Proposal re: modifications of the United States' system of charitable tax deductions

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2015

MEMORANDUM

TO: Congressman Paul Ryan, Chairman of the Joint Committee on Taxation
FROM: Lisa Martine Jenkins
RE: Modifications of the US system of charitable deductions
DATE: May 1, 2015

EXECUTIVE SUMMARY:

Taxation, at its root, is a crucial form of redistribution. Ideally, taxes move money from those at the top to benefit society as a whole, but these dynamics have become blurred and over-complicated through aspects of modern tax policy, like charitable deductions. While charitable deductions are intended to incentivize charitable spending, today's situation is a very different animal—the government has essentially been paying a portion of these endowments, many of which serve little real charitable purpose. I propose reorganizing this policy in two main ways. First, I redefine the charity, placing stricter guidelines on the label, "non-profit." Second, I create a simple, three-tiered ranking system, based entirely on how much those non-profits dedicate to real aid. The percent of the government's deduction awards will be tied directly to the amount that non-profits devote to the promotion of social and economic equality. This policy will work to ensure that the government contributes the most to charities benefitting the needy, rather than those that are non-profits in name alone.

INTRODUCTION

There is something very broken about the way we regard charity, and the government's role in charitable support. The United States tax policy intends to incentivize charitable spending by giving charity a tax deduction, but the definition of a deduction-eligible organization under Code section 170 is much too vague, leaving enormous loopholes. As a consequence, individuals and organizations making donations can deduct contributions that accomplish little real charity. In practical terms, this effectively means that the government pays a significant chunk of these donations. In many cases, a tax policy intended to promote charitable giving has actually become a way for the wealthy to avoid contributing taxes to the government, doing exactly the opposite of what was intended.

EVIDENCE AND EXISTING POLICY

The current definition of a charitable organization (i.e., an organization qualifying for deductions) is one which is "organized and operated exclusively for exempt purposes," with none of its funds "[inured] to any private shareholder or individual." Additionally, it must not "attempt to influence legislation as a substantial part of its activities" nor participate or contribute to political campaigns" (IRS 1). While this definition limits charities participation in these potentially problematic activities, it does not go much further than that. The federal government's website outlines the kinds of organizations that can qualify for non-profit status: this includes those created "for charitable, religious, educational, scientific, or literary purposes, or for the prevention of cruelty to children or animals," religious organizations, war veterans' organizations, nonprofit volunteer fire companies, civil defense organizations, domestic fraternal societies' charitable services, or nonprofit cemetery companies (IRS 2). However, current policy uses an overly simplistic definition for these organizations, restricting certain behavior rather than defining the actions that a deduction-eligible charity *should* be performing.

The government loses significant funds to these kinds of deductions, most notably to large corporations who otherwise would be contributing huge portions of their profits in taxes. According to journalist Eduardo Porter of the *New York Times,* tax breaks to encourage charity are essentially another form of government spending, and on average cost the government $39 billion per year (Porter 2). Over the course of the next ten years, these tax breaks will cost the government over half a trillion dollars (Madoff 1). For perspective, the United States 2014 spending on the environment was $35 billion, and on international affairs was $47 billion (Concord Coalition 1). Say journalists Lewis Brown Jr. and Heather McCulloch, this extraordinarily large use of government funds does not receive the same kind of public scrutiny as other budget measures for a variety of reasons– "primarily because they aren't part of the annual appropriations process, nor, with the exception of the refundable credits, are they recorded in the federal budget" (Brown 3). While much of this money is the result of donations to reputable organizations, several loopholes allow tax breaks on money sitting in investment accounts or private foundations that promise to do charitable work at some unspecified point. Considering the goal of allowing charitable deductions is ostensibly to incentivize donating, this situation is hugely problematic.

Congress has not discussed changing charitable donation policy in any serious way in 1969 (Madoff 2). The status quo has become such an entrenched part of American business that very few alternative policies have even been proposed in recent decades. However, one notable proposition is that of President Obama—in his 2015 budget, he calls for limiting the value of charitable deductions to 28 percent for the nation's highest earners. This is part of a larger trend of Obama's efforts to limit tax expenditures, particularly for the wealthy (Daniels 1). However, these last-ditch efforts to address widening inequality are expected to get little traction in the Republican-controlled legislature. Considering how drastically business has changed over the past half-century, the fact that these have gotten so little attention is absurd. Charitable deductions should evolve as business and tax policy do.

RECOMMENDATIONS

My recommendations for changing this system in an equitable way are two-fold. First, I propose changing the definition of charitable deductions to a positive, rather than a negative one—that is to say, instead of listing the activities non-profits *cannot* engage in to maintain their status, we should instead understand a non-profit in terms of the things that it does do. While your committee should revisit this definition regularly (at least every five years), the key components should be requiring at least 5% of profits be devoted expressly to aid, paying all employees, including interns, and continuing to restrict political activity.

The second part of my recommendation is to tie percent deductions not to the income bracket of the donator, but rather to the aid contributions of the charity receiving the donations. There will be three categories: (1) those organizations contributing more than 50% of their endowments to diminishing inequality, (2) those contributing less than 50% of their endowments to diminishing inequality, and (3) those whose purposes are environmental, scientific, or for the support of animals. This separates social aid from other, equally worthy kinds. The definition of "diminishing inequality" will shift depending on the organization, but it can generally be understood as promoting the well being of those experiencing undue financial, physical, or social hardship. For example, this could cover organizations helping families living below the poverty line, advocating for Americans with disabilities, or even devoting museum funds to making exhibits free for certain underprivileged communities. Donating to organizations in the first group would be eligible for a 45% deduction (which is slightly higher than the current cap of 39.6% for top earners), the second group, 25%, and the third group, 35%. This would average out to very close to current levels, simply rearranging where these funds are allocated.

The mechanics of this policy would be very simple. All non-profits would be required to re-register as non-profits, provided they meet the requirements of the new definition. Organizations that do not initially meet these requirements will be remain grouped in the seconds (25%) classification for one fiscal year, during which time they will be encouraged to reorganize. If they still do not meet the requirements after this year, they will loose their non-profit title. On the level of taxation, this new policy will not hugely change the way taxes operate. Individuals or organizations filing taxes and itemizing will have to list where they have donated, along with that organization's corresponding classification, (1), (2), or (3). Using the direct relationship listed above, these deductions will be very easy to calculate.

Ultimately, this policy will promote donating to charities with stronger charitable intent. Individuals will no longer be able to effectively pour government funds into endowments for organizations that accomplish little charity. In fact, deductions should even save the government the money currently devoted to sub-par organizations. In the current system, deductions are tied to the income of the one doing the donating, effectively telling society that the dollars of the wealthy have more weight than the dollars of others, which is contrary to the values of a nation purportedly built upon equality. Deductions would actively lead to the effective redistribution of funds, preserving their original intent.

CONSEQUENCES OF RECOMMENDATIONS

The most significant beneficiary of this policy is the government. It will streamline fund allocation, and restrict a misuse of funds, and overall, save money. Furthermore, it will illustrate to American society that the government *cares* about loosening the political hold of the wealthy, which leads us to a second point. Charities should not be tied to the nation's economic and political environment, and the current policy makes this inevitable. This reform will benefit those charities that provide the most aid by incentivizing donations to them, and ultimately allowing them to refocus on this aid. And, of course, this policy will indirectly improve the conditions for the nation's most underprivileged communities, increasing the endowments of those organizations committed to truly helping them.

Of course, this policy will have its opponents, particularly among the organizations losing non-profit status, and the (likely very wealthy) people that support them. For example, its unlikely that Harvard will qualify for the same percent deduction that it does now, which will anger many of those that donate, as well as the school itself. However, this discontentment serves a greater purpose–if education is important to a donor, he can instead donate to a charity providing scholarships to underprivileged students, which will undoubtedly qualify for the higher deduction rate. Others will question, as key philanthropy organizers did when Obama announced his plan to limit deductions, how much value the White House places upon American generosity and how much it is willing to lose in charitable investment (Daniels 1). However, those taking the time to examine the policy will see that these fears are misplaced—the policy seeks to encourage charitable donations even further, and bolster the nation's under-privileged communities. This policy is about rearranging the way we give, not limiting it.

CONCLUSION

On its surface, this policy would reduce the money that the government gives unnecessarily. However, on a deeper and more important level, it will address the issue of widening inequality in our country by encouraging donations by those at the top to organizations that provide aid to the underprivileged. Requiring non-profits to provide more information about their use of funds is a simple solution, and will increase the system's transparency. This is important because those with money have enormous power in this nation, and they need to be aware of the nuances of that power. True aid to the needy needs to be the new standard for charitable deductions—ultimately, this will contribute to a goal of improved general literacy about the mechanics of charity in the United States and internationally.

Work Cited

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