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SOME THOUGHTS ON THE VALIDITY  
OF ESTIMATES OF CHARITABLE GIVING

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No one -- repeat, no one -- knows how much money and other property is given to charity in any given year. In the absence of a Big Brother-like computer that keeps track of all the financial details of every individual's life and all the details of every organization's transactions, we will probably never know. But we do have bits and pieces of information from which we can estimate what these flows of funds are. Our real task is to make those estimates as valid and accurate as possible.

The most widely accepted, the only, and therefore the best estimates of overall charitable giving in the United States are those published annually in Giving, USA, a product of the AAFRC Trust for Philanthropy. Having for many years been an advisor in the process by which these numbers are developed, I am keenly aware of the skill, intelligence, and effort that is involved in producing those estimates. I am also aware of the virtues and

vices of the techniques and data sources that have been utilized. Let me assure you that the production of this publication is not an easy task, that the people involved agonize over the numbers, and that every method and procedure used in preparing the estimates undergoes close examination and is subject to change as new techniques and data sources become available. In short, Giving, USA rates an "A-plus," at least for effort.

Having said that, I must confess to a deep sense of unease. In the absence of any alternative set of estimates from any other source, public or private, the Giving, USA figures are accepted as gospel; in some quarters, they have become as though graven in granite. It seems very unlikely that anyone will develop a competing set of estimates any time in the foreseeable future, one that would use different techniques, and perhaps alternate sources of data, against which we could make comparisons. For the time being, we are stuck with Giving, USA, and any time we need to know anything about charitable giving -- in the large -- in this country, this is the bible to which we turn. But we must face the truth: we really do not know how good these estimates are, in whole or in part, and that is a cause for concern.

My worries are partly conceptual, partly empirical, and partly procedural. The purpose of this paper is to touch on these matters, to list some of the problems involved, and to create an awareness of just what these numbers do and do not tell

us. If this be viewed as criticism, it is intended to be just that, with every intention to make it as constructive as possible. If I understand correctly our purpose in being here today, it is to exchange views about the strengths, weaknesses, and the possibilities for improvement in the production of this kind of information.

### Conceptual Problems

My first concern is with definition. Implicit in the scheme used by Giving, USA is the notion that, on the one hand, there are people and organizations that give for charitable purposes, and, on the other hand, there are various recipient organizations in the charitable community to which such funds flow. In principle, the totality of the amounts given should equal the totality of the amounts received. Visualize a rectangular matrix, in which the rows represent the classifications into which we put charitable recipients and the columns represent the sources of charitable giving. Each cell contains an estimate of the amount of giving from a given source to a given group of charities, and the sum of the row totals equals the sum of the column totals. In broad, conceptual terms, this scheme is the ideal representation of what we strive to know.

The real world, however, is a little more complicated than that. Within the charitable community, for example, there are not only inflows of funds from the rest of society, there are

also flows of funds between charities, and it is imperative that these kinds of transfers be eliminated in order to avoid double counting. Many examples of this come immediately to mind. Local United Ways raise funds from the public and then disburse some of these funds to qualified charities in their areas; obviously, we do not want to count both the money received by the United Way and the money received by the ultimate charitable recipient. Many churches and other religious organizations operate in a similar manner; some of the funds received as gifts from their constituents and others are then disbursed to various related but separate entities. There are many other examples, and none of them really pose much of a problem.

The major area that does pose a problem in this domain is the private foundation, that independent, grant-making entity often described as a pool of money surrounded by outstretched hands. In the context of Giving, USA, private foundations are included as a source of funds, and the sum of their grants to other charities is treated as one component of the total flow of philanthropic dollars.

There are many good reasons for doing this. After all, private foundations have become important fixtures in the philanthropic community and foundation funding is a very important source of revenue to many educational and charitable organizations. Moreover, it is useful for many purposes to know

the total of foundation grant-making activity and the way in which it is distributed by purpose and by type of charitable recipient.

I would suggest, however, that it is a mistake to include private foundations in our measure of total philanthropy, for one simple reason: private foundations themselves are charitable organizations (as defined by section 501(c)(3) of the Internal Revenue Code) and as such are the recipients of significant levels of funding in the form of gifts and bequests from individual donors and their families. By including them, we are in fact double counting some of the dollars that flow from the ultimate donors to the ultimate donees.

Note that I said "some of the dollars." The conventional wisdom of foundations dictates that they should function as perpetual endowments, and in practice there have been very few exceptions to this rule. This means that the principal sums donated or bequeathed to them are to be invested and reinvested in such a manner as to generate a stream of income -- presumably increasing over time -- that is to be used for charitable purposes. As a rule, only the income from a foundation's corpus, minus foundation operating expenses and the federal excise tax on investment income, is passed on to other charities.

This is the way foundations work, and some of them have done

such a superlative job of asset investment in the years since they were founded that the total of their charitable grants is far in excess of their original corpus, while at the same time they have increased that original corpus by a large multiple. Some would argue that this fact negates the fear of double counting, pointing out that the funds that flow from private foundations to other charities come not from the amounts given to the foundations but from the earnings on those original amounts, typically over a period of many years following the time when the foundations were created.

In this respect, however, private foundations are very much akin to the endowments of other charitable entities, such as colleges and universities, hospitals, churches, and museums. In fact, there are a few examples in which private foundations have transferred some or all of their endowments to various ultimate charitable recipients, and those instances represent blatant double counting. We would certainly not think of including the incomes earned from all the accumulated endowments of non-foundation charities as part of the flow of current philanthropy, even though this does represent a flow of resources to charity that is made possible by private donors. In my view, we should also not think of including grants made out of the income generated from the investment of foundation assets, or any transfers of those asset to other charities, as part of the current flow of charitable giving.

There are many in the philanthropic community, including some associated with private foundations, who will view these thoughts as rank heresy. The inclusion of foundation grants as a source of private financial support to charitable causes has long been woven into our concept of the philanthropic sector, and the various sample surveys of giving in areas like education, the arts, and human services have long accepted this as the right thing to do. I would suggest, however, that this is a subject for reconsideration, that there should be an honest debate on the question, and that we be prepared to change our mode of thinking on the subject if there should be a net gain to our broader objective of measuring the flow of philanthropy in a valid way.

#### Empirical Problems

Looked at from the point of view of charitable recipients, total philanthropic giving is the sum of all the gifts, grants, and bequests -- what the accountants call "unilateral transfers" -- that are received from outside the charitable community in the course of a year. Now we think we know what we mean when we use a term like "charitable recipients;" in our usual parlance, the charitable community is the totality of entities (including private foundations) that are defined as tax-exempt in section 501(c)(3) of the Internal Revenue Code, and that is about as good a definition as there is.

To refresh our memories, this includes "corporations, and any community chest, fund, or foundation, operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.." [Internal Revenue Code, Section 501(c)(3)]. For many years, the Internal Revenue Service has published a list of all the organizations that it has determined to be qualified as tax exempt under this definition, and the publication now resembles the Manhattan telephone directory, with something of the order of 300,000 listings. As a practical matter, this is what we mean when we refer to the charitable community, and there can be no real quarrel with this concept.

If each and every one of these organizations could supply us with a detailed financial statement, showing all contributions received, by source, we would have the means of estimating the flow of charitable gifts in this country that would be fairly close to the mark. As a matter of fact, however, there is a substantial number of these entities that are not required to report financial information to any public authority and they are either unwilling or unable to report such information to any private data collection agency. Churches and other religious organizations are the most important group in this category, but there is also a host of other organizations so small that they

are partially exempted from government reporting requirements.

This being the case, it is simply not possible to measure the flow of charitable giving by adding up the amounts received by charitable entities. There are several ways of estimating the desired numbers, including those based on sample surveys, but the errors of estimate are believed to be relatively large, at least for some of the major categories of charitable organizations.

The alternative is to measure the amounts given by the donors, and as promising as this procedure might seem, it leaves much to be desired as far as the available data sources are concerned. The one source to which almost everyone turns for information in this area is the Internal Revenue Service. What is more natural than to look at the amounts of charitable contributions deducted by individual and corporate taxpayers on their annual income tax returns? For many years, this has indeed been the source of all wisdom on charitable giving. Upon close examination, however, there are three problems with these data.

The first is well known. The Statistics of Income, those marvelous tabulations of individual tax returns published by the IRS, can show the amounts of charitable giving only for those taxpayers who itemize their personal deductions for tax purposes. The proportion of all taxpayers who itemize has fluctuated widely over the years and now stands at roughly 25 percent. This means

that we have virtually no information about the charitable giving of three-quarters of those who file tax returns. And we know next to nothing about the amounts given to charity by those who do not file any tax returns at all.

For its estimates of charitable giving by individuals, Giving, USA faces another problem, and that is that the Statistics of Income for a given tax year is not available for two or three years after the fact. This means, for example, that in the spring of 1992, when Giving, USA for 1991 is put to bed, there is no authoritative information about charitable giving by individual donors, even for itemizing taxpayers, for any year since 1989.

Second, there are defects in the tax file data that apply to the tax returns of both individuals and corporations. When we look at individual giving by income level, which data are important for many purposes, including the estimation of the effects of tax changes on personal giving, the Statistics of Income is still the most authoritative source, at least for the taxpayers who itemize. If one looks closely at those data, however, the question of validity rears its ugly head (let us avoid the question of accuracy lest we impugn the honesty of taxpayers). Presumably, the amounts deducted by taxpayers conform to the definitions, limitations, and other provisions of the Internal Revenue Code, and this opens up several gaps between

what is reported as given by donors and what is reported as received by charitable donees.

A few specifics. In addition to the amounts given in cash or by check, taxpayers are permitted to deduct certain expenses they make on behalf of charity, including transportation costs, meals, and similar out-of-pocket expenses. I have no quarrel with the deductibility of such outlays; if they were given to the charities and then reimbursed to the donors as explicit expenses, the effect would be the same except that the donees would record higher levels of contributions received and equally higher levels of expense incurred. As matters stand, however, amounts that donors legitimately may report can be and probably are higher than the amounts received by charities.

There are other defects. The Internal Revenue Code limits the amount of contributions that a taxpayer may deduct in any one year. Since the limit on individuals' deductions for cash gifts is 50 percent of adjusted gross income, this limitation does not impinge on the vast majority of taxpayers whose giving runs in the range of 2-5 percent. But for the very wealthy who make gifts in the mega-dollar league, it can be important. And there are other limitations involving gifts of appreciated property (which are typical for mega-gifts, and, in the case of some non-cash gifts, often raise questions of valuation) and gifts to private foundations.

For any and all taxpayers faced with these limits, the Code provides for a carryover to future years' tax returns, so they do not lose their contributions deductions in excess of the limits, they merely have to postpone them to subsequent years. Obviously this produces at least a little distortion in the figures reported by the IRS. This year's deduction totals, for example, include some gifts made in prior years and exclude some gifts actually made this year. The net distortion is unknown because no one has looked at this problem; it may not amount to much, but then again it may be substantial, we simply do not know.

For corporations, there are even more problems with the IRS data. The most important of these defects have been detailed elsewhere [Smith, 1991], but it is worth noting that there is one that is unique. Many corporations, mostly the largest ones, have established private foundations as channels, or conduits, for their charitable contributions. While they are legally private foundations in all respects, corporate foundations are in reality merely charitable subsidiaries of their sponsoring companies. They are, with virtually no exceptions, staffed and governed by corporate employees, and their grants programs are essentially indistinguishable from corporate direct giving programs.

The ideal measure of corporate giving would be the consolidated giving of corporations and their sponsored foundations, with an elimination of the amounts transferred by

corporations to their foundations. Estimates are now available that make adjustments for this problem, and they show that in recent years total consolidated corporate giving exceeds, by roughly half a billion dollars, the figures published by the IRS.

There are other defects in the corporate tax files, two of which are worth detailing here. The carryover problem mentioned in the case of individuals is a very significant defect in the corporate giving data, because the charitable giving deduction for corporations is limited to 10 percent of taxable income. In any given year roughly 40 percent of all corporations report a net loss for tax purposes, which means that they may deduct nothing at all. The amounts not deducted may be carried forward to the following five years, and the result of this is that the figures for any given year include contributions made in the past and exclude some contributions made in the tax year itself. In a period of rising contributions it seems likely that this defect results in a net understatement of true corporate giving.

The other noteworthy defect has to do with gifts of a corporation's own products, that is, gifts of inventory. There are strict rules regarding the valuation of such gifts, the net effect being that they are reported for tax purposes at something less than their fair market value. At the same time, however, what is reported to the recipients of such gifts is not this tax-deduction value; rather, it is the fair market value. Hence,

there is a gap between what corporate donors say they give and what the charitable recipients say they receive.

The only available estimates of the total magnitude of these and other defects in the corporate tax files suggest that they currently add up to another half a billion dollars. So the IRS data on corporate giving is now roughly one billion dollars short of the actual flow of funds from the corporate community to the nation's charitable enterprises.

Then there is the matter of bequests. Again, the IRS tally of charitable deductions is widely regarded as the authoritative figure on this subject. But it is worth noting here that the IRS specifically excludes information on this subject for estates of less than \$500,000. At this time, we have no idea of the shortfall between the total of actual bequests to charity and the amounts that are tallied by the IRS.

The third problem in this area applies to both individuals and corporations. The organizations to which tax-deductible gifts may be made are defined not in section 501(c)(3) but in section 170(c) of the tax code, and that definition includes not only the charities defined in section 501(c)(3) but also governmental entities (such as public schools, colleges and universities, hospitals, and similar institutions), certain fraternal organizations, cemetery companies, and veterans

organizations, not all of which are quite what we usually have in mind when we think of charities. This is clearly another case of definition, and some may well argue that if the purpose of such gifts is philanthropic we should include these amounts even if the funds do not accrue to private charities.

These defects in IRS data sources are by no means fatal to our efforts to measure charitable giving. We should, however, be aware of them and make reasonable attempts to adjust this data to accord more closely with the general notion of philanthropy.

#### Procedural Problems

Faced with the unavailability of usable data, the producers of Giving, USA have been forced to turn to other techniques to prepare their current estimates. For gifts by individuals, the one now in use was developed by Dr. Ralph Nelson of Queens College, City University of New York, and it uses an econometric equation, one virtue of which is that it "fits" the available data for most past years reasonably well [Nelson, 1986]. Dr. Nelson's Personal Giving Estimating Model uses five independent variables as predictors: (1) total personal income, (2) the population in the prime giving ages of 35 through 64, (3) Standard and Poors' 500-Stock Index for the year-ending months of November and December, (4) political party of the President of the United States, and (5) a time trend. Given the time constraint for publication, I doubt that anyone could produce a

better estimate, although one would hope that continuing research might produce an alternate equation that gives even better results.

It is important to bear this equation, with all its virtues and vices, in mind. It is a pure, empirical estimate, not built up from the bits and pieces of data that are available (although those bits and pieces are used as a cross check, to the extent possible), and not directly verifiable against any tabulation of amounts reported by either individual taxpayers or recipients.

It should be especially noted that the most important independent variable, personal income, is itself an estimate, one of the components of our national income accounting framework developed by the U.S. Department of Commerce. The definition of personal income in this context includes certain imputed amounts that do not represent cash flows, such as the rental value of owner-occupied dwellings, and one may question whether such imputations have anything whatever to do with charitable giving.

All the components of the national income accounts are revised from time to time as more complete information becomes available, and the Personal Giving Estimating Model is likewise updated when revised estimates of personal income are published. The point of all this is that the first estimates published in Giving, USA are at best preliminary and tentative. But even when

the estimates of individual philanthropic giving are revised to take account of new figures on personal income and other data, we still do not have any means of verification.

I have one major difficulty with this procedure. Some of the explanatory variables do not accord with any conceptual framework, or theory, about charitable giving. We all feel strongly that charitable giving is a function of personal income, however defined, and it is probably also a function of personal wealth, for which the stock market index is but one acceptable surrogate. But the use of the 35 to 64 year-old age group is questionable, as is the political party of the occupant of the White House. And the use of a time trend simply begs the question of all the other factors that have come to be viewed as important determinants of giving. That the equation appears to work reasonably well may be a sheer accident, just as spurious correlations often give the right answers -- for the wrong reasons.

One final concern, one that has to do with the adjustments to current dollar estimates to take account of inflation. There is a need to know how the flows of charitable giving change from year to year in terms of dollars of constant purchasing power. But there are two problems with the data published in Giving, USA. One is that we need sector-specific price indices for each of the major categories of charitable organizations, and with one

possible exception they simply do not exist. The exception is in higher education where there does exist a Higher Education Price Index that measures the changes in the prices of a market basket of the goods and services on which colleges and universities spend their money. It would obviously be useful to have similar price indices for human services, health, the arts, and all the other sectors.

The other problem is more complicated. Sector-specific price indices would give us information about the impact of inflation on various categories of charitable recipients, but they would not measure the changes in the purchasing power of the resources given as far as the donors are concerned. In the case of corporations, for example, their contributions represent money and other property that has alternative uses in corporate business, and changes in the purchasing power of those resources may have an important effect on the giving decisions of corporate donors.

In the absence of what is needed in this area, Giving, USA has, in recent years, made an effort to focus on a price index that relates to what philanthropy is all about rather than to fall back on the Consumer Price Index, and that is the implicit deflator for the services component of the Gross Domestic Product. Conceptually, at least, this index is preferable to the CPI, because it is designed to measure the changes in the prices

of a fixed assortment of all the services produced and consumed within this country. For the most part, charity consists of services rather than goods, and that fact makes this index more germane to the task of making an inflation adjustment to the data on philanthropy than would be the case with the CPI. But one is still entitled to question whether any single index is appropriate for all the data series in Giving, USA.

#### Summation

This review has not been intended to be a comprehensive list of all the questions that might be raised about the validity and accuracy of our estimates of overall charitable giving in this country; rather, it is merely a selective list of those issues that appear to me to be most important. Others in this field, including those who produce Giving, USA, undoubtedly have lists that differ.

While we are the envy of the rest of the world in terms of the amount of data we have on the flow of charitable giving, it must be admitted that we are still in the early stages of philanthropic accounting; after all, the existing constellation of data has emerged in only the past 50 years. Where will we be in the middle of the 21st Century?

Clearly, we need further research in all the areas I have mentioned and all the areas that others may feel to be

significant. Estimates of overall charitable giving are too important for us to rest on whatever laurels are due, and they should not be incapable of rigorous defense against questions that might be raised by the media or by government. It is well to bear in mind the strengths and the shortcomings of the best estimates we have, and to resolve that every effort should be undertaken to make those estimates more valid, more accurate, and more useful.

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