

# Background

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## Proposed Decrease in Charitable Tax Deduction Crowds Out Civil Society

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Many nonprofit organizations are under severe financial pressure. They need donations more than ever, and the hurting people they serve have a stake in the unrestrained flow of those donations.

However, President Barack Obama's proposed budget for fiscal year (FY) 2010 moves in the opposite direction. It would raise taxes on those who can give the most and reduce their income tax deduction for charitable giving. This not only weakens one of the incentives to give, but also shifts perceived responsibility for social welfare from individual donors toward the state.

### The Administration's Proposal

In February, the Obama Administration released its proposed federal budget for FY 2010. Included in the document are proposals to raise tax rates on high-income earners and to reduce their tax deduction rate on gifts to charities. These strategies are intended to raise funds for President Obama's health care plan.

American citizens in the highest marginal income tax bracket are taxed at a rate of 35 percent.<sup>1</sup> If they donate to a charitable organization, they can receive a tax deduction at the same 35 percent rate. For example, if a couple in this bracket gives \$10,000 to a hospital, they can write off \$3,500 when filing their taxes. This write-off is not only an incentive to give to charitable organizations, but also a means for the couple to control more of their own money, from which they can potentially donate more to charity.

Under the President's proposal, beginning in 2011, families making over \$250,000 per year would see

### Talking Points

- President Barack Obama's proposal to raise taxes and reduce charitable deductions for the wealthy mistakenly suggests that government bureaucracy can deploy citizens' resources more effectively than nonprofit civil society organizations can.
- Under the President's plan, annual charitable giving would likely drop by more than \$4 billion—more than the combined annual operating budgets of the American Cancer Society, World Vision, St. Jude's Children's Research Hospital, Habitat for Humanity, and the American Heart Association.
- Perhaps more important, by absorbing more resources dedicated to social welfare, government could crowd civil society organizations out from providing for these needs.
- The President's plan conveys a troubling message about the value of civil society and the role of government. It moves the dial of social responsibility one more notch in the direction of the state at the expense of local institutions that serve the poor more personally and efficiently.

This paper, in its entirety, can be found at:  
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their marginal personal income tax rate rise from 35 percent to 39.6 percent.<sup>2</sup> Rather than keeping the charitable deduction rate consistent with the tax rate or even maintaining it at the present level, Obama proposes reducing it from 35 percent to 28 percent. At this reduced rate, the possible tax write-off for a \$10,000 donation would drop from \$3,500 to \$2,800, a reduction of \$700.

The Obama Administration estimates that its proposed tax changes will provide \$630 billion in additional revenue over 10 years.

### The Likely Consequences

The President claims that his tax plan will have only a small negative effect on charitable giving. Measured as a percentage, this may be true, but the estimated reduction in giving means billions of dollars less each year for charities, especially if weak economic conditions continue.

Scholars at the Center on Philanthropy at Indiana University recently looked at how the Administration's tax proposals would have affected giving among the wealthy in 2006 (the most recent year for which itemized deduction data are available). In 2006, taxpayers earning more than \$200,000 accounted for about 44 percent of all itemized charitable gift deductions. The center estimated that if Obama's proposed changes had been in place, total itemized contributions from wealthy households would have been almost \$4 billion lower.<sup>3</sup>

While this is only a small percentage of total annual charitable donations, it is more than the combined annual operating budgets of the American Cancer Society, World Vision, St. Jude Children's Research Hospital, Habitat for Humanity, and the American Heart Association.<sup>4</sup> Moreover, other scholars estimate that under Obama's proposal, annual donations to charitable organizations would drop by more than \$4 billion and possibly by as much as \$9 billion.<sup>5</sup>

The Obama tax plan will likely have the greatest effect on organizations that depend on donations from high-income Americans. Universities and medical centers could be hit particularly hard. The President has stated that he wants to increase the number of college graduates in America and promote research leading to significant medical breakthroughs. However, his proposed tax changes will make it more difficult for wealthy donors to make the large financial gifts on which many educational and medical institutions rely.

### Crowding Out Civil Society

In addition to receiving less money from wealthy donors, charitable organizations could face a more subtle yet significant challenge under the Obama plan: Government could crowd them out of social welfare provision. This phenomenon occurs when government claims increasing responsibility for tasks traditionally performed by civil society and

1. The marginal tax rate is the statutory rate at which a taxpayer's last dollar of income is taxed.
2. The personal income tax rate for those in the second highest bracket would increase from 33 percent to 36 percent.
3. "Obama's Tax Plan Could Cause Giving by the Wealthy to Drop by Several Billion Dollars Annually," *The Chronicle of Philanthropy*, February 27, 2009, at <http://philanthropy.com/news/updates/index.php?id=7285> (April 7, 2009).
4. Calculation based on 2007 and 2008 figures in American Cancer Society, "Combined Financial Statements as of and for the years ended August 31, 2008 and 2007," February 23, 2009, at [http://www.cancer.org/downloads/AA/ACS\\_Combined\\_Financials\\_FY2008.pdf](http://www.cancer.org/downloads/AA/ACS_Combined_Financials_FY2008.pdf) (April 7, 2009); World Vision, "Consolidated Financial Statements, World Vision, Inc. and Affiliates, September 30, 2007 and 2008," December 12, 2008, at [http://www.worldvision.org/resources.nsf/main/PRES08830\\_AFS\\_2008.pdf/\\$file/PRES08830\\_AFS\\_2008.pdf](http://www.worldvision.org/resources.nsf/main/PRES08830_AFS_2008.pdf/$file/PRES08830_AFS_2008.pdf) (April 7, 2009); St. Jude Children's Research Hospital, *2007 Annual Report*, at [http://www.stjude.org/SJFile/annual\\_report\\_07.pdf](http://www.stjude.org/SJFile/annual_report_07.pdf) (April 7, 2009); Habitat for Humanity International, "Return of Organization Exempt from Income Tax," Internal Revenue Service Form 990, January 27, 2009, at [http://www.habitat.org/giving/report/2008/990\\_2008.pdf](http://www.habitat.org/giving/report/2008/990_2008.pdf) (April 7, 2009); and American Heart Association, "Return of Organization Exempt from Income Tax," Internal Revenue Service Form 990, November 5, 2008, at [http://www.americanheart.org/downloadable/heart/12276360871452007-08%20Form%20990%202007%20Final%20\(2\).pdf](http://www.americanheart.org/downloadable/heart/12276360871452007-08%20Form%20990%202007%20Final%20(2).pdf) (April 7, 2009).
5. Editorial, "The Charity Revolt: Liberals Oppose a Tax Hike on Rich Donors," *The Wall Street Journal*, March 10, 2009, at <http://online.wsj.com/article/SB123664427493678121.html> (April 7, 2009), and Ryan J. Donmoyer, "Rich Donors May Be Undeterred by Tax Caps on Charitable Gifts," Bloomberg.com, March 4, 2009, at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aRLx2HwnWyWs> (April 7, 2009).

absorbs a larger percentage of the resources dedicated to carrying out those tasks.

Studies have shown that government spending on charitable causes leads people to give less to charity. According to Arthur Brooks of the American Enterprise Institute, a dollar in government spending on nonprofit activities displaces up to 50 cents in private giving.<sup>6</sup> One study, for example, reveals that:

Franklin Delano Roosevelt's New Deal programs sharply reduced churches' charitable giving to the poor: The researchers noticed a 30 percent drop in church-based charity from 1933 through 1939, as federal spending to aid the needy went from zero to more than 4 percent of GDP. The researchers concluded that government funds were directly responsible for nearly all the drop in private church charity.<sup>7</sup>

This "crowding out" effect does not occur only when government actually spends money on social programs for the poor. Brooks found that merely endorsing such policies—simply believing that government should move in that direction—displaces giving:

The evidence...connects charity with beliefs, not policies. The data tell us that it matters little whether the government is actually redistributing income and lessening inequality—what appears to displace charity is a person's *support* for these policies.<sup>8</sup>

Such evidence demonstrates the subtle but significant power that policy proposals exert on citizens' assumptions, expectations, and actions.

### Shifting Focus

President Obama defends his proposal as a way of "equalizing" tax breaks for donors in different tax

brackets. In his news conference on March 24, 2009, he said it would not be fair to allow wealthy donors to write off more than can be written off by lower-income or middle-income donors who give the same amount: "[U]ltimately, if we're going to tackle the serious problems that we've got, then in some cases those who are more fortunate are going to have to pay a little bit more."<sup>9</sup>

However, the President ignores the fact that the less than 5 percent of workers who earn more than \$250,000 annually pay 48 percent of all federal income taxes.<sup>10</sup> That they may use the deduction to redirect a portion of this to private charities does not change the simple fact that the wealthy shoulder a larger burden for social welfare under the present tax system. President Obama's statement about the "more fortunate" paying more is not the issue because they already pay more. The point, rather, is that he seems to believe that the federal bureaucracy can deploy the resources of the wealthy more effectively than nonprofit civil society organizations can.

Furthermore, the concern for equalizing tax breaks for donors risks distracting attention from President Obama's stated concern for helping "folks who have fallen on very hard times."<sup>11</sup> The President admits that his plan will reduce charitable giving. Ironically, however, he seems to be letting his desire to equalize differences among donors undercut his desire to help the poor. To remain consistent with his rhetoric, he should instead create conditions in which individuals can maximize their voluntary donations to charity, especially in tough economic conditions.

### The Wrong Message

Perhaps most important, President Obama's proposal sends the wrong message about the value of civil society and the role of government. Choosing to raise taxes while reducing charitable deductions

6. Arthur C. Brooks, *Who Really Cares: The Surprising Truth About Compassionate Conservatism* (New York: Basic Books, 2006), p. 58.

7. *Ibid.*, p. 59.

8. *Ibid.*, p. 61 (emphasis in original).

9. Barack Obama, "News Conference by the President," March 24, 2009, at [http://www.whitehouse.gov/the\\_press\\_office/News-Conference-by-the-President-3-24-2009](http://www.whitehouse.gov/the_press_office/News-Conference-by-the-President-3-24-2009) (April 7, 2009).

10. See The Heritage Foundation, "Who's Paying How Much to IRS," *À La Chart* No. 39, December 10, 2008, at [http://author.heritage.org/Press/ALACHart/alachart-detail.cfm?custom1\\_datapageid\\_244663=288290](http://author.heritage.org/Press/ALACHart/alachart-detail.cfm?custom1_datapageid_244663=288290).

11. Obama, "News Conference by the President."

for high-income earners indicates that the President thinks government can best determine how to distribute people's money.

In their influential book *To Empower People*, Peter Berger and the late Richard John Neuhaus describe the importance of "mediating institutions" to a healthy democratic society. Such institutions include the family, churches, and nonprofit organizations, which stand between citizens and the large institutions of public life.<sup>12</sup>

Mediating institutions are essential for generating and maintaining the operative values of American society. They are also well equipped to provide a helping hand to people in the context of face-to-face relationships. They have intimate knowledge of those in need, and they understand social problems in up-close-and-personal ways. Driven by deep convictions and compassion, such organizations can provide loving forms of assistance and care that government programs cannot offer, and often for less money. Smaller and more flexible than most government bureaucracies, local church congregations and charities can also spawn creative social innovations that benefit those in need.

Berger and Neuhaus argue that public policy should "cease and desist from damaging mediating structures."<sup>13</sup> More than that, public policy should protect mediating institutions and, where possible without co-opting them, empower them in their efforts to promote the common good.

The tax plan in President Obama's budget blueprint runs counter to the basic philosophy underlying these propositions. The President's proposal conveys the belief that government can decide better than individuals how their dollars should be spent. It also implies that the state should assume responsibility for people's needs even at the expense of vital mediating institutions. Ultimately, it communicates the notion that America is better off with expansive and intrusive government than it is with limited government.

In short, President Obama's proposed tax plan would weaken the role of the local, the personal, and the voluntary. It would penalize those who can give the most, shift dollars from citizens and local private charities to distant government bureaucracies, and prioritize mandatory taxation over voluntary tithing and charitable giving.

Such messages are important—perhaps more important than the amount by which charitable giving would decline in the short term. These messages say that people should look more to government for help in times of need. They direct people's assumptions and expectations about how the common good should be pursued in society.

Regrettably, President Obama's proposed tax changes move the dial of social responsibility one more notch in the direction of the state. This sets a course for adopting many future policies that could chip away at local, personal, and mutual obligations and increase dependence on government. The President's vision of expanding government control of health care exemplifies this mindset, and his objective of government-controlled health care is driving the plan to raise taxes and reduce charitable deductions for wealthy citizens.

## Conclusion

President Barack Obama should use his presidential authority and influence to encourage voluntary giving and protect nonprofit groups, especially during tough economic times. President Obama speaks articulately and often of the important roles that charitable institutions play in America. He should send an equally clear message in his policy. Reconsidering the proposed tax changes regarding charitable donations would be a good place to begin.

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12. Peter L. Berger and Richard John Neuhaus, *To Empower People: From State to Civil Society*, 20th anniversary ed. (Washington, D.C.: AEI Press, 1996), p. 158.

13. *Ibid.*, p. 163.