



Tax Psychology and the Timing of Charitable-Giving Deadlines

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This brief discusses the timing of the charitable-giving tax deduction deadline, evaluated in light of recent evidence from the behavioral public finance literature. We discuss how tax salience, inattention, and aversion to taxes interact with different possible deadlines. We present several arguments in favor of moving the charitable-giving deadline to tax day.

Background of the Policy Decision

Incentivizing and rewarding donations to charitable organizations is a commonly pursued policy goal. To this end, charitable donations receive favored treatment in the federal tax code. Tax filers may claim their charitable giving as an itemized deduction, reducing taxable income and thus taxes paid.

Under the current system, charitable-giving tax accounting aligns with the calendar year. A tax filer sitting down in March 2016 to complete a 2015 tax return would need to document charitable giving activities between January 1, 2015 and December 31, 2015. In this brief, we consider the merits of a modification of this deadline permitting tax filers to deduct any charitable donations made prior to the tax filing deadline (typically April 15 of the following year). Under this policy, if a tax filer donated to charity in March 2016, he or she could immediately claim the deduction when filing a 2015 tax return.¹ This alternative deadline has been examined in past research and policy writing (Steuerle and Sullivan

1995; Steuerle 2013)² and was included in the America Gives More Act of 2014, which passed the US House of Representatives in July of 2014.

How might these different deadlines influence people's motivation for charitable giving? In this brief, we approach this question based on insights from the behavioral public finance literature. We focus on three arguments:

- If people are present-focused, they will be most motivated by tax incentives when these incentives can be claimed very quickly after a donation.
- If incentives administered through the income tax are normally confusing or not fully salient, then the increased attention to tax rules that occurs before the April 15 deadline provides a window where tax incentives have more influence on behavior than usual.
- The interaction between tax aversion and tax salience would similarly advantage the April 15 deadline.

Psychological Influences of Tax Deadline Response

Present-focused Behavior

Under the current system, tax benefits from charitable donations made between January 1 and April 15 are claimed more than a year after the initial donation. Under the alternative deadline, tax benefits from these donations could be claimed nearly immediately, depending on the date the donor chose to file. Most economic models incorporate time discounting and thus would predict the incentive to be valued higher by donors under the alternative deadline.

While neoclassical and behavioral economists would both agree that rewarding an action sooner increases incentive, they would likely disagree about the size of the effect. For a fully rational donor, with time-consistent preferences and a discount rate in line with that provided by financial markets, the effect should be small. However, a large body of work suggests that people are present-focused (Frederick, Loewenstein, and O'Donoghue 2002) and discount future costs or rewards significantly more than market interest rates would predict. We believe that, for charitable-giving decisions made near April 15, the prospect of a deduction from the taxpayer's soon-to-be-filed return is sufficiently imminent to avoid the heavy discounting of more distant future states. Under this assumption, people's tendency to be present-focused implies that the alternative deadline would provide greater motivation for charitable donations.

Before advancing our next two arguments, we first briefly summarize the relevant literature on tax salience and tax aversion. We then discuss how this psychology interacts with the deadlines considered and the present-focus discussed above.

Tax Salience and Attention

When tax systems are complex, some features may not be fully understood. Some of the most influential work on this topic has demonstrated that the lack of visibility of sales taxes meaningfully influences demand for products (Chetty, Looney, and Kroft 2009) and that reduced visibility of road-use tax induced by the adoption of E-ZPass reduced its incentive effect on road use (Finkelstein 2009). Other recent work has demonstrated that similar mechanisms apply to income tax incentives. Miller and Mumford (2015) examine a change to the Child and Dependent Care Credit; this change affected the direct, visible value that could be claimed for this credit, but also interacted with the Child Tax Credit in a nonsalient but offsetting manner. They demonstrate that taxpayer response was most consistent with reaction to the salient direct incentives of the tax and with complete ignorance of the arguably nonsalient interactions with other provisions of the tax code. Thus, while the tax salience literature has often focused on commodity taxation, its core findings appear to apply to tax incentives administered through the income tax as well.

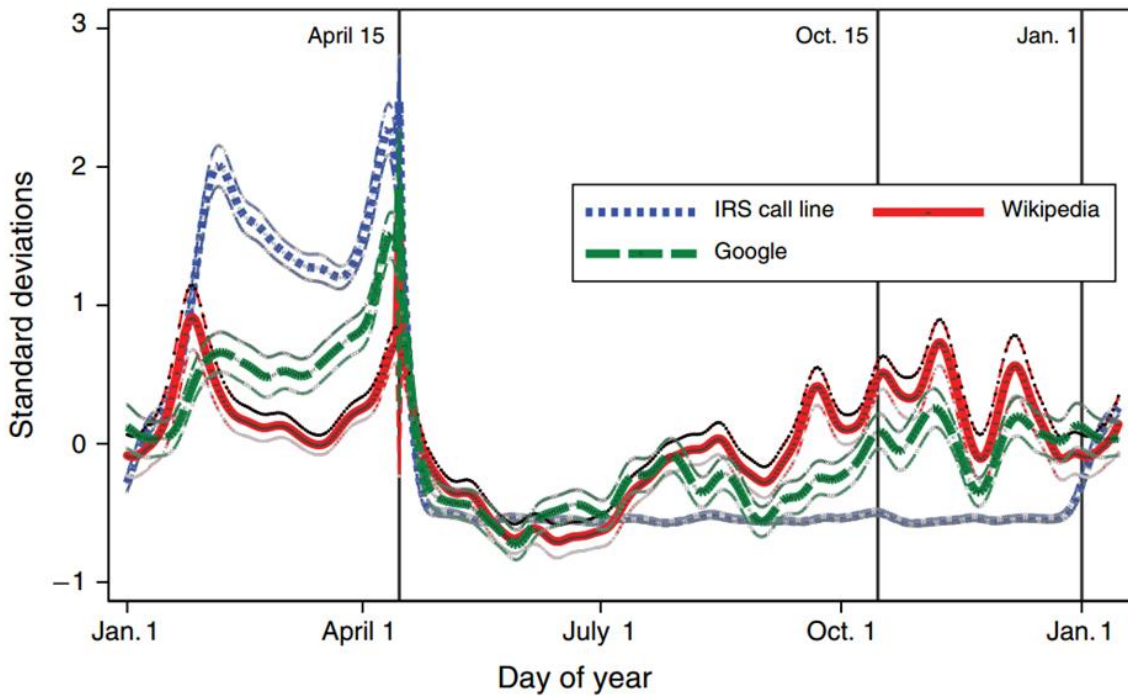
If taxpayers do not fully understand or attend to the taxes they face, how do they make tax-relevant decisions? Beyond the option of simply underreacting to the given tax incentives, existing evidence suggests two additional channels in play: the use of simplifying heuristics or “rules of thumb” and directed information search at targeted times of the year.

Simplifying heuristics. In an influential paper, Liebman and Zeckhauser (2004) discuss several potential heuristics that might influence decisionmakers facing a convex pricing schedule (like the income tax). One heuristic is a substitution of the average tax rate τ_{AVG} with the marginal tax rate τ_{MAR} . Since average rates are always lower than marginal rates in a progressive tax schedule like the federal income tax, the use of heuristics such as these would result in underreaction to incentives that reduce taxable income.³ A taxpayer using this heuristic would mistakenly think a dollar donated to charity yields τ_{AVG} in tax incentives when in fact it yields τ_{MAR} . Evidence that taxpayers are subject to misunderstandings of this sort has been documented in simplified laboratory settings (de Bartolome 1995), in labor supply responses following the loss of Child Tax Credit (Feldman, Katuscak, and Kawano 2016), and in direct survey elicitations of taxpayers’ perceptions of their tax schedules (Rees-Jones and Taubinsky 2016). To the extent that this type of misunderstanding is present when considering tax incentives for charitable giving, it will lead to less donation due to the underestimate of the financial incentives in place.

Directed information search. Perhaps the best available data on the timing of taxpayer information search behavior comes from Hoopes, Reck, and Slemrod (2015). In this paper, the authors analyze the patterns of information search for capital gains–related tax information over the course of the year. As figure 1 shows, the authors find that across several measures—including Google and Wikipedia search volume as well as IRS call line statistics—taxpayer information search behavior is somewhat responsive to events that increase the information’s value and is extremely responsive to impending tax deadlines. Similar results on search behavior have been confirmed in Benzarti (2015). If taxpayers are generally inattentive or uninformed except in the brief windows where they actively invest in tax understanding, these results suggest that January 1–April 15 is a key window in which underresponse to tax incentives might be avoided.

FIGURE 1

Seasonal Patterns of Tax Information Search



Source: Hoopes, Reck, and Slemrod (2015), figure 2.

Notes: This figure presents the estimated yearly seasonal patterns of taxpayer information search behavior for three sources: Google search, Wikipedia search, and IRS help line calls. All measures show some responsiveness to exogenous and annual increases in the value of information, and especially large spikes in search behavior in the immediate lead-up to tax day.

Aversion to Tax Payments

Recent literature has documented a significant psychological aversion to tax payments. A series of experiments presented in Sussman and Olivola (2011) finds that taxes are more aversive to people than similar or larger alternatively labeled costs. Similar results have been confirmed in experimental labor supply settings (Kessler and Norton, forthcoming). This general phenomenon is referred to as tax aversion. To the extent that giving to charity is an alternative, less aversive cost that allows one to bypass tax payments, this is a potentially fruitful psychological response to queue when optimizing incentives for giving.

Beyond pure dislike of paying taxes, recent work has also documented significant asymmetries in taxpayers' treatment of tax payments relative to tax refunds. Rees-Jones (2014) and Engström et al. (2015) develop and test a theory of loss-averse tax avoidance and evasion activities and find strong evidence that taxpayers view a marginal avoided-or-evaded dollar as "more valuable" when it reduces a tax payment as opposed to increasing a tax refund. This apparent aversion to out-of-pocket payments to the IRS could motivate the pursuit of tax-advantaged behaviors. Under the current system, this

motivation could go wasted: a tax filer learning of a liability in March cannot reduce the tax bill through charitable giving. If the deadline were extended to April 15, that tax filer could immediately reduce an aversive tax bill with a charitable donation. We believe this option would appeal to many.

Implications of Tax Salience and Tax Aversion

The psychologies of tax salience and tax aversion offer two additional reasons why changing the charitable-giving deadline to tax day presents opportunities to strengthen the incentive effect of the charitable-giving deduction.

First, extending the deadline allows taxpayers to make donations for near-immediate tax rewards at a time when tax rules are unusually salient and well understood. When assessing their annual tax in the course of completing their tax return, many taxpayers will find opportunities to reduce aversive tax especially desirable. An April 15 deadline would grant taxpayers the opportunity to immediately reduce those payments through a charitable donation. Existing research on tax salience leads us to believe that the psychological forces associated with these issues would enhance the tax-motivated pursuit of charitable giving.

Second, we believe changing the deadline would give professional tax preparers a more active role in motivating charitable giving. A significant percentage of all tax returns are completed with the assistance of a paid tax preparer. This interaction presents a unique opportunity for a professional with knowledge of the tax code to correct misunderstandings that lead to underreaction to tax incentives. A tax preparer can make nonsalient incentives salient; correct misperceptions or faulty, heuristic-based understandings of the tax code; and generally direct attention to available options for tax reduction paired with actionable advice on how to pursue those opportunities. To give a concrete example, we imagine paid tax preparers directly telling customers they have a balance due to the IRS, but that this balance could be immediately reduced with a payment to their favorite charity. Charities could partner with tax preparation services to make this type of transaction as quick and easy as possible. Interactions like these have been seen as a boon to the later deadline (Steuerle 2013),⁴ and the case is made more persuasive in light of the recent literature reviewed above. These interactions can harness all three psychological dimensions we have highlighted in this brief: they catch taxpayers at a rare moment when they are especially attentive to tax issues, remove biases about the strength of incentives for charitable donations, and present the option of charitable giving in a way where the immediate cost is offset by an immediate reward—the avoidance of aversive payments to the IRS.

While we think these two channels offer significant possibilities for increasing charitable donation activity, two important caveats must be considered. First, while these psychological issues are relevant for many, we believe they are less likely to be of primary importance for the highest-income tax filers. While many filers might interact with tax or accounting professionals only when filing their annual return shortly before tax day, high-income individuals are more likely to remain in contact with their tax preparers throughout the year. In addition, existing work has shown that high-income filers are quite responsive to charitable-giving tax incentives in a manner that suggests the issues discussed here could be secondary to standard economic incentives (Bakija and Heim 2011).

Second, a move to the alternative deadline may affect the current interaction between the year-end deadline and the holiday season. End-of-year donations are of critical importance to the charitable sector. The Network for Good's Online Giving Study found that 31 percent of 2014 annual giving occurred in December, with 12 percent occurring in the last three days of the year.⁵ This heavy concentration of giving is believed to be driven by a combination of deadline effects and religious motivation. The current deadline for charitable giving coincides with major holidays for several prominent religious groups, when religious imperatives to support the less fortunate are made salient to many Americans. To the extent that there is a complementarity between these religious norms and deadline-induced pressure for immediate donations, moving the deadline away from the holiday season might have some negative influence on this important period for charitable donation. While we suspect that the complementarity in question is not large enough to offset the significant salience-related benefits of the alternative deadline listed above, little quantitative evidence on that trade-off currently exists. We encourage further research along this particular line, which would help provide a full assessment of the net incentive effects of a deadline change.

Conclusion

In a 2015 executive order, President Barack Obama directed federal agencies to “use behavioral science insights to better serve the American people.” In light of recent research in behavioral public finance, we believe that changing the deadline for charitable giving to tax day provides an opportunity to better serve tax filers. While some countervailing forces require further study, the bulk of existing literature on tax salience suggests that the alternative deadline would increase the efficacy of this tax incentive. As consideration of potential deadline changes continues, we hope that both policymakers and researchers will devote attention to the complex psychology surrounding this seemingly simple decision.

Notes

1. Alternatively, a tax filer could forego the option to immediately claim that deduction and instead claim it on a 2016 tax return the following year.
2. Eugene Steuerle. “A New April 15,” *The NonProfit Times*, March 3, 2010, <http://www.thenonproffitimes.com/news-articles/a-new-april-15/>.
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3. Note that including additional provisions and schedules, such as the Earned Income Tax Credit, can render the tax schedule nonconvex. Despite this caveat, the key comparison that marginal tax rates exceed average tax rates still holds for most taxpayers.
4. See note 2.
5. “Network for Good Digital Giving Index,” Network for Good, accessed March 24, 2016, <http://www.networkforgood.com/digitalgivingindex/>.

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