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Impact of Tax Proposals on Charitable Giving

A Research Memo to:

Independent Sector

From:

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This memo focuses on specific provisions of the current proposal (Section 110011 H.R. 1, Section 70111 of the Senate Finance Committee Draft) to limit itemized deductions to 35% on the value of all itemized deductions, including the charitable deduction. In general, the structure of tax incentives for charitable giving can have a significant impact on the costs to the federal government, the level of charitable giving, and which (or how many) taxpayers benefit. It is important to consider the potential impact on policy changes on charitable giving.

Impact of a 35% limit on deductions, including charitable contributions

The proposal (Section 110011 H.R. 1, Section 70111 of the Senate Finance Committee Draft) to limit itemized deductions to 35% on the value of all itemized deductions, including the charitable deduction, would primarily affect those taxpayers who are in the top marginal tax bracket (37%). However, the proposal does not apply exclusively to those already in the 37% bracket. It applies to taxpayers whose taxable income exceeds the income levels for the 37% bracket before considering itemized deductions. Therefore, there could be individuals whose deductions currently place them in the 35% bracket who would also be affected.

Within the economics literature, this factor is described as "the endogeneity issue" with household income. Households, by their voluntary behaviors, can change their top marginal tax rate. In this case, by donating (or by donating more than they would have otherwise), donors may shift themselves into a lower tax bracket, thereby lowering their after-tax price of giving. It is crucial to consider these potential donor behavioral changes in a comprehensive analysis of the proposal. In some cases, there might be a difference in the tax price of donating the first dollars versus the last dollars donated.

Consider a household or individual who was at the 37% marginal tax rate (MTR) but, through prior plans to donate, lowered their post-donation income tax rate to 35%. Arguably, if they had already planned those donations, whether due to an annual charitable commitment or paying off a multi-year campaign commitment, this new 35% limit would not have altered their behavior otherwise.

We can also examine an otherwise identical household or individual who decides to make these gifts to take advantage of the 37% top marginal tax rate (MTR) and then faces the 35% limit. Households may proceed with their charitable contributions, as that was their plan. People give for many different reasons, with the tax deduction

being one of the possible reasons. Other households, being "ultra-rational" and/or feeling that this limit was unfair, decide not to give more than that for which they receive the full value of the gift. These would be the donors, who would be sensitive to the after-tax price of giving (or "price elastic"), and not make an additional donation—at least not beyond for which they got the value of the full tax deduction.

Based on existing research, the households affected by this limit on all deductions, including charitable contributions, represent a relatively small share of the population. Yet, it is an important one concerning philanthropic giving. These households play a significant role in philanthropy, and any changes to their behavior could have a notable impact. For 2025, among married individuals filing jointly, only those with an adjusted gross income (AGI) of $751,600 or more and single heads of households earning $626,350 or more are subject to the top marginal tax rate of 37%. While it is challenging to find publicly available data that aligns with these new tax brackets, we can use existing data to create some approximations.

From Table 1 below from the IRS, we can see that households earning $500,000 or more donated 57% of itemized gifts in 2022 (the most recent year available for this type of information). Similarly, using the next higher category starting at $1 million in AGI and higher, those households accounted for 48% of total itemized giving in 2022. The category from $500K to under $1 million generated 9% of total itemized giving. Given the positive correlation between income and giving amounts, it is likely that more dollars were given from the upper range of this category than the lower range. However, even if we conservatively assumed that the gifts were split evenly across that category, those subject to the 37% tax rate and the proposed 35% cap would have accounted for over half (over 52%) of total itemized giving in 2022. Using the same approach for charitable donations, our estimated itemized donations range from at least $106.1 billion to $116.3 billion in 2022. (Note: These estimates exclude all nonitemizers. This exclusion is more important in a dynamic setting than what is suggested in this short-run, cross-sectional analysis. For example, if the final legislation includes a large increase in the SALT (State and Local Tax) cap, then this 35% limit will impact considerably more taxpayers than what we have calculated in this assessment.)

Xiao Han, Dan Hungerman, and Mark Wilhelm (July 2024)[1] in a recent study, suggest that higher-income households have different responses to the tax price of giving, and that these responses are likely to be more sensitive to the incentives of tax

[1] Xiao (Jimmy) Han, Daniel Hungerman, and Mark Ottoni-Wilhelm, "Tax Incentives for Charitable Giving: New Findings from the TCJA." National Bureau of Economic Research (NBER) Working Paper Series (Working Paper 32737).

deductions than those of other households. They suggest that the tax-price elasticity of giving (pure price effects of giving--not income elasticity) may be higher than previously estimated.

Table 1: Itemized Contributions by Income Categories in 2022 (IRS Data)

IRS Data: 2022	Contributions (in $1,000s)	% of all contributions	% from incomes	% from incomes	$ of gifts from incomes	$ of gifts from incomes
All returns, total	**$222,384,855**	100.00%	>$500K	> $1.0 M	> $1.0 M	> $1.0 M
Under $5,000	$34,841	0.00%		plus half of $	(in $1,000s)	plus half of $
$5,000 Under $10,000	$92,549	0.00%		($500K-$1M)		($500K-$1M)
$10,000 Under $15,000	$159,177	0.10%		(in $1,000s)		(in $1,000s)
$15,000 Under $20,000	$281,706	0.10%				
$20,000 Under $25,000	$456,754	0.20%				
$25,000 Under $30,000	$553,969	0.20%				
$30,000 Under $35,000	$663,476	0.30%				
$35,000 Under $40,000	$1,255,200	0.60%				
$40,000 Under $45,000	$1,068,181	0.50%				
$45,000 Under $50,000	$1,311,148	0.60%				
$50,000 Under $55,000	$1,509,675	0.70%				
$55,000 Under $60,000	$1,751,614	0.80%				
$60,000 Under $75,000	$5,401,166	2.40%				
$75,000 Under $100,000	$9,073,536	4.10%				
$100,000 Under $200,000	$34,781,128	15.60%				
$200,000 Under $500,000	$37,531,722	16.90%				
$500,000 Under $1,000,000	$20,333,029	9.10%	9.10%	4.55%		$10,166,514.50
$1,000,000 Under $1,500,000	$10,226,379	4.60%	4.60%	4.60%	$10,226,379	$10,226,379
$1,500,000 Under $2,000,000	$6,269,622	2.80%	2.80%	2.80%	$6,269,622	$6,269,622
$2,000,000 Under $5,000,000	$16,801,653	7.60%	7.60%	7.60%	$16,801,653	$16,801,653
$5,000,000 Under $10,000,000	$11,261,823	5.10%	5.10%	5.10%	$11,261,823	$11,261,823
$10,000,000 or more	$61,566,506	27.70%	27.70%	27.70%	$61,566,506	$61,566,506
Taxable returns, total	**$214,634,750**	**96.50%**	**56.90%**	**52.35%**	$106,125,983	$116,292,497.50
Nontaxable returns, Total	**$7,750,104**	3.50%				

In Table 2 below, we have calculated the estimated changes in itemized donations that would result from a tax deduction cap imposed on all deductions, including charitable donations, at 35%. This would only affect those who fall into the 37% marginal tax rate bracket (MTR). Given that the research literature has found a range of tax-price elasticities of demand, we have calculated the estimates for the decline in itemized charitable deductions using commonly assumed elasticities ranging from -0.5 to -2.0. Once adjusted for inflation to 2025 price levels, the lost charitable contributions range from approximately $2 billion (-0.5 elasticity) to $8.2 billion (-2.0 elasticity).

Table 2: Estimated Declines in Itemized Charitable Contributions for a 35% Limit on Deductions for Charitable Contributions with Various Tax Price Elasticities of Demand

Elasticity assumed	Cap used	After tax cost before cap	Cost after cap	% Change in cost	% Change in giving (% Change in cost*Elasticity)	Total itemized giving in 2022	Est'd drop in giving (2022)	Drop in giving adj'd 2025 prices	% Change in giving from base
-2	35%	0.63	0.65	3.175%	-0.0635	$116.3B	-$7.3B	-8.2B	-6.3%
-1.5	35%	0.63	0.65	3.175%	-0.0476	$116.3B	-$5.5B	-$6.1B	-4.8%
1.0	35%	0.63	0.65	3.175%	-0.0317	$116.3B	-$3.7B	-$4.1B	-3.2%
0.5	35%	0.63	0.65	3.175%	-0.0159	$116.3B	-$1.8B	-$2.0B	-1.6%

We include the -0.5 tax-price elasticity estimate, as that has been an assumed value in some prior research, however, based on prior research on elasticities and a meta-analysis, we estimate the effect of this 35% limit would be at least in the $4.1 billion to $6.1 billion range. However, the new research from Han, Hungerman, and Ottoni-Wilhelm (2024) suggests that the pure tax-price elasticity could be -2 or even higher, suggesting an effect as large as -$8.2 billion (or more).

Based on recent research by Han, Hungerman, and Ottoni-Wilhelm (2024), which found there was significant heterogeneity in the price elasticities among different income groups and that higher income groups tended to have greater price responsiveness, we believe that for the tax cap, the likely loss in contributions from a 35% cap may be closer to the $8.2 billion loss estimate than the smaller estimates. The greater tax-price sensitivity of high-income households can be attributed to several factors. First, they are likely to have financial advisors that make them more keenly aware of changes in tax policies. Second, they are making larger gifts on average, so they may time their gifts to achieve both a larger impact and significant tax advantages. Third, there may be behavioral responses, including perceptions of fairness, which may cause them to reevaluate their giving.

Finally, we should note that a universal charitable deduction (even with a limit or a cap) sends a positive signal about charitable giving being a virtue that should be rewarded.

CONCLUSIONS

The overall goal of this memo is to illustrate the potential effects that changes in tax policy may have on charitable giving. Changes in governmental policies and the overall economy will likely impact giving in complex ways. At the household level, individuals may adjust their behavior in the short term in anticipation of future changes in tax benefits by shifting donations between years. Future research will focus on understanding the short-term and long-term effects of changes in tax policy on charitable giving, including who may be affected by the policy changes and the size of these effects. Furthermore, this analysis does not account for the distributional impact of policy changes across charitable subsectors, underscoring the need for further research in this area.