WRITTEN STATEMENT OF JAN MASAOKA

CEO, CALIFORNIA ASSOCIATION OF NONPROFITS

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COMMITTEE ON WAYS AND MEANS

HEARING ON

TAX REFORM AND CHARITABLE DEDUCTIONS

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Mr. Chairman and distinguished Members of the Committee:

Thank you for the opportunity to speak before you today on the issues of taxation and the charitable deduction, which are of great importance to our nation and its nonprofit sector. I am the Chief Executive Officer for the California Association of Nonprofits (CalNonprofits).

California is home to over 150,000 nonprofit organizations, including nearly 50,000 active, staffed organizations. California's nonprofit sector employs 750,000 people, engages 7 million volunteers and has purchasing power of $130 billion dollars each year.

I would like to make three brief points today on behalf of the California Association of Nonprofits:

1) Our stand on the charitable deduction is taken in the context of our support for tax policies which raise revenue in ways that are equitable and progressive, ensure funding for essential public programs, and incentivize and reward charitable giving.
2) While the current charitable deduction incentivizes charitable giving, its benefits to taxpayers and nonprofit organizations are not consistent.
3) We believe the discussion of the charitable deduction needs to expand beyond simply maintaining the status quo or limiting it in some manner. For example, two ideas worthy of discussion are establishing a floor for charitable deductions and allowing non-itemizers to benefit from charitable donations.

Starting with the most general point, the most important message from the nonprofit sector is that we represent an important partner to government and to business.

Nonprofits such as Stanford University, City of Hope, and the Getty Foundation, along with local PTAs and barn theatres, contribute to making California the economic engine that it is.

As a sector so deeply integrated with all aspects of society, we cannot look at the charitable deduction without seeing it in the larger context of taxation. The tax cuts of 2001 and 2003 have been harmful to our economy and communities, while benefitting relatively few Americans. We are pleased that the year-end budget negotiations resulted in both increased tax revenues and a more equitable tax structure.

We are also deeply concerned about the impact of the cuts looming ahead, with shrinking safety net programs and increased demand for already strained services provided by nonprofits. This can't go untold. Minimizing these cuts is a top priority for the nonprofit sector in California and across the county.

<u>In the context of the public good</u>

While we strongly support incentivizing charitable giving through tax deductions, we do so in the larger context of the public good, and not simply to protect the income streams of nonprofits or the tax benefits of the 30% of taxpayers who itemize.

California's nonprofit sector is not only large; it is also diverse, and as a result, charitable deductions affect many aspects of society. While the nonprofit sector is often characterized by organizations in health and human services, the charitable sector also includes churches, universities, hospitals, private schools, museums, SPCAs, scientific research labs, wildlife protection, and citizens rights organizations, to name just a few. Our sector also includes countless small, all-volunteer organizations such as PTAs, youth soccer leagues, Alcoholics Anonymous, and so forth.

I mention this diversity because our current system for charitable deductions does not have a uniform effect across the nonprofit sector. Nor does it have a uniform effect on those who claim the deduction. If we're going to talk about the importance of charitable deductions in the context of public policy decisions, we should be as clear as possible about who is benefitting—both from the charitable contributions and from the tax benefit of charitable deductions.

According to a report by the Congressional Budget Office, taxpayers who earn more than $100,000 a year took in 76% of the total charitable tax subsidy in 2006, despite contributing 57% of all donations. The report also describes that the charitable giving of higher earners tends to go more toward large institutions, such as for facilities projects at universities. Millionaires give just 4% of their total contributions to "basic needs" organizations.

Because the tax break is a deduction, the 70% of taxpayers who don't itemize are excluded from tax benefits from making charitable contributions. For taxpayers who do itemize, those in higher tax brackets enjoy higher benefits. If a person in the 35% tax bracket donates $1,000, the tax bill is reduced by 35% of $1000, or $350. Someone with a tax rate of 20% who donates the same amount will save only $200. So there is a greater tax incentive for higher earners to make charitable contributions, and paradoxically, the current deduction system makes it more "affordable" for them than for lower earners.

Ultimately, all taxpayers underwrite this tax benefit, but the financial benefit of the majority of these charitable contributions is not experienced by all taxpayers.

We at the California Association of Nonprofits encourage policymakers, the nonprofit community, and the public at large to advance a broader conversation about charitable deductions to strike a proper balance between sustaining the nonprofit sector's ability to provide important services, ensuring taxation and tax benefits that are equitable, and ensuring adequate revenue to run our nation to the benefit of all Americans.

Other options with the charitable deduction

Policymakers are right to look at the charitable deduction and its effect on revenue. The Joint Committee on Taxation estimated that the deduction will cost the government $246 billion between 2010 and 2014. But there are options beyond simply leaving the deduction alone and losing the revenue, or lowering the deduction and eroding the ability of nonprofits to serve our communities.

Two proposals in particular could potentially increase revenue, leave nonprofits relatively unharmed, and provide more equitable tax benefits for taxpayers: establishing a deduction "floor," or converting the deduction into a credit. While we can't endorse the specific merits of either, we think both are worthy of close consideration.

A floor would compel taxpayers to donate a certain amount of money in order to claim a tax break. The tax incentive for donations would only be reduced among those who give small amounts, where the influence of the deduction upon giving is already questionable. For those giving higher, the incentive would remain. According to the Tax Policy Center, a deduction floor of 1.7% of adjusted gross income would raise $10-11 billion in annual revenue without affecting contributions. The Congressional Budget Office estimates that a floor of 2% of income would raise $15.7 billion while cutting donations by $3 billion.

By converting the deduction into a tax credit, donors would be able to claim a flat percentage of their donations. The Congressional Budget Office found that if the charitable deduction were changed into a 25% credit with a floor of 2% of income, the government would increase revenue by $11.9 billion a year, while donations would shrink by $1 billion.

Replacing the deduction with a credit could also make the system more equitable, in that taxpayers would receive a uniform benefit for giving to charity, regardless of their tax bracket. Additionally, the credit would be available to taxpayers who don't itemize. This could also increase charitable donations among this group over time.

A full-picture approach

In conclusion, California Association of Nonprofits encourages the House Committee on Ways and Means to take a full-picture approach in considering the charitable deduction. The incentive of the deduction does support charitable giving, and a reduction would certainly have a negative impact on the ability of nonprofits to serve the community. But within that caution, it is important to understand that the current deduction system creates imbalances in terms of who donates, how they donate, and how they experience tax benefits for doing so. In the search for solutions to balance the budget, we encourage all stakeholders to explore alternatives that will preserve America's tradition of charitable giving, while increasing revenue and equitably sharing the tax incentives for donating.

We respectfully thank the Chairman and Members of the Committee for the opportunity to speak today.

California Association of Nonprofits (CalNonprofits)
180 Howard Street, Suite 300
San Francisco, CA 94105
800-776-4226

Sacramento
2207 9th Street, Suite 300
Sacramento, CA 95814

Los Angeles
3435 Wilshire Boulevard, Suite 1930
Los Angeles, CA 90010
(888) 427-5222 (toll-free)