

# A SOCIAL ARGUMENT FOR THE CHARITABLE DEDUCTION

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INTRODUCTION

How much does America get by giving? After all, according to the Joint Committee on Taxation, the federal tax expenditure for charitable deductions in 2014 will be \$43 billion.<sup>1</sup> Although that represents only a small portion of the massive federal budget,<sup>2</sup> the charitable deduction has long generated an intense debate concerning its legal and economic justifications.<sup>3</sup> Every few years a law review article expresses dissatisfaction with the traditional defenses for the charitable deduction and instead offers a novel argument explaining how the deduction serves an efficient legal or economic purpose for one or another specific form of giving.<sup>4</sup> In contrast this Note demonstrates that the charitable deduction is generally indefensible either as part of an ideal income tax or as a subsidy for

1. STAFF OF J. COMM. ON TAX'N, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012-2017, at 37-39 (Comm. Print 2013).

2. See Ilan Benshalom, *The Dual Subsidy Theory of Charitable Deductions*, 84 IND. L.J. 1047, 1081 (2009).

3. Various articles have been published in the last forty years debating whether to keep and how to reform the charitable deduction. See, e.g., William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972); Benshalom, *supra* note 2, at 1048; Boris Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?*, 28 TAX L. REV. 37 (1972); Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393 (1988); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831 (1979).

4. See, e.g., Brian L. Frye, *Solving Charity Failures*, 93 OR. L. REV. 155 (2014) (justifying so-called "crowdfunding" through internet platforms such as Kickstarter.com as helping to address criticisms classically leveled at charitable giving); Brian Galle, *The Role of Charity in a Federal System*, 53 WM. & MARY L. REV. 777, 777-78 (2012) (justifying certain types of giving as filling gaps between local governments in a federal system).

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public goods. Rather than offer a legal or economic defense, this Note argues that the charitable deduction may best be understood as a normative policy offering recognition and reward for the deeply held American ethic of charitable giving.<sup>5</sup> Furthermore this Note argues that a tax credit system should replace the charitable deduction because a tax credit can more fairly recognize giving from both rich and poor donors alike. This Note also offers a proposal to reduce enforcement burdens on the Internal Revenue Service (IRS) resulting from such a tax credit system.

This Note proceeds in four parts. Part I presents a short history of the passage of the charitable deduction and outlines the current statutory requirements for the deduction. Then on the basis of income tax and gift theory, Part II evaluates the argument that the charitable deduction is an essential part of an ideal income tax. Part III examines whether the charitable deduction can serve as an efficient subsidy for public goods that can also accurately reveal consumer preferences. Part IV offers a different, novel justification for the deduction: Americans believe in the act of charitable giving as a value unto itself and therefore want to reward the act of giving through the charitable deduction. Part IV also discusses further tax reform and argues that a credit system would more consistently and equitably recognize generosity among both rich and poor Americans than the current itemized deduction system. This analysis also draws upon previous tax reform in the United States, as well as French and Danish tax policies.

## I. BACKGROUND

### A. *History of the Enactment of the Deduction*

The charitable deduction began as an amendment to the War Revenue Act of 1917.<sup>6</sup> The stated purpose of the act was “[t]o provide revenue to defray war expenses, and for other purposes.”<sup>7</sup> More specifically the Act implemented a general income tax to

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5. John F. Coverdale has explored Catholic normative reasons for maintaining the charitable deduction, even if other economic and legal justifications are insufficient. John F. Coverdale, *The Normative Justification for Tax Exemption: Elements from Catholic Social Thought*, 40 SETON HALL L. REV. 889, 889 (2010). This Note instead searches for a more general, American ethic of giving, rather than one particular to any single religious group.

6. Pub. L. No. 65-50, § 1201(2), 40 Stat. 300, 330; *see also* Hernandez v. Comm’r, 490 U.S. 680, 707 (1989) (O’Connor, J., dissenting).

7. War Revenue Act of 1917, ch. 63, 40 Stat. at 300.

cover the costs of the United States' entry into World War I.<sup>8</sup> Yet as Congress debated the proposed legislation, Sen. Henry Hollis expressed his concern that the new income tax would discourage "wealthy men" from donating to charity.<sup>9</sup> Therefore he proposed an amendment that would allow taxpayers to deduct the value of charitable gifts from their taxable income.<sup>10</sup> Ultimately his amendment was passed into law as part of the War Revenue Act of 1917.<sup>11</sup> Later in 1954 the charitable deduction was codified into I.R.C. § 170.<sup>12</sup>

*B. The Current Version of the Charitable Deduction in the Code*

As stated in I.R.C. § 170, donors may deduct contributions to charitable organizations as long as the institution is "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals."<sup>13</sup> Not surprisingly this description strongly resembles the statutory definition of charitable institutions found in I.R.C. § 501(c)(3), which grants tax-exempt status to the charities themselves. Both for I.R.C. § 170 and I.R.C. § 501, a charity needs to provide *some* benefit to society at large, though the definition of what qualifies as charitable is very broad.<sup>14</sup> Over the years the Supreme Court has added one twist to this broad statutory definition: "an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy."<sup>15</sup> Nonetheless this further requirement to achieve a "public purpose" has not significantly narrowed the definition of a charitable institution.<sup>16</sup>

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8. See SHELDON D. POLLACK, *FAILURE OF U.S. TAX POLICY: REVENUE AND POLITICS* 55–56 (1996).

9. 55 CONG. REC. 6728 (1917).

10. *Id.*

11. § 1201(2), 40 Stat. at 330.

12. H.R. REP. NO. 83-1337, at 25 (1954), as reprinted in 1954 U.S.C.A.N. 4017, 4050.

13. I.R.C. § 170(c)(2)(B) (2012).

14. See *id.* §§ 170(b)(1)(a), (c)(1)–(5), 501(c)(3).

15. *Bob Jones Univ. v. United States*, 461 U.S. 574, 586 (1983).

16. See, e.g., David A. Brennan, *The Power of the Treasury: Racial Discrimination, Public Policy, and "Charity" in Contemporary Society*, 33 U.C. DAVIS L. REV. 389, 407 (2000) ("[T]he [*Bob Jones*] Court did not address the limits of the Treasury's ability to determine when or if a particular 'public policy' is sufficiently 'established' in any context other than whites discriminating against blacks."); Lars G. Gustafsson, *The Definition of "Charitable" Federal Income Tax Purposes: Defrocking the Old and Suggesting Some New Fundamental Assumptions*, 33 HOUS. L. REV. 587, 600 (1996) (noting that the Court's decision in *Bob Jones* failed to provide meaningful "clarity and

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Of course there are also much stricter and more concrete requirements for charitable institutions if they want their donors to enjoy the benefit of the deduction. For instance no one may draw net profits from the institution.<sup>17</sup> Similarly the IRS has established the related requirement that the value of a deduction may not include any money, property, or services returned to the donor by the organization in exchange for the donation.<sup>18</sup> In other words, a donor cannot receive anything of value in return for a donation.

Greatly reducing the use of the charitable deduction, the Internal Revenue Code only permits taxpayers to claim individual deductions (including charitable deductions) if they forgo the standard deduction.<sup>19</sup> Indeed the very function of the standard deduction is to reduce the compliance costs of taxpayers whose itemized deductions would total less than the specific dollar amount of the standard deduction allowance.<sup>20</sup> The result is that only taxpayers whose itemized deductions exceed the standard deduction allowance will forgo this administrative shortcut.<sup>21</sup> In fact a mere one-third of Americans choose to itemize their deductions.<sup>22</sup> In particular wealthy taxpayers have the greatest incentives to itemize their deductions because their deductible expenses likely exceed the set dollar amount of the standard deduction and because their higher marginal tax rates produce more savings for each dollar deducted from their taxable income.<sup>23</sup> Thus in 2013 the richest twenty percent of taxpayers enjoyed eighty-four percent of the estimated tax

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consensus about the purpose or purposes that may justify granting a tax exemption”); Nicholas A. Mirkay, *Globalism, Public Policy, and Tax-Exempt Status: Are U.S. Charities Adrift at Sea?*, 91 N.C. L. REV. 851, 867 (2013) (“Legal scholars have criticized the [*Bob Jones*] doctrine as lacking . . . a clearly defined scope of applicability.”).

17. I.R.C. § 170(c)(2)(B)–(C) (2012).

18. See, e.g., Rev. Rul. 67-246, 1967-2 C.B. 104 (offering numerous examples of what qualifies as money, property, or services); Rev. Rul. 86-63, 1986-1 C.B. 88 (addressing premium stadium tickets offered to benefactors of alumni athletic organization); cf. *United States v. Am. Bar Endowment*, 477 U.S. 105, 118 (1986) (criticizing insurance policies provided to benefactors of law research institute).

19. I.R.C. § 63(b)–(e) (2012).

20. See H.R. REP. NO. 91-413, at 201 (1969), as reprinted in 1969 U.S.C.C.A.N. 1645, 1856.

21. Louis Kaplow, *The Standard Deduction and Floors in the Income Tax*, 50 TAX. L. REV. 1, 2 (1994).

22. James R. Hines Jr. et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179, 1185 (2010).

23. See H.R. REP. NO. 91-413, at 52 (1969), as reprinted in 1969 U.S.C.C.A.N. 1645, 1698.

expenditure attributed to the charitable deduction.<sup>24</sup> Put differently the wealthy are much more likely to claim charitable deductions than most other Americans.

## II. THE CHARITABLE DEDUCTION AS PART OF AN IDEAL TAX BASE

The first possible defense for the charitable deduction portrays charitable donations as essential to an ideal tax base.<sup>25</sup> In order to appropriately evaluate this argument, this Part will first examine the theory of an income tax and the theory of gifts generally, and then apply these theories specifically to the charitable deduction.

### A. *Theory of an Income Tax*

Typically an income tax attempts to measure each taxpayer's ability to pay, which is judged as his or her capacity to shoulder the costs of government.<sup>26</sup> Income can be evaluated by the fundamental definition established by Henry Simons: income equals consumption plus change of wealth.<sup>27</sup> This formula is also commonly known as the Haig-Simons definition of income because Simons refined the work of Robert Haig.<sup>28</sup> Since this definition depends on the net change in wealth of an individual, expenditures for items other than consumption are considered negative changes of wealth and deductible from income.<sup>29</sup> For this reason ordinary business expenses are seen as nonconsumption and deductible, while business expenses whose benefit extends over time may be capitalized or depreciated to reduce income.<sup>30</sup> Although this idealized equa-

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24. CONG. BUDGET OFFICE, THE DISTRIBUTION OF MAJOR TAX EXPENDITURES IN THE INDIVIDUAL INCOME TAX SYSTEM 15 (2013), available at [https://www.cbo.gov/sites/default/files/43768\\_DistributionTaxExpenditures.pdf](https://www.cbo.gov/sites/default/files/43768_DistributionTaxExpenditures.pdf).

25. See, e.g., Andrews, *supra* note 3, at 314–15, 346 (advancing the original argument that a taxpayer does not consume funds donated to charity and therefore such funds are not income); cf. Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND. L.J. 947, 977 (2005) (arguing that donations to charities are communal consumption and therefore not income).

26. RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 232–33 (5th ed. 1984).

27. HENRY C. SIMONS, PERSONAL INCOME TAXATION 50 (1938).

28. See Mary Louise Fellows, *A Comprehensive Attack on Tax Deferral*, 88 MICH. L. REV. 722, 723 (1990).

29. See SIMONS, *supra* note 27 (explaining how changes in wealth are incorporated into income tax).

30. See IRS, PUBLICATION 946, at 3 (2013), available at <http://www.irs.gov/pub/irs-pdf/p946.pdf> (explaining how as opposed to capitalization, which deducts

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tion does not accurately describe the current American tax regime, it does help explain which deductions and exclusions are conceptually necessary parts of the tax regime and which are expenditures designed to achieve some other purpose.

*B. Theory of Gifts and Income*

In tax law a gift from one taxpayer to another presents a particular problem for deciding who should pay taxes on the change in wealth associated with the gift. Three possibilities present themselves: (1) taxing the recipient without taxing the giver, (2) taxing both the recipient and the giver, (3) taxing only the giver.<sup>31</sup> This Subpart explains the rationale for each position.

First, a tax regime might tax the gift as income to the recipient but not to the giver. Practically this approach would require the recipient to include the gift in his or her income, and the giver would need to specifically deduct the gift from his or her income. Conceptually the recipient should include this income because he or she has enjoyed an increase in net wealth as a result of the gift. Accordingly this approach has been called the “standard of living” theory of gift taxation.<sup>32</sup>

At the same time two justifications have been offered to explain why the giver should deduct the amount of the gift from income. As one defense for the giver’s deduction, scholars have suggested that it avoids double taxation on funds already taxed to the recipient.<sup>33</sup> In other words, since the value added to society has already been taxed once, it need not be taxed again. This approach makes the fundamental assumption that the income tax should only include *societal* accessions to net wealth. However, as seen from

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a business cost upon the future occurrence of a single, discreet sale, “[d]epreciation is an annual income tax deduction that allows you to recover the cost or other basis of certain property over the time you use the property”); IRS, PUBLICATION 551, at 3 (2014), *available at* <http://www.irs.gov/publications/p551/ar02.html> (explaining that “[t]o capitalize means to include certain expenses in the basis of property you produce or in your inventory costs rather than deduct them as a current expense,” and only deducting those expenses from profits when the property is sold or otherwise disposed).

31. This section draws selectively from Marjorie Kornhauser’s excellent article on this subject. Marjorie Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1, 28–37 (1992); *see also* U.S. DEP’T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 36–38 (1977).

32. *See* U.S. DEP’T OF THE TREASURY, *supra* note 31, at 36.

33. Douglas A. Kahn & Jeffrey H. Kahn, “Gifts, Gifts, and Gifts”—*The Income Tax Definition and Treatment of Private and Charitable “Gifts” and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 460 (2003).

the theoretical discussion of income taxation above, the income tax is a means to determine *individual* ability to pay and thereby distribute the costs of government to each taxpayer. As such a societal perspective on aggregate accession to wealth does little to help determine the individual's ability to pay and therefore should be avoided.<sup>34</sup>

As a more convincing reason to deduct a gift from the benefactor's income, other scholars have suggested that gifts are negative changes in wealth for givers and also do not represent personal consumption.<sup>35</sup> Therefore gifts fall outside of the Haig-Simons definition of income. This approach assumes that to qualify as a part of income, consumption must be personal to the taxpayer. In the case of a gift, it will be the recipient, not the giver, who will one day consume the gift. Therefore the giver should deduct the value of the gift from his or her income.

However, proponents of the second approach to gifts—that both the recipient *and* the giver should pay income taxes on the gift—argue that the giver also enjoys consumption during the giving process.<sup>36</sup> After all *something* must motivate the giver and that something is consumed by the taxpayer when bestowing the gift to the recipient. As one possibility the motivation for giving may be the feeling of satisfaction enjoyed when a giver can help another person.<sup>37</sup> Alternatively a gift may garner goodwill or respect for the giver, either from the recipient or from onlookers.<sup>38</sup> Just as much as the gift will qualify as consumption for the recipient if he or she immediately uses it to purchase food, the gift also represents consumption for the giver because he or she immediately enjoys intangible but real benefits.<sup>39</sup> Therefore both the recipient and the giver should pay taxes on the gift, which requires the recipient to include the gift as an item of income in his or her tax return, and requires the giver not to deduct the gift from his or her income. Accordingly this approach has been called the “ability-to-pay” theory of gift taxation.<sup>40</sup>

Supporters of the third approach—that only the giver needs to pay taxes on the gift—acknowledge that such a system actually

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34. See, e.g., Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 74–75 (1990).

35. Andrews, *supra* note 3, at 314–15.

36. Kornhauser, *supra* note 31, at 37.

37. Kelman, *supra* note 3, at 846–51.

38. See *id.* at 880.

39. See Kahn, *supra* note 35, at 460.

40. U.S. DEP'T OF THE TREASURY, *supra* note 31, at 36.



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serves as a substitute for the first approach, which requires taxation of the recipient only.<sup>41</sup> This approach is particularly important because it is the solution used by the current American tax code.<sup>42</sup> At least from the perspective of the government, the substitute works because the Treasury does not lose any tax revenue and may likely collect increased revenues when the giver is taxed for the amount of the gift.<sup>43</sup> This approach depends on the assumption that givers are usually equally wealthy as, or wealthier than, the recipient. That assumption is important in progressive tax systems like that of the United States, where marginal tax rates increase with greater ability to pay.<sup>44</sup> Thus if the giver has equal or greater ability to pay than the recipient and the giver pays tax on the gift in place of the recipient, the Treasury will receive an equal or greater percentage of the value of the gift from the giver than it would have from the recipient. What is more, the system is highly administratively efficient because the giver passively pays tax on the gift by simply refraining from deducting the gift from his or her adjusted gross income while the recipient need not take any extra steps to include the gift on his or her tax return.<sup>45</sup> In other words, in order for the giver to pay taxes on the gift, both recipient and giver can simply and passively maintain the status quo.

However, according to proponents of the second approach, which requires taxation of both the recipient and the giver, the current American system incompletely taxes the gift transaction.<sup>46</sup> By taxing only the giver, the government fails to recognize and collect the tax obligation of the recipient. The recipient enjoys increased ability to pay after receiving the gift but does not pay any greater taxes. As a result the Treasury will indeed receive less revenue than it should. Therefore, for those who strongly believe in taxing both parties to a gift transaction, simply leaving the tax obligation with the giver deviates greatly from an ideal income tax.

*C. Application of Theory to the Charitable Deduction*

If the first approach to gifts is adapted to the context of the charitable deduction, the result is that no one pays taxes on funds donated to charity. The donor as giver will deduct from income those funds he or she gives to a charitable institution, and the chari-

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41. Kornhauser, *supra* note 31, at 35.

42. *Id.*

43. *Id.* at 36.

44. *Id.* at 26.

45. *Id.* at 35.

46. *Id.*

table institution as recipient will not pay taxes on the gift because, although the recipient should theoretically be taxed on a gift, the recipient here enjoys a zero tax bracket.

This approach still depends on the assumption that charitable giving is not personal consumption and therefore also not taxable, but that assumption may have an even stronger justification for a charitable donation than for a gift to a particular individual. As William D. Andrews originally explained, charitable donations are invested into “common goods,” which are goods whose “enjoyment is not confined to contributors nor apportioned among contributors according to the amounts of their contributions.”<sup>47</sup> Like taxes, charitable donations also serve to “reduce private consumption and accumulation in order to free resources for public use.”<sup>48</sup> A charitable donation thereby grants the enjoyment of such goods to all taxpayers, not just the donor, and the donor therefore gains no greater ability to pay from the monies donated to charity than any other taxpayer. Accordingly these monies should be excluded from the donor’s taxable income.

Proponents of the second approach to gifts—where the donor and recipient of the gift are both taxed—have criticized Andrews for ignoring consumption stemming from feelings of satisfaction,<sup>49</sup> but Andrews was aware of this criticism.<sup>50</sup> He responded that, even if the donor benefited from feelings of satisfaction, these psychological benefits were not consumption because satisfaction is an inexhaustible resource.<sup>51</sup> More specifically, Andrews believed there was unlimited potential for satisfaction in the world because anyone could benefit from feelings of satisfaction without another person losing the opportunity to derive his or her own satisfaction similarly.<sup>52</sup> As such, just as the donor’s consumption of satisfaction was no greater than any other taxpayer who inevitably had equal access thereto, the donor’s ability to pay was also no greater than any other taxpayer.<sup>53</sup>

However, even if satisfaction is not a form of consumption, proponents of the second approach to gifts also argue that charita-

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47. Andrews, *supra* note 3, at 346.

48. *Id.* at 313.

49. *See, e.g.*, Kelman, *supra* note 3, at 848–49.

50. *See* David E. Pozen, *Remapping the Charitable Deduction*, 39 *CONN. L. REV.* 531, 548 (2006) (citing and elucidating Andrews’s argument).

51. *Id.*

52. Andrews, *supra* note 3, at 356.

53. *See id.* (arguing that a donor’s satisfaction can be enjoyed without “diverting economic resources away from other people”).

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ble giving provides consumption in the form of reputational benefits.<sup>54</sup> Indeed these benefits are potentially even more discernible in the charitable context than when giving to individuals. For example, only a few people can “give the most” in any one community or receive recognition through the naming of an institution’s building in their honor.<sup>55</sup>

As a counterargument to the idea that charitable giving is consumption, Boris Bittker postulated that whatever benefits charitable giving affords the giver, the decision to donate is also motivated by a sense of moral obligation that makes charitable giving nonvolitional, not consumption, and ultimately a deductible negative change to wealth.<sup>56</sup> Just like large medical expenses may be deducted from income under current law,<sup>57</sup> all nonvolitional payments should be deducted from income because taxpayers cannot choose how to use resources that must satisfy these nonvolitional expenses. Supporting this idea one comprehensive study has indeed shown that a clear majority of donations are motivated by feelings of obligation.<sup>58</sup>

However, Bittker’s counterargument can be challenged on two grounds. First, the medical expenses deduction only applies to unusually large medical costs beyond ten percent of a taxpayer’s adjusted gross income.<sup>59</sup> In other words only unusually high medical costs exceed normal consumption, but medical costs below this amount are seen as normal consumption for all taxpayers. Such medical costs do not reduce the taxpayers’ ability to pay. If all citizens feel an equal obligation to give to charity, then the nonvolitional aspects of charitable giving may also represent normal consumption and therefore ability to pay. Second, medical expenses that stave off mortality or morbidity are better examples of nonvolitional spending than moral obligations, which are premised on religious and ethical life choices. While normative questions remain about exactly when individuals have freedom of choice, it seems intuitive that medical expenses should be more readily embraced as nonconsumption than charitable deductions.

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54. See Gergen, *supra* note 3, at 1408.

55. See *id.*

56. See Bittker, *supra* note 3, at 58–59.

57. See I.R.C. § 213 (2012).

58. James N. Morgan et al., *Results from Two National Surveys of Philanthropic Activity*, in 1 RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS: HISTORY, TRENDS, AND CURRENT MAGNITUDES 157, 205 (1977), available at <http://files.eric.ed.gov/fulltext/ED143602.pdf>.

59. I.R.C. § 213(a) (2012).

Proponents of the third approach to the taxation of gifts will likely argue that, especially where the recipient charitable organization will not pay taxes on these funds, someone should pay taxes on them, and the donor seems like the best substitute.

In summary it seems that there is good reason to include charitable donations in an ideal tax base. As with the general approach to gifts that both giver and recipient should pay taxes, the giver likely receives benefits of reputation and possibly also satisfaction. As such he or she enjoys consumption when donating, and therefore his or her donations remain fundamentally taxable as part of the tax base. Alternatively the donor should be taxed as a substitute for the recipient charity because the charity enjoys a zero tax bracket and therefore never pays taxes on the funds it receives.

If the charitable deduction is not an essential part of the ideal income tax, then another justification for the charitable deduction will have to be offered.

### III. THE CHARITABLE DEDUCTION AS A TAX SUBSIDY FOR PUBLIC GOODS

An even more popular argument for the charitable deduction is that it serves as a subsidy for “public goods,”<sup>60</sup> resources that the government must provide because the private market will not achieve the optimal level of output. In contrast to the previously discussed defenses of the charitable deduction, this argument takes for granted that charitable donations should theoretically be included in income. However, since the government must provide certain public goods, proponents of the subsidy argument believe that donations to organizations providing these public goods should be deducted from income.<sup>61</sup>

In order to evaluate this argument, this Part first addresses the theory of public finance attributed to noted economists Richard and Peggy Musgrave. Then this Part presents the subsidy argument generally. Finally this Part applies the theory of public finance to various iterations of the subsidy argument.

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60. See John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 686 (2001); Pozen, *supra* note 50, at 553; *Developments in the Law: Nonprofit Corporations*, 105 HARV. L. REV. 1578, 1620 (1992).

61. Pozen, *supra* note 50, at 552.

### A. *Theory of Public Finance*

Like many American economists the Musgraves start with the dual premises that goods should normally be produced at the levels desired by consumers and that those preferences are best revealed through private, decentralized transactions that occur freely, without government intervention.<sup>62</sup> This process allows consumers to communicate their preferences through the prices they are willing to pay for such goods.<sup>63</sup> Goods produced in this decentralized fashion are known as “private goods.”<sup>64</sup>

However, there are times when the private market cannot accurately demonstrate consumer preferences.<sup>65</sup> “Market failure” could result from the fact that some goods may be either *nonrivalrous* or *nonexcludable*.<sup>66</sup> Since these goods must be provided by society collectively, the Musgraves call them *social goods*, and they are often also called *public goods*.<sup>67</sup>

Nonrivalrous goods are those goods whose benefit is not depleted by another consumer’s use.<sup>68</sup> For example streetlights can benefit multiple consumers at one time. The private market is unlikely to provide nonrivalrous goods according to the actual preferences of consumers; because more than one person can benefit from a nonrivalrous good, each individual has a rational incentive to conceal the price he or she would be willing to pay for that good.<sup>69</sup> In other words nonrivalrous goods create circumstances ripe for so-called *free riders* to wait on the sidelines for other members of society to pay for those goods.<sup>70</sup>

Nonexcludable goods create similar problems for private markets. These goods cannot be excluded from other consumers.<sup>71</sup> For instance an asteroid defense program would defend all of planet earth, but since every human being would thereby benefit, each individual consumer would have no rational incentive to pay his or her true willing price to achieve that protection since it is possible that the rest of humanity would provide sufficient funds without

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62. MUSGRAVE & MUSGRAVE, *supra* note 26, at 5.

63. *Id.* at 42.

64. *Id.*

65. *Id.* at 43.

66. *Id.*

67. *Id.*

68. RICHARD CORNES & TODD SANDLER, *THE THEORY OF EXTERNALITIES, PUBLIC GOODS, AND CLUB GOODS* 8 (2d ed. 1996).

69. MUSGRAVE & MUSGRAVE, *supra* note 26, at 43.

70. *Id.*

71. *Id.*

any one particular consumer's contribution.<sup>72</sup> This dilemma also creates free riders.<sup>73</sup>

In the case of public goods, the government must intervene and provide these goods, thereby working as a coercive intermediary between consumers and the allocation of that good.<sup>74</sup> The government uniquely has the sovereignty to determine consumers' preferred level of output of a public good, provide the good, and then force consumers to pay the price of their preference.<sup>75</sup> The central problem is accurately determining consumer preferences without private market exchanges. In representative democracies like the United States, consumers vote for legislators who will translate constituent preferences into public goods policies.<sup>76</sup> Since ultimately the government can coerce citizens to pay for the agreed allocation level of public goods, voters have incentives to accurately express their preferences in elections.

### B. Overview of Subsidy Argument

The U.S. Supreme Court itself has portrayed the charitable deduction as a type of subsidy for public goods:

Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual's contributions.<sup>77</sup>

As can be seen from this explanation by the Supreme Court, the charitable deduction can very well be understood as an indirect government subsidy for charitable organizations.

To better understand how the deduction may be conceived as a subsidy, consider the following example. When someone from the thirty-five percent tax bracket contributes to a charity and deducts the amount of the donation from their taxable income, he or she essentially gives money to the charity that would have otherwise gone to the government. For instance, if a taxpayer in the thirty five percent tax bracket gives one hundred dollars to the World Wildlife

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72. Thayer Watkins, *Public Finance*, SAN JOSÉ STATE UNIV. ECON. DEP'T, <http://www.sjsu.edu/faculty/watkins/?e132.htm> (last visited March 7, 2014).

73. MUSGRAVE & MUSGRAVE, *supra* note 26, at 44.

74. *Id.*

75. *Id.* at 72.

76. *Id.*

77. *Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 544 (1983).

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Fund (WWF), thirty-five dollars—as thirty-five percent of that donation—goes to the charity instead of the government. Accordingly it can be understood that the taxpayer donated sixty-five percent, or sixty-five dollars, to the WWF, and that the government contributed the other thirty-five dollars by forgoing an equivalent amount of tax revenue this year. The government has essentially subsidized the WWF.

Yet the argument goes even further. The Joint Committee on Taxation has assumed that, if the charitable deduction did not provide subsidies to charitable organizations, the government would have needed to provide those same funds in the same amount through a direct allocation.<sup>78</sup> Therefore the deduction “stimulates charitable giving, thereby providing more funds for worthwhile nonprofit organizations, many of which provide services that otherwise might have to be provided by the Federal Government.”<sup>79</sup>

Moreover the U.S. Supreme Court has supported this position:

When the Government grants exemptions or allows deductions all taxpayers are affected; the very fact of the exemption or deduction for the donor means that other taxpayers can be said to be indirect and vicarious “donors.” Charitable exemptions are justified on the basis that the exempt entity confers a public benefit—a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues.<sup>80</sup>

Similarly a House Report has stated that the charitable deduction simply provides money that the government would otherwise have to spend:

The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.<sup>81</sup>

Thus it is widely believed within the federal government that there is equivalence between direct government financing of public

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78. STAFF OF J. COMM. ON TAX'N, 97TH CONG., GEN. EXPLANATION OF THE ECON. RECOVERY TAX ACT OF 1981, at 49 (Comm. Print 1981).

79. *Id.*

80. *Bob Jones Univ. v. United States*, 461 U.S. 574, 591 (1983).

81. H.R. REP. NO. 75-1860, at 19 (1938) (discussing the Revenue Bill of 1938).

goods and indirect subsidies for charities via the charitable deduction.

*C. Application of Theory to the Charitable Deduction*

The charitable deduction is allocated in a way that resembles the mechanisms by which both private and public goods are usually provided, complicating the comparison between the charitable deduction and government allocation of private goods. As with public goods, the government is funding the allocation of resources through the charitable deduction.<sup>82</sup> Like private goods, though, individual private market exchanges between donors and charities indirectly determine where that funding goes, thereby allowing market forces to set the level of goods that are provided to consumers.<sup>83</sup> This middle ground makes evaluating the charitable deduction as a subsidy for public goods somewhat difficult.

First, one could ask why the subsidy is even necessary if a private market for charitable donations exists. This private market for charitable giving is the competitive field in which charities vie with one another for charitable donations by advertising their effectiveness and unique mission. These charitable institutions offer consumers the opportunity to advance a particular worthy cause for the price of a contribution, and consumers respond by paying a price that demonstrates the degree to which they individually value the cause. As with any market, consumer preferences for charitable goods could therefore be measured by summing the total donations that private households choose to contribute to nonprofit organizations. Indeed if the deduction only subsidizes a portion of the approximately 300 billion dollars donated in a given year,<sup>84</sup> then a private market for charitable donations seemingly does already exist.

In response one could suggest that private market forces for charitable donations still fail to fully express the preferences of consumers. Admittedly this Note presents the argument that the exchange between donors and charities may involve trading cash contributions for equivalently valued levels of satisfaction or reputation.<sup>85</sup> If donors in fact make this calculation, then the market for satisfaction and reputation should efficiently produce the amount

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82. See Benshalom, *supra* note 2, at 1050.

83. See *id.* at 1064.

84. STAFF OF J. COMM. ON TAX'N, 113TH CONG., PRESENT LAW AND BACKGROUND RELATING TO THE FEDERAL TAX TREATMENT OF CHARITABLE CONTRIBUTIONS I (Comm. Print 2013) (providing the amount contributed in 2011).

85. See *supra* Part II.B.



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of charitable activity that consumers (as donors) collectively desire. Yet there are certain free rider problems in this exchange that incentivize small individual donations that in the aggregate fail to provide the level of charitable funding that consumers would otherwise desire. For instance, at a fundraising event where everyone else is writing small checks for a single orphanage, a taxpayer may also write a small check in order to protect his or her reputation. Yet that taxpayer might be willing to spend much more to pay for a comprehensive, nationwide foster care system as a means to protect children generally, and indeed would do so if not for a fear that other citizens might shirk and free ride off his or her greater contribution. In this example what distinguishes the fundraising event for a single orphanage and contributions for a larger network of children's services is the rivalrous and excludable nature of reputation. As previously explained, rivalrous and excludable goods are those goods whose enjoyment is limited or can be limited to parties who pay for them.<sup>86</sup> At the fundraiser the good reputation of being a supporter of an orphanage is limited to those attendees of the fundraiser who make a donation and it is withheld from nondonating attendees.

In contrast, when considering whether to contribute to a nationwide foster care system many citizens might find emotional meaning in knowing that all orphans throughout the country are receiving care and assistance. However, since this nationwide system could be supported by some contributors while other noncontributors could enjoy knowing children were safe without paying, free riding would prevent all taxpayers from making donations that truly conveyed their individual preferences for foster care. Put differently, without government intervention, there are no further rivalrous and excludable reputational benefits to motivate this taxpayer to pay for the nationwide system once the smaller check is written. Thus the private market for charitable giving may not fully express consumers' preferred levels of a public good. For this reason subsidies are likely necessary to provide some part of the public goods desired.<sup>87</sup>

However, if the subsidy helps to provide public goods that otherwise would not be provided, the question remains how decentralized distribution of these would-be subsidies accurately identifies consumer preferences. In the absence of perfect private markets,

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86. *Id.*

87. The idea that charities too may suffer from free rider situations has been briefly suggested in Harold M. Hochman & James D. Rodgers, *The Optimal Tax Treatment of Charitable Contributions*, 30 NAT'L TAX J. 1, 2 (1977).

democratic voting would express these preferences, but the charitable deduction seemingly removes that power from voters and places it in the hands of each potential donor. This raises questions about the legitimacy and usefulness of the charitable deduction in providing public goods.

Quite creatively, Saul Levmore has suggested one solution. He coined the phrase “Taxes as Ballots” to describe the use of charitable deductions as miniature votes used by taxpayers to express their desire that certain causes receive government funding.<sup>88</sup> In fact Levmore thought that the charitable deduction might even more accurately gauge consumer preferences than normal elections.<sup>89</sup> Namely, majoritarian politics only accurately represent the preferences of the majority of voters and neglects the preferences of the minority.<sup>90</sup> Counteracting that effect, the deduction allows taxpayers to vote in proportion to their exact level of preference because as citizens contribute more of their own money to a charitable institution the government simultaneously increases its appropriations to the charity through the charitable deduction.<sup>91</sup>

Despite its creativity this approach remains open to opposition based on certain political realities. Despite the tenets of American republican democracy, the wealthy already have ways to gain more access to lawmakers than other Americans through, for example, more resources for campaign financing, relevant social networks, and greater access to information.<sup>92</sup> Rather than empowering the voices of disenfranchised voters whose minority views are drowned out by majoritarian politics, the charitable deduction actually may further enmesh wealthy minorities that already command political influence in determining policies like the provision of public goods.<sup>93</sup>

Yet there are likely wealthy citizens on both sides of any major issue who can counterbalance views that prevail in the legislature. For instance, as federal funding for scientific research plummeted in the 2000s, private philanthropy from wealthy donors increased and supplanted some of the missing federal funds.<sup>94</sup> Similarly when

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88. Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387, 404–05 (1998).

89. *Id.* at 388–89.

90. MUSGRAVE & MUSGRAVE, *supra* note 26, at 89.

91. Levmore, *supra* note 88, at 405.

92. See Benshalom, *supra* note 2, at 1068; see also Larry Bartels, *Rich People Rule!*, WASH. POST (Apr. 8, 2014), <http://www.washingtonpost.com/blogs/monkey-cage/wp/2014/04/08/rich-people-rule>.

93. See Benshalom, *supra* note 2, at 1068.

94. William J. Broad, *Billionaires with Big Ideas Are Privatizing American Science*, N.Y. TIMES, Mar. 15, 2014, at A1.

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a Republican Congress took power in 1994 and drastically cut funding to the National Endowment for the Arts, private funding for the arts increased sixty cents for every dollar of federal funding lost.<sup>95</sup>

Nonetheless, at least as the charitable deduction is currently structured, contributions from wealthy members of the political minority only approximate the preferences of that minority. However, the minority still has no way of policing free riding within its own ranks, and therefore although wealthy minority donors help to counterbalance majority decisions, they do so only by approximation, not through an accurate accounting of minority preferences.<sup>96</sup>

Therefore it seems that the charitable deduction may be useful for discerning some consumer preferences, but its limitations indicate that another explanation must be offered to fully explain the deduction's existence in the tax code.

*D. Efficiency of the Charitable Deduction as a Decentralized Subsidy*

Although it seems that the charitable deduction cannot fully express consumer preferences, there is still value to discussing whether the decentralized nature of the charitable deduction could potentially serve as an efficient subsidy. Particularly if future political decisions authoritatively demonstrate consumer preferences for the exact desired level of a public good, then a decentralized subsidy might be useful in locating the most efficient producer for those goods. For example, if legislatures eventually passed a comprehensive school voucher system that annually set the amount of funding per student, the subsidy would adequately demonstrate consumer preferences for the public good of education, and the distribution of the subsidy of the school voucher would greatly resemble that of the charitable deduction. Parents would reinvest the voucher subsidies in the school they thought best met their children's needs. Therefore the efficiency of subsidization through the charitable deduction will now be considered in comparison to the efficiency of subsidization through government production of public goods.

It should be noted that the debate over whether the government or the private sector is most effective at producing public goods dominates politics and extends well beyond the confines of

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95. Jane K. Dokko, *Does the NEA Crowd Out Private Charitable Contributions to the Arts?* 1 (Fed. Reserve Bd. Finance & Economics Discussion Series, Nov. 2007), available at <http://www.federalreserve.gov/pubs/feds/2008/?200810/200810pap.pdf>.

96. See *supra* note 90 and accompanying text.

this Note.<sup>97</sup> Much more empirical evidence is required and likely will be produced. The debate will continue for years to come. Nonetheless, certain observations can help resolve some of the doubts cast on decentralized subsidization.

Importantly, proponents of the subsidy defense of the charitable deduction believe charitable organizations are actually more efficient and capable than the government in funding public needs.<sup>98</sup> An important example of the potential efficiency of private donations may be seen in the context of primary education. In the United States, a 2006 Department of Education study demonstrated that private school students achieved between eight and eighteen points higher than their public school peers in math and reading assessments.<sup>99</sup> The World Bank conducted a similar study across five different countries and also found private school education to be superior.<sup>100</sup> In Chile, although a study found no significant difference between public and private school students after a voucher system was instituted it did find that the same level of proficiency cost much less for the private schools.<sup>101</sup>

Generally nonprofits benefit from private market competition, even as they provide public goods.<sup>102</sup> This offers two possible ways in which charitable spending is better than government spending. First, competition for donors forces nonprofits to innovate and experiment as they try to produce better practices to impress potential contributors.<sup>103</sup> Second, it has also been suggested that charitable contributions encourage citizens to actively monitor charitable organizations.<sup>104</sup> Since donors are concomitantly spend-

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97. See, e.g., Timothy Besley & Maitreesh Ghatak, *Government Versus Private Ownership of Public Goods*, 116 Q. J. ECON. 1343 (2001).

98. Pozen, *supra* note 50, at 558–59.

99. NAT'L CTR. FOR EDUC. STATISTICS, U.S. DEP'T OF EDUC., NCES NO. 2006-461, NATIONAL ASSESSMENT OF EDUCATIONAL PROGRESS: COMPARING PRIVATE SCHOOLS AND PUBLIC SCHOOLS USING HIERARCHICAL LINEAR MODELING iii–iv (2006).

100. Emmanuel Jimenez et al., *The Relative Efficiency of Private and Public Schools in Developing Countries*, 6 WORLD BANK RES. OBSERVER 205, 205 (1991) (evaluating schools in Colombia, the Dominican Republic, the Philippines, Tanzania, and Thailand).

101. Patrick J. McEwan & Martin Carnoy, *The Effectiveness and Efficiency of Private Schools in Chile's Voucher System*, 22 EDUC. EVALUATION & POL'Y ANALYSIS 213, 213 (2000).

102. James R. Hines Jr. et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 Mich. L. Rev. 1179, 1199 (2010).

103. David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 TAX L. REV. 221, 224 (2009).

104. Levmore, *supra* note 88, at 406.

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ing their own resources at the same time as distributing the government's money, they have an incentive to invest in causes to the degree, indeed to the dollar proportion, that they trust the nonprofit's administrators and believe in the organization's efficacy.<sup>105</sup> Even if donors are looking primarily for satisfaction, knowledge of an institution's effectiveness likely adds to the satisfaction received when contributing to that particular organization. Thus donors will sometimes demand greater responsiveness and reporting than the government might.<sup>106</sup> Many donors also can contribute a rich skill set from their professional lives to the organization to which they donate if they actively advise and critique the managers of that organization.<sup>107</sup>

Nonetheless there are at least five potential concerns with subsidizing charitable organizations through a decentralized subsidy. The first potential issue with the charitable deduction is that government revenue forgone for the deduction may not increase charitable spending. The second issue is that charitable spending produces significant labor costs in order to hire workers to fundraise for and manage the charity. The third issue is unpredictability stemming from inconsistent donor financing. The fourth issue concerns oversight of charitable activities. The fifth issue concerns the lack of coordination between charitable organizations in a competitive nonprofit market. Those issues will now be explored in more detail.

### 1. The Charitable Deduction as Stimulating Giving

As the first and most basic problem with subsidy efficiency, the deduction may not stimulate any greater funding for public goods because donors may contribute the same aggregate amount, whether or not the government offers a subsidy. If the deduction does not increase contributions at all, then the government should not offer a subsidy because donors would make up the difference anyway, even if the government contributed nothing.<sup>108</sup> Indeed if the deduction does not significantly increase giving, then there is

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105. *Id.*

106. See Schizer, *supra* note 103, at 258–63.

107. *Id.* at 259.

108. See Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert*, 66 TENN. L. REV. 687, 715 (1999). But see Jonathan Gruber & Daniel M. Hungerman, *Faith-Based Charity and Crowd-Out During the Great Depression*, 91 J. PUB. ECON. 1043, 1043 (2007) (attempting to demonstrate that New Deal spending reduced church spending on poverty).

no reason to waste Treasury money to fund charitable payments that would happen anyway without government intervention.

However, there is evidence that the charitable deduction is at least partially effective in stimulating giving among the wealthy. Although many studies debate the behavioral effects of the charitable deduction on society in general,<sup>109</sup> scholars have found consensus that the charitable deduction encourages the wealthy to give more.<sup>110</sup> In fact, there is good reason for the rich to consider taking the charitable deduction because the deduction offers the rich much greater relief from their higher marginal tax rates than poorer taxpayers.<sup>111</sup> For that reason, when their marginal tax rates are lower, the rich tend to make fewer charitable donations.<sup>112</sup> For example, in the 1980s marginal tax rates decreased, and although these rate cuts did not reduce giving among the general population,<sup>113</sup> wealthy taxpayers demonstrated sensitivity to the tax cuts, and their contributions noticeably decreased.<sup>114</sup> Much as one would expect, since the benefits of deductions were subdued by lower tax rates, the rich had less incentive to give and therefore gave less.

Moreover the wealthier classes who seem most sensitive to the charitable deduction also seem to provide a significant amount to charity. In the aggregate the poorest forty-nine percent of Americans have been shown to give only sixteen percent of all donations.<sup>115</sup> In contrast it appears that the top fourteen percent give just under fifty percent of all donations.<sup>116</sup> Thus the class most sensitive to the charitable deduction also gives almost half of all charitable contributions. In that way the charitable deduction is at least a partial success in motivating donations. More generally any decentralized subsidy could be similarly evaluated as to whether it increased funding of private organizations.

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109. See, e.g., Ellen P. Aprill, *Churches, Politics, and the Charitable Contribution Deduction*, 42 B.C. L. REV. 843, 857–59 (2001).

110. *Id.*

111. See, e.g., Levmore, *supra* note 88, at 414.

112. Charles T. Clotfelter, *The Impact of Tax Reform on Charitable Contributions* 23 (Nat'l Bureau of Econ. Research, Working Paper No. 3273, 1990), available at <http://www.nber.org/papers/w3273>.

113. Benshalom, *supra* note 2, at 1060.

114. Clotfelter, *supra* note 112, at 23.

115. Morgan et al., *supra* note 58, at 227. Although this study is from 1977, this Note assumes that the distribution of overall charitable giving has not significantly changed in the last forty years.

116. *Id.*

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## 2. *Organizational Overhead for Charities Exceeding Bureaucratic Costs for Government Agencies*

The nonprofit sector maintains significant overhead to run its fundraising operations to attract new donors. Charities must necessarily employ staff to market their charitable goals and achievements.<sup>117</sup> Therefore large amounts of donations, including those financed by the charitable deduction, are diverted to overhead costs, not the charitable missions of the charity.<sup>118</sup> Indeed charitable institutions only expect that sixty percent to eighty percent of their budgets will be used on programs.<sup>119</sup> Yet federal agencies also hire large bureaucracies to run their services, which creates significant costs. The Congressional Budget Office estimated in 2011 that about fifteen percent of all government discretionary spending went to federal workers' salaries.<sup>120</sup> As a result both federal and nonprofit workforces can be seen as costly, and it is not necessarily clear whether either setup is significantly more efficient than the other.

## 3. Unpredictability in Donations Reducing Charitable Efficiency

Relying on the whims of donor financing produces ups and downs for the finances of charitable organizations, especially during economic downturns when social welfare organizations are perhaps most needed. This unpredictability may reduce efficiency because organizations cannot make certain long-term investments without a reliable revenue stream.<sup>121</sup> Yet recent research indicates that federal agencies similarly engage in wasteful spending due to uncertainty about their appropriated budgets.<sup>122</sup> Without knowing their actual needs over the course of the year, agencies may save money until the end of the budget cycle to wait and see what happens.<sup>123</sup> Then they frantically and inefficiently spend the money towards the end of the budget year in order to entirely deplete their

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117. See, e.g., *Frequently Asked Questions*, NAT'L CTR. FOR CHARITABLE STATISTICS, <http://nccs.urban.org/resources/faq.cfm> (last visited March 21, 2014).

118. Pozen, *supra* note 50, at 557–58.

119. See *Frequently Asked Questions*, *supra* note 117.

120. *Hearing on Discretionary Spending Before the J. Select Comm. on Deficit Reduction*, 112th Cong. 11 (2011) (statement of Douglas W. Elmendorf, Director, Congressional Budget Office).

121. Benshalom, *supra* note 2, at 1071.

122. See generally Jeffrey B. Liebman & Neale Mahoney, *Do Expiring Budgets Lead to Wasteful Year-End Spending? Evidence from Federal Procurement* (Nat'l Bureau of Econ. Research, Working Paper No. 19,481, 2013), available at <http://www.nber.org/papers/w19481.pdf>.

123. *Id.* at 1.

appropriated funds.<sup>124</sup> Agencies have incentives to use every last dollar of funding because they are worried that leftover funds will signal to Congress that they can operate with less funding.<sup>125</sup> This end-of-year blitz spending has been demonstrated to reduce the quality of government investment.<sup>126</sup> Thus budget uncertainty may reduce the efficiency of both government and nonprofit organizations in similar ways.

#### 4. Charitable Organizations Undergoing Less Oversight than Government Agencies

Since charitable organizations undergo limited oversight by the IRS, there is concern that nonprofits are ripe for abuse and waste.<sup>127</sup> As noted above, charitable organizations benefit from private market pressures that incentivize their performance.<sup>128</sup> Government agencies on the other hand benefit from review by a centralized agency like the Office of Management and Budget.<sup>129</sup> Yet charitable organizations are not entirely without government oversight. State attorneys general assume the responsibility of *parens patriae*, suing charitable organizations on behalf of the public for violating their charitable missions.<sup>130</sup> Indeed concern has grown that perhaps attorneys general are overly zealous in attempting to regulate charitable organizations.<sup>131</sup> Therefore charitable organizations undergo significant oversight.

#### 5. Charities Lending Themselves to Uncoordinated Planning More than Lawmaking

Since the charitable deduction distributes government subsidies without central planning, there is the risk that identical organizations might develop in parallel when a single, coordinated effort

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124. *Id.*

125. *See id.* at 2. However, prior to Liebman and Mahoney's paper, there was little empirical evidence to prove this assertion and only normative arguments. Larry R. Jones, *Outyear Budgetary Consequences of Agency Cost Savings: International Public Management Network Symposium*, 6 J. INT'L PUB. MGMT. REV. 139, 149 (2005).

126. Liebman & Mahoney, *supra* note 122, at 3. Measures of efficiency came from the government's IT Dashboard website which tracks trends in the perceived efficiency of various informational technology investments. *Id.* at 14.

127. Benshalom, *supra* note 2, at 1072.

128. *See supra* note 102 and accompanying text.

129. Joseph Cooper & William F. West, *Presidential Power and Republican Government: The Theory and Practice of OMB Review of Agency Rules*, 50 J. POL. 864 (1988).

130. *See* Evelyn Brody, *Whose Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 937, 937 (2004).

131. *Id.*



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might better achieve the missions of both organizations.<sup>132</sup> Alternatively, without central planning, some organizations may be under- or overfunded, and, unlike with government spending programs, no centralized authority can control this inefficient investment.<sup>133</sup> Yet political appropriations suffer from similar risks. The legislative process combines numerous regional interests represented by two chambers of Congress.<sup>134</sup> Pork barrel projects, opaque rider appropriations, and inconsistent tax expenditures are common features of legislative politics that divert funds to a patchwork of causes.<sup>135</sup> As such, it is far from clear that decentralized funding of charities is less efficient or even less coordinated than Congressional lawmaking.

#### IV. THE CHARITABLE DEDUCTION AS A SUBSIDY FOR CHARITABLE GIVING

As this Note has demonstrated, there are serious challenges for justifying the charitable deduction as part of an ideal income tax or as a subsidy for public goods. For that reason, this Note offers a new defense. Rather than arguing about the role of charitable funds themselves, this Note suggests that the deduction stems from an American ethic for charitable giving, and that the American people have normatively decided that charitable donations simply should not be taxed. In other words, as this Part will show, Americans want the charitable deduction to serve as a way of recognizing and rewarding charitable giving, which is a strongly held and popular American value. However, if the charitable deduction is recognition of the sacrifice inherent in donating to charity, then it must be available to a wider group of taxpayers, not only the wealthy. For that reason, the following Part discusses ways of extending tax benefits to nonitemizers. Ultimately this Part suggests a nonrefundable tax credit for charitable donations akin to that of the French tax regime; it also offers a proposal to reduce the resulting increased enforcement costs for the IRS.

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132. See Gergen, *supra* note 3, at 1402.

133. Benshalom, *supra* note 2, at 1071.

134. See Einer Elhauge, *Are Term Limits Undemocratic?*, 64 U. CHI. L. REV. 83, 133–35 (1997).

135. Gordon T. Butler, *The Line Item Veto and the Tax Legislative Process: A Futile Effort at Deficit Reduction, But a Step Toward Tax Integrity*, 49 HASTINGS L.J. 1, 6–8 (1997).

A. *The Charitable Deduction as a Subsidy to Recognize and Reward Giving*

As can be seen from the long history of charitable organizations and the ubiquity of charitable giving in America, the ethic of giving is firmly entrenched in the American ethos. From the Colonial Period voluntary associations and church groups have long been providing important public assistance.<sup>136</sup> Since that time charitable giving has become a regular feature of American life. When rated by the Charities Aid Foundation, the United States was considered the most generous country when volunteerism and willingness to help a stranger were also taken into account.<sup>137</sup> Whether poor or rich, around eighty percent of Americans give to charity each year.<sup>138</sup> Moreover in 2008 nearly a quarter of all charitable contributions came from nondeducted donations.<sup>139</sup>

Interestingly, when compared with other cultures, American society seems to also embrace the notion that charitable giving warrants reward and recognition. This difference can be seen by comparing American and European philanthropy. In contrast to British society, Americans believe that donors deserve a reward for giving.<sup>140</sup> For this reason it is no surprise that American society has produced myriad ways to give back to givers: from names on buildings to dinners of honor, and even sometimes small token gifts of appreciation.<sup>141</sup> Similarly visible giving in the United States is both

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136. See Peter Dobkin Hall, *A Historical Overview of Philanthropy, Voluntary Associations, and Nonprofit Organizations in the United States, 1600–2000*, in *THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK* 32, 34 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006).

137. CHARITIES AID FOUNDATION, *WORLD GIVING INDEX 2013: A GLOBAL VIEW OF GIVING TRENDS* 10 (2013), available at [https://www.cafonline.org/PDF/WorldGivingIndex2013\\_1374AWEB.pdf](https://www.cafonline.org/PDF/WorldGivingIndex2013_1374AWEB.pdf). In terms of the percentage of citizens who regularly contribute to charity, the United States ranked thirteen out of 135 countries evaluated. *Id.* at 18, 33–34. Although this figure demonstrates a relatively strong culture of generosity, the United States appears even more committed to charitable acts when one then considers the percentage of Americans who regularly help a stranger or volunteer time.

138. Karen Wright, *Generosity vs. Altruism: Philanthropy and Charity in the United States and United Kingdom*, 12 *VOLUNTAS: INT'L J. OF VOLUNTARY & NON-PROFIT ORGS.* 399, 405 (2001); see also Gallup Editors, *Most Americans Practice Charitable Giving, Volunteerism*, GALLUP (Dec. 13, 2013), <http://www.gallup.com/poll/166250/americans-practice-charitable-giving-volunteerism.aspx>.

139. Lillian V. Faulhaber, *The Hidden Limits of the Charitable Deduction: An Introduction to Hypersalience*, 92 *B.U. L. REV.* 1307, 1322–23 (2012).

140. Wright, *supra* note 138, at 411–12.

141. René Bekkers & Pamala Wiepking, *A Literature Review of Empirical Studies of Philanthropy: Eight Mechanisms That Drive Charitable Giving*, 40 *NONPROFIT & VOLUNTARY SECTOR Q.* 924, 934 (2011).

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tolerated and encouraged in a way that the British find ostentatious and tacky; whereas the naming of a highway after a private benefactor is a known phenomenon in the United States, it is rare elsewhere.<sup>142</sup>

Although these donation benefits may be seen as either rewards or incentives, they are usually portrayed to the general public as rewards.<sup>143</sup> Donors may view these gifts as rewards to recognize their generosity, while charities may view these gifts as incentives to draw more donations. For instance, the public broadcasting channel of New York, WNET, offers signature tote bags to contributors who give forty dollars or more, and the network believes the tote bag is “the most popular premium” offered for donations.<sup>144</sup> Nonetheless the tote bag is listed on the WNET website under the heading “Support THIRTEEN: Featured *Thank You* Gifts.”<sup>145</sup> Similarly institutions will organize dinners in honor of major donors,<sup>146</sup> even though the organizations may be using the publicity to fundraise from the social contacts of the honorees. In this way the line between incentives and rewards is blurred, and, at the very least, one can observe an American culture that prefers to portray these possible incentives as rewards.

Of course, as noted above, the IRS does not permit taxpayers to deduct the value of benefits that the donating taxpayer receives in return for a contribution.<sup>147</sup> As such it may appear as if the charitable deduction discourages rewarding charitable donations. Yet these rules may also be seen as preventing a redundant reward of a donation. If the charitable deduction is the politically designated financial reward for charitable giving, the donor should not be offered any other tangible reward for his or her generosity. Similarly if an organization already offered a material reward in return for a donation, the donation is less deserving of further recognition by exactly the value of the first reward received.

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142. Shellie Karabell, *Is Modern Philanthropy the Answer to Public Debt?*, FORBES (Nov. 30, 2014, 4:56 PM), <http://www.forbes.com/sites/shelliekarabell/2014/11/30/modern-philanthropy-the-answer-to-public-debt>.

143. See George E. Newman & Y. Jeremy Shen, *The Counterintuitive Effects of Thank-You Gifts on Charitable Giving*, 33 J. ECON. PSYCH. 973, 975 (2012).

144. Irwin Molotsky, *Your \$40 Pledge, Her \$3 Tote Bag*, N.Y. TIMES, March 12, 2000, at B1.

145. *Support THIRTEEN: Featured Thank you Gifts*, THIRTEEN, <http://support.thirteen.org/site/PageServer> (last visited May 21, 2014) (emphasis added).

146. See, e.g., Columbia College Alumni Association, *2014 Alexander Hamilton Award Dinner*, COLUMBIA COLLEGE (last visited May 21, 2014).

147. See *supra* note 18 and accompanying text.

The charitable deduction has remained intact since its passage by Congress.<sup>148</sup> Its endurance likely owes to the deduction's long-standing bipartisan support.<sup>149</sup> When polled about whether to eliminate the charitable deduction in order to lower debt and avoid higher taxes, nearly seventy percent of those Americans surveyed opposed repeal of the deduction.<sup>150</sup> Furthermore, as Levmore has stated, "Congress does not appear eager to reclaim for itself the decisionmaking authority that it has delegated away through the charitable deduction. This may be because the charitable deduction is politically popular . . . ."<sup>151</sup>

Even the conservative Tea Party implicitly supports the charitable deduction, despite the tax expenditures associated with it. When rumors spread that the Obama administration wanted to limit the deductibility of charitable donations for wealthier taxpayers, the Tea Party website posted a *Washington Post* article under its own title: "Charitable giving tax break at risk."<sup>152</sup> From the title it seems that the Tea Party considers the possible limitation on charitable deductions not as a beneficial reduction in government expenditures but rather as an undesirable increase in taxes. Sharing values similar to those of these fiscal conservatives, libertarian think tanks have similarly suggested that tax expenditures should *not* be equated with direct government expenditures and that the repeal of tax expenditures should be considered an unwanted increase in taxes.<sup>153</sup>

Legal scholarship also seems to have observed an American affinity for rewarding charitable donors. In addition to his comments on the moral obligation for charity, Bittker equated charity with altruism, and thought that the government should never tax altruism

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148. See Joseph J. Cordes, *Re-Thinking the Deduction for Charitable Contributions: Evaluating the Effects of Deficit-Reduction Proposals*, 64 NAT'L TAX J. 1013-14 (2011).

149. Wright, *supra* note 138, at 399.

150. Jeffrey M. Jones, *Americans Oppose Eliminating Income Tax Deductions*, GALLUP (April 5, 2011), <http://www.gallup.com/poll/147125/americans-oppose-eliminating-income-tax-deductions.aspx>.

151. Levmore, *supra* note 88, at 430.

152. Jerry Markon & Peter Wallsten, *White House, Nonprofit Groups Battle Over Charitable Deductions*, WASH. POST (Dec. 13, 2012), [http://www.washingtonpost.com/politics/white-house-nonprofit-groups-battle-over-charitable-deductions/2012/12/13/80e67400-43f2-11e2-9648-a2c323a991d6\\_story.html](http://www.washingtonpost.com/politics/white-house-nonprofit-groups-battle-over-charitable-deductions/2012/12/13/80e67400-43f2-11e2-9648-a2c323a991d6_story.html), reprinted as *Charitable Giving Tax Break at Risk; White House, Nonprofits Battle Behind the Scenes*, TEAPARTY.ORG (Dec. 13, 2012), <http://www.teaparty.org/charitable-giving-tax-break-at-risk-white-house-nonprofits-battle-behind-the-scenes-17206>.

153. See, e.g., Michael F. Cannon, *There Ain't No Such Thing as a Tax Expenditure*, CATO INST. (Nov. 11, 2010, 1:39 PM), <http://www.cato.org/blog/there-aint-no-such-thing-tax-expenditure>.

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and instead should reward it.<sup>154</sup> In response critics have cited both social science and economics to question whether or not a psychological state of altruism truly exists, especially in light of motivations for charitable giving like satisfaction and reputation.<sup>155</sup> Yet these scholars may miss the greater significance of Bittker's argument.

While critics comment on whether altruism is an objective truth, Bittker's views may simply reflect and articulate widespread popular support for the charitable deduction as a means for rewarding giving. For instance, commenting on the appeal to the average American of Bittker's argument, Pozen has written:

[I]n the general public Bittker needs no reinforcement to imbue his argument with continued valence, for mere intuition will suffice. At an intuitive level, many, if not most Americans buy his premise that charitable donors deserve a deduction because donated money is not consumption but something else, something self-sacrificial and good, and the tax code should honor this.<sup>156</sup>

Putting aside his brief reference to the consumption issues already discussed earlier, Pozen's words further acknowledge American public support for the idea that charity should be rewarded and recognized by the tax code.

Similarly Rob Atkinson has argued: "The political battle for the exemption is winnable, even without a shield against the fitness point, because the virtues of charity that we have canvassed are close to the core values of our culture."<sup>157</sup> From Atkinson's writing it is clear that he also observes that recognizing charity is a value central to American culture.<sup>158</sup> What is more, his optimism that the charitable deduction can be defended may be representative of a wider phenomenon in tax literature where the academic community has continually striven to create new and innovative defenses for the charitable deduction.<sup>159</sup> This ongoing discussion of the charitable deduction owes partially to the conceptual gray area surrounding the deduction, but also may owe to societal attachment to

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154. Bittker, *supra* note 3, at 60–61.

155. Colombo, *supra* note 60, at 670–77.

156. Pozen, *supra* note 50, at 552.

157. Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses*, 27 STETSON L. REV. 395, 430 (1997).

158. *See id.* ("[T]he virtues of charity that we have canvassed are close to the core values of our culture . . .").

159. Consider, for example, the suggestion that the charitable deduction compensates nonprofits for taking risks in providing public goods. *See generally* Nina J. Crimm, *An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 FLA. L. REV. 419 (1998).

the charitable deduction that has long maintained the deduction's salience, and likely attracted further attention and study.

As a result it seems that the charitable deduction is perhaps more a subsidy for the act of giving, rather than a subsidy for charitable institutions themselves. The deduction is a reward for an act considered noble and good. It is a subsidy that has endured not simply because it motivates donations as originally intended in 1917, but also because it confirms an American ideal which values giving as a valorous deed, and deserving of recognition.<sup>160</sup> Diverging with the critics of Bittker's argument, this Note does not suggest that charitable giving is a praiseworthy act due to some objective truth. Rather, it seems that American society has chosen to declare charity praiseworthy because Americans believe it to be so.

Moreover there may be good reason to think that the American public's attachment to charitable giving renders a tax policy politically legitimate that might otherwise be economically indefensible. As former Deputy Assistant Secretary for Tax Policy David Bradford once explained, "As one approaches the edges of the concept of income, there is substantial grey area."<sup>161</sup> Particularly when discussing the taxation of gifts, Bradford further noted that "[t]here is no agreed upon measure of the idea of a taxpayer's ability to pay."<sup>162</sup> As such there is considerable room for political determinations of what should and should not be included in the tax base. In light of that flexibility, charity may fit the definition of a "merit good," which the Musgraves define as goods whose production may be encouraged and discouraged purely on the basis of the normative values of the electorate without regard to the economic determination of consumer preferences.<sup>163</sup> For instance, the private market could efficiently determine the appropriate level of production for housing and liquor based on individual consumer preferences. Yet voters have decided that housing subsidies to promote basic living standards for the poor and liquor taxes to discourage the vice of alcohol consumption are both important policies where government interference in otherwise efficient private markets is warranted.<sup>164</sup> So too it can be said that charitable donations are also merit goods whose value is embedded within the fibers of American society. For American voters charitable giving is an essential part of American culture that should be encouraged and re-

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160. See Bekkers & Wiepking, *supra* note 141.

161. U.S. DEP'T OF THE TREASURY, *supra* note 31, at 36.

162. *Id.* at 31.

163. MUSGRAVE & MUSGRAVE, *supra* note 26, at 57.

164. *Id.*

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warded. As such there are good reasons to exclude charitable donations from income based on normative political determinations reflecting this well-entrenched ethic of giving.

*B. Extending the Charitable Deduction: Practical Proposals*

A normative tax policy attempting to reward charitable giving should have a very different form than a tax policy attempting to measure economic ability to pay. If the charitable deduction were simply a measurement of economic ability to pay then its current form as a deduction would make more sense. As with other deductions that measure ability to pay, the magnitude of the tax benefit would depend on relative income because progressive marginal tax rates also depend on relative income. If the charitable deduction measured ability to pay, charitable giving would make otherwise wealthy donors less able to pay their higher tax rates and therefore their charitable deduction should yield a higher percentage of tax relief from their already higher tax burden.

Yet if the charitable deduction is instead meant to reward charitable giving as a virtue, then increasing the magnitude of the deduction's tax benefits for the wealthy makes less sense. At the very least the magnitude of the reward should be equivalent for similarly sized charitable gifts because a rich person's donation should be no more praiseworthy than a poor person's donation. In fact there is ample reason to think that the poor person deserves more reward and recognition for donating a greater part of his or her total wealth.

However, as it currently functions, the charitable deduction rewards the wealthy much more in two ways. First, the wealthy are more likely to itemize their deductions.<sup>165</sup> Second, the current system creates vertical inequality among itemizers because it filters donations through income tax rates.<sup>166</sup> As a result richer and poorer taxpayers will enjoy differing rewards for the same size donation. In a year where an upper middleclass household with a tax rate of thirty-five percent and a poorer household with a ten percent tax rate contributed the exact same amount of one hundred dollars, the upper middleclass household would receive thirty-five dollars as

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165. Roger Colinvau, Brian Galle & Eugene Steuerle, *Evaluating the Charitable Deduction and Proposed Reforms*, URB. INST., June 2012, at 7, available at <http://www.urban.org/UploadedPDF/412586-Evaluating-the-Charitable-Deduction-and-Proposed-Reforms.pdf>.

166. Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 720-23 (1970).

a reward while the poor household would only save ten dollars. Therefore in this Subpart this Note proceeds to examine ways to make the reward for charitable giving more equitable between social classes and throughout American society. In trying to extend the benefits of charitable giving to classes besides those at the top, this Subpart will explore three different solutions. First, this Subpart considers the seemingly simplest option: extending the charitable deduction to nonitemizers. However, that option is rejected since it continues to reward the wealthy more than the poor by filtering the tax benefit through marginal tax rates. Second, this Subpart considers offering taxpayers nonrefundable credits for charitable contributions in lieu of deductions in the model of the French system. Third, this Subpart considers Ilan Benshalom's suggestion to use a refundable tax credit.<sup>167</sup> However, Benshalom's proposal is vulnerable to the same risks of complicating tax compliance and increasing monitoring costs for the IRS as were experienced during the 1980s.<sup>168</sup> Therefore this Subpart concludes that the best alternative is a nonrefundable tax credit.

1. Allowing All Taxpayers to Deduct Charitable Giving Without Itemizing

The first option for extending tax benefits to nonitemizers would be to simply allow all taxpayers to take the charitable deduction without itemizing. Although this sounds like a relatively simple reform, it proved to be unsustainable when attempted in the 1980s.<sup>169</sup> In 1981 Congress passed a new tax bill that, among other things, provided an above-the-line charitable deduction.<sup>170</sup> This meant that nonitemizers could separately account for their charitable contributions and thereby take the deduction. However, the change did not last. In 1986 when the tax code underwent significant reform, the nonitemizer deduction was discontinued.<sup>171</sup> Based on comments from the Treasury, it seems that the extension was too administratively burdensome: "Extension of this deduction to nonitemizers—taxpayers who on average have only small amounts

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167. See Benshalom, *supra* note 2, at 1080–81.

168. See U.S. DEP'T OF TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH 82 (1984), available at <http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1All.pdf> (discussing the administrative burden which resulted from extending the availability of the charitable deduction to nonitemizers).

169. John Pelozo & Piers Steel, *The Price Elasticities of Charitable Contributions: A Meta-Analysis*, 24 J. PUB. POL'Y & MARKETING 260, 262 (2005).

170. *Id.*

171. *Id.*



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of deductions—creates unnecessary complexity, while probably stimulating little additional giving and presenting the IRS with a difficult enforcement problem.”<sup>172</sup> Thus a broader charitable deduction regime was disfavored because it made the tax benefit unmanageable. Not surprisingly examining the tax returns of millions more Americans created a nightmare for a government agency already overburdened by its mandates.<sup>173</sup> As it stands the IRS only audits about one percent of all tax returns received.<sup>174</sup>

Furthermore extension of the charitable deduction fails to address the vertical fairness issue discussed earlier. Under the nonitemizer deduction regime, a thirty-five percent taxpayer would still receive a much larger discount for his or her one hundred dollar donation than a ten percent taxpayer who donated the exact same sum. Since deductions necessarily filter through marginal tax rates,<sup>175</sup> they unfairly reward higher rate taxpayers more than lower rate taxpayers for an equally or even more virtuous charitable gift.

## 2. Granting Tax Credits, Not Deductions

Offering a model for another alternative to the current deduction system, a few countries like France grant donors tax credits for charity. Whereas deductions reduce taxable income, credit systems reduce taxes paid and, as the Joint Committee on Taxation has noted, credits allow for more equitable rewards of charitable giving since they do not depend on marginal tax rates.<sup>176</sup> Under the French system, for instance, charitable contributors reduce their taxes by sixty-six percent of the donation,<sup>177</sup> no matter the tax bracket of the donor. Thus any household that donates one hundred dollars can pay sixty-six dollars less in taxes that year. This concept of a credit could be well applied to extend the charitable deduction to nonitemizers in America. No matter the tax bracket of a taxpayer, he or she would enjoy the exact same reward for charitable giving for any given amount of money donated to charity.

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172. U.S. DEP’T OF TREASURY, *supra* note 168, at 82.

173. See 1 NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS 20–37 (2014) (discussing the insufficiency of IRS funding), available at <http://www.taxpayeradvocate.irs.gov/2013-Annual-Report/downloads/Volume-1.pdf>.

174. James Andreoni et al., *Tax Compliance*, 36 J. ECON. LIT. 818, 822 (1998).

175. See, e.g., Colinvaux, *supra* note 167, at 2 (explaining this is necessarily the case because deductions reduce taxable income, which would otherwise be subject to marginal tax rates).

176. STAFF OF J. COMM. ON TAX’N, *supra* note 84, at 53.

177. For more information about the French system, see Gabrielle Fack & Camille Landais, *Are Tax Incentives for Charitable Giving Efficient? Evidence from France*, 2 AM. ECON. J. ECON. POL’Y 117, 117–18 (2010).

Yet the French system does not guarantee tax benefits to *anyone* who contributes to a nonprofit. The French credit is nonrefundable, such that citizens who have no tax liability in a given year cannot get any benefit from their charitable donations; the French government will only reduce taxes, they will not send checks.<sup>178</sup> Therefore there is still a group who does not benefit from the charitable tax credit: the extremely poor who are therefore exempted from taxes are still excluded from the charitable compensation regime.

Offering a third alternative to the current American system, Ilan Benshalom suggests a refundable credit that would indeed give cash back to zero bracket taxpayers so that even the extremely poor could benefit from the charitable deduction.<sup>179</sup> Yet Benshalom's proposal may go too far. Recall that the Treasury lamented the 1981 charitable deduction for nonitemizers due to the administrative burden that it created.<sup>180</sup> If a new system granted tax credits to citizens who currently are too poor to file tax returns, the new regime would encourage these zero-bracket taxpayers to file tax returns for these tax benefits and once again overwhelm the Treasury with more returns.

Of course even the French-style non-refundable tax credit just suggested would also increase the administrative burden on the IRS to audit and ensure compliance among nonitemizers who could thereby claim a tax credit. Even under the current American system, forty-six percent of taxpayers who claimed a charitable deduction overstated the amount, equaling a total of 13.6 billion dollars incorrectly deducted on tax forms.<sup>181</sup> If more taxpayers could claim charitable tax credits, this compliance problem would likely be magnified enormously.

One proposal to reduce this burden on compliance would be to create an automated third-party reporting scheme. In an editorial in the *New York Times* advocating for the charitable deduction generally, tax scholar Robert Shiller came the closest to proposing this type of system:

We should also set up a system so that charitable contributions can be deducted automatically on an individual W-2 form, so we don't have to go through the nuisance of collecting information and detailing it at tax time. And we have to get out of

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178. *See id.*

179. Benshalom, *supra* note 2, at 1079.

180. U.S. DEP'T OF TREASURY, *supra* note 168.

181. Alex Turk et al., *Charitable Giving in a Voluntary Compliance Income Tax System: Itemized Deductions Versus Matching Subsidies*, 2007 IRS RES. BULL. 51, 53.

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the mind-set that tax simplification is always a good idea. With modern information technology, we can replace simplification with automation.<sup>182</sup>

Indeed aspects of Shiller's suggestion already exist in both France and Denmark. The French system already requires charities to essentially produce W-2 forms in the form of donation receipts.<sup>183</sup> More specifically all French taxpayers claiming a charitable credit must attach a receipt from the benefited charity to confirm the amount of the donation.<sup>184</sup> Subsequently scholars have demonstrated that this simple method of verifying donations has reduced the misstatement of charitable contributions on French tax returns by more than seventy-five percent.<sup>185</sup> Moreover Denmark has instituted an even more direct method of third-party verification of charitable donations: namely, all charities report their received donations directly to the government, which at the end of the fiscal year automatically generates a form summarizing total charitable contributions for each taxpayer.<sup>186</sup>

Similarly the IRS could require that charities both give official receipts to donors when they contribute and also electronically report individual donations to the government. Then the IRS could use computer software to automatically check that both the donor's and charity's accounting matched. Though this system would shift some of the administrative burden to charities, it would also create greater oversight over nonprofit finances, which would interestingly address a concern previously raised in this Note.<sup>187</sup>

Therefore a nonrefundable credit can be manageable, and if instituted, such a credit would help to equitably reward and recognize charitable giving of rich and poor alike.

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182. Robert J. Shiller, *Please Don't Mess With the Charitable Deduction*, N.Y. TIMES, Dec. 16, 2012, at B7.

183. See Garbielle Fack & Camille Landais, *The Effect of Tax Enforcement on Tax Elasticities: Evidence from Charitable Contributions in France* 4–5 (London Sch. Econ. & Pol. Sci., Working Paper, Nov. 2013), available at [http://econ.lse.ac.uk/staff/clandais/cgi-bin/Articles/tax\\_elasticities.pdf](http://econ.lse.ac.uk/staff/clandais/cgi-bin/Articles/tax_elasticities.pdf).

184. *Id.*

185. *Id.* at 2.

186. Christian Gillitzer & Peer Ebbesen Skov, *Evidence on Unclaimed Charitable Contributions from the Introduction of Third-Party Information Reporting in Denmark* (Econ. Policy Research Unit, Working Paper Series ISSN 0908-7745, 2013), available at [http://web.econ.ku.dk/eprn\\_epru/Workings\\_Papers/WP-13-04.pdf](http://web.econ.ku.dk/eprn_epru/Workings_Papers/WP-13-04.pdf).

187. See *supra* Part III.D.4.

### CONCLUSION

This Note has argued that the charitable deduction is not defensible according to two of the justifications classically offered. First, in theory, charitable giving should be included in an ideal income tax based on the theory of gifts and income because donors experience some level of consumption of satisfaction or reputation when donating. Therefore there is no theoretical justification for donors to deduct charitable contributions from their income. Second, if the charitable deduction is meant to fund public goods, it likely does not effectively express the preferences of consumers and therefore cannot be considered an efficient subsidy for public goods. Therefore taxpayers should not control such a government subsidy through their use of the charitable deduction. Nonetheless if a democratically-elected legislature set the yearly amount of a future decentralized subsidy and thereby more accurately demonstrated consumer preferences for public goods, it is likely that the decentralized subsidy would be no less efficient in providing public goods than government agencies.

Ultimately the charitable deduction should be seen as a normative policy to exclude charitable donations from taxation and thereby recognize acts of charity. Recognition and reward for giving are strongly held American ethics and for that reason, the charitable deduction has remained a fixture of tax law with widespread popular support. As such the main challenge for reform is extending the reward to those currently excluded from equally enjoying recognition for their charitable giving. A system like that in France would work best, providing a credit for both poor and wealthy alike, but without encouraging the poorest taxpayers who currently do not file a return from doing so. An electronically automated third-party reporting system would, however, be necessary to facilitate compliance for the many current tax filers that could then also claim tax credits. In this way, charitable giving could be more equitably recognized without creating an impossible administrative burden for the IRS.