

by Gene Steuerle

Expanded Information Reporting For Charitable Giving

Much attention has been given in recent years to the IRS's inability to administer well many aspects of the tax laws. Less recognized, however, has been an area of significant improvement: A system of expanded information reporting has enhanced the IRS's ability to handle many types of transactions fairly and efficiently. I suggest that now is the time to learn from this past history and apply an enhanced reporting system to a broader range of transactions — especially where the potential error or cheating rate is quite high (see "Improved Information Reporting for Capital Gains," *Tax Notes*, Aug. 8, 2005, p. 697). One item that should be high on the list for improved reporting is the charitable deduction.

Let's start with the essential facts. The IRS simply cannot and does not check up on almost all deductions reported on tax returns. It audits only a tiny fraction of people. Yet tens of millions of households declare charitable deductions of both cash and in-kind contributions. The potential for misreporting and cheating inevitably is quite large.

Important steps toward improvement in this reporting system were made when charities were required to send to the IRS a form (8282) for donated property disposed of within two years of the donation and to taxpayers an acknowledgment for each single contribution reporting of \$250 or more with a description of the donated property and the name and address of the charitable donee. Taxpayers, in turn, must file a form (8283) with the IRS on their in-kind contributions of \$500 or more. Some of the building blocks of a system of information reporting therefore are already in place. This system needs to be advanced to the next stage, with an eventual goal that the Service can generate computer matches for most of the charitable contribution deductions taken by taxpayers, just as it matches interest and dividend statements today.

Whatever this proposal's considerable advantages for reducing error and cheating, some may object to the cost of expanded information reporting for the charitable sector. After all, it would entail some expansion of its administrative responsibilities regarding charitable giving. For most charities, in truth, the net additional cost would be small, because most already have a system in place to keep track of their donors and how much they have given. Even most churches now give taxpayers a statement at the end of the year as to the cash contributions they stick in envelopes. Still, some software would probably need to be developed that would integrate their current systems with any new system of reporting to the IRS, and there would be some transition costs.

Although small in aggregate and almost inevitably a source of considerable error and cheating, something would have to be done about cash and in-kind contributions when no records are kept by the charity. Perhaps the information reporting system would apply to all giving, but taxpayers would be given some de minimis amount they could declare over and above what they have on 1099 returns — as long as they kept documentation. But let's be quite honest about this area of giving. There is almost zero enforcement possible as structured right now.

For taxpayers, an information reporting reform would almost assuredly provide simplification. Most taxpayers today no longer need to keep track on a separate ledger of their interest or dividends as they are received, but merely transfer to their tax return the information reported to them at the end of the year on information returns. If most charitable deductions were reported on information returns, they could drop keeping separate ledgers here as well.

Considered on the whole, this type of reform could be a real plus for the charitable sector. First, with little fanfare, the deduction has been eroding over the decades, and many large tax reforms would reduce or eliminate it altogether if some better reporting system is not eventually put into place. Second, a better system of information reporting expands significantly the possibility that Congress would consider increased incentives for giving, such as expanding the deduction to nonitemizers and allowing giving up to April 15 of a given year to be deducted on the tax return filed at that time for the previous year.

To see how the charitable deduction has been eroded over time, consider how within the U.S. tax system the Social Security tax has grown in relative importance while the income tax has declined. There is no charitable deduction in the Social Security tax — the most important tax for the majority of taxpayers and the one that has expanded most throughout the post-World War II era. Meanwhile, the enactment on occasion of lower income tax rates and a higher standard deduction in the income tax has tended to limit the incentive effect of the charitable deduction that has remained.

Consider also some of the broader tax reforms now under discussion. One school of thought recommends adoption of a simplified consumption tax with no charitable deduction. Others intone that a value added tax (VAT) needs to be added to the U.S. tax system. Some want to use VAT revenues to reform the income tax, some to reduce the deficit, some to pay for universal health care, some to pay for the extraordinary array of entitlement expenditures already scheduled for the future. Whatever the merit of these suggestions, the main point

here is that no charitable deduction would be allowed for those alternative or add-on taxes.

On a related front, for a number of years now, tax analysts have been examining ways to simplify tax return filing under the existing income tax. A primary candidate mentioned every few years is for the IRS to do the tax calculations for a majority of taxpayers. Sometimes that proposal is put under the banner of a "return-free" system. That terminology is misleading, since taxpayers would still need to correct any return that the IRS might prepare for them — for instance, by adding in self-employment income for which the IRS has little information. But regardless of the label, an IRS-prepared return is totally dependent on information returns. If charitable contributions are reported, they could be allowed under such a reform. If not, the eventual adoption of a return-free system would likely disallow any charitable deduction for the majority of taxpayers to whom this return-free system is applied.

How all these various reforms will play out, I do not know. I do know that if charitable contributions were subject to a good information reporting system, they would stand a much better chance of surviving if and when some significant reform is enacted.

In earlier columns in this publication, I have also suggested that legislation could simultaneously enhance incentives to give in exchange for a more administrable system (See "A Win-Win Option for Charity and Tax Policy," *Tax Notes*, Apr. 18, 2005, p. 361.) Extending the deduction to nonitemizers, for instance, makes sense only if the Service can administer that expanded responsibility. It cannot really do so now. Without more auditing of charitable contributions, it either would do little to monitor the new claims for charitable deductions or it would transfer scarce resources away from the already insufficient monitoring of itemizers.

Similarly, I have suggested that charitable deductions for the previous year should be allowed, like deposits to individual retirement accounts (IRAs), for contributions made up until a taxpayer files his or her tax return for that year (See "Increasing Charitable Giving: The April 15 Solution," *Tax Notes*, July 9, 1990, p. 221.) Yet I have also become convinced that the IRS would need a better system of information reporting to make that possible, because it would want to be assured that taxpayers did not declare the deduction twice — on the returns for both last year and this year. Once again, a system of information reporting would solve the problem. Those deductions could be allowed only for contributions reported (to both the IRS and the taxpayer) by the charity for the previous year. That is exactly how financial institutions report to the taxpayer and the IRS the amount of IRA contributions and the year to which they apply.

Here, then, is an ideal trade-off. The monies derived from the improved compliance accompanying a better system of information reporting could be spent on enhancing charitable incentives — either extending the deduction to more taxpayers or allowing taxpayers to benefit immediately from charitable contributions they make while in the process of filing their tax returns. My guess is that the combination would increase giving and compliance at the same time.

The IRS does not administer well items for which it does not have information reporting. Extending information reporting to most charitable contributions would simplify life for most individual givers, improve compliance, and likely be better for the charitable sector as well. An improved information reporting for charitable contributions goes hand-in-hand with the continually improving systems of accounting that accompany the advances of information technology.