VIEWPOINT
tax notes federal

Effects of the TCJA on Itemization Status and Charitable Deduction

by James Andreoni and Jon Durnford

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In this article, Andreoni and Durnford explain the details and potential economic implications of IRS data for 2018 showing steep declines in itemization status and charitable deductions as a result of the Tax Cuts and Jobs Act.

Introduction

The Tax Cuts and Jobs Act, which took effect in 2018, had two features that could have harmful effects for the charitable sector of the economy. First, it lowered marginal tax rates for most Americans. For those itemizing deductions, this means the subsidy to charitable giving will go down, creating a higher cost to giving and a weakened incentive to give.

Second, and perhaps more consequential, the TCJA raised the standard deduction for a married couple from $12,700 in 2017 to $24,000 in 2018. This means that those with itemized deductions above $12,700 but below $24,000 will lose their itemization status and, as a result, lose their charitable deduction. For those taxpayers, the cost of giving rises all the way to 100 percent of their gift. For the lowest income group, with marginal tax rates of 0.1, the cost of giving $1 will rise from $0.9 to $1, an 11 percent increase. For the highest income group, with 2018 marginal tax rate of 0.37, losing itemization will raise the price of giving $1 from $0.63 to $1, a nearly 59 percent increase. For those who maintain their charitable deduction, the price of giving also rises. The price rises the most for those with taxable incomes between $233,350 and $315,000, going from $0.67 to $0.76 for each $1 given away, a 13 percent rise in price. The second biggest price rise, 8 percent, hits taxpayers with middle incomes of $77,400 to $165,000.[1]

There may be reason to believe that many people did not fully understand or anticipate the effect of the tax changes on their itemization status or marginal tax rates during 2018. The TCJA was enacted relatively quickly, being introduced on November 2, 2017, and signed into law on December 22, 2017, allowing little time for the public to understand its consequences before the new tax year began. Moreover, the federal law interacted with state tax laws, adding to the complexity. We therefore expect the 2019 tax year to be the more informative time in which to measure the law's effects. The purpose of this article is to presage some of those anticipated behaviors so charities can react to the new giving landscape.

Evidence of or claims from this data have already begun to be seen by the Fundraising Effectiveness Project (FEP). Through analysis of individual donations to more than 20,000 charitable organizations, FEP has forecast a steep decline in the number of givers and in dollars collected in 2019. For the first quarter, FEP indicated that the number of donors dropped 5.7 percent relative to 2018, while dollars collected fell 2.2 percent. The report also documented a clear shift toward charities pursuing "major donors," meaning those who are capable of giving more than $1,000 per year.

[1] For a full discussion of empirical studies exploring how tax price and adjusted gross income affect giving, see James Andreoni, "Philanthropy," in *Handbook of the Economics of Giving, Altruism and Reciprocity: Applications* 1201 (2006); and Andreoni and A. Abigail Payne, "Charitable Giving," in *Handbook of Public Economics* 1 (2013).

Figure 1. Change in Itemization Status From 2017 to 2018

The Data

In mid-July the IRS revealed the first report on 2018 tax filings. Although there will be another report in the fall, which will include filers who requested extensions, the comparison between the 2017 and 2018 returns from the same period shows negligible differences in areas unrelated to the tax reform. Thus, we expect the fall report to have a similarly negligible effect on what we describe.

Figures 1 and 2 illustrate the aggregate findings.[2] Figure 1 shows that in 2017 nearly 30 percent of households could itemize their taxes and thus qualify for a charitable deduction, and Figure 2 shows that 24 percent of filers took a charitable deduction in 2017. In 2018 the number qualifying for itemization status fell to 10.2 percent, and only 8.5 percent actually took a charitable deduction. This means that the number of people who can benefit from giving to tax-exempt organizations in 2018 was one-third of what it was in 2017 and consisted of only one-tenth of the population of taxpayers.

Figure 3 disaggregates the change in itemization status. As expected, the TCJA disproportionately affects households with adjusted gross income below $250,000, but especially those at or below $100,000. The number of itemizers among those with incomes from $1 to $100,000 fell by more than 70 percent, and itemizers with AGIs below $50,000 have been reduced to only 1 percent of all taxpayers. The largest group of itemizers has AGIs between $100,000 and $250,000. The number of itemizers within that group was slashed from 11.2 percent to just 4.1 percent, a decline of 64 percent. For higher-income groups, the loss of itemization was, as expected, relatively small. Still, the numbers are not trivial: 39 percent of filers with incomes from $250,000 to $500,000 lost their itemization status, as did 18 percent of millionaires.

Figure 4 disaggregates the data in Figure 2 on the charitable deduction. Again, groups with incomes below $50,000 are now largely excluded from the benefits of giving to the nonprofit sector. The largest group, with AGIs of $100,000 to $250,000, comprises 15 percent of the population of taxpayers, yet only a quarter of them (3.6 percent of taxpayers) are claiming a charitable deduction. Comparing figures 3 and 4, the percentage reduction in charitable deductions appears to closely track the percentage reduction in itemization status, indicating that the changes in the law governing itemization are the primary

[2] All figures are our calculations from IRS filing season statistics data.

Figure 2. Change in Number of Charitable Deductions From 2017 to 2018

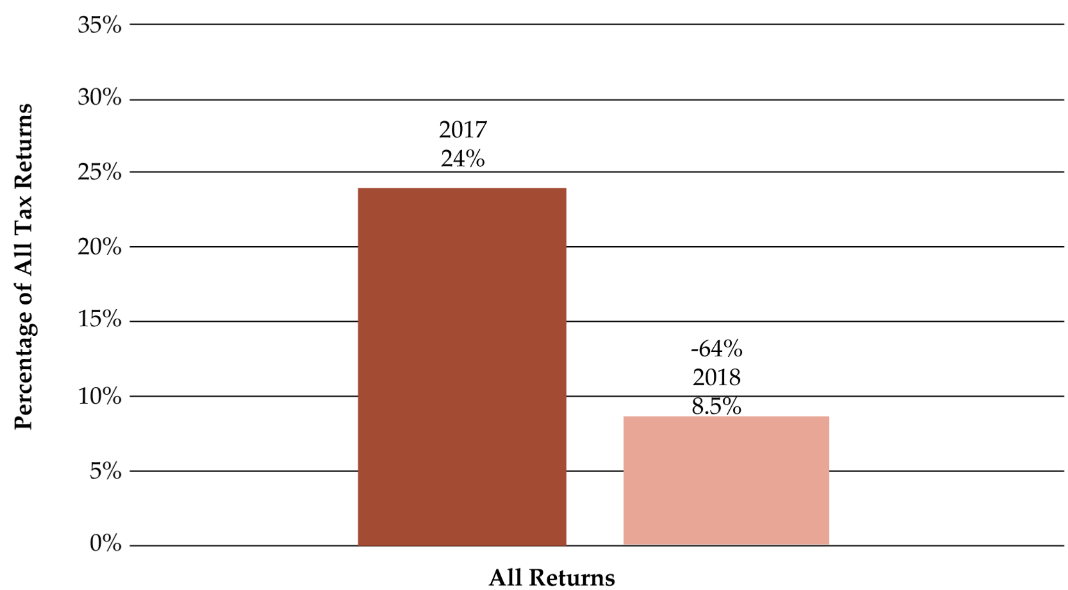
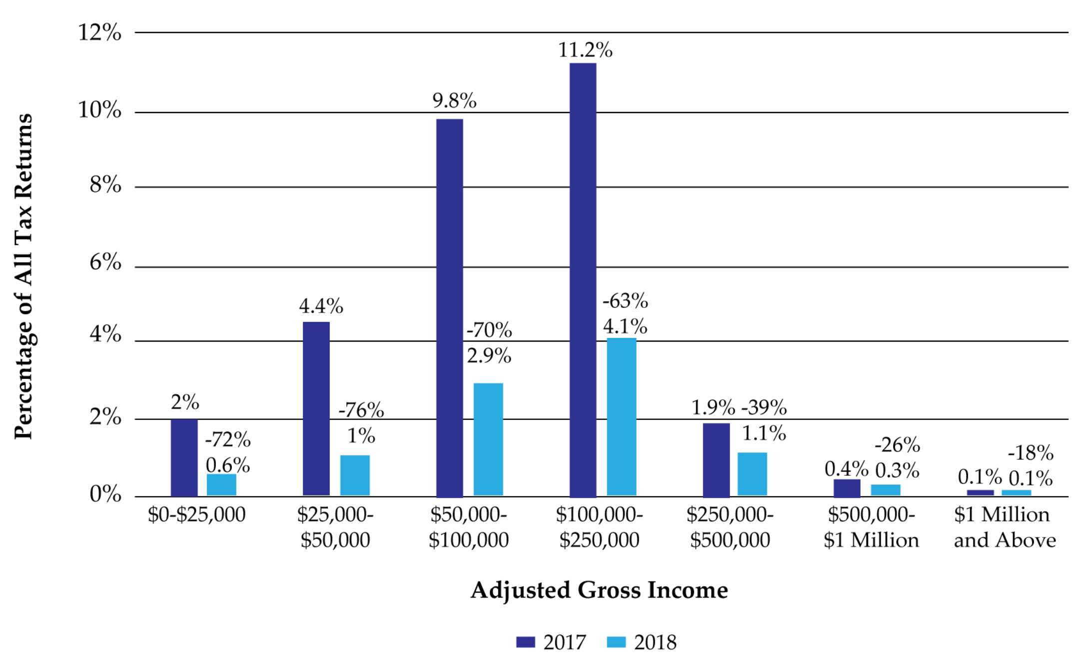


Figure 3. Decline in Itemization Status From 2017 to 2018



driver in reduced deductions. This is not surprising given both the small change in tax rates for itemizers and the anticipation that the behavioral effects will be seen more fully in 2019.

The Full Effects

Will the tax cuts put enough money in people's pockets to ignite additional generosity sufficient to offset the loss in the charitable deduction?

Figure 4. Change in Number of Charitable Deductions From 2017 to 2018

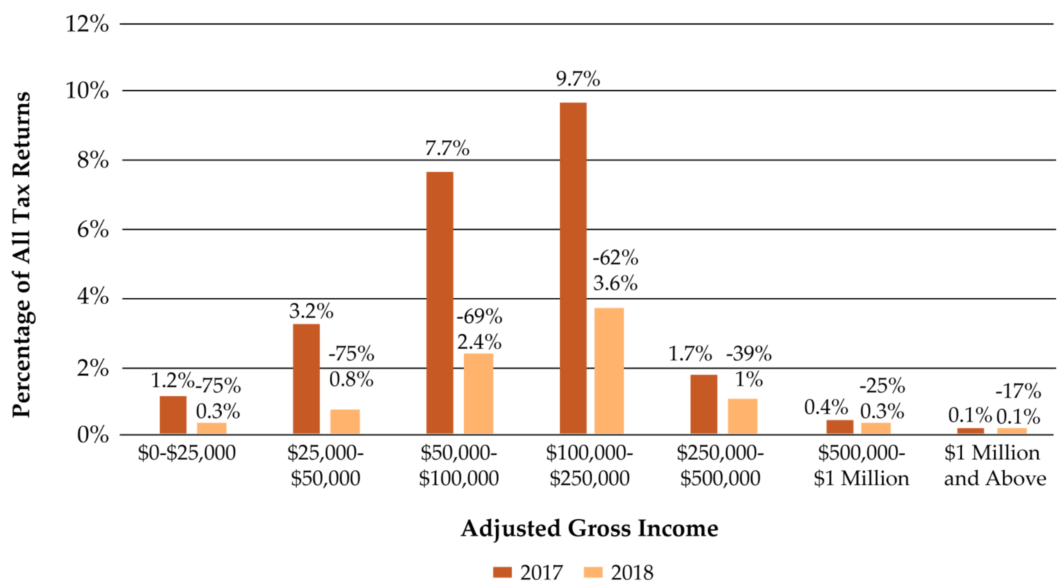
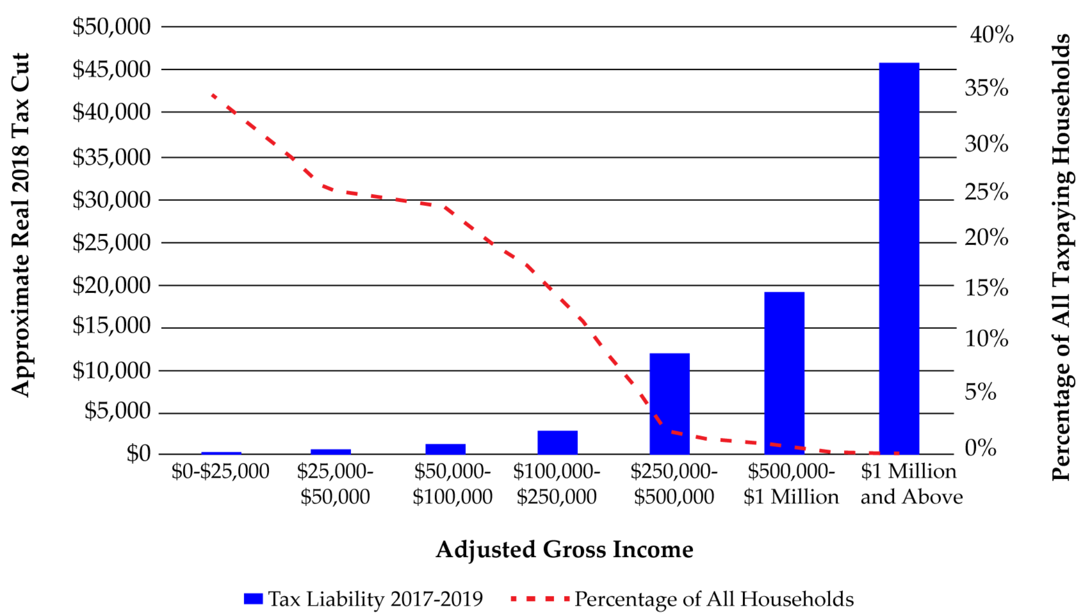


Figure 5. Tax Liability in 2017 Less 2018



The bars in Figure 5 show the difference in average real tax liabilities between 2017 and 2018 per household. These numbers should give us some indication of the increase in disposable income in each AGI bracket as a result of the tax cuts. The maximum decrease in tax liabilities went to the very top AGI group, at more than $45,000 per taxpaying household. The lowest AGI group netted just $73 by comparison. The middle AGI groups received from $1,200 to $2,500.

In contrast, these lower-income groups are far more numerous than the extremely wealthy. The red line in Figure 5 shows the fraction of the entire sample in the AGI group. The AGI categories that we anticipate received the most significant tax cuts are also the least populous. These data put charities in a quandary: Do they devote resources to gaining big donations from a very small group of people, or do they instead focus on middle-income donors who may not give large sums but could give in large numbers?

Implications for Section 501(c)(3) Charities

The main reasons for forming an organization as a section 501(c)(3) public charity are first, to prevent managers from profiting off the organization's activities, and second, to allow donors a charitable deduction.[3] If organizations rely on the tax deduction to motivate donors, the TCJA changes could impede their annual fundraising. Does the new law undermine the reasons to organize under section 501(c)(3)?

An alternative to section 501(c)(3) is available. Benefit corporations are for-profit entities, yet they are not required to maximize the profits of their owners. At the same time, the investors in the B corporation can withdraw some of the gains made by the organization, as with any for-profit. The investors typically expect a below-market return and view this lower return as their charitable contribution. Because the lower return represents income not received, it is also not taxed. Thus, the B corporation structure can effectively restore tax deductibility for would-be donors who have the means to invest in these entities.

Conclusion

The immediate effect of the TCJA has been to limit the charitable tax deduction to about 10 percent of the taxpaying population, over half of whom have incomes exceeding $100,000. The financial impact of the TCJA on the nonprofit landscape may take several more years to measure, but the outcome for itemization is already fairly clear. Federal incentives first enacted more than a century ago[4] to promote participation by all individuals in supporting a diverse and vibrant charitable sector have been significantly altered. Both the privilege and responsibility of supporting the charitable sector and choosing which organizations to support have now fallen even more heavily on those with the highest incomes and wealth. ■

[3]Evidence suggests that donors respond to the existence of a subsidy to giving but less so to the size of the subsidy, and that the difference is mainly on whether to give rather than the decision of how much to give. *See* Dean Karlan and John A. List, "Does Price Matter in Charitable Giving? Evidence From a Large-Scale Natural Field Experiment," 97 *Am. Econ. Rev.* 1774 (2007); and Steffen Huck and Imran Rasul, "Matched Fundraising: Evidence From a Natural Field Experiment," 95 *J. Pub. Econ.* 351 (2011). Also, sudden changes in funds raised can have existential consequences for small charities, as discovered by Andreoni, Payne, and Sarah Smith, "Do Grants to Charities Crowd Out Other Income? Evidence From the UK," 114 *J. Pub. Econ.* 75 (2014).

[4]The charitable deduction was initially enacted by the War Income Tax Revenue Act of 1917.