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State Tax Credits Let Donors Give Big for Much Less

By Ben Gose

Youth in Need, a St. Louis group that runs 50 programs for children and families at 25 sites, goes out of its way to honor its biggest donors. The charity recognizes its "Children's Partners"—the 33 couples and companies that give $1,500 or more per year—in a prominent spot on its Web site.

But missing from the list is perhaps the charity's most generous donor: the State of Missouri.

Thanks to a generous 50-percent state tax credit available to donors who give to Missouri youth-development organizations, some of the wealthiest supporters of the charity say they part with only about $150 for every $1,000 gift they make to the charity.

For individuals in the highest tax bracket, Missouri pays for half the gift—$500—through the state tax credit, and the federal government picks up 35 percent through the charitable deduction.

Each year, about a quarter of the money that Youth in Need raises comes from gifts tied to this state credit and a similar one for businesses. The credits allow the charity to show donors how a "stretch gift" might be within easy reach, says Rob Muschany, vice president of development and marketing.

"We absolutely love them," he says.

Religious Schools

At least 20 states offer tax credits to residents to encourage giving to certain types of charities.

The credits have become increasingly popular as states look for ways to bolster charities providing essential services and help community foundations build their endowments.

But the biggest reason for the growth is that tax credits allow legislatures to support religious schools in a way that can withstand legal scrutiny.

The fastest-growing and most controversial type of charitable tax credit—now available in 11 states—goes to individuals and businesses that support charities that provide scholarships to private schools. The U.S. Supreme Court has upheld such credits, even when the state refunds 100 percent of the cost of each gift. (See article on Page A-14.)

The tax credits uncovered by *The Chronicle* total more than $960-million—and are prompting gifts worth at least $1.5-billion a year.

Those figures may be conservative, because no one is systematically tracking all the credits.

“They’re hidden away in the nooks and crannies of state tax codes,” says Tim Delaney, president of the National Council of Nonprofits.

Big Gifts, Little Cost

The state tax credits tend to be narrowly focused, and they vary widely from state to state, which explains why they remain little known—even among some state residents who could benefit from them.

Several states—including Iowa, Montana, and North Dakota—offer tax credits to individuals and businesses that help charities and community foundations build their endowments. (See article below.) Besides Missouri, Arixona and Virginia are among the states that give tax credits to individuals who support charities that serve low-income people.

Some people argue that the tax credits make good economic sense for states, in spite of the revenue that states lose.

Bob Kalinich, a board member and donor to Youth in Need, notes that the charity provides the same kind of services—such as monitoring foster-care children and their families—that state agencies provide directly in some other states.

“They’re getting a service provided by Youth in Need for which they pay 50 cents on the dollar,” he says. “If they were doing it themselves, they’d have to pay the whole freight.”

Meanwhile, for donors like Mr. Kalinich and his wife, Mary Beth, the one-two punch of federal and state tax savings means a big-time gift costs only a little.

Mr. Kalinich declines to say how much the couple gives to Youth in Need, but he and his wife are among the 33 recognized “partners” who contribute more than $1,500 a year. Based on Mr. Kalinich’s calculations, a gift of, say, $1,500, to Youth in Need may end up costing him only a little more than $200.

Getting Back 100%

Some states, including Arizona, offer even more generous terms, which has a handful of charitable tax credits that offset 100 percent of the cost of a donation (*The Chronicle*, August 23). Residents can make a cost-free gift to a fund that helps military families, to support extra-curricular activities at public schools, or to pay for scholarships so that low-income students can attend private schools. An Arizona couple that carefully taps all of the state incentives could potentially donate $3,200 a year and receive every cent back as a credit.

“There’s loads of evidence that lowering the price of giving has a positive impact,” says Naomi Feldman, an economist who wrote a research paper in 2003 about the impact of state tax credits. “A credit is just another way to lower the price.”

IRS Rules Unclear

Even states with less generous credits are dramatically reducing the cost of giving.

In Virginia, donors can receive a tax credit if they give to state-approved charities that focus on serving low-income residents.

David John Marotta, a financial adviser in Charlottesville, co-wrote a column about the program for a local newspaper two years ago that argued that individuals giving away highly appreciated stock (thereby avoiding capital-gains taxes of 15 percent on their profit) would end up with an out-of-pocket cost of just 5 cents for every $1 gift. And that was before the state's General Assembly made the math even more favorable—raising the value of the current credit from 40 percent of the gift to 65 percent.

"Oh my," said Mr. Marotta, who heard about the increased state credit from a reporter. "That means you can actually make money by giving to charity." Mr. Marotta notes that he doesn't think it's "the best policy" for governments to allow individuals to benefit personally from their giving by combining multiple streams of tax savings.

"But as long as it's in place, you might as well take advantage of it," he says.

Financial advisers like Mr. Marotta, and many of the charities that promote state tax credits to their donors may be slightly overstating the tax benefits of such gifts. The Internal Revenue Service has not issued formal guidance on how state tax credits for charitable donations affect federal taxes.

An October 2010 memo that the IRS has made public involves a case in Missouri and suggests that taxpayers can—as Mr. Marotta and many charities assert—take a full charitable deduction on a gift for which they have also received a state tax credit.

However, the memo also says the couple should reduce their itemized deduction for paying state taxes by the amount of the state tax credit. This means taxpayers would receive no benefit on their federal taxes for the portion of the gift that is covered by the state credit.

Even so, the state tax credits have reduced the overall cost of giving enough that some charities and their supporters have figured out ways to attract "donations" from people who don't want to pay anything at all.

The Soho Center, based in Madison, Va., which promotes quality child care and school readiness, has been approved by Virginia to offer state credits to its donors.

If getting the state to pick up 65 percent of your donation doesn't sound good enough, a few of the charity's long-term donors are ready to sweeten the deal—by writing a personal check to reduce the overall cost of the new donor's gift to zero.

“In effect, you will redirect state and federal taxes you would have paid anyway and get a gift check that makes up the difference,” says a description of the “zero-cost donation” on the Soho Center’s Web site.

Jeanna Beker, Soho’s executive director, says the check is considered a personal gift from one donor to another—with no tax consequences.

The longtime donors, who have already maxed out the $50,000 annual tax credit they can receive for their own giving, are “leveraging their gift to help Soho attract another donation,” she says.

Losing the Credit

As states face budget deficits, some lawmakers seek to eliminate tax credits for charity gifts to generate more revenue.

Michigan was an early adopter of generous tax credits for giving, but last year the Legislature adopted a proposal by Gov. Rick Snyder to end them. The credits had been worth up to $400 a year for couples that gave to certain types of organizations, including community foundations, state universities, public libraries, and homeless shelters and food banks.

Kyle Caldwell, president of the Michigan Nonprofit Association, say he doesn’t think the average donor is even aware of the cuts, which became effective January 1. Most won’t notice until filing their 2012 taxes next April, he says, but he worries that some may then respond to the lost incentive by giving less.

“There’s been a dip in giving in the state the past two years,” he says. “We’re concerned that the loss of the credit will exacerbate the dip.”

Many of the state tax credits have minimum gift requirements that put them out of reach of the average donor. Virginia’s credits for antipoverty programs, for example, are available only to individuals who donate at least $500. In North Dakota, donors can receive a state tax credit for giving to charitable endowments, but only if they make a gift worth at least $5,000.

Dana Schaar, executive director of the North Dakota Association of Nonprofit Organizations, says charity leaders in the state supported the $5,000 minimum. They wanted to be sure that the typical supporter making a gift of say, $100, to an annual fund would not be encouraged to park those funds in an endowment.

“There was concern among the smaller charities they might lose some of those annual gifts that are used for operating expenses,” she says.

A few states, however, are using tax credits to bring greater parity to a system of incentives that often favord the wealthy.

Both North Carolina and Minnesota have tax breaks for people who give to charity but don't itemize their taxes. In Minnesota, residents who don't itemize can deduct 50 percent of the value of charitable gifts that exceed $500. In North Carolina, people who don't itemize receive a 100-percent state tax credit for donations that exceed 2 percent of adjusted-gross income.

"It really is giving a good tax incentive for low- and middle-income families in North Carolina to be philanthropic," says David Heinen, director of public policy and advocacy at the N.C. Center for Nonprofits. "We think that's a very positive thing."