




Tax Policy Analysis at the United States' CBO



Athiphat Muthitacharoen, PhD
Chulalongkorn University

June, 2015

Background on CBO

- ▶ Congressional Budget Office (CBO) is an analytical arm for the US Congress.
- ▶ Help Congress to
 - ▶ Develop a budget plan
 - ▶ Assess the impact of proposed legislation
 - ▶ Enforce its budget rules
 - ▶ Assess the impact of federal mandates
 - ▶ Consider issues related to the budget and to the economic policy
- ▶ CBO makes **no policy recommendations.**

Scopes on tax policy work

- 1 Federal tax revenue estimation**
 - ▶ Short term, 10-year and long-term projections
- 2 Tax policy analyses**
 - ▶ Mostly at the request of Congress
- 3 Technical papers**
 - ▶ CBO's own initiative
 - ▶ Help update CBO's estimation parameter

CBO Study: Options for Changing the Tax Treatment of Charitable Giving

- ▶ Examines patterns of individual donations
- ▶ Analyze how policy options might affect:
 - ▶ 1) Donations
 - ▶ 2) Revenue costs to the federal government
 - ▶ 3) Distribution of tax benefits by income groups

Background on the US tax treatment of charitable contribution (1)

- ▶ Taxpayers can choose two methods of tax deductions:
 - ▶ Standard deduction (\$6,300 for single in 2015)
 - ▶ Itemized deduction
- ▶ Itemizers can reduce their tax liability by deducting their donations to qualified organizations
 - ▶ This leaves out those who take standard deduction (about two-thirds of all filers)
- ▶ Tax expenditure = \$40.9 billion in 2006

High-income taxpayers are responsible for most of the donations

Charitable Contributions, by Tax Filers' Itemizing Status and Income Group, 2008

Adjusted Gross Income	Number of Tax Returns (Millions)	Share of Tax Returns (Percent)	Share of Total Income (Percent)	Percentage of Filers with Charitable Contributions ^a	Amount of Charitable Contributions (Billions of dollars) ^a	Share of Charitable Contributions (Percent) ^a
All Filers						
Under \$50,000	93	65	21	53	37	19
\$50,000 to \$100,000	31	22	27	81	47	24
\$100,000 to \$200,000	14	10	22	90	43	21
\$200,000 to \$500,000	3	2	12	93	24	12
Over \$500,000	1	1	18	94	49	24
Total	142	100	100	64	199	100
Itemizers						
Under \$50,000	14	29	8	70	20	12
\$50,000 to \$100,000	18	37	23	82	40	23
\$100,000 to \$200,000	12	25	28	90	41	23
\$200,000 to \$500,000	3	7	17	93	24	14
Over \$500,000	1	2	25	95	49	28
Total	48	100	100	81	173	100

Taxpayers with AGI > \$100,000 accounted for 13% of all filers but were responsible for 58% of total giving.

Source: Congressional Budget Office based on data from Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns 2008* (revised July 2010); the Federal Reserve Board's 2004 Survey of Consumer Finances; and the Bureau of Labor Statistics' 2002 Consumer Expenditure Survey.

a. Includes CBO's estimates of charitable contributions by people who filed income tax returns in 2008 but did not itemize deductions.

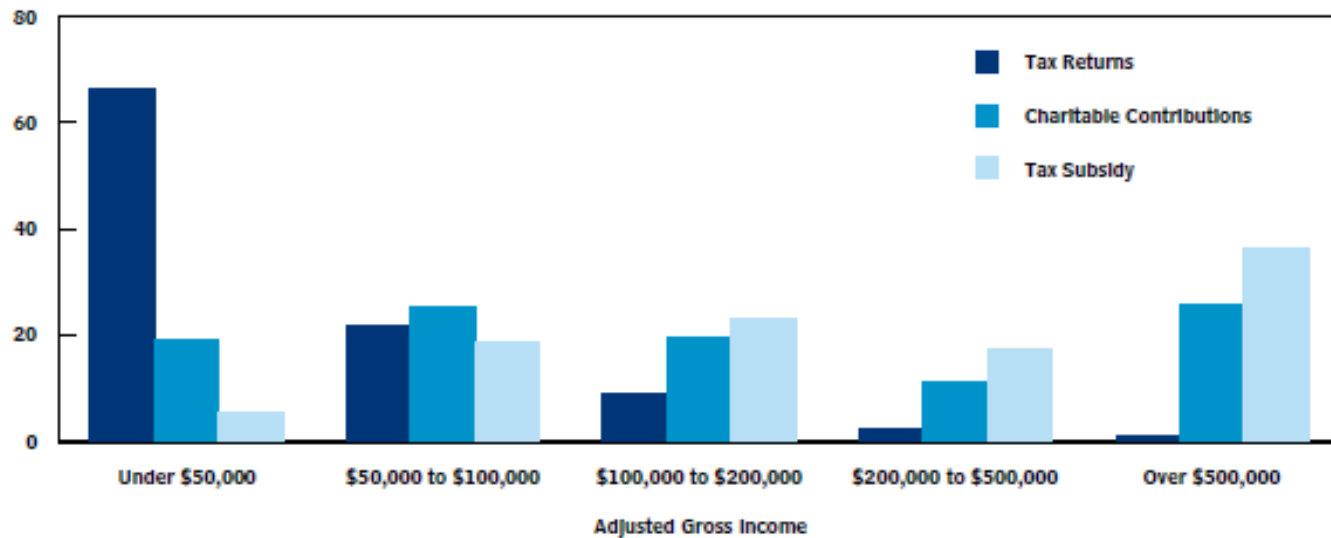
Concerns on the current tax treatment of charitable contribution

- ▶ By allowing itemizers to deduct their donations, the government indirectly subsidizes charitable giving for certain taxpayers (roughly one-third of all taxpayers)
- ▶ For a taxpayer in the 25% bracket,
 - ▶ Before-tax price of giving = \$1
 - ▶ After-tax price of giving = \$0.75
- ▶ For a taxpayer in the 10% bracket,
 - ▶ Before-tax price of giving = \$1
 - ▶ After-tax price of giving = \$0.90

The subsidy is concentrated among high-income taxpayers to an even greater extent than donations are

Different Income Groups' Shares of Total Contributions and the Total Tax Subsidy, 2006

(Percent)



Source: Congressional Budget Office.

- Two major contributing factors:
- 1) High-income taxpayers are more likely to itemize
- 2) High-income taxpayers generally pay higher marginal tax rates

Two major questions:

- ▶ 1) Could the tax subsidies be extended to more taxpayers without costing the large amounts of forgone revenue?
- ▶ 2) Could the subsidies per dollar of giving be made equal for taxpayers across the income distribution?

The 11 Policy Options: Key characteristics

- ▶ 1) whether the tax benefit includes a floor
- ▶ 2) whether it is restricted to itemizers
- ▶ 3) whether it takes the form of a deduction or a credit.

The 11 Policy Options

Retaining current deduction for itemizers

- Floor: \$500 for single; \$1000 for joint filers.
- Floor: 2% of AGI

Extend deduction to all filers

- No floor
- Floor: \$500 for single; \$1000 for joint filers.
- Floor: 2% of AGI

Replace deduction with 25% credit for all filers

- No floor
- Floor: \$500 for single; \$1000 for joint filers.
- Floor: 2% of AGI

Replace deduction with 15% credit for all filers

- No floor
- Floor: \$500 for single; \$1000 for joint filers.
- Floor: 2% of AGI

Basis for the estimates (1): CBO's microsimulation model

Bulding a representative sample of tax returns

	Itemizers	Non-itemizers
Income /taxes	IRS, Social Security	IRS, Social Security
Donation	IRS, Social Security	SCF 2004, CEX 2002

Confidential: IRS, Soc Sec
Public: SCF, CEX

CBO's federal tax calculator

- ▶ Taxes and tax rates are estimated using CBO's tax calculator
- ▶ All estimates are for tax year 2006
- ▶ Reflect the extent to which tax subsidies and charitable giving would have been different had a given option been in place in that year

Basis for the Estimates (2)

- ▶ Model taxpayers as they choose, under each policy option, between:
 - ▶ Itemizing deductions
 - ▶ Claiming the standard deduction
- ▶ Assume the taxpayers minimize their tax liability
- ▶ The tax cost of each option is computed by comparing the amount of tax collected under a given option and that would be collected if there was no deduction for donation
- ▶ Include price effects: Change in taxpayer's donation in response to a change in the after-tax price of giving

Price Elasticity of Giving

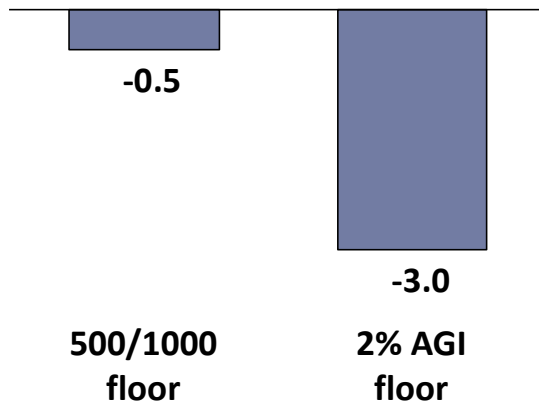
- ▶ **Main Analysis: Assume Elasticity = -0.5**
 - ▶ A percent increase in the after-tax price of giving reduces donations by 0.5%
- ▶ **Sensitivity Analyses:**
 - ▶ Higher responses: Elasticity = -1.0
 - ▶ No response: Elasticity = 0

Effects on donation and tax subsidy from introducing floors

Retaining current deduction for itemizers

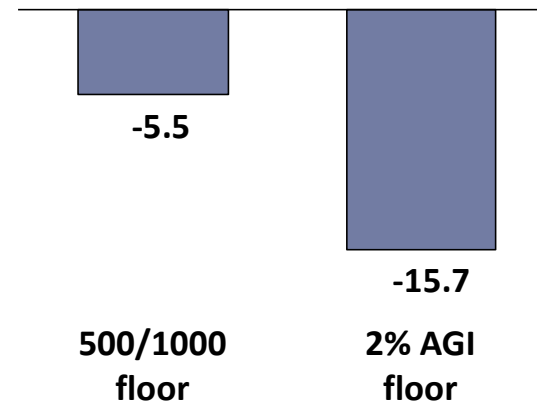
Change in donations from current law

Billions of 2006 dollars



Change in tax subsidy from current law

Billions of 2006 dollars



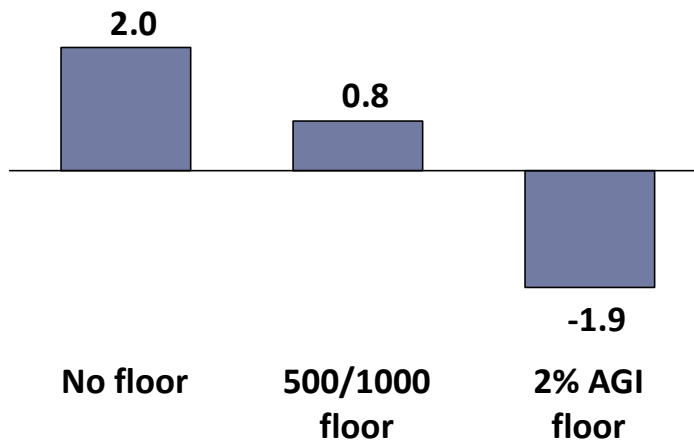
- Adding a floor would lower both donations and tax subsidy relative to the same option without a floor
- But the reduction in the subsidy would far exceed the reduction in donation

Effects on donation and tax subsidy from extending deduction to all filers

Extending deduction to all filers

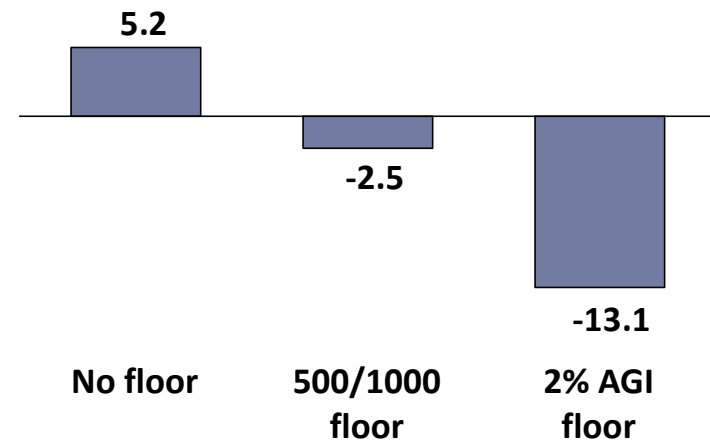
Change in donations from current law

Billions of 2006 dollars



Change in tax subsidy from current law

Billions of 2006 dollars



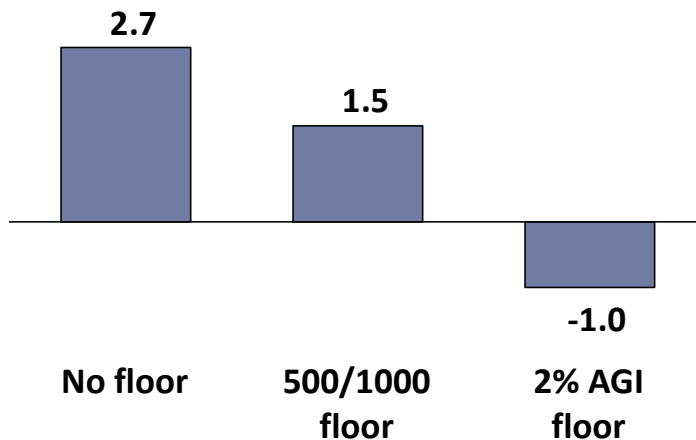
- Extending the deduction to all filers would have increased donations by \$2 billion and would increased the subsidy by \$5.2 billion
- But combining this with the floor could both increase donation and lower the subsidy

Effects on donation and tax subsidy from replacing the deduction with the 25% credit

Replace deduction with 25% credit for all filers

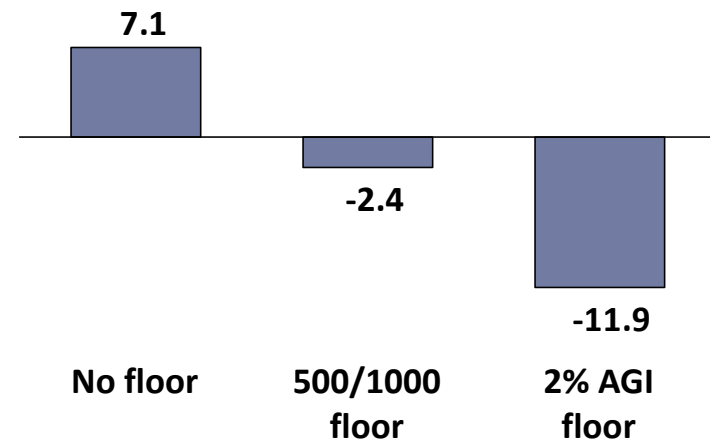
Change in donations from current law

Billions of 2006 dollars



Change in tax subsidy from current law

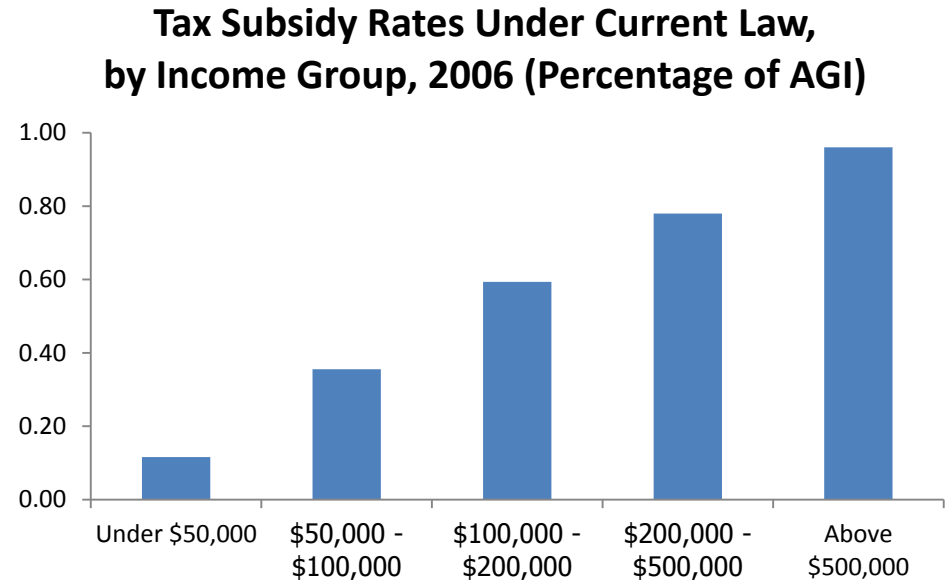
Billions of 2006 dollars



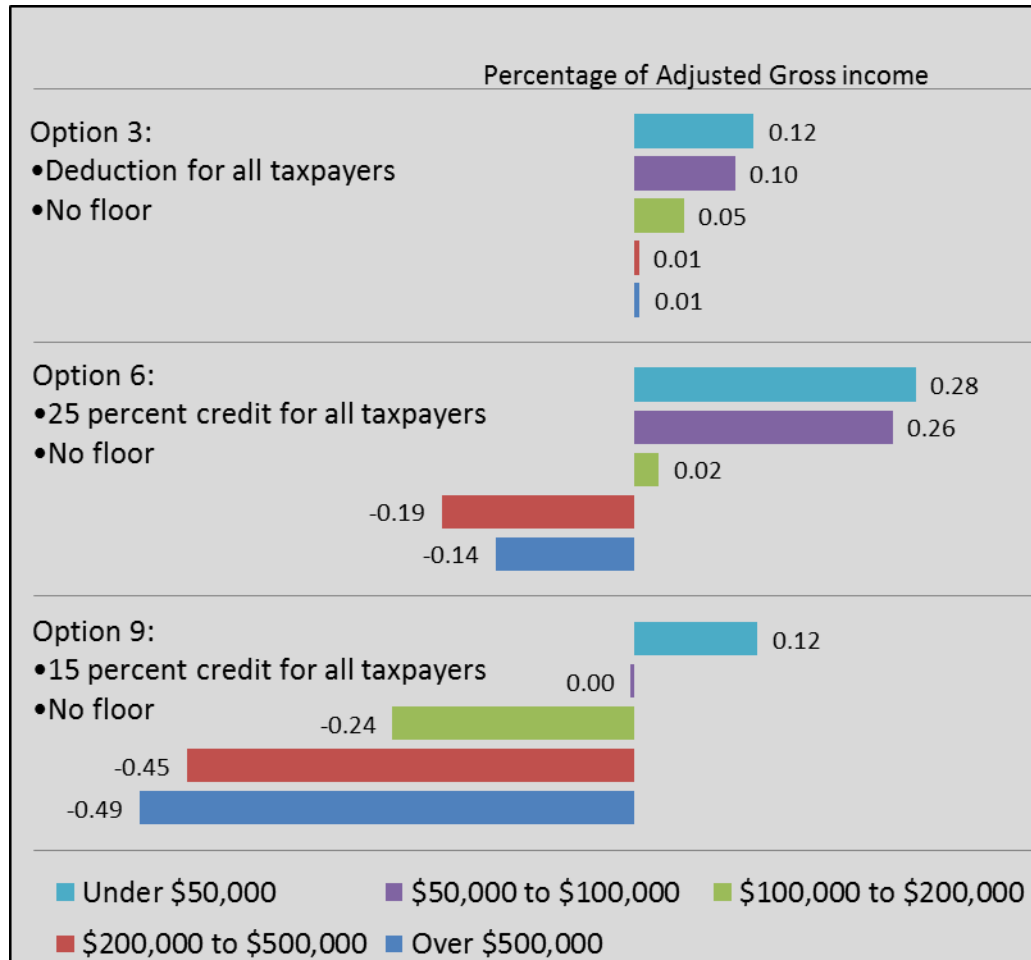
- A 25% credit would increase donations and increase the subsidy
- Combining it with the floor could increase its effectiveness significantly

Effects on Various Income Groups

- ▶ Comparing Tax Subsidy Rates (= Tax Subsidy/AGI) under current law and under a given policy change.

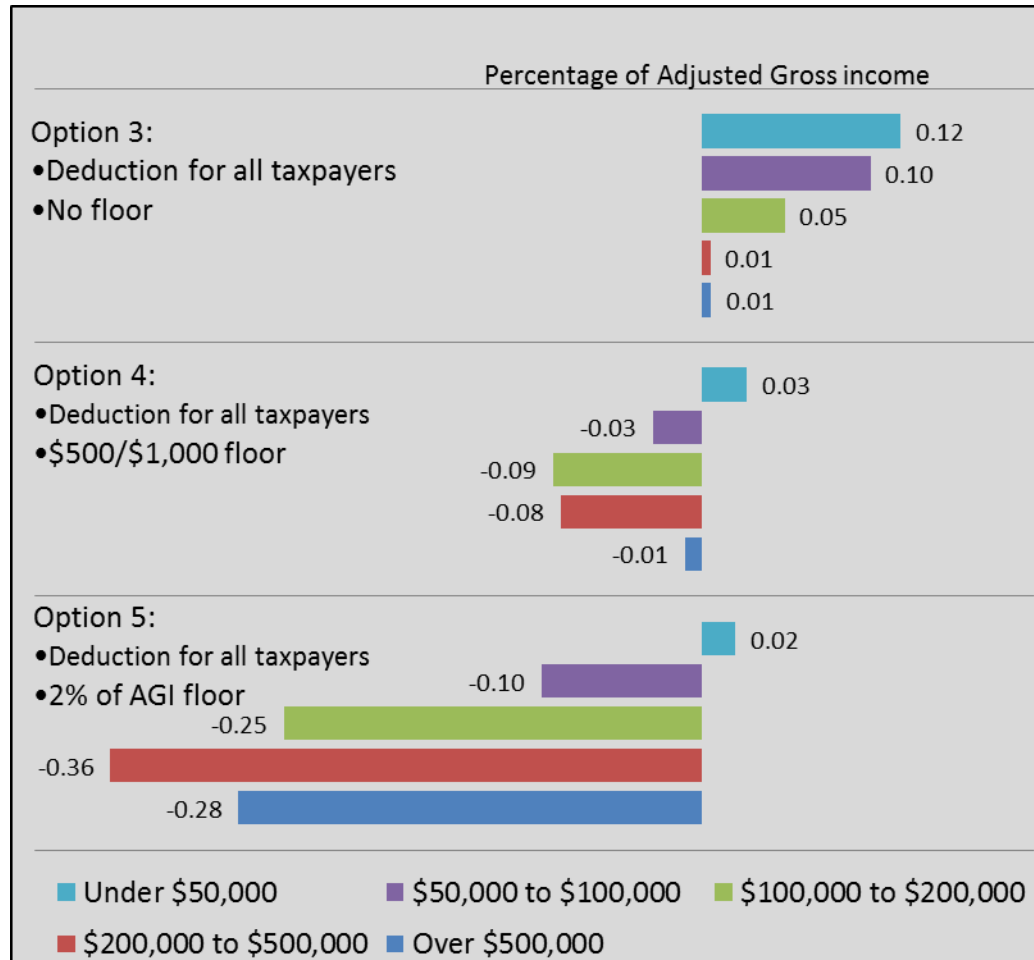


Distribution effects of extending tax benefits to all filers



Extending tax benefits to all filers would mostly benefit lower- and middle-income taxpayers.

Distribution effects of adding a floor



- Adding a floor would lower tax subsidies across the board
- High-income taxpayers are significantly worse off under the 2% of AGI floor.

Sensitivity Analysis: Alternative Elasticity Values

- ▶ Two alternative assumptions:
 - ▶ Zero elasticity
 - ▶ Elasticity of -1.0

Sensitivity Analysis: Alternative Elasticity Values

	Total Contributions	Change from Current-Law Level		Tax Subsidy	Change from Current-Law Level	
		Dollars	Percent		Dollars	Percent
Option 3--Deduction for All Taxpayers with No Floor						
Elasticity of 0 (Not responsive)	203.0	0	0	45.6	4.7	11.5
Elasticity of -0.5	205.0	2.0	1.0	46.1	5.2	12.8
Elasticity of -1.0	207.4	4.4	2.2	46.7	5.8	14.3
Option 4--Deduction for All Taxpayers with \$500/\$1000 Floor						
Elasticity of 0 (Not responsive)	203.0	0	0	38.2	-2.7	-6.7
Elasticity of -0.5	203.8	0.8	0.4	38.4	-2.5	-6.1
Elasticity of -1.0	204.9	1.9	0.9	38.7	-2.2	-5.4

- **Adding a floor would lower revenue cost significantly with moderate effects on giving.**
- **Extending tax subsidies to all filers without a floor is very costly.**

Summary of key findings

- ▶ Extending tax subsidies to all filers without a floor is very costly.
- ▶ Adding a floor would lower revenue cost significantly with moderate effects on giving.
- ▶ Replacing deduction with credit would help on an equity front
- ▶ CBO's measure capture only the price effect and does not reflect all of the possible behavioral responses
 - ▶ This also makes it less sensitive to the design details of a policy option and allows identifying the salient characteristics of the broad approaches proposed by Congress

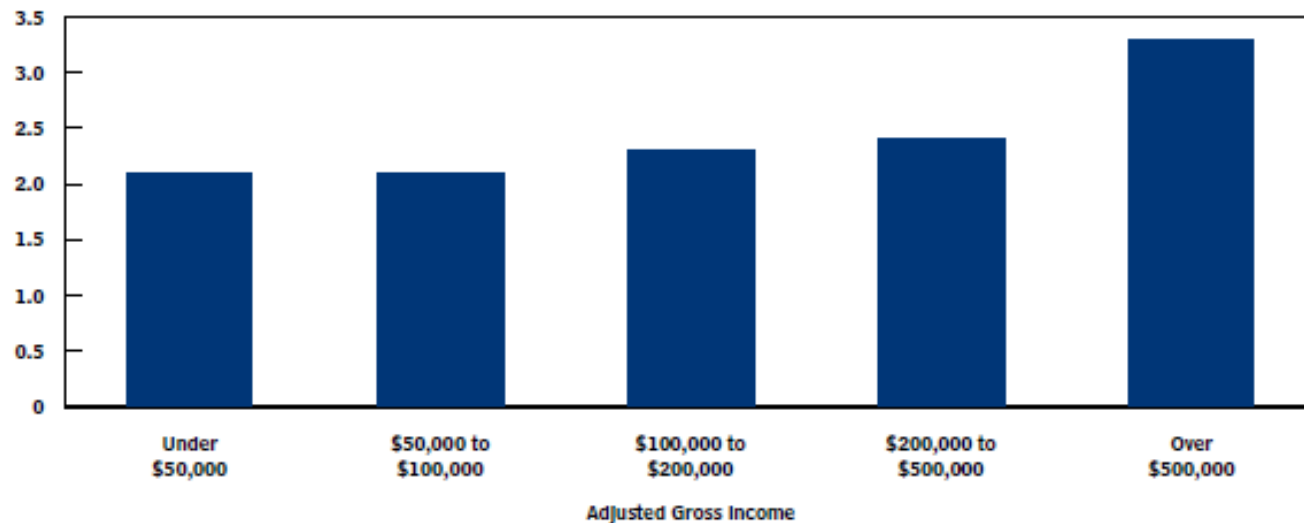
APPENDIX



Background on the US tax treatment of charitable contribution (2)

Percentage of Income That Tax Filers Contribute to Charity, by Income Group, 2008

(Percentage of adjusted gross income)



Source: Congressional Budget Office based on data from Internal Revenue Service, Statistics of Income Division, *Individual Income Tax Returns 2008* (revised July 2010); the Federal Reserve Board's 2004 Survey of Consumer Finances; and the Bureau of Labor Statistics' 2002 Consumer Expenditure Survey.

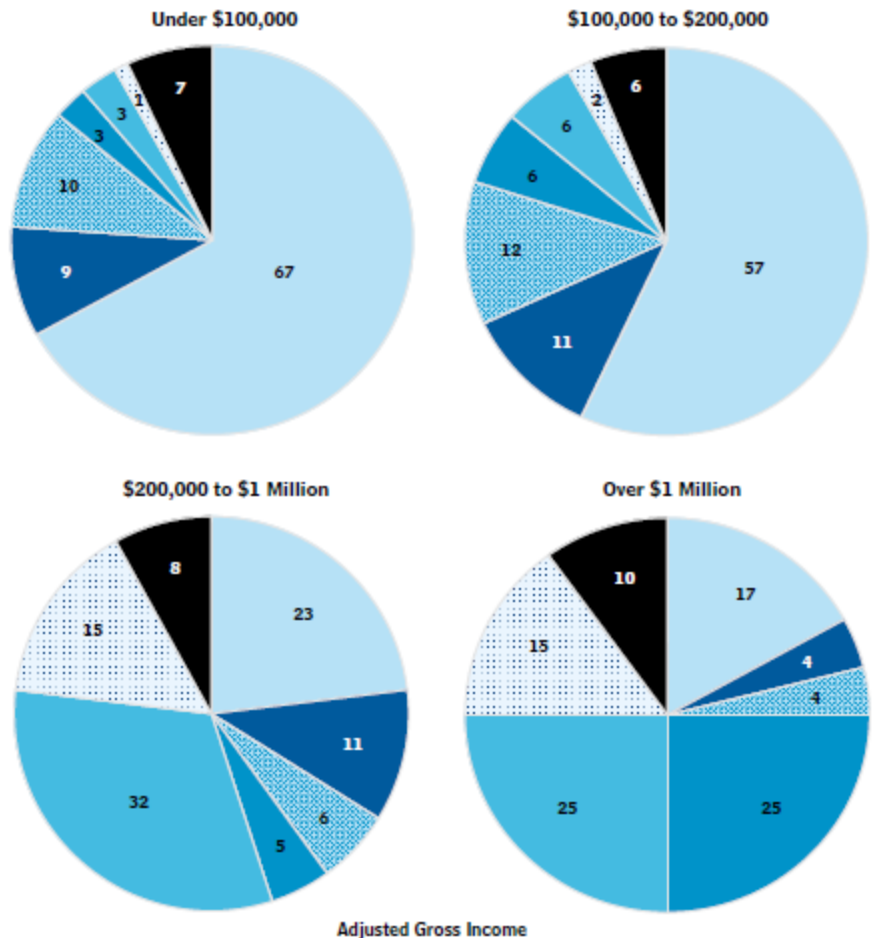
Note: Includes CBO's estimates of charitable contributions by people who filed income tax returns in 2008 but did not itemize deductions.

Giving as a share of income was fairly similar for most income groups, except for the highest-income taxpayers

Background on the US tax treatment of charitable contribution (3)

How Donors Allocate Their Charitable Contributions, by Income Group and Type of Recipient, 2005

(Percentage of donations)



In general, the higher a household's income, the smaller the share of donations that went to religious causes

Summary of effects on donations and tax subsidies

Summary of Total Donations and Tax Subsidies Under Current Law and Eleven Policy Options, 2006

	Floor for Eligible Donations	Total Contributions (Billions of 2006 dollars)	Tax Subsidy (Billions of 2006 dollars)
Current Law			
Deduction Available Only to Itemizers	No floor	203.0	40.9
Change from Current Law			
Keep Deduction Available Only to Itemizers but Add Floor			
Option 1	\$500/\$1,000	-0.5	-5.5
Option 2	2 percent of AGI	-3.0	-15.7
Extend Deduction to All Filers			
Option 3	No floor	2.0	5.2
Option 4	\$500/\$1,000	0.8	-2.5
Option 5	2 percent of AGI	-1.9	-13.1
Convert Deduction to 25 Percent Nonrefundable Credit for All Filers			
Option 6	No floor	2.7	7.1
Option 7	\$500/\$1,000	1.5	-2.4
Option 8	2 percent of AGI	-1.0	-11.9
Convert Deduction to 15 Percent Nonrefundable Credit for All Filers			
Option 9	No floor	-7.8	-13.3
Option 10	\$500/\$1,000	-8.6	-19.0
Option 11	2 percent of AGI	-10.0	-24.6

Source: Congressional Budget Office.

Notes: The simulation results are for tax year 2006, and all figures are at 2006 levels.

\$500/\$1,000 = \$500 for individual filers and \$1,000 for joint filers; AGI = adjusted gross income.

End of Document

