

ENCOURAGING CHARITABLE GIVING

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

—————
MARCH 14, 2001
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ENCOURAGING CHARITABLE GIVING

WEDNESDAY, MARCH 14, 2001

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

The hearing was convened, pursuant to notice, at 10:00 a.m., in room 215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Also present: Senators Snowe, Kyl, and Baucus.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. I am going to call the hearing to order.

Normally, I would give a statement and Senator Baucus would give a statement. But, because of the pending votes coming at 10:45, I am going to put my statement in the record. If anybody wants to know what I said—and very few people do—it is at the table. [Laughter.]

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

If Senator Baucus comes, I will let Senator Baucus give his remarks if he wants to. But I am going to pass mine out, because I want to make sure that each of the committee members have had a chance to hear all of the witnesses.

So without an introduction of Senator Lugar, other than to say Senator Lugar is chairman of the Senate Agriculture Committee, and very humanitarian-minded. The legislation he is going to talk with us about today falls into that category.

I know in past Congresses I have supported your efforts, and I assume it is similar this time. But we are willing to take your testimony at this point to raise this issue of charitable giving, and using the Tax Code to encourage charitable giving.*

Would you proceed, Senator Lugar? Oh, wait a minute for Senator Baucus?

Senator BAUCUS. I am fine.

The CHAIRMAN. Are you all right?

Senator BAUCUS. I do not want to impede the progress here.

The CHAIRMAN. I passed up giving my opening statement, because I thought we could get all the witnesses in before the vote. But if you want to make yours——

* For more information on this subject, *see also*, "Description and Analysis of Present Law and Proposals to Expand Federal Tax Incentives for Charitable Giving," Joint Committee on Taxation staff report (JCX-13-01), March 13, 2001.

Senator BAUCUS. No, let's proceed. I'll submit my statement for the record.

The CHAIRMAN. All right.

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

The CHAIRMAN. Go ahead, Senator Lugar.

**STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR
FROM INDIANA**

Senator LUGAR. Thank you very much, Senator Grassley and Senator Baucus. It is an honor to appear before you this morning.

I am pleased to be here to describe important legislation that will help to fill the shelves of our Nation's food banks.

I became involved with this effort more than a year ago after visiting and talking with many food bank volunteers in my home State of Indiana. I am confident legislation is an effective approach to addressing hunger in America through our existing network of food banks, church pantries, and soup kitchens.

In January, Senator Leahy and I introduced S. 37, the Good Samaritan Hunger Relief Tax Incentive Act. Today in the House of Representatives, Congressman Tony Hall and Richard Baker are expected to introduce companion legislation.

This bipartisan bill will provide important tax incentives for our Nation's farmers, restaurant owners, and corporations to donate food to hunger relief organizations.

The demand on our Nation's pantries, soup kitchens, and shelters continues to rise. According to an August 2000 report on Hunger Security by the U.S. Department of Agriculture, 31 million Americans—over 10 percent of our citizens—are living in food-insecure households in which family members go hungry at times throughout the year because of insufficient money for food. Although this number has declined by 12 percent since 1995, everyone agrees this figure remains far too high.

One segment of our population, families with incomes between 50 and 130 percent of the poverty level, actually experienced an increase in the numbers of households that were food insecure.

This study confirms what food banks on the front lines have been telling us. While families are transitioning from welfare to work, many remain vulnerable to hunger and are using food banks to supplement their nutritional needs.

Unfortunately, food banks cannot meet this increased demand for food. A December 2000 study by the U.S. Conference of Mayors found that requests for emergency food assistance increased by an average of 17 percent in American cities over the previous year, and that 13 percent of emergency food requests went unmet.

The U.S. Department of Agriculture estimates that up to 96 billion pounds of food are wasted each year in the United States. Redirecting just a small portion of this wasted food to charities would go a long way in our fight against hunger.

In many ways, the current tax law is a hindrance to food donations. The Tax Code provides corporations with a special deduction for donations to food banks, but it excludes farmers, ranchers, and restaurant owners from donating food using the same tax incen-

tive. For many of these businesses, it is actually more cost effective to throw away food than to donate it to charity.

S. 37, the Good Samaritan Hunger Relief Tax Incentive Act, would realign the economies of donating food by extending the special deduction to all business taxpayers, including the self-employed, and by increasing this deduction to the fair market value of the donation.

The hunger relief community believes these changes will markedly increase food donations, whether it is a farmer donating his crop, a restaurant owner contributing excess meals, or a food manufacturing concern producing specifically for charity.

One Hoosier food bank, Second Helpings of Indianapolis, estimates the legislation would cause an additional 400,000 pounds of food to be donated to its coffers.

This bipartisan legislation currently enjoys 14 Senate co-sponsors and has been endorsed by a diverse set of organizations, including America's Second Harvest Food Banks, the Salvation Army, the American Farm Bureau, the National Farmers Union, the National Restaurant Association, and the Grocery Manufacturers of America.

Chairman Grassley recently introduced S. 312, the Tax Empowerment and Relief for Farmers and Fisherman Act. This bill contains several important provisions aimed at providing relief for farmers and ranchers, including the creation of tax-deferred farm accounts, income averaging clarifications, and self-employment tax relief for farmers. I am pleased that a version of our Good Samaritan Hunger Relief Act was also included as a part of that important legislation.

Last year, our bill passed the Senate as part of an agricultural tax amendment offered by Chairman Grassley to H.R. 8, the Death Tax Elimination Act. Although it was ultimately stripped from the underlying legislation, I believe the vote indicates strong support for the legislation in the Senate.

I am hopeful that, when this committee begins to draft tax legislation in the coming months, it will favorably consider and include the Good Samaritan Relief Tax Incentive Act in that legislation.

I thank you, Mr. Chairman and Senator Baucus, for this opportunity to offer this testimony.

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

The CHAIRMAN. Thank you, Senator Lugar.

Do you have any questions of Senator Lugar? I do not.

Senator BAUCUS. I do not have any questions, Mr. Chairman. But I do want to thank you very much, Senator, for pushing this legislation. It is identical to legislation I introduced, too. I only say that, because I think you are on the right track. It is clear that the current tax law is an impediment to giving food in this situation.

In fact, it reminds me of the point that I think is generally irrefutable, namely, the reason for hunger in America, or worldwide, is not the lack of food. It is politics, or laws, or structures, or bureaucracies that get in the way. There is enough food for people, there are just too many impediments to get the food to the people who need it.

Your legislation is a big help to get the food, to Americans anyway, that is surplus, to the people who really need it. I thank you very much for your legislation.

The CHAIRMAN. I believe I am right, too, that the rationale, do we do this for corporations, this would do it for individuals and self-employed people, and small businesses that are not incorporated.

Senator LUGAR. That is correct. Right.

The CHAIRMAN. It is a matter as much of parity as it is just to do it.

Senator LUGAR. Yes.

The CHAIRMAN. Some people are doing it. They are getting a tax break for doing it. Others that would do it, would not get that tax break.

Senator LUGAR. That is correct, sir. Many apple farmers, for instance, at the end of the season just bring their apples in to the food bank without thought of deduction, and have been doing it for years.

But, in a more systematic way with restaurants, the problem of the economics I expressed is that the cost of disposing of the food is less than the packaging, transportation, whatever it takes to get it to the food banks. This is why some consideration is required to move this from the waste category to something that is productive.

Senator BAUCUS. Basically, it is not only to extend the breadth of those covered, but also provide a greater deduction, too.

Senator LUGAR. That is correct. The cost of doing so.

Senator BAUCUS. Yes. Thank you.

The CHAIRMAN. Thank you, Senator Lugar, very much.

Senator LUGAR. Thank you.

Senator BAUCUS. Thank you.

The CHAIRMAN. Will you put the signs up, please, so that people will be seated according to the way that I will introduce them?

Would you all come now as I introduce you? Do not wait for your name to be mentioned.

In our second panel, we will have the first witness being Reverend Floyd Flake, pastor of Cathedral of the Allen Episcopal Methodist Church, Jamaica, New York. He is also a former colleague of ours, being a member of the House of Representatives.

He will be testifying on President Bush's faith-based and community initiatives, and will give us a broad overview of the President's initiatives beyond just the tax aspects so that the committee can better understand the context of the President's tax proposals.

Following Reverend Flake, will be Douglas O'Brien, director of Public Policy and Research for American's Second Harvest, the food bank network.

Mr. O'Brien will be speaking to us today regarding the Good Samaritan Hunger Relief Tax Incentive Act that we have just heard about from Senator Lugar, then also the Tax Empowerment and Relief for Farmers and Fishermen Act that also has been introduced by Senator Baucus and me.

Next, we have a friend of mine, Mary Sue Coleman, the president of the University of Iowa. President Coleman is here today representing the American Council on Education, the Association of American Universities, and she will be speaking about the proposal

to make it easier for people to donate funds from individual retirement accounts for charity.

Next, we have Gene Steuerle, who has testified before my Aging Committee many times, and we welcome him back in this capacity in my chairmanship of the Finance Committee now.

He is senior fellow at The Urban Institute here in Washington. He also writes the column, "Economic Perspective" for Tax Notes magazine. Dr. Steuerle will give the committee a useful overview of the President's proposal for charitable giving, as well as providing the committee additional suggestions on encouraging such giving.

After Dr. Steuerle, we have John Walters. Mr. Walters is president of Philanthropy Roundtable, and will be discussing the future trends of charitable giving and the proposals before the committee regarding charitable giving.

Our final witness, Donald Alexander, also a friend, former Commissioner of the IRS. It is all right to have an IRS Commissioner as a friend. He, of course, has the thankless task of telling us today about some of the drawbacks of the administration's proposal. Obviously, from his background, he is well-qualified to do that.

I think that we need to make sure that the administration, being a new administration, and maybe suggesting things that can always, in our process of thoroughly considering legislation, have a view from the outside as well, and people of experience.

We are going to do it in the way that I introduced you. So, Reverend Flake, would you proceed?

I think we are going to be able to get you all in for your testimony before we go to vote. Then we will have to work out how we will ask questions. Hopefully, that will be possible.

Reverend Flake?

STATEMENT OF THE REVEREND FLOYD FLAKE, MINISTER AND FORMER CONGRESSMAN, ALLEN EPISCOPAL METHODIST CHURCH, JAMAICA, NY

Reverend FLAKE. Thank you very much. Good morning, Mr. Chairman and members of the Senate Finance Committee. It is good to be back on the Hill and see some colleagues that I have served with in the House here, and to have this opportunity to testify on what I consider to be a topic of significant importance to persons like myself who have been involved in community development, as well as the delivery of faith-based services.

I think this initiative is an important one and one that should be given full support, in large measure, because the average community development organization or faith-based institution does not have the necessary wherewithal to provide for the number of services that have been required of it over the last several years.

As a pastor over the last 25 years at the same church, including the 11 years that I served here in the House, one of the things I have taken note of is that many of these blighted communities, communities that are in stages of deterioration, are in large measure that way because there are not enough resources available to address the many problems that are a part of that community.

These problems are evident in the lack of educational access, infrastructure deterioration, high crime, which is on the decline but

was not on a decline before it destroyed many of the areas of community development.

Also, areas like domestic violence, which is ever increasing, home care for senior citizens, and providing housing for individuals who need extended living care. Under the Older Americans Act, my church has provided the Section 202 programs.

But now, with a growing frail elderly population, there are not enough resources. Therefore, the necessity for legislation that will allow for an increase in the resources that are made available to community organizations is an essential.

I tend to believe that there should not be an impediments, or barriers, based on religion, but rather deal with the reality that many of these groups see themselves involved in the mission of delivering these services and have a compassionate view and approach to dealing with real-life problems of people on an everyday basis.

As such, they are able to bring the services directly to the places where people are. There are trust relationships that are already established, and people do not feel as if government bureaucracy will ultimately remove the program from them just as they come to the point of need.

Charitable choice is a great idea. It is great because persons realize that, if they make contributions in areas where they have the greatest amount of concern, those dollars are going to be used in that community and allow institutions to purchase some of the deteriorated properties, put those properties back on the marketplace and on the tax rolls, while at the same time providing the arena in which they operate to deliver a much larger sphere of services than they currently can do.

Many of these organizations have good will, good intentions, a good purpose and focus. They just do not have the capacity to perform the task.

By expanding charitable choice and allowing individuals to give, and institutions to give, knowing that those dollars will, in fact, allow for tax deductions, will allow for those non-project and faith based institutions to do a much greater job.

I do not believe that government, in and of itself, can do the job sufficiently. But government, in partnership with faith-based institutions and nonprofit entities, has the capability to get the job done.

I would caution that if charitable choice is expanded, it is necessary to do some capacity analysis to assure that the organizations that receive the funds have the capability to deliver on whatever promises they make.

My suggestion, is that the historical means by which government has used to fund faith-based and community organizations in the past also be a part of that process in the future. That would include *capacity analysis*, which is capable through the traditional request for proposal processes.

Those processes should not be abandoned, but rather should be expanded in such ways that there is certainty that programs are not used for proselytizing, but, in fact, for the purposes for which government has intended them.

Second, I would suggest that there be a *technical assistance* component because many of the programs have persons who feel that, because of their big-heartedness, they should not be required to fulfill certain functions in terms of their reporting to government.

I believe that it is in the best interests, both of government and of those institutions, that technical assistance through seminars and workshops teaching them proper accounting, and bookkeeping, so that there is not co-mingling of funds which puts the church in jeopardy.

Lastly, I would argue for the necessary fire walls created by the traditional 501(c)(3) nonprofit corporate structure which allows for a separation of those funds and those entities, from the books of religious institutions and organizations.

As one of the largest social services providers in New York City, with 11 corporations functioning under the church, we have about 825 employees, with a \$29 million budget, of which \$9 million comes from tithes and offerings.

We could not meet the needs of that community, affordable housing that we build; senior citizens' housing; education, and the various programs we offer without creating partnerships between government and the faith-based sector.

I believe the faith based sector should be expanded. Persons who give in the collection plate, or directly to these organizations, should be given the opportunity to know that through charitable choice, they will be eligible for a tax deduction.

Let us reward the labor of love of those who feel a sense of calling to fulfill their purpose by functioning within these communities that have the greatest needs.

I believe that it is possible for us, through this faith based-charitable choice initiative, to address many of the problems that have long been ignored. Many of the problems that government has not been able to address these organizations can do so in a very compassionate, understanding way, meeting the needs of a people who have the greatest needs in our society, and thus create a much stronger America because, by reaching out to the communities in which these people reside, we will be able to strengthen not only the individuals, but strengthen the communities themselves.

As these neighborhoods are strengthened, properties will go back into the marketplace and pay taxes. Individuals will make even greater contributions, and we will become the great Nation and the great democracy that I think our forefathers intended.

With that, I reserve the remainder of my comments and will be open for questions. Thank you.

Or, as we said in the House, I revise and extend.

[The prepared statement of Reverend Flake appears in the appendix.]

The CHAIRMAN. And we do not have to say that, because we do not have limit on debate in the Senate.

Let me suggest to all of you, just in case you have a longer statement than the 5 minutes we have given you, for everybody, without your asking, your statement will be put in the record, as submitted.

Then also let me say, because I do not know how this hearing is going to end up, there may be a lot of questions that will have to be submitted to you for answer in writing.

If you do get such questions, we would like to have, in two weeks, if you could send those back to us, please. If you have never been through that process, Senator Baucus's and my staff will be glad to help you go through that process.

Now I go to Mr. O'Brien.

Reverend FLAKE. Mr. Chairman, before you go to him, I would seek your permission. I will have to go to The Brookings in a few minutes. So, if I leave, it is not out of disrespect, it is merely to participate in another panel.

The CHAIRMAN. I have at least one question I would like to ask you. If I have others, then I will do that in writing.

Reverend FLAKE. I appreciate that, sir.

The CHAIRMAN. I am going to use as background the fact that we have concerns about the President's programs on the issue of separation of church and State. There is nothing wrong with those issues being raised, because we have got to respect the constitution.

But some people who have raised these concerns must be oblivious to the fact that we have given money to religious-based service organizations before the President's suggestion, and it is simply not something new.

One example. We have had both Catholic, Protestant, and Jewish organizations assist resettlement of refugees. That is just one example. It has been a very successful program. I have never heard one criticism that that violated separation of church and State, or that any of the money was misused for religious reasons, in contravention of the constitution.

Giving several examples I could give you, do you believe that it should be possible to craft a program that addresses the concerns that we have heard about the program and still allows the goals of the President's initiatives to be realized? Is it necessary to have such a long delay in going forth with the President's initiatives?

Reverend FLAKE. I think it is absolutely possible to do so. I do not think that it is necessary for the delay. As you correctly state, the government is already involved in partnerships with a number of organizations, particularly in the area of housing, and in many other programs. Many of the Older Americans Act programs for senior citizens, for instance, are delivered through faith-based entities.

I think the difference, is that there must be an understanding of how you protect the interests of the church or institution and protect the interests of the other entities that are responsible for the delivery of that service.

As I stated in the testimony, it is critical that we make sure that there are fire walls to protect that interest. Some of that can be done through the RFP process. Some of it certainly can be done by assuring that there are appropriate 501(c)(3) corporations for the delivery of those services.

I have done this over the last 25 years with about \$20 million that we operate on in government funds. Those government funds are isolated for the purposes for which the government intends them, and they are specific to the particular needs for which the funding mechanisms are in place.

We do not really have to rebuild anything. We already have the process in place. This should be viewed as an expansion of what is already existing within the Federal sphere.

The CHAIRMAN. Senator Baucus, then Senator Kyl.

Senator BAUCUS. Go ahead.

The CHAIRMAN. All right.

Senator Kyl?

Senator KYL. I do not have any questions.

The CHAIRMAN. Thank you, Congressman, for being here.

Reverend FLAKE. Thank you very much for the opportunity. Thank you.

The CHAIRMAN. Thank you.

Now we will proceed with all five of you, unless somebody has got the same constraints. I would like to do all five of the remaining testimonies before we ask questions.

Mr. O'Brien?

STATEMENT OF DOUGLAS O'BRIEN, DIRECTOR OF PUBLIC POLICY & RESEARCH, AMERICA'S SECOND HARVEST, CHICAGO, IL

Mr. O'BRIEN. Thank you, Chairman Grassley, Ranking Member Baucus, and Senator Kyl.

My name is Doug O'Brien. I am the director of Public Policy & Research for America's Second Harvest, based in Chicago.

It is an honor to be here today to represent the views of our National network of food banks, food rescue organizations, and emergency food providers regarding tax laws to encourage charitable giving and to urge enactment of the Good Samaritan Hunger Relief Tax Incentive Act which Senator Lugar spoke so eloquently about earlier.

I would like to briefly begin by introducing America's Second Harvest to the committee. We are a 501(c)(3) organization. We are the Nation's largest private hunger relief charity, and one of the largest not-for-profit organizations in the country.

Ours is a national network of regional food banks and food rescue organizations, providing hunger relief and other services to 50,000 local private charities, operating more than 90,000 community food assistance programs.

Our network provides domestic hunger relief services in all 50 States, District of Columbia, and Puerto Rico. Some of the members of the committee may be familiar with our network affiliates in their own States and the District of Columbia.

I know Senator Grassley has visited the Food Bank of Iowa in Des Moines, and toured several others in his State. I am sure that Senator Baucus is familiar with the Montana Food Bank, with operations in Missoula and Miles City, which serves private hunger-related charities throughout his State. Here in the District, you may be familiar with our network affiliate, the Capital Area Food Bank, and its member agency, the DC Central Kitchen.

Those food banks and more than 200 other food banks and food rescue organizations that comprise America's Second Harvest provide more than 1.5 billion pounds of food and grocery products annually, with an estimated dollar value of more than \$2 billion, to

approximately 25.7 million low-income Americans, including 21 million Americans in emergency feeding sites.

Those emergency feeding sites include church food pantries, soup kitchens, congregate meal sites for the elderly poor, emergency shelters for the homeless, battered women, and other needy people seeking short-term emergency housing.

I might add, to corroborate with what Reverend Flake said, 70 percent of our emergency feeding programs are faith-based organizations, representing the broad spectrum of religious diversity in this country.

What our network and the tens of thousands of local hunger relief charities we serve have been experiencing in recent years has been a startling paradox of continued need despite a generally robust economy, low unemployment, and falling welfare and food stamp case loads.

For several years now, demand for emergency food assistance has been rising. In 1998, America's Second Harvest released independent national research on the charitable response to hunger.

What we found, was that 90 percent of the 21 million people we serve in emergency feeding sites had incomes at or below 150 percent of the poverty line, and better than 1 in 10 people we served have no income at all.

Children make up a substantial number of the emergency food recipients, representing nearly 38 percent of all emergency food clients. Another 16 percent, of emergency food recipients, were elderly Americans. Thirty-eight percent of the people served by our food banks include an adult in the household, who is working. Nearly half of those are employed full-time.

We also documented the pervasive presence of children and working single parents in soup kitchens where, in fact, 1 in 5 people in a soup kitchen line is now a child.

A compilation of published studies done on emergency food requests by Tufts University Center on Hunger and Poverty found a range of increased usage at charitable hunger relief sites from 14 percent as the low, to a high of 38 percent increase, as experienced by Catholic Charities, USA.

The most recent studies documenting increased demand at emergency feeding sites is the U.S. Conference of Mayors' report, which Senator Lugar alluded to earlier, which found a 17 percent increase in demand for emergency food, including one-third of adults requesting emergency food assistance who were employed.

Unfortunately, the growing demand for emergency food assistance has, in too many instances, outstripped food resources of local charities. Local hunger relief charities indicate that, between 115,000 and 800,000 low-income people were denied emergency food assistance because the charity they turned to at their moment of greatest need lacked adequate food to serve them.

Similarly, the U.S. Conference of Mayors reported that 13 percent of requests for emergency food assistance went unmet last year.

We estimate that our network would need to increase donations of food by nearly 100 percent to meet local hunger relief agency needs. In fact, our network alone experiences an annual shortfall of in-kind food donations of nearly one billion pounds.

The significant shortfall of food donations has led local hunger relief charities to turn away low-income people at the moment that they most greatly need us.

To address this shortfall, Senator Lugar has introduced the Good Samaritan Hunger Relief Tax Incentive Act. As he mentioned, it is a tax equity issue. It would expand the current special rule deduction allowed to regular corporations, to small businesses, restaurant owners, and farmers, and it would simplify the deduction formula for all business taxpayers. We believe very strongly in this legislation. We think it is a win-win for all parties, and we urge its enactment this year.

Thank you, Senator.

The CHAIRMAN. Thank you, Mr. O'Brien.

[The prepared statement of Mr. O'Brien appears in the appendix.]

The CHAIRMAN. Let me say, I learned a lot by going to that food bank in Des Moines about how the process works. It seemed to me very, very efficient, and particularly the use, as they do, of people from supermarkets, or retired people from supermarkets, to help them with their expertise of handling of food, and things.

President Coleman?

**STATEMENT OF MARY SUE COLEMAN, PRESIDENT,
UNIVERSITY OF IOWA, IOWA CITY, IA**

Ms. COLEMAN. Thank you, Senator Grassley and Senators Baucus, Kyl, and Snowe.

President Bush has proposed, as part of his overall tax plan, to allow tax-free charitable gifts from individual retirement accounts to encourage an outpouring of giving, the IRA Charitable Roll-Over Incentive Act, S. 205.

Today I am honored to represent the University of Iowa and others in the nonprofit sector whose programs and services would be strengthened by the proposal.

The University of Iowa is a comprehensive public research university providing higher education to 28,000 students. Our 11 colleges graduate 50 percent of Iowa's physicians, 80 percent of its dentists, 60 percent of its pharmacists, 50 percent of its baccalaureate nurses, K-12 teachers for all of its school districts, as well as a high percentage of the State's leaders and employers in business, industry, and other critical areas.

In addition, we provide a broad range of services to Iowans, including over 700,000 patient visits to our academic health centers and clinics.

State support is the foundation upon which all this is built, but I have to tell you that it provides only 21 percent of the university's \$1.5 billion budget. A critical part of the remainder comes through donations from loyal friends and alumni.

These funds provide support for facilities, equipment, student aid, recruitment and retention of outstanding faculty, and for centers and programs that would not otherwise be possible.

Our University of Iowa foundation, a private 501(c)(3) organization, is in the midst of its most ambitious, comprehensive campaign in its history. Major gifts lead the way and are well-recognized. Less well-known are the thousands of other gifts providing a much

broader base of support for the university. IRA funds represent a resource that could significantly enhance private support.

Prospective donors often ask our foundation about tax implications of donating their IRAs to become part of the university's future. Our advice is always to seek their own financial counsel appropriate to their own situations.

We know that tax implications are not the only motivations people have for private giving, but we also know that the Tax Code can influence the timing and amounts of giving.

Under current law, withdrawals from regular IRAs are fully taxable as ordinary income to the individual in the years they occur. A donor who withdraws regular IRA funds and uses those funds to support a charity is subject to tax on the entire amount, offset by varying extents of charitable deduction.

If an individual does not itemize on his or her income tax return, no charitable deduction can be taken. At the same time, current tax laws encourage individuals to liquidate their IRAs during their lifetime, since their estates will face confiscatory tax rates of up to 80 percent if their IRA funds are left to a dependent or family member other than their spouse.

Under current law, any amounts left in an IRA when an individual dies may be taxed as income to the beneficiary, and are also considered assets for the purpose of calculating an individual's estate tax liability.

Two University of Iowa current donors, one attorney and one physician, provide an example of the dilemma that many potential donors face. Both people are professionals and long-time friends of the university. Both have given substantial gifts to the university. Both are interested in a final substantial gift to the university programs of special value.

Both have indicated that they have provided for their families and will not need their IRAs for retirement. However, the IRAs are the only asset left to them to make a gift of the magnitude that they would like. Both have indicated that they do not wish to make the contribution unless the current law is changed.

In contrast, given passage of the IRA Charitable Roll-Over Incentive Act, if IRA funds were rolled over to a charity as an outright gift they would be excluded from the donor's calculation of taxable income.

In addition, if IRA funds were rolled over to create a life income gift, the annual income payments from the gift would be subject to taxation. In both cases, the donor would not receive a charitable deduction unless after-tax dollars had been contributed to the IRA.

The proposed legislation is good public policy. Since other qualified retirement plans can now be rolled over into tax-free IRAs, this proposal would unlock substantial new resources for the support of charitable organizations and their public service missions.

To the extent that donors transfer IRA funds into life income gifts after 59-and-a-half rather than waiting until the required distributions at 70-and-a-half, this proposal may accelerate the collection of tax revenues, partially offsetting revenue losses.

Although IRA funds were originally intended as a supplement to retirement income, withdrawal is now allowed in order to assist financing a home or college education. It is equally appropriate for

public policy to allow financially successful individuals to use these assets to support charities that better the lives of others.

The future of the charitable sector and the public services it provides depends on securing financial resources to meet our pressing social needs. This proposal would allow individuals who have assets in excess of requirements for their retirement to make penalty-free donations of IRA funds to support the charitable sector and its public service mission.

Thank you for the opportunity to appear before you, and I am happy to answer any questions.

The CHAIRMAN. Thank you, President Coleman.

[The prepared statement of Ms. Coleman appears in the appendix.]

The CHAIRMAN. Now, Dr. Steuerle?

**STATEMENT OF DR. C. EUGENE STEUERLE, SENIOR FELLOW,
THE URBAN INSTITUTE, WASHINGTON, DC**

Dr. STEUERLE. Chairman Grassley, Senator Baucus, Senator Kyl, Senator Snowe, I am honored to appear before you again today.

It is said that charity does not begin in the home, it begins in the House. I think, today, we have the chance to prove that good charitable tax policy, at least, comes out of the Senate.

The CHAIRMAN. Among a lot of other things.

Dr. STEUERLE. You have asked me to focus on the President's proposals and possible amendments to them. I note that all these proposals, as well as the other proposals being discussed today, have as a primary purpose the further encouragement of charitable giving.

Therefore, I think a good test that can be used by this committee in considering various alternatives is how much these alternatives expand giving relative to the revenue cost involved.

In addition to commenting on the President's proposals, therefore, I will discuss some closely related proposals that I believe would be as effective, or even more effective, in enhancing charitable giving.

Now, President Bush has several proposals to encourage charitable giving. He would expand the charitable deduction to taxpayers who do not currently itemize on their tax returns.

Second, he supports legislation that would permit individuals over the age of 59 to contribute IRA funds directly to charities. This was discussed quite thoroughly by President Coleman.

He also suggests that corporations be permitted to deduct charitable donations until their value exceeds 15 percent of the company's taxable income instead of 10 percent, which is the rule today.

Finally, although not a tax provision but more of a welfare provision, he would like to encourage States to provide a credit against income or other taxes for contributions to charities that address poverty and its impact. States would be given flexibility to offset these costs using their TANF funds.

Let me quickly discuss how I would build upon these proposals. With respect to the non-itemized deduction, I believe it is crucial to adopt a floor, and that this floor be the same for itemizers and non-itemizers alike.

I go through my logic in the testimony, but I will give it to you very briefly here. First, I believe IRS cannot monitor well small amounts of contributions. This will lead this Congress, or perhaps some future Congress, to consider putting some floor under which contributions would be deductible before they would be allowed for non-itemizers.

Fortunately, when you put a floor under deductions, it actually increases giving relative to the amount of revenue cost involved. For instance, if someone normally gives away \$300, putting a floor of \$100 under that deduction really will not affect their giving very much because their incentive is really to give more than \$300, not to give less.

However, if you decide to put a floor under non-itemizers, then we have the next set of problems. That is, itemizers and non-itemizers would be subject to different floors. Itemizers do not have a floor. So, deductions would pop up in two different parts on the tax return, thus creating an extraordinary amount of confusion for the taxpayer.

Fortunately, a common floor for both itemizers and non-itemizers relieves and removes this complexity. It also would allow us, again, to encourage more giving per dollar of revenue cost, a constraint that I know this committee is going to be dealing with when it puts together a total bill.

Now, I must admit that a small floor under itemizers, by itself, could raise taxes for some taxpayers. However, given the fact that we are giving rate reductions and increases in child credits, I think in almost every case there would be no net tax increase. The advantage, in terms of better tax policy, I think would be substantial.

Although the President does not technically propose to remove charitable deductions from the phase-out of the itemized deductions, in fact, if you put on a common floor in the charitable deductions you could almost automatically remove this provision. I know this is an issue that is important to this committee, as well as to many members of the charitable sector.

That is, once we move the charitable deduction out of the itemizer deduction schedule, then it becomes quite easy not to subject these charitable contributions to this particular phase-out that is sort of a back-door tax rate increase in the current law. I encourage you to consider this as well as you examine these various deductions for itemizers and non-itemizers.

The President has also suggested allowing money to be paid directly out of IRA accounts without having to be declared, first, as income subject to tax and then deducted.

I, by myself, have suggested that lottery winners be given a similar provision, and be granted a brief period when they can give away as much as 100 percent of their winnings in this same manner.

This selective approach does raise some issues which the committee will have to deal with, such as whether to apply the same treatment to 401(k) and other plans.

I also support the President's suggestion to increase from 10 percent to 15 percent the allowance for corporate deductions.

I also encourage this committee to begin studies now on proposals to allow credits for organizations that serve the poor. A

number of details need to be worked out, including whether these types of provisions can actually increase aid to the poor, and whether these provisions really should be a tax rather than a spending proposal.

I also suggest amendments in my testimony, such as allowing deductions to be given up to April 15, or when the taxpayer files his or her tax return, just as we allow this for IRAs and KEOGH plans. I believe this would substantially increase giving relative to the amount of revenue loss.

I have other suggestions in my testimony, including trying to amend the foundation pay-out rate so that it does not encourage giving in a pro-cyclical manner, and removing or reducing the excise tax on foundations as a very significant way of increasing giving.

In summary, the tax system can be reformed in a variety of ways to meet fundamental principles of tax and budget policy.

I hope the committee will give these proposals substantial consideration, taking into account the revenue effect, the gains in giving relative to the amount of revenue involved, as well as issues of taxpayer compliance and enforcement for the IRS.

Thank you.

The CHAIRMAN. Thank you.

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

The CHAIRMAN. Now, Mr. Walters?

**STATEMENT OF JOHN P. WALTERS, THE PHILANTHROPY
ROUNDTABLE, WASHINGTON, DC**

Mr. WALTERS. Thank you, Mr. Chairman. Thank you for the opportunity to testify before the committee.

My work with donors has led me to be more involved with the future of giving, as well as current practice. So I have been asked to talk about what is coming down the road and talk about some of the more powerful trends that are likely to affect current activity, and the future.

As my testimony summarizes, I believe three principles are coming together now that are the most important in shaping current and future trends.

First, is a renewed faith in the operation of a free society and free economy, the confidence that we can bring, and should bring, all Americans into the plenty and freedom of our society.

We do not have to have separate categories of people that are going to be permanently supported in a different arrangement on the side, the effort to bring people into employment and participation fully in our institutions rather than having to support them in some dependent status, from people who are afflicted with addiction, to people with disabilities, to people who are poor, to people who have been in minority or ethnically segregated communities still in this country.

The second factor, has been a greater awareness of the importance of issues of character and individual responsibility in some of our most difficult to alleviate problems of social policy.

That is, the need to, as Martin Luther King said, focus on the content of our character and help individuals learn, habilitate, and

rehabilitate themselves to participate in society and not simply a matter of transferring wealth to those individuals as a sole way of alleviating their problems.

Finally, I believe the most profound factor is the historic prosperity of this Nation and what is going to come from that today and in the future.

In my work with donors, the two factors that most influence their decision making is the wealth at their disposal to give and the confidence that they have that what they are giving to is worthwhile.

The biggest single question I get from either institutions or individual donors is, is my gift making a difference? Is it going to be wasted? Is it going to be used bureaucratically? It is going to be used wrong-headedly?

That is where I think some of the proposals being talked about now and efforts to support groups that are community-based or faith-based are quite encouraging to many givers, because they are clearly not bureaucratic, they produce results that seem to be quite impressive in areas where many existing institutions have been limited in their result, whether you go from education, to addiction, to sheltering individuals in need.

Also, in my experience, and there may be others on this panel that disagree, the single biggest effect in the amount of giving is the wealth available here. Tax policy affects the timing of giving more than anything else, whether people give now or later. You can influence that.

Although, I believe the second most important factor that affects the Congress is regulatory matters, which will affect the effectiveness, mostly, of the giving and the institutions that receive money. A systematic effort to look at what that means in the future is important.

As I outlined on page 3 of my testimony, the amount of money projected to come into the charitable and philanthropic field in the next 20 to 50 years is going to be quite staggering.

These models are obviously imprecise, as a lot of these economic models are, but the so-called intergenerational transfer of wealth in the 20-year period that will end in 2018, in one study, is projected to be somewhere—depending on various models of growth rate—to be between \$12 trillion and \$18 trillion, with an estimated \$1.7 trillion to \$1.2 trillion going to charity.

Even more staggering, is over the 55-year period, 1998 to 2052, the amounts going to charity from an intergenerational transfer, estimated to be between \$41 trillion and \$136 trillion, is \$6 trillion to \$25 trillion.

The real question is, are we prepared to utilize these resources effectively rather than having them either directed to some other activity or stored in endowments and equities where they are not deployed?

The most important factor, I think, for that is accountability. As I said, people want to know that their contributions make a difference.

I believe that, despite the importance that regulation and tax oversight is, the basic accountability that is most effective here is

organizations being accountable to donors, to demonstrate that they can produce valuable results for the funds invested.

You have done, already, some important things with regulation in terms of transparency, with making available tax information more widely and more easily. Also, I think the issue has to be remembered that individuals are going to be the most important policing of effective activities, not only in donors of wealth, but donors of their time.

We have a flood of volunteers and we will have more of them as the population ages, as the cultural volunteering, I think, permeates our younger generation, admirably. These people are working in the institutions that have to make a difference, and they are an important resource in determining how much people give of their wealth and of themselves.

Thank you.

The CHAIRMAN. Thank you, Mr. Walter.

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

The CHAIRMAN. Now, Mr. Alexander?

Mr. ALEXANDER. Mr. Chairman, as I see it, you have about one minute before you have to go vote.

Senator BAUCUS. We do not know that for sure.

The CHAIRMAN. We do not know yet.

Mr. ALEXANDER. You do not know yet?

The CHAIRMAN. No. So proceed. We thought that was the case, but please go ahead.

Mr. ALEXANDER. Then I will take maybe two and a half minutes rather than the one minute I was prepared to take.

The CHAIRMAN. We are all right. We will have more than enough time now, I just found out, to hear you, and maybe even ask some questions.

Please proceed.

**STATEMENT OF DONALD C. ALEXANDER, FORMER IRS
COMMISSIONER, WASHINGTON, DC**

Mr. ALEXANDER. All right. Well, we will proceed rather quickly to questions because I have no intention of reading anything to you.

I am here to talk about the administration's proposal, which is sort of a repeat of what we had from 1981 to 1985, to add a new deduction, if you will, for charitable contributions to those that do not itemize.

They seem to be proposing this on a number of grounds. One is fairness. Also they say we are going to have an outpouring of giving if we provide this deduction. It is going to more than pay the \$76 billion that is the price that Joint Staff has put on it.

I want to agree with some things that Gene Steuerle said. But first I want to go to this issue of fairness. The arguments for this proposal seem to ignore the standard deduction.

Now, the standard deduction is \$7,350 in year 2000 for those filing a joint return, over \$4,000 for those filing individually. That is made up of a bunch of components, substitutes for itemized deductions, and one of those is the charitable contribution.

I do not know how big an element it is, but I know it is an element. So, there would be a doubling up if you are going to give someone a deduction for the first dollar given to charity, as well as the standard deduction.

This a doubling up should not be ignored. To the extent that people give more than they would otherwise give, fine. That is increased giving and new giving. But I wonder how much we would have much of that considering the make-up of those who do not itemize.

What do they give to? They give to their places of worship, they give to good charities like Second Harvest, they give to United Appeal, and they give to Red Cross. To the extent that you give them both the standard deduction and the new itemized deduction, you are giving them a double tax benefit for the same dollar.

I wonder how much of a great outpouring of giving we are actually going to have? I am very skeptical about some of the predictions that have been made, because the predictions seem to assume that there is no component in the standard deduction for charitable contributions now.

Second, as Gene Steuerle pointed out, if you are going to provide this new itemized deduction, how about providing a floor, for a couple of reasons? One goes to this basic fairness issue that I have talked about, that charitable contribution deductions are already taken into account to some extent in the standard deduction.

The other goes to IRS's efforts, if they make any, to try to administer this provision. Gene pointed out that it would be very difficult for IRS to monitor a whole series of small deductions. I agree with that completely. In fact, IRS is hardly auditing any individual taxpayers at this time and cannot be expected to do so in the next few years.

When we had this deduction in the law before, the Treasury was quite concerned about it, and in 1985 made it clear that it would be in the national interest, as the then-Treasury Department saw it, to remove this deduction from the law, instead, if you will, to expand the standard deduction, and instead try to lower rates all the way up and down.

That is the way to go, I think, Mr. Chairman. I would hope that you would decide, as you review this particular proposal, to think about whether it will pay for itself in increased contributions, to think about whether the IRS can administer it, and to think about the additional burden that will be put on taxpayers, 70 percent of whom do not itemize at this time.

To add at least one line to the 1040-EZ will add complications for the taxpayers, many of them—most of whom try to file honest, complete, and reasonable tax returns. Think about whether this is really worth it. I do not think it is, and I hope you do not adopt it.

The CHAIRMAN. Thank you all.

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

The CHAIRMAN. I will start my questioning and we will use 5-minute rounds. I hope that everybody will use the time in between votes to come back, because I think maybe we will find ourselves at the end of the votes, that maybe we will not be in session any

more. So, Senator Baucus and I will take turns chairing during that period of time.

President Coleman, Senator Baucus and I will have a provision—I do not know whether it is exactly what you are asking, but at least providing for roll-overs of IRAs in the legislation that we are soon going to be introducing—that is much more comprehensive than just that subject, but that is a very important part of it. So, I do not think you have to convince Senator Baucus or me of the value of that.

But I would like to ask if it is your sense that the number of people who would like to donate their IRAs to charities, assuming that we would change the law, has been growing in the past years. Do you think that there is some pent-up desire to make these charitable IRA gifts?

Ms. COLEMAN. In anticipation of this possible question, I talked with the planning giving officers at our foundation. What I found, was that we are facing a time in which we are really seeing the retirement and planning of a large bulk of people who graduated from the university maybe 20, 30, 40 years ago.

During that time, what they have discovered is, they have more than prepared for their retirement, so they do not need these funds for retirement. So we are increasingly getting the question: what about my IRA? Can I donate my IRA? Is there a way for me to do this?

I have been told that, right now, we have 13 or 15 people actively working, trying to see if this is possible for them. Indeed, this has been an increasing question, as these people have prepared themselves extremely well for the future and been successful in their careers.

The CHAIRMAN. That would be just for our university in Iowa?

Ms. COLEMAN. Only for the University of Iowa and our foundation. My sense is, in speaking with our foundation and what they are hearing from their colleagues, particularly in the Big 10 and in the AAU, but I assume that this would be the case in other universities besides the big research universities, are getting the same kind of questions because they have the same sorts of individuals in their donor pools right now.

The CHAIRMAN. Thank you, President Coleman.

Dr. Steuerle, I was going to ask this question to both you and Mr. Alexander. I think he just touched on it in his testimony.

I would like to have you comment on the idea of deductions for non-itemizers, your views on both a floor and a ceiling in terms of policy for encouraging charitable giving, and then also in regard to the compliance issue.

Dr. STEUERLE. Mr. Chairman, I think you have asked exactly the right question. The balance this committee has to deal with, is how much is this type of proposal going to increase charitable giving, and then on the opposite side, what is the effect going to be on enforcement and on revenue costs? Those are the items to be balanced: revenue, increase in charitable giving, and compliance issues, which my friend Don Alexander speaks so eloquently about.

I think one way to resolve this issue, if we really want to move towards a charitable contribution for all taxpayers, is to think about putting on a floor.

As I mentioned, the economics literature argues that the incentives one wants to provide are at the margin. This is the same argument, by the way, for rate reduction: that rate reduction, at the margin, is the place that you are most likely to affect work and other behavior.

Well, there is the same argument with respect to charitable giving: that if you can provide the incentive for additional giving, that is much more effective than providing an incentive for the first dollars, the dollars they would automatically give anyway—say, into the collection plate or something like that. You want to encourage additional giving. So a floor allows you to resolve, it seems to me, all of these issues at the same time.

You can cut back on your revenue costs, you can get more bang for the buck, more charitable contributions because your incentive is going to be more at the margin. And you can deal with most of the issues—I am not sure Don would agree with me entirely—with respect to the IRS by not really adding substantially to enforcement costs of IRS or to administrative burdens on taxpayers because you cut out the taxpayers who give very little or give below a floor.

Now, the opposite argument applies to a ceiling. A ceiling is one of the worst types of provisions to provide, because there you are cutting people off at the margins. So suppose you provide a ceiling of \$500 and somebody is already giving \$600.

Well, you are providing that person absolutely no incentive whatsoever for the giving above a \$500 deduction, when in fact they are already giving in excess of \$600. So, ceilings tend to be very bad policies for almost the same reasons that I gave for marginal incentives from the floor provisions.

Mr. WALTERS. Mr. Chairman?

The CHAIRMAN. Yes, Mr. Walters.

Mr. WALTERS. I do not want to take additional time, but can I make a slightly contrary point to that? I think that, first of all, some of the studies actually looking at diaries kept by individuals to see how much they give, those that are non-itemizers, show that we vastly underestimate how much people give, if you really look at individuals.

Second, I would like to argue that there is a broader picture here than the regulatory issue, which is recognizing the charitable contribution and the way that weaves into our civil society. We talk about rebuilding a lot of civic institutions and communities. But if you make this kind of change in the law, you actually give recognition to individuals who do not itemize in their giving.

You do give them an incentive, but ultimately what you do is you recognize that everybody gives, no matter what your level of income, which is true basically in this country, but it also gives additional recognition now.

If you want to get accountability in a lot of institutions, you want to tie people to those institutions and to recognize their giving. I think the regulatory issue, while it is not utterly unimportant, maybe ought not be central here.

It is a way of saying that we are a generous country. We can be a more generous country now, and everybody, even the average Joe who does not itemize, has a recognized, important contribution to

the giving and reciprocity that giving provides in the institutions that are supported.

Mr. ALEXANDER. Mr. Chairman, I would like to try to answer that point. I think it is a very interesting one. Also, to respond to your question which was directed at Gene Steuerle and at me.

I think the standard deduction is overlooked here. The standard deduction does recognize that people make charitable contributions. This charitable contribution deduction is included along with medical expenses, interest, taxes, in the substitute for itemized deductions, which is the standard deduction, which most people claim.

So there is not a failure to recognize that people make contributions. There is a recognition that people make contributions. Surely, they should, and it is in the national interest that they do.

As far as the floor and the ceiling is concerned, I think if you adopt this proposal, I agree with Gene Steuerle, there should be a floor. A ceiling does have the effect that Gene pointed out. A ceiling also has another effect, and that is, it reduces revenue cost.

We were talking about \$76 billion here in the President's proposal, without either a floor or a ceiling. A ceiling, as well as a floor, does reduce administrative burden. Whether that is significant or not, I will leave to the committee.

Senator BAUCUS. The Chairman had to leave right now for the vote, and he will come right back. We will try to keep this a fluid, seamless session here.

Following on that same line of questions, what should the floor be, for those of you who advocate a floor, to the charitable itemizer?

Mr. ALEXANDER. Do you want to go first, Gene? You are the economist.

Dr. STEUERLE. In the paper I did with Joe Cordes and John O'Hare we gave various alternative floors that you could consider and examine what the possible implications would be, both for charitable giving and for how many people would be affected. We would be glad to provide that information to the committee. I think we were generally thinking in terms of modest floors, perhaps a couple hundred dollars, or \$250.

You might want to provide a floor such that half of taxpayers, for instance, would still, under current giving regimes, be likely to take a deduction either as an itemizer or as a non-itemizer. So there would be an incentive for the other half to say, "We can move up beyond that floor and give as much as close to a majority of the population."

In effect, I would look at some number that did not add substantially to IRS cost. They now have to audit about 30 to 40 percent of taxpayers on charitable contributions.

I would not bump that up to 80 percent. I would look for some number that probably increased the number who were giving and for whom you provided a deduction, and then set the floor in such a way that other people would want to move up to that level.

Mr. ALEXANDER. I would recommend \$500, indexed in increments of at least \$50, for simplicity.

Senator BAUCUS. I do not understand how the floor would apply to those who take the standard deduction. Do they just write that in?

Mr. ALEXANDER. No. What you would have, is you would have that extra line on the 1040-A and the 1040-EZ, and you would have a line for a charitable contribution deduction in excess of whatever the floor was. Internal Revenue would have to explain that to everybody, and people would claim it.

A lot of them would claim it because they deserve it, a few would claim it when they do not deserve it. Internal Revenue would not check on those people because it would lack the resources, and some say the will, to do so.

Dr. STEUERLE. Senator Baucus, you can provide a much lower floor, by the way, if you provide a common floor for itemizers than non-itemizers. You are going to solve a lot of administrative errors, and you can provide a much lower floor because now some of the money that you give away to non-itemizers, you are going to collect little back from itemizers. You can really create a lot of simplification that way.

Mr. ALEXANDER. I do not agree with Gene on itemizers, because I think that the charitable contribution deduction for non-itemizers is reflected to an extent, perhaps a considerable extent, in the standard deduction.

The itemizers do not get the standard deduction, therefore, if you want to look at purely a matter of fairness between itemizers and non-itemizers, a floor for one is not necessarily a floor for the other.

Senator BAUCUS. Mr. Walters and Ms. Coleman, what are your thoughts on this discussion? That is, one, should there be a floor for the reasons suggested, and the other question is, what about the argument of fairness? It is sort of a double deduction.

We are not talking about additional deductions for those who take the standard deduction for, say, State and local taxes, or mortgage interest, and whatnot. So there are really two questions. One is the fairness question raised by Mr. Alexander, the other is perhaps, the floor to get that additional marginal bang for the buck. Mr. O'Brien, too. I would like you to respond to all of that.

Mr. WALTERS. I understand the rationale that Mr. Alexander is talking about. But I think if you try to say, is that the rationale most Americans understand is behind the Tax Code, it is not. You can say there are a lot of things factored in the standard deduction. Fine. But essentially, it is how much tax am I going to pay, what are my deductions? You can say, well, we have already factored in a certain amount of charitable giving.

What an additional proposal for non-itemizers would do in recognizing charitable giving would highlight charitable giving and encourage more charitable giving. It would give people more wealth, which is one of the, of course, preconditions of giving.

Second, I think what it does, is it says to people who may want to give to Ms. Coleman's university, look, I have been a small-time giver, \$50 to \$100 a year. I now get this deduction, without a floor, I am assuming the proposal on the table is, and I will give them more.

Senator BAUCUS. Ms. Coleman?

Ms. COLEMAN. I am not qualified to speak about the technicalities of this issue. But I will tell you, it is interesting for me as a university president to watch the evolution of somebody who gives.

They start small, then they realize that it feels really good to give, and then they give more because it feels good, not necessarily because of the tax implications. That comes into play when you have very complicated wealth and a lot of assets, but it does not come into play, I do not think, with a smaller giver.

So as a university, what we are interested in doing is getting people involved with the university, getting them into the habit of giving. They give small, start small, and then they tend to step up and step up when they realize what good they are doing.

Whether or not this change would have that effect, I do not know. I am just not qualified to speak about it. But I do know that there is a definite evolution in people over time.

Senator BAUCUS. Mr. O'Brien, your thoughts on this question?

Mr. O'BRIEN. Well, like Ms. Coleman, I do not feel qualified to speak about the specific issue, except to say that our National organization, our food banks, are heavily reliant on individual giving. The committee would explore this proposal of a floor, and if it would increase that, I think we would be very grateful.

Senator BAUCUS. All right. Thank you very much.

Now I would like to turn to Senator Snowe.

Senator SNOWE. Thank you, Mr. Chairman.

Mr. Alexander, given your experience formerly with the IRS, in the non-itemization issue for small contributors, was there a problem in the implementation of that provision prior to the changes that occurred in the 1986 Tax Reform Act?

Mr. ALEXANDER. Yes.

Senator SNOWE. There were, in terms of implementation, monitoring, compliance?

Mr. ALEXANDER. Yes. Now, I was not around at the tax shop then, but there were various proposals when I was working for the Service to allow the deduction to individuals of more and more items in addition to the standard deduction.

One particular deduction was to allow the cost of a garden tool, up to \$25, which presumably would be used to raise tomatoes in a window box, and you could eat the tomatoes and expense the \$25.

That one would have been totally impossible for the IRS to administer. Luckily, although it was adopted in the House, the Senate, in its wisdom, got rid of the garden tool. That is just one example of an overloaded Internal Revenue Code that almost defies compliance by the public and surely tests the ability of the Internal Revenue Service to administer.

The Internal Revenue Code has been called by the new Secretary of the Treasury, as you know, an abomination and a monstrosity. While I am not suggesting that this proposal before you would be enough to make it even more of a monstrosity than it may be now to the Secretary of the department who has to enforce it, I hope we do not stretch it any more. The Service is not administering the law very effectively at this time, despite the dedication and skill of Commissioner Rossotti.

Senator SNOWE. Would the purpose of expanding the standard deduction be as effective in addressing this issue, or does that get back into the issues of whether or not people are making a certain amount of charitable contributions?

Mr. ALEXANDER. As a former tax collector, I am hardly in a position to say that I know what the general public would do in response to various efforts to stimulate a particular productive or constructive activity by the public.

All I do know, is that I am very skeptical, having seen about 40 years of predictions supporting one proposal or another, about the ability of others to make such predictions, and about the validity of the predictions once made.

The predictions made for this proposal assume, among other things, that the charitable deduction is not reflected in the standard deduction. The predictions for this proposal talk about one more dollar, assuming, if you will, that the additional dollar is going to be deductible, not the dollar that was in the standard deduction, which people will continue to give.

I agree with President Coleman's views on this subject, and I wonder whether an effort to complicate the Internal Revenue Code even more by making life a little bit more difficult for the 70 percent that do not itemize is worth that cost, is worth the benefit that would be produced.

Dr. STEUERLE. Senator, can I respond?

Senator SNOWE. Yes.

Dr. STEUERLE. I think my friend Don Alexander is right, that one cannot make a fairness argument, that given the standard deduction, that non-itemizers are entitled to a charitable deduction.

By the same token, one can define the standard deduction to be a standard deduction for all the items other than charitable contributions. That is, we can define them as a standard deduction for medical, interest, State and local taxes, the State vets with the standard deduction.

We have a number of items that we treat separately from the standard deduction. For instance, we have an exclusion for payments into pension plans, and we have deferrals, and other things that take place separately from what we provide a standard deduction for.

There is no reason why Congress cannot provide a standard deduction for non-charitable items and decide that it wants to make more universal the charitable deduction.

Going that route, which I tend to favor, I then move towards Don's position in saying, if you move in that route, I still think you have to do it in a way that minimizes administrative and enforcement costs. So at that point, I am on his side.

But I do not think the standard deduction argument, one way or another, carries much weight either for or against the charitable deduction for non-itemizers, because you could set a standard deduction for all non-charitable items, and then that is no longer the issue on the table.

Senator SNOWE. One final question. President Bush has three proposals that would presumably have a significant impact on charitable contributions between the IRAs, the non-itemizers, and increasing corporate contributions on the cap.

Could you just quickly run through which one would have the greatest impact on charitable contributions, number one being the greatest impact?

Dr. STEUERLE. Are you asking me?

Senator SNOWE. Yes. We will start with you.

Dr. STEUERLE. Because it simplifies matters, I think, actually, the IRA provision would. I say this with some hesitation, because I think there are some really tough technical issues the committee is going to have to deal with that I raised more in my testimony than I did in my oral comments.

Things like, if you give it to IRAs, what are you going to do about 401(k)s, why not allow it for stock bonus plans, and so forth. I think there are issues that are raised there.

Nonetheless, I think it simplifies matters so much relative to trusts and other vehicles that people set up. People could just automatically give 10 percent out of their IRA receipts as a retiree, and stuff like that. It would be very simple to accomplish. I think, probably, that would give you the most bang for the buck.

That is also an area where you only lose revenues if people give more. So, if it does not work, you really do not lose revenue, if you understand what I am saying.

Similarly, my own proposal to allow deductions to April 15 works in the same way. I think it would really allow advertising to take place when people file their tax return.

So, I think the bang for the buck is extraordinary. If it does not work, you do not lose anything. If it does work, you only lose about 15 cents or 30 cents on the dollar relative to the dollar charitable contribution. That is very big.

Second, I would put, in terms of the President's proposal, is the non-itemized deduction if you put a floor on it. Again, I can only refer you to an attachment I made to my testimony trying to show you bang for buck under various alternatives. Without a floor, you give away a lot, without having an incentive. With a floor, I think you can give it substantially bang for buck.

The third one, the corporate deduction, I tend to favor. I think it is probably a good idea. I think there are other increases we could allow similarly, such as allowing individuals to give up to 50 percent of their income to foundations, if they have a separate foundation limit than they have now.

I think there is a lot of movement you could make along those lines to increase the limit that now impacts on people where they hit a cap. I think you could get some of them there.

The corporate portion of it may be, in some ways, the least important. The corporations have some ability to convert charitable deductions into business expenses. So for that reason I am not sure that, defined narrowly the way the President did, that has that big of an impact, although I tend to support it.

Senator SNOWE. I appreciate it. I would love to hear from all the rest of you on that issue. Maybe you could continue. I have to leave.

The CHAIRMAN. I will allow them to continue to answer your question in your absence.

Senator SNOWE. All right. Thank you, Mr. Chairman.

Ms. COLEMAN. Thank you.

Definitely, for the University of Iowa, what we are answering is the question about which of three would have the biggest impact, the IRA roll-over, the deduction for non-itemizers, and the corporate cap lift.

For us, definitely, the IRA roll-over would be the biggest impact right away, because we have many, many people who are in a position to make that kind of contribution. We would see that benefit immediately.

I just really do not know about what the impact would be for the non-itemizers. The corporate, I agree with Dr. Steuerle, that there are other ways for corporations to increase their giving to universities.

The CHAIRMAN. All right.

Other panelists? Proceed, Mr. Walters.

Mr. WALTERS. Yes. I would guess that, of those three—and I agree with Mr. Alexander. I have some skepticism of a lot of these economic models and projections because there are a lot of factors that go into them. They may be the best tools, but they are limited.

In the aggregate, probably the deduction for non-itemizers, then the IRA provision, and the corporate cap last, because it is probably not as big of an aggregate amount.

I would mention one other thing in this regard. The other controversial proposal that we have not talked about is the abolition of the estate tax. I do believe the aggregate information suggests, because of the influence it will have on wealth and because I think the best studies suggest that, at the high end, there is a greater willingness to give to charity as wealth increases, and the percentages go to heirs and other things diminish.

I know that is controversial, but that would also be a major factor in increasing giving, I believe. I know, again, that is controversial, increasing giving sooner, rather than later.

The CHAIRMAN. On a question that I want to ask, I am going to ask Mr. O'Brien. If anybody else wants to comment on it, you may. But I think it is more directed towards his approach in the bill that Senator Baucus and I introduced, which would give the tax deduction for the donation of food.

Is it your view that passage of this legislation will encourage greater giving of food? That is, that good, wholesome food that otherwise would rot or be thrown away would be donated to help the hungry?

Mr. O'BRIEN. Yes, Senator Grassley. Much of the discussion while you were voting was around the idea of providing these types of incentives. For a lot of businesses that do not have access, non-regular C corporations—that includes farmers, ranchers, fisherman, restaurant owners, franchise owners—there really is no incentive to donate. So what they often encumber is a business cost of donating, as opposed to giving and it is just easier to dump food.

The Montana food bank operates a cannery project. Potato farmers donate potatoes to that cannery project, but the cost of packaging, cleaning, and transporting the potatoes to the cannery, which then provides donated food throughout Senator Baucus's State, actually exceeds what they get through a charitable deduction in the current tax law.

So if we were able to change the tax law and provide an incentive, and solve this tax equity issue, allowing farmers, ranchers, and small business owners to have access to the same deduction that corporations get, I think that would provide enormous incentive to provide wholesome food that otherwise gets dumped.

The CHAIRMAN. Well, obviously it is these kinds of things that encourage charitable giving that otherwise maybe would not take place, most importantly, those targeted towards those most in need—and that would be the people you would be talking about—I believe makes this legislation very good, and the type of legislation that the committee should give particular attention to in its efforts to encourage charitable giving.

For anybody on the panel, not directed to any one of you. The administration is looking at providing a great increase in both public and, through tax expenditures, the private funding to charities.

It seems to me that with this support to charities, also comes responsibilities. I believe that the public must have confidence that charities, and also foundations, are fulfilling their stated goals and they are not abusing public trust.

What recommendations does the panel have as a whole, or ways of reporting, oversight, or other means that can ensure that good words of charity are matched by good deeds?

Mr. O'BRIEN. In the case of our food banks, Mr. Chairman, all conduct independent annual audits and submit form 990s to the IRS for review. Regarding in-kind donations, we are given food and we have to give food out. We utilize, throughout the network, more than one million volunteers that help provide hunger relief services.

So I think that, in our case, we would not be able to draw volunteers or a draw from the generosity of the business community if we were not able to substantiate to donors and volunteers the good work that we do.

I think that, in our case, because we do handle in-kind donations, which are quite different than the other discussions going on regarding cash donations, the compliance of our food banks is monitored by federal, State, and local health inspectors that review their activities, making sure food goes to low-income people, truly low-income people as opposed to just anyone that wants food assistance. So I think the current regulatory regime, largely administered by USDA and by State governments, is sufficient in our area.

Ms. COLEMAN. Certainly, Senator Grassley, we find that our donors are extremely interested in the results that come from their giving to the university. We make extensive reports to them on an annual basis about the results that have been achieved.

We are also audited annually, making sure that everything in our expenditures and our foundation are according to all the IRS codes, all the regulations. We also have a board of lay individuals who are directors of the foundation who sit and look at every single part of the activities that go on.

So, we have much oversight with the expenditures that are made out of the foundation. I am very comfortable that our donors are happy with what they are getting as a result of their donations, and that we are responsible for the expenditure of those funds.

Dr. STEUERLE. Senator, today we are lucky enough to have a confluence of charitable sector groups, researchers, States attorney generals, and private sector information firms who are all united in trying to encourage electronic filing. This may sound like a very narrow subject, but in fact it is an extraordinary opportunity. Given what Commissioner Alexander says, IRS does not monitor

the charitable sector very well. It is the public that, in the end, has to do the monitoring.

What electronic filing will allow to happen is that we will get the tax returns which are publicly available. They will be available electronically. They will be accessible to the public in a way that they are not accessible now.

The IRS and the States attorney generals will immediately be able to find out whether errors are on the returns. They do not follow though now. Half of all returns have some minor error. Perhaps the number is not quite that high, but it has been as much as one-half in the past.

We have an extraordinary opportunity to enhance the public's ability to monitor the sector and simplify if we can move towards electronic filing of these tax returns—which then become publicly available information that the public can use to try to monitor the sectors. Indeed, a unique opportunity.

In a tax bill it is perhaps not an issue, because it is an appropriations issue, but even a statement of intent that Congress favors this type of activity, I think, could be extraordinarily helpful.

Mr. WALTERS. I would like to second some of the points made earlier. But in general, the individual donor is the most scrupulous in holding the recipients accountable. In general—again, I say in general—the larger and more bureaucratic the contributor, the less scrupulous they are in holding the recipient accountable.

In fact, the Federal Government, in many programs, is a rather careless donor, which is why we are constantly looking at making programs more effective and trying to build in measures of accountability. I think the criteria has to be, will the charity perform the charitable mission that has been defined, and what is the evidence for that?

When you have to ask smaller and individual donors to take money out of their pocket or their small foundations as a family, they are quite scrupulous in asking for results and asking, what is the value of this investment?

The larger you get, the more difficult it is to monitor that and the more difficult it is all the way to the IRS, trying to audit every single charity and every single charitable donor, which is not a reasonable task.

So I think the extent to which you can use the natural policing power and accountability power of a broad base of individual donors, the better you will be. They will be more healthy in their contributions, they will come along as donors over time.

As they see value, they will give of themselves, they will encourage their friends to give if it works, and you will begin to understand this in terms of results more directly than you will in larger categorical or broad-gauge gifts, which become more difficult to track.

Mr. ALEXANDER. Mr. Chairman, I just want to add a little. I certainly agree with the initiative that Gene Steuerle mentioned. I think that is the way to go, electronic filing, and making information available to the States attorney generals, making information available to the public. Sunshine is still the greatest disinfectant. It certainly is here.

The IRS should do everything it can to encourage, not discourage, and speed up, not slow down, the availability of the information that is essential, to find out whether charities are fulfilling the obligations to the public. We have had some cases, highly publicized, of course, where charities have failed.

We had a problem with United Appeal some years back that has been corrected. We had a problem, a serious problem, with the Bishop Trust in Hawaii. That, I think, is being corrected. We need to make sure, to the extent we can, that charities do their jobs well and honestly.

The CHAIRMAN. Dr. Steuerle, I need to have you make a comment regarding the part of your testimony that dealt with the foundation pay-out rule, maybe explain a little bit more, but most importantly, what can be done to address the matter from the standpoint of your saying that the pay-out rule discourages foundation grant making when the economy is in a downturn, just when you would want to encourage the opposite, because that is when people of need need more charity.

Dr. STEUERLE. Mr. Chairman, there are actually two rules affecting foundations that are perverse in the way they encourage grant making. One is the way the current excise tax works. It actually penalizes a foundation if it gives more in a particular year. What happens when you give more is it establishes a base.

You pay a higher excise tax if you do not then give more than in your base years. It is the problem we used to have with the old research and development tax credit, if you will remember. So this excise tax actually works perversely to discourage giving and needs to be reformed.

The one you mentioned here is the pay-out rule. The pay-out rule is that foundations give approximately 5 percent of their average asset value during the year.

Now, in theory they have some carry-over and carry-back, but in practice most foundations—especially the larger foundations—stick pretty closely to that rule and try to give 5 percent of their asset value year-to-year.

So what has happened is, as the stock market has gone up in the last 10 years at a remarkable rate, the grant making of foundations has gone up in parallel, which everybody has liked.

Now all of a sudden there is a fear that this has been a bubble economy, and people expect that the stock market—stock values—are going to fall, and the economy is going to fall into a recession at the same time. What will actually happen is that grant making will fall at the very time you would want it to increase, which is when the economy is in a downturn.

I think this rule could be revised in a way that does not necessarily increase the requirement on foundations to give more over time and still pay an average of about 5 percent of that asset value, but you could base it on a much longer term trend in terms of market value, or at least give them the option to do that, so that their grant making would not be so pro-cyclical. That is, they would not be making grants that are highest when the economy is doing well, and lowest when the economy is in bad shape.

The CHAIRMAN. Dr. Steuerle, first, and then I think Mr. Alexander should comment on this as well. Explain your idea of allowing

an April 15 donation, like we do for KEOGHs. I do not know whether that is applicable to IRAs or not as well. Also, from the standpoint of tax policy, respond, Mr. Alexander.

Dr. STEUERLE. Senator, Don mentions the tax reform effort in 1984 and 1986. I was economic coordinator of the Treasury's tax reform effort, so I am very much of a tax reformer in the mode of Commissioner Alexander.

One thing that we decided then was we wanted to keep the charitable deduction. I am at the stage now where I think, if we are going to have something like this and we believe in it, we ought to make it effective.

If you look at a private firm, and you examine, "When do they market? When do they advertise what they are going to sell?"—they advertise when people are buying their goods & services. So you do not see an advertisement at the grocery store for purchases you are going to make 6 months from now, nor do you get a refund 8 months after you make a purchase.

We know enough about marketing and advertising to know you market when people are most intently involved in doing something. When are they most intently involved with their taxes? For most people, it is when they file their tax return.

So I think allowing charitable deductions as of April 15, or when you file your tax return, could be an extraordinary spur to giving. People would see the incentive immediately, they could save taxes on their tax return, they could even avoid some penalties if they just happen, by some minor, freak accident, slightly to have underpaid their estimated taxes. It would be an enormous spur, I think, to charitable giving.

The cost to the Congress, if I am wrong, would be almost zero because the cost is only a percent of however much giving goes up. So if giving goes up by \$1,000, it only costs the Congress \$150 in terms of the additional tax cost. So, to me, an April 15 rule is an extraordinary way to increase giving.

It does raise an issue about IRS compliance. Here, I have to admit that it could add to its compliance burden. I have suggested a variety of mechanisms to try to limit this effect. That is, we might only allow this particular provision for types of gifts where there is paper back-up, either a statement from the charity, or at least a check.

These are the forms of charitable giving that have the least error rates. It is the cash contributions that have the largest error rates. So we could even design this in a way that would not increase errors, but decrease errors, given the fact that it does add slightly to complexity.

Mr. ALEXANDER. Mr. Chairman, I would be concerned about that. Part of my concern is the slippery slope. If you allow a particular itemized deduction to be claimed for an action taken after the end of the calendar year that individual taxpayers report on, if you allow this one, how about the rest of them? Why not permit mortgage interest, which we consider to be strongly in the national interest to be able to deduct? How about all of the other deductions? Some of them, of course, are reported back to the taxpayer by the recipient.

Now, here we do have the recipients having to report to the taxpayers on a part, perhaps the major part, of the charitable contribution universe that Gene referred to.

That is, gifts of \$250 or more where, in order to claim the gift, you are supposed to have an acknowledgment from the charity that says that you did not receive any goods or services in return, or if you did, put a value on it.

What if someone preparing his or her return on April 15 discovered that, indeed, the tax was higher than that person would like? So that person immediately makes a charitable contribution deduction well and above \$250 to a charity, receiving the necessary document considerably later.

The erosion that we would have of the annual return requirement, I think, should be considered, as well as other effects on the administration of the Internal Revenue laws, and on the understanding of those laws by taxpayers and by preparers, most of whom are trying to do their level best to report their income completely and fairly, but some of whom have no such idea in mind. It is that latter some that, as a former tax collector, I would be worried about.

Now, I have great respect for Gene, and I am sure, as he mentioned, he has various safeguards here. I do not know what those safeguards are, but I would hope you would not go into this until you considered it very carefully.

The CHAIRMAN. I would like to ask you about the effect that an itemized deduction cut-back rule that we call the Pease limit, after Congressman Pease, that thought this up for the 1990 legislation.

One of the issues that has come up in the concept of marginal rate reductions is this back door rate hike effect that comes from the Pease rule. Do you think that the elimination of Pease-type phase-out of deductions would simplify and expand charitable giving?

I will start with Mr. Alexander, and anybody else who would comment on it. I would like to have your comment, obviously for this hearing, from the standpoint of, would that enhance charitable giving?

Mr. ALEXANDER. Yes, it would. The Pease idea was a lousy idea in the first place. It is a disguised rate increase. It is much better to handle it directly. The sophisticated individual, the high-income individual that does make substantial charitable contributions, knows full well that there is going to be a cut-back under the Pease rule, and knows full well that there is something called the Alternative Minimum Tax that reaches up and bites. It would be an excellent idea to get rid of Pease. It would be an even better idea, I think, to cut back, if not eliminate, the individual AMT.

The CHAIRMAN. It would simplify the tax?

Mr. ALEXANDER. Certainly it would simplify the individual's burden.

The CHAIRMAN. All right.

And the impact on giving, from any of the other panelists?

Dr. STEUERLE. Mr. Chairman, it would have a slight impact on giving, mainly for those people who get caught at the ultimate limit of 80 percent. But the general argument against Pease is transparency, the type of arguments that Commissioner Alexander al-

ready mentioned: simplicity, transparency, making explicit the rate structure itself.

Actually, there is a way reform will increase charitable giving, which might sound a little funny. The more we go into these back-door taxes, such as Pease, the more we do not allow deductions against them.

So people actually face two income taxes. They have a Pease tax, which is sort of an extra 1 percent tax on top of their regular rate. In effect people do not get the charitable deduction against that Pease tax.

If you take the Pease tax out, make it explicit in the rate structure, then charitable deductions would have a greater incentive because then those deductions would be allowed against that combined rate. They are not allowed against the Pease rate.

The CHAIRMAN. Any other person want to comment?

[No response.]

The CHAIRMAN. Then in closing for me—Senator Baucus has questions—this is something Senator Snowe started with. Rather than give a lot of background, she mentioned the three things that we are here to talk about as far as the President's proposal, but I think we have the benefit of your testimony and expertise in this area.

When it comes to the issue of the Tax Code and incentives for giving, is there anything else that has not been mentioned by any of you that you would like to put on the table for the consideration of this committee that would enhance charitable giving and the adjustment of the Tax Code to encourage that?

Dr. STEUERLE. Senator, the only one I did not mention in my response to Senator Snowe was, again, if you cut back on the excise tax on foundations, their grants would go up by exactly the amount that you cut back on the excise tax, so you would get a dollar-for-dollar bang for buck. I think that is very important.

Also, I would just clarify. Mr. Walters responded to Senator Snowe's question by saying, what would have the biggest impact in aggregate?

I do not disagree with him that probably the charitable deduction for non-itemizers, just because of its size, in aggregate would have the biggest impact. My response was more narrowly targeted to which provisions gave you the greatest bang for buck. Lowering that excise tax, I think, is very high as well in terms of bang for buck. I will not repeat my other comments that I made to Senator Snowe.

Mr. WALTERS. Yes, Senator. I did not say anything about the excise tax, but I think lifting the excise tax would increase giving.

On one other point about the pay-out, just two quick things. It is somewhat cyclical, as my colleague here mentioned, but keep in mind that many of these foundations are running a moving average. So, for example, now, even with the market going down, many of them are going to be increasing their pay-out, so it is not exactly in synch with the stock market.

Lastly, and I think more importantly on that, while the current pay-out requirement is followed by many large foundations, organized philanthropy, I think the single biggest factor is compelling

things for people to invest in. I also know many donors in many foundations that are paying out above the minimum pay-out rate.

But the real issue here is, what is the value of what I am investing in? That is what is important. It is not simply a Tax Code matter. It is partly a matter of—and I think what is most healthy about the current discussion is—let us look at what is making a difference for what we really have as remaining needs in this country, and let us make a case for that, and let us get out of the way of people who want to support those things honestly and straightforwardly.

On the deduction for non-itemizers, I take all the discussion here. But the fact is, most non-itemizers believe that people who itemize get credit for their charitable giving and they do not.

They give anyway, and they give more than, I think, has been given credit in the past, if you look at the most serious studies of that. But I do not think it hurts to recognize, and I take Mr. Alexander's comment, that this has been factored into a model, and everything else. Frankly, that may be true, but beside the point, in my view.

The CHAIRMAN. I will close with two comments for myself.

Number one, I brought up the Pease rule because it was put in 1990 as a temporary provision. It was made permanent in 1993. I feel, with the major tax surgery that might happen during this session—and it would not happen without the surplus and paying down some on the national debt, or in fact we are going to be able to pay down as much as is possible to pay down on the national debt—it is an opportunity for us to simplify the Tax Code.

It gives us an opportunity to take some of the Mickey Mouse out of the tax increases that were put into effect that people did not have guts enough to raise, marginal tax rates, as an transparent thing. So, that is why I brought that up and appreciate your opinion that it would have an impact on charitable giving, to encourage more.

Lastly, because I have to go over and manage the Bankruptcy Reform bill, I would like to thank you all for taking time to come.

I will turn the hearing over to Senator Baucus at this point for his adjournment when he decides it should be adjourned.

Senator BAUCUS. Thank you. Thank you, Mr. Chairman.

Mr. O'Brien, I wondered if you could just share with us and expand a bit more as to why, since welfare reform has been adopted, that more people who are otherwise eligible for food stamps are not taking them, and instead are going to food banks and soup kitchens. If you could just talk to us a little bit more about that and why that is happening.

Mr. O'BRIEN. Thank you, Senator. What we are finding, is that many low-income Americans in the transition from welfare to work are finding that they often have difficulty making ends meet in the type of service sector jobs they would typically be taking in that transition.

In addition, the food stamp program, has considerable administrative burdens for people to overcome to enroll in the program particularly for working poor families. It is not, therefore, surprising that our food banks and other organizations conducting re-

search in this area have shown that demand is greatest among working poor families.

We released a study last August that showed, for example, that the average application for the food stamp program is 12 pages long. In some States, it is 36 pages long. It is similar in many respects to what Mr. Alexander was talking about, with the complexity of the Tax Code.

Benefit levels are too low, for many working poor families, we would argue and that has a negative impact on participation. Administrative burdens and just general access to the program is not that great. So what happens, for many working poor families, is they find that while they are employed and still in need, the hassles of applying for the program are too great to justify participation.

For example, in your State, there are considerable distances between where you might live and where you might work, larger towns where there are jobs. If you have a vehicle with a value of more than \$4,650, you are generally not eligible to be in the food stamp program. Well, in Montana winters you need to have a reliable vehicle to get to and from work.

There are certain disincentives, quite frankly, in the food stamp program that we hope, during reauthorization, will be addressed to help enroll more needy people that should be in the program. Really, what we have witnessed since 1996 is really just a transfer of responsibility.

The Federal Government transferred a lot of responsibility that they had once held for providing food assistance to the poor to private charities like ours, and that is, in part, why we are seeing demand for emergency food outstripping our available resources and why we believe this tax change needs to be made.

Senator BAUCUS. Right. Could you expand a bit more on the demand outstripping supply anecdotally, or just give a little more flavor to that, please.

Mr. O'BRIEN. Yes, Senator. I think members like yourself that are familiar with the charitable response to hunger in their State will tell you that, the vast majority of food pantry operators or soup kitchen operators are people in a religious congregation, 70 percent, as I mentioned earlier.

They will go to enormous efforts to provide for the poor and stay open. It is a matter of faith that they will have those doors opened every morning. It is a terrible situation that they find themselves in when they have to tell someone, "no, I cannot feed you." That is a problem that is occurring far too often.

It is not just our network, which is estimating the turn-away annually is anywhere between 115,000 to 800,000 people nationally. The U.S. Conference of Mayors also found that, in cities surveyed, the turn-away rate was about 13 percent.

So what you are having, is requests for emergency food exceeding the amount of food that is made available. We need to have these incentives to donating.

While you were voting, Senator, I mentioned the cannery project in Montana. It is a fabulous project. But we are asking struggling farmers who themselves are having, a difficult time making ends

meet to encumber the cost of donating to needy people within their State without any tax benefit.

I think, again, the turn-away rate is something that is an enormous burden for us. We are in the business of feeding people at their moment of greatest need. To not have available food resources is a tragedy, both at a personal level, and I think at a national policy level.

Senator BAUCUS. How much do you think this legislation we are talking about here—Senator Lugar, Senator Grassley, myself, and others—will help address that excess demand over supply problem?

Mr. O'BRIEN. The provision that you and Senator Grassley have, have included in S. 312, the TERFF Act, has a cost of, I believe, of \$406 million over 3 years or 4 years. I think, that gives a sense of the level of donor activity over 3 years that we would anticipate seeing.

Further, as Senator Lugar mentioned in his remarks, USDA estimates that there are 96 billion pounds of food that is dumped each year, just wasted, that ends up in landfills. A significant portion of that, according to USDA, is wholesome, good food that could go to a local hunger relief charity.

If we were to redirect just 1 percent, or 960 million pounds of that wasted food, we would nearly double the food distribution of our entire network.

I think that is what we hope to do, at some point, be able to provide as much food as we can that is currently out there to provide to the indigent. We want to provide an incentive to farmers, ranchers, small businessmen, and restaurant owners which have a great deal of food available, to give them some incentive to donate to a local charity as opposed to dumping, and not make a bad business decision. If even 1 percent of the food loss could be donated that would be significant.

Senator BAUCUS. Well, we hope our bill helps. I know it will help. We hope it helps a lot.

Mr. O'BRIEN. Yes. Me, too.

Senator BAUCUS. Do you have any other suggestions on how we should modify it?

Mr. O'BRIEN. No, Senator. Actually, it is a very good bill. This is a bill that is widely supported. From major food manufacturers, all the way to the National Farmers Union, are in agreement, and the National Fisheries Institute, and the Seafood Processors all support this tax legislation.

You have the fisherman and their processors, you have the farmers and major food companies and national charities supporting this legislation. It is a win-win for small business, for food manufacturers, but most importantly for needy people who need help.

Senator BAUCUS. Well, I thank you very much.

I have one more question, probably treading into dangerous waters here.

Ms. Coleman, as a university president, and while we are on the subject of charitable giving, estate tax repeal. How much effect would that have on charitable giving, let us say, at your institution? Your experience, generally.

Ms. COLEMAN. I wish I could give you a definitive answer. The University of Iowa does not have an official position one way or the other on the repeal of the estate tax.

To tell you personally, in talking to our donors, I have heard both sides of the issue. I have heard some people say, no, I would give more if I did not have to face that estate tax.

I have heard others say, well, I do not want to make a decision to give because, if I am not going to have to pay the estate tax, I will pass it to my children. So this is very difficult. I do not know. We do not know. I think research on the issue is pretty sparse, and it is a big unknown. I wish I could be more definitive, but I cannot.

Senator BAUCUS. Dr. Steuerle, do you have a view on that?

Dr. STEUERLE. I can only tell you, there are a number of econometric studies, and all of them can be called into question. I am sure Mr. Walters mentioned this as well. I would say the average loss is estimated somewhere between 10 percent to 30 percent of the giving out of estates.

Giving out of estates, however, is only on the order of—I am trying to remember this—\$12 or \$14 billion. So you are talking maybe \$3 or \$4 billion in some of the worst cases, a couple billion in a couple of other cases, in terms of losses.

So the numbers in some sense, in terms of charitable giving, are relatively minor relative to some of the other issues that are on the table, such as the charitable deduction for income tax filers. One really does not want to decide estate tax just purely on the charitable issue.

I should say also, by the way, most of that loss is concentrated in estates of \$10 million or more. The vast majority of it is in the much larger estates.

So, no matter what you do with respect to the smaller estates, it would not have that much impact on charitable giving. As I say, there is a loss that tends to be concentrated more in the bigger estates, simply because they are the ones that tend to give away the most.

Senator BAUCUS. Mr. Walters, do you have a view?

Mr. WALTERS. Yes, I do. I may have mentioned this when you were out voting. I think that the two principles that seem to me most powerful in the studies here—and again, I stipulate that the studies are problematic in all these areas—is, one, the estate tax would increase the wealth of the people who receive the benefit, and that at the high end, especially, they give a higher percentage of their income to charity.

In addition, there are more recent studies. Professor Paul Schervish at Boston College, for example, has done some of the most recent work on trends among the very wealthy and the percentages that are going to heirs versus the percentages going to charity.

It is an issue of, how much is enough to give my heirs? I think there are some pretty hard-headed decisions being made in the aggregate, despite the politicization of this issue, and higher percentages going to charity.

I think it would also free up money now because, as I said in my testimony, I think if you look at it overall, tax policy influences timing, wealth influences amount giving. So if you remove that tax,

you give people greater wealth now and in the future, and they are likely to give more now.

I know it sounds ironic, since the estate tax is viewed as creating foundations and causing charitable giving. But, of course, foundations, as we have been discussing, the larger ones, lock up wealth in endowments and give very small amounts, give out the pay-out rate, according to some people's view.

So I think, one, you add the accountability of so-called inter vivos, or giving during life, of having to make decisions that I think are more hard-headed when you are the actual earner of the wealth, as it were.

Also, I think, frankly, the issue is now, we have a lot of pressing needs, education, health, care of the elderly, helping the disabled, helping the poor get into the mainstream. If we could properly make those investments now, the cost of the downstream problems that we are going to face would be much less.

So part of the issue I think that is more strategic and not regulatory is, how do we encourage people to give to effective activities now that will help to address these problems so that we do not have the kind of cycle of under class, the loss of people's productivity and creativity now.

Senator BAUCUS. That is a very interesting question, everything from Bill Gates and Warren Buffett who have a view on this, as you well know, to a lot of estate tax attorneys who have all kinds of views on this subject, too. Some I have talked to suggest that repeal would have an adverse effect on charitable giving, but there are different points of view on this.

I have no more questions. Thank you very much, all of you. This has been very constructive.

Mr. Alexander, I thank you for your help, especially, and also Dr. Steuerle, in giving us a little practical consideration about what we should do with these provisions.

Thank you very much. The hearing is adjourned.

[Whereupon, at 11:51 a.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF DONALD C. ALEXANDER

First, I should point out that I am appearing here today purely in my personal capacity as a former tax collector and a longtime tax practitioner.

Among President Bush's proposals is one "to encourage an outpouring of giving" by permitting individuals who do not itemize deductions to claim the Federal charitable contribution deduction. The new allowance would apparently be phased in ratably over five years and individuals would be permitted to claim the new deduction up to an amount equal to their standard deduction. Many in the nonprofit community strongly support this proposal.

We have tried this before (1981 through 1985), and I don't think it is a good idea from the standpoint of either tax policy or tax administration.

First, the argument that this change is needed as a matter of fairness between itemizers and nonitemizers must depend, at least in part, upon the supposition that the standard deduction does not include a reasonable component for charitable contributions. When he was Assistant Secretary of the Treasury, Ronald Pearlman responded to this:

In the [Reagan] Administration's view, . . . the zero bracket amount [the standard deduction equivalent] adequately serves as an allowance for a certain level of personal expenses, including charitable contributions. *Repeal of Charitable Contributions for Nonitemizers Explained*, 28 Tax Notes 1140 (1985).

Therefore, the proposal would introduce a new element of unfairness: doubling up on the part of those claiming both the new charitable contribution deduction and the standard deduction that includes a charitable contribution component. Since the proposal contains no floor amount, the first contributed dollar would be deductible even though taken into account already in the standard deduction. At the least, why shouldn't Congress reduce the revenue loss and duplication of deductions by restricting the additional deduction to an amount in excess of a base of at least several hundred dollars?

Would the proposal produce an "outpouring of giving?" Let's think about non-itemizers. Most individuals, of course, claim the standard deduction, which now stands at \$7,350.00 (years beginning in 2000) for joint return filers. Such individuals give largely to their places of worship and to local units of broad-based charities such as the Red Cross. While it is surely reasonable to believe that they would at least maintain, and might increase, their level of giving if this tax initiative were enacted, would they increase giving substantially enough to offset its cost? Suppose, for example, an additional \$100.00 contribution would then cost an individual only \$90.00 or even \$75.00—while some individuals would take this tax saving into account in their decisions to give more in the future than the past, how many would respond and how much more would they contribute? I understand that the evidence is mixed as to the presumably adverse effect of eliminating the charitable deduction for nonitemizers that was in the law in the mid-1980s. Also, I am growing increasingly skeptical of the advocacy pieces produced by large accounting firms to provide economic support for their clients' proposals. Accordingly, I think it highly doubtful that enactment of this proposal would result in additional giving to charity in an amount larger than its revenue cost.

Moreover, this proposal would clearly produce additional complexity for millions of individuals and for the Internal Revenue Service. Taxpayers who now file 1040EZ and 1040A returns would have to cope with additional lines and computations necessary to implement the proposal, and the Internal Revenue Service would not only have an additional duty for its taxpayer service component but would have substan-

tial increased burdens in processing the simple returns now filed by more than two-thirds of individual taxpayers. Also, the Service's examination resources—far inadequate now to give any reasonable assurance to compliant taxpayers that others will be called to account—would have to make some effort to keep certain unethical preparers and certain unethical taxpayers from using the proposal to double up standard deductions. The Service is simply not equipped to administer this provision. As the Treasury stated in 1985:

In addition, the allowance of a charitable contribution deduction for non-itemizers is administratively burdensome for the Internal Revenue Service and complicated for taxpayers. In particular, it is extremely difficult for the Internal Revenue Service to monitor deductions claimed for countless small donations to eligible charities; the expense of verification is out of proportion to the amounts of tax involved. Dishonest taxpayers are thus encouraged to believe that they can misrepresent their charitable contributions with impunity. Moreover, taxpayers who claim charitable contribution deductions are required to maintain records substantiating those contributions. In the case of smaller gifts, the effort required to comply with the necessary substantiation requirements may be out of proportion to the amounts involved. *Treasury Department Statement on Tax Reform Proposal II, Chapter 3* (May 30, 1985).

Accordingly, I recommend that the Committee should not accept this proposition. I will be glad to try to answer any questions that Committee Members may have.

RESPONSE TO A QUESTION FROM SENATOR TORRICELLI

Question. Do you think that taxing charitable donations of stock donated within one year of the date of exercise acts as a hindrance to increased charitable giving?

Answer. Yes. Charitable giving would be increased if the restrictions on donations of stock held for less than one year were lifted.

PREPARED STATEMENT OF HON. MAX BAUCUS

Mr. Chairman, today's hearing is about an important and timely topic—encouraging charitable giving.

This is an area where the members of this committee have worked hard together, over many years, to develop strategies that will foster continued growth in philanthropic behavior.

Americans are a generous people. We have a long tradition of supporting charitable causes and looking out for those less fortunate.

In 1999, Americans donated a record \$190 billion to charity. That is a 41 percent increase since 1995.

At the same time, we are hearing disturbing news that in some areas, private donations are falling far short of the need.

For example, there are reports that both individuals and companies are donating less to organizations that support the homeless, the young and the hungry.

Leading charitable organizations say that as a result, they are struggling with a surging demand for their aid, and that private donations they collect are falling far short of the need.

Today's hearing gives us an opportunity to consider trends in charitable giving, and also to consider how we might change tax policy to encourage more charitable giving.

Several proposals have been made. The President has proposed to allow a charitable deduction for people who don't otherwise itemize their taxes. He also has proposed to allow charitable contributions from IRAs.

These and other proposals deserve careful review.

I also hope that we can focus on a small but important change that the Chairman and I have proposed as part of our farm tax incentive bill.

Let me give a little background.

A national study reveals some troubling statistics. The study shows that children make up a substantial number of emergency food recipients, representing nearly 38 percent of all emergency food-clients.

When we think of soup kitchens, our first thoughts are of the homeless, unemployed males. Today, one in five people in line at a soup kitchen is a child.

All of this is taking place even though the U.S. Department of Agriculture estimates that 96 billion pounds of edible food is wasted and dumped in landfills each year.

If even one percent of that food was re-directed from landfills to local charities instead, it would make a significant difference to those in need.

The bill that the Chairman and I have sponsored (S. 312), would provide a modest tax incentive for America's private sector to re-direct surplus food to the hungry in their communities.

The Chairman of the Agriculture Committee, Senator Lugar, has made a similar proposal.

As I said earlier, we are a generous people, but I think we have the potential to give more—not just to address hunger in America, but to support other worthwhile charitable endeavors.

I look forward to hearing from today's witnesses, and I thank the Chairman for holding this important hearing.

PREPARED STATEMENT OF MARY SUE COLEMAN

I am Mary Sue Coleman, President of the University of Iowa. I would like to thank the Committee for your interest in charitable giving incentives and, in particular, the proposal to make it easier for individuals to donate funds from their Individual Retirement Accounts to charities. I would like to give special thanks to Senator Grassley for your history of support for higher education and health issues and for inviting me to provide public testimony to this committee.

As you know, the President would as part of his overall tax plan allow tax-free charitable gifts from Individual Retirement Accounts to "encourage an outpouring of giving." This proposal is embodied in the IRA Charitable Rollover Incentive Act, S. 205, which was recently reintroduced by Senator Kay Bailey Hutchison of Texas.

Passage of this legislation is widely supported in the nonprofit sector. Human service and religious groups, museums and arts groups, colleges and universities, private and community foundations, and other charitable organizations from across the country have all endorsed this important proposal. Let me also take this opportunity to express my appreciation to this Committee for adopting a slightly modified version of this proposal twice in the last Congress.

Today I am honored to represent the University of Iowa, as well as the American Council on Education and the Association of American Universities, while at the same time expressing the support of the nonprofit sector, whose programs and services would be strengthened by this proposal. The University of Iowa is a comprehensive public research university providing higher education to 28,000 students from freshman to advanced residents and postdoctoral fellows. As part of our mission, we conduct advanced research to discover new knowledge at the cutting edge of the arts, sciences, humanities and engineering.

We are proud of our public mission as a resource for Iowa and the nation. The University of Iowa was the first public university to accept men and women on an equal basis and the first in the nation to accept creative work in lieu of a thesis for graduate work in the arts. The University's 11 colleges graduate 50% of Iowa's physicians, 80% of its dentists, 60% of its pharmacists, 50% of its baccalaureate trained nurses, K-12 teachers for all of its school districts as well as a high percentage of the state's leadership in business and other critical areas. In addition, we provide a broad range of services, including over 700,000 patient visits per year to our academic health center and community-based clinics.

State support is the foundation upon which all this is built, but I must tell you that it provides only 21% of the University's budget. A crucial part of the remainder comes through donations from loyal friends and alumni. These funds provide support for facilities, equipment, student aid, the recruitment and retention of outstanding professionals and for centers and programs that would not be possible otherwise.

Today, the University of Iowa Foundation, a private 501(c)(3) organization is the midst of the most ambitious comprehensive fundraising campaign in its history to enable the University to move forward as a leading educational and cultural resource in the 21st Century. Major gifts lead the way and are well organized. Less well known are thousands of other gifts providing a much broader base of support for the University. IRA funds represent a new resource that could significantly enhance this kind of support.

Over the past few years, our foundation has received an increasing number of questions concerning the tax treatment of IRAs. Prospective donors who have sufficiently provided for the financial security of their families ask us about the possibility of donating from their IRAs to become a part of the University's future. They tell us they would like to "give something back" as a symbol of their gratitude for what they were given. For many, IRA funds would provide a means to do this.

Our advice is always to seek their own financial counsel appropriate to their own situations. We know that tax implications are not the only motivations people have

for private giving, but we also know that the tax code may influence the timing and amounts of giving. Based on the fact that many inquire about giving IRA funds, but few make the gifts, the tax code does present barriers that inhibit this form of giving. A change in current law could remove these barriers while enhancing the incentives to give.

According to the Employer Benefit Research Institute (EBRI), there are currently more than \$1 trillion in IRA accounts and \$5 trillion in defined contribution accounts, which can be rolled into IRA accounts. In addition, economists estimate that more than \$41 trillion dollars in wealth may be transferred among generations over the next 55 years. One result of this large generational transfer is that, for many individuals, IRA funds accumulated under favorable market conditions will be only one part of their overall retirement assets, and, at least in part, available for charitable giving.

Under current law, withdrawals from regular IRAs are fully taxable as ordinary income to the individual in the years they occur. A donor who withdraws regular IRA funds and uses those funds to support a charity is subject to tax on the entire amount, offset to varying extents by the charitable deduction. The charitable deduction is, however, limited by several current-law restrictions, such as the percentage of Adjusted Gross Income (AGI) limitation on the charitable deduction, and the 3% floor on all itemized deductions. If an individual does not itemize on his or her income tax return, no charitable deduction can be taken.

At the same time, the tax laws encourage individuals to liquidate their IRAs during their lifetime since their estates will face confiscatory tax rates of up to 80% if their IRA funds are left to a dependent or family member (other than their spouse). Currently, any amounts left in an IRA when an individual dies may be taxed as income to the beneficiary, and are also considered assets for the purposes of calculating that individual's estate tax liability.

Although charitable organizations frequently receive inquiries from potential donors about giving regular IRA funds during their lifetimes, when donors realize that they may have to pay a significant amount of tax to make the contribution, these types of gifts rarely get made.

Two individual donors to the University provide illustrative examples of the dilemma many potential donors face. Both individuals are professionals who are long-standing friends of the University. Both have given substantial gifts to the University over many years. Both are interested in giving a final substantial gift to University programs of special value to them. Both have indicated that they have provided for their families and will not need their IRAs for retirement purposes. However, the IRAs are the only asset left to them to make a gift of the magnitude that they would like. Both have indicated that they do not wish to make this contribution unless current law is changed.

In contrast, given passage of the IRA Charitable Rollover Incentive Act (S. 205), if IRA funds were rolled over to charity as an outright gift, they would be excluded from the donor's calculation of taxable income. In addition, if IRA funds were rolled over to create a life-income gift, the annual income payments from the gift would be subject to taxation. In both cases, the donor would not receive a charitable deduction unless after-tax dollars had been contributed to the IRA.

This proposed legislation is good public policy. Since other qualified retirement plans can now be rolled over tax-free into IRAs, this proposal would unlock substantial new resources for the support of charitable organizations and their public-service missions. To the extent that donors transfer IRA funds into life-income gifts after age 59½, rather than waiting until the required distributions at age 70½, this proposal may accelerate the collection of tax revenues, partially offsetting revenue losses.

Although IRA funds were originally intended as a supplement to retirement income, withdrawal is now allowed in order to assist in financing a home or a college education. It is equally, perhaps more, appropriate for public policy to allow financially successful individuals, who have reached a point where IRA and other tax-deferred retirement assets may only be partially needed for retirement income, to use those assets not for their personal benefit, but to support charities that better the lives of others. Moreover, in the case of life-income gifts, a portion of the IRA funds would be retained as retirement income for the donor and his or her spouse alone, with the remainder passing to charity upon the death of the participants. Furthermore, since an IRA may now pass to charity at death by a direct or life-income gift, the proposal parallels the current tax code.

Some may incorrectly characterize S. 205 as a tax break for the wealthy. Although upper-bracket taxpayers can best afford, and are most likely to make, this type of wealth transfer to charity, again, the plain fact is that many middle-class Americans, including teachers, nurses, sales persons, retired military, and librarians, fre-

quently express their desire to make gifts using IRA funds. Many retirement plans have multiplied well beyond anticipated needs and expectations as a result of favorable investment markets and moderate inflation. These donors want a tax disincentive removed, not a tax break, in order to complete their charitable objectives.

Moreover, if this proposal were passed into law, although the government would theoretically give up a tax worth 39.6% of the value of the asset, the donor would give up 100% of the asset. However, the government would not collect tax on the transfer of the asset to charity because the transfer does not financially benefit the donor. Thus, there is no income on which to levy a tax. Rather, this untaxed asset transfer will increase private support for public services that the government may otherwise be called upon to provide. It is good public policy to create incentives that encourage individuals, particularly upper-bracket taxpayers who can best afford to make charitable donations, to support philanthropy through gifts of IRA funds.

The future of the charitable sector and of the public services it provides depends upon securing the financial resources to meet the nation's pressing social needs. This proposal would allow individuals, who have assets in excess of requirements for their retirement, to make penalty-free donations of IRA funds to support the charitable sector and its public-service mission. I urge you to approve once again this critical policy initiative.

I would be pleased to answer any questions that you may have. Thank you for the opportunity to appear before you today.

RESPONSE TO A QUESTION FROM SENATOR TORRICELLI

Question. I know the University of Iowa has one of the largest university-owned teaching hospitals in the country. As someone greatly interested in medical research I also know that the University has a reputation for innovative medical research to improve health care. To what extent do university hospitals like Iowa's depend on charitable donations to fund medical research? If Congress were to amend the tax code by increasing the deduction for charitable donations, what kind of effect would that have on charitable giving to university hospitals like Iowa's?

Answer. Charitable giving plays an extremely important role in biomedical research on this campus and across the country. Last year the academic health center at the University of Iowa spent over \$18 million from private charitable sources on biomedical research and related activities. Although the federal government provides the bulk of our research funding and corporate sponsors also play an important role, funds through organizations such as the American Heart Association and other groups pay for the kinds of research not covered by the federal government and corporations. These funds, however important, only build upon other charitable gifts from individuals and institutions that have underwritten large portions of the capital costs of buildings and equipment and have endowed professorships.

I do not have an estimate of what kind of effect changes in the tax code would have on the University of Iowa. We do believe that the tax code may influence both the timing and amounts of giving. It seems to provide important incentives, particularly to middle income donors, but to others as well.

PREPARED STATEMENT OF HON. REV. FLOYD H. FLAKE

Thank you for allowing me this opportunity to testify before the Senate Finance Committee regarding President George W. Bush's Faith Based and Community Initiatives. I am pleased to see that some of my former colleagues from the House have now become members of the Senate and are providing leadership on issues that have the power to transform America in very positive ways.

I speak today on the matter of Faith Based and Community Initiatives realizing that any topic that suggests a partnership between government and religion automatically triggers numerous discussions on the question of separation of church and state. Sometimes, it is a natural reaction based on one's historical understanding of the Constitution. Often, the interpretation is based on individual beliefs that have little to do with actual facts. At other times, the response is reactionary; based on fears that certain groups and religions should not have access to government funds, although these "religious" people have not been excluded from paying individual income taxes. They are classified as taxpaying individual citizens until they identify their religious faith, then, they are collectively denied participation in government-funded programs which their tax money pays for. The real constitutional issue should not be their religious preference, but their rights as taxpaying citizens.

Some will have chosen religions that may be considered "fringe" or even "radical." Yet, they have established 501-C3 corporations and follow the letter of the law in

reporting to the appropriate government agencies, recording and reporting payroll taxes and adhering to the guidelines for a faith based religious organization. Having done so, they should be eligible for participation in any program that helps to fulfill their community service, nonreligious or proselytizing agenda. As long as the organization does not use government funds for exclusively religious purposes, it should be eligible for participation in government funding. However, I must offer some words of caution—not based on religion, but on structures of reporting and accountability.

As Pastor and CEO of a large congregation with eleven corporations that provide various community, social, educational and economic services, I am keenly aware of some of the potential pitfalls that some of these organizations will face, especially if they are new in the business. The following recommendations are offered as necessities for evaluating the organization's qualifications:

I. Capacity Analysis

There are many organizations who are currently providing some level of service to needy persons in their community. Government funds will allow them to meet even greater need. However, if there is no structure, the funds could have little impact. The Office of Faith Based and Community Initiatives must have a process for analyzing capacity. The best method for determining capacity is the Request For Proposal (RFP) process currently operative in most government programs. Merely depending on good intentions is not good enough.

II. Technical Assistance

Since many of the current faith based deliverers of social services are heavily staffed by volunteers, who in many instances have a "big heart" but limited managerial abilities, the funding stream must be accompanied by a technical assistance component. Without adequate technical assistance, some of those entities will fail. Technical assistance should include workshops and seminars on government accounting, bookkeeping, management structure and internal analysis to determine if the program is fulfilling its objectives in the required manner.

III. Firewalls

Most government program funding currently requires the setting up of separate corporations which, in most instances, are 501-3C nonprofit corporations. This should continue to be a requirement for government funding, but not necessarily limited to nonprofits. Some of the organizations that are engaged in housing and welfare to work programs have developed the capacity to operate as for-profits and should be allowed to do so. The separate corporation requirement will assure that there is no co-mingling of government funds with church funds, which would open up the books of religious organizations. That could have possible disastrous effects, causing the intended good to be submerged in expensive legal fights. More importantly, it could submarine the entire Faith Based and Community Initiative.

In general, the President's Faith Based and Community Initiative should be embraced, endorsed and passed. Too many faith based organizations are currently operating on very limited resources, yet doing outstanding work. These organizations bring a level of love and compassion to the task of providing for those in need of services that is unmatched in government circles. They have, in most instances, used the limited resources of the "collection plate" or gone into their own pockets to augment existing government services. To them, this is a "labor of love," a "calling" that can be more easily fulfilled with government assistance. They should be rewarded and empowered to do even greater work. The Initiative will enhance their good intentions and broaden the sphere of services.

I commend President Bush for having the wisdom to recognize the efforts being made by the faith based community to provide for the needs of all Americans. Furthermore, he has shown that the faith based initiative is as serious as other functions of government by elevating its role in the White House. Lastly, he has selected a very outstanding individual to head this effort. John Dilulio is both a highly respected academician and practitioner in the field of community development, education and economics.

It is my hope that the Senate will give a fair hearing to the Faith Based and Community Initiative, putting religious and political preferences aside, and doing what is in the best interest of all Americans.

PREPARED STATEMENT OF HON. CHARLES E. GRASSLEY

This morning we continue our series of hearings about President Bush's efforts to provide tax relief to working families.

Today, we focus on the President's tax proposals that will encourage charitable giving. The President's tax proposal of \$1.6 trillion contains over ten years approximately \$55 billion dollars in changes in the tax code to encourage charitable giving. This is, by anyone's measure, a significant amount of money and should be subject to as careful review as we give to the rest of the President's tax proposals.

I would note to my colleagues that the \$55 billion figure is part and parcel of President Bush's efforts for a greater role for charities in our society. While the focus of the public has been on the possibility of grants to faith-based organizations, the reality is that in terms of dollars, the proposed tax initiatives to encourage charitable giving are an equal partner in the President's faith-based efforts.

Voices of concern have been raised about the President's faith-based initiative as it relates to government providing funding to religious-based organizations to assist those in need. However, even critics of this part of the administration's initiative are widely supportive of efforts to modify the tax code to encourage more charitable giving by the American taxpayer.

To a certain extent, taxpayers face an uneven playing field now. Non-itemizers, that is, the 70 percent of Americans who don't itemize their deductions on their tax return, cannot deduct charitable contributions. The centerpiece of the President's tax proposals to encourage charitable giving seeks to address this situation by allowing non-itemizers to deduct their charitable contribution.

As chairman of the committee, I support the administration's goals of encouraging charitable giving and commend its efforts. I look forward to working with the administration and the members of this committee in including in the tax bill legislation that effectively encourages charitable giving and targets those most in need.

Encouraging charitable giving is particularly important at a time when our nation's economy is slowing down, and the number of families who need the help that charities can provide is growing. Our most vulnerable in society can't afford a slowdown in the economy and also a slowdown in support for charities.

Newspaper accounts give conflicting testimony about whether charities are beginning to see a downturn in regards to donations, but whatever the verdict, clearly we need to see whether we can modify the tax code to encourage more foot soldiers to enroll in the armies of compassion.

We will listen to testimony about the President's specific proposals. In addition, the committee will explore other changes to the tax code, beyond what the President has suggested, that will encourage charitable giving. For example, there are limits in current law on the charitable tax deductions taxpayers can take—affecting the giving of both individuals and corporations.

Let me say that while we are today discussing changes in the code that encourage giving, it is my belief that nothing will do more to encourage charitable than giving middle-income families a tax cut.

I'm confident that if the federal government would allow middle-income families to keep more of their hard-earned wages through a tax cut, a good deal of that money would ultimately be placed in the collection plate or the Salvation Army kettle. So I think we shouldn't forget that overall tax relief is a critical part of encouraging greater giving.

Let me thank the ranking member, Senator Baucus, and his staff for working so closely with us on this hearing. Quick agreement was reached regarding the witnesses as well as the focus of today's hearing.

PREPARED STATEMENT OF HON. RICHARD LUGAR

Mr. Chairman, Senator Baucus and other distinguished colleagues, I am pleased to be here today to describe important legislation that will help to fill the shelves of our nation's food banks. I became involved with this legislative effort more than a year ago after visiting and talking with many food bank volunteers in my home state of Indiana. I am confident that this legislation is an effective approach to addressing hunger in America through our existing network of food banks, church pantries and soup kitchens.

In January, Senator Leahy (D-VT) and I introduced S. 37, the Good Samaritan Hunger Relief Tax Incentive Act. Today in the House of Representatives, Congressmen Tony Hall (D-OH) and Richard Baker (R-LA) are expected to introduce companion legislation. This bipartisan bill will provide important tax incentives to our

nation's farmers, restaurant owners and corporations to donate food to hunger relief organizations.

The fact is that the demand on our nation's pantries, soup kitchens and shelters continues to rise. According to an August 2000 report on Hunger Security by the U.S. Department of Agriculture, 31 million Americans, around 10 percent of our citizens, are living in food insecure households in which family members go hungry at times throughout the year because of insufficient money for food. Although this number has declined by 12 percent since 1995, everyone agrees that this figure remains too high.

One segment of our population families with incomes between 50 and 130 percent of the poverty level actually experienced an increase in the number of households that were food insecure. This study confirms what food banks on the front lines have been telling us while families are transitioning from welfare to work, many remain vulnerable to hunger and are using food banks to supplement their nutritional needs.

Unfortunately, food banks cannot meet this increased demand for food. A December 2000 study by the U.S. Conference of Mayors found that requests for emergency food assistance increased by an average of 17 percent in American cities over the previous year and that 13 percent of emergency food requests went unmet.

Statistics by the United States Department of Agriculture show that up to 96 billion pounds of food goes to waste each year in the United States. If a small percentage of this wasted food could be redirected to food banks, we could make important strides in our fight against hunger.

In many ways, current tax law is a hindrance to food donations. The tax code provides corporations with a special deduction for donations to food banks, but it excludes farmers, ranchers and restaurant owners from donating food using the same tax incentive. For many of these businesses, it is actually more cost effective to throw away food than to donate it to charity. This should not be the case.

In the past, food banks benefitted from the inefficiencies of manufacturing, gaining donations from over-production and cosmetically-flawed products. However, technology has made manufacturers significantly more efficient, thus reducing the merchandise available for donation. With the development of value or dollar stores, manufacturers now have a profitable outlet competing against charities for disposing of this non-saleable merchandise. Second Harvest, the nation's largest hunger relief charity, estimates that resales to these value stores have eliminated one-half of the \$4 billion of non-saleable product that used to be available for donation.

S. 37, the Good Samaritan Hunger Relief Tax Incentive Act, would re-align the economics of donating food by extending the special deduction to all business taxpayers, including the self-employed, and by increasing this deduction to the fair market value of the donation.

The hunger relief community believes that these changes will markedly increase food donations—whether it is a farmer donating his crop, a restaurant owner contributing excess meals, or a food manufacturer producing specifically for charity. One Hoosier food bank, Second Helpings of Indianapolis, estimates that this legislation will cause an additional 400,000 pounds of food to be donated to its coffers.

This bipartisan legislation currently enjoys 14 Senate cosponsors and has been endorsed by a diverse set of organizations, including America's Second Harvest Food Banks, the Salvation Army, the American Farm Bureau, the National Farmers Union, the National Restaurant Association, and the Grocery Manufacturers of America.

Chairman Grassley recently introduced S. 312, the Tax Empowerment and Relief for Farmers and Fishermen Act (TERFF). This bill contains several important provisions aimed at providing relief for farmers and ranchers, including the creation of tax-deferred FARRM accounts, income averaging clarifications and self-employment tax relief for farmers. I am pleased that a version of our Good Samaritan Hunger Relief Act was also included as part of this legislation.

Last year, our bill passed the Senate as part of an agricultural tax amendment offered by Chairman Grassley to H.R. 8, the Death Tax Elimination Act. Although it was ultimately stripped from the underlying legislation, I believe that this vote indicates strong support for this legislation in the Senate.

I am hopeful that when this Committee begins to draft tax legislation in the coming months that it will favorably consider and include the Good Samaritan Hunger Relief Tax Incentive Act in that legislation.



**Testimony of Douglas O'Brien
Director of Public Policy and Research
AMERICA'S SECOND HARVEST**

**Before the United States Senate Committee on Finance
Hearing on Federal Tax Law Changes to Encourage Charitable Giving**

Wednesday, March 14, 2001

Chairman Grassley, Senator Baucus and distinguished members of the committee, my name is Douglas O'Brien. I am the Director of Public Policy and Research for America's Second Harvest. It is an honor to be here today to present the views of our national network of food banks and emergency food providers regarding the *Good Samaritan Hunger Relief Tax Incentive Act, S. 37*, legislation introduced by Senators Richard Lugar of Indiana and Patrick Leahy of Vermont and its companion measure in section 7 of the *Tax Empowerment and Relief for Farmers and Fishermen Act, S. 312*, introduced by Chairman Grassley and Ranking Member, Senator Baucus.

I would like to begin my testimony by briefly introducing America's Second Harvest to the committee. America's Second Harvest is the nation's largest private hunger relief charity and one of the largest non-profit organizations in the United States.¹ We are a national network of regional food banks and food rescue organizations providing hunger relief and other services to 50,000 local private charities operating more than 90,000 community food assistance programs. Our network provides domestic hunger relief services in all 50 states, the District of Columbia, and Puerto Rico.

Some of the members of the committee may be familiar with our network affiliates in their states and the District. For example, last year Chairman Grassley toured several of the Second Harvest affiliate food banks in Iowa and I believe Senator Baucus is familiar with the Montana Food Bank in Missoula which serves private hunger relief charities throughout his state. Committee staff are probably also familiar with our network affiliate here in the nation's capitol, the Capital Area Food Bank and its member agency the DC Central Kitchen.²

Those food banks and other non-profit charitable organizations, and the more than 200 food banks and food rescue organizations that comprise the America's Second Harvest network, provide more than 1.5 billion pounds, or 750,000 tons of food and grocery products annually, with an estimated dollar value of more than \$2 billion, to approximately 25.7 million low-income Americans, including 21 million needy people at emergency feeding sites.³ Those emergency feeding sites include church food pantries, soup

¹ For more information on America's Second Harvest, please see the attached fact sheet at the conclusion of the written testimony or visit our website at www.secondharvest.org.

² A complete list of America's Second Harvest affiliate food banks is available on our website.

³ The estimated dollar value of donated food and grocery products distributed by America's Second Harvest network affiliates is determined as part of our independent annual audit conducted by the accounting firm of KPMG, LLP, August 18, 2000.

kitchens and congregate meal sites for the elderly poor, and emergency shelters for the homeless, battered women and other needy people seeking short-term housing.

America's Second Harvest is a private charitable network which has emerged in nearly every American community to meet the basic food needs of the most vulnerable and needy of our neighbors. Despite the recognized efficiency and comprehensive nature of the private charitable system, we often find ourselves in a situation where requests for aid are exceeding available resources. The trend toward greater reliance on charitable food assistance has generally grown over the last decade, with most of the growth occurring over the last four years.

Nearly all of our network food banks and the local hunger relief charities they serve have experienced in recent years a startling paradox of need for hunger relief services in a time of nearly unprecedented American prosperity. Despite the generally strong economy, low-unemployment, and falling welfare and food stamp caseloads, demand for emergency food assistance has been consistently rising in most communities.

In 1998, America's Second Harvest released a comprehensive national study on the nation's charitable response to hunger and the demographic make-up of the needy people we serve. Our study of more than 28,000 emergency food recipients found that 90 percent have household incomes at or below 150 percent of the poverty line, and better than one-in-ten people we serve have no income at all. The study found that children make up a substantial number of emergency food recipients, representing nearly 38 percent of all emergency food clients. Another 16 percent of emergency food recipients were elderly Americans. Furthermore, 38 percent of all households served by food banks included someone who was working and of those households, nearly half were employed full-time. Other troubling statistics also emerged from the research, including the pervasive presence of children and working single parents being served at soup kitchens.⁴ Our research showed that one in five people in a soup kitchen line is now a child, a feeding site which has historically served mostly homeless, chronically unemployed adult males.

The independent research we released three years ago provides compelling supporting data to similar research conducted by the federal government, state and municipal governments, academics and non-profit research organizations on the food security status of low-income households and demand for emergency food assistance.

The most recent of these studies includes the U.S. Conference of Mayors Annual Report on Hunger and Homelessness released four months ago. The Mayors' study found a 17 percent increase in requests for emergency food in the US cities surveyed. The number of families with children requesting food aid increased by 16 percent and one-third of adults requesting food assistance were employed.⁵ For example, Figure 1, a national review of multiple studies – including various local or municipal studies of hunger relief charities to state and national studies of the same – conducted by the Tufts University, Center on Hunger and Poverty shows increased requests for food aid throughout the country ranging from a low of 14 percent to a high of 38 percent.⁶

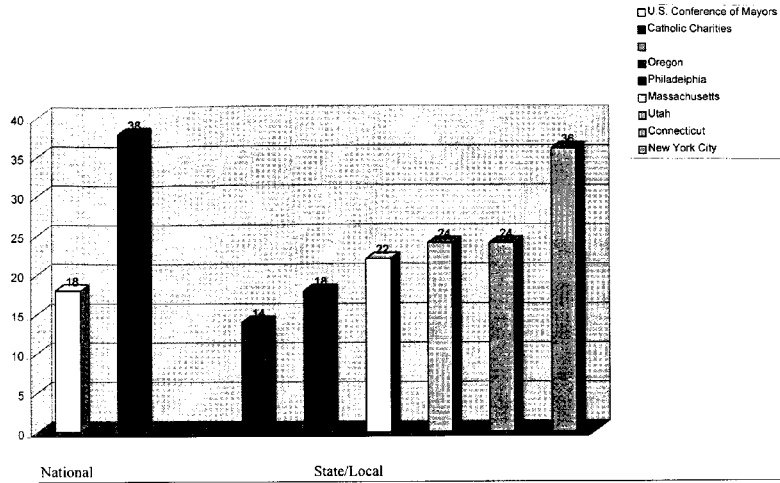
For more information, please see page 25 of the America's Second Harvest 2000 Annual Report: *A Community Ending Hunger*.

⁴ *HUNGER 1997: The Faces & Facts*, America's Second Harvest, 1998.

⁵ *A Status Report on Hunger and Homelessness in America's Cities 2000*, U.S. Conference of Mayors, December 2000.

⁶ Venner, et al., *Paradox of Our Times: Hunger in a Strong Economy*, Center on Hunger and Poverty, Tufts University, January 2000.

Figure 1. Range of Reported Increases in Demand for Emergency Food Assistance: Selected Studies from 1996 through 1999



Note: These studies were conducted at different points in time using different methodologies.

In addition, the General Accounting Office (GAO) in 1999 released a study of declining food stamp participation and stated that "...[D]emand for food assistance by low-income families has increased in recent years...the need for food assistance has not diminished; rather needy individuals are relying on sources of assistance other than food stamps."⁷ The GAO's finding of needy people turning to other sources, such as charities for food assistance, is again reflected in the U.S. Department of Agriculture's annual food security study conducted as part of the Census Bureau's Current Population Survey. USDA-Census figures show that approximately 31 million Americans are food insecure, that is they are hungry or at risk of hunger, a number that has been nearly unchanged over the period 1995 through 1998, despite the strong economy and falling food assistance caseloads.⁸

Unfortunately, the growing demand for emergency food assistance has in too many instances outstripped the food resources of local charities. Our study of network food banks indicated that between 115,000 and 800,000 low-income people were denied emergency food assistance at local charities because the charity they turned to for help lacked adequate food, representing roughly 6.5 percent of all requests.⁹

⁷ *Food Stamp Program: Various Factors Have Led to Declining Participation*, (Letter Report, GAO/RCED 99-185), General Accounting Office, July 2, 1999.

⁸ Andrews, Margaret, et al., *Household Food Security in the United States, 1999*, U.S. Department of Agriculture, Economic Research Service-Food Assistance and Nutrition Research Report No. 8, fall 2000.

⁹ *HUNGER 1997: The Faces & Facts*, p.77.

Similarly, the U.S. Conference of Mayors reported last year that 13 percent of requests for emergency food assistance in cities surveyed went unmet due to a lack of food resources.¹⁰

America's Second Harvest estimates that our network would need to increase donations by nearly 100 percent to meet local hunger relief agency needs for food distribution. According to agency surveys, our network alone experiences an annual shortfall of in-kind food donations of nearly one billion pounds.¹¹ This significant shortfall of food donations has led to local hunger relief charities turning away low-income people at the moment of their greatest need.

To address this shortfall in domestic hunger assistance, Senators Lugar and Leahy and a bipartisan group of 22 of their colleagues in the Senate and more than 80 members of the House led by Representatives Hall (D-OH) and Houghton (R-NY), introduced legislation in the last Congress to spur greater donations of food from the private sector. We are, of course, pleased that this legislation has been re-introduced in the Senate again by Senators Lugar and Leahy, and that identical legislation will be introduced in the House today.

The *Good Samaritan Hunger Relief Tax Incentive Act* has three provisions that when taken together, provide a greater incentive for businesses to donate food for local humanitarian purposes. First, the legislation expands the class of taxpayers eligible for the "special rule deduction" under section 170(e)(3) of the Internal Revenue Code currently enjoyed only by regular corporations, or Chapter C Corporations, to all business taxpayers. That would include farmers, small businesses, fishermen, franchise owners, and restaurateurs. This expansion of the special rule deduction is limited to the in-kind donation of food to a 501(c)(3) charitable organization for the express purpose of hunger relief for needy people. This is an important tax equity issue. For example, under current law, if a major food company makes a donation of cheese, the corporation is eligible for the special rule deduction under section 170(e)(3). If, however, a dairy farmer made the same donation of cheese to a local hunger relief agency, the farmer is denied the deduction under current law because the farmer is not typically organized as a regular C corporation under Internal Revenue Code definitions. Figure 2 shows how the proposed change would affect a farmer, a restaurant owner, and a food manufacturer in the donation of food for hunger relief activities.

Figure 2. Estimated Benefits under "Good Samaritan Tax Act"

Example	Current Deduction	S. 37	Difference
Farmer donates one bushel of apples*	No access to special deduction IRC Sec. 170(e)(s)	\$5.50	+\$5.50
Restaurant donates a pan of lasagna feeding 10-12 people*	No access to special deduction IRC Sec. 170(e)(s)	\$25.00	+\$25.00
Grocery manufacturer donates a package of dry rice	\$0.63	\$0.74	+\$0.11

* In the instance of the farmer and restaurant owner in the preceding table, it is assumed that both are formed as small businesses, as is often, and not Regular C corporations.

The limitation of the special rule deduction of section 170(e)(3) is a significant barrier to food donations, particularly from restaurants, small businesses, and farmers. In some instances, as Senator Lugar found in Indiana, it is actually more cost effective for a farmer to dump surplus food products than to donate it

¹⁰ U.S. Conference of Mayors, 2000.

¹¹ *HUNGER 1997: The Faces & Facts*, p.82.

to a local hunger relief charity. In Montana, the Montana Food Bank operates a non-profit cannery, where locally grown produce is canned and distributed to needy people throughout the state. The cannery project is a remarkably innovative partnership of the public and private sector. Unfortunately, most of the produce donations made by potato farmers to the cannery project elicit no tax benefit, despite the fact the farmers have invested time, money and material to the donation. To struggling farmers, the act of donating to the cannery can, and often does, represent a financial loss. The *Good Samaritan Hunger Relief Tax Incentive Act* helps rectify that situation by allowing the grower to recoup at least some of his or her investment through the tax code.

The Good Samaritan Tax Act addresses this inequity in the code by allowing all taxpayers engaged in business or trade to be eligible for the deduction when making an in-kind donation of food.

Second, the legislation enhances the deduction from the current deduction formula to the fair market value of the product in most instances, not to exceed twice the cost or basis. For farmers and other businesses using the "cash method" of accounting, the deduction is expanded to the basis of any qualified contribution at 50 percent of the fair market value. This simplified deduction formula and enhanced deduction level provides an incentive for businesses, farmers, and fishermen to donate wholesome, edible food that might otherwise go to waste. Further, the complicated nature of the current formula sometimes precludes even large food manufacturing companies from seeking a deduction for which they are eligible when donating. By simplifying the deduction formula and enhancing the deduction's value, businesses have an incentive to donate rather than dump the surplus product.

Lastly, the legislation codifies the notion that the taxpayer, not the Internal Revenue Service, should – with substantiation of fair market value – make the determination of the value of the donated food. The issue of valuation of food inventory has been an issue of dispute between food companies and the IRS for many years. In 1995, a Federal Tax Court sided with Lucky Stores, a grocery concern, in one such dispute. The Court held that the value of surplus bread inventory donated to a local food bank by Lucky Stores and claimed at the full retail price of the bread was indeed valued by the taxpayer properly, rather than half the retail price as the IRS claimed.¹² As the nation's largest recipient of donated food from major food concerns, we especially see the codification of the Lucky Stores principle as critical to our ability to gain food donations for hungry people, and provide some level of comfort to businesses partnering with us in socially responsible ways without some future tax reprisal for their generosity. Again, this level of taxpayer protection is necessary to keep simple and effective incentives for businesses to donate surplus inventories of food for local charitable hunger relief activities.

Mr. Chairman and members of the committee, the United States Department of Agriculture estimates that 96 billion pounds of edible food is wasted and dumped in landfills each year.¹³ Through enactment of the *Good Samaritan Hunger Relief Tax Incentive Act*, if even one percent of that food was re-directed from landfills to local charities instead, it would nearly double the entire food distribution throughout our network to people in need.

The *Good Samaritan Hunger Relief Tax Incentive Act* provides a responsible, cost-effective bottom-line incentive for America's private sector to re-direct surplus food to the hungry in their communities. It provides a win-win for farmers, small businesses, restaurants, hunger relief charities, and most importantly, to hungry Americans in need of help.

Thank you for your time and attention. For your ease, I have included with my written testimony a table comparing the *Good Samaritan Hunger Relief Tax Incentive Act* and current law. I am available to answer any questions you might have at this time.

¹² *Lucky Stores, Inc. v. Commissioner*; (105 T.C. 420, 1995)

¹³ Kantor, et al., *Estimating and Addressing America's Food Losses*, 1997, USDA-Economic Research Service.

Attachment 1.

Comparison of the Good Samaritan Hunger Relief Tax Incentive Act (S. 37) and Current Tax Law (I.R.C. §170(e)).

Current Law - IRC §170(e)	S. 37
<ul style="list-style-type: none"> Allows "special rule deduction" for regular corporations in the donation of in-kind gifts to charities for the care of the ill, needy, or infants 	Expands "special rule deduction" to all business taxpayers for in-kind donations of <u>food inventory</u> .
<ul style="list-style-type: none"> Allowable deduction = cost (basis) + ½ fair market value (FMV), not to exceed twice cost (basis). 	Deduction = full FMV not to exceed 2 x cost (basis). For farmers and other taxpayers using the cash method of accounting, the basis of any qualified contribution shall be deemed at 50% of the product's FMV.
<ul style="list-style-type: none"> Determination of FMV of in-kind gift subject to substantiation by taxpayer of market price and other factors. 	Allows business taxpayer to take FMV into account to the price the food inventory would have been sold without regard to internal standards, lack of market, or similar circumstances.

Background Narrative

Current Federal tax law. Under current law, regular corporations are allowed a "special rule deduction" under §170(e)(3) of the Internal Revenue Code (IRC), for contributions of in-kind gifts or inventory to charities or similar non-profits provided that such contributions are used by the charity for the care of the ill, the needy, or infants and when several other statutory requirements are met. The "special rule deduction" allows a regular corporate taxpayer a deduction of cost or basis plus one half the appreciated fair market value of the property except to the extent one half of the appreciation exceeds twice the basis of the property donated. Further, the fair market value (FMV) is the price at which the property would have change hands between a willing buyer and a willing seller.

Lucky Stores, Inc. v. Commissioner (105 T.C. 420 (1995)). Lucky Stores made donations of surplus bread inventory to food banks which qualified as permissible charitable donees under IRC §170(e)(3)(A), and claimed charitable contributions based upon the full retail prices for the bread. The Internal Revenue Service disputed claimed deductions determining that the FMV of the contributions to be approximately 50 percent of full retail prices. The Tax Court held for Lucky Stores claim of full market value and stated that §170(e)(3) "should not be interpreted in such a restrictive way as to unnecessarily inhibit donations of the type Congress meant to encourage [in the 1976 Tax Reform Act], and certainly petitioner's bread donations are of that type."¹⁴

The Good Samaritan Hunger Relief Tax Incentive Act (S. 37) expands the special rule deduction of §170(e)(3) to all business tax payers (corporate and non-corporate) in regard to contributions of food, and provides a higher deduction for the donation of food inventory in order to mitigate the effect of business tax rates which typically reduce the allowable deduction below actual costs of manufacturing or producing the product. The bill also has the effect of codifying the *Lucky Stores* decision.

¹⁴ *Lucky Stores, Inc. v. Commissioner*; (105 T.C. 420, (1995) p.435.)

Attachment 2.**America's Second Harvest Fact Sheet**

America's Second Harvest is the largest domestic hunger-relief organization in the United States. The America's Second Harvest mission is to feed hungry people by soliciting and distributing food and grocery products through a nationwide network of certified affiliate food banks and food rescue programs to educate the public about the nature of and solutions to the problem of hunger in America.

In 1999, the *Chronicle of Philanthropy* calculated an efficiency rating for America's Second Harvest of 99.3%. This means that 99.3% of all product and money donations received by America's Second Harvest go directly towards feeding hungry people.

Operations	The America's Second Harvest network of more than 200 regional food banks and food-rescue programs serves all 50 states and Puerto Rico by distributing food and grocery products to approximately 50,000 local charitable hunger-relief agencies, including food pantries, soup kitchens, women's shelters, Kids Cafes, Community Kitchens and other organizations that provide emergency food assistance.
Donations	America's Second Harvest works with more than 500 national grocery and food service companies (food growers, processors, manufacturers, distributors and retailers) to secure surplus food and grocery products. The list, which reads like a "Who's Who" in corporate America, includes such donors as Kraft Foods, Inc., General Mills, Inc., Nabisco, Inc., The Procter & Gamble Company, The Kellogg Company, The Pillsbury Company, ConAgra Foods, and hundreds more.
Funding	America's Second Harvest depends entirely on the support of individuals, corporations and charitable foundations. For every \$1 received, America's Second Harvest distributes 30 pounds of food and grocery products to network food banks.
History	America's Second Harvest was founded in 1979. In its first year, the organization distributed 2.5 million pounds of food through a network of 13 food banks. The America's Second Harvest network now constitutes more than 200 regional food banks and food rescue programs that annually distribute 1.5 billion pounds of donated food and grocery products, providing food assistance to more than 26 million hungry Americans, including eight million children and four million seniors.
Hunger	America's Second Harvest defines hunger as the inability to purchase enough food to meet basic nutritional needs. Hunger does not discriminate on the basis of age, race or sex. It affects the elderly, the unemployed, the disabled, the homeless, the working poor and victims of natural disaster. America's Second Harvest released the most comprehensive research study on emergency food providers and recipients ever undertaken. <i>Hunger 1997: The Faces & Facts</i> provides thorough data and analysis on the nonprofit charitable sector's response to hunger. Key findings of this study include: of the 26 million Americans served each year by the America's Second Harvest network, 39% are from households with working individuals, 62% are female, 38% are children (17 and under), and 16% are seniors (over 65).
For More Information:	To learn more about America's Second Harvest and how to help fight domestic hunger, please visit our Web site, www.secondharvest.org , or call 800-532-FOOD.

Attachment 3.

**ORGANIZATIONS ENDORSING S. 37,
THE GOOD SAMARITAN HUNGER RELIEF TAX INCENTIVE ACT**

NATIONAL FOOD, CHARITY, FARM AND SMALL BUSINESS ORGANIZATIONS

American Farm Bureau Federation	National Cattlemen's Beef Association
America's Second Harvest Food Banks	National Farmers Union
At-Sea Processors Association	National Fisheries Association
California Emergency Foodlink	National Milk Producers Federation
ConAgra	National Restaurant Association
Council of Chain Restaurants	Pillsbury
Grocery Manufacturers of America	Salvation Army
Indiana Farm Bureau	Tricon Global Restaurants
Kraft	

LOCAL FOOD BANKS AND HUNGER RELIEF ORGANIZATIONS

<i>Arizona</i>	Foodbank of Santa Barbara County – Santa Barbara
Westside Food Bank – Phoenix	F.I.N.D. (Food In Need of Distribution) – Cathedral City
Southeast Arizona Food Bank Association -- Willcox	Food Bank for Monterey County – Salinas
	Los Angeles Regional Food Bank – Los Angeles
<i>Alabama</i>	San Diego Food Bank – San Diego
Montgomery Area Food Bank, Inc. – Montgomery	Seniors Gleaners, Inc. – North Highlands
United Way Community Food Bank – Birmingham	<i>Delaware</i>
Bay Area Food Bank – Mobile	Food Bank of Delaware – Newark
<i>Arkansas:</i>	<i>District of Columbia</i>
Arkansas Food Bank Network – Little Rock	Capital Area Food Bank
Food Bank of Northeast Arkansas – Jonesboro	<i>Colorado</i>
Northwest Arkansas Food Bank – Ft. Smith	Weld Food Bank – Greeley
	Food Bank for Larimer County – Ft. Collins
<i>California</i>	Care and Share, Inc. – Colorado Springs
Alameda County Community Food Bank – Oakland	<i>Connecticut</i>
Second Harvest Food Bank of Santa Cruz & San Benito Counties – Watsonville	Foodshare of Greater Hartford – Windsor
Second Harvest Food Bank of Santa Clara & San Mateo Counties – San Jose	<i>Florida</i>
Second Harvest Food Bank of Orange County – Orange	Daily Bread Food Bank – Miami
Community Food Bank – Fresno	Second Harvest Food Bank of Central Florida – Orlando
The Redwood Empire Food Bank – Santa Rosa	Divine Providence Food Bank – Tampa
	<i>Georgia</i>
	Golden Harvest Food Bank – Augusta
	Atlanta Community Food Bank – Atlanta

Second Harvest Food Bank of the
Chattahoochie Valley – Columbus
The Valdosta Food Bank – Valdosta
America's Second Harvest of Coastal
Georgia – Savannah

Illinois

Eastern Illinois Food Bank – Urbana
Northern Illinois Food Bank – St. Charles
Greater Chicago Food Depository –
Chicago

Indiana

Community Harvest Food Bank – Ft.
Wayne
America's Second Harvest of Northwest
Indiana – Gary
Terre Haute Catholic Charities Food
Bank – Terre Haute
Food Bank of Central Louisiana –
Alexandria

Maine

Good Shepherd Food Bank – Lewiston

Massachusetts

Greater Boston Food Bank – Boston
Worcester County Food Bank –
Shrewsbury
The Food Bank of Western
Massachusetts – Hatfield

Michigan

Food Bank of South Central Michigan –
Battle Creek
Food Bank of Oakland County – Pontiac

Minnesota

The Second Harvest St. Paul Food Bank –
St. Paul

Mississippi

Mississippi Food Network – Jackson

Missouri

Central Missouri Food Bank – Columbia
St. Louis Area Food Bank – St. Louis

Tri-State Food Bank – Evansville
Gleaners Food Bank-Indianapolis

Iowa

Food Bank of Iowa – Des Moines
Cedar Valley Food Bank – Waterloo

Kansas

Kansas Foodbank Warehouse, Inc. –
Wichita

Kentucky

God's Pantry Food Bank – Lexington
Kentucky Food Bank, Inc. – Elizabethtown
Dare To Care Food Bank – Louisville

Louisiana

Second Harvest Food Bank of the
Missouri-Kansas Region – St.
Joseph
Harvesters – Kansas City

Nevada

Food Bank of Northern Nevada – Sparks

New Hampshire

New Hampshire Food Bank – Manchester

New Jersey

Community Food Bank of New Jersey –
Hillside

New Mexico

Roadrunner Food Bank – Albuquerque

New York

Long Island Cares – West Brentwood
Food Bank of the Southern Tier – Elmira
Regional Food Bank of Northeastern New
York – Latham

North Carolina

Second Harvest Food Bank of Metrolina –
Charlotte
Manna Food Bank – Asheville
Food Bank of the Albermarle – Elizabeth
City

North Dakota

Great Plains Food Bank – Fargo

OhioToledo-Northwest Ohio Food Bank –
ToledoAkron-Canton Regional Foodbank –
AkronCleveland Foodbank, Inc. – Cleveland
Share Harvest Food Bank, Inc. – FairfieldSecond Harvest Food Bank of North
Central Ohio – Amherst

West Ohio Food Bank – Lima

Second Harvest Food Bank of Clark,
Champaign, and Logan Counties –
Springfield**Oklahoma**Regional Food Bank of Oklahoma –
Oklahoma City**Pennsylvania**H & J Weinberg Northeast Regional Food
Bank – Wilkes BarreThe Greater Philadelphia Food Bank –
PhiladelphiaCentral Pennsylvania Food Bank –
HarrisburgGreater Pittsburgh Community Food
Bank – DuquesneSecond Harvest Food Bank of Northwest
Pennsylvania – Erie**Puerto Rico**

Banco De Alimentos – Bayamon

South Carolina

Harvest Hope Food Bank – Columbia

Low Country Food Bank – Charleston

South DakotaBlack Hills Regional Food Bank – Rapid
City**Tennessee**Chattanooga Area Food Bank –
ChattanoogaSecond Harvest Food Bank of East
Tennessee – Knoxville

Memphis Food Bank – Memphis

Texas

South Plains Food Bank – Lubbock

North Texas Food Bank – Dallas

Capital Area Food Bank of Texas, Inc. –
AustinFood Bank of the Rio Grande Valley, Inc. –
McAllen

Tarrant Area Food Bank – Fort Worth

Food Bank of Abilene – Abilene

Regional East Texas Food Bank – San
AntonioWichita Falls Area Food Bank – Wichita
FallsCommunity Food Bank of Victoria –
Victoria**Vermont**

Vermont Food Bank – South Barre

VirginiaFredericksburg Area Food Bank –
FredericksburgFood Bank of Southeastern Virginia –
NorfolkBlue Ridge Area Food Bank – Verona
Southwestern Virginia Second Harvest
Food Bank – Roanoke**Washington**Second Harvest Food Bank of the Inland
Northwest– Spokane

Food Lifeline – Shoreline

West Virginia

Mountaineer Food Bank – Gassaway

Huntington Area Food Bank – Huntington

WisconsinSecond Harvest Food Bank of Southern
Wisconsin – MadisonSecond Harvest Food Bank of Wisconsin –
Milwauk

PREPARED STATEMENT OF C. EUGENE STEUERLE

Mr. Chairman and members of the Committee:

Debate over tax policy is always intense, as it should be since much of the government's agenda is defined within the tax system. When it comes to tax cuts, this debate usually centers on size of government and progressivity of the tax system. However worthy this focus, it often takes too much attention away from such traditional tax and budget policy principles as equal justice or equal treatment of those in a similar situation, efficiency, simplicity, ease of administration, and transparency—what I will here call the effectiveness principles.

I am especially thankful that these hearings make room for discussion of these principles, whether the subject be child credits or marriage penalties or rate reduction. Tax treatment of the charitable sector—today’s hearing—is a perfect example of a discussion where these more traditional policy principles come to the fore. The basic question that you ask your witnesses is how can tax provisions affecting charities and other nonprofit organizations be revised to be made more effective?

The issues on the table today are truly nonpartisan in nature, and I know of no significant differences between the major political parties in what they hope to achieve. The President, along with many other Republicans and Democrats, have put forward a number of suggestions aimed at strengthening the nonprofit sector of the economy. The goodness of a society is defined by the sum total of what all its members do, whether directly as individuals, as contributors of time and money to others, as participants in community activities, or as taxpayers and representatives. The government can’t do it all and neither can charities. In such a dynamic world, the government’s relationship to the nonprofit sector needs periodic examination and review. It is my hope that this Committee and the Congress will consider the President’s proposals as a base but then build upon and reform that base with policy principles in mind.

The President’s proposals all have as a primary purpose a further encouragement of charitable giving. Thus, following his lead, a primary (but not only) test that this Committee should adopt is how much different alternatives expand giving relative to the revenue cost involved. In addition to commenting on the President’s proposals, therefore, I will additionally discuss some closely related proposals that I believe would be as effective or even more effective in enhancing charitable activity.

Table 1

PRESIDENT BUSH’S PROPOSALS TO ENCOURAGE CHARITABLE GIVING

- **Granting a Charitable Deduction for Non-Itemizers** The Federal charitable deduction will be expanded to taxpayers who do not itemize and thus currently cannot claim this benefit.
- **Permit Charitable Contributions from IRAs Without Penalty** Under current law, withdrawals from Individual Retirement Accounts are subject to income tax. President Bush supports legislation that would permit individuals over the age of 59 to contribute IRA funds to charities without having to pay income tax on their gifts.
- **Raise the Cap on Corporate Charitable Deductions** Corporations would be permitted to deduct charitable donations until their value exceeds 15 percent of the company’s taxable income, instead of the 10 percent limit under current law.
- **Promote a Charitable State Tax Credit** States would be encouraged to provide a credit (of up to 50 percent of the first \$500 for individuals and \$1,000 for married couples and corporations) against state income or other taxes for contributions to charities addressing poverty and its impact. States would be given the flexibility to offset the costs of a charitable state tax credit by using money from the Temporary Assistance to Needy Families (TANF) program.

Adopt a deduction that is the same for non-itemizers and itemizers alike. The President currently suggests adopting a deduction for non-itemizers, but the Administration has not suggested that a floor would be required. (A floor provides a base under which deductions would not be allowed.) For some complicated but very important reasons, I believe that it is crucial to adopt a floor and that this floor be the same for itemizers and non-itemizers alike. The goal is to expand the potential availability of a deduction to all taxpayers, but in a way that most clearly increases giving per dollar of revenue cost but does not add significantly to taxpayer and IRS administrative and compliance costs. Here, roughly speaking, is the logic that leads me to support a common floor:

Step One: IRS cannot accurately monitor small amounts of contributions. With elimination of the standard deduction, this implies that the Congress—either this year or in the future—would likely consider putting some floor under contributions before they would be deductible to non-itemizers. Fortunately, a floor significantly increases the amount of giving relative to the revenue cost.¹ With a floor, the incentive is more likely to be confined to extra giving rather than that giving that would take place no matter what the incentive. For someone giving away over \$200 already, a contributions’ deduction on the first \$200 provides almost no incentive.

¹See Cordes, et al. (attached)

Step Two. Creation of a different floor for non-itemizers than for itemizers would create a large amount of taxpayer confusion.² Deductions would pop up in two different places on the tax return, and the decision over which place was optimal would require a number of calculations. One could no longer add up itemizable deductions and compare them to the standard deduction, but, instead, one would have to compare remaining itemizable deductions plus charitable gifts with no floor to itemized deductions excluding charitable gifts plus charitable gifts less a floor. In addition, for some taxpayers, issues such as the phase-out of itemized deductions would affect where it was optimal to deduct.

Step Three. A common floor for itemizers and non-itemizers removes this complexity. It also encourages a greater level of giving per dollar of revenue cost. For instance, a \$150 floor under all taxpayers would likely raise more charitable gifts than a revenue-neutral floor—say, \$400—under non-itemizers alone.

Step Four. In patchwork tax reduction bills, the pretense often is that every provision only grants benefits to taxpayers. A small floor extended to itemizers by itself raises taxes for some taxpayers even though for almost all of them rate reduction and child credits would more than offset this minor decrease in tax benefits. Moreover, the costs of not adopting a common floor are not trivial: taxpayer reaction against a more confusing tax return and charitable contributors reaction against the increase in cheating that would arise.

Stop phasing out itemized deductions of charitable contributions. Although this reform technically is not part of the President's proposal to have a non-itemizer deduction, it would fall out almost automatically if a common floor (including no floor) on itemizers and non-itemizers were adopted. Everyone would take their deductions somewhere other than on the itemized deduction schedule, so that folding these deductions back into the phase-out would be complicated and appear somewhat silly. The current rule most penalizes those who give away a great deal and it is mainly a backdoor tax rate increase. It should be abandoned.

Consider proposals to remove limits on charitable contributions, such as the President's IRA proposal. The President has suggested allowing money to be paid directly out of IRA accounts without having to be declared first as income subject to tax and then deducted. I myself 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 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 types of 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 the Congress be able to monitor well exactly what is happening here over time.

This selective approach, however, does raise some unresolved issues. One is when to allow such exceptions and when not to allow them. For example, if IRA withdrawals are allowed, why not also apply the same treatment to 401(k) plans, stock bonus plans, and other retirement vehicles? Another is that giving out of an IRA would have a different effect on the measure of adjusted gross income (AGI) than would other charitable contributions. Since many other provisions in the Tax Code are tied to AGI, this could complicate planning. On the other hand, giving out of an IRA might be much easier to manage than more complicated charitable trusts, since a taxpayer could simply designate some percentage of annual withdrawals to go to charity.

Raise and simplify the various limits on charitable contributions that can be made as a percentage of income, such as the President's proposal for corporate contributions. 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 to both simplify and 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 present circumstances of foundation.

²See Steuerle, 2000a and 2000b.

Begin studies now on proposals to allow credits for contributions to organizations that serve the poor. The President's proposal really is a welfare rather than tax proposal and could be revised by the time that welfare or TANF bills come along. The proposal allows states to spend TANF money on charitable credits serving low-income individuals. It attempts to address worthy goals—encouraging giving to charities serving the poor and using a “market-like” test of individual contributions to see where some government subsidy ought to be provided.

To be sure, a number of difficult details need to be worked out: how to certify eligible charities; how taxpayers can identify eligible charities; whether one type of charity should be favored over another in the tax system; whether the particular caps suggested would tend to reduce, rather than increase, the net amount of funds available to the poor; how much of the charitable incentive would simply encourage givers to switch from one type of charity to another; and whether funds allocated through this type of “market test” would be too confined to particular segments of poor individuals who happened to live near the charities involved.

There may be ways to get around some of these problems, and it is not clear that this needs to be a tax rather than spending provision. For instance, states could be encouraged to pass through assistance dollars to charities that both certify higher levels of individual contributions for helping the poor and are open to serving broad segments of the poor. In any case, study should begin now rather than waiting until the welfare bills come up and it's too late to craft alternatives efficiently.

In addition to these refined versions of the President's proposals, I very much hope that you will also consider a number of other related alternatives.

Allow deductions to be given until April 15 or the filing of a tax return. This is the same rule that applies to Individual Retirement and Keogh plans. Imagine a company deciding to advertise a sale except when the purchase was taking place. 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 preparer is 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 where there is some paper back-up, as is done with IRA contributions.

Reduce and dramatically simplify the excise tax on foundations. This tax 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).³ Moreover, whatever Congress gives back here will automatically be paid out the public in the form of greater charitable activity—thus meeting the primary test for effectiveness outlined above.

Devote more IRS resources to helping the public monitor the charitable sector. The exempt organization function traditionally has been treated as an unwanted step-child of the IRS because it brings in almost no revenue. (As noted, moreover, only a fraction of the foundation tax is actually spent by the IRS monitoring the nonprofit sector). Today, however, there is an unusual opportunity that derives from a large confluence of charitable sector groups, researchers, states attorneys general, and private sector information firms who are united in trying to allow electronic filing of tax forms, such as the 990 and 990 PF. They believe electronic filing will: (1) improve compliance by charities; (2) lead to better monitoring of the sector by the public; (3) help states attorneys general catch non-tax abuses; and (4) make it easier to make charitable donations over the Web and to reduce the paperwork exchange among charities (e.g., by foundations needing information on grantees). It also makes the IRS' job easier. Although the IRS is trying to help, it is hampered by the lack of resources. Congressional backing here—even if only a statement of Congressional intent—could add to the momentum toward producing a more vibrant nonprofit sector.

Change the foundation payout rule so that it does not encourage giving in a pro-cyclical manner. Whether the average rate of payout needs to be higher or lower over time is not the issue here. Rather, just as the stock market bubble caused grants to rise dramatically over the past few years, a recession and a bursting bubble now make it very possible that these grants will fall dramatically. If so, foundation grant-making would drop when it is needed the most. Revisions to this formula that would reduce this pro-cyclical effect need to be considered.

³See Steuerle and Sullivan.

* * *

In summary, the tax system can be reformed in a way that adheres to fundamental principles of tax and budget policy. The thrust of my suggestions here is to maximize the amount of charitable giving in society for whatever revenue cost the Congress picks. My suggestions also try to minimize or reduce tax filing costs for taxpayers and deal with legitimate concerns about tax compliance and enforcement. Finally, I hope that this Committee will give these types of proposals priority in the tax bill: compared with one dollar of simple tax reduction, one dollar spent on many of these proposals has the added benefit of increasing charitable giving or grantmaking.

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It is possible to extend the charitable deduction to non-itemizers and significantly increase charitable giving at little or even no cost in tax revenue while also addressing concerns about administration and compliance

Extending the Charitable Deduction to Nonitemizers: Policy Issues and Options

by Joseph Cordes, John O'Hare, and Eugene Steuerle

On April 15, 2000, more than 30 million taxpayers who itemized deductions on their tax returns were able to claim tax deductions for any contributions made to their favorite charities. The effect of the deduction was to lower the taxpayer's cost of giving one dollar by amounts ranging from 15 cents to almost 40 cents. But many taxpayers who contribute to charities were not eligible for a charitable deduction because they claimed the standard deduction instead of itemizing deductions on their tax returns.¹ Recently, policymakers from both political parties have proposed extending the charitable deduction to taxpayers who do not itemize as one way of expanding the financial resources of charities, helping these organizations to meet a variety of social needs, and, more generally, fostering a more "giving" or "civil" society.²

The idea of allowing a charitable deduction for nonitemizers is not new. For a brief period from 1983 to 1986, such deductions were allowed, but they were then repealed as part of the Tax Reform Act of 1986. Considered in isolation, the notion of extending the charitable deduction to all taxpay-

ers, not just those who itemize, might seem unobjectionable. To the extent that the current charitable deduction is seen as a subsidy for private giving, it might seem somewhat odd to make the subsidy available to some taxpayers but not others.

Yet, repealing the charitable deduction for nonitemizers in 1986 was part of a broad effort to reform the individual income tax, an effort that had tax simplification as one important goal. Enactment of a more generous standard deduction that taxpayers could take in lieu of various itemized deductions, such as charitable contributions, was a centerpiece of these efforts. The standard deduction is large enough to provide most taxpayers with a larger deduction than they would be able to claim by itemizing medical and work expenses, state and local taxes, charitable contributions, and other uses of income. Thus, to some observers, allowing taxpayers who claim the standard deduction to also deduct charitable contributions may be seen as allowing a double deduction for some charitable gifts.

The case for extending the charitable deduction to nonitemizers is thus

Placing a common floor under all charitable contributions would eliminate the need for tens of millions of taxpayers to keep track of very small contributions and would put less pressure on an IRS that cannot even enforce the current system

not so much an issue of equity, since these taxpayers are indirectly allowed to deduct charitable contributions as part of the standard deduction. Rather, the question is whether it is good public policy to make tax incentives for charitable giving available to more persons. Almost certainly there would be some gains in terms of additional charitable contributions. But how do those gains stack up against costs, and are there ways to increase the gains relative to the costs? Answering these questions requires addressing the two major issues raised by allowing nonitemizers to claim charitable deductions—revenue cost and administrative complexity.

Concern over revenue cost may seem to be misplaced at a time when both the Congressional Budget Office and the Office of Management and Budget are projecting large budget surpluses, but it remains a real one. There is a large margin of uncertainty about the projections; even if the projected surpluses materialize, there are already many competing political claims on these financial resources, particularly Social Security and Medicare protection, new spending programs, and a host of new tax reduction initiatives (Reischauer 2000). What one *can* afford is not necessarily the same as what one *should* afford.

Associated with this revenue cost are windfalls that would be conferred on some taxpayers. Somewhat paradoxically, one group of taxpayers who could benefit from a deduction for nonitemizers would be a subset of itemizers who would be able to cut their tax liability without increasing their giving. Suppose that the standard deduction is \$6,000 and that a household has itemized deductions of \$7,000, \$2,000 of which are charitable contributions. If all charitable contributions were deductible by nonitemizers, then the individual could take a \$2,000 charitable deduction and a standard deduction of \$6,000, thus increasing total deductions by \$1,000 to \$8,000. If the taxpayer were in the 28 percent tax bracket, the \$1,000 increase in total deductions would result in tax savings (revenue cost) of just under \$300 without changing the financial incentive to give (except to the extent that the taxpayer had somewhat more after-tax income).

Those who are concerned about tax administration also worry that allowing nonitemizers to deduct charitable contributions may create compliance problems and additional tax return complexity. Again, this was one of the reasons why a standard deduction was created in the first place. When nonitemizers were last allowed to deduct charitable contributions, many reported fairly small amounts. No doubt some of these small gifts were real, but others may simply have been amounts that were “suddenly remembered” at tax time and that would be hard to document if audited. But the IRS simply does not have the resources to audit many returns, much less those reporting only small amounts of deductions. Moreover, when everyone can deduct even the smallest amount, then additional filing and administrative cost is imposed on almost everyone.

The remainder of the brief discusses the implications of these concerns for proposals to expand the charitable deduction to nonitemizers. We show how the concerns about revenue cost and administration or compliance can be addressed in the design of such policies, and we offer an alternative view of the consequences of allowing people who claim the standard deduction to also claim a separate deduction for charitable gifts.

Policy Design: The Role of Contribution Floors

The Urban Institute has developed a charitable giving model that can be used to analyze how different charitable incentives affect both tax revenue and the amount that people give to charities. The model is quite similar to models developed by the Treasury Department, the Joint Committee on Taxation, the National Bureau of Economic Research, and PricewaterhouseCoopers for the Independent Sector. Our focus here is to analyze the broad effects of different policy options rather than provide revenue estimates that might accompany any specific proposals. Thus, we show the effects of alternatives as if they were fully in place for 1995, whereas the effects of formal legislative proposals would be estimated for current and future years.

Our most important conclusion is that it is possible to extend the charitable deduction to nonitemizers and significantly increase charitable giving at little or even no cost in tax revenue while also addressing concerns about administration and compliance. We also show that these results hold even when the responsiveness of giving to changes in the after-tax cost of giving is relatively low.

Table 1 shows the simulated changes in tax revenue and charitable giving that result from four options for extending the charitable deduction to nonitemizers:

- Option 1 would simply allow nonitemizers to deduct charitable gifts beginning with the first dollar given.
- Option 2 would allow nonitemizers to deduct charitable contributions in excess of a floor of \$500 for joint filers and \$250 for single filers.
- Option 3 would allow all taxpayers to claim a charitable deduction in excess of a floor of \$500/\$250 without regard to whether they itemize or not. Such a change would limit charitable deductions for those who itemize under current law to amounts given in excess of the floor, while at the same time allowing those who currently do not itemize to deduct charitable contributions above the floor.²
- Option 4 has the same general features as Option 3, with the floors set at a level that results in no overall loss in tax revenue.

The degree to which any charitable incentive is likely to prompt additional giving depends on how sensitive people are to

changes in the after-tax cost of making charitable contributions. There is general agreement among researchers that people will give more when the cost of giving falls, but some studies estimate that the sensitivity of giving to changes in its price is relatively low, while others find that giving is fairly responsive to such changes. To capture the range of variation in these studies, the effects of each of the four options are simulated for the case in which the price sensitivity of giving is low, moderate, and high.³

The first row of table 1 shows the simulated changes in revenue and giving that result from adopting the first option. These results illustrate the concerns about revenue cost mentioned earlier. Even if giving is moderately responsive to changes in the cost of giving, allowing nonitemizers to deduct all charitable contributions, starting with the very first dollar they give, increases charitable giving by a smaller amount than the cost in foregone tax revenue. An important factor is the effect of the policy change on taxes paid by "switchers"—taxpayers who were itemizing deductions before the policy change who would have a financial incentive to switch and become non-itemizers.

The second row shows the effects of adopting Option 2. Limiting deductions to amounts greater than a specified floor has two effects. It reduces the extent to which taxpayers would be able to claim hard-to-document charitable contributions as a means of reducing their tax liability, and it substantially reduces the revenue cost of extending the deduction. Compared with Option 1, if the

TABLE 1: Summary of Revenue Effects and Change in Charitable Giving (Dollar Amounts in Millions), 1995 Income Levels

Tax Policy Options	PRICE SENSITIVITY IN GIVING					
	Low		Moderate		High	
	Revenue Effects	Change in Giving	Revenue Effects	Change in Giving	Revenue Effects	Change in Giving
1. Deductions for All Contributions by Nonitemizers	(\$5,570)	\$2,271	(\$6,215)	\$5,513	(\$6,736)	\$8,080
2. Deduction with \$500/\$250 Floor for Nonitemizers Only	(\$3,886)	\$2,166	(\$4,518)	\$5,318	(\$5,032)	\$7,816
3. Deduction with \$500/\$250 Floor for All Taxpayers	(\$1,193)	\$1,904	(\$1,828)	\$4,848	(\$2,340)	\$7,219
4. Revenue-Neutral Floor	\$660/\$325	\$1,681	\$750/\$375	\$3,964	\$800/\$400	\$5,711

Source: Urban Institute calculations based upon its charitable giving model.

responsiveness to changes in the after-tax cost of giving is low, the incentive costs roughly \$1.80 instead of \$2.45 in foregone tax revenue for every extra \$1 of charitable giving, and if the price responsiveness is moderate or high, the incentive encourages more than \$1 of extra giving for each dollar of revenue loss.

It is worth noting that even though limiting deductions to amounts in excess of \$500 or \$250 substantially lowers the revenue cost of extending the deduction, it has only a small effect on the amount of extra giving that is encouraged. This reflects the fact that many nonitemizers already give amounts in excess of the floor without any tax subsidy. In effect, the floor has the effect of providing more of the subsidy to extra giving, rather than to giving that would occur without any incentive.

The third option extends the floor to itemizers as well as to nonitemizers. If the tax rate is assumed to be 28 percent, placing a \$500/\$250 floor under charitable deductions would increase the tax bill of an itemizer who files a joint return by about \$150. In the tax model, the overall revenue pickup from a \$500/\$250 floor is over \$2 billion and helps pay for roughly 60 percent of the revenue cost of extending the deduction to nonitemizers, the precise percentage depending upon responsiveness of taxpayers to the overall incentive.⁹ Under this option, even when the responsiveness to changes in the after-tax cost of giving is low, the amount of extra giving from nonitemizers exceeds the net revenue cost. Note how this trade-off essentially exchanges weak to nonexistent incentives for first-dollar giving of itemizers with more powerful incentives more likely to apply to last-dollar giving of nonitemizers.

Option 4 shows what the value of the common floor would have to be in order to extend the deduction to nonitemizers without an overall reduction in tax revenue. The results show that it is possible to craft a charitable deduction for nonitemizers that is revenue neutral and increases total charitable giving. In effect, placing a contribution floor under all givers allows one to shift tax subsidy dollars from ranges of giving where the price sensitivity of giving is effectively zero to margins of choice where giving is sensitive to changes in the price (even if the responsiveness is modest).

Compared with placing a floor under deductions by nonitemizers only, Options 3 and 4 have an additional attraction from the standpoint of administration and compliance. Placing a common floor under all charitable contributions would eliminate the need for tens of millions of taxpayers to keep track of very small contributions and would put less pressure on an IRS that cannot even enforce the current system well for those claiming modest contributions.

Further Issues

Some models of charitable giving predict that higher-income taxpayers might be more responsive to incentives than are lower-income taxpayers.¹⁰ If this is the case, it changes the previous analysis, though only marginally. Since nonitemizers tend to have low-to-average income, the charitable contributions induced would more likely fall in the range suggested under low-to-moderate price sensitivity to giving. The revenue effects would change little, though the net increase in total giving resulting from the policy options that put a floor under all deductions would be somewhat smaller.¹¹

Still another issue not addressed here would be how to deal with complications in the design of the incentive. One layer of complication is added by the hidden tax rates that now permeate the tax code. One rate—the Pease provision, after former Congressman Donald J. Pease (D-Ohio)—reduces itemized deductions as adjusted gross income increases. The net effect for most taxpayers is a separate tax rate for which charitable contributions are not allowed. Moreover, there are a few taxpayers whose deductions are severely limited by the Pease provision. To prevent these taxpayers from gaining large tax reductions through a nonitemizer deduction that is not so limited, complications about when and how to take deductions have been added to some proposals.¹²

Some current proposals also try to limit the revenue losses associated with switchers (noted above) by limiting the charitable deduction for nonitemizers to the size of the standard deduction. But even with this provision, taxpayers whose noncharitable deductions were less than the standard deduction would still unambiguously gain by switching if their charitable deductions were less than or

equal to the standard deduction. Some other taxpayers with charitable deductions in excess of the standard deduction might also still benefit from switching, although their gain would be attenuated by the standard deduction limit, and they would have to forego some of their charitable deductions.

Next, the ability to craft a more efficient charitable incentive leaves unresolved the matter of whether it is equitable to provide a deduction for charitable gifts while also giving taxpayers the option of claiming a standard deduction of the same size as allowed under current tax law. The conventional justification for the standard deduction is that it offers taxpayers an alternative to itemizing deductions. Under this view, allowing taxpayers the option of simultaneously claiming the standard deduction and taking an additional deduction for charitable contributions would allow a taxpayer who takes the standard deduction to deduct the "same" charitable contribution twice. One response to this concern is that limiting deductions to an amount in excess of a floor addresses this issue, at least in part.

More generally, there is no reason why the standard deduction cannot be redefined to apply only to itemized deductions (e.g., state and local taxes, mortgage interest, and medical and other expenses), excluding amounts given to charity. In that case, the only policy question would be the amount of the standard deduction to allow for the remaining items. Redefining the standard deduction in this manner accepts the income tax as an administratively convenient mechanism for subsidizing charitable contributions. Such a shift would be consistent with past legislative justifications for allowing charitable contributions (Brody and Cordes 1999).⁴

Some might also argue that separate treatment of charitable deductions may be justified as a matter of fairness. A common benchmark for defining fair treatment is that taxpayers with the same ability to consume should pay the same amount of taxes. But this broad criterion leaves open the matter of how "consumption" is to be defined.

Suppose that one believed that the tax base should be limited to the ability to consume after charitable gifts were made so that those with equal incomes after charitable contributions would be treated as equals. Under this

benchmark, a generous household with \$30,000 of income and \$5,000 of gifts to charity would be deemed to have the same ability to consume as one with \$25,000 of income and no charitable contributions and would thus be taxed the same. With a standard deduction of \$6,000, however, neither household would itemize and, therefore, the households would be taxed on the basis of their total income, independent of the amount given to charity and available for the household's own consumption. On the other hand, if both households itemized, then charitable deductions would treat them more as equals on the basis of their after-contribution income. Allowing a deduction for charity without regard to whether a taxpayer claims itemized deductions simply extends the notion that those with equal incomes after contributions should be taxed the same. Since very large givers would become itemizers anyway, and since the ultimate beneficiaries of charitable contributions are not taxed on any consumption received, one shouldn't stretch this argument too far.

Lastly, extending the deduction to non-itemizers might have a lesser or greater effect on behavior than is traditionally estimated. On the one hand, those attempting to maximize the use of an incentive may bunch contributions over time so that their contributions are limited by a floor only in the years in which the bunched giving occurs rather than one floor every year. This becomes more of a problem when the floor is set very high.¹⁹ On the other hand, the symbolism of a charitable deduction for all could be a powerful one and might induce more giving by those enticed by a social standard as well as reduced price. Some modest givers may also find a floor on deductible contributions to reflect an amount above which they would like to rise so that they fall within that category of taxpayers who meet some minimum generosity standard.

Conclusion

There is now a bipartisan movement, as represented by proposals by both President Clinton and presidential candidate George W. Bush, to extend the charitable deduction to nonitemizers.²⁰ Although these proposals differ in a number of important specifics, a feature that appears to be shared is that any floor placed under contributions would apply only to non-itemizers. The apparent reluctance to consider

combining the extension of the charitable deduction to nonitemizers with the placement of a floor under all contributions may reflect the political wisdom of enacting changes in the individual income tax that are tax "cuts" and do not create losers. While placing a floor under all contributions would raise the tax bills of itemizers, the amount of the increase would be small. Moreover, as a matter of budget and tax accounting, someone always pays for any change in expenditures or taxes, so there are always losers—those who might have otherwise benefited from a different tax cut or expenditure increase than the one enacted, or those who would benefit from additional debt reduction.

Unfortunately, any differential treatment of charitable contributions for itemizers and nonitemizers would increase the complexity of filing an already complicated income tax. Many taxpayers would have to calculate taxes two different ways to decide how they would take their charitable deductions. With a common floor, it is possible to design the charitable incentive so that itemizers would almost always take the deduction in the same way as nonitemizers and avoid this tax filing complexity. A well-designed floor could also further reduce revenue cost and administrative burden on an already overwhelmed IRS. Whether these considerations will be given more attention when and if this issue proceeds to Congress, or is reintroduced in a less intense political environment after an election year, remains to be seen.

Endnotes

1. In recent years, about seven out of ten taxpayers did not itemize deductions on their tax returns.
2. A proposal was made first by George W. Bush, whose economic advisor, Lawrence Lindsey, has written on this subject. In its budget submission for fiscal 2001, the Clinton administration has also come forward with its own proposal to extend charitable deductions to nonitemizers. Thus, the appeal is now bipartisan.
3. Larry Lindsey, an advisor to George W. Bush in the 2000 presidential campaign, has himself written on the use of such floors in extending charitable deductions to nonitemizers. See Lindsey (1989).
4. In the parlance of economics, the sensitivity of giving to changes in its price is summarized by the *price elasticity of giving*, which measures the percentage by which giving changes in response to a given percentage change in the price of giving. For example, a price

elasticity of giving equal to 0.4 in absolute value would mean that a 100 percent decrease (increase) in the price of giving would increase (decrease) the amount of contributions by 40 percent. In this case, giving would be said to be relatively insensitive to changes in its price. A price elasticity of giving equal to 1.0 in absolute value would mean that a 100 percent decrease (increase) in the price of giving would increase (decrease) the amount given by 100 percent, in which case giving would be said to be moderately sensitive to changes in its price. A measured price elasticity of giving greater than 1.0 in absolute value would indicate that giving had a relatively high degree of sensitivity to changes in its price. In table 1, a low responsiveness of giving is captured by assuming that taxpayers have a price elasticity of giving equal to 0.4, a moderate responsiveness by assuming that the elasticity is 1.0, and a high responsiveness by assuming that the elasticity is 1.4.

5. These amounts are calculated from the charitable giving model but are not shown separately in table 1.
6. See, for instance, Clotfelter and Steuerle (1981) and Duquette (1999).
7. If the giving of itemizers were more price sensitive than the giving of nonitemizers, placing a common floor under all contributions while extending the deduction to nonitemizers would shift some dollars of tax subsidy from more price-sensitive to less price-sensitive givers.
8. Various aspects of these complications are discussed in Steuerle (2000a, b, c).
9. Consider a corollary: Suppose that charitable deductions were being designed in the process of a larger reform where the standard deduction and other items remained to be set simultaneously with other tax rules. Then there would not necessarily be a problem with having a charitable deduction that extended to everyone, with the standard deduction set at a slightly lower level than it would be under current law, which limits the deduction to itemizers.
10. One formal analysis of the possible effects of bunching is to be found in Feldstein and Lindsey (1983).
11. For a discussion of the proposal for extending the charitable deduction to nonitemizers that is included in the president's budget, and other issues related to the charitable deduction, see Steuerle (2000a, b).

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John O'Hare has more than 15 years of experience in analyzing the impact of tax and economic policy at the federal, state, and local levels. His areas of specialization include capital gains and losses, estate and gift taxation, consumption and saving, the taxation of insurance companies and their products, and the effect of taxes and depreciation on the user cost of capital. As a staff economist with the Congressional Joint Committee on Taxation, he introduced dynamic simulation modeling for use in assessing the effects of tax reform on the property and casualty insurance industry and extended this approach to more general models of corporate and individual decisionmaking over time.

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Institute and author of a weekly column, "Economic Perspectives," for *Tax Notes* magazine. At the Institute, he has conducted extensive research on budget and tax policy, charity and philanthropy, health care, Social Security, and welfare reform. His research on charity and philanthropy include studies on the patterns of giving by the wealthy (for the Council on Foundations), the effect of taxes on charitable giving, payout rates for foundations (for the Filer Commission), unrelated business income taxes, and ways of simplifying and reforming tax rules for charitable contributions and charitable giving.




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The **National Center for Charitable Statistics** (NCCS) became a part of the Urban Institute in July 1996 and is the statistical arm of the CNP. The mission of NCCS is to build compatible national, state, and regional databases and to develop uniform standards for reporting on the activities of charitable organizations. NCCS databases are available on CD-ROM, diskette, 9-track tape, or via File Transfer Protocol (FTP) in a variety of database formats. For information, call 202-828-1801 or visit our Web site, <http://www.urban.org/centers/cnp.html>.

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PREPARED STATEMENT OF JOHN P. WALTERS

Mr. Chairman and Members of the Committee:

Thank you for inviting me to testify. I am president of the Philanthropy Roundtable, a national association of more than 600 individual donors, corporate giving representatives, foundation trustees and staff, and trust and estate officers. Our associates include donors involved in philanthropy on a professional basis, as well as individuals for whom giving is a serious avocation. We provide publications and meeting programs designed to help donors get the greatest value for their charitable contributions. The Roundtable is not a "trade association" for donors, however. We do not take institutional positions on matters of legislation and regulation. The views I offer today are my own.

The most immediate issues before the Committee are related to the Administration's tax and budget proposals. Since a vibrant private sector is critical to generating the wealth that makes philanthropy possible, the decisions you will make regarding what is good for the economy are central to the future of philanthropy as well. However, you will also consider proposals targeted on charitable giving, such as the new charitable deduction for non-itemizers. This is an excellent way to in-

crease not only the amount Americans give, but the accountability that is a part of seeking support from many private individuals who must be convinced to give of their own wealth. I will be happy to discuss these matters in greater detail, if it would be of use to the Committee, but I wanted to use my opportunity to speak to you about the even more powerful trends that seem likely to produce truly historic changes in philanthropy, charitable giving, and the many societal institutions they shape.

The convergence of three trends offers the potential for revolutionary rather than incremental change: (1) a broad and renewed popular faith in principles of a free economy resting on individual enterprise; (2) an increasing popular realization that what the Rev. Martin Luther King Jr. called the “content of our character” is critical to our individual and collective well-being; and (3) historic high levels of wealth in many private hands.

The passage of welfare reform marked the decline in confidence that redistributive and entitlement-based social policies could effectively aid the poor, and the rise of market-based policies and programs. For both government and private philanthropy, market solutions are the growing tool of choice for helping everyone from single mothers on public assistance to recovering addicts to the disabled find employment and re-enter the mainstream of American life. In addition, many traditional charities are rushing to adopt private sector “business practices” in regard to management, finance and fundraising, strategic planning, marketing, and evaluation. Nonprofit business activity is exploding.

And when we face the limits of what the business model can accomplish, we look to religion. Whether or not they ever see a dime from the Administration’s initiative for faith-based and community programs, such local institutions will be out there inspiring hope lost by the old welfare programs for helping the poor and the addicted, as well as criminals and anyone else whose behavior prevents them from taking full advantage of the opportunity and promise of American life. The new found importance of these organizations reflects a deep consensus—across political lines—that “the content of our character” is crucial but was not being addressed by the large, bureaucratic social-welfare agencies which dispense needed funds but little else. It is not that we now despise social workers and idolize missionaries. It is rather that there has been a popular recognition of the ability of faith-centered institutions to lift up the downtrodden and rebuild shattered lives in ways unthinkable to their secular counterparts.

ARE WE READY TO RECEIVE WHAT AMERICANS ARE ABOUT TO GIVE?

News stories on the rapid decline in foundation assets over the past year have taken some attention away from what had been unceasing reports on the growth in charitable endowments and giving. The most recent edition of the annual *Giving USA* report indicates that charitable giving in the United States surged 88 percent during the 1990s, reaching nearly \$200 billion in 1999. Giving has gone up in almost every category, and many nonprofits—particularly top universities—hold record sums. Harvard’s endowment topped \$20 billion last year. That’s higher than the GDP of many developing nations. Indeed, 34 schools now have endowments over \$1 billion. And it’s not just schools: according to the *Chronicle of Philanthropy*, the Salvation Army took in \$1.4 billion in contributions from the public last year, and the YMCA, the Red Cross, and the American Cancer Society each received over \$600 million in private contributions. Indeed, 105 charities received donations of \$100 million or more last year.

Even with the recent stock market slump, a story on fundraising jitters that appeared in the *Chronicle of Philanthropy* found that approximately as many charities reported an increased amount of money in the last quarter of 2000 over the previous year, the height of the market surge. Another story on the “grim” outlook for charities featured a survey of 142 foundations, but found that only 15 of them planned to give away less money next year. Unreported in the story, or in a *dour New York Times* follow-up, was the fact that 62 of the 142 foundations said they actually plan to give out more grant money next year than in the record-setting 2000.

The trends of recent years are only the beginning, however. The best available projections of future trends in giving that I am aware of have been produced by Professors John J. Havens and Paul G. Shervish at Boston College’s Social Welfare Research Institute. They have created three different estimates of the wealth that will be transferred between generations and to charity over a 20-year period (1998–2018) and a 55-year period (1998–2052). The projections reflect three different sets of assumptions from more conservative (including a 2 percent rate of economic growth) to more optimistic (3 percent growth rate) to most optimistic (4 percent growth rate). Over the period 1998–2018 the three projections are:

1. 2 percent growth model results in \$12 trillion transferred between generations with \$1.7 trillion to charity;
2. 3 percent growth model results in \$14 trillion transferred between generations with \$2.2 trillion to charity; and
3. 4 percent growth model results in \$18 trillion transferred between generations with \$2.7 trillion to charity.

The 55-year (1998–2052) estimates are:

1. 2 percent growth model results in \$41 trillion transferred between generations with \$6 trillion to charity;
2. 3 percent growth model results in \$73 trillion transferred between generations with \$12 trillion to charity; and
3. 4 percent growth model results in \$136 trillion transferred between generations with \$25 trillion to charity.

There are additional points to keep in mind. First, the projections above rely on past ratios of total estates given to charity in relation to other elements in so-called distributional dynamics (heirs, taxes, and fees and burial costs). Yet the most recent work done by these same scholars suggests that the percent going to heirs may be decreasing over time, as wealth increases, and the percent going to charity may be growing.

Second, this is just “new” money. Between 1980 and 1998, foundation assets grew by 799 percent from \$48 billion to \$385 billion. If this growth continues and only 5 percent of the assets are paid each year, excluding all new gifts and bequests, foundation assets will grow to between \$4 trillion and \$5.9 trillion by 2035, according to some estimates.

Let me try to put that in perspective. When J. Paul Getty died in the mid-1970s his wealth stood at approximately \$1.5 billion. In the years since, Getty’s bequest has grown dramatically. Roughly \$4 billion has been spent making and executing plans for the J. Paul Getty Museum and its related acquisitions and programs since J. Paul’s death—acquisitions on such a scale that the Getty was accused of driving up art prices throughout the world and absconding to Southern California with large parts of the artistic legacy of Western Civilization. And even after that more than \$4 billion in spending, the Getty endowment retains roughly \$5 billion.

But this is wealth on a 1970s scale. Let’s suppose that instead of the \$100 billion figure quoted in recent years, Bill Gates’s net worth when he cashes it all in is only \$60 billion, and further, that he only puts \$58 billion more in his foundation (he has pledged to leave most of his wealth to charity and has already contributed \$22 billion to the foundation), under current rules, the required annual payout on that sum would be \$4 billion—the equivalent of a new Getty every year.

Imagine the institutions that can be created—and the influence that can be exerted—with that kind of war chest. Libraries? That translates into 200 million books each year—larger than the entire collection of the Library of Congress. Sports? How about a new athletic center for every Division I college, every year. Scholarships? That’s a \$4,000 scholarship for one million students. Think tanks? The annual budgets for all the major think tanks in Washington, D.C. (Right, Left—you name it) total approximately \$200 million. Such a Gates foundation could fund, in perpetuity, a public policy apparatus 20 times larger than everything that already exists.

This Gates example is only a small fraction of the wealth now poised to come into the charitable and philanthropic world over the next several decades, however. My concern is over how little attention seems to be devoted to thinking about how we utilize these resources. The first line of defense here should be an informed donor with the skills and creativity to match the opportunities before us. We are working on this priority at the Roundtable. We know that waste, fraud, and abuse are the great dangers when large sums of money are poured into an area over a relatively short period. There is no doubt that many institutions would do well to think more about the potential effects of the coming philanthropic boom.

If current patterns are any guide, the great bulk of future philanthropy will go to churches and synagogues, and the programs they administer. (In 1998 almost 44 percent of all giving went to religion.) For those concerned about the spiritual health of the nation, a vast increase in religious giving would be a welcome prospect.

Current trends also suggest that much of the new money will go to educational institutions. Over \$27.5 billion (14 percent of total giving) fell into this category in 1999. Recent years have brought some much-publicized expenditures on elementary and secondary education, and, particularly, support for reform efforts like vouchers or private scholarships and charter schools. All of these efforts show promise of continued growth.

Historically, the largest share of education giving has gone to colleges and universities (\$20 billion of the \$27 billion in 1999), with elite institutions receiving the

greatest portion. This trend may not continue, however, as the wealthiest colleges and universities fall under increasing criticism for building bigger and bigger endowments—Harvard, Yale, and the University of Texas system together are worth more than the GDP of Bolivia—rather than spending resources on their students and their institutions. Some schools, most notably Harvard, have raised their endowment spending slightly in response to such complaints, but new windfalls are likely to intensify the scrutiny of current patterns in higher education giving.

The other major current areas of giving—human services, health, arts and culture, and environment and wildlife—will also continue to grow, and it is the sheer magnitude of this growth that raises the question of whether a simple projection of current patterns is really a helpful or accurate predictor of the future. There is clearly the potential for the coming trends in giving to force a fundamental reconsideration of current institutional arrangements and how they are sustained.

Certainly there are challenges in the path of institutional change to re-privatize important aspects of our domestic life. One is the fact that the wealthy are not always located in proximity to the needy. But for a philanthropic community that has in the past dedicated itself to ending war, racism, and curbing world population growth, the task of matching up needs and resources in our own backyards would seem modest indeed.

This is not to argue that all government programs should be privatized. What it does mean is that a much larger share of social programs can be reconfigured to rely on local, private funding and, therefore, be accountable to local concerns. It also raises the possibility of strengthening our social fabric by more directly linking citizens and the institutions shaping their lives at the regional, local, and personal level. The rewards of giving and of honorably repaying a debt we all owe to others can be much more visible than when what is given must travel through a huge governmental bureaucracy.

This is another important reason to give some serious thought to wealth, giving, and the future of American institutions. As the nation was reminded in the long debate that culminated in welfare reform, the mere transfer of wealth is almost never by itself a solution to the problem of poverty or other societal needs. In fact, we know only too well that “philanthropic” dollars spent badly or wastefully make things worse, in some cases much worse. And finally, there is nothing about the ability of private individuals to provide for those in need that makes such private giving inevitable. Increasing it will require the individual decisions of many Americans, and their hard work.

As the 20th century reaches a close, Americans can take pride in, and give thanks for, the nation’s unparalleled record of generosity. In looking to the future, we should remember that the great engine of American philanthropy has two fundamental parts, the free-enterprise economy that generates astounding prosperity, and the good character of the American people that leads them to share their wealth for the benefit of so many. If we can maintain the vitality of both parts, the future holds the promise of truly revolutionary achievement.

Thank you again for this opportunity to testify.

JOHN P. WALTERS

John P. Walters is president of the Philanthropy Roundtable, a national association of over 600 individual donors, corporate giving representatives, foundation staff and trustees, and trust and estate officers. The Roundtable provides publications and programs for donors on all aspects of charitable giving.

Previously, Mr. Walters was president of the New Citizenship Project, an organization created to advance a renewal of American institutions and greater citizen control over our national life. He was a member of the Council on Crime in America, a bipartisan commission on violent crime co-chaired by former U.S. Attorney General Griffin Bell and former Drug Czar William J. Bennett. He also is a co-author—with William J. Bennett and John J. DiIulio Jr.—of *Body Count: Moral Poverty and How to Win America’s War Against Crime and Drugs*.

During 1993 he was a visiting fellow at the Hudson Institute, writing and speaking about anti-drug policy. Prior to that, Mr. Walters was appointed by President Bush and confirmed by the Senate as Deputy Director for Supply Reduction in the Office of National Drug Control Policy (ONDCP). Mr. Walters was responsible for developing enforcement policy and coordinating efforts to reduce the supply of illegal drugs. He also served as the senior advisor on national security matters related to drug control and senior liaison to the White House and all executive departments. Prior to his appointment as Deputy Director, Mr. Walters served as Chief of Staff and National Security Advisor to the Director of ONDCP from the Office’s inception in 1989. And from November 1990 to March 1991, Mr. Walters served as Acting Di-

rector of ONDCP, overseeing both the international and domestic anti-drug functions of all Executive Branch agencies.

Mr. Walters was a creator of the Madison Center, a public policy organization devoted to advancing improvements in education and related fields, including early childhood education and drug abuse prevention. Mr. Walters served as executive director from September 1988 to January 1989. Between 1985 and 1988, Mr. Walters worked at the U.S. Department of Education, serving as Assistant to the Secretary and Secretary's Representative to the National Drug Policy Board and the Domestic Policy Council's Health Policy Working Group, and was appointed Chief of Staff and Counselor to the Secretary in 1988. Mr. Walters also served as Acting Assistant Director and Program Officer in the Division of Education Programs at the National Endowment for the Humanities from 1982 to 1985. He has taught political science at Michigan State University's James Madison College and at Boston College.

RESPONSES TO QUESTIONS FROM SENATOR TORRICELLI

Question. Historically speaking, how have changes in the tax code stimulated philanthropic activity?

Answer. As noted in my written testimony, which was delivered in my capacity as an individual, the two fundamental factors that affect giving are wealth and the conviction that charitable contributions are valuable and make a genuine difference. The wealthier the nation and its citizens are, the more we give to charities.

The historical record suggests that tax policy affects giving in two ways. First, it affects wealth: the affect of tax policy on general economic growth and its specific affect on individuals and households—how much is left to give after taxes, or is anticipated to be available for giving after taxes. Second, and related, tax policy affect the timing of contributions. The estate tax may be the clearest example in that it tends to encourage wealthier givers to plan the bulk of their giving for the period near the end of their lives or after their death. Obviously, other parts of the tax code as they affect individual wealth and the cost of giving can be expected to have parallel influence.

Question. What effect has limiting deductions to 50% of adjusted gross income had on philanthropic giving?

Answer. I am not an expert on economic and tax modeling, but my experience is that most of the available data show that increasing deductions increases giving.

Question. Americans regularly donate stock acquired through a stock option plan to their favorite charity. And often they make the donation within a year of exercising their stock options. But current law penalizes these donations by taxing them as ordinary income or as capital gains. Given that these taxes can run as high as 40%, do you think that amending the tax code on stock options would increase philanthropic giving?

Answer. Increasing the wealth of individuals who are giving to charity by cutting the portion of their wealth taken by taxes will increase giving. Stipulating again that I am not an expert on the economic effects of tax policy, what I have seen in terms of research on giving, wealth, and taxes suggests tax reduction in general and reductions more closely tied to specific kinds of giving, because they increase wealth, stimulate greater giving and promote greater giving sooner.

COMMUNICATIONS

STATEMENT OF THE COUNCIL ON FOUNDATIONS

[SUBMITTED BY DOROTHY S. RIDINGS, PRESIDENT AND CEO]

The Council on Foundations is pleased to have this opportunity to comment on tax-related proposals that would protect and encourage philanthropy. The Council is an organization of more than 2,000 grantmaking foundations and corporations that serves the public good by promoting and enhancing responsible and effective philanthropy. Our members include independent, operating, community, public and corporate foundations and giving programs engaged in education, human services, health, science and research, environment, the arts, urban planning and economic development.

Our member foundations were pleased to hear the campaign proposals of then-Governor Bush and Vice President Gore that sought to boost charitable giving and acknowledged the important role that the nonprofit sector plays in addressing pressing national concerns. We strongly support two measures President Bush has endorsed: restoration of the charitable deduction to taxpayers who do not itemize, and a provision that would allow taxpayers to contribute tax-deferred retirement assets, such as IRAs, to charity without incurring tax liability. Both of these proposals should result in additional funds to charitable organizations that work in our communities.

EXCISE TAX ON PRIVATE FOUNDATIONS INVESTMENT INCOME

A priority of the Council is repeal of the excise tax on private foundation investment income. Because the tax paid qualifies as a credit toward the 5 percent minimum distribution, eliminating the tax would automatically result in an equal increase in qualifying charitable distributions per year, about 90 percent of which typically go to grants, according to IRS estimates.

As you are aware, private foundations generally are subject to a 2 percent excise tax on their net investment income. The tax is 1 percent in any year in which the foundation's percentage of distributions for charitable purposes generally exceeds the average percentage of its distributions over the five preceding taxable years. Private foundations generally must make annual distributions for charitable purposes equal to roughly 5 percent of the fair market value of the foundation's endowment assets. The excise tax paid acts as a credit in reducing the 5 percent requirement.

The policy presents several problems.

First, the revenue raised by the tax is not being used as Congress envisioned. The tax was enacted in 1969 to cover costs of IRS oversight of exempt organizations. Originally 4 percent, the rate was cut in half in 1978 because revenue far exceeded expenditures for its intended purpose. In 1999, the last year for which figures are available, the excise tax raised \$499.6 million. But the current-year budget earmarked for all IRS exempt organization activities is about \$59 million.

This is no aberration. While excise tax revenues have steadily climbed, IRS audits of private foundations have steadily dropped over the past decade. In 1990, the excise tax raised \$204 million and the IRS conducted 1,200 audits of private foundations. In 1999, the IRS conducted 191 audits.

Second, the 2-percent/1-percent structure of the tax penalizes foundations for substantially increasing charitable spending. The two-tiered structure was enacted in 1984 as an incentive to increase distributions. But the result has been the reverse.

Many foundations set spending policies of 5 percent to 6 percent to preserve the long-term value of their endowments. A significant increase in distributions one year (while making them eligible for the 1 percent rate for that year) will increase a foundation's five-year average spending percentage to a level it is not willing or

able to maintain. As a result, for the next five years, its tax rate doubles to 2 percent.

Finally, we believe the tax is inequitable, because other tax-exempt organizations are audited, but only private foundations are subject to a similar tax.

Mr. Chairman, repeal of the excise tax would result in an increase in qualifying distributions of hundreds of millions of dollars every year, boosting the ability of charitable organizations to address national priorities across the range of fields that are the focus of some 47,000 private foundations.

I will detail how the \$500 million in 1999 excise tax revenues would have been spent had there been no tax. As I noted, about 90 percent of qualifying distributions take the form of increased grants. Typically, the other 10 percent goes to other types of expenditures. These include many of the costs of operating a foundation, such as administering grants programs and preparing and filing the foundation's tax returns. Qualifying distributions also include the cost of charitable activities that foundations undertake directly; set-asides for future projects (but only if approved by the IRS), and investments made primarily to further a charitable purpose rather than to produce a financial return. Costs of managing a foundation's portfolio or endowment are not qualifying distributions.

Eliminating the tax would spur charitable giving. On February 28, a bill was introduced in the House of Representatives that would do just that. Representatives Cliff Stearns and Phil Crane introduced H.R. 804, which would repeal the excise tax for tax years beginning after 2001. As Congressman Stearns said in his introductory statement, "What we have is a private foundation making a charitable grant to the federal government every year."

It is important to emphasize, Mr. Chairman, that repeal would have no financial benefit for foundations. Every dollar not paid in taxes would go directly into the charitable stream. We urge your support for repeal.

UNRELATED BUSINESS INCOME TAX ON LEVERAGED REAL ESTATE INVESTMENTS

Mr. Chairman, the Council advocates a change in the tax treatment of income from leveraged real estate investments held by 501(c)(3) organizations.

Investment income is generally tax-free. Charities that actively own and run businesses unrelated to their charitable purposes must pay unrelated business income tax (UBIT) on the income earned from these operations. However, passive investment income (such as interest, dividends, rents and royalties) is not taxable. Thus, the vast majority of endowment income of private and community foundations is not subject to UBIT.

Section 514 of the tax code requires tax-exempt organizations to pay some tax on assets that are financed in part with debt, such as property purchased with a mortgage. The income of "debt-financed" property that is subject to UBIT is that portion of the cost of the asset that is financed by the debt. For example, if 40 percent of the asset's cost is financed by a mortgage, then 40 percent of the income from the asset is subject to UBIT. The greater the debt as a percentage of the price of the investment, the greater is the portion of the income that will be taxed.

Section 514(c)(9) provides a complete exemption for the UBIT tax on debt-financed property so long as the asset is real estate and the owner of the property is a pension plan or an educational institution (college or university).

Mr. Chairman, there is no valid tax policy reason to exempt pension funds and educational institutions from section 514 but not charities. Endowed private and community foundations often are urged by their investment advisors that a portion of their assets should be invested in real estate as a hedge on inflation. It is the nature of real estate markets that the most attractive real estate investment options involve purchases that are heavily financed by debt. Current law discourages this prudent investment choice by endowed foundations.

Most foundations will not invest in otherwise attractive real estate offerings because of the complications and penalties of UBIT. Unfortunately, some foundations find themselves at the end of the tax year having made an investment in leveraged real estate by their investment advisors. In other cases, foundations do not want to hamstring their financial advisors by insisting that they not enter leveraged real estate investments—and they pay the price in UBIT.

The Council urges Congress to remove the application of UBIT to all debt-financed investment property by repealing section 514. Alternatively, Congress could consider extending the current exemption under section 514(c)(9) to all 501(c)(3) organizations.

Thank you very much, Mr. Chairman, for allowing us this opportunity to submit our views. The Council on Foundations stands ready to assist the committee in its consideration of these and other charitable issues.

NATIONAL CHRISTIAN CHARITABLE FOUNDATION, INC.

March 14, 2001

Hon. CHARLES E. GRASSLEY,
Committee on Finance,
219 Dirksen Senate Office Building,
Washington, DC.

Hon. MAX BAUCUS,
Committee on Finance,
203 Hart Senate Office Building,
Washington, DC.

Re: Tax Free Distributions from Individual Retirements Accounts for Charitable Purposes

Dear Chairman Grassley and Ranking Member Baucus: In the last three years our organization has distributed over \$200,000,000 to almost 5,000 charities in the United States. Because of this, we have had the opportunity to observe what a significant impact the private charitable sector of America has on our way of life.

Therefore, we strongly support the recent proposals that would waive income inclusion on distributions from individual retirement accounts ("IRAs") to the extent the distributions are for charitable purposes.

I can safely say that I speak for not only our organization, but also twenty-six publicly supported Christian community foundations across America.

Sincerely,

NATIONAL CHRISTIAN CHARITABLE
 FOUNDATION, INC.
 TERRILL A. PARKER, *Chairman of the*
Board

STATEMENT OF THE TULSA COMMUNITY FOUNDATION

INTRODUCTION AND OVERVIEW

This testimony outlines the comments and suggestions of the Tulsa Community Foundation ("Foundation") relating to President Bush's charitable donation tax incentive proposals. Specifically, our testimony focuses on the President's proposal to increase the corporate deduction limit for charitable donations.

The Foundation was formed in 1998 as a tax-exempt, public charity to receive, protect and distribute gifts from individuals and organizations for the improvement of the Tulsa and northeastern Oklahoma area. The Foundation includes a collection of many charitable funds varying in size from \$500 to more than \$11 million, each with its own identity and philanthropic purpose. The Foundation accepts gifts of almost every kind and distributes its funds to a wide variety of local nonprofit organizations and programs, taking into account its donors' requests. The generosity and foresight of the Foundation's donors reflect a passionate commitment to the Tulsa community and a desire to improve the quality of life for future generations residing in our area.

The Foundation strongly supports the President's charitable donation tax incentive proposals. Further, the Foundation specifically recommends that the limit on corporate deductions for charitable donations under section 170 of the Internal Revenue Code ("Code") be increased from 10 percent to an even higher 50 percent of modified taxable income. The Foundation believes that amending section 170 in this manner will encourage greater corporate giving and provide our country's charitable organizations with greater resources to assist those in need.

DESCRIPTION OF CURRENT LAW AND PROPOSAL

Current Law

Under section 170 of the Code, a corporation may deduct up to 10 percent of its modified taxable income for charitable contributions. In contrast, an individual taxpayer, as well as a partner in a partnership or shareholder in a sub-S corporation,

may deduct charitable gifts generally in amounts up to 50 percent of his or her adjusted gross income.

Proposed Change

As part of his budget recommendations for FY2001, President Bush has proposed a number of amendments to the Code aimed at encouraging greater private and faith-based charitable giving. Among the suggested amendments is a proposal to increase the corporate charitable deduction limit to 15 percent of modified taxable income. This initiative clearly recognizes that charitable organizations play a vital role in meeting our country's needs, as these organizations possess a greater understanding of local concerns and a heightened ability to quickly tailor their programs and services to meet such concerns. Further, the President's proposal aptly recognizes that corporations play an important role in supporting charitable organizations. Unfortunately, Congress has not closely examined the corporate charitable deduction limit for 20 years, since the debate on the Economic Recovery Tax Act of 1981, P.L. 97-34, when the corporate limitation was increased from 5 percent to 10 percent. In light of the Administration's and Congress' dedication this year to considering incentives aimed at increasing charitable giving, the Foundation believes now is the time for Congress to reexamine the effectiveness and fairness of the current corporate deduction limitation.

Although the Foundation is supportive of the President's corporate charitable deduction proposal and believes the proposal is an important first step toward encouraging corporate giving, the Foundation also believes that the proposal does not fully recognize how corporations can be encouraged to address the needs of charitable organizations. Accordingly, the Foundation recommends that Congress raise the section 170 deduction limit for corporate charitable donations to 50 percent, equal to the individual limitation.

A. Need for Corporate Giving.

As previously stated, the Foundation urges Congress to expand the President's corporate deduction proposal. Despite the recent growth in charitable giving, charitable organizations continue to face an increase in needs for resources. The Code can be an effective tool for encouraging corporate charitable giving to provide these resources; however, current law penalizes corporate taxpayers for donations made above the 10 percent limitation. Although many corporations do not have funds available to donate more than 10 percent of their modified taxable income, those corporations that do should be encouraged and not harmed by their philanthropic approaches.

B. Business Structure Should Not Dictate Result.

The Code also draws an unfair distinction between taxpayers that operate their businesses in corporate form and comparable taxpayers that operate their businesses as proprietorships, sub-S corporations or partnerships. Currently, corporate taxpayers are allowed one-fifth the deduction allowed to other business forms whose individual owners may deduct up to 50 percent of their adjusted income for charitable donations. Amending section 170 to permit the full 50 percent limit for corporations would allow all business donors, regardless of how their businesses are organized, to make the same level of deductible gifts.

CONCLUSION

The Foundation recognizes the current pressure on charitable organizations to provide much needed services to those in need and believes that any business entity that is willing and able should be allowed to give up to 50 percent of their income to charitable organizations without penalty. The Foundation therefore recommends that Congress take the President's corporate deduction one step further, and raise the section 170 deduction limit for corporate charitable donations to 50 percent, equal to the individual deduction. Such a change to the Internal Revenue Code would encourage greater giving by corporations. In turn, our country's charitable organizations would have access to greater resources to provide services to those in need.

