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Recently Expired Charitable Tax Provisions ("Tax Extenders"): In Brief

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Introduction

The Protecting Americans from Tax Hikes Act of 2015, enacted as Division Q in the Consolidated Appropriations Act, 2016 (P.L. 114-113), made permanent several temporary charitable tax provisions. Previously, these charitable tax provisions had been a part of the “tax extenders.” Most recently before P.L. 114-113, “tax extenders” were extended in The Tax Increase Prevention Act of 2014 (P.L. 113-295). Under P.L. 113-295, provisions that had expired at the end of 2013 were extended, for one year, through 2014. This report briefly summarizes the temporary charitable tax provisions that were made permanent in P.L. 114-113. The report also discusses the economic impact of these charitable tax provisions.

The four charitable tax provisions are discussed in this report are

1. the enhanced charitable deduction for contributions of food inventory;
2. the tax-free distributions from individual retirement accounts (IRAs) for charitable purposes;
3. the basis adjustment to stock of S corporations making charitable contributions of property; and
4. the special rules for contributions of capital gain real property for conservation purposes (conservation easements).

There are other “tax extender” provisions that may affect tax-exempt entities discussed in other CRS products. Specifically, CRS Report R43510, *Selected Recently Expired Business Tax Provisions (“Tax Extenders”)*, by Jane G. Gravelle, Donald J. Marples, and Molly F. Sherlock includes a discussion of the modification of tax treatment of certain payments to controlling exempt organizations, which was also made permanent in P.L. 114-113.¹ Extender provisions related to the low-income housing tax credit, which may be relevant for tax-exempt organizations, are discussed in CRS Report R43449, *Recently Expired Housing Related Tax Provisions (“Tax Extenders”): In Brief*, by Mark P. Keightley. Other CRS products that provide background on tax extender provisions include CRS Report R43541, *Recently Expired Community Assistance-Related Tax Provisions (“Tax Extenders”): In Brief*, by Sean Lowry; CRS Report R43688, *Selected Recently Expired Individual Tax Provisions (“Tax Extenders”): In Brief*, by Jane G. Gravelle; and CRS Report R43898, *Tax Provisions that Expired in 2014 (“Tax Extenders”)*, by Molly F. Sherlock.

As an alternative to extending the expired provisions, Congress may allow provisions to expire. Several provisions that might have been considered “traditional extenders”—that is, they had been extended multiple times in the past—have not been included in recent extenders packages. Two charitable provisions, the enhanced deduction for donations of computer equipment, and the enhanced deduction for book inventory to schools, which were first enacted in 1997 and 2005 respectively, were allowed to expire as scheduled at the end of 2011.

The extenders provisions in the Protecting Americans From Tax Hikes Act of 2015, as enacted in P.L. 114-113, is estimated to reduce federal revenues by \$628.8 billion over the 10-year budget window.² Of that cost, \$12.8 billion is attributable to the four charitable provisions discussed in this report.

¹ In the past, this provision has been classified as a business-related provision, rather than a charitable one.

² Joint Committee on Taxation, Estimated Budget Effects of Division Q of Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40), The “Protecting Americans From Tax Hikes Act of 2015,” 114th Cong., (continued...)

Before permanent extensions of temporary charitable tax provisions were enacted in P.L. 114-113, several House-passed bills had included permanent extensions of these provisions. Legislation in the 114th Congress that proposed to make permanent the expired charitable provisions is noted in **Table 1**. Comprehensive tax reform legislation introduced in the 113th Congress, the Tax Reform Act of 2014 (H.R. 1), would have made permanent the basis adjustment to stock of S corporations making charitable contributions or property and the special rules for contributions of capital gain real property for conservation purposes. The President's FY2016 budget proposed to make permanent the enhanced incentives for conservation easement contributions, with certain reforms.³

Table 1. Cost of Extending Expired Charitable Provisions
(billions of dollars)

	10-Year Cost of One-Year Extension through 2014 in P.L. 113-295	10-Year Cost of Permanent Extension in P.L. 114-113	Other Legislation to Permanently Extend in the 114th Congress
Enhanced Charitable Deduction for Contributions of Food Inventory	\$0.1	\$2.2	Fighting Hunger Incentive Act of 2015 (H.R. 644); Subsequently the America Gives More Act of 2015
Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes	\$0.4	\$8.8	Permanent IRA Charitable Contribution Act of 2015 (H.R. 637); America Gives More Act of 2015 (H.R. 644)
Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property	\$0.1	\$0.6	Permanent S Corporation Charitable Contribution Act of 2015 (H.R. 630); America's Small Business Tax Relief Act (H.R. 636)
Special Rules for Contributions of Capital Gain Real Property Made for Conservation Purposes	\$0.1	\$1.2	Conservation Easement Incentive Act of 2015 (H.R. 641); America Gives More Act of 2015 (H.R. 644)

Source: Joint Committee on Taxation revenue estimates for the legislation listed in the table can be found at <https://www.jct.gov/publications.html>.

On February 12, 2015, the House passed the America Gives More Act (H.R. 644), that would make permanent the deduction for charitable contributions of food inventory, provisions allowing for tax-free distributions from IRAs for charitable purposes, and the special rule for qualified conservation contributions.⁴ The bill was subsequently used in the Senate as a vehicle for trade

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December 16, 2015, JCX-143-15, available at <https://www.jct.gov/publications.html?func=startdown&id=4860>.

³ See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals*, February 2015, http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx.

⁴ The America Gives More Act, in addition to making permanent three of the charitable extenders, proposed several modifications to these provisions. For example, the percentage-of-income limit for contributions of food inventory would have been increased from 10% to 15%. Additionally, the America Gives More Act included language from the Private Foundation Excise Tax Simplification Act of 2015 (H.R. 640), which proposed setting the excise tax rate on net (continued...)

legislation. The provision providing basis adjustment to stock of S corporations making charitable contributions of property was included in America's Small Business Tax Relief Act (H.R. 636), that passed the House on February 13, 2015.⁵

Enhanced Charitable Deduction for Contributions of Food Inventory⁶

Corporations that donate food inventory to charity are generally allowed a deduction for the cost (not to exceed the market value). A special rule allows businesses paying the corporate tax an additional deduction equal to half the appreciation (half the difference between market value and cost) if the inventory is given to an organization that directly passes it on to the ill, the needy, or infants, and other criteria are met. The total deduction cannot be more than twice the cost.

The enhanced deduction for food inventory was temporarily expanded to include contributions made by businesses other than C corporations (e.g., sole proprietors, partnerships, and S corporations) in the Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73). Further, under the provision, only "apparently wholesome food" qualifies for the enhanced deduction. In recent years, this provision has been extended as part of the "tax extenders," and was made permanent in P.L. 114-113. P.L. 114-113 also modified the provision, increasing the charitable percentage limitation for contributions of food inventory from 10% to 15% of a taxpayer's adjusted gross income (AGI) (or 15% of taxable income for a C corporation) and modifying other rules related to valuing food inventory.

The provision allowing non-corporate businesses an enhanced deduction for charitable contributions of food inventory was enacted in response to the Gulf Coast hurricanes in 2005 (although nothing in the provision limited the deduction to contributions made as part of hurricane relief efforts). The provision promotes equity; allowing non-corporate businesses the same enhanced deduction that is available to C corporations provides greater equity across different types of business taxpayers. Allowing this enhanced deduction can also simplify compliance, particularly when viewed as an alternative to a "fair market value" deduction, by reducing the scope for disputes regarding valuation between taxpayers and the Internal Revenue Service (IRS).

Allowing deductions for appreciated property lets firms deduct amounts that have not been included in income. If the donated property (in this case, food) had been sold, the income would have been taxed at ordinary rates. Generally, there are additional limitations on charitable contributions of appreciated property, reflecting the fact that by donating property, the donor avoids generating income that would otherwise be taxed.

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investment income of private foundations at 1%. Under current law, such income is subject to a 2% excise tax. The tax rate can be reduced to 1% if private foundation giving exceeds historical levels.

⁵ America's Small Business Tax Relief Act, as passed in the House, proposed to make permanent two other "extender" provisions: (1) the increased expensing allowances for small businesses under Section 179; and (2) the reduction in S corporation recognition period for built-in gains. Both provisions are discussed in CRS Report R43510, *Selected Recently Expired Business Tax Provisions ("Tax Extenders")*, by Jane G. Gravelle, Donald J. Marples, and Molly F. Sherlock.

⁶ Internal Revenue Code (IRC) Section 170(e)(3)(C).

As is generally the case with gifts of capital gain property, an important concern is the potential overstatement of market value. Firms may only be able to sell donated inventory at a much lower price because the product is damaged in appearance, is older, or has other characteristics that would require deep discounting to sell. Moreover, a firm with market power may not wish to sell its inventory because increasing supply will drive the price down more for a sale than a donation. It is possible that a provision that is extended to non-corporate businesses, which are smaller and more numerous, will be more difficult to monitor for compliance.

For inventory that cannot be practically sold, the barrier to a donation by the firm is the extra costs encountered in distributing the product. Thus, there is a tradeoff between creating an incentive to donate and providing a windfall for businesses that would have donated absent enhanced tax incentives.

Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes⁷

Currently, individuals aged 70½ and older are allowed to make tax-free distributions from individual retirement accounts to charities. The amount is limited to \$100,000 per person. The recipient is limited to active charities, and cannot include non-operating private foundations, supporting organizations, and donor-advised funds. The excluded organizations do not directly engage in charitable activities, but instead provide funds to active charities.

The provision was first enacted in the Pension Protection Act of 2006 (P.L. 109-280). Since being enacted in 2006, these temporary provisions have regularly been extended as part of the "tax extenders," and were made permanent in P.L. 114-113.

In effect, the distribution is a tax-free "rollover" rather than a charitable contribution. Thus, the benefit is available to taxpayers who do not itemize deductions and therefore would not otherwise be able to take a deduction.⁸ Although this treatment may appear no different for itemizers from simply including the amounts in adjusted gross income and then deducting them as itemized deductions, it can provide several types of benefits even to those who itemize. This treatment reduces adjusted gross income, which can trigger elements of various entitlement programs, including the phase-in of taxation of Social Security benefits and the size of Medicare premiums. Limits on medical expense deductions and casualty losses are also tied to adjusted gross income. There are also income limits on charitable contributions: individuals can contribute no more than 50% of income in cash to charities and no more than 30% in appreciated property. In some states, state income taxes may be reduced. Additionally, the provision allows qualified charitable contributions made from IRAs to satisfy IRA distribution requirements.

There is some debate about the responsiveness of charitable giving to tax benefits, although most evidence suggests that the effect is small.⁹ There is no obvious reason for targeting this particular group of taxpayers for an additional incentive. This age group is the group that is required to take

⁷ IRC Section 408(d)(8).

⁸ This provision was originally in a package of proposals made by President Bush in 2001, which included a deduction for non-itemizers, which was not enacted. Its original objective, therefore, was not to allow a benefit for non-itemizers.

⁹ For a review of the evidence on the effects of tax incentives on charitable giving, see CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2011 Budget Options*, by Jane G. Gravelle and Donald J. Marples, and U.S. Congress, Joint Committee on Taxation, Present Law And Background Relating To The Federal Tax Treatment Of Charitable Contributions, 113th Cong., February 11, 2013, JCX-4-13.

distributions from IRAs each year, and could choose to donate distributions to charity, absent this special incentive.

For more information, see CRS Report RS22766, *Qualified Charitable Distributions from Individual Retirement Accounts: Features and Legislative History*, by John J. Topoleski and Gary Sidor

Basis of S Corporation Stock for Charitable Contributions¹⁰

Under current law, a shareholder in a Subchapter S corporation (a corporation not subject to the corporate income tax) is allowed to deduct his or her pro rata share of any corporate charitable contribution. At the same time, the taxpayer must decrease the basis of stock by the amount of the charitable contribution (which is a way of reflecting the effect on the shareholder's asset position for tax purposes). This extender provides that a taxpayer does not have to reduce basis in the stock to the extent a deduction is taken in excess of adjusted basis of the donated property (e.g., cost).¹¹ That is, the taxpayer will only reduce the stock value by the adjusted basis of the contributed property.

For example, assume an S corporation with one individual shareholder makes a charitable contribution of property with a \$1,000 market value and a \$300 basis. The shareholder will be treated as having made a \$1,000 charitable contribution. Under the special rule provided by the provision at hand, the shareholder will reduce their basis in the S corporation stock by \$300 (rather than the \$1,000 market value). The smaller reduction in basis means that if the shareholder were to sell their stock in the S corporation, a lower capital gain would be realized. In this example, the capital gain in the S corporation stock resulting from the charitable contribution would have been \$1,000 without the special rule, but is \$300 with the special rule.

The Pension Protection Act of 2006 (P.L. 109-280) included this provision effective through 2007, and it has subsequently been extended as part of "tax extenders" legislation. The provision was made permanent in P.L. 114-113.

This provision appears to be consistent with allowing a deduction for the market value of appreciated property without including the appreciation in income. Generally, contributions of appreciated property do not require taxpayers to realize income before contributions are made.

Special Rules for Contributions of Capital Gain Real Property Made for Conservation Purposes¹²

A charitable income tax deduction is generally allowed for qualified conservation contributions, including conservation easements. Qualifying conservation purposes include (but are not limited to) the preservation of land or open spaces for scenic enjoyment, for recreational or educational purposes, or to protect natural habitats. Gifts of appreciated property are generally deductible at

¹⁰ IRC Section 1637(a)(2).

¹¹ For more on tax basis, see CRS Report RL34662, *Tax Basis: What Is It? Why Is It Important?*, by Carol A. Pettit.

¹² IRC Section 170(b)(1)(E) and 170(b)(2)(B).

the fair market value, but, for individuals, are subject to lower limits (30% of income) than ordinary gifts such as cash (50% of income).

Temporary provisions initially enacted as part of the Pension Protection Act (P.L. 109-280) increase the limit for appreciated property contributed for conservation purposes to 50% for individuals. For farmers and ranchers, including individuals and for corporations that are not publicly traded, the limit is increased to 100% of income. To qualify for the higher deduction, land used or available to be used for agricultural or livestock production must remain available for such purposes. Conservation contributions that exceed the 50% or 100% of income giving limits can be carried forward for 15 years, instead of the usual 5 years, under the special temporary rules. Since being enacted in 2006, these temporary provisions have regularly been extended as part of the "tax extenders," and were made permanent in P.L. 114-113.¹³

Conservation easements that restrict development may reduce the value of the underlying land. Economic incentives, including the charitable deduction for conservation contributions, encourage voluntary restriction of development. Landowners with modest incomes, including farmers and ranchers, may not be able to claim the full value of their conservation contributions under the general limits placed on gifts of appreciated property. The increased income limits and longer carry-forward period increases the value of the deduction for donors with modest incomes. Providing increased limits for conservation contributions, however, enhances the charitable benefits associated with these types of gifts, relative to other forms of giving.

Lower income limits for gifts of appreciated property reflect concerns about the overstatement of fair market value. Recently, there have been concerns regarding valuation claims for conservation contributions preserving recreational amenities, such as golf courses. Lower income limits for gifts of appreciated property also reflect the fact that deductions are being claimed for amounts that have not been included in income (the property has not been sold, and capital gains taxes have not been collected).

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¹³ In addition to making the provisions permanent, P.L. 114-113 also enacted special rules for conservation contributions made by certain Alaska Native Corporations.