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What is the Future of the Charitable Deduction? House Committee on Ways and Means Announces Hearing on Tax Reform and Charitable Contributions

On Tuesday the Chairman of the House Committee on Ways and Means, Dave Camp (R-MI), announced that the Committee will hold a hearing to examine the itemized deduction for charitable contributions as part of its work on comprehensive tax reform. The Committee has issued an open call for any individual or organization interested in providing oral testimony with respect to the charitable deduction to submit an official request to testify by close of business today Thursday, February 7. The hearing is scheduled to take place Thursday, February 14 in room 1100 of the Longworth House Office Building beginning at 9:30am.

In announcing the hearing, Chairman Camp noted that "public charities and private foundations perform invaluable services for our society, especially during this time of economic slowdown and high unemployment. These organizations depend upon the goodwill of the American people – the most giving and charitable people in the world. Because of the critical role that charities play, the Committee must hear directly from the charitable community before considering any proposals as part of comprehensive tax reform that might impact their ability to obtain the resources they need to fulfill their missions."

Despite these positive remarks toward the charitable sector, it appears that the deductibility of charitable contributions is on the table as one of the "pay-fors" for a larger tax reform initiative. As the federal government continues to struggle to address the record national debt and annual trillion dollar budget deficits, the deductibility of charitable donations has received a lot of attention in the past two years given that President Obama has long been on record as supporting a cap on charitable deductions.

H.R. 8's Impact on Charitable Organizations and the "Pease Limitation"

In recent months there was concern that the charitable deduction would fall victim to the "fiscal cliff" negotiations. However, in the early morning hours of New Year's Day, the U.S. House of Representatives passed the American Taxpayer Relief Act of 2012 (H.R. 8) that averted the automatic, across-the-board tax increase of the "fiscal cliff" and delayed for two months the spending cuts that had been set to take effect on January 1st as part of sequestration. The good news is the bill did not include the much discussed cap on itemized deductions. However, the bad news is that it did reinstate the smaller "Pease" limitation on itemized deductions—opening the door to further limitations in the future.

The Pease Limitation (named after the Congressman from Ohio who originally authored it) raises the effective tax rate of affected taxpayers by reducing the amount of their allowable deductions (including their charitable deduction). It was first enacted in 1990, but it was gradually phased out by the tax cut that was passed in 2001. The revised Pease Limitation applies to taxpayers at higher levels of income than the earlier, expired version:

- $300,000 for married couples and surviving spouses,
- $275,000 for heads of household,
- $250,000 for unmarried taxpayers, and
- $150,000 for married taxpayers filing separately.

If a taxpayer's income exceeds the relevant filing threshold and he or she itemizes deductions, an amount equal to 3 percent of the excess over the threshold is disallowed. No more than 80 percent of the taxpayer's deductions can be lost. Certain deductions, such as medical expenses, investment interest, and casualty, theft or wagering losses, are exempt from the limitation.

Continuing Threats to Deductibility from Debt Limit to Tax Reform

While the immediate term danger of substantial overhaul to the charitable deduction has diminished, it has not disappeared. As long as Congress and the President continue to spar over increases in the debt limit ceiling and fundamental tax reform, the possibility of substantial changes to the charitable deduction remain.

The House ensured itself time to work on a broader tax reform bill when it passed H.R. 325 (The No Budget, No Pay Act) that was signed into law Monday by President Obama. The law lifts the current debt limit of $16.4 trillion through May 18, allowing the federal government to continue borrowing to pay its bills until then. Likely, Congress has more flexibility than the May 18 deadline, as the Treasury Department can take "extraordinary measures" that will give it until August before it defaults. The law also prohibits lawmakers from getting paid should they fail to pass a fiscal 2014 budget. This provision was intended to pressure Senate Democrats to pass a budget resolution this year (the Senate last passed a traditional budget on April 29, 2009). At the same time, House Republicans are reportedly planning to produce a budget that would curb deficit spending by 2023.

As the House and Senate get to the business of producing a budget, tax reform will loom large as Congress confronts record annual deficits. The increasing calls for fundamental tax reform as part of an effort to address the unsustainable national debt may threaten the charitable deduction for years to come. Thus, charities need to continue to make their voices heard on Capitol Hill.

For more information on the provisions of H.R. 8 or other developments on Capitol Hill, please contact Gammon & Grange attorney Patrick Purtill.