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Tax Policy Analysis

S. 3191 (117th Congress) – Everyday Philanthropist Act

By: Jakub Hench, Tiago Iorio, and Ronald Le, MST Students

On November 4, 2021, U.S. Senators Ben Sasse (R-NE) and Tammy Baldwin (D-WI) introduced the Everyday Philanthropist Act (S. 3191, 117th Congress) and referred it to the Senate Finance Committee as a proposed amendment to IRC Section 132. The bill was introduced as a fringe benefit change and a new tax expenditure to incentivize U.S. taxpayers to engage in pre-tax charitable giving of up to \$2,700 using new Flexible Giving Accounts (FGA). These FGAs would be created using an employer's separate written plan for the benefit of all "eligible employees." Taxpayers would be allowed to deduct the amount they donate through the FGAs as a pre-tax exclusion on their tax return with no charitable donation deduction allowed.

To qualify for a Flexible Giving Account, taxpayers must be an "eligible employee" defined as excluding "highly compensated employee" per IRC Sec. 414(q) and "key employees" per IRC Sec. 416(i). S. 3191 allows employers to exclude otherwise eligible employees who are under 21 years of age, have less than one year of work experience with their current employer as of the current plan year, and nonresident aliens who work outside of the United States.

Employees who qualify for a Flexible Giving Account "may elect—(I) to receive a reduction in compensation and have the employer deposit the amount of the reduction in a flexible giving account of the electing employee, and (II) before the reduction under subclause (I), to designate 1 or more eligible entities to which distributions are to be made from the account." Employers would have to play their part by only allowing a deduction if the qualified employee has named at least one eligible entity to whom the donation in the FGA would go to, engages in providing reductions to the employee after the initial donation deposit to the FGA, is transparent to the employees about the arrangement availability, manages FGAs for qualified employees, and provides qualified employees with financial information regarding the initial deposits and donations made by their FGA during the prior tax year before February 1 of the current tax year.

For example, Louis, a U.S. citizen, is a 23-year-old college student at San Jose State University and works part time for 30 hours a week as a lower-level employee at a technology company for a salary of \$75,000 per year over a period of four years. He is not a highly paid employee, nor does he make significant contributions to the firm. Assume the Everyday Philanthropist Act is passed, and the technology company makes a separate written agreement with Louis to allow him to obtain a Flexible Giving Account. This agreement would allow Louis to provide charitable donations of up to \$2,700 to one or more entities that Louis lists that he would like the donations to go to. This would allow him to take an itemized pre-tax deduction of up to \$2,700.

Application of the Principles of Good Tax Policy

The following section applies the 12 Principles of Good Tax Policy as outlined in the *AICPA Guiding principles of good tax policy: A framework for evaluating tax proposals*¹ to S. 3191, the Everyday Philanthropist Act.

Criteria	Does the proposal satisfy the criteria? (explain)	+/-
<p><i>Equity and Fairness</i> – Are similarly situated taxpayers taxed similarly? Also consider any different effects based on an individual’s income level and where they live.</p>	<p>Horizontal equity requires similarly situated taxpayers to be taxed similarly. This principle is not met in this proposal because for two eligible individuals with the same level of income, the benefit of this credit may or may not be the same because let’s say earning \$80,000 for company A may allow you to be eligible for this deduction, while earning the same \$80,000 for company B may not allow you to be eligible for this deduction if that is considered “highly compensated employee” for company B. Factors such as the type of industry who work in, size of the company, and other factors, can easily change eligibility.</p> <p>It is also important to consider whether the employer allows employees to set up Flexible Giving Accounts. Let’s say that Company A allows their employees to obtain FGAs while Company B decides not to allow employees to obtain FGAs. Employees at Company A making \$80,000 a year would be allowed to take the pre-tax deduction for donations made to FGAs while employees making \$80,000 at Company B would not qualify for the pre-tax deduction owing to their inability to obtain an FGA. Thus, the principle of horizontal equity is not satisfied.</p> <p>The vertical equity principle is satisfied when taxpayers with higher income pay more tax than taxpayers with less income. This logic also applies to deductions in the sense that taxpayers with higher income should receive less deductions than taxpayers with lower income.</p> <p>S. 3191 includes a cap of the amount of pre-tax FGA deductions that taxpayers may take of \$2,700. A high-income person with a salary of \$300,000 per year would take the same amount of deductions as a low-income</p>	<p>+/-</p>

1 American Institute of Certified Public Accountants. Tax Policy Concept Statement 1: Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals, Association of International Certified Public Accountants, 2017.

	taxpayer making \$30,000 a year (assuming both are “eligible employees”). Hence, vertical equity is met for the Everyday Philanthropist Act.	
<i>Certainty</i> – Does the rule clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined?	<p>The proposal provides a good description of how and when the amount of the deduction is determined. It is determined based on the “written plan of an employer for the exclusive benefit of all eligible employees” and the timing of this credit is determined “on or before January 31 of each year” based on “a written accounting of the employee’s flexible giving account showing deposits and disbursements during the previous calendar year.” This credit is only available for individuals who are “eligible employee[s]” per Section 2, (o)(2)(A)(i).</p> <p>The amount to be deducted (i.e. not paid) is determined per “amount of the reduction in a flexible giving account of the electing employee” up to \$2,700.</p> <p>This proposal also clarifies if there will be any changes to the individual income tax return form due to this deduction. So, the taxpayer will be able to get the deduction while filing a tax return.</p> <p>However, while employees should be able to comprehend that they can qualify for a pre-tax deduction based on the amount of charitable donations that they provide for an FG, some may have a difficult time determining whether they qualify as an eligible employee. S. 3191 identifies an eligible employee as “any employee who—(I) is not a highly compensated or key employee, and (II) has not been excluded from the arrangement.” S. 3191 does not define what a highly compensated employee or a key employee is, instead redirecting the definitions to IRC Sec. 414(q) and IRC Sec 416(i). This adds some uncertainty on part of the taxpayer as to whether they would qualify as an eligible employee, highly compensated employee, or key employee.</p> <p>The level of confidence in this proposal is neutral because on one hand, the calculation for this credit described in the bill is easy to understand, and it will use information from reliable sources. However, it does not provide the taxpayer with any information about what constitutes a highly compensated employee or a key employee.</p>	+/-
<i>Convenience of payment</i> – is the tax	The bill's introduction of the flexible giving account and its distributions do not affect the due date to pay taxes or	

<p>due at a time that is convenient for the payor?</p>	<p>methods to pay them. Also, the distributions are considered to be charitable contributions to the eligible entities and might make it easier for taxpayers to pay their taxes as they decrease the amount owed if they could itemize said distributions.</p> <p>This is why the bill is neutral for the principle of convenience of payment.</p>	<p>+/-</p>
<p><i>Effective Tax Administration</i> – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also consider the time needed to implement this tax or change.</p>	<p>S. 3191, the Everyday Philanthropy Act, provides a simple calculation for the taxpayers since they only deduct a pre-tax amount based on the total amount of deposits that qualified taxpayers put into their flexible giving accounts as long as they are at or below \$2,700. Given that the bill provides guidance on how to be eligible for FGAs, who may qualify, and how to attain the pre-tax deduction, the government would incur low costs enforcing compliance with the law. But they need to provide guidance to employers and employees.</p> <p>Taxpayers would also incur low costs in following the Everyday Philanthropy Act due to being attracted by its promise of a pre-tax deduction along with its simplicity in understanding the rules. However, the amount of compliance costs can further be lowered if the IRS could explain to taxpayers what a pre-tax deduction is. That is, when can they deduct the charitable donated amounts that they gave to their FGAs. This would allow taxpayers to understand whether they are given a benefit.</p> <p>Hence, S. 3191, the Everyday Philanthropy Act, meets the effective tax administration requirement.</p>	<p>+</p>
<p><i>Information Security</i> – Will taxpayer information be protected from both unintended and improper disclosure?</p>	<p>The new information introduced by the bill is the flexible giving account and the eligible entity of where the distribution from said account is given. The distribution will not be excluded from gross income unless taxpayers specify the name and address of the eligible entity on their tax returns. The bill also does not state whether the charities named by the employee in their flexible giving accounts require the employees to provide them with employees' taxpayer identification number (TIN). Hence, it is possible that the information may not be for an eligible entity and, as such, misused due to unintended and improper disclosure of taxpayer information.</p>	<p>+/-</p>

<p><i>Simplicity</i> - can taxpayers understand the rules and comply with them correctly and in a cost-efficient manner?</p>	<p>The taxpayers can understand the rules regarding S. 3191, the Everyday Philanthropist Act, and comply with them in a cost efficient manner. The taxpayer needs to elect whether or not they would like to deposit money (up to \$2,700) into a flexible giving account that would be later donated to a charity or charities of their choice. The taxpayer also needs to name the charities where they would like the money deposited in their FGA to go to.</p> <p>The Everyday Philanthropist Act also clearly defines which taxpayers can qualify to attain a FGA, including identifying “eligible” employees, that is employees who are neither highly compensated nor key employees, as a taxpayer working in the United States, at least 21 years of age, and has more than one years of work experience with their current firm in the taxable year that they apply for the FGA.</p> <p>However, there should be an explanation in the bill as to which taxpayers constitute a highly compensated or key employee instead of redirecting the taxpayer to IRC Sec. 414(q) or 416(i). There should also be a provision in the proposal directing employees to send information to employers including prior employers and educational institutions, and bank statements, to help employers verify whether their employees can be classified as eligible employees. At present, the absence of this specific provision means more work and complexity for the employers to verify their employees as eligible employees.</p> <p>Despite this, S. 3191, the Everyday Philanthropist Act, passes the simplicity test to attain a simple understanding of the bill for taxpayers.</p>	<p>+/-</p>
<p><i>Neutrality</i> - The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</p>	<p>The goal of this principle is to minimize situations in which a taxpayer’s decision is affected by a tax rule.</p> <p>For taxpayers who are eligible for this deduction and use the standard deduction, this flexible giving account will be more likely to have an impact on their behavior since they would actually be able to deduct (up to \$2,700) in their tax return the amount contributed to this account. In other words, this bill can help them get a higher tax deduction, which could influence them to donate more money through the flexible giving account.</p> <p>However, the percentage of taxpayers taking itemized deductions has always been small. Currently, the</p>	<p>+/-</p>

	<p>percentage of taxpayers taking itemized deductions is 11%. Before the passage of TCJA, the percentage of taxpayers taking itemized deductions was 30%. In this regard, the Everyday Philanthropist Act would encourage more employees to take itemized deductions instead of standard deductions as the pre-tax deduction is an itemized deduction.</p> <p>For other taxpayers, particularly the ones who itemize deductions or/and who are “highly compensated employee” or “key employee”, this bill most likely will have no effect since they can donate to charity and itemize those amounts (subject to AGI limitations) regardless of this flexible giving account.</p> <p>Low-income taxpayers are also less likely to get impacted because they earn less money, so may not be able to afford to make charitable contributions. This accounts for 40% of all taxpayers in the U.S., with the remaining 60% being those who likely can afford to make charitable donations. This displays favoritism to the top 60% of U.S. taxpayers compared to the bottom 40%.</p> <p>Overall, the influence to carry out a particular transaction will be neutral with this bill.</p>	
<p><i>Economic growth and efficiency – will the tax unduly impede or reduce the productive capacity of the economy?</i></p>	<p>S. 3191, the Everyday Philanthropist Act, provides taxpayers “a tax-advantaged flexible giving account as a fringe benefit. Flexible giving accounts allow employees to set aside up to \$2,700 of their annual pretax earnings to make tax-deductible charitable contributions without having to itemize tax deductions.” This bill will not impede or reduce the productive capacity, as “the philanthropy industry . . . thrive[s] as the economy prospers”.² Hence, as the economy is also dependent on charitable and philanthropic giving, the Everyday Philanthropist Act would help the economy prosper even more, especially given that as “. . . [of] 2021, the civilian labor force of the United States numbered about 161.2 million people.”³ Hence, S. 3191 passes the economic growth and efficiency test.</p>	<p>+</p>

2 Murillo, Ruben Hernandez, and Deborah Roisman. “The Economics of Charitable Giving: What Gives?” Saint Louis Fed Eagle, Federal Reserve Bank of St. Louis, 1 Oct. 2005, <http://www.stlouisfed.org/publications/regional-economist/october-2005/the-economics-of-charitable-giving-what-gives>.

3 Statista Research Department. “Topic: Employment in the United States.” Statista, Statista, 21 June 2022, http://www.statista.com/topics/771/employment/#dossierContents__outerWrapper.

<p><i>Transparency and Visibility</i> – Will taxpayers know that the tax exists and how and when it is imposed upon them and others?</p>	<p>It is likely that employees and employers can get the information about the bill from tax professionals, charitable organizations, and their employer. However, it is also unlikely that taxpayers as employees may not know that the entity that they named and addressed the distributions to may be eligible or not. Employees may not consider themselves to be highly compensated or a key employee for them to not have a flexible giving account.</p> <p>As such, the transparency principle is partially met.</p>	<p>+/-</p>
<p><i>Minimum tax gap</i> – is the likelihood of intentional and unintentional non-compliance likely to be low? Is there any way people may intentionally or unintentionally avoid or evade this tax or rule?</p>	<p>The likelihood of intentional and unintentional noncompliance is likely to be low because it provides taxpayers with a simple understanding in how to qualify for a flexible giving account, the amount of money that can be donated via an FGA (up to \$2,700), and the fact that they can achieve a pre-tax deduction from an FGA. This bill would attract most middle-income taxpayers who use the standard deduction so they can take advantage of charitable giving and helping the economy while being able to take a pre-tax deduction. The bill would also encourage employers to comply with this proposal should it pass as the bill directs them to write a separate written plan with the employees to help the employees obtain a FGA. Thus, this bill would result in a wider taxpayer base and meets the requirement of minimum tax gap.</p>	<p>+</p>
<p><i>Accountability to taxpayers</i> – Do taxpayers have access to information on tax laws and their development, modification and purpose; is the information visible?</p>	<p>The bill has a strong intention to encourage eligible employees to make a reduction of their paid wages to invest in the flexible giving account for each employee to make charitable contributions all the while their employer manages each account. The rationale for making distributions from the flexible giving accounts can be clear to both employees and employers. However, employees who are not designated as highly compensated or a key employee are unlikely to elect a cut of their earnings and need information of who exactly is eligible to invest in the flexible giving accounts. Lawmakers, however, are likely to support such a rationale to increase charitable contributions.</p>	<p>+/-</p>
<p><i>Appropriate government revenues</i> – will the government be able to determine how much tax</p>	<p>The cost of providing this deduction could be estimated by knowing how many taxpayers have W-2 income, minus the ones that are considered to be a “highly compensated employee” defined per 414(q) or “key employee” defined per 416(i). According to IRS statistics from 2018 (latest data</p>	<p>+/-</p>

<p>revenue will likely be collected and when?</p>	<p>available), there were 144,631,072 taxpayers with wage income.</p> <p>The \$2,700 limit on the total contribution still helps the government a little bit in having a basic idea of the maximum amount of government tax expenditure per taxpayer with this bill.</p> <p>However, it is challenging to estimate how many are considered to be a “highly compensated employee per 414(q), which is defined as being in the top 20 percent of the employees when ranked based on the compensation during that year. This calculation is different for every company, so it is very difficult to have an estimate. For instance, for company “A”, a highly compensated employee could earn \$80,000 while in company “B” this number could be \$200,000.</p> <p>Additionally, the amount contributed to this flexible giving account could fluctuate based on variables such as the condition of the economy, the salary (which if you get promoted and get a raise, you might now be considered “highly compensated employee”), and other factors.</p>	
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Summary:

Overall, S. 3191, the Everyday Philanthropist Act, passes the majority of the requirements in the principles laid out by the AICPA’s Principles of Good Tax Policy. Through this analysis, we have determined that the Everyday Philanthropist Act provides U.S. taxpayers with more benefits than weaknesses. Given that the bill has a good intention of encouraging charitable giving through the use of flexible giving accounts (FGAs), one strength that it possesses is that it provides taxpayers with the simplicity and certainty on how the requirements of obtaining an FGA and how the proceeds in the FGA get distributed. Another strength that the bill has is that it encourages economic growth and efficiency as charitable giving to non-profit entities plays a major factor in the growth and prosperity of the economy. Another strength that this bill has is that it encourages compliance with taxpayers given the bill’s simplicity, certainty, and attractiveness of a possible pre-tax deduction. This bill also does not widen the tax gap or provide any excess burden to neither the US government nor US taxpayers.

One weakness that S. 3191, the Everyday Philanthropist Act, provides is in regard to equity and fairness. Even if “eligible employees”, employees may only participate if their employer establishes an FGA plan.

Another weakness presented by the Everyday Philanthropist Act is that it does not provide a definition on what constitutes a highly compensated employee or a key employee without referring to Code sections and company information. Every employer or company has a different

limitation of what constitutes a highly compensated employee, and employees may consider themselves to be highly compensated in different situations.

One simplification for the proposal is to remove the limitation for “highly compensated employees” to participate. These individuals may not opt to participate anyway as they likely itemize deductions so can claim charitable contributions and the FGA amount may not be large enough to entice them to participate.

This bill is directed towards middle income taxpayers who use the standard deduction and end up not receiving the temporary tax deduction over \$300 (single) or \$600 (MFJ) for contributing to charity that existed in 2021. For example, with this bill, a middle-income taxpayer who is in the 22 percent tax bracket, single, and uses the standard deduction, could donate \$2,700 through their employer’s flexible giving account. The \$2,700 deduction for this taxpayer would lower the tax liability by \$594 dollars ($0.22 \times 2,700$), whereas without this bill, this taxpayer would only get a tax reduction of \$66 ($0.22 \times \300, if the small above-the-line charitable deduction were renewed).

In conclusion, S. 3191, the Everyday Philanthropist Act, is a helpful idea to encourage individuals to give to charity while lowering their tax liabilities with a pre-tax deduction and encourages donations even without itemizing deductions. However, this bill should be passed in a way that provides more horizontal equity among U.S. taxpayers, discourages noncompliance and tax evasion, and identifies which taxpayers are allowed a flexible giving account and subsequently a pre-tax deduction.