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Charitable Giving and Tax Policy in the U.S.¹

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In several important ways, U.S. tax policy favors charitable giving and nonprofit organizations. Not only are nonprofit organizations generally exempted from income and property taxes, but most contributions to them from living donors, corporations, and estates are also tax-deductible. This favorable tax treatment is one important component of a more general American approach to the provision of public goods. The nation's tax policy toward charitable giving has had three broad effects. First, this tax policy allows many citizens to gain a sense of participation that they might not otherwise have, by choosing the causes and organizations that will receive their donations. Institutionally, this sense of participation is reflected and enhanced by a very prominent nonprofit sector. Second, this policy has the effect of handing over to wealthy individuals an extraordinary amount of influence over the allocation of public funds. As a result of these two effects, American tax policy contains an inherent tension between participatory citizenship and elitism. Third, because it operates through a tax deduction, tax policy toward charitable giving is vulnerable to inadvertent modification simply as a result of otherwise unrelated tinkering with the income tax.

The paper begins by providing some broader context for understanding the role of tax policy toward charitable giving. The second section describes the basic components of American tax policy, its implications for incentives for donors, and some of the prominent tax policy issues that arise in connection with the charitable deduction. The third section discusses the unusually large role played by wealthy donors by virtue of the charitable deduction. The fourth section

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examines the possible effect of tax reform on charitable giving. The last section offers a brief recapitulation.

I. American Exceptionalism, the Social Contract, and Charitable Giving

Compared to other developed countries, the United States has developed a distinctive approach to meeting social needs. It relies less on direct government provision and compulsory taxation and more on voluntary provision. In 2007 government spending for social expenditures was 16.2% of GDP in the U.S., compared to 19.2% in the OECD, as shown in Table 1. The corresponding ratios in Continental Europe's largest economies, France and Germany, were 28.4% and 25.2%, respectively. As has been frequently documented, the consequences of the comparatively weak American social safety net are higher poverty rates and greater income inequality, after taxes and transfers. For example, Smeeding (2006, Table 4) calculates that government spending on social insurance and social assistance reduced the poverty rate in the U.S. by 26%, compared to an average of 61% in the OECD as a whole.² Similarly, the United States generally lags behind Europe in public expenditures for health, education, and culture.³ Alesina, Glaeser and Sacerdote (2001, pp. 46, 55 and 57) offer several explanations for this difference, including racial heterogeneity, Protestantism, and an American tendency to ascribe poverty to laziness.

In contrast to its stingy public provision, however, the United States tends to be a leader when it comes to private provision, expenditures controlled by individuals rather than the government, some of which is subsidized by the government through tax breaks. As shown in Table 1, the portion of GDP the U.S. devoted to social expenditures not controlled by government was 10.5% in 2007, well above the OECD average of 2.5%. Part of this private expenditure comes in the form of tax expenditures, tax revenue that is sacrificed as a result of exemptions, deductions, or other exclusion from taxation, such as the exclusion for health premiums, pension contributions, and the deduction for charitable contributions.⁴ Because tax expenditures for social purposes have an effect similar to direct government provision, Howard (1997) refers to them as the "hidden welfare state."

² See also Neubourg et al. (2007, p. 7) for an analysis with similar findings. Comparisons use poverty rates defined relative to each country's median income.

³ See *OECD Factbook 2011*, http://www.oecd-ilibrary.org/economics/oecd-factbook_18147364, 3/20/12.

⁴ For an official run-down of U.S. tax expenditures, see U.S. Office of Management and Budget (2010), chapter 17, "Tax Expenditures."

A centerpiece of this shadow welfare state is charitable giving. According to household surveys, Americans contribute about 1.7% of national income, a far higher percentage than in other developed countries, as shown in Table 2. When combined with contributions by corporations and charitable bequests from estates, Americans give roughly 2% of their income to nonprofit organizations, a ratio that has held rather steady for decades.⁵ Scholars have made a great deal of this tradition of personal generosity, giving it a prominent place in the larger portrait of America's distinctive approach in addressing social needs. Indeed, the American record of giving and volunteering has been celebrated as often as its weak government safety net has been decried. From this laudatory perspective, the generosity of spirit revealed by the country's high rate of charitable giving is inextricably wedded to the country's historical reliance on non-governmental organizations to address social problems and provide collective goods. Political scientist Lester Salamon sees in this model a tension between "two seemingly contradictory principles" honored by Americans: individualism and solidarity.⁶ No history of the American nonprofit sector can be complete without a quotation taken from the eloquent Frenchman Alexis de Tocqueville, who was enamored by much of what he encountered in his visit to the United States in 1831. He may be best known for his description of the American tendency to form voluntary associations: "In no country in the world has the principle of association been more successfully used or applied to a greater multitude of objects than in America."⁷ This theme has been embraced by many American historians of the nonprofit sector, and highlighting this distinguishing national characteristic often goes hand in hand with noting with approval the tradition of voluntary giving that supports it. For example, Bremner writes: "We do not need to exaggerate the extent of our national generosity to recognize that voluntary benevolence has played a large role and performed important functions in American society."⁸

There is no shortage of evidence to illustrate the significance of the nonprofit sector in the United States. In no other developed country are there, for example, so many thriving and prominent nonprofit universities. Of the 15 American universities listed among the *Times* of

⁵ Wing et al. (2008, Figure 3.1, p. 73). For a summary of aggregate giving from these various sources over time, see the annual publication *Giving USA*.

⁶ Salamon (2002, p. 10).

⁷ Quoted from *Democracy in America* in Hammack (1998, p. 143).

⁸ Bremner (1977, p. 89).

London's top 20 in the world, 12 are private.⁹ Nonprofit institutions are similarly prominent among the country's leading medical centers, museums, and symphony orchestras. Religious organizations, most of them small congregations, are ubiquitous. Many social services are provided by religious and other nonprofit organizations, and "community chest" funds provide a significant portion of spending for public needs, as indicated by the figures given above. Nonprofits employ nearly a tenth of the American work force.¹⁰

One inevitable consequence of this reliance on independent organizations is decentralization of power. Letting a thousand flowers bloom fits nicely, in terms of political philosophy, with America's pluralistic principles. According to Prewitt (2006, pp. 39-41), these principles are aligned with the country's historical preferences for weak and unobtrusive government. The significance of all this for the current paper is in the revenue side of this sector. By leaving such a large share of the funding up to individuals, the system takes much of the decision-making away from legislatures and hands it over to individual donors. For a country that historically has revered individual liberty, this devolution of responsibility is attractive and natural. In allowing a deduction for charitable donations, American tax law in effect recognizes that donations replace government spending and, by extension, gives legitimacy to the social value of donors' preferences. Not only is this decentralization of decision making consistent with pluralism, but some observers also see it as a market-like mechanism that makes public provision more efficient, a viewpoint concisely stated by Yale law professor Stephen Carter:

The charitable deduction also helps resolve an information problem: Government officials, no matter how well-intentioned, cannot know all the places where donations are needed, or the form that will be most useful. The deduction is democracy in action. By encouraging individuals to make their own choices on how to spend money for the public good, the deduction makes society as a whole better off.¹¹

⁹ Website for the *Times* of London, <http://www.timeshighereducation.co.uk/world-university-rankings/2010-2011/top-200.html>, 3/17/12.

¹⁰ Wing et al. (2008, Table 1.8, p. 20) estimate that nonprofits employed 9.7% of the U.S. workforce in 2005.

¹¹ Stephen L. Carter, "Ending Charity Tax Break Will Hurt Poor Most," *Bloomberg*, November 22, 2011; <http://www.bloomberg.com/news/print/2011-11-23/ending-charity-tax-break-would-hurt-poor-commentary-by-stephen-l-carter.html>, 3/8/12.

Despite the frequently obvious disadvantages of inadequate resources and duplicated effort, such a system also offers the advantage of efficiency-enhancing competition, such as that which occurs among research universities.¹²

By almost any yardstick, the magnitude of charitable giving in the U.S. is large. For the year 2010, donations from living individuals amounted to some \$211.8 billion. Corporations contributed an additional \$15.3 billion, and decedents left another \$22.8 billion in charitable bequests.¹³ For individuals in the United States, making donations to tax exempt organizations is quite common, with more than two thirds of all households reporting making such donations. Both average contributions and the percentage of households who report any contributions tend to rise with age into middle age and then go back down.¹⁴ The pattern of average giving is much smoother when households are arranged by income, and the percentage that make contributions also tends to rise with income. As a percentage of annual income, deductible contributions make a U-shape pattern, falling with income up to the \$200,000 to \$500,000 category, after which they rise again.¹⁵ As shown in Figure 1, however, the taxpayers responsible for this rising portion at high incomes account for a relatively small share of total contributions. Differences across individuals have also been noted between those who attend church and those who do not, with the former group more likely to give. Other variables that have been found in past studies to be positively related to giving include education, marriage, number of children, home ownership, living in a city under one million in population, and having parents who gave regularly.¹⁶

One fact of great significance for any discussion of U.S. tax policy toward charitable giving is that donative preferences differ markedly across individuals. That preferences differ from one person to the next is not surprising, and indeed the efficiency of the tax deduction that Carter notes above depends crucially on the ability of each individual taxpayer to direct a portion of the national tax subsidy to the charity of his or her choice. One taxpayer donates to the local soup kitchen while another chooses to support medical research. But there is one dimension of systematic variation in the types of organizations supported that is worthy of special note. On average, the types of organizations favored by donors differ systematically up and down the income distribution. For individuals of modest means, religious organizations are far and away

¹² For an argument to this effect, see Clotfelter (2010, Introduction).

¹³ *Giving USA 2010* news release, June 20, 2011; http://www.aafrc.org/press_releases/gusa/GUSA-2011-Final-Release.pdf, 3/18/12.

¹⁴ See Clotfelter (1997).

¹⁵ See Appendix Table A.1 for detail on the distribution of charitable contributions in 2009.

¹⁶ See, for example, Clotfelter (1997).

the most favored type of donee. As shown in Table 3, contributions to religious organizations (even subtracting the portion that are ultimately used to provide aid to the needy outside of congregations) made up two thirds of the contributions made by individuals with incomes under \$100,000 in 2005. For those in the next highest income class, \$100,000 to \$200,000, giving to religious organizations remained the leading category, though its share was only a little more than half. For the two highest income categories, religion is eclipsed by education, which turns out to be mainly higher education. Owing mainly to these preference patterns and the sheer magnitude of donations made by high-income individuals, donations to educational institutions are almost half as large as the total giving directed to religious institutions. And the totals given to education, health, and the arts depend almost exclusively on gifts from the affluent. These patterns have policy relevance because not all contributions receive the same tax treatment, to which treatment I now turn.

II. The Basics of the US Income Tax Policy

The centerpiece of U.S. tax policy towards charitable giving is the deduction available in the personal income tax, the corporation income tax, and the estate and gift tax.¹⁷ The modern U.S. individual income tax was passed in 1913. The deduction for donations to nonprofit charitable and educational organizations was added in 1917, a year in which Congress increased tax rates to finance the war effort, raising the top marginal tax rate from 15% to 67%. Arguing for the deduction was Senator Henry Hollis of New Hampshire, who stated, “we impose these very heavy taxes on incomes, [and] that will be the first place where these very wealthy men will be tempted to economize, namely, in donations to charity.”¹⁸ Very wealthy men, indeed: to qualify for the top tax rate, a taxpayer needed an income of \$35 million in 2011 dollars. Those with incomes of a mere \$1 million were subject only to a 16% marginal rate. Top marginal rates fluctuated thereafter, falling as low as 24% (in 1929) and rising as high as 94% (1944-1945).¹⁹ In

¹⁷ Contributions are deductible if given to nonprofit organizations described in section 501(c)3, defined as “charitable, religious, educational, scientific, literary, ...fostering national or international amateur sports competition, and preventing cruelty to children or animals.” A deduction is not allowed for one group of 501(c)3 organizations, namely, those testing for public safety. are not all See IRS, <http://www.irs.gov/charities/charitable/article/0,,id=175418,00.html>, 3/26/12.

¹⁸ *Congressional Record*, September 7, 1917, p. 6728, as quoted in Clotfelter (1985, p. 31), which mistakenly reports that the top marginal rate in 1917 was 15%.

¹⁹ Tax Foundation, *Federal Individual Income Tax Rates History*, http://www.taxfoundation.org/files/fed_individual_rate_history_nominal&adjusted-20110909.pdf, 3/8/12.

1944, the Congress introduced a standard deduction, after which most taxpayers stopped itemizing deductions. In 1945 only 17% of taxpayers itemized, a percentage that crept up over time to a peak of 48% in 1970, after which the minimum standard deduction amount was increased and, eventually, indexed to inflation.²⁰ Except for a brief period in the 1980s, nonitemizers received no tax deduction for making charitable donations.²¹ Finally, the deduction for contributions is limited in any year to no more than half of a taxpayer's income, with the excess being carried forward as many as five more years.²²

It follows from these few details of tax structure that two facts above all determine how any given taxpayer's contributions will be treated: itemization status and marginal tax rate. As a practical matter, almost anybody who spends a sufficient amount on a handful of items will usually find it advantageous to be an itemizer. Since two of the most important of these items for middle-income taxpayers are mortgage interest and property taxes, itemization for the middle class is more or less coincident with home ownership.²³

The effect of becoming an itemizer is to lower the net-of-tax cost of making contributions, defined as the amount of net income or potential consumption that is forfeited when a dollar is given away as a charitable contribution. For anyone who is an itemizer, this net cost, or "tax price" (p), of giving away cash is defined simply, $p = 1 - m$, where m is the marginal tax rate on income. For a taxpayer facing a marginal tax rate of 35% and who itemizes deductions, for example, giving one more dollar in contributions, because it reduces taxable income by \$1 and tax by 35 cents, ends up costing the taxpayer only 65 cents. So the tax price is said to be 0.65. Reflecting the variation in top marginal tax rates over time, Figure 2 shows how the tax price of giving cash for top-bracket taxpayers has varied over the last 50 years changed

²⁰ Clotfelter (1985, pp. 25-26).

²¹ As stipulated in the Economic Recovery Tax Act of 1981, nonitemizers could deduct 25% of the first \$100 (married filing jointly) of donations in 1982 and 1983, 25% of the first \$300 in 1984, 50% of all contributions in 1985, and 100% of all contributions in 1986, after which the provision went away (Ackerman and Auten 2006, p. 510).

²² The rules are summarized in IRS, Charitable Contribution Deductions, <http://www.irs.gov/charities/charitable/article/0,,id=134331,00.html>, 4/26/12. Contributions to most private foundations and a few other types of charitable organizations are limited to 30% of adjusted gross income and gifts to some organizations are limited to 20%. See IRS, Exempt Organizations Select Check, <http://www.irs.gov/charities/article/0,,id=252661,00.html>, 4/26/12. There has been and will be a further percentage reduction on all itemized deductions for taxpayers whose AGI exceeds a specific threshold, with total itemized deductions being reduced by as much as 20% (Ackerman and Auten 2006, p. 512; CBO 2011, p. 2).

²³ Some have pointed to the connection between these two deductions as one of the absurdities of the tax: owning a house has become virtually a necessary and sufficient condition for receiving a government subsidy for donations. See, for example, Richard H. Thaler, "It's Time to Rethink the Charity Deduction," *New York Times*, December 18, 2010.

since 1960. In 1960, the tax price of making cash gifts for the most affluent taxpayers was a mere 9 cents per dollar of giving, owing to the 91% top marginal tax rate existing at the time. Over the next five decades, the tax price of giving generally rose, as Congress periodically cut the top marginal tax rate, first to 70%, then to 50% in the 1981 tax act, and again following the 1986 tax reform act to 28%. As of 2011, the top marginal tax rate was 35%, making the tax price of giving cash 0.65.

Other provisions of the income tax, especially those applying primarily to wealthy taxpayers, complicate this simple relationship. The most important such complication relates to gifts of appreciated property. When an appreciated asset is sold, at least a portion of any capital gains is subject to taxation, unless the asset is contributed.²⁴ Therefore, making a contribution using appreciated property can lower a taxpayer's tax price even more than donating cash.²⁵

A second, and related, complication is the Alternative Minimum Tax, a tax provision which is in effect a parallel income tax. Whether it or the regular tax applies to any particular taxpayer in a given year will determine the tax price of giving, but this is not something that is always easy to predict in advance of the ultimate calculation of one's taxes, a predicament that can call for very sophisticated tax planning surrounding gifts.²⁶ As a matter of policy, the elements of the AMT tax base may have an especially big effect on the price of giving appreciated property. In 1986 Congress made the portion of a gift of property that was appreciation a "tax preference item" in the Alternative Minimum Tax, which had the effect for taxpayers affected by the AMT of limiting the deduction value for a gift of appreciated property to the basis. For some potential gifts, this provision had the effect of virtually wiping out the bulk of the deduction, particularly of artwork. Museums, in particular, worried about the potential detrimental effect, and their fears seemed to be confirmed by a drop in gifts right after the rule

²⁴ There are notable exceptions to this exception. For contributed non-stock assets that cannot be used by the receiving organization for its exempt purpose, only the basis is deductible. Gifts of appreciated property made to private foundations are also limited to the tax basis, and short-term capital gains are not ignored as long-term gains are (Ackerman and Auten 2006, p. 512). For a description of the limitations on gifts of appreciate property, see IRS, Publication 526, Charitable Contributions, <http://www.irs.gov/pub/irs-pdf/p526.pdf>, 4/26/12. See also (Auten, Clotfelter, and Schmalbeck 2000, p. 395).

²⁵ The actual tax price depends on the tax rate on capital gains income, the portion of the asset value that is appreciated property, and what would have been done with the asset were it not contributed. In formal terms, the tax price of giving away an asset that would otherwise have been sold is $p = (1 - m - (a)(mc))$, where a is the portion of the asset's value that is appreciation and mc is the marginal tax rate on capital gains income.

²⁶ See, for example, the tax planning advice offered in Tara Siegel Bernard, "Minimizing A.M.T. Through Charitable Donations," *New York Times*, December 22, 2010.

was introduced. These institutions lobbied, successfully, to have this provision rescinded. Today, museums remain vigilant to the threat of tax reform that would end the ability of taxpayers to donate artwork at market value.²⁷ In a statement submitted to a Senate hearing in 2011, the Association of Art Museum Directors stated:

The tax treatment of gifts of art has been altered several times since 1969, and donors' behavior has responded directly, immediately and always negatively....[W]e suggest that discouraging gifts to the arts by reducing their tax deductibility would have a counter-productive effect. It would lessen institutions' growing ability to serve the very populations whom Members of Congress most wish charities to serve....The social safety net has many strands; weakening any single strand only diminishes the safety net's overall integrity. Supporting the needy and supporting the arts are not mutually exclusive enterprises.²⁸

The attention to the tax price of giving in the preceding paragraphs can be justified on the basis of its presumed behavioral effect. For over three decades, there has been sustained attention and vigorous debate in the public finance literature about the degree to which donors respond to the tax price. Virtually all scholars who have weighed in on the issue conclude that the tax price affects the amount that people donate, and many observers believe that this price effect can be stated in terms of a price elasticity in the range -0.5 to -1.0. An elasticity of -0.5 implies that a 10% decline in the tax price, say from 0.50 to 0.45, would lead to a 5% increase in contributions; an elasticity of -1.0 would imply a 10% increase. Statistical studies also suggest that taxation has an income effect on giving, by affecting taxpayers' disposable income. An increase in tax liability reduces after-tax income and thus contributions. Regardless of the precise values of the price and income elasticities, it is not hard to see how changes in tax rates and other features of the income tax might influence the level of charitable giving. If marginal tax rates are reduced, for example, as they were for the top brackets in 1981 and 1986, the price of giving to itemizers in the affected tax brackets will rise. Depending on what happens to tax liabilities, the economic model would imply that contributions by these taxpayers would be lower, at least in the long run, than they would have been had the change not occurred. Another clear implication is that eliminating the deduction altogether, as has been suggested in numerous proposals in the past

²⁷ Auten, Clotfelter, and Schmalbeck (2000, pp. 395-396).

²⁸ Association of Art Museum Director, Statement Submitted to the United States Senate Committee on Finance, Hearing on tax Reform Options: Incentives for Charitable Giving, October 18, 2011; <http://www.aamd.org/advocacy/documents/PhilanthropyTestimony.pdf>, 3/8/12.

couple of decades, would raise the price of giving for all itemizers, again implying (in the absence of large changes in total taxes) a long-run level of contributions lower than what would have been the case under the existing type of income tax.

One perhaps inevitable consequence of the liberal treatment of charitable contributions in the U.S. is abuse. As with dozens of other areas of the income tax, crafty or unscrupulous taxpayers occasionally endeavor to reduce their tax liabilities by pushing the limits of the law. One perennial area of potential abuse involves questionable valuations of assets that are donated. For the common man, this ploy might take the form of claiming an exaggerated value for old clothes donated to the Salvation Army thrift store. Because valuations of this sort mostly work on the honor system, there is often latitude for a taxpayer to overstate the market value of the donated items, should he or she be so inclined. Similar abuse has been associated with donating used cars, but much of the abuse associated with that form of giving has been eliminated in recent years.²⁹ The real potential for mischief lies in donations of assets whose value has risen rather than fallen. Thus one tempting form of abuse is exaggerating the value of donated art work, making such behavior a longstanding concern for policy makers and tax authorities.

III. The Outsized Role of the Rich

A signal feature of the American grants economy, noted in section I, is the considerable influence that individuals have over the allocation of public subsidies. For the affluent, this point deserves to be made in bold face type. A Methodist congregation in Kansas can decide to put a steeple on its church building, and the government will subsidize that steeple, but only to the extent that those parishioners itemize their deductions. If, as is often the case in many religious congregations across the country, most members take the standard deduction, there will be little in the way of tax subsidy for that steeple. Now consider a taxpayer who wishes to make a \$50,000 gift to Stanford University. A gift of this size might be made to set up a special fund for library collections or for need-based financial aid. Or, for the athletically-inclined, a gift of this

²⁹ It was possible a decade ago to deduct exaggerated values for vehicles whose true market value were far below the value shown on standard publications, and even then the nonprofit organizations typically received only a portion of that, after fundraising companies specializing in these transactions had taken as much as two thirds of the value. In 2004, the law was changed, requiring vehicles to be donated to low-income individuals. See Tyler Cabot, "The Tow-Away Tax Break: Why Car Donation Programs Benefit Everyone but the Charities They're Intended to Help," *Washington Monthly*, June 2002, pp. 39-42 and Arden Dale, "Tax Breaks for Donating a Car," *Wall Street Journal*, July 25, 2008. Such compliance issues are the reason why the charitable deduction appears on the IRS's "Dirty Dozen Tax Scams for 2012" list; <http://www.irs.gov/newsroom/article/0,,id=254383,00.html>, 3/16/12.

amount will allow a donor to travel with the Stanford football team to an away game.³⁰ If this donation is made in cash, American taxpayers, by virtue of the deduction, in effect subsidize the gift to the tune of \$17,500, leaving the donor to bear the remaining \$32,500.

Three features of the income tax treatment of contributions are particularly conducive to this outsized influence. One is the standard deduction, which effectively limits itemization to a minority of taxpayers, most of whom have above-average incomes. A second is the upside-down nature of the deduction. Owing to the role of itemization and the progressivity of the tax rate structure of the tax, the affluent face the lowest tax price of giving among all taxpayers. Third, the especially favorable treatment of gifts of appreciated property, which is held disproportionately by the affluent, further reduces the tax price. Beyond these advantages, the affluent and their tax advisors over the years have shown remarkable ingenuity in devising ways of reducing their tax burdens while making contributions. For its part, Congress has responded by erecting restrictions on giving, whose primary effect is on high-income taxpayers, but these limits do not negate those three features of the law.³¹

By virtue of their high incomes and these favorable tax features, the wealthy not only account for a vastly disproportionate share of the country's total charitable donations, but they also account for an even bigger share of tax subsidies for donations. As shown in Table 4, individuals with incomes over \$500,000, representing just 1% of all taxpayers and earning 18% of all income, accounted for almost a quarter of all contributions in 2008. By contrast, taxpayers with incomes under \$50,000, who were almost two thirds of all taxpayers, had about a fifth of the income and made about a fifth of all donations. To see that the distribution of tax subsidies was even more lopsided than the distribution of donations, consider the table's last column, showing the percentage of taxpayers in each income category who itemized their deductions. The table shows that only 15% of these under-\$50,000 taxpayers were itemizers, implying that 85% of the taxpayers in that category received no subsidy at all. In contrast, virtually all those in the top categories itemized their deductions. Further differentiating the subsidies received at the top and bottom of the income scale is the fact that those at the top also faced higher marginal rates

³⁰ Stanford's athletic booster organization, the Buck-Cardinal Club, publishes a chart showing the benefits available at various giving levels. A gift of \$50,000 enrolls the donor in the Director's Circle and entitles the donor "to travel with the football team to a select away game (maximum of two people)." http://grfx.cstv.com/photos/schools/stan/genrel/auto_pdf/BCC-Benefits-chart.pdf, 3/8/12.

on average, making the subsidy per dollar given greater than for those who itemized in the bottom income category. In 2006 taxpayers with incomes over \$100,000 received 76% of the total \$40.9 billion tax subsidy due to the charitable deduction, although they made just 57% of all donations. In contrast, those with incomes less than \$50,000 received just 5% of the subsidy, despite making 19% of all contributions (CBO 2011, p. 4).³²

These differences in the rate of tax subsidy across the income scale take on added significance when one considers the particular charitable tastes of the wealthy. As noted above, taxpayers with incomes over \$1 million tend to favor higher education, health, and the arts. For the super-wealthy, these preferences are even more pronounced. An analysis of the 90 largest gifts in 1996, for example, showed a stunning 56% of the total going to higher education. In addition, 17% went to health organizations, 14% to arts and culture, and 8% to private foundations.³³ Patterns of charitable bequests by the wealthy lean heavily toward private foundations. A tabulation for estates in 1995 showed that nearly three quarters of bequests from estates over \$20 million went to foundations.³⁴ The wealthy have long occupied a prominent position in American philanthropy, of course, as seen in the foundations established by robber barons like Carnegie, Duke, and Rockefeller. Today's captains of industry and finance are no less prominent, and, indeed, discussion of "the 1%" is very prominent these days. One development of note, though, is a movement among some super-rich to emulate those robber baron philanthropists by giving away most of their money. This movement has been formalized in the form of a public pledge to give a majority of their wealth to philanthropy in their lifetimes or after their death.³⁵

The very biggest donors, indeed, are in a class by themselves. Not surprisingly, they enjoy a disproportionate amount of influence in the governance of the nonprofit organizations receiving their donations. A glance at the board of directors of any large museum or private

³² These figures, like those in Table 4, are based on all taxpayers, not just those who itemized.

³³ See Clotfelter et al., (1998, Table 12.2, p. 406). For the most recent data on large gifts, see the Slate 60, http://www.slate.com/articles/life/the_slate60/2011/02/the_2010_slate_60.html, 3/29/12. By comparison, charitable bequests reveal similar patterns, with private foundations accounting for the largest share for the very biggest estates. The shares of bequests in 2007 for estates of \$3.5 million or more were: philanthropy, 56.5%; education, 12.3%; arts, 6.7%; human services, 4.9%; health and medical, 4.3%; religion, 4.2%; environment, 2.3%; and other, unknown, 8.8% (Raub 2009).

³⁴ Auten, Clotfelter, and Schmalbeck (2000, p. 415).

³⁵ The Giving Pledge <http://givingpledge.org/>, 3/29/12. Michael Bloomberg, Warren Buffett, Paul Allen, Charles Feeney, Bill and Melinda Gates. T. Boone Pickens, Ted Turner.

university, even the guest list in the president's box at a university's football stadium, will attest to this disproportionate influence. What else do these big donors get in return for their big gifts? According to Ostrower (1995), philanthropy for the wealthy takes on considerable social significance, acting as a marker of elite status. Being identified as a member of this exclusive circle is strengthened by membership on boards and recognition at dinners, receptions, and other public events. Not only do they sit on governing boards and boards of visitors, but they are also invited to receptions, and singled out for recognition at public events. There are also naming opportunities, ranging from the scholarship or alcove worth a million dollars to having a building, or even a school, named after you. At one extreme, Odendahl (1989, p. 243) has argued that the wealthiest donors fund institutions from which they benefit and over which they exert great control: "Whether it be high culture, high education, or the high medicine of private nonprofit hospitals, the rich fund and make policy for these institutions, while, on the whole, the middle class produces the cultural and intellectual products and services."³⁶

Although the charitable deduction has been justified on the basis that money given away is no longer available to the donor, and therefore should not be taxed as income, there are ways for donors, particularly wealthy ones, to retain considerable control even after the donation has been made. The most familiar means of retaining control is the private foundation. Subject to several limitations, most of which were imposed by the Congress in 1969, wealthy individuals can retain control over how their charitable funds are distributed to the ultimate charitable recipients simply by remaining in control of their own private foundation.³⁷ For less expense and trouble, donors with more modest means can likewise receive an immediate tax deduction while retaining considerable control over the disposition of funds by utilizing donor-advised funds,

³⁶ Community leaders from the middle class may play similar leadership roles in local fundraising efforts. In their classic sociological study of American urban life in the 1920s, Lynd and Lynd (1929, p.464) describe the launching of the community chest drive in Muncie, Indiana: "The first step was to enlist the big men in town, the Rotary crowd, as the responsible heads upon whom success or failure depended. There was the minimum of Christian *caritas* about it, no zeal for a particular emergency or needy family...."

³⁷ Among the limitations imposed on foundations are: a lower portion of income may be deducted for gifts to them; deductions of gifts of appreciated property to them are limited to the tax basis rather than their market value; a minimum of 5% of assets must be distributed each year; there are limitations on self-dealing; and there is an excise tax on investment income (Auten, Clotfelter, and Schmalbeck 2000, p. 397).

commonly overseen by community foundations and investment companies, or a so-called supporting organization, often established by large nonprofits like universities.³⁸

Americans often write in celebratory terms about the country's generosity and voluntary spirit, and indeed there is much that is admirable in the U.S system. But, as John Shoven has noted, one can question just how public-spirited some of this giving really is. Since donations are often used for things the government would not have purchased, it is natural to compare the public benefit of tax expenditures for donations with what those dollars would have paid for in the absence of the donation. Shoven's example is a \$3 million bequest to pay for a fountain on a university campus. Shoven asks the question: Which taxpayer is more charitable, the one who makes the donation, thereby imposing all taxpayers to subsidize it, or the one who makes no donation, thus increasing total tax receipts by the amount that would otherwise have been forgone tax revenue?³⁹ The answer will inevitably depend in part on one's comparison of the social value of the donation and that of the government's counterfactual expenditure. If gridlock on Capitol Hill means that the kinds of international programs undertaken by the Gates Foundation can only be done through charitable contributions, Shoven's speculation could well be turned on its head, leading back to what has become one of the principal justifications for nonprofit organizations – that they plug holes in the provision of public goods left when both the market and government fail to supply them.⁴⁰ This example raises the possibility of applying different rates of subsidy to different types of donations depending on the public benefit generated, an approach implied by optimal tax theory (Saez 2004). The U.S. tax law has largely sidestepped this issue, choosing instead to differentiate simply by allowing or disallowing gifts by type of organization. The result is that donations producing little apparent public benefit can end up being subsidized.⁴¹

IV. Ongoing Issues in U.S. Tax Policy and Charitable Giving

Change could come about in U.S. tax policy toward charitable giving – inadvertently or deliberately. As to the first, the treatment of contributions could find itself an innocent bystander

³⁸ See Auten, Clotfelter, and Schmalbeck (2000, p. 398). In recent years, Fidelity and other investment companies have made it easy for investors to set up donor-advised funds. See Fidelity Charitable, <http://www.fidelitycharitable.org/giving-strategies/give/donor-advised.shtml>, 5/2/12.

³⁹ Shoven (2000, pp. 425-426).

⁴⁰ For a cogent statement of this thesis, see Weisbrod (1988).

⁴¹ One such category is donations to aid commercial college sports enterprises. See Charles Clotfelter, "Uncle Sam Takes one for the Team," *Washington Post*, December 31, 2010.

affected by wider tax reform. Judging from the policy debates in Washington, the individual income tax, that reliable source of more federal revenue than any other source, has many critics but precious few admirers. Among the most frequent charges against it are that it is unnecessarily complex, that it taxes the rich too lightly, and that its many loopholes make it unfair and inefficient. At the same time, among the existing tax's many provisions, the deduction for charitable contributions does enjoy wide support, a fact that becomes evident as soon as someone proposes to simplify the income tax by getting rid of base-eroding loopholes, usually for the purpose of lowering tax rates. "Flat rate tax" schemes, a tax reform cottage industry in the 1980s, enjoyed a resurgence in 2012 with one presidential candidate's advocacy of a plan to tax income at a flat 9% rate.⁴² The argument that the rich are taxed lightly, central to the opposition to extending the George W. Bush tax cuts for the high-income taxpayers, got a second wind thanks to billionaire Warren Buffett's complaint that he paid a lower income tax rate than his secretary.⁴³ The debate about fairness was also fueled by evidence showing that households at the very top of the income distribution were enjoying a growing share of the economic pie.⁴⁴ Whether any of these complaints would ultimately lead to tax reform was unclear, they bring to mind the quip that "skeptical politicians rank serious tax reform with gun control and free world trade – as worthy causes unworthy of the time of realists."⁴⁵ Yet major tax reform – incorporating changes in marginal tax rates or the charitable deduction itself – does occasionally happen, and when it does, it will inevitably affect donors' incentives to give.

Beyond the slim but ever-present possibility of fundamental reform, a second way tax treatment of charitable giving could change is by way of deliberate modification of the current deduction. One motivation for change is unhappiness with the whole upside-down nature of the existing subsidy. A straightforward remedy would be to replace the deduction with a credit that applies to all taxpayers. A less radical approach would be to cap the tax rate applied to the deduction, exemplified by the Obama Administration's proposal to limit itemized deductions to 28%, or to allow nonitemizers to deduct donations, as they could briefly, in 1986.⁴⁶ But in opposition to any expansion of the deduction are those who want to see the tax base expanded

⁴² Herman Cain's "9/9/9" plan was not a fully fleshed out proposal, however, as were some of the proposals of the 1980s, like the Hall-Rabuska Flat Tax; <http://www.hoover.org/publications/books/8329>, 4/1/12.

⁴³ Warren E. Buffett, "Stop Coddling the Super-Rich," *New York Times*, August 14, 2011.

⁴⁴ Between 1977 and 2007, the share of total income going to households in the top 1% doubled, from 10% to 20% (CBO, *Trends*, 2011, p. xi).

⁴⁵ Editorial, "Yes, There Is a Better Income Tax," *New York Times*, June 6, 1982.

⁴⁶ Robert Frank, "Why Obama's Jobs Bill Could be Bad for Charity," *Wall Street Journal*, September 13, 2011.

rather than narrowed. Thus one perennial idea is to permit a deduction, but only for donations that exceed a certain floor. Not only would a floor reduce the amount of revenue lost, it would also simplify tax compliance, since taxpayers giving less than the floor would not need to keep records. It would also eliminate at least one source of potentially questionable deductions, since the tax authorities currently have no way to verify small charitable contributions. Opponents of a floor counter by noting that those same taxpayers would lose the tax incentive to donate, or might seek to bunch their gifts, for example, by donating every other year, so that they could deduct more of their giving, thus negating some of a floor's potential revenue savings. Such a floor (at 1% of income) was one of the reforms proposed by a prominent panel in 2005. The panel's other ideas for reforming the treatment of charitable contributions included mandating that charities report to the IRS all gifts over a certain size, reconsidering the kinds of organizations eligible to receive deductible gifts, and requiring gifts of appreciated property to be realized, while retaining the non-taxation of gains.⁴⁷

To assess the likely effects of reforms such as these, the CBO recently produced projections based on simulated effects for individual taxpayers, using data for 2006. Presented in Table 5, the first two show the projected effects of placing a floor beneath the current deduction. Imposing a \$1,000 floor for joint returns (\$500 for individuals) would, as expected, save revenue and discourage contributions, but imposing a much more stringent 2% of AGI floor would have much bigger effects, of both kinds.⁴⁸ Extending the deduction to nonitemizers would increase the tax subsidy by more than 10% but increase total giving by only 1%. The last four options included in the table show the effects of replacing the current deduction with a nonrefundable credit applied to all taxpayers. Contributions and total subsidy are predicted to rise in the case of a credit of 25% with no floor. The other three credit options show declines in both.

Most of the tax policy issues applying to donations during life have a counterpart in the estate and gift tax with respect to charitable bequests. Only the aggregate dollar amounts are smaller. Whereas deductible contributions in the income tax were \$158 billion in 2009, deductions for charitable bequests in estates were only about \$20 billion.⁴⁹ To be sure, as noted above, the great bulk of charitable bequests are made by a tiny minority of decedents, and they

⁴⁷ President's Advisory Panel on Federal Tax Reform (2005, pp. 75-78).

⁴⁸ Ackerman and Auten (2006) provide simulations for a 1% floor, which are similar to those produced by the CBO for a 2% floor.

⁴⁹ Deductions in individual income tax: U.S. Internal Revenue Service, *Statistics of Income 2009*, Table 2.1; charitable bequests: \$19.7 billion in 2007, <http://www.irs.gov/pub/irs-soi/07es01fy.xls>, 4/8/12.

are much more likely to go to private foundations or higher education than are contributions from the living. In 2012 the tax applied to estates of \$5.12 million or more, with a rate of 35%. As with giving in life, bequest giving is thought to have a tax price effect.⁵⁰ So the vitriolic debate over the “death tax” – which could lead to an increased exemption, a lower rate of tax, or outright elimination – has the potential to leave a mark on charitable bequests. Econometric studies imply that eliminating the tax would result in declines in charitable bequests ranging from 20 to 37% (Joulfaian 2009, p. 1227).⁵¹

V. Conclusion

Charitable contributions play a bigger role in the provision of public goods in the United States than in other developed countries. By allowing taxpayers to have a large role in allocating public subsidies, American tax law reflects a tradition of reliance on nonprofit organizations and individual choice, as opposed to tax-financed government provision. The centerpiece of U.S. tax policy is a deduction for contributions to charitable, educational and scientific nonprofit organizations, a feature that ends up subsidizing the gifts of high-income taxpayers the most, lower-income renters the least, and middle-class homeowners in the middle. One of the most significant consequences of this tax treatment of charitable giving is to give to the wealthiest taxpayers a disproportionate role in allocating public resources and influencing the direction that institutions will take. Within American policy, therefore, there exists an inherent conflict between participatory citizenship and elitism.

This tax treatment could change, for either of two reasons. First, tax reforms that modify the tax rate structure or the portion of taxpayers who itemize their deductions will necessarily affect the tax price of giving for some or many taxpayers. Second, any one of a number of reforms specifically related to charitable giving, such as applying a floor, could also affect the tax price of giving. These changes would affect not only the amount of revenue lost, but also, depending on the assumed behavioral parameters, the amount of donations made.

⁵⁰ I.R.S., Publication 950, *Introduction to Estate and Gift Taxes*, p. 4.

⁵¹ For taxpayers with enough wealth to be subject to the estate tax, making donations in life has the extra tax benefit of reducing the taxable estate. Thus part of the observed tax effect on lifetime giving could be masking an estate tax effect as well.

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Tables and figures

Figure 1. Contributions as Percent of Income

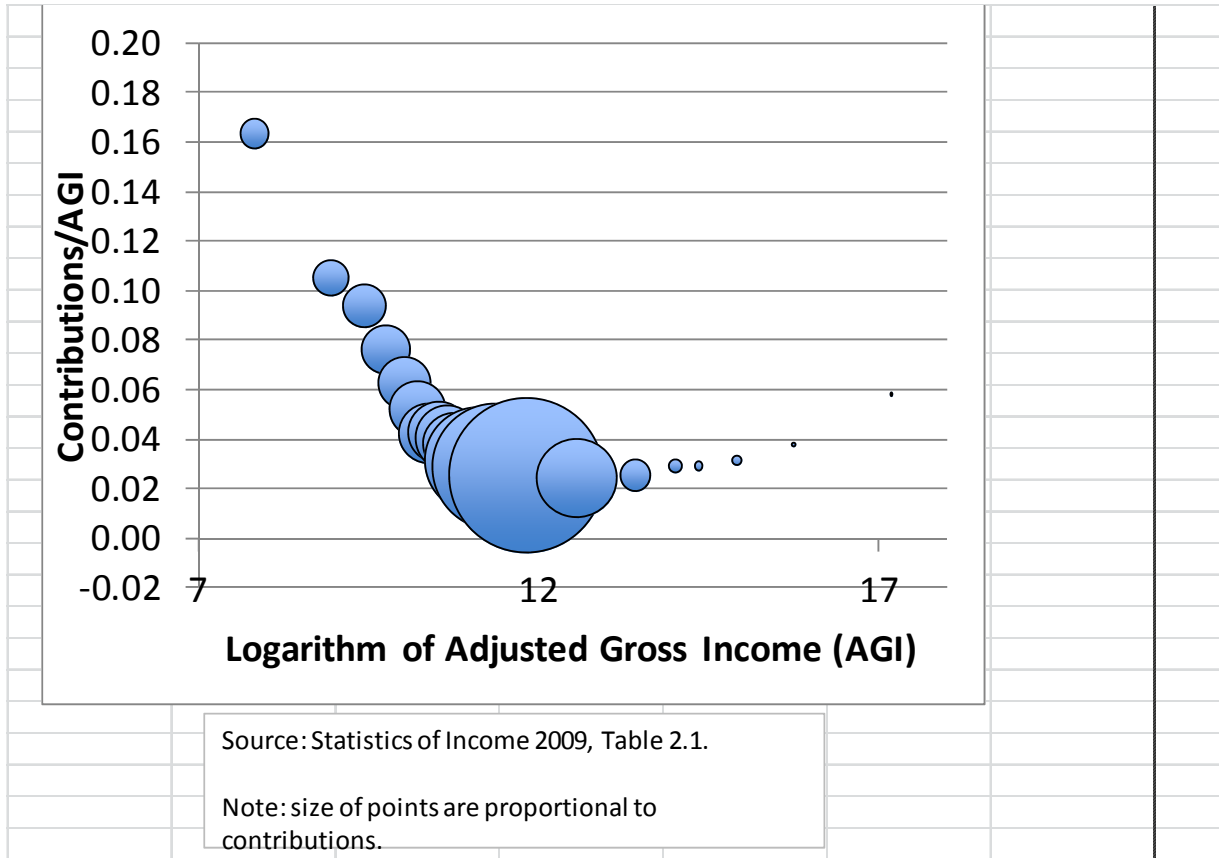
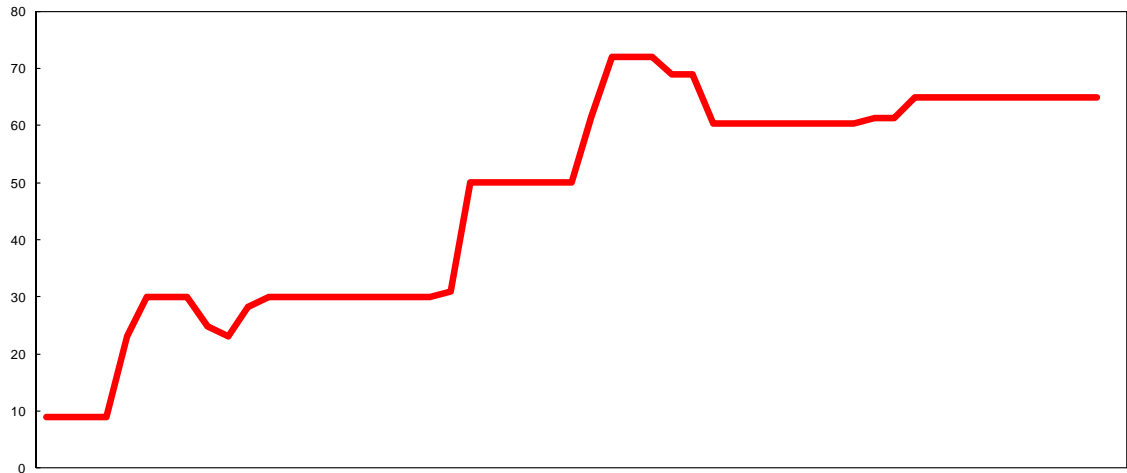


Figure 2

Price of Giving Cash at Top Marginal Tax Rate, 1960-2012



1960

1970

1980

1990

2000

2010

Note: Price calculated as 100 minus the top marginal tax rate on taxable income.

Table 1				
Public and Private Social Expenditure as Percent of GDP				
2007, Selected Countries				
Country	Public	Private	Total	
Australia	16.0	3.8	19.8	
Canada	16.9	5.3	22.2	
France	28.4	2.9	31.3	
Germany	25.2	2.9	28.1	
Netherlands	20.1	6.9	27.0	
United Kingdom	20.5	5.8	26.3	
United States	16.2	10.5	26.7	

Source: OECD *Social Expenditure Statistics* (2011).

Note: social expenditures include cash benefits, direct and indirect in-kind provision of goods and services, and tax breaks with social purposes. These must entail redistribution or compulsory participation.

Table 2				
National Giving as Percent of GDP, Selected Countries				
				%
Australia				0.69
Canada				0.72
France				0.14
Germany				0.22
Netherlands				0.45
United Kingdom				0.73
United States				1.67

Note: Based on surveys of adults covering various years between 2000 and 2004.

Source: *International Comparisons of Charitable Giving* (Kent, UK: Charities Aid Foundation, November 2006, p. 6).

Table 3					
Contributions by Income and Subsector, 2005, as Percent of Total					
Income	Less than \$100,000	\$100,000 to \$200,000	\$200,000 to \$1 million	\$1 million or more	Total
Subsector					
Religion	23.7	4.5	8.3	3.4	40.0
Combined	3.0	0.9	4.0	0.8	8.8
Basic needs (1)	3.7	1.0	2.1	0.8	7.5
Health	1.2	0.4	1.9	5.1	8.7
Education	1.1	0.5	11.5	5.1	18.2
Arts	0.4	0.2	5.4	3.1	9.1
Other	2.4	0.5	2.9	1.9	7.8
Total	35.6	7.9	36.2	20.3	100.0

Source: Patterns of Household Charitable Giving by Income Group, 2005 (Indianapolis: Center on Philanthropy, Summer 2007), Table 9
(1) Providing food, shelter, or other necessities.

Table 4				
Share of Tax Returns, Income, and Contributions and Percent Itemizers, by Income, 2008				
Share of....Share of....Share of....	Percent itemizers
Adjusted gross income (\$ thousands)	Tax returns	Income	Contributions	
Under 50	65	21	19	15
50 - 100	22	27	24	58
100 - 200	10	22	21	86
200 - 500	2	12	12	96
Over 500	1	18	24	96
Total	100	100	100	34

Note: Percentages based on all taxpayers, except for percentage itemizing in two highest income groups, which is based on taxable returns only.
Source: CBO, *Options for Changing the Tax Treatment of Charitable Giving* (May 2011, Table 1, p. 5); *Statistics of Income 2008*, Table 1.2.

Table 5			
CBO's Predicted Effects for Eight Illustrative Tax Reforms, 2006 Levels			
	Floor for donations?	Total contributions (\$ billion)	Tax subsidy (\$ billion)
		<u>Current law</u>	
Deduction for itemizers only	No	203.0	40.9
		<u>Changes from current law</u>	
Deduction for itemizers only	\$500/\$1,000	-0.5	-5.5
Deduction for itemizers only	2% of AGI	-3.0	-15.7
Extend deduction to nonitemizers	No	2.0	5.2
Extend deduction to nonitemizers	2% of AGI	1.9	-13.1
Replace deduction with 25% credit	No	2.7	7.1
Replace deduction with 25% credit	2% of AGI	-1.0	-11.9
Replace deduction with 15% credit	No	-7.8	-13.3
Replace deduction with 15% credit	2% of AGI	-10.0	-24.6
Note: \$500/\$1,000 floor would be \$500 for individual filers and \$1,000 for joint filers. Credits would be nonrefundable. Changes in contributions assume a price elasticity of -0.5.			
Source: Congressional Budget Office (2011, Summary Table 1, p. ix).			