Tax Reform and Charitable Giving

Early Results on the Implication of the Tax Cuts and Jobs Act of 2017

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Summary

The Tax Cuts and Jobs Act of 2017 made significant changes to federal income and estate taxes. Most taxpayers will face a lower tax bill thanks to the provisions in the new law.

But there is some provisions that could lead to a decline in charitable giving. Far fewer donors are itemizing their charitable deductions; thus, they no longer get a tax benefit from their charitable gift. In addition, since marginal tax rates are lower for most taxpayers, those who continue to itemize will see a smaller tax benefit from their deductible charitable gifts.

Preliminary data from the Internal Revenue Service indicate that around 26 million fewer households itemized their deductions under the new law. In addition, more than 21 million households no longer deduct charitable gifts.

Actual data, combined with academic research, suggest that charitable giving fell by around 4% in 2018 because of the new law. Nationwide, this amounts to approximately $19 billion to $22 billion in decreased charitable giving.

The New Law

Numerous changes were implemented with the passage of the Tax Cut and Jobs Act of 2017 (TCJA), but perhaps the most significant provision was an increase in what is known as the "standard deduction". The standard deduction is the amount that all taxpayers can deduct from their taxable income before computing their taxes.

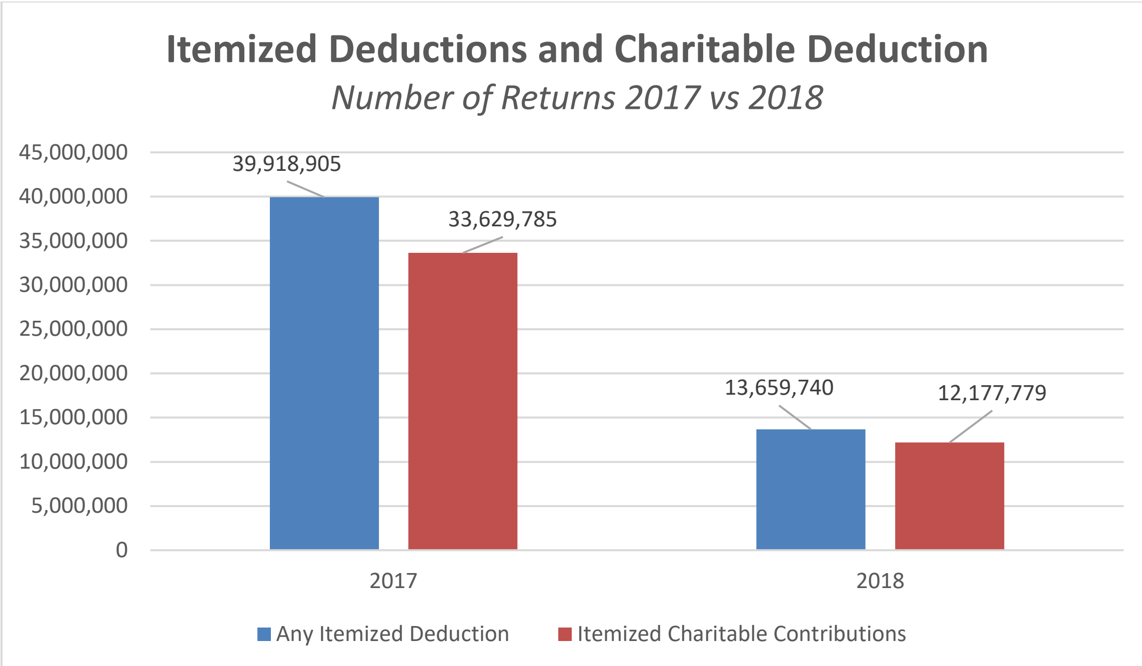
Some expenses can be included as itemized deductions; most notably, state and local taxes, mortgage interest and charitable contributions. If a taxpayer has itemized deductions in excess of the standard deduction, they itemize those deductions on Schedule A of their tax return. Those who have itemized deductions less than the standard deduction simply deduct the standard deduction from their taxable income.

TCJA increased the standard deduction substantially – to $12,000 for a single return, and $24,000 for a joint return. Because far fewer donors are itemizing their charitable deductions, far fewer taxpayers will get a tax benefit from their charitable gift.

Tax Reform and the Charitable Deduction

Preliminary data from the Internal Revenue Service for charitable giving in 2018 is now available.[1] The numbers show that just 12,177,779 taxpayers claimed the charitable donation deduction for the 2018 tax year, out of 13,659,740 that itemized any deduction. That compares to 33,629,985 taxpayers who claimed the charitable donation deduction for the 2017 tax year, with 39,918,905 itemizing any deduction.

Charitable contributions deducted on tax returns fell from $160 billion to $102.7 billion. That's a difference of 21,452,206 taxpayers claiming nearly $37 billion less in donations. (It's important to note that those taxpayers did not decrease their charitable *giving* by $37 billion; instead, they reduced their charitable *deductions* by that amount.)

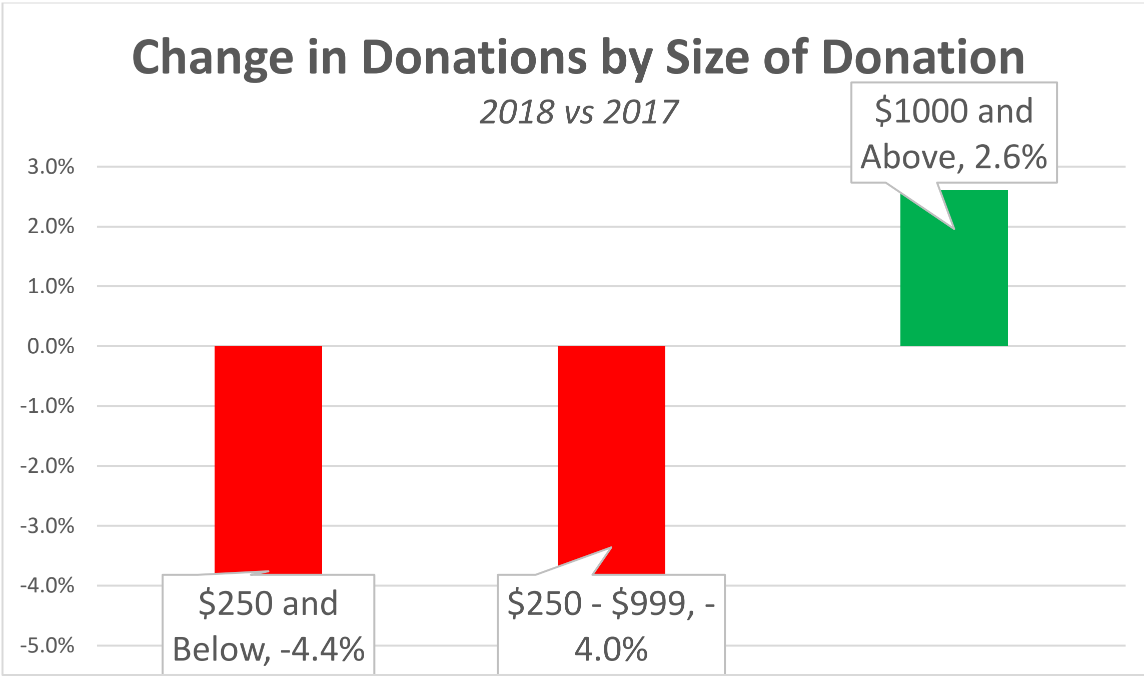


Preliminary Data on Charitable Giving

Normally, charitable giving increases in most years. But early data for 2018 indicate that Americans decreased their 2018 giving by 3.4% from 2017 levels, dropping from $302.5 billion to $292.1 billion. That's a decline of just over $10 billion, according to the Giving USA study.[2]

In addition, drilling down into the data suggests the type of changes we would expect with the new tax law. Because of the increased standard deduction, donors at the lower income levels – who we can assume make smaller gifts – no longer itemize and thus cannot get a tax benefit from their charitable gifts.

A study release by the Association of Fundraising Professionals indicates that the number of smaller donations fell from 2017 to 2018.[3] While total giving from gifts of $1,000 or more increased by 2.6%, revenue from smaller gifts decreased. Gifts in the $250 - $999 range dropped by 4.0%, while gifts of under $250 dropped by 4.4%. The number of donors also fell, as did retention rates (the percentage of donors who continue to give to the same organization).



Elasticity of Charitable Giving – The Academic Research

Some of the best work in this area is done by professors Jon Bakija of Williams College and Bradley Heim of Indiana University. In a 2011 paper[4], they conclude “peoples’ decisions about how much to donate to charity are influenced significantly by tax incentives”.

While the result depends on factors such as income levels and whether the change is permanent or temporary, the research indicates the price elasticity of demand for charitable giving may be in excess of -1.0 – meaning that a 28% increase in the price of charitable giving could lead to more than a 28% decline in charitable gifts.

Similar results were projected by researchers at the Penn Wharton School at the University of Pennsylvania.[5] Researcher John Ricco projected that total charitable contributions would fall by about $22 billion in 2018, because of the passage of TCJA. This reduction represents a 5.1% reduction in total charitable giving. (Note that Ricco’s prediction estimates the drop in charitable giving relative to normally expected levels. So, though actual numbers noted above show a $10 billion decline, the amount of giving is likely $22 billion below that might have occurred without the passage of TCJA).

Yet another study by the Urban Institute and Brookings Institution found a large, but smaller, potential reduction in charitable giving.[6] This study projected the decline in charitable giving at $17.2 billion for 2018. (Most of that is due to the increase in the standard deduction, and a smaller portion is caused by a reduction in marginal tax rates.)

What's Next?

It's still unclear what the long-term consequences will be of the new tax legislation. Donors may respond by giving more, since many saw their after-tax incomes rise with the new law (this is known as the "income effect").

On the other hand, it may take more than one tax cycle before the consequences of the TCJA are fully felt by the charitable sector. The multi-billion dollar decline in 2018 may be just a start; don't be surprised by further declines in 2019 and beyond.

What is the Community Foundation Research and Training Institute?

The Community Foundation Research and Training Institute was created to help good community foundations become great community foundations. We provide a wide range of services, including trainings for staff members, board members and volunteers, strategic planning facilitation, and organizational assessments. We also deliver continuing education programs for professional advisors, as well as leadership training for nonprofit executives.

More information is available at www.cfrti.com.

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[1] This data reflects forms 1040 processed by the IRS on or before week 30 of each calendar year.

[2] *Giving USA 2019: The Annual Report on Philanthropy for the Year 2018*. This report is published by Giving USA Foundation, a public service initiative of The Giving Institute. It is researched and written by the Indiana University Lilly Family School of Philanthropy at IUPUI.

[3] Fundraising Effectiveness Project's 2018 Fourth Quarter Report.

[4] Bakija, Jon, and Bradley T. Heim, 2011. "How Does Charitable Giving Respond to Incentives and Income? New Estimates from Panel Data." National Tax Journal 64 (2), 615-650.

[5] Ricco, John, *TCJA Projected to Lower 2018 Charitable Giving by $22 Billion*, July 20, 2018 blog post, http://budgetmodel.wharton.upenn.edu/economic-matters/2018/7/20/tcja-projected-to-lower-2018-charity-giving-by-22-billion

[6] *Effects Of The Tax Cuts And Jobs Act:A Preliminary Analysis*; William G. Gale, Hilary Gelfond, Aaron Krupkin, Mark J. Mazur, and Eric Toder; June 13, 2018