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2019 Junior Faculty Investigator Award

Tax Subsidies and the Finance of Nonprofit Organizations.

I. Summary of the project

The project explains how the design and magnitude of tax incentives for charitable contributions affect the fiscal health of nonprofit organizations. Though a sizable existing literature explores how individual households respond to tax incentives for giving, those studies explain little of the importance of incentives for charities themselves, for two reasons. First, charities' donation revenues are not driven by the behavior of the typical donor, but by a relatively small number of mega-donors, and thus charity-level policy outcomes can and do differ substantially from household-level effects. Second, the IRS form 1040 data commonly used to study household-level tax effects does not disaggregate giving by charity type, concealing important heterogeneity.

My research uses a combination of careful causal identification strategies applied to existing data and the development of novel data sources that permit the study of understudied policy interventions. In this way, I obtain credible estimates of the effects of aspects of tax subsidy design for charities and can answer questions that have not previously been asked.

II. Description of Activities

My reputation in this research area has brought research funding to me. Last summer I was approached by the Council of Michigan Foundations to study the effects of the 2017 tax law on charitable giving and to propose and simulate the effects of a charitable giving tax credit for nonitemizers. The Council funded this research with a $27,000 grant that covered a spring 2019 course buyout. My simulations demonstrated that a two-tier credit (with a low rate for giving up to 2% of AGI, and a high rate on donations beyond that point) would substantially increase charitable contributions at a relatively modest cost to tax revenues.

In mid-March 2019, I travelled to Washington, DC and shared my findings in one-on-one conversations with two US Senators, and in longer discussions with those senators' staffers and staff from Representatives on the House Ways and Means Committee (which oversees tax policy). I also presented my findings at the United Philanthropy Forum's conference, which convenes philanthropic associations for policy conversations, and in conversations with members of DC-area trade associations and think tanks who research the tax policy of charitable contributions.

I expect further funding of this type. Specifically, I plan to propose new funded research into the causal effects of charitable giving on nonprofit labor markets and local employment. Informal conversations with foundation associations indicated keen interest in this question, which would be valuable for their policy advocacy. I aim to assemble a proposal and budget with my coPI on this new project, Eric Ohrn, and submit it for consideration by this summer.

III. Description of Outcomes

My first publication on charitable contributions and charities is my 2016 Journal of Public Economics paper, "Do tax incentives affect charitable contributions? Evidence from public charities' reported revenues." I find that exogenous variation in the tax subsidies of giving implies a tax-price elasticity of charities' donations of -3 to -4. This elasticity is much larger than consensus estimates at the household level. Importantly, I further find substantial heterogeneity in tax-sensitivity by charity; individual organizations vary wildly in the importance of tax incentives for giving, with some hardly affected and others extraordinarily sensitive to rate changes. This research has been reported on in prominent publications such as the *Chronicle of Philanthropy* and *Bloomberg View*.

The difference between charity- and household-level elasticities makes sense if major donors are highly tax-sensitive. Such donors are more likely to be affected by the limit on the deductibility of charitable giving as a share of adjusted gross income (currently 60% of AGI for gifts of cash). As of 2012, the most recent year of data, this limit was binding for only 0.64% of returns, but those returns accounted for 12.8% of itemized contributions. My 2019 *Economics Letters* note, "Do share-of-income limits on tax-deductibility of charitable contributions matter for charitable giving?," is the first research to estimate the effects of the AGI limitation. I exploit a natural experiment wherein the AGI limit was raised for some charities before others. I find that a 10% increase in the AGI limit boosts giving to treated charities by 3 to 6% relative to the control.

My ongoing research in this area is very active. To give one example, a new paper quantifies the effects of wealth shocks on gifts by charitable cause. We know that tax subsidies are more valuable to those who can donate appreciated assets (adding avoidance of capital gains tax to deduction against ordinary income tax), but we know little about how asset price shocks affect giving because unrealized gains are not observed in tax return data. My working paper matches survey data with an instrumental variable strategy identifying exogenous shocks to wealth and tax incentives to estimate causal wealth effects and wealth-driven tax-incentive effects on giving for the first time. I find that wealth shocks are economically important for giving. This effect is concentrated among pre-retirement households and for giving to religion and human services. I presented this paper November 2018 at the ARNOVA conference.

Additionally, a working paper with Brian Galle, Alex Graddy-Reed, and Mark Phillips titled "State income tax credits for charitable giving: Extent and efficacy" links a hand-collected panel of 46 state income tax credits by state, year, and policy characteristics to charity data to assess the effectiveness of these increasingly common policies. The typical state giving credit does not induce any additional giving, though the effectiveness of these policies varies substantially in credit design.

Beyond success in publishing and policy influence, this line of research informs my teaching. I regularly add new insights on tax incentives for fundraising and nonprofit finance to my course on nonprofit management.