When President Obama outlined a plan last month to "transform our economy for the 21st century," he dropped a bombshell that surprised the charitable world.

To help pay for a plan to reshape the country's health-care system -- which he called a huge drag on the economy -- President Obama proposed limiting the federal tax breaks that wealthy people can get for their itemized deductions, including donations to charity, starting in 2011.

To many nonprofit leaders and experts, the announcement felt like another body blow at a time when charities are under severe strain because of the recession.

"The nonprofit sector is getting hit on every level," says Maya Ajmera, president of the Global Fund for Children, a charity in Washington that provides grants to overseas grass-roots groups. "Endowments are going down, charitable donations are going down because people are losing their jobs, stock portfolios are going down for people with incomes $250,000 and above."

She adds: "It feels like the nonprofit sector is the voodoo doll and another pin is going into it."

'Not So Simple'

Many other nonprofit leaders, fund raisers, and wealth advisers echo that view. But the proposal also opened a wider debate about just how much money would be affected, whether the current tax code is fair, and whether charities should weigh the potential benefits of President Obama's proposal against the costs.

"This is not so simple," says Diana Aviv, president of Independent Sector, a national association of charities and foundations. Shortly after Mr. Obama's tax-deduction proposal was announced, her organization issued a statement saying it could be a "disincentive" for giving. "This could be a problem for many struggling nonprofits vital to our communities that are already facing a very difficult fund-raising environment."

Since then, she says, she has been deluged with "ardent and passionate" e-mail messages from the group's members.

Some say Independent Sector should take a stand against the proposal, arguing that charities should not be deprived of revenue at a time when demand for their services is increasing. But others support President Obama's efforts to reduce health-care costs and bring more fairness to the tax code, which now gives wealthy people the biggest tax breaks for charitable donations.
Nonprofit groups are "there to serve the public good," Ms. Aviv says. "The question is, How do we do that and what is the best definition of public good?"

Mr. Obama made his proposal in a document outlining his 2010 budget plans along with a 10-year budget strategy. The president said he wanted to set up a $634-billion reserve fund over 10 years to improve the health-care system.

To pay for $318-billion of that fund, he proposed limiting the tax break that families earning more than $250,000 can get for the deductions they itemize on their tax returns, including donations to charity.

Taxpayers now can save the same percentage as their tax bracket. Those in the highest tax brackets -- 33 percent and 35 percent -- can save 33 cents or 35 cents in taxes for each dollar donated. Mr. Obama would cap the tax break at 28 percent.

If a wealthy donor in the top tax bracket made a $100,000 gift today, he or she would save $35,000 in taxes. Under the president's proposal, that same donor would save only $28,000, a difference of $7,000.

Economy Concerns

While many nonprofit experts have criticized the administration for limiting tax breaks during an economic downturn, the White House emphasizes that the plan would not take effect until January 1, 2011, when it expects the economy to be in recovery.

Some charity leaders are not reassured.

"I don't know what sort of crystal ball they have to discern when the recession would be over," says William Daroff, vice president for public policy at United Jewish Communities, an umbrella group for Jewish social-services charities. Even if the recession does officially end by 2011, he adds, its impact is likely to be felt "for a significant amount of time."

Although the proposal is a long way from becoming law and wouldn't take effect for at least two years, "our view is these are really complex times and anything that has the potential to disincentive philanthropy seems kind of counter-productive," says Kathie Lowry, chief development officer at Larkin Street Youth Services, in San Francisco. She adds that because of the high cost of living in the Bay area, many couples who make $250,000 don't feel very wealthy.

Some organizations that represent fund raisers are making a similar case. The Association of Fundraising Professionals and the Association for Healthcare Philanthropy released a joint statement last week saying that the budget proposal "sends the wrong message at the wrong time."

Some fund raisers are less worried about the precise impact of Mr. Obama's plan than about the precedent it could set.

"You start worrying about where the slippery slope will end," says Bruce Flessner, a fund-raising consultant in Minneapolis. "You have a philosophical issue about whether the government should play a bigger role and the private sector should be in a smaller role. There is a question of whether this is a direction in which we want to move."

But others argue that even if Mr. Obama's proposals depress giving, the philanthropic world should weigh that against the merits of his approach.

Ms. Aviv, of Independent Sector, says some of her members argue that nonprofit groups would save money, like other employers, by the effort to curtail the spiraling cost of health-insurance plans.

The Center on Budget and Policy Priorities, a Washington think tank, is among the most vocal supporters of the president's plan, saying its effort to provide health coverage to most or all of 45 million Americans who now lack insurance would help charities.

"Health reform will greatly reduce the burden on nonprofit organizations to provide free health care, thereby offsetting to a significant extent the overall drop in contributions," it says in an analysis of the tax proposals.

The center, which analyzes the impact of federal spending on lowand middle-income families, also noted that charities would benefit from other parts of the budget plan, for example, the proposal to keep the estate tax as it stands instead of phasing it out or shrinking it as advocated by many Republicans. Fund raisers say that tax provides an incentive for wealthy people to give to charity as a way to lower the tax liability on their estates after they die.
Some people in the health-care world, however, believe the tax change would harm their institutions. William C. McGinly, president of the Association for Healthcare Philanthropy, which represents hospital fund raisers, says that any benefits from new government spending on health care would not make up for lost revenue from donors.

"Plus, it's not an effective way to get the money where it's needed," he says, adding that donors provide money for buildings and equipment, unlike Medicare or Medicaid.

Question of Fairness

The White House says its tax proposal is designed to promote fairness, since people in lower tax brackets get smaller tax breaks than wealthy people do.

"If you're a teacher making $50,000 a year and decide to donate $1,000 to the Red Cross or United Way, you enjoy a tax break of $150," Peter Orszag, director of the Office of Management and Budget, wrote on his blog. "If you are Warren Buffett or Bill Gates and you make that same donation, you get a $350 deduction -- more than twice the break as the teacher." The new plan, he said, "walks that difference back some of the way."

But some experts say the plan would introduce a new kind of unfairness -- by raising taxes on the most generous taxpayers. "If we need this money for social purposes," says Robert F. Sharpe Jr., a planned-giving consultant in Memphis, "why not tax wealthy people who do not give to charity?"

Mr. Obama plans to issue more detailed budget proposals in April, but some Republicans have already taken aim at the charitable-deduction measure.

"During this difficult time, charities provide vital support mechanisms for families in need of help, and this budget is a direct assault on the financial resources they require," Rep. Eric Cantor of Virginia, the House of Representatives' Republican whip, said in a statement.

Reaction from Democrats has so far been muted.

Sen. Max Baucus, who as chairman of the Senate Finance Committee will be an influential voice in the debate, issued a statement saying that some elements of the president's budget proposal, including the limits on itemized deductions, "raise concerns and will require more study." However, an aide to Mr. Baucus, Democrat of Montana, declined to elaborate, saying only that the senator was still analyzing the budget package.

Roger Colinvaux, an associate law professor at Catholic University and a former top aide to Congress's Joint Committee on Taxation, says the tax-deduction proposal is not likely to fly politically without an active push by the White House, especially since other groups that are affected, like real-estate agents, are likely to line up against it.

He says some lawmakers might be tempted to tinker with the proposal -- for example, to propose new limits on tax breaks for donations of goods and other noncash gifts as a way to raise money.

Sense of Urgency

While many charity leaders are opposing President Obama's plan, some fund-raising experts see one possible silver lining if it takes effect: It could create a short-term surge in giving, as wealthy donors rush to make gifts and take advantage of the higher current deduction levels, says Richard Steinberg, an economist at the Indiana University Center on Philanthropy.

He says such a gain occurred in 1986, the year before the tax code was changed to reduce the value of the charitable deduction.

Donations by individuals grew by 14.8 percent that year, to $127-billion, and then dropped to $118-billion in 1987, the year the tax change took effect, according to Giving USA, the annual tally of philanthropy.

Neil Kawashima, a lawyer in Chicago who advises wealthy donors, says people who are considering types of giving that offer one-time, upfront charitable deductions on their federal taxes may especially be tempted to consider acting before the deduction rate falls.

Those would include gifts to donor-advised funds, which allow people to make contributions to special accounts, claim a deduction, and then recommend how to distribute the money to charity over time; and "grantor charitable lead annuity trusts," which allow donors to set up a trust to give annual payments to charities, claim a tax deduction, and then pay taxes on the income produced by the trust.
However, Mr. Kawashima says, fund raisers may have a hard time enticing donors, thanks to the bad economy. "Most people are feeling tapped out already," he says.

Furthermore, a short-term bump in giving won't help charities in the long run, says Tim Walter, chief executive of the Association of Small Foundations. "When you look further out, to 2011 and beyond, what you've done is made charitable giving more expensive."

LOAD-DATE: March 10, 2009