

**GEORGIA STATE UNIVERSITY  
ANDREW YOUNG SCHOOL OF POLICY STUDIES  
FISCAL RESEARCH PROGRAM  
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**SUBJECT:** An Income Tax Credit for Contributing to an Arts Foundation

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The Georgia Counsel for the Arts has established a non-profit foundation for the purpose of soliciting contributions that will enhance the ability of the Counsel to make grants. The Counsel has proposed to allow an income tax credit for contributions provided the contributor makes an equivalent contribution to an arts organization. This Memorandum considers the effect on state tax revenue from the credit under alternative assumptions regarding the level of the credit.

The credit creates two incentives. First, allowing a credit for the contribution reduces the cost to the contributor from making a contribution. There are many empirical studies that find that as the cost of making a contribution falls, individuals give more. These studies use the fact that a charitable contribution is deductible for income tax purposes. Thus, a contribution reduces the contributor's taxes and thus the net cost of making a dollar contribution is less than a dollar. These studies find that a 10 percent reduction in the cost increases contribution by 8 to 12 percent. So, one effect of the credit would be to increase contributions.

Second, allowing a credit for just contributions to the foundation reduces the cost of contributions to the arts relative to other organizations. This could lead the contributor to shift existing contributions from one organization to the foundation. There is little existing information on this effect.

For the moment, ignore the second effect. We assume that if the contributor takes the credit for the foundation, he cannot use that contribution as a deduction in determining Georgia income taxes. If the credit equals 100 percent of the contribution, then the individual would make a contribution equal to his contribution to arts organizations. In other words, if the individual had contributed \$1000 to arts organization, he would contribute \$1000 to the foundation. The reason is that the cost to the individual of the contribution to the foundation is zero. He gives \$1000 to the foundation and then credits his Georgia income tax by \$1000. On his Federal return he is allowed a \$1000 in additional contribution, but his deductible state income tax falls by \$1000, and thus there is no change.

With a smaller credit the "cost" of the contribution increases. First, the value of the credit decreases. However, this is offset by the reduction in federal income tax. For example, with a 60 percent credit, the individual gets a \$600 reduction in state income taxes for a \$1000 contribution. But net deductions for the federal income tax increases by \$400 since the contribution deduction increases by \$1000 and the state tax deduction

goes down by \$600. If the credit is 0, the cost of a contribution is same as with no credit, so the individual is not expected to make any contribution.

Thus, as the credit goes from 0 percent to 100 percent, it is expected that the individual's contribution will go from zero to 100 percent of his current contributions to the arts.

Table 1 gives the expected contribution to the foundation for someone currently giving \$1000 to the arts for selected credit levels. We assumed an increasing response to the change in cost as the credit level increases.

**TABLE 1. AN INDIVIDUAL'S CONTRIBUTION TO THE FOUNDATION FOR DIFFERENT CREDIT LEVELS**

<b>Credit Level</b>	<b>Contribution to Foundation*</b>
0%	\$0
10%	\$25
20%	\$61
30%	\$109
40%	\$171
50%	\$249
60%	\$345
70%	\$463
80%	\$608
90%	\$784
100%	\$1,000

\*Assumes an arts contribution of \$1000.

The incentive affects both individuals and corporate contributors, but not foundations. However, we calculate the tax cost of the credit separately for firms and individuals.

This considers just those who are currently itemizing deduction for tax purposes. For those who are currently making arts contributions but use the standard deduction the credit provides an incentive to contribute to the foundation. However, since current individual contributors to the arts are generally higher income, the amount of contribution to the foundation from non-itemizers is likely to be very small. We assume that this effect would increase total contributions to the foundation by individuals by 5 percent if the credit were 100 percent, declining proportionally with any reduction in the tax credit below that level.

The second effect might work as follows. Suppose that the credit is 100 percent and the individual had been contributing \$1000 to the arts and \$1000 to another organization. If he matches his current arts contribution, the foundation gets \$1000 (and the arts community gets \$2000). But the individual could give \$2000 to arts organization (and nothing to the other organization). Then, the person could give the foundation \$2000 (receiving a credit equal to \$2000). In this case, the arts community gets \$4000. While, this effect is possible, we do not think it would be substantial, even if the credit is 100 percent. We assume that current arts contributors would increase their current arts

contributions by 10 percent by shifting contributions from other organizations to arts organizations, if the credit were 100 percent. As with projections for those using the standard deduction, this is reduced proportionally with an decline in the tax credit percentage.

Given these assumptions and current contributions to arts organizations in Georgia, we estimate the tax cost of the credit for various credit levels. The revenue loss includes the credit, calculated at the credit level times the contribution. If the new contribution, net of the credit, is deductible for Georgia income tax purposes, this will further reduce tax revenue.)

The results are shown in Table 2. This table reports the negative effects on state tax revenues from induced increases in private individual arts donations resulting from the tax credit (not private foundation or business corporate donations). The effects from increases in business corporate contributions (but not tax free foundations) are crudely estimated following Table 2.

Note that Table 2 includes both the primary effects linked to Table 1, and the pro-rated “secondary” effects related to the combination of the incremental contributions to the foundation from those using the standard deduction plus the “contribution shifting effect” as the attraction of giving to the arts increases relative to giving to other types of organizations. While the first effect is assumed to be purely incremental (i.e. those who do not itemize deductions, are assumed to increase arts donations without any reduction in other donations), the second effect has slightly more complicated state tax revenue implications. That is, if a person currently donating \$1,000 to the arts were to increase their donations to the arts by \$100 (i.e. the 10 percent assumption based on a 100 percent tax credit from the previous discussion) but reduce their contributions to non-arts recipients (for which the usual deduction from state taxable income applies) by that same \$100, the net effect will be a loss of tax revenue equal to the difference between the tax credit rate and the state marginal tax rate applicable to the typical donor (i.e. 6 percent). Thus, the net loss of state revenue in the case of a 36 percent arts foundation tax credit would be  $36 - 6 = 30$  percent of the shifted \$100 donation, or \$30.

**TABLE 2. PROJECTED TAX REVENUE LOSSES FOR DIFFERENT CREDIT LEVELS  
(CONTRIBUTIONS BY INDIVIDUALS)**

Credit Level	-----Revenue Loss in Millions of \$-----			Total Effect
	Primary Effect	Standard Deduction Effect	Contribution Shifting Effect	
0%	\$0	0	0	0
10%	\$0.051	\$0	\$0	\$0.051
20%	\$0.248	\$0.041	\$0.057	\$0.345
30%	\$0.664	\$0.091	\$0.146	\$0.902
40%	\$1.389	\$0.162	\$0.276	\$1.828
50%	\$2.529	\$0.254	\$0.447	\$3.229
60%	\$4.204	\$0.366	\$0.658	\$5.228
70%	\$6.582	\$0.498	\$0.910	\$7.990
80%	\$9.879	\$0.650	\$1.202	\$11.731
90%	\$14.331	\$0.823	\$1.535	\$16.689
100%	\$20.310	\$1.016	\$1.909	\$23.235

Notes:

(1) The primary effect is derived assuming that the current FY '04 private individual aggregate contribution of \$20.310 million is the contribution to the foundation with a 100% credit. We use the amount per \$1000 from Table 1 to calculate a percentage and then multiple that percentage by \$20.310 million to get the contribution to the foundation for each credit level.

(2) The standard deduction effect assumes a 5 percent increase in aggregate individual donations if the tax credit is 100 percent. This 5 percent increase is proportionally reduced for any tax credit under 100 percent, so that at 50 percent, the incremental foundation contributions are assumed to be 2.5 percent of FY 2004 levels. The revenue loss for a 50 percent tax credit is then  $0.025 \times \$20.310 \text{ million} = \$0.508 \text{ million}$  in induced contributions  $\times 0.50 \text{ tax credit rate} = \$0.254 \text{ million}$ .

(3) The contribution shifting effect is assumed to generate a 10 percent increase in net arts contributions to the foundation if the tax credit is 100 percent, which would then cost the state (100 percent tax credit rate – 6 percent marginal tax rate for itemized contributions) =  $94 \text{ percent} \times \$2.031 \text{ million} = \$1.909 \text{ million}$ . The \$2.03 million is 10 percent  $\times$  the FY'04 total individual contributions of \$20.310 million. If the tax credit were only 70 percent, the projected shift in donations toward the arts becomes only  $0.7 \times 10 \text{ percent} = .07 \times \$20.310 \text{ million} = \$1.422 \text{ million}$ , which would have a net cost in state tax revenue of  $0.64 \times \$1.422 = \$0.91 \text{ million}$  (where  $0.64 = \text{the tax credit rate of } 0.70 - \text{the marginal tax rate on non-credit eligible non-arts donations of } 0.06$ ).

Interestingly, the projected annual tax revenue loss of \$23.234 million due to induced incremental individual private contributions to the arts foundation resulting from a 100 percent tax credit is very close to what might have been projected for Georgia based on the only current experience from another state. The Oregon Cultural Trust tax credit was begun in 2002. Regarding individual donations the Oregon tax plan allows a 100 percent state tax credit on any matching arts contributions to the trust (but limited to \$500 per

year). While that contribution ceiling is not incorporated into the above analysis, Oregon state tax office projections are for an additional \$114.649 million over a 10-year period “through personal tax credits” to be raised by the trust “over and above current giving” levels to cultural organizations (from web-site information provided by the Oregon Cultural Trust). This is the equivalent of about \$11.465 in incremental personal contributions per year in a state with a population of 3.56 million compared to Georgia’s 8.685 million (as of 2003, from Table 17 of the *Statistical Abstract of the United States*, 2004-2005). The implied per capita individual incremental arts contribution in Oregon is thus \$3.22.

While Georgia has 2.4396 times the population of Oregon, it has only 2.1947 times the state gross domestic product (Table 645 of the *Statistical Abstract*, based upon ‘chained 1996 dollar comparisons). An admittedly crude full adjustment would be to divide 2.1947 by 2.4396 to get 0.8996 and multiply that adjustment figure by the Oregon per capita incremental donation level of \$3.22 to obtain a Georgia per capita projection of \$2.90. The resulting projected Georgia incremental individual contributions would then be \$25.187 million with a 100 percent tax credit, about 8 percent higher than the projection in Table 2 for the 100 percent tax credit level. Since the Oregon tax credit is restricted to gifts of \$500 per year, and the Georgia proposed credit has no restrictions in the above analysis, the Georgia revenue loss might be expected to be greater than the Oregon analogy would suggest (although a competing consideration is the stronger support for the arts that has typically been found to exist in states like Oregon compared to the relatively weak support in Georgia based on Georgia demographics).

Finally, Table 2 applies only to private individual grants, not to business corporate donations (which were \$12.425 million in Georgia in FY’04). While the focus of this analysis has been on private individual grants, one might suggest the crudest of possible effects on business donations of the 100 percent tax credit case in Table 2 based on FY’04 grants having been only 61.2 percent of individual grants. So, to get an estimate for businesses we multiplied 0.612 by the amounts in Table 2. However, the literature on corporate donations suggests more complex considerations in determining the level of donations that is the case for individual donations. Therefore, this last figure is provided as only the roughest of approximations.

Table 3 provides a summary of contributions and total tax loss.

**TABLE 3. TOTAL CONTRIBUTIONS AND TAX REVENUE LOSS**

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**Contributions to Foundation**  
------(in millions of \$)-----

<b>Credit Level</b>	<b>Individuals</b>	<b>Business</b>	<b>Total</b>	<b>Total Tax Loss (in millions of \$)</b>
0%	0	0	0	0
10%	0.812	0.497	1.310	0.111
20%	1.848	1.131	2.979	0.557
30%	3.128	1.914	5.042	1.454
40%	4.692	2.871	7.563	2.947
50%	6.580	4.027	10.608	5.206
60%	8.835	5.407	14.242	8.427
70%	11.536	7.060	18.596	12.880
80%	14.786	9.049	23.835	18.910
90%	18.665	11.423	30.088	26.902
100%	23.357	14.294	37.651	37.454

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