



Information about the *Proposed* Reductions to Tax Deductions, Including Deductions for Charitable Contributions

Nonprofit leaders need to understand the distinctions between the three different federal budget bills that have filled news headlines the last month. While the federal stimulus package and the 2009 federal budget have been enacted, the third item (the President's proposed budget for 2010) likely will not be voted on for months. This last one has generated lots of concern and confusion among nonprofits and some donors because it proposes to reduce the amount that high-income individuals can deduct from their taxes (including for charitable contributions) in order to help pay the largest part of health care reform. To help nonprofit leaders answer questions and lead informed discussions about the last item, this Special Report supplies some basic information about the three budget matters, explains aspects of the proposed change to tax deductions as it relates to charitable contributions, and offers three simple action steps.

The Three Different Federal Budget Matters

- *One-time extra funding:*

On February 17 President Obama signed into law the emergency \$787 billion economic stimulus package, the American Recovery and Reinvestment of 2009, PL 111-5, to spend extra money and provide extra tax cuts beyond the normal budget.

- *Current operating year budget:*

In February Congress resumed action on the current year (2009) budget that actually began last October 1st. In 2008, Congress and the Bush Administration could not agree on various aspects, so only parts of the budget officially got passed last year; other parts of the federal government were operating through "Continuing Resolutions" that allow government operations to continue at the same basic level as the previous year's budget. The House and the Senate recently finished their work on the rest of the 2009 federal budget, which the President signed last week.

- *Proposed budget for future years:*

On February 26 President Obama released his PROPOSED budget for 2010, which – if passed – would go into effect from October 1, 2009 through September 30, 2010. His proposed budget included two interrelated proposals of interest to many nonprofits. The first is the President's proposal to create a \$634 billion reserve fund to underwrite the initial major step towards reforming our nation's health care system, an issue that many people perceive as the greatest threat to our country's fiscal sustainability. The second item is the proposed mechanism for paying for the bulk of that reform (\$318 billion worth): the President's PROPOSAL to change the amount that "high income" people (the 1.2% of Americans with income greater than \$250,000 a year) can deduct from their taxes (including for charitable donations), reducing the deduction from 33% or 35% (depending on the person's tax bracket) to the 28% rate that other itemizers can claim. Importantly, even if Congress agreed with the reduction, it would not apply to anyone until – at the earliest – January 2011.

The Proposals to Pay for Health Care Reform and Limit Some Charitable Contribution Deductions:

- The 2010 budget proposal: <http://www.whitehouse.gov/omb/budget/>
- Director of the federal Office of Management & Budget (blog entry on Feb 26): "Let's focus specifically on the revenue increases for high-income taxpayers. The Budget proposes that the tax cuts currently enjoyed by those with incomes above \$250,000 be allowed to expire at the beginning of 2011, at which point the economy should have recovered from the current downturn. Again, the revenue increases for those with incomes of \$250,000 or more a year would become effective January 1, 2011 – and not before." (emphasis in original) <http://www.whitehouse.gov/omb/blog/09/02/27/TheBudgetandCharitableDonations/>

The Immediate Reactions – a *sampling* of media stories:

- *The New York Times*, "Limiting Deductions on Charities Draws Ire" (Feb. 27) http://www.nytimes.com/2009/02/27/us/27charity.html?_r=1
- *Los Angeles Times* blog: "Are charitable contributions really at risk under Obama budget?" (Feb. 27) <http://latimesblogs.latimes.com/washington/2009/02/charitable-cont.html>
- *The Chronicle of Philanthropy*, "Charitable-Giving Plan Divides Nonprofit Groups and Worries Donors" (March 2) <http://philanthropy.com/news/updates/index.php?id=7301>

Analysis:

- Indiana University's Center for Philanthropy (Feb. 27): "How Changes in Tax Rates Might Affect Itemized Charitable Deductions," finding: "The Obama Administration's proposals to reduce the tax deduction high income taxpayers can take for charitable gifts and to increase the top personal income tax rate, would, by themselves, have a relatively small negative effect on itemized charitable giving.... However, the cumulative effect of those changes and the current economic situation could further increase the challenges nonprofits and their constituents are facing." <http://www.philanthropy.iupui.edu/News/2009/02/pr-TaxProposals.aspx> (press release: "Proposal to Reduce Charitable Gift Tax Deduction Likely to Have Relatively Small Negative Effect on Charitable Giving Overall"); full report at http://www.philanthropy.iupui.edu/docs/2009/2009_TaxChangeProposal_WhitePaper.pdf
- The nonprofit Center for Budget and Policy Priorities: "Proposal to Cap Deductions for High-Income Households Would Reduce Charitable Contributions by Only About 1 Percent," finding: "The President's 2010 budget proposes to limit the tax subsidy for deductible expenses of the most affluent Americans and to use the additional revenue to help finance national health reform, including universal coverage. This proposal has been attacked on the grounds that it would lead to substantial reductions in charitable contributions and hit charities at a time when they face increased need and decreased contributions due to the recession. Careful examination indicates that ... President Obama's proposal to limit the tax deduction for charitable contributions would affect only the top 1.2 percent of affluent U.S. households and, despite claims to the contrary, would reduce total charitable contributions by only 1.3 percent." <http://www.cbpp.org/3-3-09bud.htm>

Recent developments include these news articles reporting:

- "Key Democrats oppose Obama's tax reduction plan," Associated Press (March 5), and noting both Senate Finance Chairman Max Baucus and House Ways & Means Chairman Charles Rangel have expressed strong reservations about further hurting nonprofits at this time when they already are struggling to help their communities; http://news.yahoo.com/s/ap/20090305/ap_on_go_ca_st_pe/obama_taxes
- "White House Rethinks Tax Hikes," *Wall Street Journal* (March 5) as Treasury Secretary Geithner, in the face of strong opposition by lawmakers at the Capitol to the reduction in charitable deductions proposal, indicated a possible willingness by the Obama Administration to drop the proposal; <http://online.wsj.com/article/SB123621392108135233.html>

Action Steps for Moving Forward

1. The Nonprofit Sector: Call “Time Out” to Think

With our nation in crisis right now, the responsible thing for nonprofits to do is to call “time out” to understand the facts and study the proposal. Rather than just rejecting the proposal in a knee-jerk fashion, we should listen to and consider the possible benefits. That is not to say that our sector needs to concede that the reduction is acceptable; rather, it is to say we have a legitimate role at the policymaking table. We should consider not only our nation’s collective need for health care reform, but also our own sector’s needs with so many employees of small and mid-size nonprofits – those comprising more than 95% of America’s nonprofits – seeking help with the spiraling costs of health care. Additionally, we should consider the apparent disconnect between statements that the costs to the nonprofit sector will not be that great versus statements that the revenues gained will be so huge they can help pay for the health care reform for all Americans. Indeed, before the federal government goes off in this new direction, we need a national dialogue about the importance of the nonprofit sector and the dire financial situations many nonprofits are in as they try to serve their communities with rapidly declining revenues.

2. Nonprofit Leaders: Calm the Waters

It is important for everyone to recognize that the proposed reduction in the percentage that the top 1.2% of America’s highest income people could claim for charitable contributions (and other deductions) is just a proposal that would not go into effect for another 20 months even if it were adopted. Historically, when people know there will be a change in tax law next year, they tend to take action this year to reap the benefits, so such a change might generate more short-term revenues for nonprofits to then meet their missions. Yet before this proposal was a week old, reports were already coming in that some donors are citing this proposed change in the tax law as their justification for not giving this year. The key now is to share information so people can make informed decisions rather than acting out of fear.

3. Individual Nonprofits: Come Together as a Sector

This recent series of governmental actions and proposals reinforces the tremendous need for the nonprofit sector to come together, both to share information and then to take collective action. Nonprofits need to inform government officials at the local, state, and federal levels just how badly this economy is ravaging nonprofits. Anecdotal stories here or there by themselves may not prove persuasive enough, but if we come together we have a louder voice and a better opportunity to be heard. As Benjamin Franklin encouraged his colleagues when taking the bold move of signing the Declaration of Independence, *“We must all hang together, or assuredly we shall hang separately.”* Now is the time for nonprofits to come together to monitor and take action at the local, state, and federal levels. The best way to do that is by joining and being an active member of your state association of nonprofits. <http://www.councilofnonprofits.org/salocator>

Special Reports on Economic Recovery

This Special Report is one in a series prepared by the National Council of Nonprofits to help nonprofit leaders, grantmakers, policymakers, and the general public better understand the intersections between the nonprofit sector and our nation’s economic recovery. To review the other Special Reports, go to www.councilofnonprofits.org/stimulus