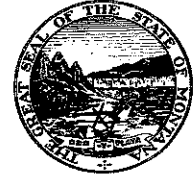




Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
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Date: September 4, 2008
To: Revenue and Transportation Interim Committee
From: Dan Dodds, Tax Policy Analyst
Subject: Annual Report on Charitable Endowment Credit

The Department of Revenue is required by 15-1-230, MCA, to make an annual report to the Revenue and Transportation Interim Committee on the Charitable Endowment Credit. This memo describes the credit and its legislative history and reports on use of the credit and the department's costs of administering the credit.

The Credit

The Charitable Endowment Credit is allowed against either individual income tax or corporation license tax. The credit is 40% of the present value of a planned gift made by an individual or 20% of an outright gift made by a corporation to a qualified endowment.

A qualified endowment is a permanent fund held by or on behalf of a 501(c)(3) charitable organization. A planned gift is one of nine types of arrangements specified in the IRS code where the donor places assets in a trust arrangement that generally provides income to the donor either for life or for a set period and then the remainder goes to the charity.

The credit is limited to \$10,000 for either an individual or a corporation. An individual would receive the maximum credit for a gift of \$25,000, and a corporation would receive the maximum credit for a gift of \$40,000. If a taxpayer makes an eligible gift of more than this amount, they may claim the maximum credit and take an itemized deduction for any excess contribution.

The Charitable Endowment Credit provides an incentive for taxpayers who are considering making a large charitable contribution to make the contribution as a planned gift to a qualified endowment. A taxpayer who makes an ordinary charitable contribution can take an itemized deduction equal to the amount of the contribution for both federal and state income tax purposes. For a taxpayer in the top federal and state brackets, the deductions reduce combined federal and state tax liability by 41.9% of the amount of the contribution. Thus, each dollar going to the charity costs the giver \$0.581.

If the taxpayer makes a planned gift instead, the federal deduction reduces tax liability by 35% of the gift and the state credit reduces tax liability by 40% of the gift. Each dollar going to the charitable endowment costs the giver \$0.25.

From the point of view of the state budget, the credit is essentially a transfer from the state general fund to a private non-profit of the taxpayer's choice.

Legislative History

The Charitable Endowment Credit was enacted by the 1997 Legislature (HB 434). The credit originally was 50% of the present value of the planned gift for both individuals and corporations with a limit of \$10,000. The credit originally was to sunset at the end of 2001.

The 2001 legislature (HB 377 and SB 350) reduced the credit to 40% of the present value of the planned gift for individuals and 20% of the value of the gift for corporations. It also clarified the definition of planned gift and extended the sunset date to the end of 2007.

In August 2002, the legislature met in a special session to deal with revenue shortfalls. To reduce the costs of the credit in the short run, the legislature (SB 15) reduced the credit for the period from August 28, 2002 through June 30, 2003. For credits claimed in this period, the credit was 30% of the present value of the gift with a \$6,000 cap for individuals and 13.3% of the gift with a \$6,600 cap for corporations. The same bill increased the credit for the period from July 1, 2003 to April 30, 2004 to 50% for individuals and 26.7% for corporations, with a cap of \$13,400 for both. The credit returned to its previous levels May 1, 2004.

The 2003 legislature (SB 143) eliminated double dipping by specifying that a taxpayer could not take the credit and a deduction for the same contribution.

The 2005 legislature (HB 193) provided for recapture of the tax credit when the taxpayer recovers a gift.

The 2007 legislature (SB 150) clarified that building funds are not charitable endowments and extended the sunset date to the end of 2013.

Credit Use

The following table shows the amount of charitable endowment credits claimed each year since 1997, the first year it was available, through 2006.

Total Amount of Charitable Endowment Credits

<u>Year*</u>	<u>Individuals</u>	<u>Corporations</u>	<u>Total</u>	<u>% Change</u>
1997	\$1,332,693	n/a	\$1,332,693	n/a
1998	\$3,288,234	\$63,516	\$3,351,750	151.5%
1999	\$5,660,049	\$313,675	\$5,973,724	78.2%
2000	\$7,121,923	\$462,002	\$7,583,925	27.0%
2001	\$7,550,411	\$703,420	\$8,253,831	8.8%
2002	\$1,694,781	\$622,099	\$2,316,880	-71.9%
2003	\$2,179,696	\$425,846	\$2,605,542	12.5%
2004	\$2,585,041	\$117,618	\$2,702,659	3.7%
2005	\$2,518,859	\$106,490	\$2,625,349	-2.9%
2006	\$3,245,026	\$121,753	\$3,366,779	28.2%

* Tax year for individuals and year return filed for corporations.

The total amount of credits claimed grew rapidly from 1997 through 2001. Credits dropped significantly in 2002, when the credit percentages and caps were temporarily reduced, but have increased since 2002. Most credits are claimed by individuals rather than corporations.

The next table shows credit use by individuals.

Charitable Endowment Credits - Individuals

<u>Tax Year</u>	<u>Number</u>	<u>Residents</u>		<u>Non-Residents and Part-Year Residents</u>		
		<u>Amount of Credits</u>	<u>Average Credit</u>	<u>Number</u>	<u>Amount of Credits</u>	<u>Average Credit</u>
1997	338	\$1,303,654	\$3,857	8	\$29,039	\$3,630
1998	732	\$3,191,545	\$4,360	29	\$96,689	\$3,334
1999	1,045	\$5,547,290	\$5,308	39	\$112,759	\$2,891
2000	1,419	\$6,960,128	\$4,905	44	\$161,795	\$3,677
2001	1,593	\$7,410,957	\$4,652	61	\$139,454	\$2,286
2002	560	\$1,610,509	\$2,876	32	\$84,272	\$2,634
2003	603	\$2,138,607	\$3,547	24	\$41,089	\$1,712
2004	720	\$2,502,605	\$3,476	35	\$82,436	\$2,355
2005	740	\$2,491,431	\$3,367	29	\$27,428	\$946
2006	870	\$3,164,764	\$3,638	35	\$80,262	\$2,293

Both the number and average size of credits decreased significantly in 2002 with the change in the law. Since 2003, the average size of credits claimed by residents has been relatively stable while the number of credits claimed has grown.

The final table shows credit use by corporations.

Charitable Endowment Credits - Corporations

<u>Year Return Filed</u>	<u>Number</u>	<u>Amount of Credits</u>	<u>Average Credit</u>
1997	n/a	n/a	n/a
1998	15	\$63,516	\$4,234
1999	58	\$313,675	\$5,408
2000	100	\$462,002	\$4,620
2001	127	\$703,420	\$5,539
2002	125	\$622,099	\$4,977
2003	77	\$425,846	\$5,530
2004	52	\$117,618	\$2,262
2005	38	\$106,490	\$2,802
2006	45	\$121,753	\$2,706

Recapture of credits was first required in 2006. Three individuals reported recapture of a total of \$403 of credits on their 2006 tax returns. No corporations reported credit recapture.

Department Costs

The Department of Revenue experiences some additional costs because of this credit. Tax return booklets for all taxpayers are slightly longer, the department must produce and process a form for taxpayers who take the credit, and audit resources may be used on this credit rather than on checking compliance in other areas. These costs are difficult to separate from the department's general costs and the costs of this single credit are not significant.

However, the legislature has created over 80 credits, deductions, and check-offs that cause Montana's income tax law to diverge from federal law. These special provisions account for one-fourth to one-third of the pages in the 2007 Form 2 booklet. The cumulative costs for the department to administer all credits and special provisions of Montana's income tax law are significant. These special provisions also substantially increase the cost and inconvenience for taxpayers to comply with the law.