

Hearing on Tax Reform and Charitable Contributions

Statement for the Record

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February 13, 2013

Every charity begins with a gift. Limiting the charitable contribution deduction not only would harm the charities that exist today, but also those that future generations will form. The charitable deduction protects our freedom to create, fund, and operate the institutions that make up American civil society. By altering it, we risk tearing the delicate fabric that binds us all together.

Civil society is the space in which ordinary people associate to advance their common interests. It is outside of the family, the state, and the market. It is made up of churches, schools and universities, arts organizations, animal welfare leagues, homeless shelters, public safety and disaster relief organizations, medical organizations, crime prevention groups, civil rights organizations, recreation and sports leagues, community improvement groups, scientific research organizations, youth centers, international development organizations, military and veterans associations, and volunteer organizations of all kinds.¹ The list is as broad and diverse as America itself.

The vibrant civil society that thrives within our borders is the envy of the world. It is the product of our freedom of association, a basic right guaranteed by the Constitution, and it is America's most distinguishing feature. It is what our founding fathers fought for and died trying to protect.

What does this have to do with tax? Everything. When Congress determined that an income tax was necessary to pay for World War I, the members understood that they needed to protect civil society from crowding out by the federal government. After all, they reasoned, there would be little point in fighting a war to defend the American way of life only to turn around and sacrifice the very thing that defines us as a nation.² Therefore, when Congress imposed the income tax, it removed charitable gifts from the tax base.

¹ See IRS and National Center of Charitable Statistics, National Taxonomy of Exempt Entities (May 2005), available at <http://nccs.urban.org/classification/NTEE.cfm>.

² "The time may come when the Government will have to choose between national defense, on the one hand, and the continuance of educational and philanthropic institutions. We may have to turn our schools and hospitals and playgrounds into battleships and ammunition. That time has not yet come even in France." 55 *Cong. Rec.* 6729 (1917) (quoting Edward T. Devine, "Exemption of Contributions," *The Survey*, July 7, 1917).

Congress also determined that taking charitable contributions out of the tax base is good tax policy because it “would remove the absurdity of exacting a tax even on that share of a man’s income which he devotes not at all to himself, but to the pressing needs of educational and charitable institutions which operate without private profit.”³ In other words, because the charity consumes the gift rather than the donor, it does not make sense to tax the donor on the gift.

For nearly 100 years, the charitable deduction has stood as a fiscal barrier between the federal government and civil society, and it has remained intact despite two World Wars and the Great Depression, when the federal government’s need for revenue was even greater than it is today.

The charitable deduction enables the government to collect taxes without harming civil society. The top federal income tax rate has ranged from 77% in 1918, down to 24% in 1929, up to 94% in 1945, down to 28% in 1988, and up again to 39.6% in 2013.⁴ Throughout this time, the charitable deduction has fully exempted charitable gifts from taxation. It does not matter if your tax rate is 10% or 39.6%, when you make a gift of \$100, your adjusted gross income is reduced by \$100, and your income tax rate—whatever it may be—is applied to the remainder.⁵

Some regard this as unfair. They believe that because the tax benefit a person derives from making a charitable gift is greater the higher the person’s marginal tax rate, the charitable deduction should be viewed as a tax subsidy that favors the wealthy. They argue that the charitable deduction should be modified so that rich and poor alike have an equal tax incentive to give to charity.

Well intentioned as such proposals may be, they fundamentally misconstrue the relationship between the federal government and civil society. The U.S. federal government is not civil society’s benefactor. How could it be? The Constitution requires a separation of church and state. It also requires the government to tolerate our freedom to speak, assemble, protest, and engage in activities that the government may not otherwise approve of. In short, the Constitution requires government neutrality toward civil society, and that is why the charitable contribution deduction exempts charitable gifts from the tax base.⁶

One of the collateral consequences of exempting charitable gifts from tax is to reduce the after tax “cost” of giving. This phenomenon may affect some donors’ incentive to give. It is also true that the tax incentive likely increases with the donor’s marginal tax rate.

³ 55 *Cong. Rec.* 6729 (1917) (quoting *Boston Transcript*, “Do Not Penalize Generosity,” June 29, 1917).

⁴ Robert A. Wilson, Personal Exemptions and Individual Income Tax Rates, 1913-2002, IRS Stat. Income Bull., Spring 2002, at 219-220 tbl. 1.

⁵ Because the charitable deduction is reported “below the line” on Form 1040, only taxpayers who itemize deductions are able to claim a charitable deduction on their tax return; nonitemizers claim the standard deduction.

⁶ For the same reason, the tax code also exempts charitable organizations from income tax. As Chief Justice Warren Burger has explained, the tax exemption of churches is not a subsidy from the government. Rather, the tax exemption is a logical consequence of the separation of church and state. “The exemption creates only a minimal and remote involvement between church and state, and far less than taxation of churches. It restricts the fiscal relationship between church and state, and tends to complement and reinforce the desired separation insulating each from the other.” *Walz v. Tax Commission of the City of New York*, 397 U.S. 664, 677 (1970).

This discussion about the tax cost of giving and tax incentives, however, is a red herring from the issue at hand. When Congress enacted the charitable deduction, the members understood that the deduction's purpose is not to create a tax incentive to give but rather to prevent the government's need for revenue from suffocating civil society.⁷

Another collateral consequence of exempting charitable gifts from tax is that the federal government foregoes revenue that it could otherwise claim through taxation. This policy choice should not be confused with a subsidy. Congress did not intend to create a subsidy when it enacted the charitable deduction.⁸ The charitable deduction is not a matching gift from the government to the charity of the donor's choice. It is, rather, the logical consequence of a policy of neutrality toward civil society that permits donors to fund the causes they favor with minimal government interference. It is dangerous to construe the charitable deduction as a subsidy because doing so risks subjecting civil society to government control. As Alexander Hamilton once wrote, "[t]hat power which holds the purse strings absolutely, must rule."⁹

All of the proposals now before this Committee renegotiate the relationship between the federal government and civil society. Any proposal that does not fully exempt charitable gifts from the tax base blurs the line between the state and civil society in an undesirable way.

Proposals that (1) limit the tax rate against which contributions may be deducted, (2) impose a dollar cap on total itemized deductions, or (3) establish a floor below which contributions may not be deducted all appropriate a portion of charitable gifts into the tax base for use by the federal government. Such proposals jeopardize civil society because, as Justice John Marshall once wrote, "the power to tax involves the power to destroy."¹⁰

The Pease limitation on overall itemized deductions, which was recently revived under the American Taxpayer Relief Act of 2012,¹¹ is another example of a revenue raising measure that violates the principle of government neutrality toward civil society. By limiting overall itemized deductions, of which the charitable deduction is one, Pease pulls a portion of charitable gifts back into the tax base where they do not belong. For that reason, Pease should be amended to exclude the charitable deduction from the overall limitation on itemized deductions.

In America, government neutrality toward civil society is paramount. It is therefore incumbent upon Congress to consider these proposals with extreme caution.

⁷ The purpose of the deduction "is not that benefactions should be encouraged by legislation, but that they should not be discouraged by penalties." 55 *Cong. Rec.* 6729 (1917) (quoting *The Washington Post*, "Conscription of Income," July 12, 1917).

⁸ "[The charitable deduction] does not create a new form of special privilege or a new subsidy." 55 *Cong. Rec.* 6729 (1917) (quoting Edward T. Devine, "Exemption of Contributions," *The Survey*, July 7, 1917).

⁹ Letter from Alexander Hamilton to James Duane, (Sept. 3, 1780).

¹⁰ *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819).

¹¹ Pub. L. No. 112-240.