Montana Department of Revenue

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To: Revenue and Transportation Interim Committee

From: Dan Dodds, Senior Economist

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Subject: Annual Report on Charitable Endowment Credit

Sections 15-30-2327 through 2329 and 15-31-161 and 162, MCA allow a credit against individual income tax or corporation license tax for certain types of gifts to a Montana charitable endowment. Section 15-1-230, MCA requires the department to make regular reports to the legislature on use of the credit and the department's costs of administering the credit. Since the credit sunsets at the end of 2013 and the 2013 Legislature may consider whether to extend the credit, this report presents additional information on how the credit works and its legislative history.

This report is in five sections. The first section presents basic information on credit use in the last two years. The second section explains the mechanics of the credit. The third section explains how the credit affects the state budget. The fourth gives its legislative history. The final section gives additional information on use of the credit in past years and on the characteristics of taxpayers who have taken the credit.

Credit Use the Last Two Years and Department Costs

Table 1 shows credits claimed and recaptured for the last two tax years for which data has been compiled. For individual income tax, this is calendar years 2009 and 2010. For corporation license tax it is tax years beginning in 2008 and 2009.[1] Credits claimed in an earlier year are recaptured if a charity returns a gift.

Table 1
Charitable Endowment Credits for Last Two Tax Years

	Individual Income Tax					Corporation License Tax			
	Credits Claimed		Credits Recaptured			Credits Claimed		Credits Recaptured	
Tax Year*	Number	$	Number	$	Tax Year*	Number	$	Number	$
2010	630	$1,827,181	2	**	2009	30	$94,889	0	$0
2009	604	$1,808,443	1	**	2008	14	$35,256	n/a	n/a

*For individual income tax, tax year is the calendar year. For corporation license tax, it is the year when the corporation's fiscal year starts.
**Withheld to Protect Taxpayer Confidentiality

On average, the department allocates about 0.25 FTE to verifying and auditing returns that claim the charitable endowment credit. Annual salary for a beginning auditor in pay band 5 is $36,597. Annual benefits, insurance, and operating costs for a typical employee with this type of duties are $19,000. Thus, the department's costs of administering this credit average about $13,899 per year.

Mechanics of the Credit

The credit is available for taxpayers who make an eligible gift to a Montana charitable endowment. A charitable endowment is a permanent fund that is intended to provide income for an organization that is tax exempt under Section 501(c)(3) of the IRS code. Individuals may take the credit for making a planned gift, where the charity receives assets either in the future or over time. Corporations may take the credit for any gift to a charitable endowment. For individual donors, planned gifts are often part of the estate planning process. They provide a way for individuals to obtain an immediate tax benefit for committing to a future contribution. For endowment funds, they provide a way to lock in future donations.

Section 15-30-2327(1)(b), MCA defines nine types of planned gifts, generally by reference to sections of the IRS code. Planned gifts basically fall into three categories. In the first, the donor continues to

[1] Individual income tax returns are due in April, or October if the taxpayer requests an extension. Corporate license tax returns are due in the fifth month after the end of the corporation's tax year, and corporations may also request a six month extension. About one-fourth of corporations have tax years that start after January 1. Because of this, return data for a tax year is compiled in November for individuals and in May for corporations.

receive income or benefits from the donated assets, either for a fixed term or for life, and the endowment receives the assets at the end of the term or when the donor dies. Examples include charitable remainder trusts and life estate arrangements. In the second category, the endowment receives income from the assets, generally for a fixed term, and then the assets revert to the donor or the donor's heirs. Charitable lead trusts fall into this category. A third category of planned gifts is paid-up life insurance.

Individuals may claim a credit equal to 40% of the present value of assets that will ultimately be transferred to the charitable endowment. Corporations may claim a credit equal to 20% of the value of a gift. For both individuals and corporations, total credits are limited to $10,000 per year, the credit is non-refundable, there is no carry-back or carry-forward of credits in excess of tax liability, and a taxpayer may not claim the credit and take an itemized deduction for the same contribution. A taxpayer may claim the credit for multiple gifts in one year as long as total credits do not exceed $10,000. A taxpayer who makes eligible contributions in multiple years may take the credit each year. An individual will receive the maximum credit for a gift with a present value of $25,000. A corporation will receive the maximum credit for a gift of $50,000.

There is no federal equivalent of this credit, but a taxpayer will generally be able to claim a federal itemized deduction for the gift, subject to the normal cap on charitable contribution deductions as a percentage of income.

When an individual takes both the state credit and the federal deduction, the reduction in combined federal and state taxes is smaller than it would seem when looking at state and federal taxes separately. This is because the state credit decreases state taxes that can be deducted on the federal return, and the federal deduction decreases federal income taxes that can be deducted on the state return. The smaller federal deduction for state taxes increases federal taxes by a fraction of the state credit. If the taxpayer's federal taxes are less than the maximum state deduction of $5,000 ($10,000 for a married couple filing a joint return), the federal itemized deduction increases state taxes by a fraction of the federal deduction.

The state deduction for federal taxes and the federal deduction for state taxes are both for taxes actually paid during a year less any refund of previously deducted taxes. Because of this, the interaction of state and federal deductions generally will play out over at least two years. For example, a taxpayer who takes the credit for a contribution in 2010 may receive a larger refund with their 2010 state return (filed in 2011), which will reduce the deduction for state taxes on their 2011 federal return.

Table 2 on the next page, shows an individual taxpayer's cost of a $100 contribution to a charitable endowment, assuming the taxpayer is in the top federal and state tax brackets, and taking the interaction of state and federal taxes into account. It also shows the state and federal subsidies, or tax expenditures.

The left side of the table shows the case when the taxpayer's federal income tax is more than the cap on the state deduction for federal taxes, and the right side shows the case when it is less. In both cases, the first column shows the cost to the taxpayer, the federal government, and the state general fund when the taxpayer takes the state itemized deduction for the contribution. The second column shows the same information when the taxpayer takes the charitable endowment credit, and the third column shows the difference. This difference is the savings to the taxpayer and the federal government, and also the additional cost to the state because the taxpayer took the credit rather than the deduction.

Table 2
Who Pays for $100 Individual Contribution to a Charitable Endowment?

	Federal Income Tax More Than Cap on Deduction			Federal Income Tax Less Than Cap on Deduction		
	Itemized Deduction	Credit	Difference	Itemized Deduction	Credit	Difference
Taxpayer	$60.52	$39.00	-$21.52	$62.01	$39.97	-$22.05
Federal Government	$32.59	$21.00	-$11.59	$33.39	$21.52	-$11.87
State General Fund	$6.90	$40.00	$33.10	$4.60	$38.52	$33.92
Total	$100.00	$100.00	$0.00	$100.00	$100.00	$0.00

When the taxpayer's federal income tax is more than the cap on the itemized deduction for federal taxes, there is no partial offset through federal taxes – the cost to the state general fund is the marginal tax rate of 6.9% times the deduction or the full amount of the credit. When the taxpayer's federal income tax is less than the cap, part of the cost of the state deduction or credit is borne by the federal government, and part flows back to the taxpayer.

In both cases, when a taxpayer claims the credit, a little less than 40% of the donation comes from the donor and a little more than 60% comes from other taxpayers.

Table 3 shows the same information for a corporate donor. Corporations do not deduct federal taxes in calculating Montana taxable income, so the cost to the state general fund is the tax reduction from the deduction or credit with no offset from reduced federal taxes. However, claiming the state deduction or credit does reduce the value of the taxpayer's federal deduction.

Table 3
Who Pays for $100 Corporate Contribution to a Charitable Endowment?

	Donor Takes Deduction	Donor Claims Credit	Difference
Taxpayer	$60.61	$52.00	-$8.61
Federal Government	$32.64	$28.00	-$4.64
State General Fund	$6.75	$20.00	$13.25
Total	$100.00	$100.00	$0.00

When a corporation claims the credit, a little more than half of the donation comes from the donor corporation and a little less than half comes from other taxpayers.

Effect on State Budget

The charitable endowment credit is an example of a tax expenditure - a special provision in the tax code that reduces taxes for some taxpayers based either on their characteristics or the fact that they have taken certain actions. As can be seen in Tables 2 and 3, the credit is equivalent to a transfer from the state general fund to private non-profits. Without the credit, approximately $2 million would have been available each year to spend on other programs or taxes could have been reduced by this amount.

Legislative History

The credit was created by HB 434 of the 1997 Legislature. HB 434 set the credit at 50% of the present value of the planned gift for individuals and 50% of the gift for corporations, with a limit of $10,000. The credit was to sunset at the end of 2001.

Two bills passed by the 2001 Legislature affected the credit. HB 377 reduced the credit to 40% of the present value of the planned gift for individuals and 20% of the gift for corporations, and extended the credit through 2007. It also added the language that is now Subsection (2) of 15-30-2327, MCA, clarifying the definition of a planned gift. SB 350 created an affordable housing revolving loan program and made contributions to the account for this program eligible for the credit. This provision sunset at the end of 2004, and the legislature did not extend it.

In August 2002, the legislature met in a special session to deal with revenue shortfalls. To reduce the cost of the credit in the short run, the legislature passed SB15, which reduced the credit for the period from August 28, 2002 through June 30, 2003 and then temporarily increased the credit for the period from July 1, 2003 through April 30, 2004. In the first period, the credit was reduced to 30% of the present value of the gift for individuals and 13.3% of the gift for corporations, with a cap of $6,600. In the second period, the credit was increased to 50% for individuals and 26.7% for corporations, with a cap of $13,400. After April 30, 2004, the credit returned to its previous levels.

SB 143, passed by the 2003 Legislature, defined the term “charitable gift annuity” in Title 33, which deals with insurance, and made the credit language refer to that definition.

The 2005 Legislature passed HB 193, which provides for recapture of the credit when a gift is returned to the taxpayer.

SB 150, passed by the 2007 Legislature, clarified that a building fund or other fund that spends from contributions rather than just from its earnings is not a charitable endowment. SB 150 also extended the credit through 2013.

Detailed Information on Credit Use

Table 4 on the next page, shows credits claimed for each tax year since the credit was first available in 1997. In the accompanying chart, the red line shows the credit percentage for individual taxpayers, and the blue line shows total credits. Together, they show the growth in credit use in the early years of its existence when the credit was 50% of the value of the gift, and the lower amount of total credit claims since the percentage was reduced.

Table 4
Charitable Endowment Credits Since Enactment

Tax Year	Individuals	Corporations	Total
1997	$1,332,693	$173,972	$1,506,665
1998	$3,288,234	$380,512	$3,668,746
1999	$5,660,049	$652,207	$6,312,256
2000	$7,121,923	$751,549	$7,873,472
2001	$7,550,411	$712,539	$8,262,950
2002	$1,694,781	$108,087	$1,802,868
2003	$2,179,696	$112,435	$2,292,131
2004	$2,585,041	$134,070	$2,719,111
2005	$2,558,333	$169,948	$2,728,281
2006	$3,245,026	$198,242	$3,443,268
2007	$2,858,835	$134,927	$2,993,762
2008	$1,980,831	$35,256	$2,016,087
2009	$1,808,443	$94,889	$1,903,332
2010	$1,827,181	n/a	n/a

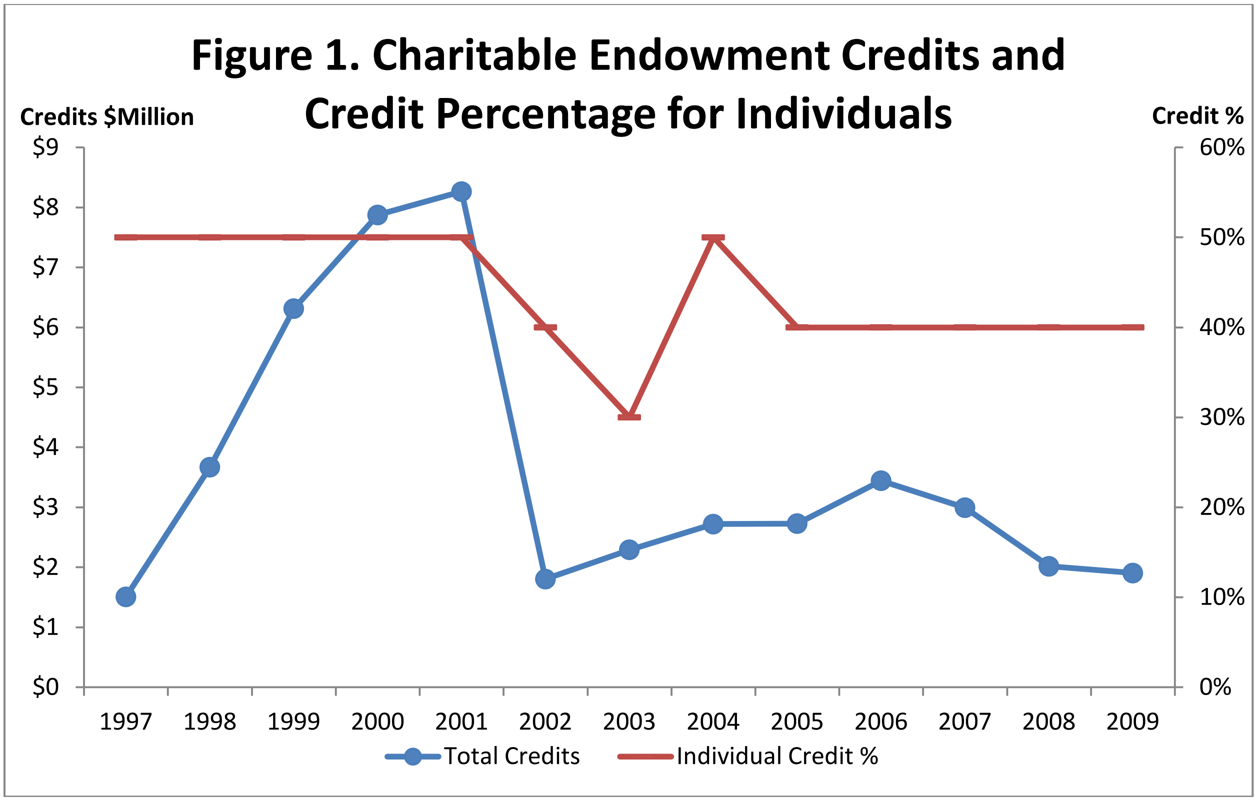

Table 5 shows income tax credits claimed by residents and non-residents for the last three tax years. Part-year residents, taxpayers who moved either to or from the state during the year, are combined with full-year residents to avoid disclosing information about individual taxpayers.

Table 5
Charitable Endowment Income Tax Credits Claimed by Residents and Non-Residents

	Full-Year and Part-Year Residents		Non-Residents		Total	
Tax Year	Number	$	Number	$	Number	$
2008	618	$1,919,891	18	$60,943	636	$1,980,834
2009	579	$1,746,260	25	$62,183	604	$1,808,443
2010	616	$1,768,060	14	$59,121	630	$1,827,181

Table 6 shows endowment credits claimed for the last three years by households in six income groups. It shows the number and total value of credits claimed by taxpayers with household incomes in each range. When a married couple filing separate returns each claimed a credit, it was counted as two credits.

Table 6
Charitable Endowment Income Tax Credits by Income

	2008		2009		2010	
Household Income	Number	$	Number	$	Number	$
Less than $100,000	113	$185,891	110	$172,826	106	$132,317
$100,000 to $249,999	221	$491,372	221	$391,843	235	$388,995
$250,000 to $499,999	156	$485,217	143	$444,278	128	$377,906
$500,000 to $999,999	83	$374,058	80	$417,336	92	$469,087
$1,000,000 to $1,999,999	34	$233,729	23	$149,854	32	$196,183
$2 million and over	29	$210,567	27	$232,306	37	$262,693

Table 7 shows the average size of credits, the percentage of credit claims made by taxpayers in each income group, and the percentage of credits claimed by taxpayers in each group. It also shows the average percent of taxpayers in each group who claimed the credit.

Table 7
Average Charitable Endowment Income Tax Credits by Income, 2008 - 2010

Household Income	average credit	% of claims	% of credits	% of group claiming
Less than $100,000	$1,493	17.6%	8.7%	0.02%
$100,000 to $249,999	$1,879	36.2%	22.7%	0.27%
$250,000 to $499,999	$3,062	22.8%	23.3%	1.19%
$500,000 to $999,999	$4,943	13.6%	22.4%	1.76%
$1,000,000 to $1,999,999	$6,514	4.8%	10.3%	1.43%
$2 million and over	$7,587	5.0%	12.6%	1.25%

Table 8 shows the number of previous years that individuals who claimed the credit for 2010 had claimed the credit.

Table 8
Number of Credit Claims in 1998 - 2009
by Individuals who Claimed Charitable Endowment Credits for 2010

Previous Credits	Taxpayers with this Many Previous Credits	% with this Many Previous Credits	% with this Many Previous Credits or More
0	154	24.4%	100.0%
1	75	11.9%	75.6%
2	53	8.4%	63.7%
3	42	6.7%	55.2%
4	36	5.7%	48.6%
5	41	6.5%	42.9%
6	40	6.3%	36.3%
7	35	5.6%	30.0%
8	29	4.6%	24.4%
9	31	4.9%	19.8%
10	41	6.5%	14.9%
11	31	4.9%	8.4%
12	22	3.5%	3.5%
Total	630	100.0%	

About three-fourths of individuals who claimed the credit for 2010 had claimed the credit at least once before, and over half had claimed it at least three times. Twenty-two individuals have claimed the credit every year it has been available.

Table 9 shows the percentage of corporations that claimed the credit for 2009 with a Montana address and the average apportionment factor. A corporation's apportionment factor is the average of the percentages of the corporation's payroll, property, and sales in the state.

Table 9
Location of Corporations Claiming Charitable Endowment Credit for 2009

Corporations with Montana Address on Return		Average Apportionment Factor
Number	%	
30	100%	95.7%

All of the corporations that took the credit for 2009 have a Montana address, and most of them do not do business in other states.

Table 10 shows credits claimed by corporations for 2009, with corporations divided into three groups based on federal taxable income. Only companies that do business in multiple states are required to report payroll and sales, which would be better measures of firm size. Since most of the corporations that took the credit only did business in Montana, net income is the only measure of size they report.

Table 10
Size of Corporations Claiming Credit for 2009

Federal Taxable Income	N	Credits
Less than $45,000	10	$10,779
$45,000 to $349,999	10	$31,940
$350,000 and Over	10	$52,170
Total	30	$94,889

The income groups were selected so that there would be ten taxpayers in each to avoid the possibility of revealing individual taxpayer information. As table 8 shows, most corporations claiming the credit were relatively small, but a few were large.

Table 11 shows repeat credit use by corporations.

Table 11
Number of Credit Claims for 1997 - 2008
by Corporations that Claimed Credits for 2009

Previous Credits	Taxpayers with this Many Previous Credits	% with this Many Previous Credits	% with this Many Previous Credits or More
0	0	0.0%	100.0%
1 - 4	11	36.7%	100.0%
5 - 7	9	30.0%	63.3%
8 - 10	10	33.3%	33.3%
11	0	0.0%	0.0%
Total	30	100.0%	

All corporations that claimed the credit for 2009 had claimed it at least once before, and more than half had claimed it at least six times. No corporations claimed it every year it was available.