Special Report

The Fiscal Cliff’s Twin Threats Against the Work of Charities

The nation’s looming “fiscal cliff” threatens the work of charitable nonprofits serving individual Americans and local communities in two significant ways:

**Threat #1:** If Congress fails to act before January 2, 2013, automatic spending cuts will further reduce funding for almost every domestic program – without reducing the underlying human needs – thereby *increasing demands* on nonprofits in local communities while also *decreasing resources* for nonprofits to provide needed services. After five years of dealing with higher demands for assistance despite declining resources, charitable nonprofits are already severely depleted from serving so many more for so much longer with so much less.

These additional cuts of $54.6 billion – slashing more than 8 percent across-the-board from domestic programs funded by the federal government – will touch virtually every person and every community in America, taking away huge amounts of funding for everything from infants to seniors and food safety to safe transportation. The cuts will occur not on an informed, considered, priority basis, but arbitrarily and across-the-board, using simple math without regard to human consequences.

**Threat #2:** To reduce the deficit, Congress is considering proposals to “raise revenues” not by increasing tax rates but by setting a ceiling on (“capping”) itemized deductions, including charitable giving, which would effectively *take away incentives for donations* to churches and synagogues, domestic violence shelters, early childhood programs, education, food banks, youth and senior groups, and all other charitable nonprofits. Capping deductions will further reduce the ability of charitable organizations to meet the increasing needs for services.

To illustrate, policymakers have discussed setting the cap at $15,000 or $20,000 as the maximum amount an individual could deduct. The big fixed-cost deductions for mortgage interest and state/local taxes – which nationwide totaled an average $22,233 in 2010 – would eat away the entire deduction and leave no room to deduct contributions to the work of charities. Research shows that even raising the cap to $30,000 or $50,000 will take away billions of dollars, hurting communities nationwide.

This Special Report identifies what the fiscal cliff’s twin threats mean to people in local communities throughout America and offers a way for readers to voice their views, at [www.givevoice.org](http://www.givevoice.org).

December 3, 2012

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If the automatic spending cuts (scheduled for January 2, 2013) and the automatic tax increases (scheduled for January 1, 2013) in existing law are not stopped or at least significantly modified, our country likely will plunge back into recession.¹ Yet some of the “solutions” that congressional leaders and the President are negotiating to avert the looming fiscal cliff would cause unnecessary and severe pain in communities across America.

Before turning to the twin threats, consider the weakened state of the economy and what governments at the federal, state, and local levels have silently assumed the nonprofit sector would somehow manage to do as governments cut their own budgets the last several years: fill the growing gap in human need. The following direct observations from charitable nonprofits across the country tell the real story:

- “Since Medicaid has been cut in our state, our services to those that have no insurance have increased by 75%. We serve these individuals through donations. Where are they going to turn to if you block our charitable donations?” – from a child and family services nonprofit in Arizona
- “With nonprofits taking on more and more of the roles that state and federal agencies used to do, we need to ensure they can operate at their greatest capacity. To cut the tax deduction would increase state and government costs in the long run.” – from a local United Way in South Carolina
- "Our government contracts have been cut by over $200,000 this past year. The only way we can replace that money is through private grants and individual donations. Tax deductibility of those donations is crucial to making that system work." – from a neighborhood nonprofit in New York

SOURCE: These and other “observations from the field” in this Special Report are comments submitted by charitable nonprofit organizations from all 50 states in 2011 to protect the charitable giving incentive and oppose proposals to reduce or cap the value of deductions for charitable contributions.

Threat #1: Sequestration’s arbitrary, across-the-board spending cuts to domestic programs

Terms such as “sequestration” and “non-defense discretionary spending” (budgetary language for domestic spending) deflect the human pain that people in local communities across America will face beginning January 2, 2013, when an additional 8 percent of funding of domestic programs automatically gets taken away. The sequestration’s scheduled cuts of $54.6 billion will further shrink funding for basic services on which Americans rely, including – among many other things:

- Cutting numerous “programs that benefit the middle-class, seniors, and children"
- Withholding funding for “smaller classes, afterschool programs, and children with disabilities"

¹ An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022, Congressional Budget Office (August 2012); see also Major Fiscal Issues Before Congress in FY2013, Congressional Research Service (August 2012).
Undermining FEMA's "ability to respond to... catastrophic events"
Cutting “critical housing programs and food assistance for low-income families.”

These and hundreds of other cuts will hurt charitable nonprofits in two ways: (a) increase the volume of work as even more individuals turn to nonprofits for help, and (b) take away dramatic amounts of funding from federal, state, and local government agencies, further limiting their ability to pay their existing and future contracts and grants with nonprofits to deliver needed services.

The January 2, 2013, cuts will not be the first cuts to government budgets. Since 2007, the federal and state governments have cut more than a trillion dollars. Congress cut almost a $1 trillion of spending in the Budget Control Act of 2011 (before the additional $1.2 trillion to be dealt with through the sequestration process). State governments have cut an additional $290 billion.

Of course, those spending cuts did not erase the underlying human need; if anything the cuts have increased needs as people lost their jobs and various services. Those in need have turned to charitable nonprofits for help on a massive scale. Nationwide, research reveals that demands on the nonprofit sector have soared since at least 2008:

- In 2011, 85 percent of nonprofits surveyed reported that demands for services had increased;
- On top of 77 percent reporting increases in 2010;
- On top of 77 percent reporting increases in 2009; and
- On top of 73 percent reporting increases in 2008.

Charitable nonprofits simply do not have the capacity to bear this continuous shifting of additional burdens without resources. Charitable nonprofits live on the edge of survivability right now. More than half of nonprofits surveyed (57%) have just 3 months or less cash-on-hand. From 2000 to 2010, sector-wide “the gap between income and expenditures ... was negative for 8 of the

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3 Out of Balance: Cuts in Services Have Been States’ Primary Response to Budget Gaps, Harming the Nation’s Economy, Center for Budget and Policy Priorities (April 18, 2012).
4 State of the Sector 2012 Survey, Nonprofit Finance Fund (April 2012); see also The Nonprofit Almanac 2012, Urban Institute’s National Center for Charitable Statistics (2012) (trend analyses can “underestimate the full impact because they do not capture the surge in demand for services that many social services nonprofits experienced in the wake of job losses and foreclosures”); Borderline: Hope and Concerns of Arizona Nonprofits, Alliance of Arizona Nonprofits (Feb. 2012) (“three-quarters of nonprofits surveyed saw demand for their services increase,” serving an average 16% more residents in 2011 than the year before, which is problematic because 45% of Arizona’s nonprofits have had to reduce their budgets); Oregon Nonprofit Sector Report 2011, Nonprofit Association of Oregon and Portland State University (May 1, 2012) (65% of Oregon’s nonprofits surveyed reported increased demand for services).
5 State of the Sector 2012 Survey, Nonprofit Finance Fund (April 2012); see, e.g., Oregon Nonprofit Sector Report 2011 (57% of nonprofits reported not having three months of operating reserves and 24% reported having less than one month of operating reserves).
10 years.” During much of the period when demands have skyrocketed, resources to charitable nonprofits have plummeted: “Payments from government agencies dropped, donations from individuals, corporations, and private foundations shrank, and investment returns and fee income fell.”

- Governments – which provide about a third of the sector’s revenue through contracts and grants to deliver services – have engaged in harmful practices such as not paying nonprofits for full-costs for contracted services, paying late, and changing contract terms mid-stream.
- Individuals – who provide about 10 percent of the sector’s overall revenue via donations – have given less during the economic downturn. “In constant dollars, itemizers’ charitable deductions dropped 14 percent from 2007 to 2008 and by another 8 percent from 2008 to 2009.”
- Foundations – which provide about 2 percent of the sector’s overall revenue – lost 17 percent of their assets in 2008 when the economy was in free fall.

**Painful, Arbitrary Cuts:** In August 2011, Congress enacted a law intentionally designed to be so onerous that it would force both sides to the negotiating table to avoid the dangerous consequences. Unfortunately, the resulting negotiations failed. So on January 2, 2013, an additional $54.6 billion will be taken from federal, state, and local programs. Almost every domestic program funded by the federal government will be slashed more than 8 percent, programs that touch virtually everyone in the country, ranging from infants to seniors and safe food to transportation. These cuts will occur not on an informed, considered, priority basis, but arbitrarily and across-the-board, using simple math without regard to human consequences. As the White House warned earlier, “no amount of planning can mitigate the effect of these cuts. Sequestration is a blunt and indiscriminate instrument. It is not the responsible way for our Nation to achieve deficit reduction.” The House has passed a bill noting

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6 The Nonprofit Almanac 2012, Urban Institute’s National Center for Charitable Statistics (2012); see also State of the Sector Report, Nonprofit Center of Northeast Florida (Fall 2012) (“Since 2007, the percentage of nonprofits operating in the red has risen, reaching 45% in 2009, the highest since this research began, indicating the gravity of the recession’s impact”); New Jersey Non-Profits 2012 Trends and Outlook, Center for Non-Profits (April 2012) (“Amid widespread reports of increased demand for programs and services, 40% of responding organizations reported spending more money than they took in during their most recent fiscal year”); Oregon Nonprofit Sector Report 2011 (in 2010, expenses for Oregon-based public charities “increased by nearly one billion dollars, while revenue remained flat. The increased expenses were entirely program related. Management costs actually declined.”).

7 Human Service Nonprofits and Government Collaboration, Urban Institute (Oct. 2010); see also footnote 6.


9 The Nonprofit Almanac 2012 (“What is particularly striking is the decline in numbers of individuals making contributions and bequests during the recession.”).

10 The Nonprofit Almanac 2012.

11 Sequestration Transparency Report, Office of Management and Budget (Sept. 2012) (a 394-page report detailing the cuts to every federally-funded program other than Social Security, Medicaid, Children’s Health Insurance Program, and federal pensions; even Medicare will incur cuts of 2%).
“there is bipartisan agreement that the sequester going into place would undercut key responsibilities of the Federal Government.” Yet these cuts that all agree are wrong remain the law of the land.

Consider AARP’s warning of cuts to "programs that affect older people, including home-based nutrition, Meals on Wheels, transit and housing." Organizations that receive government contracts or grants to carry out their missions will see big chunks of their budgets erased. The nonpartisan Pew Center on the States explains how sequestration cuts ordered by Congress will – among many other things – slash Head Start ($600 million), disaster-relief (nearly $600 million), child care and development ($187 million), and food for women, infants, and children (WIC program – $543 million). These cuts will, once again, both increase the demands on nonprofits while taking away even more money to handle the added burdens.

**Myth:** The fiscal cliff and sequestration will only “cut the size of the federal bureaucracy in DC.”

- **Reality:** Federal funds flow to states and cities to allow their taxes to be lower, so the massive $54.6 billion in additional cuts will reach not just balance sheets in D.C., but every community throughout America. The National Conference of State Legislatures cautions that the scheduled cuts will affect “virtually every category of state-federal discretionary programming,” including “in the areas of education, environment, energy, human services, housing, community development, labor, job training, law enforcement and homeland security.” At the local level, more than 130 Mayors warn on a bipartisan basis that sequestration will force "cuts to a number of critical local services and dramatic job losses for teachers, first responders, and health care workers." And states and localities frequently contract with or provide grants to charitable nonprofits to perform services more efficiently and effectively for the public.

**Myth:** Budget cuts will not hurt people because charitable nonprofits will again pick up the slack created by continued government cuts.

- **Reality:** Charitable nonprofits across America are already struggling to serve rising needs with decreased resources.

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12 H.R. 6365.


14 Jake Grovum, “Sequestration: How a Spending Stalemate Would Affect the States,” Pew Center on the States (Sept. 20, 2012). To translate some of those dollar figures into human impact, consider these facts about how this year alone the sequester will – among other things – cut Head Start by eliminating funding for 75,000 children in need, cut cancer research funding nearly in half for the National Institutes of Health, and reduce the Border Patrol by approximately 1,870 agents. H.R. 6365.


17 See footnotes 5 to 7 above; see also Urban Institute Survey of Nonprofit-Government Contracting and Grants (2010) (noting that in 2009 higher demands and fewer resources forced human service nonprofits with government contracts/grants to take one or more actions, including freeze or reduce employee salaries (50%); reduce employees (38%); reduce health, retirement, or other staff benefits (23%); and, as last resort, reduce service (21%).
• **Observation from a nonprofit food bank in Montana**: “The demand on our services has never been greater than today. Private nonprofits are feeding, housing, and healing those most in need in our community. To take away the tax deductions that make it possible for nonprofits like [our nonprofit] to exist would break these entities. Please don't throw the hungry and homeless under the bus in the process.”

• **Observation from a nonprofit in Michigan fighting child abuse and neglect**: “Do not take away our ability to effectively raise resources and then expect us to fill the social service holes you create with program cuts.”

**Myth**: Nonprofits can fill the void of spending cuts from foundation grants and corporate giving.

• **Reality**: Foundations simply do not have the resources to fill the tremendous funding gaps created by governments retreating. Indeed, combined, foundations and corporations provide only about three percent of the nonprofit sector’s revenues. Generally, on a sector-wide basis (not for an individual nonprofit), about half of the sector’s revenues come from fees (such as tuition, hospital charges, theater tickets), a third from government contracts/grants, and 13 percent from private donations (individuals, foundations, and corporations).

• **Observation from a nonprofit domestic violence shelter in Texas**: “With dollars declining from government, foundations and corporations, our nonprofit depends on individuals’ generosity to ensure we can protect abused women and children with shelter and other services that create contributing members to a healthy community.”

**Threat #2: Taking Away Charitable Giving Incentives**

Politicians have been using sanitized terms such as “limiting tax expenditures,” “reducing deductions,” and “cap on deductions” that obfuscate that such actions could reduce donations to churches, cultural, educational, human services, and every other charitable nonprofit.

**The Squeeze**: Virtually everyone agrees that resolving the deficit will require “a balanced approach” that includes both more revenue and spending cuts. The initial questions then become how to raise the revenue and what spending to cut. On the revenue side involving individuals, the choices are to increase tax rates or reduce deductions. President Obama ran for re-election proposing to freeze tax rates for lower and middle-income individuals and raise taxes on the wealthiest – by allowing tax rates on incomes of more than $250,000 to move from 35 percent to the 39.6 percent rate in place during the Clinton years. Many Congressional Republicans ran for re-election opposing higher tax rates, and instead prefer to raise more revenue by “reducing tax expenditures” and “lowering deductions,” an approach advanced by Governor Romney during the presidential campaign.

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The Threat: It is widely reported that those negotiating to avert the fiscal cliff – Republicans and Democrats alike – are actively considering a proposal to cap itemized deductions at $15,000, $20,000, or some other level.\textsuperscript{20}

How a capped ceiling on deductions would hurt charitable work

Individual taxpayers who itemize would add all of their deductions (such as mortgage interest paid, state and local taxes paid, and charitable contributions made). But they would only be able to claim a deduction up to the amount of the cap. So after adding together their fixed “mandatory” costs of health care, mortgage interest, and state and local taxes paid, there would be little to no room left for discretionary charitable contributions.

- **Basic math leaves out charitable deductions:** The big fixed-cost deductions, such as for mortgage interest (national average of $10,640 in 2010) and state/local taxes (national average of $11,593 in 2010), total $22,233. They would eat away the entire deduction at the cap levels initially being discussed ($15,000 or $20,000), leaving no room for discretionary gifts to the work of the charities. **SOURCE:** “Average Tax Deductions, State by State,” *Wall Street Journal*, (Nov. 18, 2012). Even if the cap were increased to $25,000, given that nationally the average total deductions in 2010 was $26,112, there would be no incentive for making charitable contributions.

- **Discriminatory disincentives.** According to an analysis by the *Wall Street Journal* using IRS data from 2010, a capped ceiling would have disproportionate impact in states with higher taxes and higher real estate costs, where mortgage interest paid is higher. So the capped ceiling for total deductions will hit people in California, Connecticut, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, and New York earlier – thus squeezing out room for charitable contributions. So individuals in those states may not give as much to charitable nonprofits, thus further restricting the ability of nonprofits in those states to meet the growing needs of people there.

Myth: Changes to the charitable giving incentive will have little to no impact on nonprofits, because the charitable deduction does not really motivate people to give more than they otherwise would.

- **Reality:** Congress has long recognized the incentive effect of favorable tax policy, as shown recently when temporarily lifting the annualized limit on charitable deductions and enacting other giving tax incentives to support relief efforts after Hurricanes Katrina and Rita, flooding in the American Midwest, tsunami relief in Indonesia, and earthquake relief in Haiti.

- **Reality:** More than 20 percent of online giving for the entire year occurs on December 30 and 31, demonstrating that tax incentives are on the minds of donors.\textsuperscript{21}


\textsuperscript{21} The Online Giving Study, Network for Good, and True Sense Marketing (2012).
• **Reality:** A 2012 national poll found that “without tax incentives for charitable contributions, 30 percent of Americans would reduce their giving levels” and among “those who would reduce their giving, a majority (62%) indicate they would have to reduce their contributions by a significant amount. (26% would have to reduce their contributions by 50% or more; 36% would have to reduce their charitable giving between 25%-50%).”

• **Observation from a nonprofit shelter in Massachusetts:** “If you believe that people give out of the goodness of their hearts, think again and come see the donations that we receive in December with 'year-end tax donation' written out on the check.”

**Myth:** The charitable giving incentive only benefits wealthy individuals and elite institutions.

• **Reality:** Among itemized deductions, the charitable incentive is the only one for which the donor is encouraged to give money away to help others and not receive a personal benefit. While the taxpayer gets a partial tax benefit (of 10-35 percent) for making a donation, the community gets the entire benefit of every dollar donated to charitable nonprofits. The community, more than the individual taxpayer, would suffer the greater adverse consequences of a cap on the charitable giving incentive.

• **Observation from a church in New York:** "Our outreach programs to the community and financial support for food pantries, housing for homeless persons, minority advocacy, and other programs would not continue without financial support from our members and the community; this would diminish dramatically if the deduction for charitable giving were to disappear."

• **Observation from a nonprofit serving the blind in Pennsylvania:** “Our organization is 90% funded by charitable giving. Changing the charitable giving tax law would hurt our organization substantially. In the current economic time, individual giving has decreased. We can’t afford any additional decrease in giving, if we are to sustain our programming.”

• **Observation from a nonprofit school for disadvantaged youth in North Carolina:** “We work with high school dropouts, young people that have fallen through every crack there is. There is a huge need - and our need is the ability to raise funds to keep going every day. The charitable deduction is essential to that fundraising. And since government is reducing their services to the poorest in our nation we nonprofits have to take on more. To do that we need the money to keep our doors open. Do not take away a very critical tool in our fundraising toolbox!”

• **Observations in this Special Report and hundreds more like them:** They all disprove the false assumption that only elite institutions and wealthy individuals benefit from the tax incentives for charitable giving. Small, local nonprofits in communities throughout America know they depend on charitable contributions.

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22 “The Charitable Tax Deduction Poll was conducted from November 9-20, 2012, by United Way Worldwide. The study was based on phone interviews of 2,000 adults, age 18 and older, with a margin of error of +/-2.2% at the 95% confidence level. It is a representative sample of the U.S. adult population.” Importantly, the survey also found that the “vast majority of Americans (79%) believe reducing or eliminating the charitable tax deduction would have a negative impact on charities and the people they serve.”
Myth: It’s time for everyone to do their fair share and absorb some pain to reduce the deficit, so charitable nonprofits need to suffer some, too.

- **Reality:** Charitable nonprofits already have paid more than their fair share as they have handled the skyrocketing demands with declining resources for more than five years now, helping communities by delivering more services while at the same time depleting their reserves and cutting nonprofit employees’ benefits, hours, and even jobs.23

- **Observation from a New York alcoholism and substance abuse facility:** "Nonprofits struggle all the time to provide programs to more and more recipients. In a weakened economy it has been difficult to fund raise and maintain a workable budget. If charitable deductions are cut, we will cease to exist."

Myth: Curtailing charitable giving will have no effect on the economy.

- **Reality:** Every nonprofit that closes its doors places new strain on the economy. Nonprofit employees, who make up 10 percent of the American workforce, will join the unemployment rolls. For-profit and government employees who rely on nonprofits to care for their children or elderly relatives will have nowhere to turn. People who rely on nonprofits for job training and placement services will remain out of work. The public ultimately will turn to government to create bureaucracies to replace work that was accomplished more efficiently and effectively by charitable nonprofits, thus driving up costs for taxpayers.

- **Observation from a faith-based nonprofit in Michigan:** “If nonprofits are unable to function, what will Congress do to take care of all the needs that nonprofits currently do for low-income families? Additionally, our [nonprofit] creates revenue for local businesses through local purchases made that are donated to our programs. Without charitable tax incentives those local businesses will lose out as well. If Congress does not protect the charitable giving tax incentives there will be a ripple effect that will devastate our Nation at a time when we cannot afford to reduce the number of social service programs that meet basic human service needs.”

**Realistic Solutions**

First, regarding the sequestration spending cuts, while most Americans agree that some spending cuts may ultimately be in order, the arbitrary cuts that are being made across-the-board rather than based on priority needs are completely irrational. Congress can stop these arbitrary cuts on both the defense and domestic sides before they occur. Then Congress could do its work in a meaningful and public way to review spending priorities and make informed decisions based on the merits and factoring in human values and not just simple math.

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23 Indeed, nonprofit employees – who make up 10 percent of America’s workforce – are the ones who have already paid dearly, as the boards and management of nonprofit organizations have responded to the heightened demand for services with declining resources by focusing first of mission delivery to those in need – which has meant that nonprofit employees have suffered as their hours get reduced, benefits withdrawn, furloughs forced, and then jobs lost. See footnote 17 above; The Nonprofit Almanac 2012 (“Some organizations closed their doors during the recession; others cut staff, wages, or program activities to stay afloat”).
Second, in light of all the substantive work load that the federal, state, and local governments have off-loaded onto charitable nonprofits the last several years, Congress can take action to **encourage charitable giving** rather than **discourage** individuals from giving to organizations that are making a real difference in our communities – thereby reducing the burdens on government as a result.

**Action: Use Your Voice and Tell Your Story**

Individual Americans can make democracy and representative government work by contacting your current U.S. Senators and Representatives to share your views. Readers can also share their stories. A convenient site has been created for readers and others at www.givevoice.org.

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