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

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Introduction

The 113th Congress has considered legislation that would extend certain expired and expiring tax provisions. The Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act (S. 2260), which was reported by the Senate Finance Committee on April 28, 2014, would extend most expired and expiring tax provisions through the end of 2015. The bill did not advance in the Senate, as a motion to end debate on H.R. 3474, the legislative vehicle for the tax extenders package, was voted down on May 15, 2014. The House has taken a different approach, voting to make permanent certain expired tax provisions. Several expired tax provisions would be permanently extended as part of the Jobs for America Act (H.R. 4), passed in the House on September 18, 2014. This legislation includes several provisions from bills passed in the House earlier in the 113th Congress.

Temporary tax provisions that are regularly extended for one or two years are often referred to as "tax extenders." This report briefly summarizes the temporary charitable tax provisions that expired at the end of 2013 and are being considered for extension. The report also discusses the economic impact of these charitable tax provisions.

Four charitable tax provisions are discussed in this report: (1) the enhanced charitable deduction for contributions of food inventory; (2) tax-free distributions from individual retirement accounts for charitable purposes; (3) basis adjustment to stock of S corporations making charitable contributions of property; and (4) special rules for contributions of capital gain real property for conservation purposes. 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.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 ("Extenders"): In Brief*, by Jane G. Gravelle; and CRS Report R43124, *Expired and Expiring Temporary Tax Provisions ("Tax Extenders")*, by Molly F. Sherlock.

Several provisions that might have been considered "traditional extenders"—that is, they had been extended multiple times in the past—were not included in the extenders package enacted in the American Taxpayer Relief Act (ATRA; P.L. 112-240). 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.

It would cost an estimated \$84.9 billion in foregone tax revenue to extend nearly all expired and expiring provisions through 2015, as proposed in the EXPIRE Act as considered by the Senate on May 15, 2014.² The charitable provisions discussed in this report would cost \$2.4 billion to

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

² This cost includes \$87.4 billion for extending provisions that expired at the end of 2013, \$0.1 billion for provisions (continued...)

extend, and thus represent a small portion of the overall cost of extending expired provisions. **Table 1** provides information on the cost of extending the charitable provisions discussed in this report through the end of 2015, as proposed in the EXPIRE Act.

Permanent extension of certain expiring provisions has recently been discussed in the context of tax reform.³ Legislation has passed the House that would make permanent certain provisions that are currently part of the tax extenders. As noted in **Table 1**, 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 have been proposed to be made permanent in the House Committee on Ways and Means Chairman Dave Camp's tax reform discussion draft, the Tax Reform Act of 2014. The House has also passed legislation to make permanent certain rules regarding basis adjustments to stock of S corporations making charitable contributions of property (see the Permanent S Corporation Charitable Contributions Act of 2014 (H.R. 4454), passed in the House on June 12, 2014). This provision was also included in an omnibus bill, the Jobs for America Act (H.R. 4), passed in the House on September 18, 2014.

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

	10-Year Cost of Extension through 2015 in EXPIRE Act	10-Year Cost of Permanent Extension	Made Permanent or Extended in the Tax Reform Act of 2014
Enhanced Charitable Deduction for Contributions of Food Inventory	\$0.3	\$1.8	
Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes	\$1.8	\$8.8	
Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property	\$0.1	\$0.7	YES ^a
Special Rules for Contributions of Capital Gain Real Property Made for Conservation Purposes	\$0.3	\$0.7	YES

Source: Joint Committee on Taxation, Estimated Budget Effects of an Amendment in the Nature of a Substitute to H.R. 3474, the "Expiring Provisions Improvement, Reform, and Efficiency ('EXPIRE') Act of 2014," Scheduled for Consideration by the Senate, 113th Cong., May 15, 2014, JCX-51-14, <https://www.jct.gov/publications.html?func=startdown&id=4601>; Congressional Budget Office, The Budget and Economic Outlook: 2014 to 2024, Washington, DC, February 4, 2014, <http://www.cbo.gov/publication/45010>; and the Tax Reform Act of 2014, available at <http://tax.house.gov/>; and U.S. Congress, Joint Committee on Taxation, Description of H.R. 4454, A Bill to Make Permanent Certain Rules Regarding Basis Adjustments to Stock of S Corporations Making

(...continued)

expiring in 2014, a revenue gain of \$3.4 billion from various revenue-raising provisions, and a cost of \$0.7 billion for the Hire More Heroes Act of 2014 (H.R. 3474). See Joint Committee on Taxation, Estimated Budget Effects of an Amendment in the Nature of a Substitute to H.R. 3474, the "Expiring Provisions Improvement, Reform, and Efficiency ('EXPIRE') Act of 2014," Scheduled for Consideration by the Senate, 113th Cong., May 15, 2014, JCX-51-14, <https://www.jct.gov/publications.html?func=startdown&id=4601>.

³ Testimony and statements from a recent hearing on this issue can be found at U.S. Congress, House Committee on Ways and Means, *Benefits of Permanent Tax Policy for America's Job Creators*, 113th Cong., April 8, 2014, <http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=374899>.

Charitable Contributions of Property, 113th Cong., April 25, 2014, JCX-40-14, <https://www.jct.gov/publications.html?func=startdown&id=4590>.

- a. The House has voted to make this provision permanent as part of the Permanent S Corporation Charitable Contributions Act of 2014 (H.R. 4454) and the Jobs for America Act (H.R. 4).

Enhanced Charitable Deduction for Contributions of Food Inventory⁴

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.”

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.

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.

⁴ Internal Revenue Code (IRC) Section 170(e)(3)(C).

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 Purposes⁵

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." In recent years, special rules have allowed qualified charitable distributions made in January to be treated as if they had been made during the previous tax year.

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.⁶ 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.⁷ 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 distributions from IRAs each year, and could choose to donate distributions to charity, absent this special incentive.

⁵ IRC Section 408(d)(8)

⁶ 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.

⁷ 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.

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

Basis of S Corporation Stock for Charitable Contributions⁸

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).⁹ 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.

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 Purposes¹⁰

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

⁸ IRC Section 1637(a)(2).

⁹ For more on tax basis, see CRS Report RL34662, *Tax Basis: What Is It? Why Is It Important?*, by Carol A. Pettit.

¹⁰ IRC Section 170(b)(1)(E) and 170(b)(2)(B).

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."

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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