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Tax Exemption Essay

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The Current Tax Deduction for Charitable Donors:

A Favorable Incentive

In recent years, social concern has grown from a rise in donations and use of the current tax deduction system. According to the Congressional Budget Office, from 1963 to present, total charitable contributions to 501(c)3 public charities have skyrocketed and so has the use of tax deductions for annual income taxes (2011, p. 3). One benefit of charitable donation is that charitable gifts reduce taxable income regardless of a person’s income level or tax bracket, while simultaneously offering a deduction on their income taxes. In effect, those who donate to 501(c)3 nonprofit organizations will pay an effective lower tax because their taxable income has decreased.

Despite the rising concerns about today’s fiscal policies from advocates of social justice, charitable tax deduction should not be considered for reform. The current system is amply functional. Regardless of the donor’s income and the charitable organization they donate to, all 501(c)3 charitable nonprofit donors should be supported with charitable tax deductions, provided these deductions comply with existing maxima. These deductions often encourage investment into local communities while avoiding further disconnects between the rich and poor. This paper will first examine the vulnerability of the benefiting charitable organizations along with their impact on the community, and then move on to discuss the equality of tax deductions regarding the nation’s citizens.

The current tax deduction system is a critical incentive which maintains cash flow to already vulnerable nonprofits centered about a community. Many nonprofits are at severe risk of financial insecurity and operate under financial hardship. Within the past year, the Nonprofit Finance Fund conducted a survey, including 5,451 respondents, to evaluate the state of the nonprofit sector. When 56% of surveyed nonprofits cannot meet their demands out of financial instability, 55% have three months or less available capital, and 28% end their fiscal year in deficit, these charitable organizations rely heavily on scarce monetary resources, especially the resources of charitable donors (Nonprofit Finance Fund, 2014). Providing means for more donations, the current tax deduction system was designed partly in concern for these near-failing organizations to obtain stability; tax deductions offer a substantial incentive for tax filers, those looking to reduce their income taxes while giving to charity, to donate. Assuming the Nonprofit Finance Funds survey represents the majority of the nonprofit sector, if the nonprofit sector were to lose such a crucial driving force of their operations as discussed in further detail below, then the nonprofit sector would quickly vanish.

Many people wish to donate and do; recent studies indicate that 12.9% of nonprofit revenue is obtained through donations (McKeever & Pettijohn, 2011, p. 5). Of these donations, there exists correlation between the tax deduction incentive and donor behavior; of the United States’ online donations between 2003 and 2009, over one fifth of total donations were made on the last few days of the year implying some were attempting to acquire last-minute deductions as a result of tax implications (“Don't Push Charities Over the Fiscal Cliff,” 2012). Additionally, a study by the Center on Philanthropy at Indiana University (2010) found a decrease in charitable donation if the donor received less tax deduction: “Nearly 19 percent of wealthy households reported that their giving would dramatically decrease if they did not receive any tax deductions for their donations to nonprofit organizations” (p. 47). A change in the tax deduction system to lower the benefits of charitable donors may result in the decrease of donation quality and thereby the unsustainability of a community’s nonprofit organizations. With regards to the state of many nonprofits, charitable donors should be supported with tax deductions as a method to avoid any further damage to the financial state of the same nonprofits. Even though no existing evidence firmly concludes tax deductions vary the sizes and amounts of donations, it is not worth gambling an eighth of the nonprofit sector’s revenue when many nonprofits already struggle for resources.

The sustainability of nonprofits, as mentioned above, is a sizeable return on an investment for a community. In a state where the nonprofit sector is a substantial part of its well-being, Ohio relies heavily on the nonprofit sector for job creation and job retention. While Ohio accounted for less than 4.5% of the country’s nonprofit workers in 2010, nonprofit workers account for 11.6% of Ohio’s private workforce (Salamon, Sokolowski, & Geller, 2012, p. 3). Many jobs in Ohio rely on charitable donations. Noting the correlation between tax deductions and donations, a decrease in donations from a decrease in tax deductions would be detrimental to the employment rates of Ohio if nonprofits were to fail. The tax deduction incentive is a key driving force for the sustainability of Ohio nonprofits especially with respect to the poor state of the nonprofit sector. Charitable donors should be supported with tax deductions because the money they give to nonprofits sustains employment and the service the nonprofits conduct. Each donation is an investment into the community’s well-being by creating jobs and creating a service purposed for the community. There is a much needed mutualistic relationship of investment and return between donors and nonprofits; donors supply resources and in return, nonprofits provide a service to the community.

Charitable donations can have profound impact on the lives of many within a community. One such donation was given by Lebron James who has made a notable commitment and investment in the children of Akron, Ohio. In a community where nearly one in five Akron residents holds a bachelor’s degree or higher, and the high school graduation rate is below 83%, Lebron James will make a difference with a pledge of 42 million dollars in an effort to further children’s education (US Census Bureau, 2015). Students involved with his private foundation, who can meet a set of requirements, will attend the four year University of Akron, a 501(c)3 nonprofit school, for free on behalf of his private donation. Akron and all other communities need this investment through charitable donation. Of the 27% of Akron residents who live under the Federal poverty level, many residents would otherwise lack the financial support to attend a four year university on their own (US Census Bureau, 2015). With one donation, even though large, Lebron James has affected the lives of the Akron community. Although some macroeconomic analysis may view the $42 million dollars and lesser donations as petty, Lebron James and other charitable donors deserve tax deductions because of the profound effect a donation can have on the community. With each donation, the total sum grows along with the return on investment that can be achieved, when funds are appropriated correctly. When every donation has some sort of positive effect on others, the change a donation can make surely warrants a deduction for the donors’ taxes.

Social justice proponents may argue in favor of reform for preserving the current tax deduction system due to its discrimination against different levels of income. However, there lies a great social misunderstanding which fuels this false concern. The current system is in favor of no one tax bracket level or no level of income. Both the upper and the lower income tax filers receive fair benefit: “someone in the 25 percent tax bracket faces an after-tax price of only 75 cents when giving a dollar to charity. In other words, a person in that bracket who donates $1 to charity has his or her taxes reduced by 25 cents, so his or her consumption and savings decline by 75 cents. In general, the deduction lowers the after-tax price per dollar of charitable contributions from $1 to $1 multiplied by the difference between one and the marginal tax rate” (Congressional Budget Office, 2011, p. 2). The after-tax price per dollar is true for all levels of tax bracket. Even though donating tax filers’ income taxes are reduced, the overall payment, including donation cost and income tax, is more than the same tax filers who decline to donate at all. When individuals donate money to a charitable organization, they are reducing their own wealth.

Addressing the marginal tax rate which stands as the deduction factor per dollar donated, the marked difference from upper to lower tax brackets is admissible. With the evident difference in tax rates comes an evident difference in donation among the nation’s wealthy and poor. Although only 3% of tax filers have annual incomes over $200,000, those households contribute 36% of the money that individuals give to charity every year, a total of $73 billion in 2008. When skewing these numbers to the 13% of tax filers whom have annual incomes over $100,000, these households present a share of 57% of total charitable donations (Congressional Budget Office, 2011, p. 5). Here lies the reasoning supporting the marked difference of the tax deduction between the wealthy and poor. The extreme difference between tax deduction rates from different tax brackets is supported by the extreme difference between donation values. It is the common principle that committing a greater good is deserving of more in return. Of the wealthy donating, they are committing more of their own resources to these charitable organizations. Mentioned above, there is no known loophole to acquire wealth through donation. However, in return for committing much more resources to the nonprofit sector, it is fair to deduct at a greater rate from the upper-tax-bracket filers’ income taxes. The rich are already paying a substantially higher tax rate and, based off the Congressional Budget Office survey group, any lowering of tax deduction status will eventually reflect poorly on the public charities as a loss in charitable donations revenue. Reducing the tax deductions for the wealthy is no different than punishment as their benefits would be slashed for some perceived fault: having additional capital. With regards to the equity of the current tax deduction system, there is no loophole pitting the wealthy against the poor.

Though berated by its dissenters, the current tax deduction system offers profound social gains and equity for the communities they serve. The resources provided by charitable donors toward charitable organizations are transmutably returned back to the community: scholarship funds, food and shelter for the poor, public advocacy, and employment among many other services. The public seeks to significantly gain from charitable tax deduction incentive. With the benefits of tax deductions, communities employ an incentives to donate and improve upon their overall worth. While some argue that the current system favors the wealthy and handicaps the poor, there is a marked social misunderstanding surrounding such a concern. No one group profits from the use of the tax deduction system. Donating to a charitable organization results in a decrease of personal wealth for the rich, for the poor, and each person in between. Despite the rising concern for social equality, the public must understand that the “problem” of charitable tax deduction is, in actuality, quite unproblematic. Yet, if this leaves some unfilled void for reform, then there should be reform of donors’ inclination to give in spite of tax deductions. Even though claims of charitable tax deductions are not immoral, it should not be the defining motive for donation. Instead, the members of the public who donate largely in part of tax deductions should shift paradigm and donate to invest in their own self-worth and their community’s growth.

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