What is the tax treatment of charitable contributions?

Q. What is the tax treatment of charitable contributions?

A. Corporations and individual taxpayers who itemize can deduct charitable contributions to 501(c)(3) organizations.

Many nonprofit institutions are exempt from paying federal income tax, but taxpayers may deduct donations to organizations set up under Internal Revenue Code section 501(c)(3) on their income tax returns. Donations to other nonprofits are made after taxes.

Since 1917, individual taxpayers have been able to deduct charitable contributions from income that might otherwise be taxed. Individuals may deduct cash and certain other contributions up to 60 percent of adjusted gross income (AGI) in a given year and may carry forward any excess for deduction on future tax returns for up to five years. Before the 2017 Tax Cuts and Jobs Act, the limit was 50 percent of AGI. An important caveat: only taxpayers who itemize may take the charitable deduction. Most taxpayers instead claim a standard deduction, which generally is larger than their potential itemized deductions but which does not provide a tax incentive to make charitable contributions. The Tax Cuts and Jobs Act nearly doubled the standard deduction amounts, which greatly reduced the number of taxpayers who itemize and hence the number who have a tax incentive to make charitable contributions.

In 1935, Congress extended the right to deduct charitable contributions to corporations. Corporations may not deduct more than 10 percent of their pretax income in a given year but, like individuals, may carry forward excess donations for five years. Some corporate contributions, however, might also qualify as business expenses.

Contributions by individuals or corporations can take the form of cash, financial assets, or other noncash property such as real estate, clothing, or artwork. Certain contributions face greater restrictions than cash contributions, whereas others receive more generous treatment than cash. The limit for donations of appreciated real property is generally 30 percent of AGI, and the limit for contributions to private nonoperating foundations is the same. But donors may deduct the full current market value of appreciated property. This effectively allows them to deduct capital gains twice: donors pay no tax on the capital gains of the appreciated property, and then reduce their other income subject to tax by the full amount of their contribution, thereby effectively deducting from income the capital gains that had never been included in income. However, those capital gains would also be excluded from income tax if held until death, even if not given away, so unless that provision is simultaneously addressed, removal of the special tax break for gifts of appreciated property would discourage such gifts.

Updated May 2020

Key Elements of the U.S. Tax System

TAXES AND CHARITABLE GIVING

What is the tax treatment of charitable contributions?

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Q. What entities are tax-exempt?

A. Nonprofit organizations that do not distribute profits can be exempt from federal income tax if organized expressly for public purposes.

Tax-exempt organizations (including charities) include many diverse entities. The National Taxonomy of Exempt Entities—developed by the National Center for Charitable Statistics at the Urban Institute and used by the Internal Revenue Service—classifies them into 9 major groups, 26 categories, and over 600 subcategories. The major groups are as follows:

1. Arts, culture, and humanities (e.g., art museums, historical societies)
2. Education (e.g., private schools, universities, parent-teacher associations)
3. Environment and animals (e.g., humane societies, the Chesapeake Bay Foundation)
4. Health (e.g., nonprofit hospitals, the American Lung Association)
5. Human services (e.g., the Girl Scouts, the YMCA, food banks, homeless shelters)
6. International and foreign affairs (e.g., CARE, the Asia Society, the International Committee of the Red Cross)
7. Public society benefit (e.g., the Rockefeller Foundation, the Urban Institute, civil rights groups, the United Way)
8. Religion-related (e.g., interfaith coalitions, religious societies)
9. Mutual membership or benefit (e.g., nonprofit credit unions, labor unions, fraternal organizations)

Although tax exemption requires that owners do not receive profits from the organization, employees and contractors with a nonprofit still earn private benefits, creating potential conflicts over such issues as defining when compensation is excessive. Also, many types of mutual benefit organizations qualify for tax exemption, though not usually deductibility of charitable contributions to them.

In 2020, approximately 1.74 million tax-exempt organizations were registered with the Internal Revenue Service. These nonprofits accounted for approximately 5.5 percent of US gross domestic product in 2019. About 35 percent of registered nonprofits are required to file annual returns (Form 990, 990-EZ, or 990-PF); other organizations with gross receipts between $25,000 and $50,000 must file a simpler information return known as the 990-N (e-postcard). Religious congregations, as well as organizations with less than $25,000 in gross receipts, are exempted from the annual filing requirement. All private foundations are required to file the 990-PF.

Key Elements of the U.S. Tax System

What entities are tax-exempt?

Tax-exempt status confers exemption from federal tax on earnings from income-producing assets and activities (other than those that generate unrelated business income). States generally follow the federal precedent if they impose state income taxes and often exempt charities from state and local property taxes and sales taxes. Charities also sometimes qualify to issue tax-exempt bonds.

Although many nonprofits qualify for tax exemption, only about two-thirds also qualify to be "charities" and receive contributions that donors can deduct on their tax returns. "Charitable purpose" is defined under section 501(c)(3) of the tax code as "religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition [or] the prevention of cruelty to children or animals." This definition covers both public charities and private foundations; the latter organizations are created to distribute funds for charitable purposes to other charities or individuals.

Updated May 2020

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Q. Who benefits from the deduction for charitable contributions?

A. The charitable deduction subsidizes charitable giving by lowering the net cost to the donor. If the tax deduction spurs additional giving, charitable organizations can provide more services.

A charitable contribution is intended for the benefit of those supported by the charitable activity, whether through education, health care, or the like. Just under three-quarters of charitable giving comes directly from individuals, with the balance coming from foundations, estates, and corporations (figure 1). According to Giving USA, total contributions totaled $427.71 billion in 2018, though there is some double counting, in the sense that this year's grants by foundations derive from past contributions by individuals, corporations, and bequests.

The charitable deduction subsidizes donors by lowering the net cost of the gift. Just how much the tax deductibility lowers the cost of giving depends on the donor's marginal tax rate. For instance, a donor in the 30 percent tax bracket pays 30 cents less tax for every dollar donated. Higher-income individuals generally save more taxes by giving to charity than those with lower incomes for two reasons: they have higher marginal tax rates, and they are more likely to itemize deductions and take advantage of the tax savings.

The deductibility of contributions subsidizes charitable activity but is also sometimes independently justified as an appropriate adjustment to the tax base. Many economists and lawyers argue that a taxpayer's taxable income should be determined by income net of contributions, because a taxpayer with, say, $50,000 of income and $10,000 of contributions has no more ability to consume than someone with $40,000 of income and no contributions. Others see the $10,000 as a consumption choice made by the donor that does not warrant special tax treatment. Either way, the amount of income subject to tax still decreases because the charitable gift is generally transferred tax free to beneficiaries.

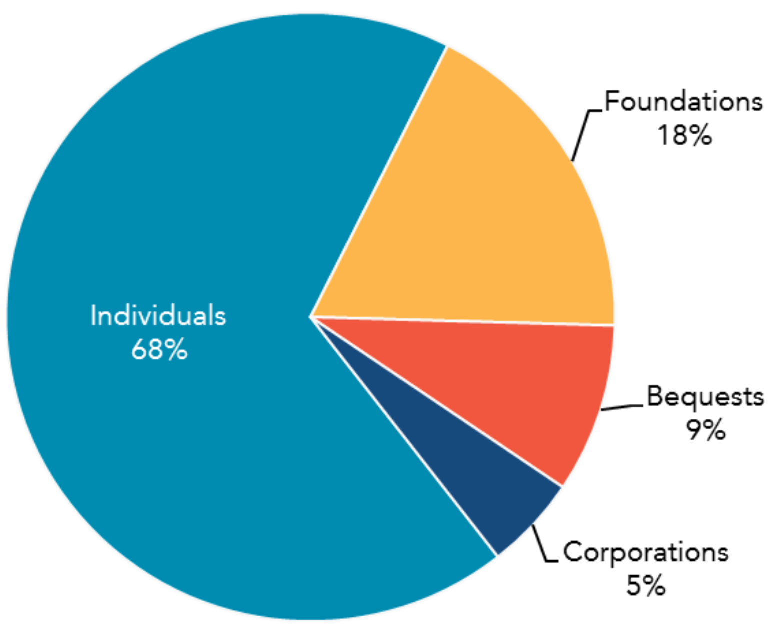
Donors may choose which charitable activities to support. Thus, because part of the cost of donations is borne by the government through reduced revenue, donors effectively have some say in which activities the government supports. The same situation exists in many other programs, such as tax credits for research and development, whereby businesses determine among eligible research activities the ones that the government supports.

Who benefits from the deduction for charitable contributions?

FIGURE 1

Sources of Charitable Giving

2018



Source: Giving USA Foundation. 2019. *Giving USA 2019: The Annual Report on Philanthropy for the Year 2018.* Indianapolis, IN: Giving USA Foundation.

Some donations fund activities that substitute for those the government might otherwise undertake. Other donations complement government activities, and still others support an adversarial relationship with government. Nonprofits, for instance, may seek government funding for an activity, or its members may engage in debates with government officials, though various rules limit outright lobbying. Many believe these types of charitable activity make democracies healthier, even when particular chartable efforts have little impact.

Who benefits from the deduction for charitable contributions?

Although the tax deduction likely induces additional giving, estimates of the size of this effect vary. Indeed, there is considerable debate over whether the increase in giving exceeds the loss of government revenue, though valuing the deduction on that basis alone treats charitable contributions and government spending simply as substitutes.

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Q. How would various proposals affect incentives for charitable giving?

A. Proposals include providing more effective or more universal incentives for charitable giving, but often in exchange for some restrictions, such as a floor or a small percentage of income above which incentives would be provided. Many proposals aim to enhance the amount of giving per dollar of revenue loss; some take account of IRS capabilities to monitor taxpayer claims.

Under current law, taxpayers who itemize deductions can deduct most of their charitable contributions, thereby reducing their tax liability. Most taxpayers give up that charitable incentive, along with other itemized deductions, to take a standard deduction of greater value.

A MORE UNIVERSAL DEDUCTION

Until recently, a significant share of taxpayers could claim a deduction for charitable giving, along with other itemizable expenses such as mortgage interest deductions.

The 2017 Tax Cuts and Jobs Act (TCJA), however, went in the opposite direction and reduced tax subsidies for charitable giving to less than 10 percent of all taxpayers. It did so not directly but mainly through several provisions that together substantially increased the share of taxpayers taking a larger standard deduction in lieu of a smaller amount of itemizable expenses, including the charitable deduction. Accordingly, renewed interest has been expressed in a more universal deduction, though advocates often favored such a proposal to expand the reach of the charitable deduction even when a greater share of taxpayers itemized.

A more universal deduction likely would displace the existing deduction for itemizers. Some proposals, however, would create two charitable incentives, one for itemizers and one for everyone else, despite the complexity this would create. A completely universal deduction, almost without restriction, raises two issues: effectiveness and compliance.

First, incentives for the first dollars of giving are considered relatively ineffective because they subsidize giving that taxpayers would take with or without a deduction. Consider a taxpayer who normally gives away $1,000 and, because of an incentive, increases that giving to $1,200. The money spent on the deduction for the first $1,000 is somewhat ineffective; the money spent on the last $200 is where the bang per buck is concentrated.

Second, the Internal Revenue Service (IRS) audits very few people, and the reporting system for charitable contributions is somewhat weak. IRS research clearly indicates that cheating is much more frequent when weak reporting systems are in place.

FLOOR ON DEDUCTIONS

If a more universal deduction were combined with a reasonable floor applied to all taxpayers, much or all the revenue loss would be eliminated, as would many problems with additional noncompliance and complexity.

Taxpayers, for instance, might be allowed to claim charitable deductions greater than 1 or 2 percent of their adjusted gross income, regardless of whether they itemize. A modest floor would leave in place an incentive for all taxpayers, though they must give more than a modest amount to take advantage of it. Meanwhile, the subsidy for some of the first dollars of giving would be eliminated for everyone. Almost no matter how sensitive or insensitive taxpayers are to incentives, a revenue-neutral reform that exchanges fewer subsidies for the first dollars of giving in favor of more subsidies for the last dollars of giving would almost inevitably increase giving.

At the same time, such an approach would address concerns about administration and compliance by eliminating the need for IRS to monitor small givers, which it has not been able to do effectively.

A BETTER REPORING SYSTEM FOR CHARITABLE CONTRIBUTIONS

Expanding reporting requirements for charitable contributions would raise revenues. Congress occasionally has required increased reporting, as when it required charities to track and send letters to donors for contributions greater than $250. Yet no reporting goes directly to IRS, which over the years has increasingly relied upon document matching as perhaps its primary way of enforcing proper reporting of individual's income tax liability. Various options include sending the IRS information already required for the letters to donors, or allowing an April 15 deduction option (see below) only for contributions directly reported to the IRS.

RAISING THE LIMIT ON THE DEDUCTION

The TCJA raised the annual limit on deductible contributions from 50 to 60 percent of adjusted gross income in 2017 legislation. Another option would be to raise the limit even further or to expand the current carryover provision for excess contributions beyond the five years now allowed.

IRA ROLLOVERS

Yet another proposal would expand the charitable individual retirement account (IRA) rollover provision. More generous than an itemized deduction, this provision allows some taxpayers over age 72 years to donate up to $100,000 from traditional IRAs to charity without having to count the distributions as taxable income or separately take an itemized deduction for these contributions. (the RMD, or required minimum distribution, age used to be 70 years and 6 months, but following the passage of the Setting Every Community Up for Retirement Enhancement (SECURE) Act in December 2019, it was raised to 72.) Raising or eliminating the $100,000 annual limit on donations, lowering the age limit to 59 years and 6 months (the age at which IRA owners may withdraw funds without penalty), or allowing taxpayers to deposit such giving in donor advised funds (currently ineligible for such tax treatment) could increase charitable giving.

How would various proposals affect incentives for charitable giving?

FOUNDATION EXCISE TAX

Another option would eliminate or reduce the excise tax on foundation income, which would increase net assets used for charitable purposes. The current excise tax on income from foundation assets was initially intended to cover the IRS's costs of overseeing the tax compliance of charitable organizations, but the monies were never appropriated for that purpose. For tax years beginning on or before Dec. 20, 2019, the excise tax is 2 percent of net investment income, but is reduced to 1 percent in certain cases. For tax years beginning after Dec. 20, 2019, the excise tax is 1.39% of net investment income, and there is no reduced 1 percent tax rate.

At very least, Congress could impose a single tax rate on all such income; this would eliminate the current perverse incentive for foundations to limit current grants today to avoid a higher tax in the future.

ALLOWING CHARITABLE DEDUCTIONS UP TO APRIL 15 OR TIME OF FILING TAX RETURNS

In the America Gives More Act of 2014, the House of Representatives passed a proposal, sometimes called the April 15 option, which would allow individuals to take charitable deductions up to April 15 or the time of filing tax returns. The proposal costs the government almost nothing if there are no increases in giving because it doesn't really change the subsidy value of gifts already available. Thus, in terms of bang per buck, or increased giving per dollar of revenue cost, it ranks very high, because the incentive for the most part only loses revenues when there are additional gifts.

Economic and marketing evidence supports the notion that saliency matters: people would give more because they would be more aware of the size of the incentive, partly through the information tax return preparers and tax software developers provide.

CAPS ON CHARITABLE INCENTIVES

Prior to passage of TCJA, two proposals—a cap on total itemized deductions and a cap on the top rate at which deductions can be made—had been suggested to reduce incentives for charitable giving and raise revenues.

President Trump at one point proposed an overall cap on itemized deductions of $100,000 per single return and $200,000 per joint return. Higher-income taxpayers with mortgage interest, property tax, and other deductions in excess of such amounts would have been left with no tax incentives to give, while others would be left with a subsidy only for their first dollars of giving, up to the point they hit the cap.

A maximum cap on the tax subsidy rate for itemized deductions, proposed by President Obama, could also be reintroduced. Alternatively, in the presence of a universal deduction to nonitemizers and itemizers alike, the maximum cap could be replaced by a cousin, a maximum rate for that subsidy alone. For instance, if the top statutory tax rate is 37 percent but the maximum tax subsidy rate for deductible contributions is set at 27 percent, then the subsidy for those in that 37 percent bracket would be reduced by more than one-quarter. Because the cap applies to all additional giving, as opposed to be concentrated on the first dollars of giving, it would reduce total giving much more than many other types of limitations that raise the same amount of revenues, such as the floor discussed above.

Although the tax deduction likely induces additional giving, estimates of the size of this effect vary. Indeed, there is considerable debate over whether the increase in giving exceeds the loss of government revenue, though valuing the deduction on that basis alone treats charitable contributions and government spending simply as substitutes.

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Q. How large are individual income tax incentives for charitable giving?

A. The individual income tax deduction for charitable giving provides a substantial incentive to give by reducing the economic cost of making a donation. In 2018, charitable giving by individuals is estimated to reach $299 billion at an annual revenue loss of around $44 billion.

CHARITABLE GIVING BY ITEMIZERS AND NONITEMIZERS

An income tax deduction for charitable giving is available only to taxpayers who itemize their deductions. Estimates from the Urban-Brookings Tax Policy Center (TPC) suggest that for 2020, charitable giving by individuals could reach $324 billion. TPC estimates that the 90 percent of households that do not itemize their deductions will contribute about 40 percent of total charitable giving, while the 10 percent of households who itemize will provide about 60 percent (table 1).

TABLE 1

Estimated Charitable Giving by Itemizers and Nonitemizers

2020, under current law

Current law baseline	Itemizers	Nonitemizers
Number of tax units (thousands)	19,031	166,769
Percentage of total tax units	10%	90%
Total giving ($ billions)	200	124
Percentage of total giving	62%	38%

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-2).

GIVING BY INCOME GROUP

Charitable giving patterns differ by income. The charitable deduction provides higher-income taxpayers with a larger tax subsidy per dollar donated, because such taxpayers are more likely to itemize deductions and because they generally face higher tax rates. Some research indicates that higher-income taxpayers are more responsive or sensitive to each dollar of tax subsidy—that is, each dollar of government cost generates more charitable contributions—perhaps because a subsidy is more salient to those more likely to use tax advisers,

How large are individual income tax incentives for charitable giving?

or simply because they tend to consume a smaller share of their income and therefore have a larger share of income out of which they can give.

Tax proposals that affect incentives for higher-income individuals to give, however, will have a disproportionate effect on the charities to which these individuals are more likely to donate, such as higher education and museums.

Table 2 shows the amount of charitable contributions for taxpayers claiming an itemized deduction for those contributions in the last year before the number of itemizers was substantially reduced. It does not include giving by nonitemizers. A few things to note: First, most low- and moderate-income taxpayers do not claim a deduction for charitable contributions, largely because most do not itemize. Second, at high-income levels, about 90 percent or more taxpayers claim charitable deductions (before TCJA). And third, the pattern of deductible charitable giving as a percentage of income is U-shaped—average giving is very high for the small percentage of low-income taxpayers who claim a deduction, as well as for the large percentage of very high income taxpayers. The pattern of giving for atypical low-income taxpayers who itemize, however, may not be indicative of giving—or, for that matter, of unrealized income that doesn't show up in adjusted gross income—by all low-income households.

TABLE 2

Returns Claiming Charitable Deduction: Number of Returns with and Amount of Charitable Deduction by Adjusted Gross Income

Tax year 2016 (filling year 2017)

AGI category	Percent Claiming Charitable Deduction	Total Charitable Deductions	Average Charitable Deduction for those Claiming Deduction	Charitable Deduction as a Percentage of AGI[a]
Under $50,000	7.5	17,836,225	2,588	8.4
$50,000 under $100,000	35.0	38,417,634	3,305	4.5
$100,000 under $500,000	70.6	88,440,900	5,124	2.9
$500,000 under $2,000,000	88.0	26,142,094	25,510	3.1
$2,000,000 under $10,000,000	89.1	20,219,824	164,814	4.4
$10,000,000 or more	94.6	42,810,648	2,813,343	9.3
All returns	**24.6**	**233,867,324**	**6,332**	**4.3**

Source: Internal Revenue Service, Statistics of Income Division, August 2018.

Notes: AGI = adjusted gross income. Table only captures charitable donations reported to the Internal Revenue Service.

(a) Charitable deduction as a percentage of AGI is calculated as the average charitable deduction for returns claiming the deduction divided by the average AGI for all returns with any itemized deductions.

AVERAGE TAX INCENTIVE FOR GIVING

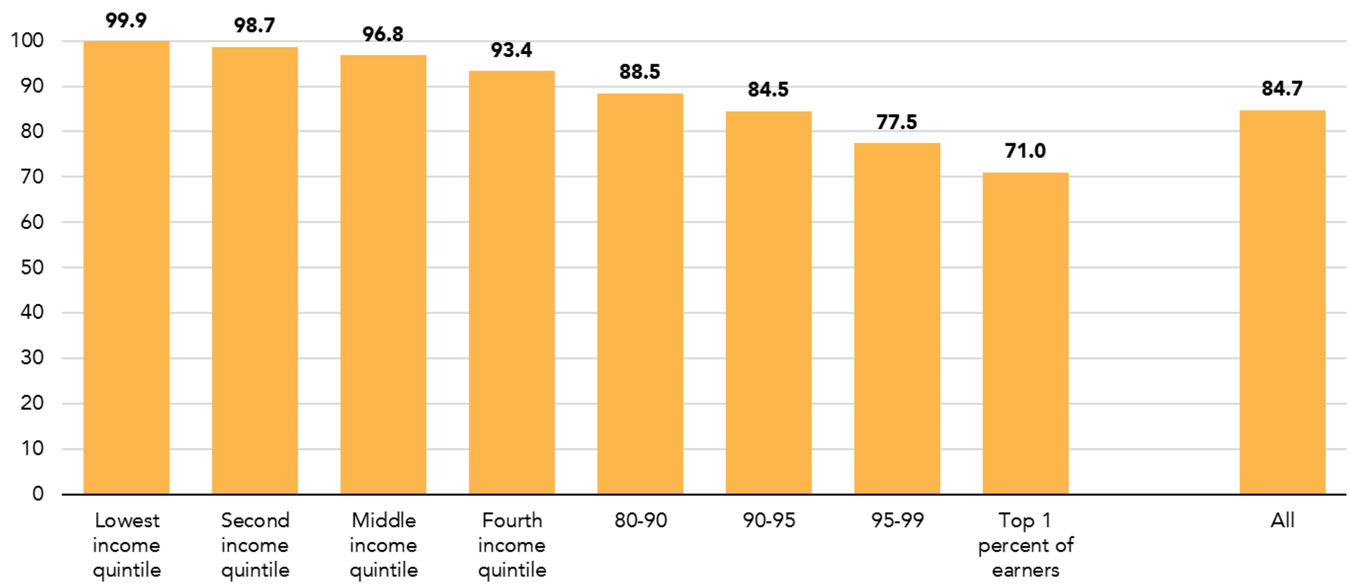
The after-tax cost of giving is the value of the gift minus any tax benefits received. If an itemizing taxpayer with a marginal tax rate of 24 percent (that is, the tax rate on the last dollars of income) gives $100 to a local college, for instance, the gift reduces the income tax bill for that person by $24, so the deductible charitable gift has a net cost of only $76. The $24 is the amount of the federal subsidy for giving. If the taxpayer had a 40 percent tax rate, the donation becomes even less costly to the taxpayer, at only $60. In other words, as tax rates increase, the after-tax "price" of charitable giving decreases.

Figure 1 shows a summary of the average after-tax price of charitable giving for taxpayers at different income levels in 2020. For the entire population, it is about 85 percent; that is, on average the after-tax federal subsidy is 15 percent. This represents a drop of about 6 percentage points from the average federal subsidy rate of around 21 percent before the passage of the 2017 Tax Cuts and Jobs Act. Note that taxpayers in the top 1 percent have the lowest after-tax price of charitable giving both because they face higher tax rates and because they are more likely to itemize.

FIGURE 1

Estimated Average After-Tax Price of Charitable Giving, 2020

By expanded cash income percentile, under current law



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-2).
Note: Graph depicts the average marginal after-tax price of a $100 donation.

ESTIMATED REVENUE LOSS FROM THE CHARITABLE DEDUCTION

The individual charitable deduction is estimated to cost approximately $44 billion in 2020 and $230 billion over five years (2019–23) (table 3). The relationship between the revenue loss and the amount of additional giving created by the tax incentive has significant policy implications. For example, if the loss in federal revenue from allowing the charitable deduction is greater than the increase in charitable giving caused by the deduction, then a portion of the federal subsidy is going to donors rather than to the ultimate beneficiaries of charitable gifts. To the extent that Congress views charitable and government efforts as direct substitutes, it might be more efficient to eliminate the deduction and provide charities with direct federal support.

This sometimes leads to proposals, such as allowing a deduction only for giving that exceeds a dollar floor, to concentrate a greater share of the tax incentive on the last rather than first dollars of giving by any taxpayer getting the incentive. Research suggests that first dollars of giving are much less responsive to tax incentives. Studies on the impact of the tax incentive, however, do not deal with and therefore may underestimate the extent to which the presence of a tax incentive helps create a culture of giving.

TABLE 3

Estimated Tax Expenditures by Charitable Deductions

Fiscal years 2019–23 ($ billions)

Charitable deductions	2019	2020	2021	2022	2023
Educational institutions	$6.6	$6.8	$7.0	$7.3	$7.5
Health organizations	$3.6	$3.7	$3.9	$4.0	$4.1
Other	$32.9	$33.9	$35.0	$36.1	$37.2
Total	**$43.1**	**$44.4**	**$45.9**	**$47.4**	**$48.8**

Source: Joint Committee on Taxation (2019, 55–19).

LIMITS ON THE CHARITABLE DEDUCTION

Congress has placed many limits on the availability of a charitable deduction. Among them are the following:

- The charitable deduction is only available for a subset of qualifying tax-exempt organizations that are charitable in nature, as defined in section 501(c)(3) of the tax code.
- Contributions for individuals are generally allowed up to 60 percent of adjusted gross income, but there is a 30 percent limit for contributions to a foundation and certain other organizations and a 30 percent limit for contributions of capital gain property. Deductible contributions for corporations are limited to 10 percent of corporate income.
- Contributions to many tax-exempt organizations, such as unions and chambers of commerce, are not deductible, though income earned on assets within those organizations is generally excluded from taxation.

Updated May 2020

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Key Elements of the U.S. Tax System

How large are individual income tax incentives for charitable giving?

TAXES AND CHARITABLE GIVING

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Q. How did the Tax Cuts and Jobs Act affect incentives for charitable giving?

A. The 2017 Tax Cuts and Jobs Act will discourage charitable giving by reducing the number of taxpayers claiming a deduction for charitable giving and by reducing the tax saving for each dollar donated.

The Tax Cuts and Jobs Act (TCJA) made major changes that discourage charitable giving relative to under prior tax law. It lowers individual income tax rates, thus reducing the value and incentive effect of all tax deductions. It increased the standard deduction to $12,000 for singles and $24,000 for couples, capped the state and local tax deduction at $10,000, and eliminated other itemized deductions—steps that significantly reduced the number of itemizers and hence the number of taxpayers taking a deduction for charitable contributions. The new law also roughly doubled the estate tax exemption to $11 million for singles and $22 million for couples, which discourages tax-motivated charitable bequests by some very wealthy households.

The Urban-Brookings Tax Policy Center estimates that TCJA shrunk the number of households claiming an itemized deduction for their charitable gifts from about 37 million to about 16 million in 2018, and reduced the federal income tax subsidy for charitable giving by one-third—for instance, from about $63 billion to roughly $42 billion in 2018.

Overall, the TCJA reduced the marginal tax benefit of giving to charity by more than 30 percent in 2018, raising the after-tax cost of donating by about 7 percent. Unless taxpayers increase their net sacrifice—that is, charitable gifts less tax subsidies—charities and those who benefit from their charitable works, not the taxpayers, will bear the brunt of these changes.

REDUCING TAX RATES

For taxpayers who itemize their deductions, the tax saving from charitable contributions depends on the donor's marginal tax rate. For instance, a donor in the 30 percent tax bracket pays 30 cents less tax for every dollar donated; that is, an additional dollar of contribution costs the donor on net 70 cents. By lowering tax rates only modestly for individuals, the rate reduction in TCJA reduced the tax saving for each dollar donated much less than other provisions.

RAISING THE STANDARD DEDUCTION AND LIMITING SOME ITEMIZED DEDUCTIONS

Taxpayers who choose to itemize their deductions on their income tax returns can deduct charitable contributions from income that would otherwise be taxed. This lowers the cost of charitable giving by the amount of taxes saved. Most taxpayers, however, do not itemize but instead claim the standard deduction

How did the Tax Cuts and Jobs Act affect incentives for charitable giving?

because it is larger than the sum of their potential itemized deductions. Taxpayers who take the standard deduction cannot reduce their taxable income by the amount of their charitable contributions; only itemizers have an incentive to give to charities because it reduces their taxes.

TCJA significantly increased the standard deduction amount. It also capped the deduction for state and local taxes at $10,000 and eliminated some other itemized deductions. The combined effect of these changes is a substantial reduction in the number of taxpayers who itemize, and thus the number who take a deduction for charitable contributions.

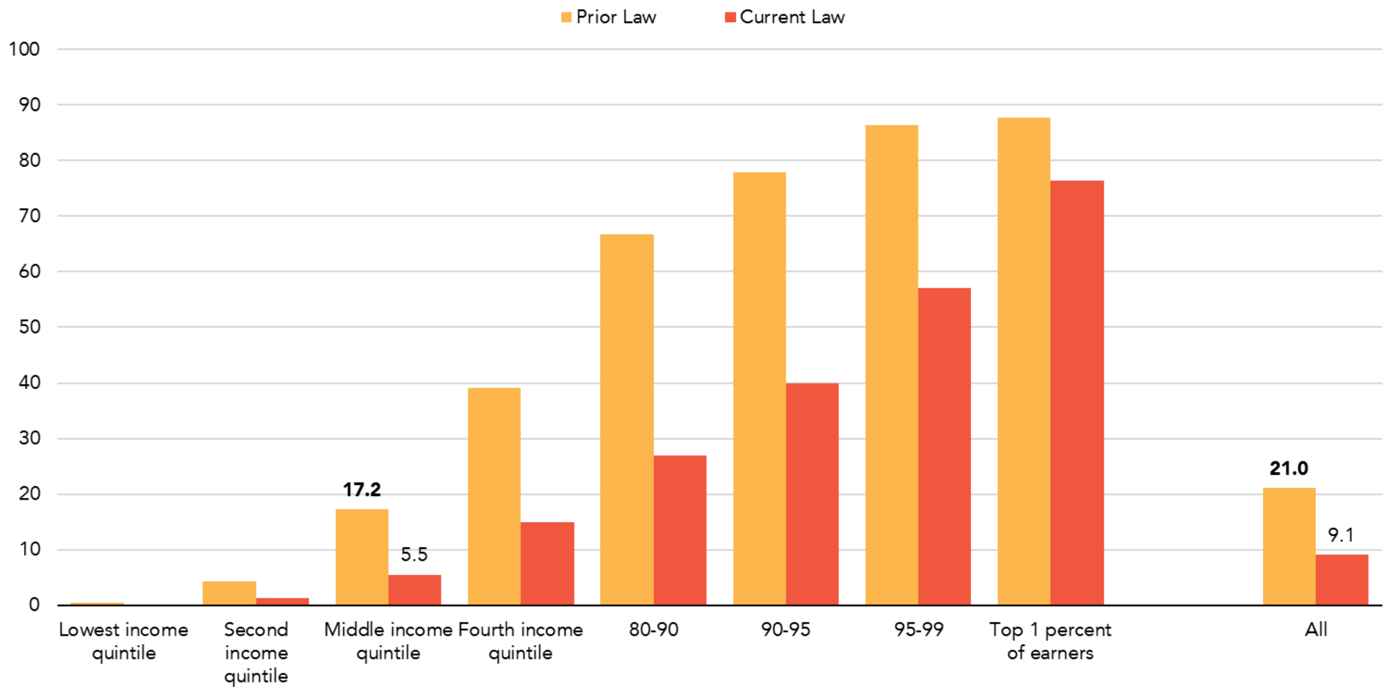
Before accounting for any changes in the amount of charitable giving, TPC estimates that the law cut the number of those itemizing their charitable contributions by more than half, from 21 percent to about 9 percent of households. The share of middle-income households, defined here as those in the middle quintile of the income distribution, claiming the charitable deduction fell by two-thirds, from about 17 percent to just 5.5 percent (figure 1).

The share of households itemizing their charitable contributions fell even among high-income households. The share of households in the 90th–95th percentile (those making between about $216,800 and $307,900), taking a deduction for charitable gifts dropped from about 78 to 40 percent, and the share itemizing among households in the 95th–99th percentile (those making between about $307,900 and $732,800) fell from 86 to 57 percent (figure 1).

FIGURE 1

Change in the Share of Taxpayers Taking Itemized Deductions for Charitable Giving under the TCJA

By expanded cash income percentile, under prior law and current law



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1).
Notes: Graph depicts the average marginal tax subsidy for a $100 donation.

How did the Tax Cuts and Jobs Act affect incentives for charitable giving?

While nonitemizers do not receive any subsidy for their current level of gifts, the incentive remains for some to make large gifts, even if unused. Thus, a couple filing a joint return with $280,000 of adjusted gross income and paying state and local taxes in excess of $10,000 still has an incentive to give more than $14,000, at which point their total itemized deductions would exceed the standard deduction. However, the tax incentive now applies to excess gifts, that is, giving that raises their total itemized deductions above the $24,000 amount of the standard deduction. Under prior law, which had a much lower standard deduction and no cap on deductible state and local taxes, the tax incentive for giving might very well have applied to the total amount of their charitable donation.

Some taxpayers can avoid these limitations. An individual retirement account charitable rollover allows people aged 72 and older (before another 2019 reform, the age was 70.5) to make direct transfers from their IRAs totaling up to $100,000 per year to qualified charities, without having to count the transfers as income for federal income tax purposes. Also, some taxpayers can bunch gifts. For instance, a couple with $10,000 of state and local taxes would take the standard deduction if the only other itemizable expenses were contributions of $10,000 a year for each of five years. However, the couple might give away $50,000 in one year and nothing in the other four—thus gaining the advantages of both the increased standard deduction and a deduction for most of their charitable contributions.

AVERAGE SUBSIDY FOR CHARITABLE GIVING

The combination of provisions in TCJA that reduced both the number of itemizers and tax rates lowered the average subsidy for charitable giving (the marginal tax benefit averaged across all charitable gifts) from 20.7 percent to 15.2 percent. While the average subsidy for charitable giving declined significantly for low- and moderate-income taxpayers, it hardly changed for the highest-income taxpayers. For example, the average subsidy for middle-income taxpayers (those whose income places them between the 40th and 60th percentile of the income distribution) fell from 8.1 percent to 3.3 percent. By contrast, for those in the top 1 percent, it fell from 30.5 percent to 28.9 percent (figure 2).

Key Elements of the U.S. Tax System

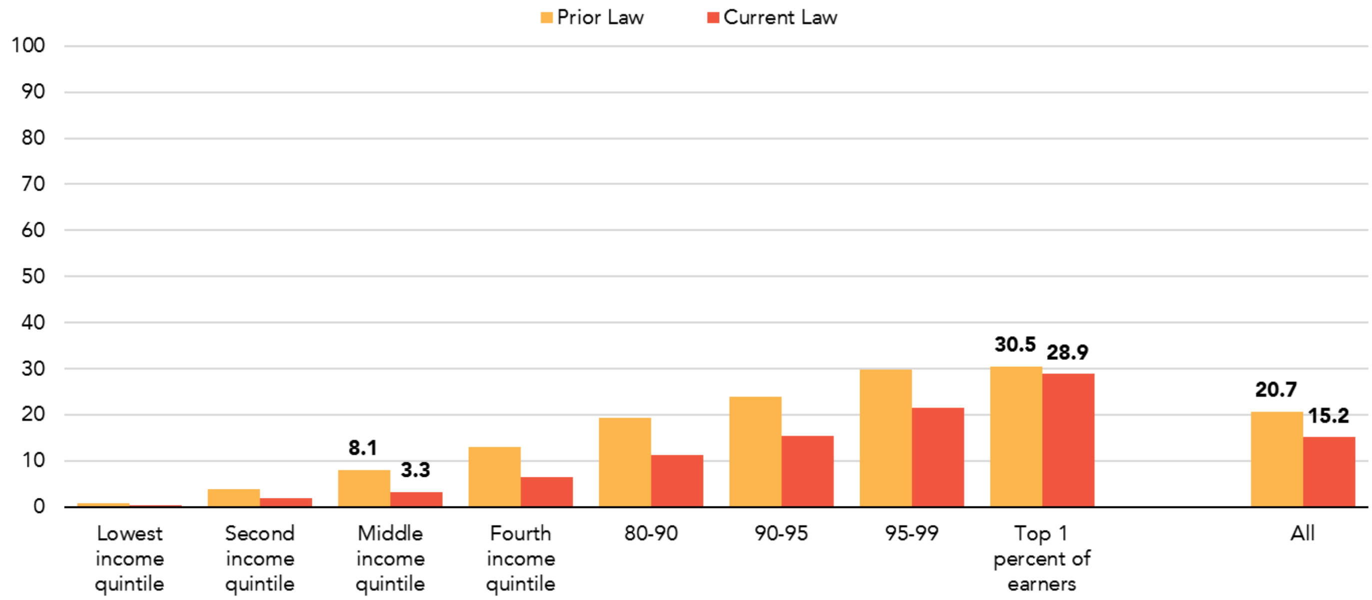
How did the Tax Cuts and Jobs Act affect incentives for charitable giving?

TAXES AND CHARITABLE GIVING

FIGURE 2

Estimated Effective Marginal Tax Benefit of Charitable Giving, 2018

By expanded cash income percentile, under prior law and current law



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1).
Notes: Graph depicts the average marginal tax subsidy for a $100 donation.

Updated May 2020

Data Sources

Urban-Brookings Tax Policy Center. "TPC Microsimulation Model, version 0319-2."

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