Charity Tax Credits:

Federal Policy and Three Leading States

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Executive Summary

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President George W. Bush proposes to expand charitable giving with state charity tax credits for donations to poverty-fighting programs by permitting states to pay for the cost of the credit (in lost revenue from taxes) with the state welfare block grant (Temporary Assistance to Needy Families). "States would be encouraged to provide a credit (of up to 50 percent of the first $500 for individuals and $1,000 for married couples and corporations) against state income or other taxes for contributions to charities addressing poverty and its impact. States would be given the flexibility to offset the costs of a charitable state tax credit by using money from the Temporary Assistance to Needy Families (TANF) program."[1] This paper considers whether such a policy would benefit low-income families, the communities where they live, and charities serving those families, by reviewing the history of charity tax credit proposals, surveying three leading states that have implemented the credits, and considering key questions.

Earlier proposals for tax credits were packaged as part of the devolution revolution and welfare reform; current proposals are promoted as a way to increase support for faith-based and other community organizations or to alleviate poverty. However, all of these proposals share the common goal of shifting decision-making about how and where public resources are used to meet the needs of poor families from elected and appointed officials to individual taxpayers. Consistently, supporters promote the credits as a way to let taxpayers take control of allocating tax dollars to meet social welfare needs of poor households.

An attempt to answer important questions for policy-makers reveals the need for study of existing state credits in places like Arizona, Michigan and North Carolina. First, there is no empirical evidence that a charity tax credit increases charitable giving. While claims for the credit increased each year in those three states, key contacts indicate there are reasons other than new giving to explain these increases. For example, tax credits may be claimed by contributors who gave the same amount to anti-poverty programs in years before the credit was established, but each year more of these long-time contributors learn of and take the credit. Study of the tax credits' impact in states with existing credits should be the first step in any effort to design a national program.

Second, shifting decisions about where to invest public anti-poverty funding from government to individuals eliminates the built-in accountability of public decision-making. The public officials responsible for social service programs have the advantage of surveying the broader system of community services. They know the impact of other funding sources and where charitable giving has more capacity to meet community needs. The job of these officials is to determine need and to assess the capacity of specific providers to meet that need. They are accountable to the taxpayers, and can review performance outcomes pursuant to conditional grants and contracts. If public funds are used to offset tax credits for funding decisions made by individuals, the accountability inherent in the competitive, performance-based system of public funding is lost. It is surprising that the Bush administration would suggest a funding mechanism that eliminates accountability in government funding since President Bush has stated his commitment to performance-based grant making: "We must be outcome-based, insisting on success and steering resources to the effective and to the inspired."[2]

Third, high-poverty neighborhoods and the families who depend on social service providers in these neighborhoods would likely be losers with a funding mechanism like the state charitable tax credit proposed by the Bush administration. In poor communities, the capacity to give is lower, and the dependence on funding streams like TANF by both providers and families is greater than in places less impacted by poverty. If the administration's tax credit proposal is enacted, resources that today are sent into the poorest communities could be redistributed to places with more wealth and less need.

By the third month of the Bush administration, the charity tax credit proposal had not received much attention from the press or affected constituencies. However, with the charitable choice proposal for increased direct federal funding of religious organizations under fire, a number of proponents of public funding for religious organizations have begun to point to the charity tax credit as a preferable alternative. In fact, Don Eberly, now the deputy director of the White House Office of Faith-Based and Community Initiatives, wrote an essay during the 2000 campaign advising the next president that the tax credit is preferable to other means of expanding the role of nonprofits because it would "channel more funds to faith-based institutions" and would protect "the autonomy of charities, including faith-based ones, from state regulation and encroachment."[3]

In the months to come – including during the anticipated debate about reauthorization of TANF in 2002 – members of Congress should carefully consider the questions of whether the charity tax credit proposal would result in more charitable giving, and whether such an increase would be worth the loss of accountability and flexibility inherent in other uses of federal dollars. The conclusion of this paper is that more study of charity tax credits is necessary (and fortunately possible, since there are state experiments already underway) and that, no matter what design of the credit may be chosen, it is nevertheless unlikely that the proposal would be in the best interest of poor families and children.

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President George W. Bush proposes to expand charitable giving with state charity tax credits for donations to poverty-fighting programs by permitting states to pay for the cost of the credit (in lost revenue from taxes) with the state welfare block grant (Temporary Assistance to Needy Families). "States would be encouraged to provide a credit (of up to 50 percent of the first $500 for individuals and $1,000 for married couples and corporations) against state income or other taxes for contributions to charities addressing poverty and its impact. States would be given the flexibility to offset the costs of a charitable state tax credit by using money from the Temporary Assistance to Needy Families (TANF) program."

This paper addresses the question of whether President Bush's charity tax credit proposal would enhance or weaken the set of services available to low-income families. The paper includes a review of charity tax credit proposals (including pending federal proposals), a summary of characteristics of the legislation, a survey of tax credits in three leading states, and a list of questions about the policy that need to be answered before decision makers can determine whether the credit can enhance the ability of nonprofits to meet the needs of poor families and communities across the country.

History of Federal Proposals

The case for a charity tax credit (CTC) has evolved over time. Early proposals were packaged as part of the devolution revolution and welfare reform; current proposals are promoted as a way to increase support for faith-based and community organizations or to alleviate poverty. However, all of them share the common goal of shifting decision making about how and where public resources are used to meet the needs of poor families from elected and appointed officials to individual taxpayers. Consistently, supporters promote the credits as a way to let taxpayers take control of allocating tax dollars to meet social welfare needs of poor households.

The charity tax credit has been proposed many times by members of Congress and various think tanks since the mid-1990s as part of the welfare reform debate. Organizations like the National Center for Policy Analysis (NCPA), led by Pete DuPont, the Beacon Hill Institute for Public Policy Research at Suffolk University, and the National Center for Neighborhood Enterprise have supported a proposal to privatize welfare by allowing "individual taxpayers rather than politicians [to] decide how their share of the welfare bill would be spent by allocating their welfare dollars to any qualified charity."[5]

The NCPA proposal advocates a shift from individual entitlements and formula grants for "welfare" to state block grants. Each federal taxpayer would have an established "share" of the federal welfare budget and could receive a one-dollar tax credit for each one-dollar donation. In turn, each state's block grant would be reduced by one dollar for each dollar of tax credit claimed by a [taxpayer] resident of that state. Taxpayers could claim the credit only for donations to a new category of qualified charities – charities that provide services to the poor. The NCPA proposal suggested a state tax credit if the federal government failed to enact a federal credit. A critical component of these proposals is that the option be revenue neutral. Charity tax credits in these proposals were not intended to increase charitable giving as much as they were supposed to shift allocation of public resources for welfare from elected and appointed officials to individual taxpayers.

Indeed, the executive director of the Beacon Hill Institute (BHI) stated that the "economic argument for the tax credit is the same as for any form of privatization: to replace a government monopoly with a system of competing enterprises – in this instance, private, community-based charitable organizations – that vie with each other to provide better services at lower cost."[6] In 1995, BHI published a lengthy study on the tax credit, subtitled "A New Approach to Welfare Funding," in which the authors proposed "… a 100 percent tax credit for contributions to qualified organizations by individual taxpayers for up to 25 percent of their tax liability."[7] The study determined that the credit would "shift the delivery of up to $115 billion of federal means-tested benefits from government to private charities" and "succeed in the *principal goal of making welfare spending taxpayer controlled as well as taxpayer funded."*[8] (Emphasis added.)

Representatives Joe Knollenberg (R-MI) and Jim Kolbe (R–AZ) introduced the first charity tax credit legislation at the very beginning of the newly Republican 104th Congress on January 31, 1995. The legislation called for the elimination of a large number of welfare and anti-poverty programs, replacing them with block grants to the states and a charity tax credit for taxpayers. Rep. Knollenberg described the mechanism in his introductory remarks: "How should we reform the welfare delivery system? Our bill, like many others, would consolidate dozens of overlapping, inefficient Federal programs and put that money into a State block grant. However, it also provides for a choice-in-welfare tax credit that would give individual citizens a voice in how this country fights poverty. Under our plan, every taxpaying American would be free to direct up to 10 percent of their Federal income taxes to a charitable organization in their community that is engaged in antipoverty efforts.

Each time a taxpayer claimed this credit, the Federal Government would make a corresponding reduction in their State's block grant—thereby making it revenue neutral."[9]

Also that year, former Senator Dan Coats (R-IN) introduced federal charity tax credit legislation. Sen. Coats said: "Can private charity replace Government? I am not suggesting that Federal, State and local governments will not have to be involved in poverty relief. But private initiatives can offer a viable alternative that the Government can at least encourage. I believe a charity credit will go a long way toward nurturing and encouraging those private efforts that I think are going to be more and more important as we begin to reform *and reduce the scope of the Government involvement*, because government alone simply has not worked for the well being of our people."[10] (Emphasis added.)

In every Congress since then, members of Congress have proposed some form of charity tax credit. Since the federal welfare legislation passed in 1996, the primary focus of charity tax credit proponents has been on promoting state charity tax credits rather than a federal credit.

In 1998, the Community Services Block Grant (CSBG) was amended to permit the use of up to 10 percent of each state's discretionary funds to offset losses from a state charity tax credit. Representatives Mark Souder (R-IN) and Bobby Scott (D-VA) offered the amendment. Rep. Souder said: "We also have a bipartisan amendment with the gentleman from Virginia (Mr. Scott) and myself that would allow at the State level their portion of Community Services Block Grant to be set aside to pay for State charitable credits." Rep. Souder described the state charitable credits as "an important breakthrough" because it provides an alternative to government assistance for those "who have been left behind in economic growth."[11] The charity tax credit incentive in CSBG is the only federal legislation that has been signed into law to promote charity tax credits. However, to date, no state has taken advantage of this option.

In 1999, Sen. Rick Santorum (R-PA) and former Rep. John Kasich (R-OH) introduced companion bills in the House and the Senate permitting states to offset up to 100 percent of losses from a state charity tax credit with up to 50 percent of federal funds provided under the Temporary Assistance to Needy Families block grant, the Child Care Development Fund, the Social Services Block Grant, the Community Services Block Grant, the Low Income Home Energy Assistance Program, the Job Training Partnership Act, and the Community Development Block Grant. The bill would have permitted charity tax credit losses that exceeded the 50 percent cap to be counted toward the state's TANF "maintenance of effort" requirement.[12] At FY 2000 funding levels, the total available for state charity tax credits would have been nearly $27.4 billion.

107th Congress and the 43rd President

In 2001, Representatives Jim Kolbe (R-AZ) and Joe Knollenberg (R-MI) once again introduced a CTC bill. Its title reflects the times: Eliminate Poverty Tax Credit Act of 2001. In the 107th Congress, welfare is mostly considered to have been reformed. Nationally, welfare caseloads have dropped nearly 60 percent since 1993, and millions of former welfare recipients have gone to work. States have begun to use the flexible TANF block grant to support low income working families, without regard to their previous connection to the cash assistance program. Viable legislative proposals in this session are more likely to focus on alleviating poverty. The new Kolbe/Knollenberg bill proposes a federal tax credit for charitable contributions to nonprofits providing services to the poor. Significantly there is no offset for the credit, except that the existing tax deduction for the charitable contribution would not be allowed. In these days of budget surplus, it is no longer necessary to propose an offset for the credit. To the sponsors, it is still preferable to allow individual taxpayers to decide how to spend the surplus, by giving them a charity tax credit, than to let federal officials spend it.[13]

However, even without a specific offset, the tax credit policy in this bill is still intended to empower taxpayers by letting them make decisions about using tax collections to assist poor families. In his letter to other members of the House, Rep. Kolbe says: "When you fill out your tax forms this year, wouldn't you like the opportunity to redirect $100 of your money that is headed to the federal bureaucracy and give it directly to an organization that is helping raise the standard of living of some of America's poorest citizens? This bill makes every American an Appropriator. They can choose how to spend money that would normally be going to the IRS."[14]

Putting a new gloss on it, President George W. Bush has made his state charity tax credit proposal an element of his faith-based and community initiatives plan with the explicit goal of increasing charitable giving. Yet, three months into his administration, and even after the introduction of bipartisan legislation to implement tax proposals from the President Bush's Faith-Based and Community Initiatives plan in both houses of Congress, no member had proposed legislation to enact President Bush's state charity tax credit incentive.[15] Legislation would be necessary because the proposed federal incentive to the states is the permission to offset lost revenue from the credit with the Temporary Assistance to Needy Families block grant (TANF). Limits on the use of TANF block grants prohibit giving these funds to taxpayers with enough household income to be eligible for a refund based on the credit.[16]

However, as the charitable choice provisions of the faith-based initiative continue to generate controversy, some advocates of funding for religious organizations are beginning to lobby for charity tax credits. These supporters believe that credits avoid the constitutional problems inherent in direct funding of pervasively religious organizations. One of the early promoters of this approach is Don Eberly, now the deputy director in the White House Office of Faith-Based and Community Initiatives, who has written that the tax credit is preferable to other means of publicly funding charities because it would generate more funding for religious organizations and would not subject those institutions to "state regulation and encroachment." [17] Another prominent supporter of faith-based funding, Marvin Olasky, is a longtime advocate of charity tax credits. Olasky has recently said he prefers tax incentives such as charity credits to direct funding mechanisms.[18] Meanwhile, David Tuerck of Beacon Hill Institute plans an updated paper on charity tax credits and argues that just creating the credits without a reduction in federal spending is insufficient. Tuerck remains convinced that the purpose of the CTCs is to shift decisions about allocation of funding for welfare services from government to individual taxpayers, and to create a "competitive market" among nonprofits for welfare funding. Finally, Tuerck believes that getting government out of the delivery system will mean that needy individuals must "find a charity that wants to provide" the necessary services, while taxpayers have to take an interest in service providers.[19]

In sum, all of these proposals are reportedly made with the goal of reducing public spending on the poor, and to shift decision making from appointed and elected officials to individuals. With the exception of President Bush's proposal, there is very little reference to increasing contributions to charities serving the poor. And there is almost never any discussion of whether these proposals will enhance or weaken the set of services available to families in communities.

Characteristics of the Charity Tax Credit Proposals

Federal proposals for CTC, whether for a federal or state credit, and whether or not they include an offset to pay for the credit, share many characteristics in the definition of eligible "qualified charities". For example:

1) Minimum expenditure requirement: Nonprofit expenditures on anti-poverty programs must exceed a defined minimum, often 75 percent of annual organizational expenses.

2) Expenditures: Poverty program expenditures are usually defined to exclude spending on administration or management, influencing legislation, legal services, and fundraising.

3) Poor individuals to be served: Eligible poverty programs are only those serving households below a certain income level, usually between 150 percent and 185 percent of the federal poverty level. Some proposals create record keeping exceptions for shelter and feeding programs, assuming that individuals served in those programs will meet income eligibility criteria.

Generally, the credit is for 50 percent to 100 percent of the contribution and is capped at a maximum of $50 to $500 for each taxpayer.

Other provisions, not common to all proposals, include:

- Permitting "solicitation organizations" like United Way to qualify as eligible charities under certain circumstances;

- Mandating new reporting requirements for eligible charities; for example, the percentage of organizational expenses for various categories of activities (e.g., fundraising, program, management, etc.);

- Recommending that states limit qualified charities to those that have been operating for more than a year;

- Recommending that states develop additional limits on legislative advocacy, legal services, voter registration, and public policy activities for qualified charities; and

- Requiring study of the impact of the credit, including "the geographic distribution of the funding" and type of services funded by the credit, to determine whether the funding mechanism of the credits matches the services that would otherwise be provided by the federal funds "without the enactment of the reductions in the programs permitted" by the federal legislation.[20]

A Survey of Charity Tax Credits in Three Leading States: Arizona, Michigan and North Carolina

Most surveys of state tax policy conclude that there are about 20 states that have enacted targeted tax credits for contributions to charitable organizations.[21] However, most of these are for contributions to community economic development organizations, and they are sometimes limited to enterprise zones as well.[22] This report will focus on three leading states:

- Arizona, because the credit is most like President Bush's proposal and earlier federal proposals, since it is available specifically for charitable contributions to programs serving poor households;

- Michigan, because the credit is for contributions to charities serving two poor populations: the homeless and hungry; and,

- North Carolina, because it is the only state that has taken a broader approach by creating a credit for contributions to all charities – not just those serving the poor.

Arizona

Arizona is the only state in the country to establish a tax credit like that proposed by the Bush administration. The tax credit for contributions to charities that provide assistance to the working poor was enacted as part of the state's welfare reform legislation in 1997.[23] The staff of the Valley of the Sun United Way (Phoenix) believes that the credit was created to generate more charitable giving to nonprofits, which anticipated increased demand for assistance as a result of welfare reform policies.[24] Working with state Rep. Mark Anderson (R- Mesa), the United Way and others supported a state credit that took effect in tax year 1998. Rep. Anderson recalls that he got the idea for this legislation after reading materials from the Beacon Hill Institute.[25] In fact, Beacon Hill prepared a report entitled "A Charitable Tax Credit for Arizona" for the legislature recommending a tax credit that would maintain deficit neutrality by reducing "federal welfare spending … dollar-for-dollar with the increase in private giving" and a "five year phase out of the government welfare expenditures that the fully implemented credit is intended to replace."[26] However, the final legislation did not include an offset.

The Arizona credit is for cash contributions to a nonprofit organization spending at least 50 percent of its budget on services to households receiving TANF or with income below 150 percent of the federal poverty level. The definition of services does not include the explicit limits on lobbying or legal services for the poor that are usually found in the federal legislation. Community Action Agencies receiving CSBG funding are also eligible (although it does not appear that the state is using the option to offset the cost of the credit with CSBG discretionary funds). A qualifying organization must certify that it meets all criteria for eligibility to the state Department of Revenue.

A 100 percent credit of up to $200 is allowed for contributions above the amount contributed in the taxpayer's baseline year. The baseline year is the first year after 1995 that the taxpayer itemized charitable contributions. Key contacts in the state recalled that the purpose of the baseline year requirement was to promote new giving to charities, rather than rewarding existing givers. It was also intended to reduce the likelihood of the "substitution effect," in which givers shift contributions from an ineligible charity to a qualified charity. Under the Arizona law, substitution could occur, but increased overall giving to nonprofits is required of the individual who takes the credit. However, no one has attempted an empirical study of the new credit to determine whether it has resulted in increased giving to eligible charities.

The state can provide unverified, unofficial data regarding the number of filers who have claimed the credit and the total amount claimed. For the two tax years, 1998 and 1999, less than 1 percent of filers claimed the credit. In 1998, 2,183 filers claimed $385,890; in 1999, 3,621 filers claimed $678,575. Thus, the percentage of filers claiming the credit did increase in the second year, as did the average credit claimed.[27]

The Valley of the Sun United Way created a new fund that qualifies as an eligible charitable organization under the statute: the Helping the Working Poor Fund. United Way fundraisers use the credit to market the fund, which is designed to make grants to nonprofits providing services to underemployed working poor individuals and their families. The funded agencies compete for the award in an annual process conducted by United Way volunteers. In this way the fund provides an option for taxpayers who want to be sure their contribution fills an identified community need and also ensures that outcomes are measured.

The United Way fund has nearly doubled since it was created before the 1997 fundraising campaign. The staff attributes the growth in part to the fact that they market the fund with the tax credit. However, the fund has received contributions in an amount nearly double the credits unofficially reported to have been claimed by taxpayers. This may be because some contributors to the fund do not claim the credit, may not have increased their giving above the baseline year, or may not be itemizers.[28]

Rep. Anderson was the chairman of the legislature's Block Grants Committee and is currently chairman of the Human Services Committee, which has responsibility for oversight and legislation concerning the TANF block grant. He stated that he would not support offsetting the cost of the credit with TANF as proposed by the Bush administration.[29] Although there has been no analysis of the impact of the credit on charitable giving in Arizona, the goal of the legislation seems to have been to increase giving – particularly in light of the anticipated additional demand on anti-poverty agencies as families lost welfare benefits.

Michigan

Michigan's credit for homeless shelters and food banks was also created at a time when social service providers felt burdened by demand created as a result of state policy changes. In 1991, Michigan passed legislation creating a new credit for 50 percent of a charitable contribution made to agencies whose primary purpose is to provide food or shelter to indigent persons. The maximum credit is $100, or $200 for spouses filing a joint return.[30] At about the same time, the state was significantly reducing funding for an entitlement program for emergency assistance and eliminating a program of cash assistance for unemployed childless adults. Like the United Way in Arizona, homeless shelter and food bank operators in Michigan recognized the need for additional resources to cope with the increased demand resulting from the reduction in state funding – and they urged creation of the targeted tax credit.[31]

The Michigan statute does not require the taxpayer to exceed contributions made in a baseline year – in fact, Michigan does not offer state deductions for charitable contributions at all. Instead there are credits for targeted charitable contributions. In addition to the homeless shelter and food bank credit, there are credits for contributions to community foundations and public institutions, e.g., universities, libraries, museums and public broadcasting stations.

No one has analyzed the impact of this credit on charitable contributions. However, Michigan Department of Treasury data show that the percentage of total income tax returns claiming the credit increases annually. The total homeless shelter and food bank credits claimed have increased from $3.3 million in 1992 (the first year of the credit) to $12.3 million in 1999 (the most recent data available). The amount of credits claimed has grown an average of 20.6 percent annually, with total growth of nearly 300 percent since the 1992 tax year. Treasury Department staff report that the amount of homeless shelter/food bank credits has a higher growth rate than Michigan's other nonrefundable income tax credits.[32]

North Carolina

North Carolina is the only state in the nation to create a state tax credit for contributions to all nonprofits. The credit is for contributions made by taxpayers who do not itemize their deductions and was intended to increase charitable giving – much as President Bush believes his proposal to extend the federal deduction for charitable contributions to nonitemizers will do.

The North Carolina credit was created in 1996 and went into effect in 1997.[33] It now permits nonitemizers to claim 7 percent of their charitable contributions above 2 percent of their adjusted gross income (AGI). Supporters say the credit was designed to reward donors who contribute more than the average, which is about 2 percent of AGI. Until the 1999 tax year, the credit was for only 2.75 percent of the contribution; the percentage was increased by the legislature in 1998. Legislators sponsoring the increase said they did so because the "state must do what it can to stimulate giving for the important work nonprofits do."[34]

The North Carolina Department of Revenue reports that the number of returns claiming the credit went from 88,560 in 1998 to 121,673 in 1999, while the total credits claimed increased from $3.3 million to nearly $12 million. The total number of returns with taxable income remained at about 3 million in both years, so the percentage of filers claiming the return doubled from 2 percent to 4 percent. However, the numbers are not neatly comparable because the percentage of a filer's contributions eligible for the credit also increased from 2.75 percent to 7 percent between the two years.[35]

Again, there has been no research to determine whether the credit – or the increase in the percentage in 1999 – has had an impact on charitable giving.

The credit was advocated by the North Carolina Center for Nonprofits (NCCN) and its allies across the state. The national organization Independent Sector (IS) provided technical assistance to NCCN on the development of the credit.[36] Unlike the Arizona and Michigan charity credits, the North Carolina credit was not created as part of a change or reduction in public funding of social services.

Lessons and Questions

The review of policy goals for earlier federal CTC legislation and the state legislation in three leading states reveals some lessons and many questions for policymakers considering President Bush's proposal. While there are numerous ways to consider such a proposal, this paper focuses primarily on the question of how such a policy shift would impact poor families and children, services to those individuals, and the communities they live in. Attempts to answer important questions for policymakers reveal the need for more data and information about the impact of existing credits.

Would the proposed CTC increase charitable giving to anti-poverty programs?

President Bush's proposal is intended "to stimulate additional charitable giving."[37] The three states surveyed for this paper cannot provide empirical evidence that CTCs increase giving. While the amounts claimed for the credit increased annually in each state, key contacts stated that there could be many explanations for the increase. For example, increases may just reflect a new awareness of the credit by individuals who had previously made annual contributions to an eligible charity without knowing about the credit. In this case, the credit has not induced new giving but given an unexpected tax reduction to the donor. The Arizona and North Carolina credit statutes attempt to address this possibility with provisions intended to reward new or above-average giving.

The Arizona credit requires that the donor make contributions in excess of the baseline year. However, this does not guarantee that the increase in overall giving is going to the eligible charity. For example, the donor may increase giving to a university while keeping her contribution to an anti-poverty program at the same level. She would still be eligible for the credit because her overall giving increased. The North Carolina credit requires giving above 2 percent of adjusted gross income in order to claim the credit, to reward giving greater than the average household. Still, a household that has always given above 2 percent of income would be rewarded without increasing giving at all.

Despite the experimentation in these three states, there has been no study of the impacts on charitable giving. A survey of the donors and eligible nonprofits about impacts in these three states would contribute knowledge critical to assessing whether President Bush's goal could be achieved.

Finally, the proposal would reduce TANF funding available to nonprofits in order to offset state revenue losses from the credit. The administration's budget indicates that states would have to reduce funding for existing TANF funded programs (like child care and transportation assistance) over time if states used the block grant to pay for the increasing cost of the credit.[38] As a result, nonprofit providers question the advantage of increasing charitable giving (if the credit actually did that) when it would simply be offset by reductions in public funds.[39] In fact, it is possible that the credit could result in a net loss of funds for anti-poverty programs. This would happen if the credit does not stimulate additional giving to social service providers and taxpayers claim credits for their existing level of giving because the public funds currently available for grants to these nonprofits would still be reduced to cover the state's lost revenue.

Who should determine and be accountable for the allocation of federal dollars dedicated to assisting poor families – government officials or taxpayers?

There is an assumption built into most federal proposals for CTCs, and Congressman Knollenberg says it well when he suggests making "every American an appropriator." The arguments made by supporters of the CTC mechanism for funding anti-poverty or welfare services suggest that individual taxpayers will know best which local charity should be funded, urging further devolution of welfare reform – all the way down to the individual. David Tuerck of Beacon Hill Institute argued that this "privatization" of welfare services would require the individual taxpayer to pay attention to the effectiveness of nonprofit service providers.

While it may be true that increased charitable giving would result in some additional scrutiny of nonprofits by donors, this argument overlooks the importance of the role of elected and appointed officials. The public officials responsible for social service grant programs have the advantage of surveying the broad system of community services. They know the other public funding sources and where charitable giving has more capacity to meet community need. The job of these officials is to determine need and to assess the capacity of providers to meet that need. They are accountable to the taxpayers, and can review performance outcomes pursuant to conditional grants and contracts. If public funds are used to offset tax credits for funding decisions made by individuals, the accountability inherent in the competitive, performance-based system of public funding is lost. Interestingly, the importance of auditing for results of public investment is a major of focus of the Bush administration charitable choice initiative to let religious organizations deliver more social programs with existing federal funds. Thus, President Bush's proposal seems, on the one hand, to recognize the importance of government oversight, and, on the other, to dismiss it with the use of TANF funds offsetting charity tax credits.

Mostly, arguments for CTCs view the world through the eyes of the taxpayer. What if we consider the proposal from the perspective of the nonprofit? Generally, nonprofit providers of social services receiving public funding must compete on an annual basis for a grant or contract. Increasingly, organizations must also report results and meet performance goals in order to be eligible to compete the following year. Nonprofit managers do not object to a competitive marketplace for funding.

However, nonprofits have tight budgets. They cannot carry over funds from year to year or their funders will object. This is especially true for the small, community and faith-based organizations that President Bush seeks to support. Thus, nonprofits need to be assured of a certain cash flow, some nearly guaranteed income. Depending on charitable contributions encouraged through tax credits while losing a TANF contract is not an easily managed budget scenario for the small nonprofit operator.

Marcia Hopp-Newman, executive director of Downtown Neighborhood Learning Center in Phoenix, said she'd much rather give up the charity tax credit than lose the block grant funding she depends on to run her programs. She describes the proposal to offset credits with other public funds as a "shell game." However, she has found the Arizona tax credit – with its requirement to increase giving above a baseline year, and dollar-for-dollar reduction in state taxes – to be an effective marketing tool for her center. In addition, she points out that the flexibility of the unrestricted funding from charitable donations is hard to get from public or foundation funding.[40]

One of President Bush's frequent arguments for tax cuts has been that taxpayers know better how to spend their tax dollars than policymakers do. Senate Minority Leader Daschle has responded in this way: "I really defy someone to say you can spend that money in fire protection or law enforcement better if you were doing it yourself than if you did it collectively."[41] The same response can apply to the design, funding and monitoring of assistance to poor households.

How would the credit impact funding mechanisms designed to match resources to need?

Federal anti-poverty and welfare programs were created in part because poor communities were not able to provide services based solely on ability to collect local taxes or charitable contributions. Congress has developed complex funding formulas based on assessment of need. Within states, TANF funds are distributed based on elected and appointed officials' conclusions about how best to address need across the state. President Bush's proposal would shift the distribution of TANF from a method that involves assessment of the entire state system to one that is based on capacity and willingness to make charitable contributions.

Research conducted by Julian Wolpert of Princeton University suggests that the geography of giving would not correlate to need. In "What Charity Can and Cannot Do," a report for the Twentieth Century Fund, Wolpert finds that almost all charitable contributions are made and spent locally. People give where they live. Yet, need does not necessarily correlate to willingness or capacity to give. Except in cases of a natural disaster, like a flood or earthquake, or other emergency attracting widespread media attention, most charitable giving does not get reallocated across communities. In addition, across states there are differences in how much individuals are willing to donate, and the nonprofit efforts they favor. Wolpert concludes that "philanthropy would be a limited and uneven supplement to the government safety net" and that charities in central cities "find that the need for their assistance increases in proportion to their inability to raise funds."[42]

High-poverty neighborhoods and the families who depend on social service providers in those neighborhoods would likely be losers with a funding mechanism like the state charitable tax credit proposed by the Bush administration. In poor communities, the capacity to give is lower, and the dependence on funding streams like TANF by both providers and families is greater than in places less impacted by poverty. If the administration's proposal is enacted, resources that today are sent into the poorest communities could be redistributed to places with more wealth and less need.

The geography of giving would be relevant to any CTC proposal, whether or not it permits offsetting revenue losses with public funds. Spending taxes collected as a charitable credit to taxpayers reduces the flexibility of elected appropriators to meet needs across states and communities.

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No doubt there are other questions that should be asked. If the particular charity tax credit creates new compliance requirements for eligible charities, there would be a question about the capacity of states and nonprofits to monitor and adhere to new regulations. Many nonprofits have objected to proposals that create a "hierarchy among charities … such that charities that serve the poor directly are given a special status, while those which focus on worker safety or civil rights or the environment, or that work internationally rather that domestically, are relegated to a secondary status."[43] Also, anti-poverty policy advocates object to legislation that is drafted in such a way as to discourage lobbying and legal services on behalf of poor families. Many service providers and advocates see these measures as critical options on the menu of activities to reduce poverty.

To address these questions, a study of the impact of a charity tax credit on charitable giving, state flexibility, and nonprofit administration could begin right away in any one or all of the three states surveyed in this report.

Legal Issues

TANF statute: The statute would have to be amended to allow states to use the block grant to offset revenue losses from charity tax credits. First, all federal funds must be spent on activities reasonably calculated to accomplish one of the statute's purposes. Although the statute has broad purposes, families with enough income to be eligible for tax credits would not be "needy families," as required. Second, use of TANF for tax credits is limited to the refundable portion of refundable credits (where the taxpayer is entitled to the full credit even when the amount of the credit exceeds

her tax liability), when the tax credit is designed to accomplish one of the TANF purposes. Charity tax credits are not refundable in this proposal, or any earlier federal proposal.[44]

First Amendment: Groups that monitor government involvement with religious organizations are likely to disagree about the constitutionality of charity tax credits offset by public funds. However, there is no question that some of the CTCs' most vocal supporters see credits as a way to get more funds to religious organizations. Don Eberly, now the deputy director of the White House Office of Faith-Based and Community Initiatives, wrote an essay during the 2000 campaign advising the next president that the tax credit is preferable to other means of expanding the role of nonprofits because it would “channel more funds to faith-based institutions” and protects “the autonomy of charities, including faith-based ones, from state regulation and encroachment.”[45] Marvin Olasky, one of President Bush’s most influential advisers on these issues during the campaign, has repeatedly indicated that tax credits are preferable to direct funding of faith-based organizations.

Supporting and Opposing Organizations

An informal survey of organizations that monitor and lobby on welfare and anti-poverty policy reveals that very few groups have established a formal position on the administration’s proposal for charity tax credits. Nonprofits have been largely preoccupied with other proposals in President Bush’s faith-based initiative. Most of the attention and energy has been applied to the questions of whether religious organizations should receive direct funding from the government, nonitemizers should get a federal charitable deduction, and the estate tax should be eliminated. Of course, the impact of proposed income tax cuts have also been a matter of considerable focus by anti-poverty groups.

Nevertheless, two large and significant national organizations have taken positions opposing charity tax credits.

Independent Sector recently issued a statement opposing President Bush’s targeted tax credit. The national organization supports “the critical need to increase giving to charities that serve the poor, but oppose[s] charity tax credits as a means to accomplish this goal. Charity tax credits would inappropriately insert government tax policy into the private giving choices of individual Americans, would increase regulation, and could reduce the net flow of resources to organizations addressing poverty.”[46] Sara Melendez, president of IS, has said she objects to the use of welfare funds as an offset for charity tax credit costs in the states. "It is robbing Peter to pay Paul," she said.[47] Meanwhile, IS supports a broader approach to increasing charitable giving: allowing nonitemizers to take a *federal deduction* for all charitable contributions.[48] Emphasis added.

United Way of America (UWA) has also stated that it does not support charity tax credits because the policy “could have unintended consequences for the network of community based organizations which support human services as well as for the people and communities they serve.” The issue statement indicates that UWA will not support proposals that displace existing funding or treat charitable donations differently depending on the subset of charities they benefit. UWA also supports tax proposals that increase overall charitable giving, and notes that there is no evidence that charity tax credits would do so.[49]

Groups supporting the charity tax credit policy (though not necessarily President Bush’s specific proposal) include Acton Institute, Beacon Hill Institute, and the National Center for Policy Alternatives. These are all think tanks that have been supporters and promoters of the CTC for several years.

Conclusion

President Bush’s proposal to increase charitable giving by promoting state charity tax credits is not in the best interest of low-income children and families. The credits are purportedly expected to increase charitable giving to “charities addressing poverty and its impact.” Yet, there is no evidence that tax credits would increase giving, and every reason to expect that the particular design of the credit program would significantly impact the chances of achieving that outcome. Charitable giving experience indicates that programs in communities with the greatest need would receive the least in contributions. People give where they live, and poor communities would be losers in a system that depends on charitable giving to support community needs. Finally, because the federal incentive for the credit is to allow states the use of an existing anti-poverty funding stream to offset the cost of the credit to the state treasuries, charities, poor communities, and families should be wary. Block grant funds that are sent to the poorest communities today could be reallocated to communities with the greatest capacity for charitable giving, if not the greatest need for services.

Further, President Bush's own budget numbers acknowledge that states would have to reduce funding for services like child care and transportation assistance to pay for the credits. Congressional decision makers and others concerned about the impact of policy on children and families, communities, and charities, should not accept the tax credit proposal on faith, but instead urge study of existing state charity tax credits and consider carefully any proposal that substitutes an unregulated, unmonitored system of publicly financed support for one that comes with rational spending formulas and the oversight of government officials. Loss of the accountability inherent in competitive grant and contract programs from government is one of the great ironies of this proposal from a president who says: "The paramount goal must be compassionate results, not compassionate intentions. … We must be outcome-based, insisting on success and steering resources to the effective and to the inspired." Chances are, that's something all concerned agree with. But, as always – and even in a faith-based initiative – the devil is in the details.

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[1] “Rallying the Armies of Compassion,” The Faith-Based Initiative, January 2001. http://www.whitehouse.gov/news/reports/faithbased.html
[2] “Rallying the Armies of Compassion.”
[3] Don E. Eberly, “Enact Charity Tax Credits,” Alternatives for Philanthropy (Capitol Research Center, July 2000).
[4] “Rallying the Armies of Compassion,” The Faith-Based Initiative, January 2001. http://www.whitehouse.gov/news/reports/faithbased.html
[5] John Goodman, president and chief executive officer, National Center for Policy Analysis, “Statement on Taxpayer Choice: A Solution to the Crisis of the Welfare State,” testimony before the U.S. Senate Subcommittee on Children and Families, Labor and Human Resources Committee, March 26, 1996.
[6] David G. Tuerck, “The Comprehensive Charity Reform Act,” testimony before the U.S. Senate Subcommittee on Children and Families, Labor and Human Resources Committee, March 26, 1996.
[7] James P. Angelini, William F. O’Brien Jr., and David G. Tuerck, “Giving Credit Where Credit Is Due: A New Approach to Welfare Funding” (Boston: Beacon Hill Institute for Public Policy Research, 1995).
[8] Angelini et al., “Giving Credit Where Credit Is Due.”
[9] Introduction of the Common Sense Welfare Act of 1995 – Hon. Joe Knollenberg, Extension of Remarks, *Congressional Record*, January 31, 1995.
[10] Statements on Introduced Bills and Joint Resolutions – Senate, *Congressional Record*, July 27, 1995.
[11] Human Services Reauthorization Act of 1998 -- House of Representatives, *Congressional Record*, September 14, 1998.
[12] S. 997 and H.R. 1607; 106th Congress.
[13] Author interview with Kevin Messner of Congressman Kolbe’s office, March 26, 2001.
[14] http://www.house.gov/kolbe/ptc_colleague.htm
[15] The bipartisan bills intended to implement the president’s proposals to increase charitable giving are H.R. 7 and S.592.
[16] See explanation p. 25.
[17] Don E. Eberly, “Enact Charity Tax Credits,” Alternatives for Philanthropy (Capitol Research Center, July 2000).
[18] Thomas B. Edsall, “Charity Aid Worries Some Conservatives; Critics Say Bush Plan Has Drawbacks,” *Washington Post*, February 17, 2001; p. A10.
[19] Author interview with David G. Tuerck, March 29, 2001.
[20] S. 997, Sec. 103; 106th Congress.
[21] David G. Tuerck, "The Compassion Tax Credit: Evidence From the States and A Survey of Nonprofit Organizations," (Boston: The Beacon Hill Institute at Suffolk University, December 12, 1996); Jenice View and Carol Wayman, “Neighbors Building Community: A Report of the Neighborhood Assistance Program” (Washington D.C: The Union Institute, 1995).
[22] There are other tax credits that this paper does not address at all because they are so dissimilar to the charity tax credit design: earned income tax credits for low-income workers, low-income housing tax credits for equity investments in affordable housing development primarily for corporate taxpayers, etc. The paper focuses on those credits that are primarily targeted to charitable giving and generally for individual taxpayers.
[23] A.R.S. Section. 43-1088.
[24] Author interview with Brian Hassett, chief executive office, Valley of the Sun United Way, February 24, 2001.
[25] Author interview with Rep. Mark Anderson, February 24, 2001.
[26] David G. Tuerck, and William F. O’Brien Jr., “A Charitable Tax Credit for Arizona,” a report to the Arizona House of Representatives, Committee on Block Grants and Welfare Reform, p. 12.
[27] Author interview with Karen Jacobs, economist, Arizona Department of Revenue, March 13, 2001.
[28] Author interview with Brian Hassett, chief executive officer, Valley of the Sun United Way, February 24, 2001.
[29] Author interview with Rep. Mark Anderson, February 24, 2001.
[30] MI Compiled Laws, 206.261.
[31] Author interview with Sharon Parks, director, Michigan Budget and Tax Policy Project, Michigan League for Human Services, March 29, 2001.
[32] Author interview with Scott Darragh, economist, Michigan Department of Treasury, March 28, 2001.

[33] NCGS § 105-151.26.
[34] North Carolina Center for Nonprofits, "Public Policy Alert," March 23, 1998.
[35] Author interview with Patricia C. Seawell, director, Tax Research Division, North Carolina Department of Revenue, March 29, 2001.
[36] Author interview with David Arons, former legislative assistant, Independent Sector, February 27, 2001.
[37] "A Blueprint for New Beginnings," U.S. Budget, p. 57. http://www.whitehouse.gov/news/usbudget/blueprint/budx.html
[38] "A Blueprint for New Beginnings," table S-8, Mandatory Proposals.
[39] United Way of America and Independent Sector, see details on page 26.
[40] Author interview with Marcia Hopp-Newman, executive director, Downtown Neighborhood Learning Center, March 30, 2001.
[41] John Lancaster, "Soft-Spoken Daschle Wields Hefty Clout; Senator's Ability to Unite Democrats Spurs Talk of Presidential Aspirations," *Washington Post*, April 8, 2001; p. A01.
[42] Julian Wolpert, *What Charity Can and Cannot Do* (The Twentieth Century Fund, 1996). http://www.tcf.org/Publications/Inequality/What_Charities_Can_and_Cannot_Do/Chapter6.html.
[43] "Charity Tax Credit Passes, Contains Language of Concern to Nonprofits," OMB Watch analysis, December 23, 1998. http://www.ombwatch.org/npadv/1998/charity.html
[44] TANF Program Instruction, Treatment of Tax Credits for Federal TANF and State "Maintenance of Effort" (MOE), January 17, 2001. http://www.acf.dhhs.gov/programs/ofa/taxcrdt.htm
[45] Eberly, "Enact Charity Tax Credits."
[46] Independent Sector Adopts Principles for Public Policy on Charitable Giving, press release from Independent Sector, March 6, 2001.
[47] Dana Milbank, "Senators Slow Action On 'Faith-Based' Aid," *Washington Post*, March 14, 2001, p. A1.
[48] Wolpert, "What Charities Can and Cannot Do."
[49] Charitable Giving Tax Incentives Issue Brief, United Way of America, March 2001.