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Should We End the Tax Deduction for Charitable Donations?

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Washington is desperate for new revenue. And the charity deduction looks like a very tempting target these days.

Politicians and pundits across the political spectrum have been calling for cutting back the tax break that people get for making donations to charities. With the country's finances in such a mess, they say, we simply can't afford to be so generous about rewarding charitable giving—especially when it's mostly the very rich who claim the deduction. Even though trimming or eliminating the deduction won't solve our fiscal problems, they say, the contribution will certainly help get us closer to making ends meet.

Opponents of cutting back argue that things aren't that simple. The deduction, they say, is a critical incentive that keeps much-needed cash flowing to charities. And donations have already fallen in recent years—at a time when the need for services is soaring.

Yes: It Doesn't Increase Giving

By Daniel J. Mitchell

The charitable deduction can go.

For all the praise it gets, there's just no evidence that the tax break leads people to increase their giving—but it does lead them to make bad choices about giving. What's more, it favors a segment of the public, the very wealthy, that can afford to give without a break. And cutting the deduction does a lot less economic harm than other ways of raising tax revenue.

To be clear, I feel strongly that the best way to help charities is to boost economic growth, which leaves people with more money to donate. And I think the best way to do that is to replace our current system with a simple and fair flat tax. But even without that radical change, I don't think there's a compelling argument for the charitable deduction.

No Big Incentive

Let's start with the most basic point: It doesn't do what it promises—that is, to boost charitable giving.

Over the decades, there have been major changes in tax rates and thus major changes in the tax treatment of charitable contributions. At some points, there has been a big tax advantage to giving, at others much less. Yet charitable giving tends to hover around 2% of U.S. gross domestic product, no matter what the incentive.

So, trying to influence people's decisions by giving them a tax break is pointless. Efforts to spur more giving—such as extending the deadline to claim deductions, so people can help out victims of a tragedy—may be well intentioned but amounts to little more than grandstanding. Year in and year out, that 2% stays roughly the same. At most, it affects *when* people give, not the amount.

Another reason to drop the deduction is that it's exclusive—and it gives a break to people who really don't need one. Upper-income households are the biggest beneficiaries of the deduction, with those making more than $100,000 per year taking 81% of the deduction even though they account for just 13.5% of all U.S. tax returns.

The data are even more skewed for households with more than $200,000 of income. They account for fewer than 3% of all tax returns, yet they take 55% of all charitable deductions.

Pressure to Write Checks

These are people who can not only afford to give up the tax break, they would very likely give to charity without the deduction. They would still face tremendous cultural pressure to write charitable checks, as well as the prompting of their own conscience. Besides, many of them would still get nice perks for doing good—like seats at the opera or buildings named after them.

Sure, there are surveys that say wealthy people will cut back on giving if the deduction is limited or eliminated. But, again, history shows that whatever the incentives, total giving has stayed about the same, year in and year out. Why would the wealthy stop writing checks now?

Cutting Corners

What's more, the case for the deduction is weak even if you look at those people who*do* write their checks with tax in mind.

By focusing on getting a break, donors get sloppy, and they don't carefully monitor nonprofits to make sure their money is being used wisely. If it costs you just 65 cents to give a dollar to charity after taxes are figured in, you're less likely to pay attention to where you put that dollar, or how every cent is being used. The deduction becomes the tail that wags the charitable dog.

Charities, meanwhile, get fatter and lazier because of that dynamic. Think of all the exposés in recent years about charities that devote an overwhelming share of their budgets to administrative costs and marketing expenses. No system will create perfect nonprofit groups, but cutting back or cutting out the deduction would break the cycle of inefficiency that now exists.

Finally, ditching the deduction is one of the better options for raising tax revenue here and now. To be clear, I don't want to give more revenue to Washington. That's like putting blood in the water with hungry sharks around.

But if politicians are going to extract more money from the private sector anyway, reducing or eliminating the deduction is much less damaging to growth than imposing higher marginal tax rates.