



## A FairTax<sup>SM</sup> White Paper

### The impact of the FairTax on religious and other charitable giving

In a letter to the *National Gazette* in 1792, James Madison wrote:

Government is instituted to protect property of every sort; as well that which lies in the various rights of individuals, as that which the term particularly expresses. This being the end of government, that alone is a just government, which impartially secures to every man, whatever is his own.

According to this standard of merit, the praise of affording a just security to property, should be sparingly bestowed on a government which, however scrupulously guarding the possessions of individuals, does not protect them in the enjoyment and communication of their opinions, in which they have an equal, and in the estimation of some, a more valuable property.

More sparingly should this praise be allowed to a government, where a man's religious rights are violated by penalties, or fettered by tests, or taxed by a hierarchy. Conscience is the most sacred of all property; other property depending in part on positive law, the exercise of that, being a natural and un-alienable right. To guard a man's house as his castle, to pay public and enforce private debts with the most exact faith, can give no title to invade a man's conscience which is more sacred than his castle, or to withhold from it that debt of protection, for which the public faith is pledged, by the very nature and original conditions of the social pact.

#### **How does our current tax law affect religious practice?**

Our current tax law is thought to have two major effects on religious institutions. First, many assume that the level of religious and other charitable giving in America is driven by the tax code and its tax deductions, concluding that if donations were not deductible, then such organizations would experience lower donations. Nothing could be further from the truth. Second, the current tax code has a huge effect on religious freedom of speech, requiring American religious leaders to curtail political commentary to preserve tax-exempt status. The effects of the tax code here are very, very real and a dangerous affront to religion freedom.

#### **What is the effect of current charitable deductions on religious donations?**

While religious institutions rely on charitable donations, they are somewhat impervious to the tax motivation, as charitable contributions are linked more to attendance than to tax credits or incentives. "Americans who regularly attend church services contribute 2.2% of their income, a much higher average than non-church-goers who average 1.4%. And the churchgoers' higher level of giving is not confined to [their] own congregations but extends to all types of non-profits



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... Active civic participation, and church attendance in particular, is more important to a healthy non-profit sector than the presence of any tax credit or deduction.”<sup>1,2</sup>

### **What is the FairTax Plan?**

The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16<sup>th</sup> Amendment. This nonpartisan legislation (HR 25) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

### **Take federal tax collectors and enforcers out of religion with the FairTax.**

The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system. Specific to this discussion, repealing the income tax code also repeals any deductions for giving, *as there is no longer any income tax from which to deduct!* And, as the federal tax code no longer contains such encouragements for giving to religions, it also ends the justification for government control of political commentary by religious leaders. Under the FairTax, the IRS is no longer the final arbiter of what is and is not religious in the U.S.A., as if the current reality was anything but ludicrous in the first place.

### **The majority of charitable contributions today come from *non-itemizers*.**

Under current income tax law, most taxpayers *cannot* deduct charitable contributions. Only the one-out-of-three taxpayers who itemize may deduct their contributions.<sup>3</sup> Thus, the incentive for giving to religious and other charitable organizations is not diminished in any respect by the FairTax. It increases. Under the FairTax, wage earners take home their *entire* paychecks – for families of modest means, whose charitable giving is often a very high percentage of their income, this is a substantial increase in available funds. Thus those congregants who already give 2.2 percent of their income today have higher incomes from which to give under the FairTax.

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<sup>1</sup> Barry, John S., “Faith, Growth, and Charity,” *Policy Review*, March, 1997.

<sup>2</sup> Rose Anne Devlin also found religious giving was not influenced by the fact that charitable donations were tax deductible. See Devlin, Rose Anne, “Charitable Giving and Charitable Gambling: an Empirical Investigation,” *National Tax Journal*, March, 2000.

<sup>3</sup> The percent of taxpayers who itemize deductions averages about 33 percent based on data reported in Table 1, Individual Income Tax Returns: Selected Income Tax Items for Specified Tax Years, 1985-2002, IRS Statistics of Income Bulletin, Winter 2003-2004.



Additionally, these contributions are also made with *pre-tax dollars*. Under the current system, the charitable deduction only offsets a portion of a taxpayer's tax liability. For those generally less affluent taxpayers who do not itemize, their pool of available funds is significantly reduced by the withholding of Social Security and income tax dollars. With such withholdings repealed, *the cost of charitable giving actually goes down* under the FairTax; donors give to their houses of worship or other charitable organizations from *pre-tax dollars*.

Under the FairTax, the two-out-of-three taxpayers who currently do not itemize deductions are not taxed on charitable contributions, and therefore, for the first time since 1986, the vast majority are actually encouraged to make charitable contributions. It should be noted that percentage ceilings also limit individual contributions today – even if a taxpayer itemizes. For example, all contributions are limited to fifty percent or less of adjusted gross income. This percentage is ten percent for corporations. These ceilings all disappear under the FairTax.

After the 1986 Tax Reform Act, charitable giving increased rather than decreased, despite the lowering of marginal income and transfer tax rates. Charitable giving rose by \$6.4 billion, or 7.6 percent, in 1987 after the top tax rate fell from 50 to 28 percent (more than doubling the tax price of giving).<sup>4</sup> Likewise, the growth of charitable bequests was most rapid from 1980 to 1987 when estate taxes were coming down.<sup>5</sup>

### **When do people increase their giving and when do they cut back? It's the economy!**

Charitable giving is actually a function of the economy, not the tax code. The common phrase, "It's the economy, stupid!" applies here yet again. Over the past forty years, the level of annual donations almost exactly tracks personal income growth.<sup>6,7</sup> When the economy is up, along with personal income, Americans give. When the economy falls off a cliff, so does charitable giving. Americans are always generous, but the key to sustaining their giving is a booming economy. From the earliest economic studies conducted on consumption taxes, economists have predicted a huge and sustained boom in the American economy once such taxes replace income taxation.<sup>8</sup> This will drive charitable giving to new heights.

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<sup>4</sup> Stephen Moore's response in "Republic of Taxes: When Uncle Sam Takes Do Americans Give?", *Philanthropy Magazine*, Spring, 1997.

<sup>5</sup> Based on federal estate tax returns data reported in Reynolds, Alan, "Death, Taxes and Giving: The Conventional Wisdom and Why it is Wrong," *Philanthropy Magazine*, Winter, 1997.

<sup>6</sup> Moore, *ibid.*

<sup>7</sup> "The most overwhelming proof that tax incentives have a relatively minor effect on individual charity is the tremendous consistence over time of giving as a percentage of income. Although the tax code has changed frequently and dramatically over the past 23 years, giving as a share of personal income has hovered around 1.83%. This measure reached as high as 1.95% in 1989 and as low as 1.71% in 1985. The narrow range has persisted even though the top marginal tax rate has fluctuated in that period between 28 and 70 percent. It suggests that raising income growth will do more to boost charitable giving than any tax incentive." Quoted from Barry, John S., "Faith, Growth, and Charity," *Policy Review*, March, 1977.

<sup>8</sup> Harvard economist Dale Jorgenson shows a 13 percent initial increase in the gross domestic product and a 9 percent long-range increase. Similarly, Boston University economist Laurence Kotlikoff predicts a 7 to 14 percent increase in national output within 20 years, about half of which occurs within 2 years. See Burton, David R. and Mastromarco, Dan R., "Emancipating America From the Income Tax: How a National Sales Tax Would Work," Cato Policy Analysis No. 272, April 15, 1997.



**When do the wealthy give? When they want to give!**

While serious wealth is only a narrow sector of charitable giving, when compared to the breadth of modest giving, it does command high visibility in the press. Therefore, it is worthwhile addressing here. The highest net worth benefactors, who grant large donations, are primarily and overwhelmingly influenced by their desire to contribute to a cause.<sup>9</sup> Once they make that decision to contribute, they then tailor that contribution to maximize the contribution while minimizing taxes.<sup>10</sup> The reciprocal is very rarely the case. Just as the FairTax allows every American to make their business decisions solely on what is good for their customers and employers, rather than being hamstrung by tax consequences, the FairTax unfetters the wealthy from any tax considerations on their charitable giving.

**Non-religious charities such as universities and museums, for example, rely little on donative sources of giving.**

The large nonprofits (whose assets account for more than three-fourths of the total assets of tax exempt charitable organizations) received only 7.8 percent of their income in 1998 from direct public contributions. Revenues from program services and membership, on the other hand, made up 74.5 percent of total revenues.<sup>11,12</sup>

**The FairTax ends the prohibition of political dialog by religious leaders.**

A quick study of the current prohibition of political dialog by religious leaders – or spokesmen for any charity for that matter – leads to the “Johnson Amendment” of 1954. Prior to that year, churches were free to speak out about any and every topic – without government limitations.

On July 2, 1954, Texas Senator Lyndon Baines Johnson slipped in a negligible amendment to the Internal Revenue Service tax code that would silence the political speech of 501(c)(3) churches, pastors, and nonprofit organizations. Churches who opted to exercise their First Amendment rights to free religious and political speech would lose their tax exemption. The amendment was presented so subtly that it was approved unanimously.

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<sup>9</sup> The 2000 National Committee on Planned Giving’s updated donor survey results show “unequivocally that the top reason people create a charitable bequest, establish a charitable remainder trust or other planned gift is the desire to support the charitable organization and its mission. Charitable intent as a key motivating factor was much more of a priority than financial or tax considerations.” Quoted from Burrill, Janice H., “The Effects of Estate Tax Repeal on Philanthropy,” *Trust & Estates*, Oct. 2001, Vol. 140, No. 10.

<sup>10</sup> A 1996 Independent Sector poll of people who made charitable donations found that “keeping taxes down” ranked dead last on a list of seven reasons people gave for giving, and was cited as the second least likely factor to influence giving (even behind “being encouraged by an employer”). See Riley, Tom, “The Final Cut,” *Philanthropy Magazine*, March, 1999.

<sup>11</sup> Large nonprofits are those 501(c)(3)s with over \$50 million in assets. Percentages are calculated from data in Table 1, “Form 990 Returns of Nonprofit Charitable Section 501(c)(3) Organizations: Selected Balance Sheet and Income Statement Items, by Asset Size,” IRS Statistics of Income Bulletin, Fall, 2001.

<sup>12</sup> For tax-exempt charitable organizations, as a whole, contributions from direct public support accounted for 11.12 percent of total revenue for reporting year 1998. Revenues from program services and membership accounted for 68 percent of total revenues. Percentages are calculated from data in Table 1, “Form 990 Returns of Nonprofit Charitable Section 501(c)(3) Organizations: Selected Balance Sheet and Income Statement Items, by Asset Size,” IRS Statistics of Income Bulletin, Fall, 2001.



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In this “enhancement” of the tax code, Lyndon Johnson traded the federal government's “encouragement” of donations to churches (by making them deductible) for an enforced silence on political matters.

It first should be noted that the tax-exempt status of houses of worship is a tradition dating to the earliest recorded history on this planet. Most know the Rosetta Stone led to the deciphering of hieroglyphics, but few know the subject of its text. It is a tax treaty between pharaoh and the priests, assuring the tax-exempt status of the temples. It may also be one of the earliest examples of the necessity of carving such treaties in stone (in three languages!) to ensure government's continued compliance. Any other treatment of religion and its practice is a violation of religion's traditional status from our earliest history.

Second, our Founding Fathers insisted that all citizens be taxed uniformly, to ensure that the tax code could not be used to reward the friends and punish the enemies of government. Where has the Johnson Amendment taken us? It has ensured that some religious organizations are carefully scrutinized (and punished) for supposedly steering too close to political dialog with their parishioners. While other organizations skate by unphased. Who makes such arbitrary enforcement decisions? The very government our Founders sought to remove from this equation with the Constitution’s uniformity demands.

Finally, it is the height of folly that the Internal Revenue Service now stands as the final arbiter of what is and is not a religion through its control over what is and what is not deductible. Can there be any travesty more threatening to the long-term independence of religious organizations and freedom of religious speech in this nation? Is there any action more at odds with the original intention of the Constitution? The FairTax ends this serious infringement for all religious organizations, regardless of denomination, and likewise for all charities.

### **Additional points**

Several more points should be mentioned.

- A large source of income for universities, colleges, and other training institutions is tuition payments. Under current law, tuition payments are not deductible, not creditable, and must be paid with after-tax dollars. Under the Fair Tax, all payments for tuition and training are considered investments in human capital and not taxable.
- Voluntary services provided to nonprofits today, under the income tax system, are discouraged because out-of-pocket expenditures are not fully deductible. Under the FairTax, such expenditures are paid from pre-tax earnings.
- Those uncompensated services provided by a charity to that population for which the charity was founded and by which it fulfills its mission do not generate a taxable, retail-delivery event under the FairTax. This stands in contrast to barter between commercial interests and individuals or between individuals. Such barter does generate a taxable event.





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- Charitable operations, of course, continue to be tax exempt, operating under a sales tax exemption certificate as they do today with most states. No purchase made by an exempt charity is taxed.
- When charities provide products or services to individuals for compensation, essentially a retail transaction, that transaction is taxed. This is comparable to the current system not allowing the deduction of that portion of a gift for which the donor received some return compensation.

**In summary: The Second Golden Age of Charitable Giving starts with the FairTax.**

The first golden age of charitable giving paced the Industrial Revolution boom in the American economy in the early part of the last century, benefiting religious and secular institutions alike. This age ended with the passage of the income tax. Ending that income tax initiates the Second Golden Age. When this happens, religions' ability to meet their parishioners' needs increases dramatically, reducing demand for government to fill the gap. Which in turn means that tax dollars can be spent more beneficially elsewhere, or taxes may be reduced.

**What is the FairTax Plan?**

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**What is Americans For Fair Taxation (FairTax.org)?**

FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: [www.FairTax.org](http://www.FairTax.org) or call 1-800-FAIRTAX.

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(AFFT Documents)\Papers on a specific subject(The impact of the FairTax on religious and other giving)