USA LLC

Change Your World...One CHIRA® At A Time.℠

Written Statement of

CHIRA USA, LLC

Douglas S. Delaney, JD, LL.M (Tax)
Director

Senate Committee on Finance

October 18, 2011

Hearing on Tax Reform Options: Incentives for Charitable Giving

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Written Statement of
CHIRA USA, LLC

Douglas S. Delaney, JD, LLM (Taxation)
Director

Senate Committee on Finance

October 18, 2011

Hearing on Tax Reform Options: Incentives for Charitable Giving

Chairman Baucus, Ranking Member Hatch and Members of the Committee:

Thank you for the opportunity to address this Committee on the topic of how tax reform can stimulate charitable giving. My name is Doug Delaney, I am a licensed attorney in the state of South Carolina assisting families with their estate, wealth and charitable planning needs for over a decade. I have enclosed material on my professional and charitable background. I have conducted extensive research in the area in the following areas of law in which I speak and am happy to share any information that may be of assistance.

I am also a Director of CHIRA USA, LLC. CHIRA USA, LLC is an intellectual property enterprise that assists properly licensed securities professionals implement the CHIRA® plan. The CHIRA® plan has been reviewed at the federal and state administrative and legislative levels.

The legislative proposal addressed in this statement (US CHIRA) can generate billions of dollars in immediately consumable charitable capital without tax increase or government expenditure. Many individuals have suggested that the true impact of this legislation, when considering the time value of money with immediate monetary velocity, could be in excess of $1 trillion. While I am not an economist, this means jobs. The legislation, audacious in its brevity, can generate an immediately positive impact on our economy.

While adaptions to the legislation are certain to be made, this proposal is representative of a proper method. It is a beginning. To be sure, this one piece of legislation can have an immediate and meaningful result at the community level throughout our country. We are a gratuitous nation!

This legislation is based on a simple concept: ***people should be able to lend to a charity without requiring the donor to charge interest.***

The legislation proposed herein will encourage the immediate release of cash to our local and national charities for the good of humanity. It will allow our gratuitous citizenry the ability to preserve their estate for heirs while immediately enjoying the wonder of significant giving in a responsible manner.

I. Background

Many donors consider any amount of interest charged to a charity to be tantamount to usury. As demonstrated in Temporary Regulation 1.7872-5T, this proper relationship between donor and charity is a known factor and its parameters can be clearly structured to preserve the tax base while encouraging charitable giving. Consistent with the purpose of this Temporary Regulation, the legislation proposed discussed herein is, in a sense, *charted territory*. **This legislation allows donors to lend to charities without usury, from their retirement accounts.**

Temp. Reg. 1.7872-5T allows gift loans without interest for loans up to $250,000. This treatment presumably extends only to loans generated from the donor's **after-tax** environment. It does not appear, at least in application, to apply to the **pre-tax** environment. This is unfortunate, because, as I discuss below, the **pre-tax** environment would be where these types of loans would naturally be made and it is a much larger monetary environment. This Temporary Regulation represents but a whisper of its true potential.

A better result would be to clearly extend this treatment to the pre-tax environment. Many donors are concerned about their financial needs. Donors consume **after-tax** capital. **Pre-tax** capital is the most long term of all personal capital. Many donors die leaving retirement assets to spouse or children. Retirement assets continue where even the primary residence is sold. Donors often do not intend to consume that last 10% of their retirement assets. For many donors, this is their "residuum", or wealth transfer amount. Many donors would sell their house, and live off the proceeds, prior to distributing the last dollar in their retirement account. Many individuals view the residuum as a wealth transfer asset.

If the residuum can be protected, many would be very motivated to help. People want to help their neighbor. For example, this residuum may exceed one ($100,000) hundred thousand dollars. For the sake of discussion, let us assume a fictional donor was willing to loan $100,000 to their favorite charity from their retirement account. To preserve the estate, the charity agrees to use half of the loan proceeds to guarantee repayment of the entire loan through the use of a life insurance policy on the donor. After payment of the necessary premium, the balance would be $50,000. This would be immediately available for charitable, not personal, use. Upon the donor's death, the retirement account note is repaid in its entirety.

Only those active in charitable fundraising, maybe at the most local level, can appreciate the difficulty in raising even $20,000, much less $50,000. It often takes 20 volunteers 20 hours to raise $20,000. A joyful, but daunting enterprise. The $50,000 contemplated in this plan involves is very real. It is a viable market for charitable giving existing under a proper regulatory environment: at both federal and state levels (i.e. securities, insurance and charitable). I strongly recommend embracing this market and extending your legislative guidance.

II. U.S. Charitable Investment Recovery Act of 2011 (US CHIRA)

Stimulative legislation needs to adapt to the real world and that means adapting to the donor's concerns. IRAs are retirement assets. Many donors want to preserve a portion for their spouse, children or charity. Charitably-inclined donors are often not as concerned about making an investment return on the residuum as they are about furthering their charitable cause. This is consistent with one of the purposes behind Charitable Lead Trusts (CLUT).

With the implementation of the enclosed legislation, our donor mentioned above could release an immediately consumable $50,000 for the benefit of their charity while still preserving the $100,000 for their estate. Or, an immediate benefit to charity, with wealth and tax base preservation. No tax expenditure, revenue positive, and great for humanity. This $50,000 could be used by the charity to purchase goods and services to further their charitable goal. This benefit can be generated without additional taxation to the individual, but generate gratuity at the most local of levels.

The enclosed legislation, "The U.S. Charitable Investment Recovery Act of 2011 (US CHIRA)," is revenue and jobs positive. It encourages the immediate movement of capital from passive retirement accounts to active charities for the betterment of humanity. It encourages the most noble of intention within the framework of one of the donor's concerns: principal preservation. This simple piece of legislation could release up to $1 Trillion in charitable capital into the immediate economy to feed the poor, care for the sick and relieve suffering. This is the type of meaningful legislation that is sure to garner broad support in the Senate, Congress, Presidency and state government.

III. State Legislation

It is contemplated that this US CHIRA legislation would be administered through the states with enabling legislation similar to that enclosed "South Carolina Charitable Investment and Recovery Act" (SC

CHIRA). This legislation is being reviewed in committee in the South Carolina legislature (Rep. Herbkersman-R). This legislation in South Carolina contemplates the protection of the donor, charity, industry and taxpayer. It would serve well as a beginning template.

SC CHIRA serves to prevent the type of industry gaming prevalent during the summer of 2004 involving insurance and charities. See the outstanding enclosed testimony to this Committee on June 22, 2004 from JJ.MacNab, CFP, CLU, QFP. Where the donor is the insured and sole lender, and where the charity is the owner and sole beneficiary of a life policy without third party influence, the donor, charity, taxpayer and insurance industry can be protected.

The South Carolina legislation is the anti-CHOLI plan. The CHOLI plan was an example of many vehemently rejected in Ms. MacNab's testimony. US CHIRA allows all parties to cooperate into rebuilding communities, generate jobs and help our neighbor. It is fair to the donor, charity, insurance company and the taxpayer. It does not allow for the exploitation of the donor, charity or insurance industry whether by dead pool trading, pre-planned sale, manipulative charitable ownership or personal benefit. It is not a backdoor method of enriching family at the expense of charity and the tax base. It is not a strategy to sell more life insurance. Life insurance is what preserves the estate.

In addition to South Carolina, a related piece of legislation has been introduced in Massachusetts (Rep Pignatelli-D). This attached legislative proposal tactically addresses the planning at the insurable interest level. It demonstrates proper financial planning. It demonstrates compassion for humanity. It demonstrates that this solution is not one based on party affiliation. It addresses the human party and its promotion is one for the betterment of mankind. It is my honor to be associated with it.

A federal legislature that would consider extending the tax free treatment to charitable distributions from retirement accounts ("Charitable Rollovers") *must* consider the enclosed legislation. US CHIRA preserves the estate. Charitable Rollovers do not. By expanding the charitable giving base, US CHIRA would generate benefits in excess of Charitable Rollovers without the significant loss of assets to family as well as the tax base.

IV. Conclusion

US CHIRA will encourage the immediate release of cash to our local and national charities for the good of humanity. It will allow our gratuitous citizenry the ability to preserve their estate for heirs while immediately enjoying the wonder of significant giving in a responsible manner. This lending method does not reduce, defer or minimize tax. It stimulates the charitable economy by encouraging the donor to infuse capital into the charity while preserving their estate for family. There is no tax benefit or detriment associated with the planning.

This type of revenue positive infusion is a responsible and balanced manner to deficit reduction. It can spur job creation, strengthen the economy while building certainty. It puts America back to work and expands the tax base through monetary velocity at the precinct level. It minimizes economic disparity through charitable motives.

I strongly urge your immediate review of this legislation as a revenue positive solution whose time has come.

Douglas S. Delaney, JD., LL.M
Director
CHIRA USA, LLC

U.S. CHARITABLE INVESTMENT RECOVERY ACT OF 2011

To amend the Internal Revenue Code of 1986 to promote private investment in charitable organizations by allowing interest free lending from donors to charities from their retirement accounts provided the loan is secured by a life insurance policy on the donor,

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. APPLICABLE FEDERAL RATE FOR SECURED CHARITY LOANS

(a) In General -- Paragraph (A) of section 7872(f)(2) of the Internal Revenue Code of 1986 (relating to tax treatment of distributions) is amended to include the following paragraph (i) to read as follows:

(2) Applicable Federal rate

(A) Term loans

In the case of any term loan *excluding secured charity loans set forth in (i) below*, the applicable Federal rate shall be the applicable Federal rate in effect under section 1274 (d) (as of the day on which the loan was made), compounded semiannually.

(i) Secured charity loans. Notwithstanding any code section to the contrary, term loans from a retirement account governed under section 401, 408 and 408A, to an organization exempt from tax under section 501(c)(3), secured by an in-force life insurance policy on the account owner or employee, shall have an applicable Federal rate of zero percent.

(B) Termination

This paragraph shall not apply to any loan executed after December 31, 2015.

A BILL

TO AMEND THE CODE OF LAWS OF SOUTH CAROLINA, 1976, BY ENACTING THE "SOUTH CAROLINA CHARITABLE INVESTMENT RECOVERY ACT OF 2011" BY ADDING SECTION 33-56-56 SO AS TO EXEMPT CERTAIN LOANS TO CHARITIES FROM RETIREMENT ACCOUNTS FROM REPORTING REQUIREMENTS RELATED TO THE SOLICITATION OF CHARITABLE FUNDS; BY ADDING SECTION 38-63-110 SO AS TO PROVIDE A BONA FIDE CHARITY OR NOT-FOR-PROFIT CORPORATION MAY HAVE AN INSURABLE INTEREST IN AN INSURED'S LIFE IN CERTAIN CIRCUMSTANCES; TO AMEND SECTION 33-31-1407, RELATING TO A KNOWN CLAIM AGAINST A DISSOLVED CORPORATION, SO AS TO PROVIDE A CLAIM FOR A LIFE INSURANCE POLICY OWNED BY A CHARITY UNDER CERTAIN CIRCUMSTANCES MAY NOT BE BARRED; AND TO AMEND SECTION 35-1-102, RELATING TO CERTAIN DEFINITIONS ASSOCIATED WITH SOUTH CAROLINA UNIFORM SECURITIES ACT OF 2005, SO AS TO AMEND THE DEFINITION OF AN INVESTMENT CONTRACT.

Be it enacted by the General Assembly of the State of South Carolina:

SECTION 1. This act must be known as and may be cited as the "South Carolina Charitable Investment Recovery Act of 2011".

SECTION 2. The General Assembly desires to support the economic development goals of this State by improving the availability of capital for bona fide charities and not-for-profit enterprises in South Carolina. To further these goals, this legislation is intended to:

(1) support the social structure of this State through private capital by encouraging charitably inclined donors to invest in and redirect private retirement capital to bona fide charities resulting in continuity of services for local communities, job creation and economic activity;

(2) encourage monetary velocity from passive retirement accounts to state and local communities for the active use and betterment of our State as determined by private citizens;

(3) expand the economy of this State by preserving and enlarging its base of bona fide charities and fostering the use of private capital for social programs desired by private citizens; and

(4) foster continued gratuity in our state citizenry without increasing individual taxation or depleting the tax base.

SECTION 3 Article 1, Chapter 63, Title 38 of the 1976 Code is amended by adding:

Section 38-63-110. (A) A bona fide charity or not-for-profit corporation that complies with the Solicitation of

Charitable Funds Act in Chapter 55, Title 33 shall have an insurable interest in the life of an insured under a life insurance policy if:

(1) the charity or not-for-profit corporation owns the policy from inception;

(2) the charity or not-for-profit corporation is the sole beneficiary of the policy as designated in writing by the insured on the policy beneficiary designation;

(3) the insured's retirement account is designated as the sole collateral assignee of the insurance policy in order to secure repayment of a loan made from the retirement account; and

(4) no future assignment, sale or conveyance of the insurance policy is made by the retirement account or the bona fide charity except in dissolution of the charity or not-for-profit corporation.

(B) Neither the insured nor the retirement account providing a loan described in subsection (A) shall be considered to have received an economic benefit from the existence of the collateral assignment.

(C) A loan described in subsection (A) and made to the charity or not-for-profit corporation without interest or requiring any payment during the life of the insured shall be considered a legitimate debt as between the retirement account and the charity or not-for-profit corporation.

(D) A broker fee or commission (other than a commission paid from an insurance company related to the issuance of an insurance policy) or a similar remuneration shall not be paid by the charity or not-for-profit corporation for soliciting an investment contemplated by this Section.

SECTION 4. Section 33-31-1407 of the 1976 Code is amended to include a new section (D):

"Section 33-31-1407. (A) A dissolved corporation may dispose of the known claims against it by following the procedure described in this section.

(B) The dissolved corporation shall notify its known claimants in writing of the dissolution at any time after its effective date. The written notice must:

(1) describe information that must be included in a claim;

(2) provide a mailing address where a claim may be sent;

(3) state the deadline, which may not be fewer than one hundred twenty days from the effective date of the written notice, by which the dissolved corporation must receive the claim; and

(4) state that the claim will be barred if not received by the deadline.

(C) A claim against the dissolved corporation is barred if a claimant:

(1) if a claimant who was given written notice under subsection (B) does not deliver the claim to the dissolved corporation by the deadline;

(2) if a claimant whose claim was rejected by the dissolved corporation does not commence a proceeding to enforce the claim within ninety days from the effective date of the rejection notice and the rejection notice stated that a proceeding to enforce the claim must be commenced within ninety days.

(D) A claim related to a life insurance policy owned by a charity under Section 38-63-110 may not be barred under a provision of this section.

(E) For purposes of this section, 'claim' does not include a contingent liability or a claim based on an event occurring after the effective date of dissolution."

SECTION 5. Chapter 56, Title 33 of the 1976 Code is amended by adding:

Section 33-56-56. The provisions of this chapter do not apply to a loan under Section 38-63-110 from a donor's retirement account to a charity if a fundraising activity is not conducted by a professional solicitor paid directly by the charity. A commission paid by an insurance company is not considered to be paid by the charity.

SECTION 6. Section 35-1-102(29)(E) of the 1976 Code, as added by Act 110 of 2005, is amended to read:

(E) 'Investment contract' may include, among other contracts, an interest in a limited partnership and a

limited liability company and shall include an investment in a viatical settlement or similar agreement. An investment contract does not include an insurance policy issued to a charity to secure repayment of a loan from a donor's retirement account under Section 38-63-110.

SECTION 7. This act takes effect upon approval by the Governor.

Before the Committee on Finance
United States Senate
Hon. Charles E. Grassley, Chairman

June 22, 2004

Charity Oversight & Reform:
Keeping Bad Things from Happening to Good Charities

Statement of:
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Mr. Chairman and members of the Committee, I thank you for inviting me to speak before you on the topic of tax schemes involving charities. My name is JJ MacNab, I'm a life insurance analyst in Bethesda, MD and I am the co-author of a professional trade book entitled Tools and Techniques of Charitable Planning. I count among my clients several high quality charities and many more wealthy individuals who are philanthropically minded.

Introduction

The Problem

In the past, charity has held a highly favored status, both in the Tax Code and in the hearts and pocketbooks of millions of American donors. Unfortunately, in recent years, that confidence has become eroded. Bad players have discovered that they can use small, hungry, or newly formed tax exempt organizations to conceal everything from Ponzi and affinity scams to high end corporate fraud and terrorism funding. And while there is a tendency among the charitable industry to simply ignore these bad players, the games and schemes are spreading at such a rapid pace, that even good charities are finding themselves sorely tempted to, if not sell their souls, at least rent them out to the highest bidder. Where the focus was once on fiduciary duty and preserving the public trust in their respective missions, a few well meaning charities are becoming blinded by the profits to be had from tax schemes. Instead of thinking, "Should we do this?" many charities are now ignoring the ethical and moral elements of the decision and are instead focusing on the bottom line of the program.

For example, when pitched a high end tax scheme by a donor's advisor, a charity might be faced with two choices: 1) turn down involvement in the scheme and receive $0, or 2) agree to participate in the scheme and receive $1,000,000. In many cases, the charity never actually sees how or how much the donor benefits from the plan, and so the decision is fairly simple. As long as the charity thinks the risks in the program are manageable, that $1 million can feed a lot of hungry children, buy numerous wheelchairs, or provide scholarship for many deserving students.

The Reasons behind the Problem

The last few years have been hard on charity[1]. Corporate donations are down, economic uncertainty has resulted in donors delaying or reducing their contributions, competition among charities has increased substantially, and charities have experienced losses in the market on their own investment portfolios. Any program that can successfully bring in a sizable donation is therefore given serious consideration even if, just ten years ago, the same scheme would have earned a resounding "no" from non profit executives.

Another important factor is the perceived lack of regulatory scrutiny. While many regulatory agencies (IRS, state attorneys general, SEC, FTC, state insurance and securities departments for example) can potentially attack charity abuses, most if not all of these agencies have strained budgets and have simply not made charity schemes a priority. In other industries where multiple regulatory bodies have jurisdiction, a turf war often emerges over who gets to shut down the scheme. In the charity industry, the opposite seems to be true – all of the various agencies generally seem to assume that one of the others will handle the problem.

And finally, risk of audits and sanctions imposed by the IRS have all but disappeared in recent years. Ten years ago, most charities would actively avoid schemes and plans that might subject them to taxes, penalties, or even loss of tax exempt status. Today, the only loss of exemption seems to occur when churches become involved in politics and the audit rate for tax exempts is so small that fear of the IRS has all but vanished. As of 2001, there were an

[1] See "Surviving Tough Times," by Brad Wolverton, the *Chronicle of Philanthropy*, October 30, 2003.

estimated 1.4 million[2] charities and foundations in the United States. Of these, approximately 285,000 filed Form 990 tax returns with the IRS[3], but only 1,237 (.43%) charities had their returns reviewed by the Service and only 835 (.29%) charities faced an IRS examination. For a system of voluntary compliance to be effective, there has to be some form of real risk that an audit will occur. With IRS staffing at record lows and risk of government regulatory scrutiny practically non-existent, the bad players in the charitable industry are escaping unscathed while the otherwise ethical charities are engaging in schemes which are increasingly risky.

So What Are the Schemes and Abuses?

Using tax exempt entities to shield or hide corporate and consumer fraud

In recent years, a number of fraud and embezzlement stories have come out which show con artists and schemers using non-profit entities to enrich themselves at the cost of investors' money and public confidence in the charitable industry. While these stories in no way reflect the philanthropic community in general, they do show what happens when an industry has little or no regulatory supervision.

Example: After being banned for life from securities trading in 1992, Martin Frankel[4] almost got away with a $215 million heist. With the assistance of Vatican officials, Frankel set up a scheme to purchase insurance companies through a non profit entity he founded called the St. Francis of Assisi Foundation. He promised high rates of return to his investors (many of them major churches) and described the charity as a benevolent foundation which assisted children's causes. Moneys raised would go to acquiring insurance companies, and profits (after paying his investors) would be used for charitable purposes. Instead of investing the moneys to

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[2] Source: *The New Nonprofit Almanac and Desk Reference*, published in 2002 by the Urban Institute's Center on Nonprofits and Philanthropy.
[3] Source: GAO-02-526 *Oversight of Charities*, published April 2002.
[4] For further details, see Court TV's *Martin Frankel: Sex, Greed and $200 Million Fraud* at http://www.crimelibrary.com/notorious_murders/classics/frankel/1.html?sect=27

pay those promised returns, Frankel siphoned cash from the insurance companies, diverted it to his own accounts, and fled to Europe when state insurance regulators discovered the theft. When fleeing the country, Frankel left behind a "to do" list in his home which included the entry "launder money". Frankel has since been taken into custody, has pleaded guilty to 24 Federal charges and faces up to 150 years in prison.

Example: In 1999, the Baptist Foundation of Arizona[5] filed for Chapter 11 bankruptcy, owing more than $600 million to 13,000 investors, most of them elderly and retired. In what turned out to be the largest fraud case ever involving a religious trust, thousands invested their life savings with the foundation, which promised high investment returns and charitable grants for Baptist causes, but turned out to be nothing more than a complicated pyramid scheme. Three foundation executives have pleaded guilty to defrauding investors and in May, 2002 the now-defunct accounting firm Arthur Andersen agreed to pay $217 million in damages to investors for their role in helping executives cover up the scheme.

Example: In 1997, an insurance agent named Robert Dillie[6] owned a life insurance brokerage company called Mid America Financial Group. Dillie's company worked closely as the marketing arm of a nonprofit called New Life Corp selling charitable split dollar programs and charitable gift annuities which paid insurance agents hefty commissions for the donations they raised. Recognizing that selling "charity" could be a lucrative business, Dillie decided to form his own non profit called Mid America Foundation which offered charitable gift annuities and donor advised funds through a sizable group of independent insurance agents and financial planners. Only four years later, the charity had raised almost $53 million in donations through charitable gift annuity investments, but one week after publishing a financial statement showing

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[5] See the Arizona Corporation Commission's website for additional information: http://www.ccsd.cc.state.az.us/hot_topics/hfa.asp

[6] See the SEC's website for additional details: http://www.sec.gov/litigation/litreleases/lr17986.htm

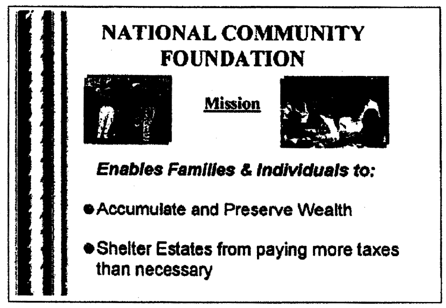
$42 million in assets in October, 2001, Dillie closed the charity's doors and disappeared with the money. He had diverted almost $20 million to a hidden account, had lost almost $10 million in gambling debts, and had paid $3 million in commissions to insurance agents. The charity had failed to file Form 990s with the IRS, and the financial advisors who had placed their clients with this non profit were shocked that the charity turned out to be nothing more than a Ponzi scheme. Dillie was indicted in 2003 on 193 counts of wire fraud, money laundering, and transacting in proceeds from a criminal activity. His trial is scheduled for October, 2004.

Summary: Martin Frankel could not have raised the moneys needed to fund his heist without a charity shell to hide his participation. The Baptist Foundation of Arizona could not have duped 13,000 elderly investors to trust it with their savings without the respectability of the charitable structure. Robert Dillie found that selling charity was much easier and more lucrative than selling life insurance. The charitable industry is attracting con artists and fraudsters simply because there is little or no regulatory scrutiny and because the general public places their trust in charity.

"Accommodation" Charities, Operating Foundations, and Donor Advised Funds

In the past decade or so, a small handful of charities have focused on building their organizations by catering to their donor's tax planning needs and by selling charitable "products" through an army of financial planners and insurance agents. Most of these organizations grew from small, fairly anonymous charities to very large entities as a result of selling large amounts of charitable split dollar life insurance in the late 1990s. When that program was shut down by a combination of Federal legislation, Tax Court opinions, and an IRS Notice, these organizations adjusted their marketing plans to "tax deductible annuity" sales (better known as charitable gift annuities) and donor advised funds, both of which pay hefty commissions and trailing fees to the insurance agents which bring in the charitable donations.

In a 2001 slide show geared towards their insurance agent sales force, New Life Corp (doing business as National Community Foundation) declared their charitable mission to be as follows:



A second organization called National Heritage Foundation makes similar promises to donors:

> *One of the most fundamental principles behind the National Heritage Foundation (NHF) is that you can set up and then work for your own foundation receiving taxable income – even if the only donations are those you provided.*
>
> *Think of the retirement planning implications. Put money in a "Foundation at NHF" where it grows tax-free. Then during retirement, recover these funds as taxable income and nontaxable expenses for bona fide charitable activities.*

Source: http://www.nhf.org/nacec/nacec_ch_employ.htm

And apparently, such promises combined with high commissions paid to the advisor who sets up the fund are effective. New Life Corporation currently has accumulated approximately $189 million in assets, while National Heritage Foundation boasts $200 million in assets, 7000 "foundations", and more 3000 financial advisors.

Example: Set up an NHF Foundation to deduct adoption expenses that would ordinarily not be 100% deductible.

> *We help adoptive parents throughout the United States that are currently working with adoption agencies to set up their OWN family foundation. Once the family foundation is in place, adoptive parents will pay for their adoption expenses through the new, tax-exempt Foundation. The National Heritage Foundation is the entity that will hold and disperse funds, and the Child Adoption Funds Organization is the facilitator of the process.*

Source: *http://www.childadoptionfunds.org/whatwedo.asp*

Example: Set up a corporate "foundation" with tax deductible money and pay yourself for "charitable employment" when you retire. The tax benefits are comparable to a qualified pension plan but there are no ERISA rules, no annual contribution limits, no penalty for early withdrawal, the plan can discriminate in favor of high compensated employees, and there are no annual IRS or DOL reporting requirements.

> *Need Income During Retirement. Our society, at least here in America is facing a dramatic social change called "The Widening Retirement Gap." Employees are both retiring earlier and dying later than they used to. Now, with funds saved up and growing tax free, they may be used, again with NHF approval, during retirement for bona fide charitable activities and employment.*

Source: *http://www.nhf.org/magic/magic_markets.htm*

Example: Donations to international charities are not generally tax- deductible, but checks distributed through an umbrella charity are. So before writing a check to a foreign country, just set up an account and you'll be able to deduct it.

As you know, a person seeking a deduction of a contribution to a charity or charitable project in another country, must make that donation to a U. S. based-charity like the National Heritage Foundation. A gift directly to the project is not deductible.

One of the objectives of NHF is to "touch lives in other countries". We support our "Foundations at NHF" when they desire to do so. 1. They may support charitable organizations in other countries, and 2. They may support charitable projects in other countries.

Source: http://www.nhf.org/foundation_services/ot_countries.htm

Example: Avoid self dealing rules when you sell inventory to your foundation by setting up an NHF fund rather than a "traditional" corporate foundation.

Through an NHF foundation, any corporation can sell its goods or services to its foundation for distribution to charitable activities and organizations and still avoid any risk of self-dealing. That's because NHF administers the foundation and supervises and approves the activities. If ever a doubt arises, NHF files a Certificate of Independent Review to certify that prices are no higher than "normal" and that goods and services are actually received by the designated charities or charitable activities.

Source: http://www.nhf.org/nacec/nacec_corp_fndtn.htm

Example: Set up a foundation with an accommodating charity and use the tax deductible donations to pay for your children's education. In June, 2003 a CA insurance agent named a Tim Mosley was sentenced to five months in prison for tax evasion. Mr. Mosley made tax deductible donations to his NHF "foundation" and then advised the charity to issue checks to his children's private school to pay for their primary school education[7].

Example: Run your insurance or other for-profit business through an NHF Foundation. A company called Elder Planners of Washington has established their insurance agency as an NHF Foundation, through which they offer Long Term Care insurance, reverse mortgages, senior mortgages, estate planning, and other financial products to seniors[8]. In May, 2003, the Attorney General for the state of Washington issued a consumer alert regarding the business practices of this insurance outfit[9]. The agent running the "foundation" had already lost his securities license in the state and had been fined $10,000 by the state Department of Financial Institutions[10].

Summary: The abuses in this field are too numerous to list. Family vacations, school tuition, Olympic size swimming pools, deferred compensation plans are all being funded through accommodation charities who are willing to often bend and sometimes break the rules.

International Gifts and Concerns about Money Laundering and Funding Terrorism

While most donations go to good charities that use the funds to provide important services, the recent focus on terrorism funding through non profit entities has grown sharply since September 11, 2001. A handful of charities have now been shut down and it would appear that finding and stopping such organizations have become a priority among US regulatory agencies. The situation, however, is potentially more complex when it isn't the charity that is raising funds for terrorist groups but rather a charity that plays an unwitting role in funneling money to groups such as Al Qaeda.

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[7] http://www.usdoj.gov/usao/can/press/html/2003_06_20_mosley.html
[8] http://www.epwa.org
[9] http://www.atg.wa.gov/releases/alert_tax_050903.html
[10] "Seniors Warned About Tax Scam," by Candace Heckman, *Seattle Post-Intelligencer*, May 8, 2003

Several US charities offer international grant making abilities to their donors, and while many claim that they investigate the foreign charity prior to making a grant, such due diligence is necessarily limited, especially in countries which have no charity structure and regulatory system comparable to ours[11]. While the US Treasury has recently released voluntary guidance[12] on this issue, most charities are unaware of these recommendations and the majority of charities who make international grants simply don't have the resources or the sophistication to perform the necessary due diligence. The voluntary guidance requires that the grant maker gather a significant amount of information about the international grantee, but it fairly clear that such information will not prevent terrorism funding when the terrorist group exhibits flexibility and mobility. A legitimate orphanage in Afghanistan today could easily become a terrorist front next week, and by the time that organization is placed on the international watch lists, the terrorists have moved on to additional shell entities.

While the Treasury seems to be focusing on shutting down the worst offenders, good charities are likely being used to funnel at least some money to terrorist groups, and unfortunately, a significant percentage of that funding comes from US tax payers in the form of a deduction. Whereas donations made directly to foreign charities are not deductible, donations made to a US charity are, even if all they do is immediately cut a check to the foreign entity.

Tax Shelters Involving Life Insurance and Dead Pools

In the mid 1990s, some rather creative financial advisors devised a scheme whereby wealthy clients could purchase substantial amounts of life insurance for the benefit of their heirs using moneys "donated" to accommodating charities. The charity would end up with pennies on the dollar while the average donor saved tens of thousands in income and estate taxes. In the

[11] "Al Qaeda Skimming Charity Money", CBS News, June 7, 2004
[12] Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities, US Treasury

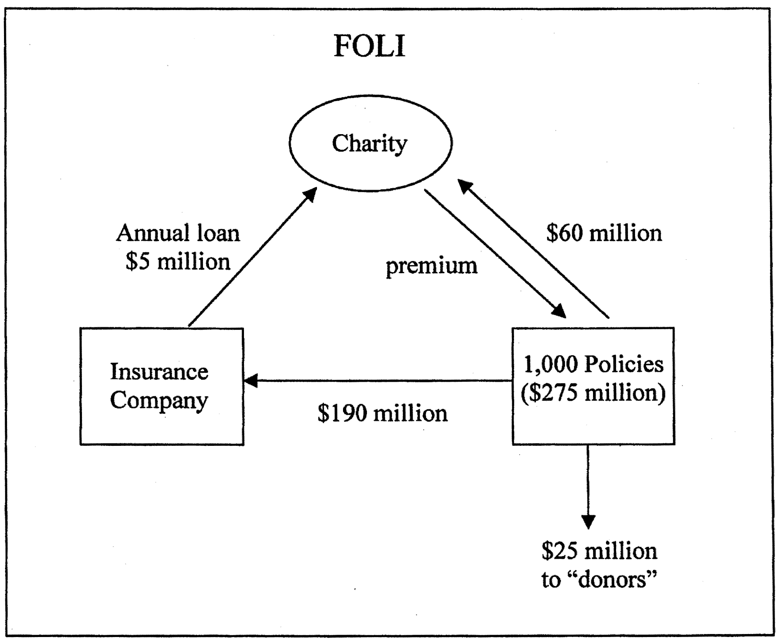
first couple of years, only a handful of charities were willing to participate in this charitable split dollar scheme, but when good charities saw that enough pennies on the dollar eventually added up to nickels and dimes, otherwise honest and ethical organizations began to accommodate wealthy donors too. In 1999, the IRS Released Notice 99-36, Congress passed legislation that added hefty penalties to charities that participated in these plans, and shortly thereafter, the Tax Court ruled in two different cases that the plan had never worked[13]. While the 1999 legislation effectively eliminated this particular scheme, many financial, legal, and accounting experts, struggling to replace the tax beneficial techniques that were being shut down in the corporate and offshore arenas started focusing their sales efforts on shelters involving tax exempt organizations.

Foundation Owned Life Insurance (FOLI) and Charity Owned Life Insurance (CHOLI)

Fundamentally, life insurance is a risk management tool. By design, it pays a lump sum benefit when someone dies. In certain circumstances, it may be appropriate for a tax exempt organization to purchase individual life insurance on the life of a donor, alumnus, or volunteer. There are also times when purchasing a group policy can also make sense for a charity. For example, a university may ask the Class of '50 to purchase life insurance to establish a scholarship fund or erect a building in their name. Unfortunately, a growing number of promoters have realized that buying large group policies can be profitable from a statistical gaming point of view. Using a technique called a "dead pool" such investors know that the more policies they hold in their portfolio, the more predictable the death rate becomes, enabling them to play the statistical odds. The gambling behind such an investment strategy is the reason why the state insurable interest laws exist; they ensure that life insurance is only purchased by someone who has a financial interest in the continued life of the insured.

[13] Addis v. Comm'r, 118 TC 32 (June 10,2002) and Weiner v. Comm'r, T.C. Memo 2002-153 (June 18, 2002)

Institutional investors are actively looking for ways to fund life insurance pools as an investment. As outlined earlier in this report, many charities are also financially unsteady right now and are willing to engage in somewhat aggressive techniques in order to raise donations. Add these factors together, and the investors have found a willing – and cheap -- partner in charitable industry.



Example: In Southern California, a landscaper / dog catcher by the name of Robert Sandifer was approached by an insurance agent, who recommended that Sandifer start up a charity in order to establish a dead pool[14]. If Sandifer could find 1,000 people who would agree to have life insurance purchased on their lives, his new charity – a humane society – could

[14] "For Charities, a New Twist in Raising Money: Corporate Investors in Life-Insurance Policies", by Debra Blum, *Chronicle of Philanthropy*, August 12, 1999

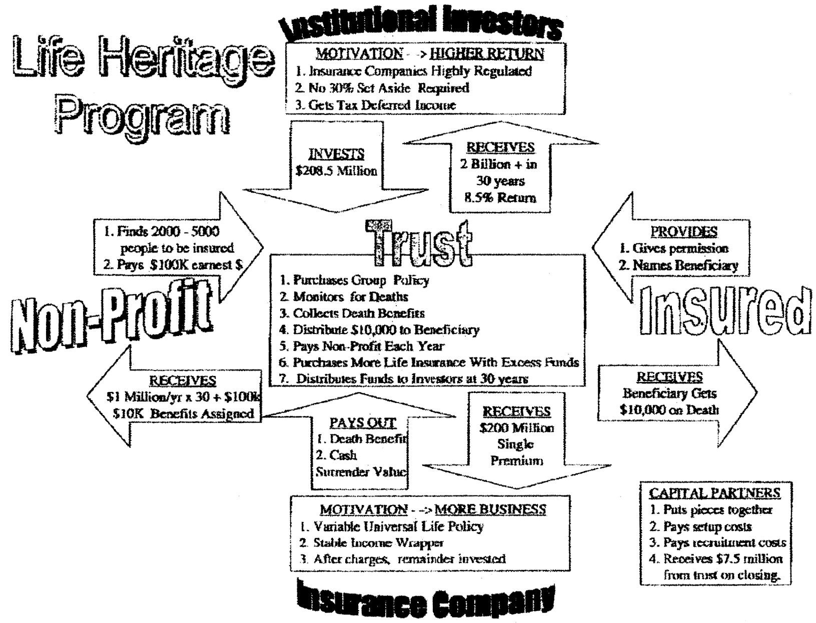
borrow large sums of money each year, use it to pay life insurance premiums, and then keep any death benefits remaining after the loans were paid off. Since this charity had no donor list, Sandifer recruited insurance applicants at a local church and a motorcycle club, he ran advertisements in newspapers, and even signed up strangers in a car dealership.[15] While his motivation to fund a charity may have been good, the decision to start that charity with such a long term investment pool was faulty. The plan quickly collapsed and the charity has closed.

Investor Owned Life Insurance

While the FOLI dead pool was likely doomed from the start – the charity couldn't meet the public support test, and the size of the dead pool wasn't sufficient for death rates to be predictable – other more sophisticated plans have arisen which could turn a profit. It isn't the charity, though, who benefits most in the new schemes; it is an outside group of institutional investors (primarily insurance companies and hedge funds) who stand to gain the most.

As anyone familiar with the secondary life insurance market can attest, many investors would love to start an insurance pool insuring older, wealthy lives. For example, a life insurance company can only invest a small percentage of its reserves in the stock market, and the remainder must generally be invested in long term fixed income holdings. Since long term bonds are paying very low rates of return in recent years, insurance companies have been looking for creative ways to increase those fixed income yields. Buying a large pool of insurance policies would make a very good investment for this situation, but insurance companies don't have the ability to go out and buy 10,000 policies on the lives of targeted people. Charity, however, does.

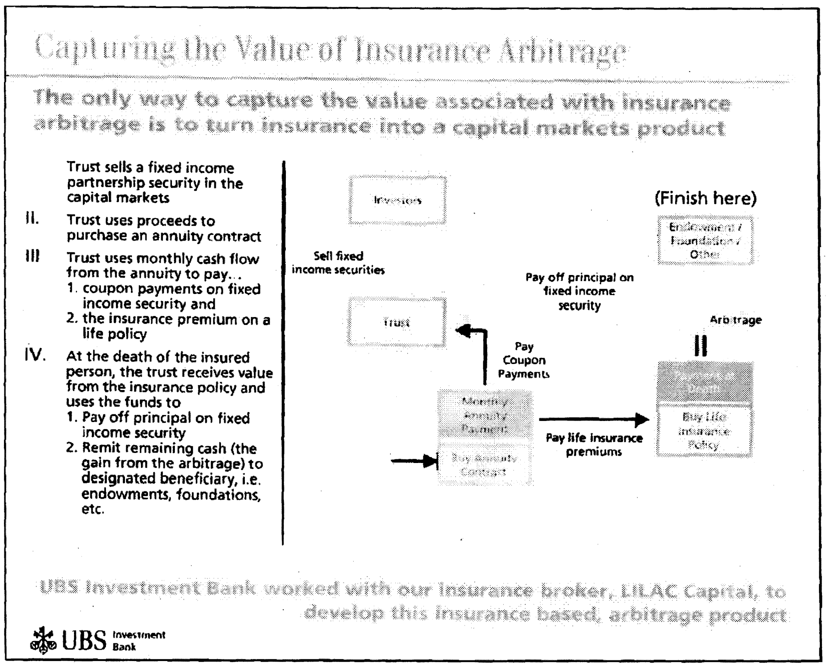
[15] "Dying to Donate: Charities Invest in Death Benefits", by Theo Francis and Ellen Schulz, *Wall Street Journal*, February 6, 2003



The L.I.F.E. Heritage plan diagram above provides the details for one such plan. The charity sets up a trust which sells either fixed income shares or debt instruments to the insurance company / investor. Using the money raised, the trust purchases 10,000 life insurance policies totaling $2+ billion from a different insurance company on the lives of the charity's donors. The charity receives the first $1 million in death benefits each year for 30 years, and the remaining pool (approximately $2 billion) goes to the insurance company / investor. Each donor receives a small death benefit ($10,000) as an enticement to have the policy purchased on his or her life. Charity's share in this plan ($30 million) may seem enormous to the non-profits agreeing to enter into this arrangement, but it is nothing more than rent for the insurable interest they transferred to the trust for the use of the institutional investors who benefit substantially more. While there are several variations of this plan, the promoter for the LIFE Heritage plan above claims to have already put together at least eighteen $2+ billion pools for his institutional clients using a variety of charities[16].

Life Insurance Life Annuity Combination (LILAC)

The newest Investor Owned Life Insurance (IOLI) scheme to hit the non-profit world is also the best funded in terms of marketing and lobbying budgets. The LILAC plan uses a structure which is similar to the LIFE Heritage Plan above, but adds an immediate annuity to the product mix.



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16 "Death dividends or creative financing?" by Tom Gascoyne, *Chico News and Reviews*, February 20, 2003.

To summarize briefly, the charity sets up a trust and sells fixed income securities interests in that trust to institutional investors (life insurance companies, hedge funds, and private banking clients). The moneys raised are used to purchase immediate annuities on the lives of the charity's donors. The income from these annuities is then used to purchase life insurance on the lives of the same donors. The charity benefits by receiving the "arbitrage" from the program – the annuity rates received are more favorable than the life insurance rates paid out – with the remainder going to the institutional investors. UBS has successfully put together several of these plans already (totaling $2 billion) in their first year, and as they lobby to change the insurable interest laws in additional states, more and more plans are likely to fall into place[17].

Life Insurance and Life Annuities Based Certificates (LILACS)

❖ *Transaction Summary*

	LILACS 2003-I	LILACS 2003-II	LILACS 2003-III	LILACS 2003-IV
Date of Closing	10-Jul-03	10-Oct-03	17-Dec-03	23-Dec-03
Series A Investor Certificate Amount	231,908,260	170,525,000	238,842,600	188,499,000
Total Death Benefit Amount	242,898,750	179,500,000	251,413,250	198,420,000
Distribution Rate	5.8594%	5.0456%	5.6460%	5.7750%
Number of Donors	15	10	15	17
State	Texas	Texas	Texas	Texas
Weighted Average Life	8.5	9.9	9.4	10.0
Targeted to Charities	10,990,490	8,975,000	12,570,663	9,921,000
Potential to Charities	13,139,579	10,680,250	14,707,675	11,607,570
Annuity/Life Insurance Provider	Two of the nation's leading insurers	Two of the nation's leading insurers	Two of the nation's leading insurers	Two of the nation's leading insurers
Upfront Annuity Premium	192,921,991	140,595,835	200,101,848	158,420,394
Upfront Life Insurance Premium	17,638,586	9,371,687	17,000,432	10,094,746
Rating (Moody's/S&P)	Aaa/AAA	Aa2/AA+	Aaa/AAA	Expected/AAA

The institutional investors (insurance companies and hedge funds) investing in this plan would be unable to purchase these insurance contracts on their own. They must borrow – or rent

[17] "Charities Look to Benefit from a New Twist on Life Insurance" by Stephanie Strom, *NY Times*, June 6, 2004.

- the charity's insurable interest. In exchange, the charity is receiving a very small percentage of the overall scheme. Once again, the charities are willing to sell their insurable interest for pennies on the dollar, simply because they reason that those are pennies they wouldn't have had otherwise.

Investing in life insurance dead pools clearly goes against public policy. The insurable interest laws pre-date the American Revolution and were put into place to prevent gambling on the lives of others. Under most state laws, the above transactions are already prohibited because while charity may have an unlimited insurance interest in the life of a donor, the trust funded by the institutional investors does not. For this reason, UBS and the promoters of this plan have been actively lobbying at the state level to get the insurable interests laws expanded, effectively gutting the purpose of these laws in order to arrange more LILACs for their institutional clients. Texas' and Virginia's laws were already sufficiently open to allow these plans, but the UBS lobbying efforts have recently resulted in Tennessee and Nebraska changing their laws to accommodate this program. Nine additional states currently have legislation under consideration which would allow charities to assign their insurable interest to outside investors, even when those investors have no reason – other than statistics gambling – to purchase such policies.

From a charity's point of view, participating in a scheme that enriches outside investors is bad public policy, even if the charity receives funds it would not ordinarily get. From an insurance industry viewpoint, this plan is equally problematic. If a person's death is allowed to become a commodity rather than a risk to be covered by life insurance, then the tontines and dead pools of the 17th and 18th centuries will return.

Summary

I have worked in and around the insurance industry for approximately eighteen years, usually as one of their harsher critics. The reaction to the investor insurance programs involving charity is the first time I've seen the two largest insurance agent associations -- Association for Advanced Life Underwriting (AALU) and the National Association for Insurance and Financial Advisors (NAIFA) – jointly publish a statement warning their members away from a plan[18]. The lobbying efforts at the state level would do tremendous damage to the consumer protections that insurable interest laws are supposed to provide.

In the past year, I have spoken with literally dozens of people who were looking into variations of Investor Owned Life Insurance (IOLI) plans involving charity. The charities who have been pitched the program and agree to participate only see that they would have $10 million if they do it and nothing if they don't. None knew how much the outside investors would get or even who those outside investors were. All appear to be caught up in the minutia of the plan - which arrow points where, which contracts pays what – without stepping back and looking at the big picture. It is not the charitable mission to make wealthy investors wealthier by entering into complicated schemes.

Conclusion

Each of the examples above has one common theme: all of these schemes and arrangements allow people to do things that they couldn't do without the involvement of a charity. All receive a benefit that would be otherwise unavailable to them. A corporate raider is able to steal because a charity shell hides his identity and give him credibility. A terrorist group is able to raise tax deductible money from US supporters and can launder that money through non profit entities. A few thousand taxpayers are able to fund personal expenses using tax

[18] http://www.naifa.org/frontline/20040615_nfl_1.html

deductible "donations" to an accommodating non profit. And institutional investors are able to purchase sizable life insurance pools where ordinarily, the state insurable interest requirements would make such investment pools impossible.

I would really like to thank the Senate Finance Committee for holding these hearings and to commend the staff on their White Paper which thoughtfully addresses the myriad of concerns that the panel members have raised. Despite the horror stories told today, the charitable industry is still relatively clean, and it is my hope that shining a harsh light on the few abuses that do occur will have the effect of wiping out the bad practices before they have a chance to spread.

HOUSE DOCKET, NO. 03698 FILED ON: 04/28/2011

HOUSE . . . . No. xxxxx

The Commonwealth of Massachusetts

PRESENTED BY:

William "Smitty" Pignatelli

To the Honorable Senate and House of Representatives of the Commonwealth of Massachusetts in General Court assembled:

The undersigned legislators and/or citizens respectfully petition for the passage of the accompanying bill:

An act authorizing charitable life insurance policies.

PETITION OF:

NAME:	DISTRICT/ADDRESS:
Paul McMurtry	*11th Norfolk*
Gailanne Cariddi	*1st Berkshire*
Randy Hunt	*5th Barnstable*
William "Smitty" Pignatelli	*4th Berkshire*

HOUSE . . . . No. xxxxx

By Mr. Pignatelli of Lenox, a petition (subject to Joint Rule 12) of William "Smitty" Pignatelli for legislation to make certain changes in the laws relative to the issuance of charitable life insurance policies. Financial Services.

The Commonwealth of Massachusetts

In the Year Two Thousand Eleven

An act authorizing charitable life insurance policies.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. The definition of "Professional fund-raising counsel" contained in section 18 of chapter 68 of the General Laws, as appearing in the 2008 Official Edition, is hereby amended by striking out the second sentence and inserting in place thereof the following:-

A bona fide salaried officer or regular, non-temporary employee of a charitable organization maintaining a permanent establishment within the commonwealth shall not be deemed to be a professional fund-raising counsel. An insurance commission paid by an insurer to a licensed insurance agent pursuant to an insurance policy issued in accordance with the provisions of sub-section (3) of section 123A of chapter 175 shall not be deemed to be consideration paid by a charitable organization;

SECTION 2. The definition of "Professional solicitor" contained in said section 18 of said chapter 68, as so appearing, is hereby amended by striking out the fourth sentence and inserting the following:- No attorney, investment counselor or banker who advises an individual corporation or association to make a charitable contribution shall be deemed, as a result of such advice, to be a professional fund-raising counsel or a professional solicitor. An insurance commission paid by an insurer to a licensed insurance agent pursuant to an insurance policy issued in accordance with the provisions of sub-section 3 of chapter 175 shall not be deemed to be consideration paid by a charitable organization;

SECTION 3. Section 123A of chapter 175 of the General Laws, as appearing in the 2008 Official Edition, is hereby amended by adding the following sub-section:-

(3) A donor's retirement account may be designated as a collateral assignee of a life insurance policy made to secure the repayment of a loan made to the charitable institution from the retirement account; provided that no further assignment may be made by the retirement account.

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Written Statement for the Record
Submitted to
U.S. Senate Committee on Finance
For the October 18, 2011 Hearing Titled
Tax Reform Options: Incentives for Charitable Giving

October 31, 2011

We appreciate the opportunity to submit a written statement for the record to members of the Senate Committee on Finance on the importance of preserving the value of the federal income tax deduction for charitable contributions.

Headquartered in Washington, D.C., with offices in London, Singapore and Mexico City, the Council for Advancement and Support of Education is the professional organization for advancement professionals at all levels who work in alumni relations, communications, fundraising, marketing and other areas. Today, CASE's membership includes more than 3,400 colleges, universities, independent elementary and secondary schools, and educational associates in 74 countries around the world. CASE helps its members build stronger relationships with their alumni and donors, raise funds for campus projects, produce recruitment materials, market their institutions to prospective students, diversify the profession, and foster public support of education.

Private support raised from individuals has become an essential funding source for both public and private colleges and universities and independent schools. According to the Council for Aid to Education's Voluntary Support of Education survey, donors contributed $28 billion to colleges and universities in 2010. These gifts help institutions fund scholarships for poor and low-income students, cutting edge research, top-notch faculty, and strong academic programs.

In the aftermath of the global recession, students and their families are struggling to pay tuition costs that continue to rise. At the same time, colleges and universities are also seeing more and more cuts to their state and federal funding. Unless institutions can convince donors to provide additional aid for deserving students, educational opportunity will shrink even as the need for education grows.

That is why we strongly urge the Finance Committee to support policies that incentivize giving to charitable organizations, including colleges, universities and independent schools. While charitable giving is a voluntary act, driven by a desire to do good, to have impact, and to give back, tax incentives do play a role in encouraging donors to accelerate giving. Major donors often determine the size and timing of their gifts, at least in part, based on tax considerations.

And major donors are exactly the taxpayers who would be most affected by proposals that reduce the value of the charitable deduction. According to a 2010 Bank of America Study on High Net-Worth Philanthropy, high net-worth households (household income greater than $200,000 and/or net worth of at least $1 million) account for between 65 and 70 percent of all individual giving in America. The study also found that 80 percent of high net-worth households gave to education in 2009. These are the donors who have the resources to give to charitable organizations consistently, and our tax policy should encourage them to continue to give generously.

Perhaps most alarming about efforts to reduce the value of the charitable deduction is that they occur at a time of rapidly increasing wealth disparities. With a smaller percentage of the population holding a larger share of the world's financial resources, we should be encouraging—not discouraging—voluntary giving by the most fortunate among us.

Once again, we strongly urge the Finance Committee to preserve the value of the federal income tax deduction for charitable deductions. Countries around the world have been adopting the U.S. charitable deduction model in order to increase donations to their educational institutions. Now is not the time to fundamentally change a tax incentive that has contributed to a cherished tradition of charitable giving unmatched in the world.

Thank you for this opportunity to submit a statement for the record and for your consideration of our views.

Testimony of

Nancy Van Milligen

President, Community Foundation of Greater Dubuque

on behalf of

The Council on Foundations

presented to

The United States Senate
Committee on Finance

hearing on

Tax Reform Options:
Incentives for Charitable Giving

October 18, 2011

Chairman Baucus, Ranking Member Hatch, and members of the Finance Committee, thank you for the opportunity to present testimony to the committee concerning tax reform options as they relate to incentives for charitable giving. The subject of this hearing is extremely important, and I thank the committee for seeking to probe further into the complex issues this subject presents.

My name is Nancy Van Milligen, and I have been president of the Community Foundation of Greater Dubuque since 2003. I am testifying today on behalf of the Council on Foundations, which serves as the voice of philanthropy on a range of policy matters. The Council represents more than 1,750 grantmaking foundations and corporations with assets of approximately $300 billion. Moreover, I am pleased to report that those assets have been put to work in recent years. Though the philanthropic sector has, like everyone, been hit hard by the poor economy, with a consequent decline in our assets, we have responded vigorously to meet the increased needs of our communities and neighbors, many of whom face unprecedented hardships. In 2010 alone, foundations donated $41 billion, which comprised a major component of donations from all sources for the year.

The Council and its members are committed to the core principles of the "Three I's": innovation, investment, and independence. The Council's work, including its public policy advocacy efforts, is directed toward promoting those ends: permitting foundations to develop new ways of approaching pressing problems, ensuring that they make the necessary commitments of energy and capital to the communities they serve, and protecting the ability to pursue their goals in the manner they believe is most likely to achieve the desired results.

I hope my testimony will help illuminate some of the real-world implications of the policy decisions you make here in Washington, D.C. I know that the senators on this panel are very attentive to those concerns, and that you travel around your states and listen to the issues your constituents face. Toward that end, I hope to provide some observations on how the tax code affects our mission from the perspective of a community foundation in America's Heartland, Iowa.

Community foundations are grass-roots philanthropy at its best—organizations that are rooted in the community they serve, focused on local needs and reliant on local resources.

As a technical matter, community foundations are tax-exempt public charities serving thousands of people who share a common interest—improving the quality of life in their area. Individuals, families, businesses, and organizations create permanent charitable funds that help their region meet the challenges of changing times. The foundation invests and administers these funds. All community foundations are overseen by a volunteer board of leading citizens and run by professionals with expertise in identifying their communities' needs.

Community foundations have proven to be an extraordinarily effective tool, both in the city of Dubuque and around the country, because of their effectiveness in identifying and addressing the needs of their communities with resources drawn from those same areas. Community foundations have grown to administer more than $41 billion in charitable funds, and now serve nearly 1,200 communities and regions throughout the United States.

The Community Foundation of Greater Dubuque is surely representative of community foundations across the country in that we serve our neighbors and our region by supporting a wide range of programs, each conceived and implemented to address a very specific need in our community through targeted and innovative initiatives. A few of those programs are highlighted below:

- Project HOPE (Helping Our People Excel) is an employment initiative of the city of Dubuque designed to serve as a catalyst to help service providers, educators, employers, and job seekers build bridges to establish rewarding, long-term employment opportunities.
- The Children's Trust is a community initiative that works to improve early care and learning for children up to age 8, thus ensuring that all Dubuque children enter school ready to succeed.
- Dubuque 2.0 promotes conservation and sustainability by supplying the city's citizens with the tools and information necessary to measure and manage their resource utilization.
- The 2011 Recovery Fund and Project Concern help area families cope with the devastating losses that resulted from this year's record flooding in the Midwest. Through those efforts, the Community Foundation of Greater Dubuque helps provide critical resources to families seeking to rebuild their lives in those instances where insurance or other resources are insufficient or unavailable.

Community foundations are a unique structure, but they share key attributes with other foundations. Because of the way foundations are funded and administered, they can act quickly, innovatively, and cost-effectively without the constraints that limit government agencies or even some other nonprofits. That's why foundations have a proven record of applying resources in highly innovative ways to achieve solutions to intractable problems. Also, foundations have demonstrated that they can realize disproportionate results by leveraging their own resources with those from other sectors and implementing innovations on a large scale.

The Council on Foundations and its members believe that federal policies should encourage charitable giving and ensure the health and vitality of the sector.

We also recognize that our nation faces very severe fiscal problems. As government, particularly on the state and local levels, has been forced to cut back, foundations have stepped up to help fill the void. Indeed, foundations have focused disproportionately in recent years on sectors that tend to be most sensitive to declines in government funding. According to the Foundation Center, more than 45 percent of foundation funding in 2009 went to support needs in education and health care.

Foundations also have been very focused on efforts to help communities reverse the economic downturn. Toward that end, they have marshaled private sector resources and innovations to serve the common goal of economic revitalization. By doing so, foundations have provided policymakers with a critical tool to reverse the loss of human and financial capital and use that recovered capital to help address growing needs in challenging times.

Though Council members are increasingly taking on burdens formerly borne by government, they do not seek additional support through the tax code. To the contrary, the Council has been careful to craft any tax code changes that they advocate, such as the proposed simplification of the excise tax on private foundations' investment income, so those changes would be revenue neutral. However, though the Council does not seek additional assistance through the tax code, it does ask that the committee, and Congress as a whole, refrain from making adverse changes to the tax code as it already exists.

Because of our tax-exempt status, and the tax deduction afforded to our donors, foundations are very much affected by tax policy. Over the past century, the philanthropic sector has evolved in response to well-established tax policies that, in most respects, have remained unchanged since the charitable deduction was first established.

Most notably, for nearly 100 years, the value of the charitable deduction has been tied to an individual's tax rate. Thus, each taxpayer receives the same benefit from charitable deductions—itemized deductions are not included in taxable income. The fact that some taxpayers pay taxes at a higher rate is a burden, not a benefit, even if there is a corresponding effect on their tax liabilities if taxable income is reduced.

The current income tax deduction for charitable giving has proven to be a critical factor in the growth of the philanthropic sector. Accordingly, the Council strongly supports maintaining current law permitting full deductibility of itemized charitable deductions.

Given the current economic downturn and the increased reliance on the sector for basic social services, now is not the time to discourage charitable giving. Yet that is precisely what would happen if a century of precedent is set aside and donors are taxed on amounts they donated to philanthropy. Capping the value of charitable deductions would reduce by billions of dollars the resources available for private philanthropy to address critical needs:

- In 2009, the Indiana University-Purdue University Indianapolis Center on Philanthropy estimated that charitable giving by households with incomes above $200,000 would have ***decreased 4.8 percent*** in 2006 if both the 28 percent limitation on itemized deductions was enacted and the scheduled 39.6 percent marginal income tax rate had been in effect. Moreover, that estimate did not factor in the reinstatement of the "Pease" itemized deduction phase-out or the high-income tax increase later enacted as part of the health care legislation.

- An earlier Center on Philanthropy study found that ***79.4 percent of gifts to foundations*** in 2005 came from households with income above $200,000. (Charitable giving totaled $290.89 billion in 2010, of which foundations received $33 billion.)

- A Center on Philanthropy study also reported that, in 2005, households above $200,000 were "responsible for ***approximately two-thirds*** of all household charity in this country."

- In recent years, according to a 2010 Center on Philanthropy study, giving vehicles such as foundations have become ***increasingly reliant on fewer high-net-worth donors***. The study notes that the average amount given to those vehicles by high-net-worth (income above $200,000 or assets of more than $1 million) households increased from $64,680 in 2007 to $75,867 in 2009, even as the percentage of such individuals who donated to a giving vehicle declined from 21.7 percent to 15.6 percent.

The Council has reviewed carefully various proposals regarding changing the tax treatment of charitable deductions, including the deductions cap proposed by the president as part of his Fiscal 2011 and 2012 budget submissions, the similar (though more expansive) proposal included in the American Jobs Act as proposed by the administration, and the various alternatives outlined in the May 2011 Congressional Budget Office (CBO) report, "Options for Changing the Tax Treatment of Charitable Giving."

The Council believes that these efforts have prompted a useful discussion of issues relating to charitable giving and the role of philanthropy generally, and we encourage further study in this critical area. However, we believe that these specific proposals would have a harmful effect on philanthropy and those whom we serve. Moreover, we are concerned that, however limitations on charitable deductions are packaged, including each of the options identified in the CBO report, the fundamental policy consequences will remain the same. The laws of economics are immutable, no less so in the philanthropic sector than in the for-profit world. If something costs more, there will be less of it. Thus, if charitable donations are more expensive to donors, there will be fewer donations.

As someone who deals daily with donors and prospective donors, I can tell you that they are very sensitive to the tax implications of their charitable options. Our donors are good people who are motivated by worthy goals. They do not support the Community Foundation of Greater Dubuque because of the tax benefits for doing so. Under any circumstance, they make a considerable sacrifice for donating; the tax benefits, even under current law, do not come close to making them whole. However, the tax treatment of their donations does affect the amounts that they believe they can give responsibly while continuing to honor their other obligations.

As someone who is always mindful of how the Community Foundation of Greater Dubuque may come up with the resources needed to meet the needs of our community, I also can tell you that any diminution of support that would result from adverse tax law changes would impose real hardships on the people whom we serve.

I urge the committee to remain committed to powerful incentives in the tax code that fully encourage and reward the selfless act of contributing to charity.

FEEDING AMERICA

Statement for the Record

Submitted by

Vicki Escarra, President and CEO,

Feeding America

(35 E. Wacker Dr, Suite 2000 Chicago, IL 60601)

For The Hearing On

Tax Reform Options: Incentives for Charitable Giving

Before The

United States Senate

Committee on Finance

Tuesday, October 18, 2011

Chairman Baucus, Ranking Member Hatch, and members of the Senate Finance Committee, thank you for the opportunity to submit this statement for the record on behalf of Feeding America. We look forward to the Committees examination of tax reform and the role charitable tax deductions play in encouraging monetary and in-kind donations to the nation's nonprofit organizations.

Feeding America is the nation's leading domestic hunger-relief charity with a network of more than 200 food banks in every state serving over 61,000 local food assistance agencies. Feeding America food banks as well as food assistance agencies rely on a variety of public and private funding streams to feed 37 million Americans a year, including 14 million children and nearly 3 million seniors.

During the worst economic downturn since the Great Depression, the number of American families struggling to make ends meet has increased significantly. With unemployment still hovering near 9 percent, the need for food assistance continues to grow and food banks continue to be pressed to meet the need in their communities. Last year, **37 million people, or one in eight Americans, received emergency food assistance** through the Feeding America network of over 200 food banks. This represents **an increase of 46%** since 2006. As a result, **approximately 5.7 million people per week** are now receiving emergency food assistance through Feeding America food banks.

The food distributed by Feeding America and the children's programs our food bank members run in local communities provides a solid return on taxpayer investments and helps reduce state government and private sector health costs as well as investing in a healthy future workforce. Emergency food assistance provides support not only to struggling working Americans but also to farmers and the agriculture industry through purchase of commodities.

Feeding America network members utilize local and national public private partnerships to maximize the impact of government commodities and provide the most complete and nutritious food packages available. We also continue to do more with less, responding to an unprecedented increase in demand while combatting a 15% decline in manufactured food donations and a staggering 150% increase in the amount of food *purchased* by the network.

In this "perfect storm" of increased need and declining food and fund donations, federal tax policy plays a significant role in encouraging donations to nonprofit organizations like Feeding America. Charitable donations remain a significant source of funding for Feeding America and other nonprofits nationwide, a donation stream that is compounded by declines in giving over the last few years. Further reductions in charitable giving would have a detrimental impact on the ability of Feeding America and our network members to feed millions of struggling Americans. Feeding America urges the Senate Finance Committee to reject any changes to charitable giving incentives that would result in less food and funds donated to the Feeding America network.

Along with the charitable giving tax deduction, the food donation tax deduction (Internal Revenue Code Section 170 e3) is a critical tool for Feeding America network members in obtaining donated food. The deduction provides an incentive for businesses to donate fit and wholesome food inventory to a 501c3 organization serving the poor and needy. The deduction seeks to capture food that would otherwise be wasted by providing an incremental tax deduction over the cost of goods sold if the food is donated to a 501c3. Without Section 170e3, there is no incentive for a business to donate the food verses dumping the food inventory in question.

Since the inception of the food donation tax deduction in 1976, the provision was available to C corporation taxpayers only. However, as manufacturing efficiencies and improved sales forecasting by food manufacturers decrease the surplus goods donated to Feeding America members, it is vital to secure additional food product that is available across the food industry spectrum, including from small businesses like restaurants, farmers, and retailers. In 2006, Congress enacted as part of the Pension Protection Act a two year provision expanding the food donation tax deduction to include all business taxpayers as eligible donors, not just C corporations. This modification to the food donation tax deduction gave small businesses, including pass-through entities (Subchapter S corporations, limited liability companies), the ability to take the same enhanced deduction for the contribution of food inventory as C corporations.

Feeding America strongly believes enactment of the ***entire*** Good Samaritan Hunger Relief Tax Incentive Act (S. 166) would help encourage donations of excess food inventory across the food industry spectrum. The legislation would make permanent the temporary provision allowing all qualified business taxpayers (including farmers, retailers, restaurants and food manufacturers) to take a heightened charitable tax deduction for donations of fit and wholesome food to non-profit charitable organizations that serve the needy. Feeding America has seen a significant increase in the amount of food donations from small businesses such as restaurants, retailers, and farmers since the temporary provision was enacted in 2006. According to data collected by Food Donation Connection, in 2005 prior to the 2006 expansion donations of food from restaurants enrolled in FDC's Harvest Program were approximately 15 million pounds. By 2008, that amount had grown through the expansion of the provision to include 22 million pounds of food donated in 2008. However, the temporary nature of this provision makes it very difficult for small businesses to incorporate food donations into a long term business plan and reduces the amount of businesses willing to donate food.

Second, the legislation would increase the amount of the deduction to full fair market value (not to exceed twice cost) for a two year trial period. Currently many businesses find it more advantageous to *dump* nutritious food rather than incurring labor and transportation costs to donate the food; this provision seeks to change the dynamic so that more donors can afford to donate food.

Third, the legislation would allow farmers and other "cash method" accounting taxpayers to consider 25% of the fair market value of the donated food as the cost to produce the food. Current law does not accommodate the accounting choices that most farmers organized as sole proprietors use and prevents farmers that are sole proprietors from taking the tax deduction.

Lastly, the legislation would codify an important Tax Court ruling, *Lucky Stores, Inc. v. Commissioner of Internal Revenue*, in which the Court upheld the right of the taxpayer to determine a reasonable fair market value of donated food rather than the IRS.

We greatly appreciate the opportunity to submit testimony today on behalf of Feeding America, our over 200 member food banks, and the 37 million Americans fed last year. Protecting the ability of Feeding America and other nonprofits to continue their work on behalf of millions of Americans has never been more important. Protecting the charitable giving tax deduction and expanding food donation tax incentives provide the right approach to staggering need. The Good Samaritan Hunger Relief Tax Incentive Act would provide strong incentives to capture millions of pounds of nutritious food currently going to waste while giving small business owners fair and equitable access to the food donation giving incentives C corporations have had for decades.

INDEPENDENT SECTOR
A vital voice for us all

STATEMENT FOR THE RECORD
DIANA L. AVIV
INDEPENDENT SECTOR, PRESIDENT AND CEO

SENATE FINANCE COMMITTEE HEARING
"TAX REFORM OPTIONS: INCENTIVES FOR CHARITABLE GIVING"
OCTOBER 18, 2011

Chairman Baucus, Ranking Member Hatch, and distinguished Members of the Committee, thank you for the opportunity to share with you the perspectives of the nonprofit and philanthropic community as the Committee examines alternatives to the tax treatment of charitable giving.

I serve as the president and chief executive officer of Independent Sector, a national coalition with nearly 600 member organizations, working to advance policies that ensure the ability of America's 1.5 million organizations to help people and improve communities across the country and around the world every day.

Importance of the Nonprofit Sector

Every day, U.S. nonprofits assist victims of disaster, provide educational and economic opportunities for families in need, alleviate poverty and suffering at home and abroad, and foster worldwide appreciation for the democratic values of justice and individual liberty.

The community benefits of nonprofit work are felt in every state. For example, Vital Ground, a member of the Land Trust Alliance, has worked with local partners and landowners to protect over 98,000 acres of crucial Montana wildlife terrain, including the Swan Valley and Cabinet-Yaak areas, to conserve the habitats of grizzly bears and other wildlife. In Utah, the American Red Cross trains over 10,000 people each year in disaster preparedness through courses like first-aid trainings, CPR and workplace safety. They also provided humanitarian assistance, including shelter, food, and clothing, to over 1,570 Utahans affected by disaster last year.

But the nonprofit and philanthropic sector is even more than the community benefit that derives from our work. It often surprises people to learn that nearly one in 10 workers in the U.S. are employed by a nonprofit organization, and that with 13 million employees, we are larger than the finance and real estate sectors combined.

We collectively pay nearly $670 billion annually in wages and benefits -- salaries that support middle class families in communities across America. Additionally, nonprofit organizations inspired 63.4 million American adults to perform 8 billion hours of volunteer service in 2009, the equivalent of 4 million full-time jobs valued at approximately $169 billion.[1]

Clearly, nonprofits are a major part of the U.S. economy, generating annual economic activity of more than $1.3 trillion, which is roughly equivalent to 10 percent of our country's Gross Domestic Product. A vibrant

[1] Urban Institute, "The Nonprofit Sector in Brief: Public Charities, Giving, and Volunteering, 2010," 2010 and Corporation for National and Community Service," "Volunteering in America 2010: National, State, and City Information," 2010.

and healthy nonprofit sector will be critical for the United States to regain its economic footing and recover from the current downturn.

Impact of Economic Downturn

Unfortunately, America's nonprofits have been particularly hard hit in recent years. The Nonprofit Finance Fund, a community development financial agency, surveyed over a thousand organizations in April 2010, and found only 12 percent operating above break-even.[2] Sixty two percent of organizations had enough cash on hand to cover less than three months' worth of expenses, and half of those (31%) had only enough for less than one month.

Like our counterparts in other major sectors of the economy, many nonprofit employers have struggled to meet payroll during the past three years, and countless more have been unable to hire additional workers needed to keep pace with the increased demand for services. In 2009 alone, 38 percent of human services nonprofits reported laying off employees, 50 percent froze or reduced salaries, and 23 percent reduced employee benefits.[3]

These financial challenges have been exacerbated by a significant increase in demand for nonprofit services. Nonprofits are an important source of support for individuals and families who have lost their jobs, their health insurance, and often their homes, as well as a key resource for individuals seeking to find new opportunities through education and job training, solace and encouragement through counseling, and inspiration and expression through the arts.

Numerous studies have documented this increased demand for services. A study conducted by the NonProfit Research Collaborative noted that human services organizations experienced a 78 percent increase in demand for services between 2009 and 2010.[4] An annual survey conducted by Catholic Charities found that its agencies had served 9,164,981 people in 2009, an increase of 7.5 percent over 2008, and a nearly 19 percent increase from 2007.[5]

Nonprofits have struggled to keep pace with this increased demand in part because revenue has declined during the economic downturn, as well. From 2007 through 2010, charitable giving declined by almost $24 billion[6] as Americans struggled to navigate a difficult economy. Federal and state budget cuts have further overburdened and diminished the capacity of nonprofits, and have disproportionately affected those least able to help themselves.

The Incentive Effect of the Charitable Deduction

It is in this context of increased demand and declining revenue that the Committee's consideration of the charitable deduction takes place. Despite recent declines in giving, charitable donations remain a major source of revenue for nonprofits working in communities across the country.

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[2] Nonprofit Finance Fund, "2011 State of the Sector Survey," 2011
[3] Elizabeth T. Boris, Erwin de Leon, Katie L. Roeger, and Ileana Nikolova, "Human Service Nonprofits and Government Collaboration: Findings from the 2010 National Survey of Nonprofit Government Contracting and Grants" (Urban Institute, October 2010).
[4] The NonProfit Research Collaborative, *November 2010 Fundraising Survey*, 2010.
http://www2.guidestar.org/ViewCmsFile.aspx?ContentID=3117
[5] Catholic Charities USA, *2009 Annual Survey Final Report*, 2009.
Center for Applied Research in the Apostolate, Georgetown University, Washington, DC, July 2010.
(http://www.catholiccharitiesusa.org/NetCommunity/Document.Doc?id=2392)
[6] Giving USA 2011, The Annual Report on Philanthropy for the Year 2010

For example, more than 95 percent of Feeding America's nearly $700 million in 2009 revenue came from charitable contributions. American Cancer Society, March of Dimes and Environmental Defense Fund -- which collectively received over $600 million in charitable contributions in 2009 – each relied on the generosity of donors for more than 90 percent of their funding for programs and services in communities across America. The fact is that further reductions in charitable giving would have a potentially devastating impact on the families and individuals served by the nonprofit and philanthropic community. It is therefore crucial that the Committee reject any proposed alternatives to the charitable deduction that would result in decreased charitable giving.

Congress has, in fact, long recognized the connection between the tax code and giving to charitable organizations, dating to the inception of the charitable deduction in 1917. Since then, our tax system has strongly encouraged Americans to give back to their communities, and the broad concept of charity on which the deduction is based has given rise to a diverse and pluralistic set of organizations all dedicated to the public good. More recently, in the days following the devastating January 2010 earthquake in Haiti, legislation was enacted allowing taxpayers to claim a 2009 deduction for donations made to Haiti relief efforts between the date of the earthquake and March 1, 2010. Similar extensions were enacted following the Southeast Asia tsunami of 2004, Hurricane Katrina in 2005, and storms in the American Midwest in 2008.

Congress took these steps because it recognized that the deduction does, in fact, encourage people to give to charity. We know that more than 80 percent of the 46 million Americans who itemized their tax returns in 2009 claimed the charitable deduction. These individuals and families, who represent barely one quarter of all taxpayers, were responsible for more than 76 percent of individual contributions to charitable organizations.[7]

Moreover, the power of the incentive can be seen in the timing of charitable gifts. Between 2003 and 2009, charitable organizations in the U.S. received $281 million in online donations. Remarkably, more than 22 percent of those donations were made on December 30 and 31 each year, underscoring how much their giving is influenced by tax provisions.[8]

<u>Fairness of the Charitable Deduction</u>

The American people understand the positive impact of the charitable deduction on their communities. An April 2011 Gallup Poll found that 62 percent of Americans *who do not claim the deduction* support its preservation as an incentive for giving. The deduction likely enjoys such broad support because Americans recognize the deduction as a fair and equitable way to encourage giving to all types of charitable organizations.

While some advocates of changing the charitable deduction believe it disproportionately benefits high income taxpayers, this is not the case. The current tax code treats every taxpayer who claims the deduction equitably; regardless of the rate at which their income is taxed, people are not required to pay taxes on the portion of their earnings donated to charity. This is an appropriate treatment of charitable contributions in a progressive tax system.

It is also important to keep in mind the unique nature of the charitable deduction. Unlike incentives to save for retirement or purchase a home, for example, the charitable deduction encourages behavior for which a taxpayer receives no direct tangible benefit. The charitable deduction does not subsidize personal consumption or underwrite the accumulation of personal wealth. It simply and effectively encourages taxpayers to give away a portion of their income to benefit others.

But reducing the value of the charitable deduction for taxpayers earning over $200,000 will blunt the impact of services across the sector. Despite assumptions to the contrary about the giving of wealthy individuals, basic needs organizations are their number one benefactor. A 2010 study by the Center on Philanthropy at Indiana University found that 85 percent of high net worth households[9] donated to basic needs charities in 2009, compared with 31 percent of other taxpayers[10]. The reality is that Americans in every income bracket give generously to all types of charitable organizations, and reducing incentives to give will hurt all charities and the people they serve.

Not only is the charitable deduction fair, it is an extremely efficient way for the federal government to spur investment in communities. When an individual in the highest tax bracket donates $1,000 to charity, the government foregoes $350 in tax revenue. However, communities benefit from the entire $1,000 gift. The government is unlikely to find another vehicle that can leverage private spending for community services on a nearly 3-to-1 ratio.

Conclusion

Independent Sector champions the effort to put America on a sustainable fiscal path and spur economic growth. Our workforce is a powerful engine to fuel recovery. But as you consider alternatives, it is not enough to just consider the effects on government revenue and which taxpayers would owe more or less. It is imperative that the Committee understand the impact of any proposed alternatives on charitable giving, and reject any change that would result in decreased contributions to America's nonprofits.

Now is the time to *increase* charitable giving, not inhibit the incentives that have helped strengthen our communities since 1917. Otherwise, millions of individuals and families who depend on our services and programs will suffer.

Diana Aviv

Diana L. Aviv
President and CEO
Independent Sector

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[7] Source: IRS Statistics of Income data for 2008. Does not include bequests and estates.,

[8] "Online Giving Study: Donations Driven by Donor Experience, Year-End Gifts and Large-Scale Disasters." Network for Good and True Sense Marketing, Dec. 2010, reported in Philanthropy News Digest, Dec. 15, 2010.

[9] Households with annual income greater than $200,000 and/or personal wealth of at least $1,000,000.

[10] The 2010 Study of High Net Worth Philanthropy, Center on Philanthropy at Indiana University, November 2010

Testimony of William C. Daroff

Vice President for Public Policy &

Director of the Washington Office

The Jewish Federations of North America

United States Senate Committee on Finance

Tax Reform Options: Incentives for Charitable Giving

October 18, 2011

Summary: The Jewish Federations of North America urges the Senate Finance Committee to preserve the current incentives in the tax code which promote charitable giving in the United States. As one of the nation's largest philanthropic networks, we know first hand that tax incentives do result in increased charitable giving. Further, we urge the Committee to protect important charitable giving vehicles that operate in the current tax environment to foster continued philanthropic involvement of donors and their families and ask that such giving vehicles not be burdened with unnecessary regulation.

Background: The Jewish Federations of North America (herein referred to as "JFNA") is the national organization that represents and serves 157 Jewish Federations, their affiliated Jewish community foundations and 300 independent Jewish communities in more than 800 cities and towns across North America. In their communities, the Jewish Federations and Network volunteers (collectively, the "JFNA System") are the umbrella Jewish fundraising organizations and the central planning and coordinating bodies for an extensive network of Jewish health, education and social services. Thus, the JFNA System represents over one thousand affiliated agencies and serves several million individuals throughout the country.

JFNA conducts an annual fundraising campaign that collectively raises almost $1 billion system-wide each year from over 400,000 donors. In addition, the endowment departments of Federations or their affiliated Jewish community foundations raise in excess of another $1 billion each year through charitable vehicles including donor-advised funds, supporting organizations, (together referred to a "participatory funds"), which support one or more specified public charities or programs through an active grant-making program, as well as maintaining charitable income plans. The combined endowment assets of the JFNA system is in excess of $14 billion and annual endowment grants from the participatory funds and other endowment assets is approximately $1.5 billion. Grants are almost evenly split between Jewish organizations and those of the general charitable sector. As discussed below, the IRA charitable rollover is another relatively recent incentive added to the income tax code which has materially increasing giving to Federations throughout the country.

The Federal income tax system has included tax incentives for charities and donors for almost 100 years. The principal tax advantage for charities is the exemption from taxation on net earnings related to their charitable purpose. Over the years, the charitable deduction for donors has been strengthened several times by raising the contribution limits and expanding the types of permissible charitable donees. However, Congress has also added several regulatory rules and requirements for certain types of donations in several recent pieces of tax legislation. We are exceptionally proud that agencies within the JFNA system employ the highest ethical standards of self-regulation in governance and operation and regularly share expertise with other charities and policy makers outside the Jewish community on a variety of charitable giving issues, especially as they pertain to participatory funds. We continue to work closely with officials at the Treasury Department and the Internal Revenue Service as they work to promulgate guidance on some of the provisions added to the tax code by the Pension Protection Act of 2006 ("the PPA of 2006") regarding donor advised funds and supporting organizations.

The Importance of Tax Incentives in the Tax Code: Similar to many other large national charities, the JFNA system has a sophisticated fund raising operation as well as highly-organized procedures for allocating such collected monies to fund a broad range of social service programs in their communities. Perhaps the primary mission of JFNA is to assist Federations as they inspire Jews to fulfill their religious duty to be charitable by securing the financial and human resources necessary to care for those in need, rescuing Jews in danger, and ensuring the continuity of the Jewish people. This critical fundraising task is essential to provide the strategic resources and direction to help local federations fulfill their individual and collective responsibilities to improve the world, build community, and foster Jewish renaissance. As noted above, the two key elements of such fundraising is a highly-recognized annual campaign supplemented by a sophisticated planned giving operation that utilizes a number of established and highly-regulated charitable giving vehicles.

Because the JFNA system is one of the largest philanthropic networks in the nation, our perspective on charitable giving and the importance of tax incentives is grounded on years of experience. Although our donor base is large, with over 400,000 donors per year, as noted above, we also recognize that the overwhelming percentage of dollars raised come from a relatively small percentage of donors. As a result of this so-called "90-10" or even "95-5" rule, in which the overwhelming percentage of dollars raised flows from a small, but tax-sophisticated donor group who make large gifts either through the annual campaign or most importantly, through the use of planned giving vehicles that are discussed below. In either case, it is this tax sophistication that permits such individuals to structure gifts so that the maximum amount of funds flow to the JFNA system and then to the supported agencies, charities and beneficiary individuals and that flow to such charities today, rather than later.

We will leave it to tax economists to debate the relative responsiveness of sophisticated donors to tax incentives and will not enter the debate over "economic efficiency" and "elasticity of demand" of charitable giving. However, we see the impact of economic and tax factors on charitable giving every day. At a time when our social service partners are being asked to meet increasing demands for services and government funding at the federal, state and local level is shrinking, we know that charitable incentives in the tax code are more important today than ever.

Importance of Other Charitable Vehicles: Over the past several decades, the JFNA system has been proud of the growth in charitable giving that has been generated through planned giving vehicles. Of special importance have been participatory funds, such as donor advised funds and supporting organizations, which are essential in creating a broad base of support for the Jewish community to fulfill its social services mission, especially in times of economic distress. Participatory funds offer an efficient and economical means for those with sufficient charitable assets to both benefit the community through on-going partnership with public charities such as Federations and have been an indispensible tool in encouraging intergenerational involvement in Jewish charity through family philanthropy. In addition to providing financial resources for critical human services in the local Jewish and general communities, these charitable vehicles also advance the values and goals of the JFNA System through:

- Nurturing relationships between Jewish philanthropists and Federation lay and professional leadership
- Building leadership and social capital in the Jewish community
- Establishing priorities that consider the future needs of the Jewish community
- Reinforcing the positive perception of the Federation as a philanthropic partner within the larger community
- Helping to build the Federation's unrestricted endowment fund

Such participatory vehicles provide a reliable pool of dollars to fund a variety of social service activities, in particular support of a Federation's annual campaign, which remains the top fundraising priority of Federations. Permitting, indeed encouraging, participatory funds to exist for extended periods provide greater opportunities for sponsoring organizations such as Jewish Federations and related foundations to continue to build a collaborative philanthropic relationship with the donor and the donor's family. One of the greatest strengths of the JFNA System lies in its unique ability to match donor's interests with funding needs in the Jewish community. Because donor advised funds can continue for an extended period of time, including the lifetime of the donor and spouse, heirs and additional successors, this relationship continues to grow over time and succeeding generations of Jewish community leaders can be fostered. This provides the JFNA System with a valuable tool to educate future generations of donors so that they can become effective funders in the future. As the Committee continues to consider tax reform options in general, and charitable giving incentives in particular, JFNA urges that growth in participatory vehicles be allowed to flourish and be left with a minimum of regulatory burdens. We further believe that the regulatory regime established by the PPA of 2006 provides such a robust framework.

Another important charitable giving incentive, the IRA charitable rollover, was added to the tax code by the PPA of 2006 and has been extended by Congress in the years following such enactment. The current version of the IRA charitable rollover, ***which expires on December 31, 2011***, permits individuals at age 70 ½ to make tax-free charitable gifts of up to $100,000 directly from their individual retirement account to eligible charities. Amounts rolled over are not taken into income by the IRA owner and are not eligible for a charitable contribution deduction. However, such rollovers qualify as an annual required minimum distribution from the owner's IRA. The existing IRA charitable rollover has been an overwhelming success for the charitable sector in general, and the JFNA system in particular. The IRA charitable rollover helps charities provide needed social services at a time when there is both an increased demand and fewer resources available from government sources. In a relatively short period of time, Jewish federations have received more than $30 million in contributions from IRA charitable rollovers, through targeted campaigns, such as one to attract rollover gifts from grandparents to help fund Jewish day schools. The resulting charitable rollover gifts have enabled federations to accelerate capital campaigns to finance new construction projects, expand existing social services programs, among other worthwhile projects. In addition, many donors have taken advantage of the IRA rollover provision to fund an endowment for their annual federation campaign gift. Several large Federations received rollover contributions in excess of $1 million again in 2010 and are beginning another targeted campaign for IRA rollover dollars as we approach year-end. JFNA recommends that, at a minimum, the current IRA charitable rollover be made a permanent part of the Federal tax code.

JFNA applauds the Senate Finance Committee for its deliberative process and several-year long study of the many issues which need to be considered in contemplating fundamental tax reform. As it pertains to charitable giving incentives, we remind the Committee that any proposals that could result in a decrease in private giving will have significant negative consequences for America's charities, including JFNA. For example, current proposals submitted by the Administration over the past three years to limit the value of itemized deductions to 28 percent, including the charitable contribution deduction, represent a serious threat to charities that remain at the forefront of the fight to feed the hungry, cloth the naked, and heal the sick. JFNA remains committed to ensuring that federal tax policies continue to encourage private philanthropy.

I thank the committee for the opportunity to present this testimony. If you have any questions regarding this submission, please feel free to contact William C. Daroff, Vice President for Public Policy and Director of the Washington Office at 202-736-5868 or william.daroff@jewishfederations.org or Steven Woolf, senior tax policy counsel at 202-736-5863 or steven.woolf@jewishfederations.org

League
of American
Orchestras

Written Statement: Senate Finance Committee Hearing
Tax Reform Options: Incentives for Charitable Giving
October 18, 2011

Jesse Rosen, President and CEO, League of American Orchestras
33 West 60th Street, Fifth Floor, New York, NY 10023

The League of American Orchestras urges the committee to support the vital work of nonprofit organizations in communities nationwide by preserving the tax deduction for gifts to charitable organizations. Private contributions are a critical source of support that enables orchestras to broaden public access to the arts, nurture cultural diversity, spur the creation of new artistic works, and foster a sense of cultural and historic pride, all while supporting countless jobs in communities nationwide.

The League of American Orchestras leads, supports, and champions America's orchestras and the vitality of the music they perform. Its diverse membership of nearly 900 orchestras across North America runs the gamut from world-renowned symphonies to community groups, from summer festivals to student and youth ensembles. The only national organization dedicated solely to the orchestral experience, the League is a nexus of knowledge and innovation, advocacy, and leadership advancement for managers, musicians, volunteers, and boards. Founded in 1942 and chartered by Congress in 1962, the League links a national network of thousands of instrumentalists, conductors, managers, board members, volunteers, and business partners.

Orchestras are tax-exempt organizations and are part of the nation's nonprofit charitable sector working to improve the quality of life in communities nationwide. Orchestral activity is supported by an important combination of public volunteerism, private philanthropy, and civic support that is made possible by virtue of tax exempt status. Ticket sales and admission fees alone do not come close to subsidizing the artistic presentations, educational offerings, and community-based programming of nonprofit arts organizations. In fact, total private contributions represent roughly 40% of the revenue that makes the work of U.S. orchestras possible. Contributions from individuals and individual family foundations account for 19.4% of total revenue to nonprofit orchestras in the United States. At a time when all forms of revenue – earned, philanthropic, and governmental – are extremely challenged, many nonprofit cultural organizations are simply unable to withstand decreasing support from individual donors. We urge the Committee to take the following into consideration as it considers any measures to change the tax incentive for charitable giving:

The public would suffer the loss of vital nonprofit programs: Unlike other tax deductions, the charitable deduction does not increase the wealth of individual donors, it is an investment in the public good. Should individual donations decline, the capacity of nonprofit performing arts organizations to provide educational programs and widely accessible artistic events, and to boost the civic health of communities and the artistic vitality of our country, would be diminished at a time when the services of all nonprofits are most in demand.

Reducing incentives for charitable giving would harm nonprofit jobs: Nonprofit jobs account for 1 in 10 members of the U.S. workforce. The jobs of many artists and administrators working in the nation's nonprofit performing arts community would be imperiled by declines in charitable giving. American orchestras alone employ thousands of professional musicians, administrators, educators, and stage personnel in cities and towns across the country.

Major policy changes could have long-term negative impacts: Researchers and scholars continue to investigate how any of the myriad possible changes to the tax structure under consideration might impact giving to nonprofit organizations. Congress must protect against any unintended consequences that might result from rapid adoption of changes to a system that has provided a base of support for nonprofit endeavors for decades. Any hasty changes to deductibility in the interest of short-term revenue gain could have lasting unintended consequences for nonprofit services and jobs.

Orchestras are important contributors to the American civic life, and charitable giving to orchestras substantially improves the civic health, education, and artistic vitality of communities nationwide. More than 60% of the 32,000 concerts given annually by League member orchestras are specifically dedicated to education or community engagement, for a wide range of young and adult audiences. Orchestras partner with other arts organizations and community-based nonprofits to serve specific community needs, such as the thirteen orchestras across the country that are combining instrumental instruction with social justice programs in disadvantaged neighborhoods, partnering in every instance with community-based organizations. And, orchestras nurture the creative endeavors of contemporary classical musicians, composers, and conductors. All of the following endeavors are made possible with support from individual contributions:

The **Boise Philharmonic**, a 70-member professional orchestra with an administrative staff of 9 employees, is Idaho's largest and oldest performing arts organization. The orchestra maintains a vast array of educational programs, including classes for young children, a Family Concert series, annual *Children's Concerts* with full symphony orchestra performing for 15,000 school children in 9 free performances, *Musicians in the Schools*, *Ensembles in the Schools*, *Conductor in the Schools* and the *Jeker Eagle Schools* music project. The Boise Philharmonic has presented *Classic Collaborations*, a series of concerts accompanied by related educational activities. Each concert in the series integrated symphonic music with vocal music, theater, or dance along with participating area opera, theater, and dance companies, embodying the collective strength of arts disciplines coming together.

Private support to the **Boston Youth Symphony Orchestras** (BYSO) is 53% of total revenue and directly funds a total of 118 jobs (16 full-time with benefits and 102 part-time). These employees are artists, teachers, and professional arts administrators. The BYSO enriches the lives of youth and serves surrounding communities by providing 450 children ages 6-18 with high quality arts programming. These children come from Boston, over 120 communities and all 6 New England states. Public concert programs attract attendance by more than 10,000 individuals. Contributed revenue is the only source of support for the BYSO's outreach program which provides all services free of charge.

The **New World Symphony**, a 23-year old orchestral academy whose 750 graduates now perform in over 176 orchestras across the country, is also committed to serving America's youth. In addition to connecting musicians and artists around the globe, the orchestra provides instruction and mentoring to schools by making its performances available to school systems across South Florida. The *Musician Professional Development Program* offers performances, coaching, and community outreach activities as a means to prepare more than 80 gifted young musicians each year for musical leadership positions in the orchestral field. These young musicians have the opportunity to experience music at multiple levels of engagement and leverage the skills of highly trained coaches to develop their own professional careers in music.

At the **Kalamazoo Symphony Orchestra**, vital private support represents 59% of total revenue, and individual giving is the lifeblood of the organization. Through public concert programs, including free summer concerts, the Kalamazoo Symphony Orchestra reaches more than 20,000 people per year and the orchestra's education programs last year reached 40,000 children. The education initiatives, which serve not just Kalamazoo but the entire Southwest Michigan region, are almost exclusively free of charge to the schools and the students, and donations are the only source of their support. Along with Youth Concerts, the orchestra provides in-depth preparation materials, linked to state and national standards, which many music teachers use as the backbone of their lesson plans for the year. The level of service provided to the educational community is profound and is supported nearly entirely by private donations. And, those education programs and donations also have an impact on employment. Contributions to support the recent expansion of education programs resulted in an Artist-in-Residence program, which added 10 full-time positions to the orchestra as well as 1.5 full time equivalent positions on the administrative staff. These are jobs with benefits that exist exclusively as the result of private donations, and all of the orchestra's jobs (a total of 17 full-time and 65 part-time positions, between administrative and artistic staff) would not exist without substantial private support.

Utah Symphony | Utah Opera (USUO) regularly provides high-quality musical programs to over 820 organizations in Utah and surrounding states. Of these 820 cultural partners, nearly 675 are educational institutions statewide that have received USUO performances, classes, public programs, tours and resources. Community partnerships extend to community-based organizations, senior groups, and libraries. The Utah Symphony | Utah Opera performs for more than 155,000 students and 7,000 teachers each year, in Abravanel Hall, Capitol Theatre, and in schools throughout the state.

With 10 full-time staff and approximately 70 part-time musicians, the **Albany Symphony Orchestra** is keeping living American composers at the center of its mission. The production of the orchestra's *American Music Festival* nurtures and supports the work of living composers like Joan Tower, Zhou Long, and Michael Daugherty. Festivals such as this one are essential to assuring that orchestral music remains a part of the American cultural experience and that opportunities can be presented to composers to have their works shared.

The **New Jersey Symphony Orchestra's** (NJSO) mission states, "We commit with equal passion to artistic excellence and engagement with our communities." Over 30,000 students and families are served annually through a diverse array of high-quality comprehensive education programs and performances, including the Greater Newark Youth Orchestras which serve underfunded Abbott districts, and the Early Strings program in Newark, through which the NJSO annually brings Suzuki violin instruction to 600 second through fourth graders in the Newark Public Schools. NJSO offers 12 different concert series in seven outstanding venues throughout New Jersey, bringing live symphonic music to more than 150,000 people each year. The NJSO counts on 56% of its operating revenue from contributed income.

Orchestras extend their reach beyond their immediate cities and towns, bringing unique musical experiences to communities that would not otherwise be able to enjoy them. The **Bremerton Symphony Orchestra** employs 11 full-time and part-time staff, and with 120 volunteer orchestra and chorale members, is presenting an "Inspiring Virtuosity" concert with violinist Marié Rossano. In addition to the concert itself, the orchestra will help make the concert accessible to the Hispanic and Tribal populations of the Kitsap Peninsula as well as low income families of Bremerton. Individual contributions are a vital part of the support system that enables orchestras to showcase our society's rich array of cultures and to engage and connect with the diverse audiences around them.

In addition to widening access to our country's cultural diversity, orchestras aid in the remembrance of key moments in our American history. To commemorate the 10th anniversary of September 11th, the **New York Philharmonic** commissioned a new work, "One Sweet Morning," by American composer John Corigliano. The orchestra, which employs 192 full-time and 353 part-time or seasonal staff, along with 190 volunteers, presents this poignant artistic perspective, incorporating texts on war and peace by American lyricist E.Y. "Yip" Harburg, Lithuanian-American poet Czeslow Milosz, the Ancient Greek poet Homer, and Tang Dynasty poet Li Po. Millions of Americans attended memorial orchestral concerts in venues ranging from large concert halls to tiny village squares in the unforgettable days and weeks following the horrific events of September 11, 2001. Some were staged specifically for the moment, like the National Day of Prayer and Remembrance at Washington National Cathedral, while others were adaptations of previously scheduled performances. In all cases, orchestras, their musicians and their music became a source of strength and pride, as well as a vehicle for community unification and reflection.

The United States relies upon the nonprofit community to provide many public services in fields ranging from education and health care to arts and culture. America's nonprofit arts organizations promote access to the arts, are important participants in education for children and adults, and support jobs and economic growth. Thank you for this opportunity to express the value of individual contributions to the communities served by orchestras across the nation. The orchestras profiled in this statement represent just a fraction of the artistic activity, civic engagement, and creative workforce supported by the more than 1,800 orchestras across the country. On behalf of the full range of American orchestras, I urge the committee to preserve tax incentives for charitable giving.

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October 17, 2011

Senate Committee on Finance
Attn: Editorial and Document Section
Rm. SD-219
Dirksen Senate Office Bldg.
Washington, DC 20510-6200

Statement for hearing:
Tax Reform Options: Incentives for Charitable Giving
Tuesday, October 18, 2011
Dirksen Senate Office Building, Room 215

I respectfully entreat the committee to safeguard tax deductions for charitable gifts to all not-for-profit entities, including colleges and universities and their foundations.

There may be a tendency to think of universities as elite, wealthy, and able to attract large gifts. However, across the nation, there are many universities like Montana State University Billings that have neither a wealthy alumni base nor connections with large corporations to provide major gifts.

Montana State Billings serves working class folks who want to improve their lives through higher education. If they succeed, the lives of their families, communities, and, indeed, the life and economic health of our entire nation, will also improve. For these students and prospective students, the cost of a university education, even at a state school like MSU Billings, can be prohibitive. Our students are hard workers:

- 82% have jobs and most work more than 30 hours a week;
- More than 60% receive need-based financial aid;
- Half are non-traditional college age, many of whom have families to support;
- 60% are female, many of whom are single moms.

Student need is rising dramatically. Last year, 63% of MSU Billings FAFSA-filing students were Pell eligible; 56% of those had a zero expected family contribution, which reflects acute financial need. Three years ago, those numbers were 49% and 47%, respectively.

Between 2001 and 2006, the Montana State University Billings Foundation raised $8.5 million in scholarship support (immediate and endowed) as part of a $30 million comprehensive campaign. We are now in the midst of a $6 million scholarship campaign to help financially challenged students and have raised $4.5 million to date. There is no doubt that donors to these efforts consider the effect of charitable tax deductions.

Getting a tax break is not the primary reason donors support MSU Billings. They support us because they believe in the potential of the students we serve and the transformative power of higher education. But charitable tax deductions are a serious consideration when these generous folks decide how much they will or can contribute.

Our students need these donors. Please maintain federal tax deductions for charitable gifts.

Marilynn Miller, President & CEO
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NORTHWEST
KIDNEYCENTERS

October 27, 2011

United States Senate Committee on Finance
"Tax Reform Options: Incentives for Charitable Giving"
Tuesday, October 18, 2011, 10:00AM

Statement for the Record
Joyce Jackson, President and CEO
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Chairman Baucus, Ranking Member Hatch and Members of the Committee, thank you for allowing Northwest Kidney Centers (NKC) to provide a Statement for the Record on the "Tax Reform Options: Incentives for Charitable Giving" hearing held on October 18, 2011. As a non-profit dialysis provider, the issue of charitable giving is of great importance to Northwest Kidney Centers.

Northwest Kidney Centers is a dialysis provider based in the Puget Sound region of Washington State. We were founded in 1962 as the world's first out-of-hospital dialysis program. Today, we are one of the largest community-based non-profit dialysis providers in the United States and the largest one in Washington State. NKC provides care to approximately 25 percent of the state's dialysis patients in 14 centers and 11 hospitals in King and Clallam counties.

While we understand that Congress and this Committee must make difficult decisions with regard to deficit reduction and tax reform, NKC strongly opposes any changes to reduce the value of the tax deduction for charitable giving. Currently, the federal tax code allows individuals who itemize their taxes to deduct charitable contributions at a percentage that is equal to the individual's tax rate. While the individual gains no economic benefit from the donation, they do not pay taxes on the income they give to charity. Such tax incentives are a fair and important motivation for charitable giving.

A number of proposals have been offered to limit the federal income tax deduction for charitable giving. President Obama has proposed to limit the value of all itemized deductions at 28 percent for individuals earning more than $200,000 a year and households earning more than $250,000. The National Commission on Fiscal Responsibility and Reform, which issued its final report in December 2010, suggested that itemized deductions for charitable contributions be eliminated and replaced by a 12 percent tax credit for all taxpayers who give above 2 percent of their adjusted gross income. Northwest Kidney Centers does not support any of these proposals.

Charitable donations provide vital funding for NKC's mission, services to our patients and community benefits. We actively seek private, corporate and public support from individuals, companies and foundations. In the 2011 budget year, NKC received $2 million in charitable donations. This represents about 2 percent of our total budget. We use these donations to provide:

- Charity care, including medications for transplant patients;
- Emergency grants for patients in crisis – in FY10 NKC gave 271 grants;
- Educational scholarships for patients so they can return to work with treatment or post transplant;
- Information and classes for pre-dialysis patients to help prepare them to select treatment options;
- Research – in 2008 we established the Kidney Research Institute as a collaboration between Northwest Kidney Centers and the University of Washington; and
- Training of kidney physicians.

In addition, we believe education is an essential part of our mission and, therefore, we allocate donations toward public health education about kidney disease and organ donation. Northwest Kidney Centers participates in 60 outreach events each year, reaching more than 12,000 people with kidney information. Our "Living Well with CKD" program offers classes on treatment options and good nutrition for nearly 1,000 pre-dialysis patients and family members each year, at no cost to the participants. And since 2003, we have hosted an annual Kidney Health Fest for African American families to educate and screen participants.

Proposals to cut or cap itemized deductions would have long-lasting negative consequences for Northwest Kidney Centers and all the charitable organizations that millions of Americans rely on for help and assistance. According to the Association of Healthcare Philanthropy, if significant changes are made to limit tax incentives on charitable giving, the health care philanthropic sector alone could see more than a $1.07 billion reduction in charitable contributions. More importantly, it will hurt those in the lowest income brackets that rely heavily on charities for services. Now more than ever – in these difficult economic times – charities are bridging the gap by serving those in need, as budgetary constraints prevent state and federal governments from providing similar services.

We take pride in being a community-based non-profit dialysis provider that provides patients with more than just dialysis treatments. As we prepare to celebrate our 50th anniversary in 2012, Northwest Kidney Centers looks forward to providing charity care, scholarships, pre-dialysis services, education, training and research to our patients and community for many more years to come.

Sincerely,

Joyce F. Jackson

Joyce F. Jackson
President and CEO

FOR YOUTH DEVELOPMENT
FOR HEALTHY LIVING
FOR SOCIAL RESPONSIBILITY

STATEMENT FOR THE RECORD
AUDREY TAYSE HAYNES
YMCA OF THE USA
SENIOR VICE PRESIDENT AND CHIEF GOVERNMENT AFFAIRS OFFICER
SENATE FINANCE COMMITTEE HEARING
"TAX REFORM OPTIONS: INCENTIVES FOR CHARITABLE GIVING"
OCTOBER 18, 2011

Chairman Baucus, Ranking Member Hatch, and distinguished Members of the Committee, thank you for the opportunity to share with you the views of the YMCA of the USA as the Committee reviews alternatives to the tax treatment of charitable giving.

The YMCA of the USA is the national resource office for the 2,700 YMCAs in the U.S. The nation's YMCAs engage 21 million men, women and children - of all ages, incomes and backgrounds - with a focus on strengthening communities in youth development, healthy living, and social responsibility. YMCAs are led by volunteer boards and depend upon the generosity and dedication of their 550,000 volunteers for support and strategic guidance in meeting the needs of their communities.

We urge you to oppose any changes to the charitable deduction. The charitable deduction is a powerful incentive for giving. Unlike other tax incentives, the charitable deduction encourages behavior for which taxpayers receive no personal tangible benefit. This deduction is a means of enriching communities rather than the individual taxpayer.

It has been estimated that annual giving would drop by 25 to 36 percent if the deduction were eliminated and the current proposed cap could cost charities as much as $7 billion a year in contributions. Since 2008 charitable giving has declined by $25 billion, as a result of the difficult economy. In addition, federal and state budget cuts are overburdening many nonprofits.

In 2009, YMCA's across the country received approximately $191 million in annual campaign donations, much of which was individual donations. There is no doubt that capping or reducing the charitable deduction will reduce donations and diminish the capacity of nonprofits, including the Y's, to serve those most in need.

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The charitable deduction encourages people to give to charities. More than 80 percent of the 46 million people who itemized their taxes in 2009 claimed the charitable deduction. In addition, more than 22 percent of all donations, between 2003 and 2009, were made on December 30 and 31, which again demonstrates the deduction's positive influence on giving.

Even those taxpayers who do not claim the deduction support it. A Gallup Poll in 2011 found that 62 percent of these Americans support it's preservation as an incentive to give. It has broad support because it is seen as a fair way to encourage giving to a broad range of charities and nonprofits.

Reducing the value of the charitable deduction for taxpayers earning over $200,000 will greatly diminish the effectiveness of services among charities and nonprofits and hurt both the organizations and the people they serve.

The YMCA of the USA understands the need to reduce the deficit. However, changing the charitable deduction so as to decrease giving would harm the millions of families who depend on YMCAs and other nonprofits across the country.

Thank you for your consideration.

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