The Surprising Relationship Between Taxes and Charitable Giving

By
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When it comes to charitable giving, it’s well known that taxes matter. The promise of a big deduction is a great way to get people to open their checkbooks.

Yet the relationship between taxes and giving isn’t as simple as it looks.

Researchers have been studying the issue for years, some by sifting through masses of tax-return data, others by handing people money and seeing how their donation decisions change when they are “taxed” in various ways. The results show that the money and taxes relationship is a lot more nuanced than the idea that a bigger deduction means a bigger donation—with significant implications for both charities and policy makers.

For instance, research suggests that the system of itemized deductions the U.S. has been using for decades is much less effective at spurring donations than tax systems in other countries that, for instance, offer charities matching donations. Still other research suggests...
people may even be willing to give money voluntarily to the government—if the government gives them the chance to direct the money to a cause they approve of.

Meanwhile, some scientists have found that the brain reacts the same way to making donations as it does to paying taxes, if the taxes are clearly being used for a good cause—suggesting that people may be more willing to pay taxes if they know how the money's being used. And some findings even suggest that offering deductions for charitable giving may promote good health.

Here's a look at some of the findings, and the lessons they hold for policy planners.

Watch what people do, not say
One of the basic findings of the recent tax research is that people don't admit how important taxes are until push comes to shove.

Consider the findings from the U.S. Trust Study of High Net Worth Philanthropy, conducted by U.S. Trust and the Indiana University Lilly Family School of Philanthropy every two years since 2005. According to the survey, people's main motivations for giving were to make a difference (73.5%) and for personal satisfaction (73.1%). Receiving a tax benefit came way down in 11th place in the list of possible reasons, cited by just 34.4% of respondents. And most people insisted that they'd still give the same amount even if they received no income-tax deduction for charitable giving.

But their answers changed when there was a real possibility of that tax deduction being reduced, indicating that people were happy to say that the tax deduction wasn't all that important, until they came face to face with the likelihood that it might go away. In 2009, when the future of the charitable deduction was being debated, 67% of people said they would decrease charitable giving if the deduction were eliminated, up from 46.6% in 2005. In 2013, when the debate about capping the deduction had died down, the results returned more or less to the 2005 levels.

What's more, as expected, when tax rates are higher, people are generally willing to give more. Jon Bakija of Williams College in Williamstown, Mass., examined income-tax-return data to track donations over almost four decades. Back in the 1970s, when the top rate of federal income tax was 70%, wealthier Americans (people with incomes of over $500,000 in 2007 dollars) gave around twice as much of their money to charity than they did in 2007, when the top rate had fallen to 35%. People in other income brackets, on the other hand, saw smaller changes in their tax rates, and made smaller changes to their charitable giving.
The reason: A higher tax rate tends to favor charitable giving, because it gives people a larger charitable deduction, and hence a lower price of giving. If you pay tax at the 28% rate, for example, the “price” of making a $1 donation is 72 cents, because you get 28 cents back as long as you itemize the deduction on your tax return. If your tax rate is 40%, making a donation becomes even cheaper: Your price is 60 cents.

Deductions may not be the best way to go

For decades, Americans have been using the same tax system to handle donations: itemized deductions. But some recent research suggests that this venerable method may not be the best way to spark giving.

Philip Grossman, economics professor at Monash University in Australia, has conducted several experiments with Catherine Eckel of Texas A&M University and others. They looked at itemized deductions versus a matching system such as that used in the U.K., where charities can claim an extra 25 pence from the government for every pound donated by a taxpayer.

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**THE GIVING EFFECT**

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<th>34%</th>
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<th>38%</th>
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<td>wealthy households citing a tax benefit as a top motivation for giving</td>
<td>wealthy households that would give less without a charitable deduction</td>
<td>decrease in charitable donations when people think government spending is wasteful</td>
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**A $1-for-$1 match**
helps a charity raise 20% more money, but boosting the match to $3-for-$1 has no additional effect.

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**A 1% increase** in the tax subsidy for charitable giving is associated with a 0.1% increase in a health index.

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**People give between** 1.2 and 2 times as much when offered a match than with an equivalent rebate.

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**A $10,000 government grant** to a charity reduces private donations by about $7,500.

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*2014 U.S. Trust Study of High Net Worth Philanthropy, Dean Karlan and John A. List, James Andreoni and A. Abigail Payne, Roman Sheremeta and Neslihan Uler, Philip Grossman and Catherine Eckel, Baris Yörük* 

The WALL STREET JOURNAL.
In one experiment, they gave people money and offered them a list of charities to which they could donate. Some people were offered a 50% rebate on their donations, others a dollar-for-dollar match with no rebate or deduction. In both scenarios, the charity received $1 for every 50 cents the participant donated. But people’s reactions were far from equal.

“We found consistently that subjects gave more under the matching system than the rebate system,” says Prof. Grossman.

In a follow-up study, Prof. Grossman and his colleagues offered people a choice between getting a rebate and getting a match, and were surprised to find that about half chose each option, meaning they didn’t see one as being more advantageous than the other. And, again, the people receiving the match gave more generously than those receiving the rebate.

Separate research by Kimberley Scharf at Warwick University and Sarah Smith at the University of Bristol has reached similar conclusions: People respond more to the match than the rebate.

What’s more, other research has found that the amount of a match doesn’t necessarily matter—just the fact that there is a match.

John A. List of the University of Chicago and Dean Karlan of Yale University reached this conclusion by conducting a large-scale field experiment, joining with a nonprofit to send fundraising letters to 50,000 households. Some were offered various levels of matching donations by a wealthy supporter of the charity, while others were simply asked to donate, with no match available.

The subsidy had a substantial effect: Just by offering a match, the charity was able to raise about 20% more money. But the amount of the match “didn’t matter at all,” Prof. List says. Those who were offered a one-for-one match gave about the same as those who were offered a 2-for-1 or three-for-one match.

Since the original 2006 study, Prof. List and his colleague have repeated the experiment in slightly different forms and found that the results are “pretty stable”: a subsidy leads to more giving, but the amount of the subsidy doesn’t matter.

The implication for tax policy, Prof. List says, is that increasing the amount of an existing incentive is likely to be less effective than creating an entirely new incentive. “Going from zero to something positive is a big change, but going from something positive to something a little more positive is less important. So we should look for places where there is not currently any charitable contribution benefit. Those are the places where we’ll find the largest changes in behavior.”

Government grants can hurt giving

Another aspect of government policy that may be damping donations is making grants directly to charities.

A. Abigail Payne of McMaster University in Ontario and James Andreoni of the University of
California, San Diego, have combed through the tax returns of thousands of charitable organizations, looking at their funding sources and using a variety of statistical techniques to establish the effect of government grants on subsequent private donations.

Their overall results: A government grant of $10,000 reduces giving by about $7,500. Part of this is because of an economic effect called “crowding out”—when people know that the government is contributing to a charity, they feel less need to make personal contributions, because their tax money is already going to that cause. But it’s also because of the behavior of the charities themselves.

“A lot of that fall in private giving is attributable to the charity cutting back on its fundraising efforts” when they get government grants, says Prof. Payne.

So, should the government stay out of the grant-giving business? That’s probably not a good idea, Prof. Payne says. The government has an important role to play in supplementing private donations and ensuring a fairer distribution of cash. Otherwise, charities in rich areas would likely receive more money than those in poor neighborhoods, and those that tug at the heart strings (such as puppy shelters) would receive more than those that serve important but less-popular causes (such as halfway houses for parolees).
“If the government doesn’t do something, there will be an underprovision,” Prof. Payne says. “The question is, what’s the most effective way for the government to be engaged so that it actually adds to the provision, and it’s not just serving as a substitute.”

Her recent research suggests a possible answer to that question. She and her colleagues studied charities in the U.K. that had won grants from the National Lottery—and found that these grants did not crowd out other sources of income.

The difference, she says, could be that the lottery grants were mostly for very specific functions that were separate from the charities’ day-to-day activities. So rather than replacing existing funding, they added something new. She gives the example of a homeless shelter that wins a grant to start up a new nutrition program. The money will go into establishing a new program, but the organization will still need to raise money from private donors to fund the shelter.

People will give extra to government Taxes are one thing—they’re inevitable, and people are resigned to them, even if they would like to keep their payments as small as possible. But researchers have found that people will actually give extra money to the government under the right circumstances.

In another experiment by Prof. Grossman and his colleagues, people were given money and provided with a list of organizations to which they could donate: governmental organizations and equivalent private charities.

Although people did give more to the private charities, it was much closer than Prof. Grossman had expected: People gave on average 22% of their money to government and 27% to the private charities. In a separate experiment published this year, the same researchers...
found that people are more likely to give donations to the government when they're given more choice over where their money goes. “People are probably never going to be overly generous to government,” says Prof. Grossman, “but when you give them some choice in how the money they’re contributing is going to be spent, it might make taxation a bit less negative in their minds, and you might get a bit more.”

Waste drives down donations

Beyond the simple higher-taxes-spur-more-giving equation, some studies reveal a more complex dynamic at work. For instance, when facing high taxes, some people may give less than they otherwise would if they think the government is wasting their tax dollars.

Roman Sheremeta of Case Western Reserve University, and his colleague Neslihan Uler of University of Michigan, had students perform tasks for which they could earn money and gave them the opportunity to donate part of their earnings to charity. Their income was then taxed and the money redistributed among the group. The idea of the study was to mimic the setup of society as a whole, in which the government raises taxes and uses the money for the common good—in theory at least.

In one variation, some participants were told that a portion of the tax money would simply be kept by the experimenter, the equivalent of the government wasting tax dollars. When that was the case, donations tanked. One theory is that people felt angry at their money being wasted, and that reduced their altruism toward charitable causes, or made them view the charities as potentially wasteful.

“There’s a perception among many people that government is wasting money or using it on issues they don’t care about,” says Prof. Sheremeta. “Our study shows that this has an effect on charitable giving. So maybe we should be talking less about the amount of taxation, and more about the perception of waste.”

For policy makers, that means “it might be worthwhile to make an effort to convince individuals that collected taxes are being used for public services efficiently,” he says.

Paying taxes feels a lot like giving

Other researchers have been approaching the topic of voluntary and involuntary giving from a very different angle: conducting brain scans on people as they give money to charity and as they pay a “tax.” The surprising result is that people’s brains react in very similar ways in both situations.

Ulrich Mayr, a psychology professor at the University of Oregon, and his colleagues gave subjects $100 each, and then presented them with different scenarios. In some, they were allowed to choose whether to give money to a local food bank, and in others they simply had money taken away from them and given to the same charity. All the while, their brains were being scanned using functional magnetic resonance imaging.

The brain scans showed very similar “reward” responses in most people’s brains whether they chose to keep the money, donate it or had it taken away from them. The initial study in 2007
tested just 19 people, but Prof. Mayr and his colleagues have spent recent years conducting similar experiments on a much larger scale, and expect to publish those findings soon.

Prof. Mayr acknowledges that his experiment represents a “very idealized tax situation.” A food bank is a cause more people can agree with than supporting the government, and it’s unlikely that many people will experience great satisfaction when writing a check to the Internal Revenue Service. But it does point to an opportunity for policy makers, he says. If the government can do a better job of explaining what tax revenue is used for and showing how it contributes to the common good, people might feel better about paying taxes, and might view it more like charitable giving.

Deductions may improve your health

Finally, tax subsidies for charitable giving may have some positive unintended consequences, according to research by Baris Yörük at the University at Albany, State University of New York. Prof. Yörük has dedicated several studies to looking at what he calls the “spillover effects” of charitable tax benefits. Since the charitable tax deduction boosts donations, and separate studies have found that giving to others reduces stress and strengthens the immune system, he decided to combine the two ideas. “My hypothesis was that if giving to others is better for health and if tax subsidies significantly increase charitable giving, then increasing tax subsidies may positively affect health,” he says.

He analyzed data from the Philanthropy Panel Study, a regular survey in which heads of households report both their level of charitable giving and their health. Factoring in changes in the tax code and a range of other variables, he found that a 1% increase in a tax subsidy for charitable giving is associated with a 0.1% increase in the health index. Applying similar methodology, he has found that other “spillover effects” of the tax subsidy for philanthropy include higher rates of voting, more religious attendance, and more donations to political as well as charitable causes.

“My findings imply that further expansions in tax subsidies for charitable giving would positively affect the health status of individuals in the U.S., but more research is needed,” he says.

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