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Client Alert: Delaware HB 240: Draft Legislation Regarding Charitable Deduction to Impact Delaware Nonprofits and Other Charitable Organizations

Delaware Nonprofits and Supporters Should Be Concerned and Voice Their Opinions to their State Legislators

Summary. The Delaware General Assembly is currently reviewing legislation that, if passed, will have a significant impact on all Delaware nonprofits and charitable organizations. As discussed herein, House Bill 240, related to taxes on personal income ("HB 240"), contains a provision (Section 4) to eliminate itemized deductions. This provision seeks to impact only those taxpayers who itemize their state returns, or about a third of the Delaware tax filer population. While this may have some positive effect on the state treasury, Delaware nonprofits and the communities they serve will be impacted adversely by this legislation. As such, Section 4 to HB 240 should not become law in its current form.

The elimination of the state charitable deduction in Section 4 to HB 240 will negatively impact individual charitable giving in Delaware. When comparing outcomes in other states that passed similar legislation, Section 4 to HB 240 could result in Delaware charitable organizations such as nonprofits and houses of worship collectively receiving anywhere from $30 million and $60 million less from individual donors in FY18 than FY17. Consequently, these groups will likely be forced to lean more heavily on the State in the future and reduce services to the communities and constituents they serve, offsetting any potential revenue gains since local governments will be forced to pick up the slack with their own funds and resources.

Call to action. All nonprofits should be aware of Section 4 to HB 240 and carefully review it to determine the extent it will impact their operations and budget. A copy of the most up-to-date version of legislation is available on Delaware's Legislative Tracking website. Nonprofits or their supporters who oppose or have any concerns with this legislation should contact their board, legislators, or professional counsel to voice their opinions and speak out about Section 4 to HB 240. The Delaware House Revenue & Finance Committee will be holding a hearing on HB 240 on June 21, 2017 at 3:00 pm at Legislative Hall in Dover. Nonprofits, their representatives, and members of the public are encouraged to attend.

Summary of Section 4 to HB 240. Among other things, Section 4 to HB 240 seeks to eliminate the charitable gift deduction on the Delaware income tax return. According to HB 240's Synopsis, Section 4 "*eliminates itemized deductions and increases the standard deduction amount from $3,250 to $5,000 for single and married taxpayers filing separately and from $6,500 to $10,000 for taxpayers filing joint returns*. In addition, Section 4 reduces from $110 to $85 the amount of the personal credit. Lastly, Section 4 raises the eligibility age from 60 to 65 in one-year increments over a five-year period for the extra, age-based personal credit." (emphasis added).

Summary of Potential Impact of Section 4 to HB 240. As discussed herein, Section 4 to HB 240 could have a significant and adverse impact on the amount of money collected by charitable organizations from individual donors. The tax deduction is not the only reason people give to charity, but there is no dispute it has influence. A large majority of Delawareans (83%) across the income tax spectrum contribute to charitable organizations.[1] In 2012, the most recent year for which federal income tax data is available, Delawareans gave $476,117,000 to charities, with a median contribution of nearly $3,000/person.[2] The giving ratio for Delaware is 2.74%, which is comparable to the surrounding Mid-Atlantic states.[3] As Table 1 shows, more than half (63%) of the charitable dollars donated in Delaware by private individuals are given by those making $100,000 or more in adjusted gross income (AGI).

Table 1. Delaware Giving Profile (2012).[4]

Income Bracket	Giving Ratio	Total Contributions	Average contribution
Up to $25,000	7.60%	$ 11,917,000	$ 1,792
$25,000 to $50,000	4.17%	$ 40,190,000	$ 2,244
$50,000 to $75,000	3.21%	$ 59,592,000	$ 2,521
$75,000 to $100000	2.82%	$ 63,402,000	$ 2,906
$100,000 to $200,000	2.46%	$ 146,222,000	$ 3,711
$200,000 or more	2.50%	$ 154,794,000	$ 12,189
Total	**2.74%**	**$ 476,117,000**	**$ 2,957**

[1] *See* National Center for Charitable Statistics, *Profiles of Individual Charitable Contributions by State: 2013* (Feb. 10, 2016) (showing in Table 2 that 439,680 returns were filed in Delaware in 2013, with 144,650 itemizing their returns (33%) and 119,840 of those returns (82.8%) contained itemized charitable deductions), *available at* www.urban.org/research/publication/profiles-individual-charitable-contributions-state-2013 (last visited June 20, 2017).

[2] Justin Myers et al., *How America Gives* (Chronicle of Philanthropy), *available at* www.philanthropy.com/interactives/how-america-gives#state/10 (data last updated January 5, 2015; website last visited June 20, 2017). This is the most recent compilation of data that we could find.

[3] Maryland's giving ratio is 3.2%, Pennsylvania is 2.68%, and New Jersey is 2.12%. *Id.* Giving ratio is defined as the "percentage of adjusted gross income given to charity as determined using the charitable deductions reported on the income-tax forms." *Id.*

[4] Data compiled from the Chronicle of Philanthropy's *How America Gives* tables. *Id*.

Similar legislation in other states. The majority of states offer tax deductions for charitable contributions.[5] In recent years, a few state legislatures have made changes to their state's itemized deduction requirements, including capping or eliminating the deductions for charitable giving, similar to Section 4 to HB 240.[6] Two state statutory regulations in this arena are instructive when considering the potential impact for Section 4 to HB 240: Michigan and Hawaii.

Michigan removed three tax credits in 2011 that were designed to encourage charitable giving to food banks, homeless shelters, and community foundations. A study following the enactment of this legislation found a significant drop in small donations to the Michigan community foundations: $400 dollar donations dropped 51% and $200 donations dropped $28%.[7] A follow-up study found that the decrease in $200 and $400 donations continued to drop by 46% and 64%, respectively, in the following year.[8] From 2011 to 2013, the study found that there was a 44% decline in $200 donations and a 76% decline in $400 donations, leading them to conclude that the legislation had a significant impact on individual contributions and donations.[9] In real dollars, Michigan's legislative enactment translated into a $50 million reduction in donations to those nonprofits impacted by the legislation in 2012 alone.[10] Six years later in 2017, the Michigan state legislature has introduced legislation to restore these tax credits.[11]

Hawaii enacted a cap on itemized deductions in 2011 (effective 2012) applying to taxpayers with adjusted gross incomes of $100,000 or more. Similar to the results in Michigan, donations declined from $19,302 per donor in 2011 to $15,632 per donor in

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[5] *See* Common Good Vermont, *Impact of Charitable Deduction Caps in Hawai'i and Michigan* (Apr. 4, 2015) (summarizing charitable deduction requirements by state), *available at* blog.commongoodvt.org/2015/04/impact-charitable-deduction-caps-hawaii-michigan (last visited June 20, 2017).

[6] *See id.*; *see also* Elaine S. Povich, *Charitable Giving Tied To State Tax Write-Offs*, *USA Today* (Sept. 24, 2013) (describing how several states have addressed these deductions), *available at* www.usatoday.com/story/news/nation/2013/09/24/charitable-giving-state-tax-deductions/2860755 (last visited June 20, 2017); Jeannie Fox, *Who Wins With Charitable Giving Tax Credits?*, Nonprofit Quarterly (June 13, 2017) (describing how Michigan is likely to change its legislation this session), *available at* nonprofitquarterly.org/2017/06/13/wins-charitable-giving-tax-credits (last visited June 20, 2017).

[7] Johnson Center at Grand Valley State University, *Impact on Giving After the Repeal of the Michigan Community Foundation Tax Credit* 4 (Feb. 2013), *available at* www.michiganfoundations.org/sites/default/files/resources/Impact-of-Giving-After-Repeal-of-Tax-Credit-Johnson-Center-2013.pdf (last visited June 20, 2017).

[8] Johnson Center at Grand Valley State University, *Impact of the Tax Credit Repeal* (June 2014), *available at* www.michiganfoundations.org/sites/default/files/resources/JCP%20CF%20Tax%20Credit%20Study_2014_Full%20Report_FINAL.pdf (last visited June 20, 2017).

[9] *Id.* at 3.

[10] Povich, *Charitable Giving Tied To State Tax Write-Offs*, *supra*.

[11] Jeannie Fox, *Who Wins With Charitable Giving Tax Credits?*, *supra*.

2012, a drop of nearly 20%.[12] The cap was expected to bring in about $12 million to the Hawaii treasury but wound up costing the charities between $50 million and $60 million in lost donations.[13] Because of the significant impact, Hawaii restored the charitable deduction two years later in 2013.

In more recent years, other states have given strong consideration to the charitable contribution outcomes that occurred in Michigan and Hawaii when examining potential changes to their own tax code with respect to itemized deductions. Vermont, after considerable debate, recently passed tax legislation that places no new limits or additional restrictions on charitable deductions or catastrophic medical expense deductions, but put a cap on all other deductions at 2.5 times the standard deduction.[14] Similarly, in North Carolina, recent tax legislation allowed unlimited itemized deductions for charitable contributions but capped mortgage interest and property tax deductions.[15] New York enacted caps on itemized deductions on state taxpayers with adjusted gross income of more than $1 million (50% state tax deduction) and more than $10 million (25% state tax deduction).[16]

Nonprofit Impact in Delaware. While every state is different, the reductions in charitable giving in Michigan and Hawaii may be prescient. Should Section 4 to HB 240 pass and individual charitable giving in Delaware at the highest levels (i.e., more than $100,000 in AGI) decrease by between 10% and 20% (using the 20% decline experienced in Hawaii as a benchmark) that would mean that Delaware charitable organizations could collectively see between $30 million and $60 million less in individual donations as soon as one year after HB 240 is implemented. It is unclear the exact impact a shortfall like that would have, but it almost certainly would result in most—if not all—Delaware nonprofits and charitable organizations making hard decisions regarding reductions in force and the scaling back of services they provide, many of which affect the most vulnerable Delawareans, such as low income families, children, veterans, seniors, people with disabilities, victims of domestic violence, those battling addiction, and the homeless. In many cases, these Delawareans would have no option but to turn to the State or their local government for assistance.

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[12] Common Good Vermont, *Impact of Charitable Deduction Caps in Hawai'i and Michigan*, *supra*.
[13] Povich, *Charitable Giving Tied To State Tax Write-Offs*, *supra*.
[14] *See* Alliance for Charitable Reform, *Vermont Preserve Charitable Deduction in Final Tax Deal* (May 19, 2015), *available at* acreform.org/blog/vermont-preserves-charitable-deduction-in-final-tax-deal (last visited June 20, 2017).
[15] *See* Barry Smith, *North Carolina Gets Sweeping Tax Reform*, Carolina Journal (Aug. 19, 2013) (also noting that the plan eliminated the personal income exemption and increased the standard deduction to $15,000 for married taxpayers filing jointly, $12,000 for heads of household, and $7,500 for single taxpayers and married taxpayers filing separately), *available at* www.thetribunepapers.com/2013/08/19/north-carolina-gets-sweeping-tax-reform (last visited June 20, 2017).
[16] Povich, *Charitable Giving Tied To State Tax Write-Offs*, *supra*.

<u>Next Steps</u>. Innovincent and many others working in or with the nonprofit sector, including the Delaware Alliance for Nonprofit Advancement (DANA), believe that HB 240 and particularly Section 4 will have a significant and detrimental impact on every nonprofit and house of worship in the state. Given how similar legislation has affected charitable donations in other states, the potential impact on charitable organizations in Delaware with this legislation is too great to merit passive consideration. Should this legislation pass, Innovincent and others will undoubtedly hold roundtable discussions and other events to discuss and learn about the new requirements and how nonprofits are impacted.

Should HB 240 and Section 4 not pass or the charitable deduction language be eliminated or exempted from the final bill, Innovincent will continue to work with its clients and other industry professionals on determining the best approach to address the budgetary issues HB 240 attempts to solve.

<u>Conclusion</u>. For the reasons discussed above, the potential impact on Delaware nonprofits and other charitable organizations far outweighs any potential benefit of Section 4 to HB 240 as drafted, and the relevant language addressing the charitable donation deduction should be reevaluated or eliminated. While budget cuts and new and novel revenue solutions are needed to help close the budget deficit, it should not come at the expense of the charitable organizations supported by the vast majority of Delawareans throughout the State.

Should you have any questions or concerns about HB 240, you should contact your state legislator. If you do not know your state legislator, you can find that online at http://legis.delaware.gov/FindMyLegislator.

In addition, the Delaware House Revenue & Finance Committee will be holding a hearing on HB 240 on Wednesday, June 21, 2017 at 3:00 pm at Legislative Hall in Dover. Innovincent encourages all nonprofits and Delawareans with issues regarding HB 240 to attend or have a proxy or representative attend on their behalf.

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