

**Senate Bill 796 (Substitute H-1)
First Analysis (3-8-00)**

**Sponsor: Sen. Bill Schuette
House Committee: Tax Policy
Senate Committee: Finance**

THE APPARENT PROBLEM:

Since 1989 taxpayers have been able to claim an income tax credit for contributions to community foundations in the same way that credits can be claimed for contributions to public broadcasting, Michigan colleges and universities, and public libraries. Up to certain limits, a taxpayer can claim a credit equal to 50 percent of contributions made. A credit is a direct reduction in taxes owed. The limit for an income tax credit is \$100 for a single taxpayer and \$200 for a joint return. (A resident estate or trust can claim a credit up to a limit of \$5,000 or ten percent of tax liability, whichever is less.) Contributors to a community foundation can also claim a single business tax credit.

The Council of Michigan Foundations has described a community foundation as "a tax-exempt public charity organized and operated as a permanent collection of endowed funds for the long-term benefit of a defined geographic area." According to the council, the state has 61 certified community foundations with 34 geographic component funds covering the state and each of the 83 counties. Together they are said to have assets of \$1.2 billion and make annual grants totaling over \$50 million. It is the endowment feature of community foundations that is most often cited, because these organizations typically spend only the earnings from their endowments rather than, say, making grants out of annual contributions (like the United Way).

To qualify as a community foundation for purposes of the tax credit, an organization must be certified by the Department of Treasury as meeting certain criteria in the Income Tax Act. Legislation has been introduced that would strengthen the criteria by which organizations qualify as community foundations for state income tax purposes so as to ensure that they are legitimate foundations that can be sustained over the long term.

THE CONTENT OF THE BILL:

The bill would amend the Income Tax Act to add to the criteria that an organization must meet to be certified as a "community foundation" for the purpose of the tax credit available to a contributors to a community foundation. The certification is by the Department of Treasury.

Under the bill, an organization would have to meet the following new criteria:

- ** be incorporated or established as a trust at least six months before the beginning of the tax year for which the credit was being claimed (rather than, as now, before September 1 of the year immediately preceding the tax year);
- ** have an endowment value of at least \$100,000 before the expiration of 18 months after being incorporated or founded;
- ** have an independent governing body representing the general public's interest and not appointed by a single outside entity;
- ** provide evidence to the Department of Treasury that it maintains at least one part-time or full-time employee continually during the tax year for which a credit is claimed (and had one before the expiration of six months after incorporation or establishment);
- ** be subject to an annual independent financial audit (if its endowment value is \$1 million or more) or be subject to an annual review and a financial audit every three years (if its endowment value is under \$1 million); and
- ** provide documentation to the department annually demonstrating compliance with federal regulations that describe a "publicly supported" organization.

In addition, an organization incorporated or established after the effective date of the bill could only be certified as a community foundation for purposes of the tax credit if it operated in a county that was not already served by a community foundation at the time it was incorporated or established or if it operated as a geographic component of an existing certified community foundation.

MCL 206.261

HOUSE COMMITTEE ACTION:

The House Committee on Tax Policy adopted three amendments (incorporated into a substitute bill). The Senate-passed bill requires a community foundation to have a part-time or full-time paid employee. The committee amendment removed the word "paid." The Senate-passed bill required the raising of an endowment of \$100,000 within six months of existence. The House substitute requires the same amount to be raised within 18 months. Finally, the Senate-passed bill required all community foundations to be subject to an annual independent financial audit. The House substitute limits that requirements to community foundations with endowments of \$1 million or more, with smaller foundations to be subject to annual reviews and audits every three years.

BACKGROUND INFORMATION:

The current criteria that an organization must meet to be certified are that it: qualifies for exemption from federal income taxation under Section 501(c)(3) of the Internal Revenue Code; supports a broad range of charitable activities within the specific area . . . that it serves, such as a municipality or county; maintains an ongoing program to attract new endowment funds by seeking gifts and bequests from a wide range of potential donors in the community or area served; is publicly supported as defined by federal treasury regulations; is not a supporting organization by federal standards; meets the federal treasury requirements for treatment as a single entity; and is incorporated or established as a trust before September 1 immediately preceding the tax year for which the credit is claimed.

FISCAL IMPLICATIONS:

The House Fiscal Agency reports that the bill would not have any significant fiscal impact. (Fiscal Note dated 3-7-00)

ARGUMENTS:

For:

Community foundations provide many valuable public services and their funds have been used to promote crime reduction, affordable housing, educational improvements, and economic development. Contributions to these organizations can be seen as permanent gifts to the community being served. The legislature has recognized their special nature by allowing an income tax credit to their contributors. The bill would strengthen the definition of "community foundation" in the Income Tax Act to ensure that such organizations are legitimate and accountable and can be sustained over the long run. Supporters say it does this by establishing a fund-raising benchmark for foundations to meet in order to be certified by the Department of Treasury; by requiring regular financial audits or reviews to provide accountability and efficiency; and by promoting partnerships to minimize operational expenses and make more money available for charitable purposes. Proponents say the bill would reduce the likelihood that an organization would become a community foundation solely to gain the benefit of the tax credit. Instead, the additional criteria would reinforce the role of community foundations as permanent tools in assisting their communities and, as a result, encourage donations to these valuable organizations.

Against:

A number of concerns have been raised about the impact of the bill. First, it appears to prevent any new community foundations from being certified for tax credit status in a county if one already exists there (unless it operates as an affiliate or "component"). Doesn't this close the door on new, independent foundations? If so, is this fair? It appears to require a new foundation to operate as a component of an existing one. Doesn't this prevent the creation of new organizations with different approaches or visions or special purposes? Also, it requires organizations to raise a considerable amount of money in a relatively short time in order to qualify as a community foundation. Some foundations now operating would not have met this standard, and it could pose a hardship in less populous areas or areas without large donors. Also, it is not entirely clear how the Department of Treasury is to administer the provision giving organizations 18 months to reach an endowment of \$100,000.

Response:

The bill does not prevent the creation of new charitable organizations or foundations or limit their independence. The criteria in the bill determine which organizations can get certified by the state so that contributions made to them qualify for the tax credit. Organizations that do not meet the criteria can still operate, but without the credit available to their donors. (Donors would still be eligible for a federal deduction.) It should be noted that as the bill passed the Senate, it would have required the raising of \$100,000 in six months (which the Council of Michigan Foundations thought appropriate for a legitimate foundation). The House substitute gives an organization 18 months to establish its ability to raise endowment funds. Without a significant endowment, a community foundation will not have the earnings to make substantial grants.

Against:

Since the inception of the credit, some people have questioned why community foundations are deserving of this special treatment in the Income Tax Act when other kinds of nonprofit charities (the United Way, the Boy Scouts, the Red Cross, churches, etc.) are not. What is the justification for this? Perhaps the issue of tax credits for charitable giving should be examined comprehensively.

POSITIONS:

There are no positions on the substitute at present.

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.