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BILL ANALYSIS

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Senate Bill 38 (Substitute S-1 as passed by the Senate)
Sponsor: Senator John Pappageorge
Committee: Finance

Date Completed: 4-1-10

RATIONALE

Michigan's Income Tax Act allows taxpayers to claim various credits, which directly reduce the amount of tax liability. The credits include a community foundation credit and a public contribution credit, which is available for donations to Michigan colleges, libraries, museums, and public broadcasting stations. Each of these credits is limited to 50% of the amount of a contribution, subject to a dollar or percentage cap ($100 for an individual, $200 for a husband and wife filing jointly, or, for a resident estate or trust, the lesser of $5,000 or 10% of its tax liability). In order to help schools raise funds, it has been suggested that an income tax credit also should be allowed for contributions to education foundations. Although school districts evidently have established foundations to support their instructional programs for a number of years, donors receive no income tax credit.

CONTENT

The bill would amend the Income Tax Act to allow a taxpayer to credit against the tax 50% of the total amount the taxpayer contributed during the tax year to an endowment fund of an education foundation or to a specific project organized by an education foundation. The maximum amount of the credit would be $50 for an individual taxpayer or $100 for a husband and wife filing jointly. For a resident estate or trust, the credit could not exceed 5% of the taxpayer's tax liability for the tax year before any credits allowed by the Act were claimed, or $2,500, whichever was less. The credit would be allowed for the 2010 tax year and each subsequent tax year.

The bill would define "education foundation" as an organization that applies for certification by April 1 of the tax year for which the taxpayer is claiming the credit, that annually submits to the Department of Treasury documentation of its continued compliance with requirements listed in the bill, and that the Department certifies for that tax year as meeting all of the proposed requirements. These include a requirement that the education foundation exclusively dedicate all funds, gifts, and bequests to providing assistance to students and teachers in the schools of this State, including school districts, public school academies, and schools described in Public Act 302 of 1921 (which governs private, denominational, and parochial schools).

The foundation also would have to meet all of the following requirements:

-- Qualify for exemption from Federal income taxation under Section 501(c)(3) of the Internal Revenue Code.
-- Maintain 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.
-- Be subject to a program review every year and an independent financial audit every three years, and give copies of the review and audit to the Department within three months after the review or audit is completed.
-- Be publicly supported as defined by U.S. Department of Treasury regulations.
-- Meet the requirements for treatment as a single entity contained in U.S. Department of Treasury regulations.

-- Be incorporated or established as a trust at least six months before the beginning of the tax year for which the credit is claimed.
-- Have an independent governing body that represents the general public's interest and is not appointed by a single outside entity.

MCL 206.261

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Many school districts are in dire financial straits and are searching for ways to increase their revenue. State school aid payments have been reduced and are potentially subject to further cuts, and State law limits the millage that a district may levy. Nonpublic schools, of course, ware not eligible for State aid and cannot levy millages. By providing an income tax credit for donations, the bill would create an incentive for taxpayers to contribute to an endowment fund or special project of an education foundation, helping schools to avert program cuts. Although these donations can be deducted for Federal income tax purposes, no State income tax benefit is available, as it is for gifts to community foundations and colleges. In addition, a credit for contributions to education foundations already can be taken under the Michigan Business Tax (MBT) Act. Like the existing credits, the proposed credit would depend on a foundation's compliance with a number of requirements, which would ensure accountability and oversight.

Opposing Argument

This legislation is unnecessary. Under current law, a school or a school district that has endowment funds may transfer the funds to a community foundation under an agency fund agreement and receive the same or greater benefits. According to the president of the Council of Michigan Foundations, every school district is in an area served by at least one community foundation. Nonpublic schools that are 501(c)(3) organizations also may partner with community foundations. If a district or a school partners with a community foundation, the foundation will manage its endowment funds, the district or school will continue to receive distributions, and the people who donate to the endowment fund will receive a tax credit. Because the community foundation is managing the funds of its other participants as well, and has the expertise to do so, and because the community foundation's costs of managing funds are proportionately lower, the school or district is likely to receive a better return on its investments, than it would managing the funds itself.

In addition, donors can continue to contribute to an individual school or school district that has partnered with a community foundation, simply by designating that the contributions are to be allocated to the school or district.

Opposing Argument

Michigan cannot afford to create a new tax credit. If the State had the money to support the proposed credit, it would be more equitable to appropriate the dollars directly to the School Aid Fund. There are a total of 784 school districts and public school academies, and more than 800 nonpublic schools, in the State. Potentially, each of these entities could create an education foundation. In addition to reducing tax revenue, this would impose significant new responsibilities on the Department of Treasury, which would have to certify each foundation annually.

Opposing Argument

At a time when schools are desperate for funding, it would make more sense to encourage contributions directly to schools, rather than to their endowment funds. An endowment fund is designed to hold money in perpetuity and its distributions are typically a small percentage of its assets. In a simplistic example, if $1.5 million is endowed to a school, and the endowment fund distributes 5%, the school will receive only $75,000. A direct contribution of $1.5 million would be more beneficial to a school that is strapped for cash.

Opposing Argument

Article VIII, Section 2 of the State Constitution prohibits the appropriation of public money to support nonpublic schools, and prohibits any public credit from being used "directly or indirectly to aid or maintain any private, denominational or other nonpublic…school". It also states, "No payment, credit, tax benefit, exemption or deductions…shall be provided, directly or indirectly, to support the attendance of any student…at any such nonpublic school…". The bill would violate these prohibitions by making the proposed credit available for contributions to nonpublic schools' education foundations, as well as those of public schools. This would surely result in litigation that the State cannot afford. In addition, under the comparable MBT credit, all contributions must be dedicated to a school district or public school academy.

Response: Limiting the income tax credit to contributions to public schools' education foundations would pick winners and losers by giving taxpayers an incentive to contribute to the foundation of one category of schools but not the other. An equitable tax policy would allow a credit for contributions to any school's education foundation. If a court found specific provisions to be unconstitutional, the court could strike that language from the law.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce State income tax revenue by an unknown, and potentially significant, amount. Michigan currently offers similar credits, the Public Contribution Credit and the Community Foundation Credit, which totaled $28.3 million for tax year 2007. While the allowable amounts for these similar credits are double those that would be allowed under the bill, the number of contributors under the bill's credit is expected to be greater. Data from 2008 for a similar program in Arizona imply a Michigan impact of about $17.5 million per year, given the provisions of the bill's credit. Approximately, 80% to 90% of the reduction would lower General Fund revenue, while the remaining impact would lower School Aid Fund revenue.

Fiscal Analyst: David Zin