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We're Keeping Those Tax Breaks

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Congress gears up to just say 'No' to Obama's plan to reduce the deductions that the wealthy get for giving to charity

Now we have two issues on which the Republicans and Democrats agree. First, the AIG bonus takers must be punished with confiscatory taxes if they don't willingly return the money. Second, charities should *not* be punished by reducing the charitable deductions that the wealthy can take.

Bipartisan opposition is likely to doom the White House's proposal to help pay for universal health care by reducing the tax deductibility of itemized deductions (including the charitable and mortgage deduction) for taxpayers earning more than \$250,000 a year.

Also hurting the proposal's chances is the outcry from charities, which already are struggling in this economic downturn with the double whammy of drooping donations and a rising need for services.

On Feb. 26, 2008, the White House released its 2010 budget blueprint. To raise \$320 billion during the next 10 years to fund health care, the budget proposes limiting itemized deductions for taxpayers earning more than \$250,000. Starting in 2011, it would cap the deduction for gifts to charity and mortgage interest at 28 percent of adjusted gross income. At the same time, it would raise the top income tax rate from the current 35 percent to 39.6 percent.

So, if a wealthy taxpayer in the top bracket gives \$1 million to charity in 2011, her tax savings would be limited to \$280,000, rather than \$396,000.

If she were in the top 35 percent rate for the charitable deduction in 2009 and 2010, her deduction would be \$350,000.

Bottom line: capping the deduction at 28 percent rather than 39.6 percent starting in 2011

reduces the after-tax value of the charitable deduction for the wealthy by about 30 percent.

Big Potential Impact

What would that mean to charities?

Studies on the impact of a 28 percent deduction cap on charitable giving indicate that it would result in a 2 percent to 10 percent annual reduction in charitable contributions.

Clearly, the deduction isn't a primary motivator for most donors. But let's not kid ourselves, the value of the charitable deduction does impact charitable giving.

White House officials justify the tax increases as necessary to make the country's health care system more affordable and accessible. Peter Orszag, director of The Office of Management and Budget wrote on his blog on Feb. 27, 2009, that bringing health-care costs down "is the single most important thing we can do to get our country back on a sustainable long-term fiscal path."

Orszag claimed that budget blueprint initiatives, such as a proposal to retain the estate tax due to expire in 2010, would encourage charitable giving. After all, giving to charity is a way of reducing the estate tax liability on the estates of wealthy individuals.

Orszag also made an interesting populist point: He said that the current system is unfair because it lets the wealthy have a bigger tax break when giving to charity than the middle class can take. "If you're a teacher making \$50,000 a year and decide to donate \$1,000 to the Red Cross or United Way, you enjoy a tax break of \$150," he wrote. "If you are a Warren Buffet or Bill Gates and you make that same donation, you get a \$350 deduction—more than twice the break as the teacher."

Treasury Secretary Timothy Geithner reiterated the fairness argument in his testimony on the proposed budget on March 3, 2009 before the House Ways and Means Committee. "This is a deep moral imperative to make our society more just," he said, emphasizing that the tax increases would not go into effect "until we are safely into recovery" in 2011.

Congress Pushes Back

Both Democrats and Republicans in Congress were unconvinced. They are united in opposition to the proposal to limit the charitable deduction for the wealthy out of fear of its impact on charitable giving.

House Ways and Means Committee Chair Charles B. Rangel (D-NY) announced on March 10, 2009, plans to hold hearings on the proposal saying he's "deeply concerned" about the negative impact of the 28 percent cap on charitable donations and that he'd

“never want to adversely affect anything that is charitable or good.”

Republicans in the House were equally adamant. “There are people with the means to help,” said Rep. Thaddeus McCotter (R-Mich.), chairman of the House Republican Policy Committee. “Why would you make it harder for them to do it?”

Obama’s proposal didn’t fare any better in the Senate. Senate Budget Chair Kent Conrad (D-ND) said that he has heard so many complaints from other senators that he’s “certain he cannot pass the budget” with the cap on itemized deductions. Said Senator Mitch McConnell (R-KY): “A new tax related to charitable giving would punish organizations Americans depend on more and more during times of distress.”

Perhaps most important to the fate of the cap on itemized deductions is its opposition by the Senate’s top tax writers on the Senate Finance Committee—Max Baucus (D-Mt.) and Charles Grassley (R-IA)—who typically act as a unit.

Baucus, the Senate’s top tax writer as chairman of the Senate Finance Committee, stated that he is “wondering about the viability of that provision” since the cap on itemized deductions “has nothing to do with health care.”

Grassley, the senior Republican member of the Senate Finance Committee, stated that “given the economic crisis and the important role charities play in responding to the crisis, any proposal that might reduce charitable deductions seems counterproductive.”

Charities have also shown great concern over the proposed tax change. The Association of Fundraising Professionals, the Council on Foundations and the Association for Healthcare Philanthropy are among the groups representing charities that have come out against the proposed measure.

President Obama has indicated that more details on the budget could be coming out as early as this week.