



BHI FaxSheet

Information and Updates on Current Issues

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Improving the Generosity Rate Charitable Tax Deduction Would Boost Charitable Giving in Massachusetts

Massachusetts falls in the lower third of all states when measured according to the rate at which its residents give to private charities. This would change dramatically if Massachusetts voters approve ballot question 7, which would establish a state-level charitable tax deduction. The state would move from the bottom third to either the middle third or the top third of states in terms of its generosity, and residents would expand their giving by \$1.43 billion over the next five years – or by \$410 million more than the reduction in tax revenues.

These are the findings of an analysis by the Beacon Hill Institute at Suffolk University. BHI's Ray Shamie Center for Civic Enterprise developed an index for the state's Generosity Rate in order to perform this analysis.

Question 7

Under current law, charitable donations may be deducted from income in figuring federal, but not Massachusetts, personal income tax payments. Ballot question 7 would allow charitable donations to be deducted from Massachusetts income, not only for the one-third of taxpayers who currently itemize charitable deductions on their federal tax returns, but for non-itemizers as well. The law would take effect on January 1, 2001 and would supercede an outside budget section (Sec. 119) approved by the state legislature and signed into law by Governor A. Paul Cellucci. The outside section calls for a similar tax deduction.

With the charitable deduction, Massachusetts will join 33 other states that already offer tax incentives for giving to non-profit organizations. Eligible organizations that would benefit from the deduction include religious, health, educational, human service, arts and cultural, civic, environmental, and international organizations as determined by the Internal Revenue Service code. According to the National Center for Charitable Statistics, Massachusetts is home to 19,373 active charities. (See http://nccs.urban.org/stcover/stc_MA.htm.)

The Generosity Rate

The Beacon Hill Institute's *Generosity Rate* measures the value of charitable deductions itemized on federal tax returns as a fraction of adjusted gross income, scaled so that the most generous state has a Generosity Rate of 100%. According to the Generosity Rate, the Commonwealth ranked 39th in generosity among states in 1998. Utah, the

Table 1
Generosity Rate

| | Generosity Rate (%) ^a | Ranking | Itemized deductions as % of AGI | |
|--------------|----------------------------------|-------------|---------------------------------|-------------|
| | Utah | 100.0 | 1 | 4.63 |
| | Alabama | 53.7 | 2 | 2.49 |
| | Georgia | 53.6 | 3 | 2.48 |
| | Maryland | 53.0 | 4 | 2.45 |
| | South Carolina | 52.9 | 5 | 2.45 |
| | Wyoming | 52.4 | 6 | 2.42 |
| Top Third | New York | 51.8 | 7 | 2.40 |
| | Idaho | 51.8 | 8 | 2.40 |
| | Oklahoma | 51.5 | 9 | 2.38 |
| | North Carolina | 50.7 | 10 | 2.35 |
| | Arkansas | 50.6 | 11 | 2.34 |
| | Nebraska | 47.4 | 12 | 2.19 |
| | Mississippi | 47.1 | 13 | 2.18 |
| | Minnesota | 45.8 | 14 | 2.12 |
| | Delaware | 45.7 | 15 | 2.12 |
| | California | 45.2 | 16 | 2.09 |
| | Oregon | 44.8 | 17 | 2.07 |
| | Virginia | 44.7 | 18 | 2.07 |
| | Tennessee | 44.5 | 19 | 2.06 |
| | Kansas | 43.3 | 20 | 2.00 |
| | Colorado | 42.6 | 21 | 1.97 |
| | Arizona | 42.6 | 22 | 1.97 |
| Middle Third | Michigan | 42.1 | 23 | 1.95 |
| | Florida | 42.0 | 24 | 1.94 |
| | Nevada | 40.9 | 25 | 1.89 |
| | Missouri | 40.9 | 26 | 1.89 |
| | Wisconsin | 40.2 | 27 | 1.86 |
| | Kentucky | 39.8 | 28 | 1.84 |
| | Montana | 39.8 | 29 | 1.84 |
| | New Jersey | 39.6 | 30 | 1.83 |
| | Illinois | 39.2 | 31 | 1.81 |
| | Washington | 38.8 | 32 | 1.79 |
| | Hawaii | 38.8 | 33 | 1.79 |
| | Indiana | 38.6 | 34 | 1.78 |
| | Iowa | 38.5 | 35 | 1.78 |
| | Connecticut | 38.0 | 36 | 1.76 |
| | Pennsylvania | 37.6 | 37 | 1.74 |
| | Texas | 37.4 | 38 | 1.73 |
| | Massachusetts | 37.2 | 39 | 1.72 |
| Lower Third | Ohio | 36.8 | 40 | 1.70 |
| | New Mexico | 35.4 | 41 | 1.64 |
| | South Dakota | 35.0 | 42 | 1.62 |
| | Louisiana | 34.6 | 43 | 1.60 |
| | Rhode Island | 33.8 | 44 | 1.56 |
| | Vermont | 33.3 | 45 | 1.54 |
| | Maine | 31.5 | 46 | 1.46 |
| | Alaska | 31.4 | 47 | 1.45 |
| | North Dakota | 30.4 | 48 | 1.41 |
| | New Hampshire | 29.7 | 49 | 1.37 |
| | West Virginia | 25.7 | 50 | 1.19 |
| | US overall | 43.1 | | 2.00 |

^aComputed by dividing “itemized deductions as % of AGI” by 4.63.

most generous state (with the highest amount of itemized deductions as a fraction of taxable income), had a Generosity Rate of 100%, while for Massachusetts the rate was just 37.2% (see Table 1 for a full listing). An alternative measure, the *Generosity Index* published by the Catalogue for Philanthropy, ranked the Commonwealth dead last among all states.¹

The charitable deduction would raise the amount of charitable giving in Massachusetts. In doing so, it would cause the state to lose some revenue but also cause taxpayers to give more. This is a matter of basic economics. When charitable donations are deductible, it is cheaper to give, and so households will make more donations to non-profit organizations that work for the public good. Thus charitable donations rise as tax revenues fall.

Here is how it works. Currently a taxpayer who gives \$100 to a charitable organization may deduct it from income in computing federal income tax. This saves the average taxpayer \$21 in federal taxes, so the net cost of giving the \$100 is actually \$79.

If the donation may also be deducted in computing state income taxes, the cost of giving falls. Given a 5.8% state income tax, a taxpayer who gives \$100 to a good cause will now save \$5.80 in state taxes and \$19.78 in federal taxes (= $\$100 \times 0.942 \times 21\%$). The net cost of giving \$100 is now just \$74.42, or about 6% lower than it was before. This in turn will encourage more giving. The state will lose \$5.80 in revenue but giving will rise.

It turns out that giving will rise by substantially more than this amount. An analysis by the Beacon Hill Institute earlier this year found that, with the deduction, donations to non-profit organizations will rise by \$1.43 billion over the next five years, while state revenues will fall by \$1.02 billion.² This is based on our determination that charitable giving rises by 1.12% for every 1% decrease in the "tax price" of giving.

In the process, Massachusetts would rise from ranking 39th in terms of its Generosity Rate to ranking between 14th (putting it in the top third) and 30th (putting it in the middle third). We reach this conclusion as follows: If the net cost of giving falls by 6% and if, as we have found, the "elasticity" of giving with respect to tax price is 1.12, then Massachusetts' Generosity Rate will rise by 2.42 percentage points, pushing its Generosity Rate from 37.2 to 39.62, just above New Jersey, and thus into the middle third.

Another line of reasoning suggests that Massachusetts would rise far higher, into the top third. This argument is based on the greater generosity exhibited by states with income taxes and charitable deductions. Divide the 50 states into three groups: those with no income tax (e.g. New Hampshire), those with an income tax and state charitable deductions (e.g. New York), and those with an income tax and no state-level charitable deductions (this category includes Massachusetts). See Table 2. The Generosity Rate is 8.8 percentage points higher (= 45.4%-36.6%) in states with an income tax and deductibility than in states with an income tax and no deductibility. If Massachusetts were to allow state-level charitable deductions, it is plausible that its Generosity Rate would rise by 8.8 percentage points, or from 37.2% to 46.0%, catapulting it from 39th to 14th in the state rankings.

¹*Catalogue for Philanthropy*, "Generosity Index" as prepared by the National Center for Charitable Statistics at the Urban Institute. See http://www.givingnewengland.org/new_index.html.

² "Charitable Tax Deduction Would Increase Bay State Giving Substantially," *BHI Faxsheet*, Beacon Hill Institute, April 5, 2000. See <http://www.beaconhill.org/faxsheets/TaxDed4500.html>.

Table 2

Generosity Rate for states that do, and do not, allow charitable contributions to be deducted

| Does state have an income tax? | Are charitable contributions deductible at the state level? | Generosity rate (%) | Number of states | States |
|--------------------------------|---|---------------------|------------------|--|
| Yes | Yes | 45.4 | 33 | AL,AZ,AR,CA,CO,DE,GA,HA,ID,IO,KA,KY,LA,ME,MD,MI,MN,MO,MT,NB,MN,MY,MC,MD,OK,OR,RI,UT,VT,VA,WI |
| Yes | No | 36.6 | 8 | CT,IL,IN,MA,NJ,OH,PA,WV |
| No | not applicable | 39.1 | 9 | AK,FL,NV,NH,SD,TN,TX,WA,WY |
| <i>Memo:</i> | | | | |
| Massachusetts | No | 37.2 | 1 | |
| US overall | | 43.1 | 50 | |