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# NEW CBO STUDY FINDS THAT ESTATE TAX REPEAL WOULD SUBSTANTIALLY REDUCE CHARITABLE GIVING

by David Kamin

A new Congressional Budget Office study on the effect of the estate tax on charitable giving finds that elimination of the estate tax would cause charitable contributions to fall by large amounts.[1] CBO estimates that if estate-tax repeal had been in effect in 2000, charitable donations would have been reduced by $13 billion to $25 billion that year.[2] The amount by which CBO finds that charitable donations would fall exceeds the total amount of corporate charitable donations in the United States, which equaled $11 billion in 2000. The amount by which charitable donations would shrink also approaches the total amount that foundations contribute for charitable causes each year.

Moreover, with the growth in wealth over time and the coming increases in the size of the elderly population — and, subsequently, in the number of people who die — the loss in charitable donations that would result from repeal of the estate tax would be even larger in the future.

As the CBO report explains, the estate tax leads affluent individuals to donate more than they otherwise would, since estate tax liability is reduced through donations made both during life and at death. CBO divides the effect of the estate tax on charitable giving between two types of donations:

- *Charitable contributions made during life*. CBO finds that, as of 2000, repeal of the estate tax would have reduced charitable contributions made during life by between 6 percent and 11 percent. While a 6 percent to 11 percent reduction may not sound large, substantial amounts of donations are involved. CBO reports that charitable contributions from individuals totaled $196 billion in 2000. A reduction of 6 percent to 11 percent would shrink charitable contributions by approximately $11 billion to $21 billion.

- *Bequests at death*. CBO reports that estate tax repeal would have an even larger effect, in percentage terms, on bequests. Repeal of the estate tax in 2000 would

[1] Congressional Budget Office, *The Estate Tax and Charitable Giving*, July 2004.

[2] CBO reports that, in 2000, charitable donations from individuals and estates would have fallen by 6 percent to 12 percent if estate tax repeal were effective in that year. CBO also estimates that charitable contributions and bequests totaled $212 billion in 2000 ($196 billion from individual contributions and $16 billion from bequests). Thus, a reduction in donations of between 6 percent and 12 percent would have resulted in a reduction of $13 billion to $25 billion. The dollar estimates throughout this paper are based on the reductions in charitable giving that CBO reports in percentage terms and on CBO's estimates of the total amounts of charitable giving.

have led to a reduction in charitable bequests of 16 percent to 28 percent, CBO estimates.

> Although the percentage reduction in bequests is larger than the percentage reduction in charitable contributions made during life, smaller dollar amounts are involved. In 2000, there were $16 billion in charitable bequests (as compared to $196 billion in charitable contributions made during life).[3] A reduction in bequests of 16 percent to 28 percent would amount to a loss in charitable donations through bequests of about $3 billion to $4 billion.[4]

The total reduction in charitable giving due to estate tax repeal — from both charitable contributions made during life and bequests — would have equaled about $13 billion to $25 billion in 2000, the study concluded. This is a substantial drop. As noted above, the decrease in contributions from repeal of the estate tax would exceed total corporate giving in the United States. According to the American Association of Fundraising Counsel's Trust for Philanthropy, total corporate contributions to charitable services equaled approximately $11 billion in 2000.

The drop in contributions that CBO projects also would approach the total amount of giving by foundations. Total foundation giving equaled $25 billion in 2000.[5]

As these CBO findings document, the estate tax acts as a powerful incentive in encouraging affluent Americans to donate more to charity than they otherwise would. The estate tax makes charitable giving considerably less expensive than it otherwise would be.

An example may help illustrate this concept. If the assets in an estate above a certain level are subject to a 55 percent estate-tax rate, a charitable bequest of $100 reduces the tax bill that the estate must pay by $55, since bequests are exempt from taxation. The charitable bequest of $100 thus costs the estate only $45. Without the estate tax, however, a charitable bequest of $100 would reduce bequests to other beneficiaries of an estate by the full $100, as there would be no tax saving from the contribution. In this way, the estate tax makes charitable bequests much less expensive and encourages wealthy individuals to donate more.

[3] This CBO estimate of bequests includes only bequests made by estates that file a federal estate tax return. The vast majority of bequests are made by these large estates. The Center on Philanthropy at Indiana University estimates that estates not filing a federal estate tax return made only about $1 billion in bequests in 2000.

[4] CBO also has released a technical paper that provides further details related to its analysis of the estate tax's effect on charitable bequests. The findings of this technical paper are consistent with those of the broader CBO paper on the effects of the estate tax on charitable giving. See Robert McClelland, "Charitable Bequests and the Repeal of the Estate Tax," CBO, July 2004.

[5] Data on giving by corporations and foundations from a presentation by Alexander, Martin, Haas, and Partners, based on the American Association of Fundraising Counsel's Trust for Philanthropy, *Giving USA 2004*. The American Association of Fundraising's estimates for individuals' charitable contributions and bequests differ somewhat from CBO's. The Association finds that, in 2000, individuals' charitable contributions totaled $175 billion (as compared to CBO's estimate of $196 billion) and bequests equaled $18 billion (as compared to CBO's estimate of $16 billion).

The issuance of the CBO study comes at a time when the federal estate tax faces an uncertain future. The 2001 tax-cut legislation provided for the gradual phase-down of the estate tax, and its elimination in 2010. Prior to passage of the 2001 tax law, the exemption from the estate tax was scheduled to increase gradually from $675,000 for an individual in 2001 ($1.35 million for a married couple) to $1 million by 2006 ($2 million for a couple). The top estate tax rate stood at 55 percent. Under the 2001 law, the estate-tax exemption level will increase by considerably larger amounts through 2009, and the top tax rate is being reduced. In 2009, the year before repeal of the estate tax, the exemption will be $3.5 million ($7 million for a married couple), and the top estate-tax rate will be 45 percent. The estate tax will then be eliminated in 2010.

The repeal of the estate tax currently is scheduled to last only one year and to expire after 2010, along with all of the other tax cuts included in the 2001 tax-reduction legislation. After 2010, the estate tax is slated to revert to prior law (i.e., to the law as it stood before enactment of the 2001 legislation), with a $1 million individual exemption ($2 million for a married couple) and a top tax rate of 55 percent.

Yet few observers expect this to occur. The 2001 tax cut was made temporary *not* for reasons of policy, but as a budget gimmick to hold down the official cost of the 2001 tax-cut package. In its current budget, the Administration proposes making permanent the 2001 tax cut, including repeal of the estate tax. Many in Congress also favor permanent elimination of the estate tax. The likely alternative is to *reform* the estate tax rather than to repeal it — for instance, by making permanent the estate-tax policy that will be in place in 2009, with an exemption of $3.5 million for individuals and $7 million for couples and a top rate of 45 percent.

The new CBO study finds that a reformed estate tax would still serve as an important tool in encouraging charitable giving. In the study, CBO analyzed the effect on charitable giving of raising the estate-tax exemption. CBO found that in 2000, raising the estate-tax exemption to either $2 million or $3.5 million (with the exemption being double these amounts for a married couple) would have reduced total charitable giving by about $1 billion to $6 billion. This is a modest fraction of the loss of $13 billion to $25 billion in charitable donations that CBO estimates will occur if the estate tax is eliminated.

**Reform versus Repeal: Effect of Estate Tax Options on Charitable Giving in 2000**

| | Annual Reduction in Charitable Giving |
|---|---|
| Raise exemption to $2 million or $3.5 million (double that for married couple) | $1 - $6 billion |
| Repeal estate tax | $13 - $25 billion |

Source: CBO and author's calculations.