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COALITION MAKES FLAWED ARGUMENTS AGAINST PROPOSAL TO HELP FINANCE HEALTH REFORM BY MAINTAINING CURRENT VALUE OF ITEMIZED DEDUCTIONS FOR WEALTHY HOUSEHOLDS

By Robert Greenstein

A coalition consisting of several trade associations for foundations and some nonprofit organizations along with a number of large charities has raised objections to a proposal that would help finance improved health coverage for low- and moderate-income people by maintaining the value of itemized deductions for wealthy Americans at its current level.

Under current law, the value of those deductions is scheduled to rise after 2010 when the 2001 tax-rate reductions are slated to expire. Objecting to a proposal to maintain the current value of those deductions for wealthy Americans, rather than let them rise, the coalition explained its position in a September 21 letter to Senate Finance Committee Chairman Max Baucus.[1] Unfortunately, that letter rests to a significant degree on a mischaracterization of the proposal, a faulty analysis of its effects, and a selective (and misleading) use of the two studies the letter cites.

High-Income Households Would Maintain Current Tax Benefits from Donations

Though a major step forward, the health reform plan that Chairman Baucus unveiled September 16 provided insufficient subsidies to enable many low- and moderate-income families to afford adequate health insurance. Several Finance Committee members filed amendments to the plan to help address this matter and to offset the costs by maintaining the value of itemized deductions for high-income households at its current level.

Currently, households in the top two tax brackets (35 and 33 percent) that are not subject to the Alternative Minimum Tax receive a tax subsidy for itemized deductions at a rate of 35 cents and 33 cents on the dollar, respectively.[2] However, President Bush's large 2001 tax cuts are scheduled to expire at the end of 2010, which will raise the two top rates to 39.6 percent and 36 percent. As a consequence, the tax subsidies that people in those brackets will receive from itemized deductions will rise as well.

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[1] http://www.pppnet.org/pdf/09_Coalition_Letter_to_Chairman_Baucus_0921.pdf.

[2] Itemized deductions are worth 28 cents on the dollar to households subject to the AMT.

Earlier this year, President Obama proposed to cap the value of itemized deductions for high-income households at *28 cents* on the dollar to help pay for health care reform. That proposal would reduce the tax subsidies that deductible expenses — including charitable donations — now provide to people in the top tax brackets, and it drew significant criticism. (It should be noted, however, that studies indicate charitable giving would decline by 2 percent or less under the proposal.[3])

The proposal by several Finance Committee senators is markedly different: it would *not reduce the current tax subsidies for deductible expenditures at all.* It would simply keep those subsidies where they are today — at 35 cents on the dollar for those with the highest incomes — rather than allowing them to grow larger in 2011.

Coalition Arguments Against Proposal Are Flawed

The coalition's September 21 letter raises various objections to the proposal. Most rest on faulty analysis or mischaracterize the proposal.

- The letter claims that limiting the value of the deduction for charitable contributions would create a disincentive for affluent individuals to donate. This ignores the fact that the proposal would merely keep the incentive for high-income people to donate where it is today.

- The letter states that while donors would probably continue to give if the value of the charitable deduction were reduced, "it would likely affect the timing and size of their gifts. Even though the proposals would not take effect until 2011, charities report that donors are already delaying gifts and multi-year pledges." The implication is that under the proposal, the value of the tax deduction would shrink, donations would fall, and gifts would be delayed. Such claims are without foundation:

  ✓ As noted, the proposal would not reduce the value of the tax deduction but, rather, maintain it at its current level.

  ✓ The claim that this change would create an incentive for donors to delay gifts is backwards. Wealthy donors already have a reason to delay contributions now, at a time when they are badly needed, because the tax subsidy for such donations is scheduled to rise in 2011 to 39.6 percent. Acting now to keep the tax subsidy at 35 percent would *remove* that incentive. If anything, therefore, the proposal would accelerate donations, not delay them.

The tax subsidies for charitable giving have been at their current levels since 2001. The coalition of groups that signed the September 21 letter has not argued in the past eight years that these subsidies are too small. Nor did these groups object when the 2001 tax cuts reduced the top subsidy from 39.6 cents on the dollar to 35 cents.

Coalition Misuses Studies in Attempt to Bolster Case Against Proposal

The September 21 letter cherry-picks findings from two studies that it cites and omits relevant information from those studies that does not support the coalition's arguments.

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[3] Paul N. Van de Water, "Proposal to Cap Deductions for High-Income Households Would Reduce Charitable Contributions by Only 1.9 Percent," Center on Budget and Policy Priorities, revised March 31, 2009, http://www.cbpp.org/cms/index.cfm?fa=view&id=2700.

The letter says that "a recent study conducted by Michelle and Robert Yetman at the University of California at Davis found that donations to charities that appeal to the higher human needs, such as education, arts and culture, and environmental causes, are very sensitive to tax incentives. The authors suggest that decreasing the value of the charitable deduction will likely decrease donations recorded by these types of charitable organizations." The proposal would not, in fact, decrease the current tax value of the deduction. Hence it should not decrease donations to these types of organizations.

More disturbing, the coalition letter omits the study's other key finding, which appears immediately before the sentence that the letter cites: "changes in the price of giving *would have little or no effect on the amount of donations recorded by charities whose missions are human services, public and social benefit, and health"* (emphasis added).[4]

Taken together, the study's findings imply that allowing the top deduction rates to rise to 39.6 and 36 percent could generate a modest increase in donations to museums, universities, and the like but would have little impact on donations to other charities. Many people — and many charities — would regard it as a reasonable tradeoff to forgo the possibility of modestly increased donations to arts-related and other such charities in order to help provide more adequate and affordable health care to tens of millions of less fortunate Americans.

The coalition letter also cites the "2008 Bank of America Study of High Net-Worth Philanthropy" as finding that high net-worth households account for a substantial share of individual giving. Citing this finding, the letter argues that changing the value of the tax deduction for high-income households would weaken charitable giving. But the letter omits the finding in the same study that, when high net-worth households were surveyed, "overall, high net-worth households reported they believe there would be very little change in their giving if there were no tax deductions for donations."[5]

Proposal Would Help Pay for Health Care Improvements That Benefit Many Charities

As some have noted, the proposal might *benefit* the charitable sector by strengthening health reform legislation. Providing uncompensated care to uninsured or underinsured people in hospital emergency rooms, neighborhood health clinics, and other charitable entities strains those charitable organizations' budgets. The revenues that the proposal would generate would enable health reform legislation to reduce the number of Americans seeking charity care by even larger numbers than the current Baucus proposal, since those revenues would pay for more adequate assistance to people of modest means in obtaining insurance. This should reduce the burden on nonprofits that provide free or reduced-price health care.

In addition, well-designed health reform legislation should help small and mid-size nonprofits to obtain decent, affordable health insurance for their employees.

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[4] Michelle H. Yetman and Robert J. Yetman, "Does the Incentive Effect of the Charitable Deduction Vary Across Charities?," July 22, 2009. Available at http://ssrn.com/abstract=1435150.

[5] Bank of America, *The 2008 Study of High Net Worth Philanthropy*, March 2009. Available at http://newsroom.bankofamerica.com/file.php/mr_bankofamerica/spinsite_docfiles/693/2008+BAC+HNW+Philanthropy+Study.pdf.

Charitable Sector Divided Over This Issue

Finally, the coalition letter states that signatories represent "a broad cross-section of charities across the country." The letter should not, however, be taken as representing a consensus in the charitable community on this matter, as no such consensus exists. The charitable community is split on this issue. For example, the largest, broadest coalition of charities — Independent Sector — did not sign the letter and has neither endorsed nor come out in opposition to the proposal to cap itemized deductions, precisely because its membership is split on this issue.