



ENCOURAGING CHARITABLE GIVING: MATCHING GRANTS VERSUS REBATES

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The federal government subsidizes charitable contributions for those taxpayers who have positive tax liability and itemize their deductions. However, especially since the passage of the 2017 Tax Cuts and Jobs Act, few taxpayers itemize, and those that do tend to have higher incomes – limiting the progressivity of the deduction. Replacing the charitable contribution deduction with a tax credit is one solution, but that would still only affect donors that file federal returns and owe taxes. This brief considers an alternative: matching grants to nonprofit organizations.. A grant system would require neither that donors file returns nor owe taxes, and research also suggests that donors are more incentivized by grants than by equivalent deductions. Contributions to religious organizations pose one complication to this solution, but a carefully designed program could avoid them.

For many decades, the federal government has allowed individual taxpayers to deduct charitable contributions from income that might otherwise be taxed. Although evidence supports that this incentive encourages additional giving, it only offers incentives to those who have positive tax liability and itemize their deductions. Even among the 8.5 percent of returns that fall into this group, the largest incentives apply to those in the highest tax brackets.¹ Families with low incomes rarely have access to charitable giving incentives.

An alternative method for providing charitable giving subsidies is a matching-grant system. Qualified charities report donations to the federal government and receive matching funds in return, offering the same level of incentive for any taxpayer, regardless of tax liability or deduction selection. A fixed-percentage matching grant for charities—the most common form of this grant type—is roughly equivalent to a flat-rate tax credit for individuals.

¹ “Table 1.4. All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2020 (Filing Year 2021)” Internal Revenue Service, accessed January 23, 2024, <https://www.irs.gov/pub/irs-soi/20in14ar.xls>

But matching grants differ from flat-rate tax credits in that they can help subsidize more taxpayers' giving, especially among those who do not owe taxes or are exempt from filing taxes. They are also perceived differently: matching grants are add-ons to a donation, while credits or reimbursements reduce the cost of the donation at tax time.

A large body of evidence suggests that, even for the same level of subsidy, matching grants would provide a more powerful incentive than a credit (examples include Davis 2006; Davis et al. 2005; Eckel and Grossman 2006a, 2006b, 2008, 2017; Lukas et al. 2010, and Hungerman and Ottoni-Wilhelm 2018). Complications to this approach exist, such as how to handle contributions to religious organizations, but a carefully designed program could avoid them.

THE CHARITABLE DEDUCTION AS AN INCENTIVE TO GIVE

The modern income tax system was started in 1913 and applied to only 0.8 percent of families (Sailer 1994). In 1917, taxpayers could deduct donations made to charitable organizations from their taxable income, up to a limit of 15 percent of their reported income. This provided an incentive to make charitable contributions, as the "price" of contributing fell from 1 to $1-t$, where t is the tax rate on the last dollar of their income. For example, a household in the 15 percent bracket could reduce their taxes by \$15 for every \$100, hence facing a price of only 85 cents for each dollar given.

Funding World War II required extending taxes to a larger share of the population. To lessen the newly imposed burden on those taxpayers and to simplify tax filing, in 1944, the Congress created the standard deduction. Taxpayers could select a standard deduction as an alternative to itemizing and deducting several expenditures, including charitable contributions, state and local taxes, and other items. Initially, the standard deduction equaled the lesser of 10 percent of income or \$500. Over time, the standard deduction has increased, and in 1986, it was indexed for inflation.

A limited charitable deduction was available for nonitemizers in 1982 through 1985, and again in 2020 and 2021. Congress has also changed the cap on the share of income that could be deducted as a charitable contribution (raised to 100 percent for 2020 and 2021). However, apart from these changes, the charitable deduction has retained its basic structure and remained an itemized deduction only available to those who opt out of the standard deduction.

Although in principle any taxpayer with a positive tax liability may make use of the federal tax incentive to make charitable contributions, it provides the largest subsidy to families with high incomes for at least three reasons. First, the progressive nature of the tax code means that those with higher incomes face higher tax rates. In 2023, rates increase for a single person from 10 percent on the first \$11,000 of taxable income to 37 percent for taxable income above \$578,125. This means that the price of giving for single itemizers with less than \$11,000 in taxable income was 90 cents on the dollar but only 63 cents on the dollar for those with taxable incomes above \$578,125.

Second, unrealized capital gains, a large share of which are held by taxpayers with very high incomes, receive advantageous tax treatment. Consider two taxpayers: Both taxpayers itemize and have \$60,000 in taxable income and face a marginal tax rate of 22 percent. The first wishes to give away \$1,000 in cash, and the second wishes to give away a capital asset that has grown in value of \$1,000 since its purchase years ago. The first taxpayer owes taxes of \$220 on the \$1,000 of earnings that they ultimately gave away. Because they itemize their deductions, the \$1,000 is subtracted from their taxable income and from a tax perspective, the contributions essentially remove \$1,000 of earnings. The second taxpayer does better than that. By giving away capital assets, they pay no taxes on any unrealized capital gains, and they can further deduct the \$1,000 from their taxable income. In a sense, the second taxpayer gets a double deduction.²

In 2020, the most recent year available, taxpayers made more than \$80 billion in noncash contributions, compared with \$137 billion in cash contributions. Of the noncash contributions, nearly \$60 billion were corporate stock, mutual funds or other investments.³

Finally, the deduction is only available to those who itemize. The contributions of those taking the standard deduction are not subsidized as they are for itemizers. In 2024, the standard deduction for a single taxpayer is \$14,600. This means that if a taxpayer has less than this amount in potential deductions, they can lower their federal taxes using the standard deduction. To be clear: those who take the standard deduction can itemize if they wish, but most households find the standard deduction more advantageous and would be left with less after-tax income if they had itemized. They can contribute the money they save from using the standard deduction, but they do not receive the direct subsidy like itemizers do.

By substantially raising the standard deduction and limiting or capping other itemized deductions, the 2017 Tax Cuts and Jobs Act (TCJA) accentuated these patterns.⁴ In 2017, about 31 percent of taxpayers itemized their deductions (see table 1). As always, it was more common for those with higher incomes to itemize: in that year, about 20 percent of those with adjusted gross incomes (AGI) of \$100,000 or below itemized, in contrast with 92 percent of those with incomes greater than \$500,000.

In 2020, the share of itemizers had fallen to less than 10 percent of taxpayers. Less than 5 percent of those with incomes below \$100,000 itemized, but nearly two-thirds of those with incomes above \$500,000 did. Taxpayers with high incomes made about 39 percent of all deducted contributions in 2017, but by 2020, their share climbed to 56 percent. The decline in share of itemizers for those with incomes greater than \$10 million was smaller: from 97 percent to 88 percent.

As a result, the number of taxpayers deducting contributions fell by similar amounts. For those with AGI of less than \$100,000, the share of taxpayers deducting contributions fell from just under 15 percent to 4 percent. For those with incomes greater than \$500,000, the share claiming contributions declined from 87 percent to 59 percent.

² This example assumes that both taxpayers owe at least \$220 in federal taxes and remain in the same tax bracket with or without the charitable contribution.

³ “Table 2.1. Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2020 (Filing Year 2021),” Internal Revenue Service, accessed January 23, 2024, <https://www.irs.gov/pub/irs-soi/20in21id.xls>; “All Individual Returns with Noncash Charitable Contributions Reported on Form 8283, by Donation Type, Tax Year 2020,” Internal Revenue Service, accessed January 23, 2024, <https://www.irs.gov/pub/irs-soi/20infigacc.xlsx>.

Correspondingly, more deductions were claimed by taxpayers with higher income. In 2017, 23 percent of contributions were claimed by those with an AGI of less than \$100,000. By 2020, that share fell to 11 percent. Those with incomes greater than \$500,000 saw their share increase from 39 percent to 56 percent and those with more than \$10 million of income saw their share of deducted contributions increase from 18 percent to 29 percent.

TABLE 1

Taxpayer Contributions and Itemization, 2017 and 2020

Share of taxpayers with contributions and share of all claimed contributions by income group



Source	2017	2020
All Taxpayers		
Share itemizing	30.6%	9.5%
Incomes < \$100k		
Share itemizing	19.6%	4.8%
Share claiming contributions	14.7%	3.5%
Share of all claimed contributions	22.7%	10.9%
Incomes >\$500k		
Share itemizing	92.5%	64.1%
Share claiming contributions	87.3%	59.3%
Share of all claimed contributions	39.4%	56.0%

Source: Table 1.4. All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Years 2017 and 2020 and Table 2.1. Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Years 2017 and 2020

Of course, many families make contributions without any federal tax incentive. Recently, Lillian Hunter and I used state income taxes to show how contributions fell by much less than indicated on federal forms after TCJA (McClelland and Hunter 2022). We found that total contributions by taxpayers with very high incomes actually increased in nominal terms between 2017 and 2018.⁵

COULD THE FEDERAL GOVERNMENT SWITCH TO MATCHING GRANTS?

Under the current tax system, the charitable giving subsidy rate is related to the tax rate on income: as noted, for an itemizer facing a tax rate t , the price of giving is $1-t$. But the best subsidy rate for contributions may not be related to the tax rate on income. It could be higher or lower, depending in part on how much people are motivated by incentives.

For example, donors could get great satisfaction from the benefit recipients receive from the gift and see the subsidy as expanding that opportunity. Or just the opposite—they may get satisfaction from the after-tax money they transfer. Increasing the subsidy could decrease that amount, leaving them worse off than not having a subsidy. Thus, using a subsidy rate that is tied to the tax rate on income could lead to too little giving (Kaplow 1998).

⁴ In particular, the TCJA imposed a \$10,000 cap on the deduction for state and local taxes.

⁵ See McClelland and Hunter (2022).

Several alternatives to the current system exist that would provide a more equal level of incentive per dollar of giving or across households than the current system. One alternative involves switching to a universal tax credit (Steuerle et al. 2021). This has several advantages, but, without an improved system of reporting to Internal Revenue Service (IRS), it raises a compliance problem for small donations. Allowing only donations above some share of AGI (such as 2 percent) to qualify for the subsidy partially addresses that problem and provides some additional progressivity by lowering available deductions mainly for those who already take them—existing itemizers.

Another alternative would be a system in which the federal government matches contributions made by families. For example, charities could report the contributions they received to the federal government, which would then provide some amount of matching funds. In this case, it not only changes who does the reporting but converts the subsidy to a flat rate independent of the taxpayer's marginal tax rate.

With a flat-rate credit or matching grant, no longer would high-income taxpayers receive a larger rate incentive to give than taxpayers with lower incomes, though they might still give a larger share of their income to charities. If the incentive was offered to all families, including those who do not itemize or even pay income taxes, this approach would broaden the scope of encouragement for giving across the population.

For both cash and noncash contributions, donors would not be required to keep receipts or otherwise fill out forms for their contributions to be matched by federal funds. The situation is switched for charities, although charities already should report their contributions when they file form 990. These filings may contain errors—no tax consequences exist for accidentally misreporting. Charities are also now required to report acknowledgements of individual gifts of \$250 or more to donors.

Under the existing system, charities have traditionally opposed sending reports on the \$250 gifts to the IRS. Small charities (those with gross receipts less than \$200,000 and assets less than \$500,000) are not required to file detailed Form 990s, so they might have to make the biggest adjustment with a matching grant. On the other hand, recipients of contributions from taxpayers with lower incomes may benefit because their contributions come from those that often do not currently receive a tax subsidy. At the possible cost of more administrative burden, matching grants would not only unwind the reduction in support caused by the TCJA, but they would incentivize support from those without incentives even before the TCJA.

The switch to reporting by charities rather than donors could also improve the reporting of noncash contributions in the form of apparel and household items, corporate stock, and other items. Of course, those itemizing deductions of these types of donations technically are already required to place a value on each item, but overreporting by donors has always been a problem with respect to such items as conservation easements, artwork, and household goods (Looney, 2017). By transferring the task from individual taxpayers to institutional charities who do not receive a tax benefit from overreporting, the accuracy of reports might improve.

The incentive for charities to make false claims of the existence and value of charitable contributions also exists, but it might be mitigated by only offering some sort of confirmed audit or processing through a third party who also bears some responsibility for accuracy. If Congress decided to implement a matching approach, this deserves further legal scrutiny. Most money flowing through charitable organizations from government already comes from the spending, not tax subsidy, side of the government's ledger. Lessons could be applied to a government match either for some specific charitable purpose or for a more universal subsidy.

Overall, compliance is a problem with the existing deduction system and with any alternative. The relative benefits of each largely depend on the improvements offered if Congress decides to expand incentives beyond the narrow range provided in TCJA.¹⁶

⁶ These correspond to the tax unit-weighted average of marginal tax rates on ordinary income and the taxable income-weighted average of marginal tax rates on ordinary income. Data drawn from "Table 3.4. All Returns: Tax Classified by Both the Marginal Rate and Each Rate at Which Tax Was Computed, by Filing Status, Tax Year 2020 (Filing Year 2021)," Internal Revenue Service, accessed January 23, 2024, <https://www.irs.gov/pub/irs-soi/20in34tr.xls>.

Although finding the match rate that maximizes contributions is complicated, it is straightforward to determine the match rate equivalent to a charitable deduction at any given rate. If an itemizer in the current system faces a tax rate of t , the equivalent match rate is $m = t/(1-t)$. For example, a tax rate of 50 percent corresponds to a 100 percent match rate. To see this, imagine a married couple who itemizes their deductions and gives away \$100. If they face a 50 percent tax rate, they will reduce their taxes by \$50, which is the same as if a couple gives away \$50 with a \$50 match by the federal government. In each case, the person's income net of contributions funds has been reduced by \$50, and the charity receives \$100.

What would match rates look like if they reflected current federal marginal tax rates? Marginal rates above 0 range from 10 percent to 37 percent, which correspond to match rates from 11.1 percent and 58.7 percent. However, providing more than one match rate would be confusing and difficult to administer. A single match rate would likely correspond to some sort of typical marginal tax rate.

Setting a single match rate means that it would not be possible for all taxpayers to face the same incentive they would face by itemizing because different people have different tax rates. If the match rate was 11.1 percent, taxpayers with high incomes, who make most of the contributions, would have a substantially reduced incentive. Alternatively, a match rate of 58.7 percent could be used, which corresponds to the highest marginal tax rate. This would provide a much higher subsidy than most taxpayers would receive if they itemized, and so it would be more expensive to enact.

Instead, the match rate corresponding to the typical marginal tax rate could be used. To calculate that rate, we must first distinguish between the marginal tax rate of the average taxpayer and the marginal tax rate of the average dollar earned. Because incomes are concentrated at the top of the income distribution, a large share of income is in the higher tax brackets. As a result, in 2020, the marginal tax rate of the average taxpayer was about 12 percent, but the marginal tax rate of the average dollar of taxable income was about 23 percent. Those correspond to match rates of 13.6 percent and 30.2 percent, respectively.⁷⁸

Although we have no experience with the federal government providing a matching grant for most charitable contributions, it is common in other contexts. Many private employers, for example, offer matches for contributions by their employees.⁹ Further, the federal government does provide matching funds in some cases. For example, the National Endowment for the Humanities will provide a dollar-for-dollar match of private contributions to many National Endowment for the Humanities sponsored projects.¹⁰ The Office of Refugee Resettlement provides funds matched to cash or in-kind contributions at the rate of two dollars for every private dollar.¹¹ Agencies in the federal government will, in rare cases, match not just private contributions but funds from other government agencies.¹²

Substantial evidence supports the idea that people respond more favorably to matches than to equivalent subsidies, such as deductions. Numerous experiments also show that people respond more strongly to matches than rebates (Davis 2006; Davis et al.

⁷ A wide selection of these employers is available at "Employee Match Programs," Charity Navigator, accessed January 23, 2024, <https://www.charitynavigator.org/donor-basics/giving-101/employee-match-programs/>.

⁸ For more information, see "Federal Matching Funds Guidelines," National Endowment for the Humanities, accessed January 23, 2024, <https://www.neh.gov/grants/manage/federal-matching-funds-guidelines>.

⁹ Voluntary Agencies Matching Grant Program," US Department of Health and Human Services, accessed January 23, 2024, https://www.acf.hhs.gov/orr/programs/refugees/matching-grants_

¹⁰ Several examples are available at "Center for Innovative Finance Support," US Department of Transportation, Federal Highway Administration, accessed January 23, 2024, https://www.fhwa.dot.gov/ipd/finance/tools_programs/federal_aid/matching_strategies/_

¹⁰ For more information, see "Federal Matching Funds Guidelines," National Endowment for the Humanities, accessed January 23, 2024, <https://www.neh.gov/grants/manage/federal-matching-funds-guidelines>.

¹¹ This discussion relies heavily on Vesterlund (2017) and Epperson and Reif (2019).

¹² "PowerPoints," Giving USA, accessed January 22, 2024, <https://store.givingusa.org/collections/powerpoints>.

2005; Eckel and Grossman 2006a, 2006b; Lukas et al. 2010).¹³ Although not all studies entail the same subsidy rate when providing matches and rebates, those that do still find that matches outperform rebates. Field experiments in which charities offer potential donors randomly selected matching grants or rebates on their donations find a similar result, although usually the difference between the two is smaller (Bekkers 2015; Eckel and Grossman 2008, 2017).

In a compelling real-world example, Hungerman and Ottoni-Wilhelm (2018) examine an instance in which both a rebate and a match were available. During the study, state residents in Indiana could receive a 50 percent tax credit for contributions to state universities. But then a generous donor made \$3 million in dollar-for-dollar matching funds available for a 19-month period, and donors had both a match and a rebate available to them. The results show that, as with the experimental evidence, matches provide a stronger incentive to contribute than do rebates.

Moving to a matching system would involve many challenges. One of the most obvious involves giving to religious organizations. In 2021, 28 percent of contributions were made to religious organizations.¹⁴ Constitutional issues may arise with the federal government funding religious organization through matching grants, even if matching funds were made available to all organizations. If the constitutional constraint does arise, one solution would be restricting matching funds to secular charities and offering an equivalent refundable tax credit for giving to religious organizations.

Another problem is that, although evidence supports the idea that people give more when matching funds are provided, it is not understood *why* they give more. Theories that could explain the effectiveness of matching funds include simple confusion on the part of donors. It also may be that when people hear of a match, they are motivated to give, just like they are enticed by the notion of a bargain rather than just a low price. Evidence also suggests that with some types of charitable solicitations, matching raises contributions, but the amount of the match does not. Karlan and List (2007), for example, found that a direct mail solicitation offering a dollar-for-dollar match increased revenue and the response rate, but that a two-for-one or three-for-one match had about the same effect. In summary, the conditions that lead to the effectiveness in matching in lab and field studies may not exist with a similar federal program.

CONCLUSION

The current subsidy for charitable contributions only benefits a small fraction of taxpayers and provides the largest subsidy to those with the highest incomes. One alternative for a replacement subsidy—or, for that matter, for specific types of charitable subsidies, as when Congress offers special tax breaks after a natural disaster—would be to provide a direct match for contributions. Substantial evidence shows that people give more in response to matches than to equivalent rebates. Although potential problems, particularly with respect to the switching of reporting burdens to charities, may arise, potential ways to address those issues also exist. If the net result is a stronger and more compliant charitable sector, this could turn out to be a better alternative to the current system.

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