Charitable giving just got more expensive for your donors… are you ready?

Winter 2018

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There is still confusion about what the new Tax Cuts and Jobs Act of 2017 (TCJA) changes for nonprofit organizations. Three elements of TCJA, however, will clearly make giving more expensive for individual donors and fundraising more difficult for nonprofit organizations: 1) Higher Standard Deduction, 2) Lower Marginal Tax Rates, and 3) Higher Threshold for the Estate Tax. The purpose of this paper is to discuss these changes and what nonprofit organizations might do about them.

1) Higher Standard Deduction

TCJA will substantially reduce the number of taxpayers filing itemized returns. Beginning in 2018, the standard deduction nearly doubles from $6,350 to $12,000 for single filers and from $12,700 to $24,000 for married filers.

The Urban-Brookings Tax Policy Center estimates that 45.5 million Americans will file itemized tax returns in 2017, claiming a total of $239 billion in charitable giving deductions, or 82% of all funds donated by individuals. The remaining 129 million 2017 taxpayers are likely to contribute around $53 billion, or 18% of individual giving.

Estimated Charitable Giving by Itemizers and Non-Itemizers (2017)

Current law baseline	Itemizers	Non-Itemizers
Number of filers (millions)	45,460	129,220
Percent of total filers	26%	74%
Total giving ($billions)	$239	$53
Percent of Total Giving	82%	18%

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1).

Starting with the 2018 tax year, however, the higher standard deduction is likely to reduce the proportion of itemizers from 1 in 4 taxpayers to around 1 in 20. That would remove the tax incentive currently underpinning about $95 billion of individual giving (NonProfit Times). In the table below, projected 2017 filing and giving behavior appears in the first row. In the second, 2017 figures are recast as though TCJA were already in effect. The result is startling; TCJA shifts individual giving from a world dominated by itemizers to one that is more balanced, with a slight majority of funds now coming from non-itemizers. This leads to an important question: *How will as many as 36 million filers losing itemization affect total giving?*

Period	Number of Itemizers	Giving by Itemizers	Number of Non-Itemizers	Giving by Non-Itemizers
Laws applying for 2017 tax year	45 million	$239 billion (82%)	129 million	$53 billion (18%)
*If TCJA was in effect for 2017 tax year**	9 million**	$144 billion (49%)	165 million	$148 billion (51%)

*The figures above were created using information from the NonProfit Times to adjust the Urban-Brookings estimate.
** Estimates for the number of itemizers in 2018 and later tax years range from 9 to 20 million.

Looked at another way, the higher Standard Deduction increases the after-tax cost of giving for 36 million taxpayers who will no longer itemize from the present average of $0.79 per $1.00 to $1.00 per $1.00 -- an increase of 21%. (The after-tax cost of giving for non-itemizers is, and will remain, $1.00 for every $1.00 in donations.)

There are not many products or services that could take a 21% overnight price increase without a significant decrease in demand. It is likely, however, that these soon-to-be former itemizers will remain generous to the causes they have supported. In consequence, while giving by former itemizers is likely to decline somewhat, it seems unlikely to decrease by more than each donor's increased after-tax cost of giving. As a result, the maximum decline in giving from the higher Standard Deduction should under no circumstances be more than $20 billion ($95 billion in giving less the 21% average subsidy previously provided to itemizers through tax deductibility of charitable gifts). It is more likely, however, that the actual decline will be significantly less than that owing to significant "price elasticity" surrounding charitable giving.

Damage to fundraising from the higher Standard Deduction is likely to show up among donors averaging between $100 and $5,000 in annual giving to your organization. It is probable that $5,000/year donors will still be itemizing under TCJA, whereas many donors of $100/year or less are likely to have already been using the Standard Deduction.

2) Lower Marginal Tax Rates

TCJA continues the current structure of seven tax brackets. Tax rate decreases or adjustments to the brackets themselves will lead most of the 9 million taxpayers likely to still be itemizing to experience lower marginal tax rates (and higher after-tax costs of charitable giving) through 2025 when TCJA's individual tax cuts expire.

Tax Brackets and After-tax cost of Giving: Current Law vs TCJA

1.Current	10%	15%	25%	28%	33%	35%	39.6%
2.TCJA	10%	12%	22%	24%	32%	35%	37%
3. TCJA After-tax Cost of Giving	No Change	No Change	Cost Increases	Cost Increases	Cost Increases	No Change	Cost Increases

Sources: IRS for lines 1 & 2. Line 3 was estimated using data from the Tax Policy Center and IU Lilly School studies.

There is no reason to believe that this group of 9 million taxpayers is likely to cease giving to the causes they have supported just because giving has become more expensive. At the same time, there is no reason to believe that they will all simply absorb such a substantial increase in their cost of giving. As a result, there will certainly be some decline in individual giving, but how big a decrease remains unclear. When the impact on giving of a proposal similar (but not identical) to TCJA's changes to marginal tax rates was examined by scholars at IU, they estimated that about $2.1 billion of charitable giving/year might be lost as the result of lower marginal tax rates.

Combined Negative Impact of Higher Standard Deduction and Lower Marginal Tax Rates

As mentioned previously, there is substantial "price elasticity" for charitable giving. As a result, increases in the cost of giving do not necessarily lead to proportional decreases in giving. In a study for Independent Sector, scholars at Indiana University's Lilly School of Philanthropy estimated that the combination of a higher Standard Deduction and lower marginal Tax Rates will affect charitable giving as follows when price elasticity is considered:

> *The current proposals, which include an increase in the standard deduction and a decrease in the top marginal tax rate, would have* ***a negative effect on charitable giving with giving decreasing between $4.9 and $13.1 billion (-1.7 percent to -4.6 percent).***

3) Higher Threshold for the Estate Tax

Despite the small reach of the federal Estate Tax, it has long had an outsized influence on many Americans. The early-2000s battle over the "Death Tax" was only possible because many Americans for whom it is personally irrelevant still both fear and loathe it. The loathing has primarily political consequences with which we are not concerned here. The fear, however, generates interest in "Estate Planning", with which we are concerned.

In 2018, the threshold at which an estate becomes subject to the federal Estate Tax will rise from $5.49 million to $11.2 million for individual filers and from $11.18 million to $20.18 million for couples. Under the law prevailing in 2017, 5,500 estates per year (representing 0.2% of all deaths in the US) are subject to the federal Estate Tax.

Under TCJA, that is likely to fall to around 1,700 estates (representing less than 0.1% of all US deaths) through 2025 when the higher Estate Tax threshold expires along with the other tax cuts for individuals.

The well-publicized increase in the threshold is likely to reduce interest in both Estate Planning and Planned Giving on the part of those 3,800 taxpayers each year whose estates will no longer be subject to the tax. Because of the Estate Tax's outsized influence on the American psyche, however, a higher threshold may also diminish interest in Estate Planning much more broadly. **Fundraisers traditionally "back into" Planned Giving discussions via donor interest in Estate Planning; as a result, a higher Estate Tax threshold is likely to be problematic for fundraisers.**

What should nonprofit organizations do?

To cope with how TCJA changes the incentives for charitable giving, most nonprofit organizations should review and many should revise their fundraising strategies, programs and supporting communications. This will be especially important for organizations that: 1) Are highly dependent on individual giving, and 2) Have donor bases that skew toward middle and upper-middle income Americans who may not be itemizing after the 2017 tax year.

1. Gauge the probable impact of TCJA on giving to your organization.

Watch early 2018 giving closely; compare it to giving at the same time in earlier years. Use Geo/Demographic data for your donors to get a better general sense of how likely they are to be effected by the changes discussed here. Survey (formally or informally) a cross section of your more significant individual donors.

2. Consider alternative fundraising and giving structures.

Taxpayers who will no longer routinely itemize, but who still want the deduction, are likely to "bunch" the charitable contributions they might previously have made over several years into a single year in order to take the gift deduction. Widespread adoption of bunching, however, would present cash flow challenges. As a result, gift timing and structure are subjects on which it would behoove organizations to lead, rather than follow, donors.

3. Learn to love DAFs.

By using Donor Advised Funds (DAFs), donors gain the tax advantages of bunching their contributions while still making annual operating support available to the nonprofits they previously supported directly. This approach would present a much smaller cash flow challenge for nonprofits as well as requiring less change to the fundraising strategy and tactics of most. It would, however, require getting over our sector's instinctual resistance to DAFs.

4. Adjust fundraising messaging.

After 2017, traditional messaging about deductibility is likely to ring hollow and may even offend some former itemizers. The tax deduction has never been fundraisers' strongest argument for giving. It has, however, been routinely highlighted in the messaging used by most organizations. In part, this is because the deduction truly matters (probably more emotionally than financially) to some donors. But, also in part, this is just habit.

5. Reconsider the timing of appeals.

In the short term, the traditional December 31 "drop dead date" becomes less compelling given that there will be fewer itemizers. In response, fundraisers need to find new ways of creating urgency to give on the part of donors. In the longer run, reduced importance of the end of the tax year to donors might prove liberating. At the simplest level, it gives organizations an opportunity to more evenly spread their fundraising and stewardship work over the whole year. By moving their appeals to other times, organizations may also be able to more easily gain and hold their donors' attention than in the traditional November-December "Giving Season." Most importantly, organizations can now move their major appeals to dates that are genuinely important to their organizations and about which they can tell their donors a much more compelling story than *The Tax Man Cometh*.

6. New strategy and messaging for Planned Giving

With greatly reduced concern about the federal Estate Tax, there is likely to also be less interest in the careful estate planning that has traditionally opened the door for fundraisers to suggest Planned Giving to their donors. Going forward, fundraisers will need more direct ways of getting donors to consider Planned Giving. That will require significant rethinking on the part of many organizations and is likely to produce changes in Planned Giving strategy, tactics and messaging on the part of many. The good news is that reduced concern with Estate Planning will make Planned Giving less technical and reduce the barriers that have kept many nonprofits out of the market.

7. Thoughtful reallocation of fundraising and development communications resources.

Because the fundraising and communications resources of most organizations are finite, it will be necessary for many if not most organizations to reallocate resources in order to address challenges arising from the Tax Cuts and Jobs Act of 2017. Determining which current fundraising and communications activities should be discontinued or substantially revised will require careful analysis of not only past performance but of future potential in our new very different environment for fundraising.

Sources:

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