

COMMONWEALTH INSIGHTS



A publication of the
Massachusetts Nonprofit
Network
2017 Second Edition

Tax Reform: Up to \$513 Million of Massachusetts Donations at Risk

Last fall's elections opened the door to national tax reform legislation. A wide range of proposals are being considered, several of which would negatively impact charitable giving. As outlined in the third edition of Commonwealth Insights, charitable giving is critical to the work of Massachusetts nonprofits.

This edition of Commonwealth Insights takes a look at the highest-profile tax reform proposals affecting charitable giving. It also outlines an agenda to protect and expand giving. Massachusetts nonprofits and all of their supporters – in the philanthropic, business, civic and government communities – must work together for the goal of tax reforms that increase, rather than decrease, charitable giving.

TAX POLICY HAS A LARGE IMPACT ON MASSACHUSETTS NONPROFITS

The federal tax code has a large impact on giving because donations are tax deductible, a policy established 100 years ago. The charitable tax deduction is available to those who itemize their deductions (30% of filers nationwide, 37% in Massachusetts). It's not available to filers whose

Key Points:

- Federal tax reform proposals would reduce giving, harming people who are served by nonprofits.
- The total amount of Massachusetts donations at risk is \$513 million per year.
- Itemized charitable contributions in Massachusetts totaled \$5.7 billion in 2016.
- Congress should enact a universal charitable deduction, to expand giving and reward taxpayers who give but don't itemize.

deductions are below the threshold for itemizing. Those filers, a significant majority of filers in all 50 states, receive no benefit from the current charitable deduction.

For those who itemize, the charitable deduction provides a powerful incentive to give. It lowers the cost of giving by the itemizer's marginal tax rate. For a taxpayer in the 28% bracket, an itemized \$100 contribution only costs \$72, because they receive a \$28 tax deduction. The incentive is even more powerful at higher income levels. For a taxpayer in the top 39.6% bracket, an itemized \$10,000 contribution only costs \$6,000, because they receive a \$4,000 tax deduction.



The charitable deduction incentivizes a torrent of giving each year. In 2016, itemized charitable contributions totaled \$5.7 billion in Massachusetts and \$271 billion nationwide. (Footnote 1 outlines how these numbers were calculated). Tax law changes which decrease, or increase, that \$5.7 billion of giving would have a powerful impact on the people served by Massachusetts nonprofits.

FEDERAL PROPOSALS THREATEN CHARITABLE GIVING

Over the past several months, as tax reform has become a priority for the President and Congress, a number of proposals have emerged. The most current proposals are the recent White House outline of reforms, the House Republicans' "Blueprint", and the President's campaign tax platform. Several elements of those proposals would negatively impact charitable giving:

Cap on deductions: The President's campaign tax platform included a cap on total itemized deductions (\$100,000 individual/\$200,000 couples, joint filing). The effect of such a cap would be to diminish the giving incentive, particularly for major donors. Their cost of making donations would rise by up to 39.6%.

Rate cuts: All three proposals cut personal income tax rates. The White House proposal reduces the number of individual income tax brackets to three (10%, 25%, and 35%) from the current seven (10%, 15%, 25%, 28%, 33%, 35%, 39.6%). It is designed to lower rates for taxpayers in every bracket. It would diminish the incentive for tax itemizers to give by reducing the tax deduction they claim.

Larger standard deduction: All three proposals increase the standard deduction, by 100% or more. This would significantly increase the number of taxpayers who take the standard deduction, and significantly decrease the percentage of taxpayers who itemize.

Repeal of the estate tax: All three proposals eliminate the federal estate tax. In its current form, the estate tax encourages wealthy individuals to donate to charity. Its elimination would remove that incentive for giving.

The impacts of those changes have been analyzed in multiple studies. Highlights include:

- The Tax Policy Center, a joint initiative of the Brookings Institution and the Urban Institute, analyzed the President's campaign tax platform which contains all four changes. It found that the platform would reduce giving by 4.5 to 9.0%, lowering contributions nationwide by \$13 to \$26.1 billion annually.
- A new study for Independent Sector (IS) by the Indiana University Lilly Family School of Philanthropy finds that increasing the standard deduction and lowering top individual tax rates would decrease charitable giving by 1.7% to 4.6%, reducing contributions nationwide by \$4.9 to \$13.1 billion. (IS represents nonprofits and their supporters across the United States.)
- The IS study also estimates that creating a universal charitable tax deduction, available to all taxpayers whether or not they itemize, would increase giving by 1.3% to 4.3%. This would promote giving in both tangible and intangible ways. It would have only a slight impact on total federal tax revenues (a decrease of 0.5%).

The studies make it clear that the four changes outlined above would have a large, negative effect on giving across the country.

How much is at risk in Massachusetts? Up to \$513 million in annual giving. That's how much Massachusetts donations would drop each year if all four of the tax changes above were adopted. (See footnote 2 for calculations.)

Total MA itemized charitable contributions in 2016:

\$5.7 BILLION

Annual MA contributions at risk from tax reform:

\$513 MILLION

A drop in giving of that magnitude – or even half the size – would have disastrous consequences. It would mean large cuts to services that people depend upon. It would put hundreds if not thousands of small nonprofits across the state out of business. And it would jeopardize the financial health of medium- and large-sized nonprofits, threatening their ability to deliver services.

To illustrate the point, \$513 million could provide health insurance for over 25,000 four-person families in Massachusetts. It could provide full-time child care for over 30,000 infants in Massachusetts. And it could provide \$1,000/month of housing payment support, every month of the year, for over 40,000 housing units in Massachusetts.

Even if some but not all four of the changes were enacted, they would reduce giving in Massachusetts by hundreds of millions of dollars per year. The threat to charitable contributions is clear. Steps must be taken to avert that threat and to advance measures that increase giving.

RECOMMENDATIONS TO PROTECT AND INCREASE CHARITABLE GIVING

A) Preserve, and don't curb, the federal charitable tax deduction

Curbing or eliminating the federal charitable tax deduction would have an immediate and dramatic effect on Massachusetts nonprofits. It would also have an impact on communities and families throughout the Commonwealth that depend on nonprofits for health care, shelter, food assistance, education, and more. Protecting the charitable deduction means protecting those services.

There is another reason to protect the charitable deduction. It is triggered when taxpayers give money away, while most deductions and credits are triggered when taxpayers purchase goods (e.g. housing) or services (e.g. education). As a result, the charitable tax deduction historically has had bipartisan support. That support must continue.

B) Enact the universal charitable tax deduction

While effective, the current federal charitable tax deduction is not available to a majority of the 103 million federal tax paying Americans who do not

Massachusetts Charitable Tax Deduction

In 2000, Massachusetts voters approved a ballot petition creating a state income tax deduction for charitable contributions. Unlike the federal deduction, a taxpayer could take advantage of the deduction without itemizing deductions on a federal income tax return (similar to the universal charitable tax deduction).

The deduction was in effect for one year before it was suspended by the Legislature as part of a tax package to close a deficit in the state budget. Under current law, the state's charitable deduction will not resume until the year after the state's income tax rate drops to 5%. While that step is years away, it is important that it be completed, to promote further charitable giving in Massachusetts.

itemize their taxes. This makes the incentive to give dependent on income levels. Yet as a percentage of income, Americans who earn the least tend to give more to charity.

The Independent Sector study also looked at the new giving that would result from a universal charitable deduction. It found that giving would increase at all income levels – in low- and middle-income households by as much as 8.4%, and in high-income households by as much as 1.6%. It would only reduce federal tax revenues by 0.5%.

In addition, a universal charitable deduction would be more fair than the current version. It would incentivize all Americans, regardless of income, to support their local communities through donations to nonprofits.

C) If other tax policies are changed, couple them with the universal charitable deduction

Given their inclusion in all three of the proposals cited above, rate cuts and an expansion of the standard deduction are likely to be included in a final tax bill. To avoid negative unintended consequences to charitable giving, any proposed tax legislation that includes rate cuts and an expansion of the standard deduction should be coupled with a universal charitable deduction.

As the IS study points out, cutting tax rates and

Preserve the Johnson Amendment

Another tax reform issue, not part of charitable giving but equally important, is the Johnson Amendment. The Amendment is a provision in the U.S. tax code prohibiting 501(c)(3) nonprofits from participating or intervening in any political campaign on behalf of, or in opposition to, any candidate for public office (i.e. "political activities"). Earlier this year, President Trump called for a repeal of the Johnson Amendment. The Chairman of the House Committee on Ways and Means has expressed support for changing the Amendment in a tax bill.

If the Johnson Amendment were to be repealed or amended, nonprofits, foundations, and religious institutions would be: (1) under pressure to endorse candidates, especially those receiving government funding; (2) asked to fundraise and make political financial contributions to candidates, pulling nonprofits into the world of bundling, dark money, and super PACS; and (3) irreparably harmed if the entire charitable sector's credibility was called into question. To ensure that nonprofits remain nonpartisan, Congress should not include changes to or a repeal of the Johnson Amendment in any proposed federal tax legislation.

expanding the standard deduction will impact giving. But it also notes that that loss could be more than offset by new giving from the universal charitable deduction, with a projected net increase in giving between 0.4% to 1.7% annually. The result would benefit people and communities served by nonprofits across the country.

CONCLUSION

Promoting giving, and preventing measures that would reduce it, is a goal that cuts across sectors, regions, and party lines in Massachusetts. This goal is under pressure in the federal tax reform debate. It also presents an opportunity, and creates an imperative, for leaders in the nonprofit, philanthropic, government, business and civic sectors to collaborate.

The Massachusetts Nonprofit Network will continue to work with nonprofits and leaders in all sectors to strengthen charitable giving. Nonprofits are uniquely qualified to weigh in on the tax debate. They are recipients of donations, providers of vital services, and partners with both government and business. Nonprofits can help illuminate the risks associated with tax law changes—and point the way to reforms that strengthen support for the people and communities they serve.

 89 South Street,
Suite 603
Boston, MA 02111
617.330.1188

About the Massachusetts Nonprofit Network

MNN is the only statewide organization that brings together nonprofits, funders, business leaders, and elected officials to strengthen nonprofits and raise the sector's voice on critical issues. The network has more than 650 nonprofit member organizations and more than 100 for-profit affiliate partners. To join visit massnonprofitnet.org/join.

This publication series is made possible by support from the Barr Foundation.



Footnotes

1. According to the Internal Revenue Service (IRS), in 2013 itemized charitable contributions totaled \$5.1 billion in Massachusetts and \$195.3 billion nationwide. Historical data shows that charitable giving increases as the economy grows, at a faster rate than the economy. 2016 itemized charitable contributions can be conservatively estimated by applying 2014-2016 economic growth rates to the IRS data on 2013 itemized contributions.
2. The maximum risk is estimated by applying the projected impacts of the four tax law changes on page 2 to total annualized giving in the Commonwealth. When the upper end of the Tax Policy Center projection (9% drop in giving) is applied to the total amount of itemized deductions in Massachusetts cited earlier (\$5.7 billion), the result is \$513 million dollars of annual Massachusetts giving at risk.

Source List

1. Rosenberg, et al. An Analysis of Donald Trump's Revised Tax Plan, Tax Policy Center, October 8, 2016.
2. Tax Policy and Charitable Giving Results, Indiana University Lilly Family School of Philanthropy and Independent Sector, May 2017.