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THE HIDDEN COST OF STATE INCOME TAX REPEAL: A CASE STUDY OF THE WEST VIRGINIA NEIGHBORHOOD INVESTMENT PROGRAM CREDIT

Elaine Waterhouse Wilson[*]

ABSTRACT

In March 2023, West Virginia significantly cut its personal income tax rates and paved a path toward the full repeal of the personal income tax. This repeal would directly impact West Virginia's nonprofit sector and reduce charitable giving because it would render West Virginia's Neighborhood *Investment Program ("NIP") tax credit ineffective. NIP tax credits have been the primary charitable tax incentive in the state's income tax code and have* been *widely supported by nonprofits. This Article argues that if the NIP credit program incentivizes charitable giving, then state income tax repeal comes with a hidden cost—the cost of lost revenues to private charities increasingly tasked with providing vital social services.*

Following the introduction in Part I, Part II looks at West Virginia's state personal income tax repeal and similar repeal proposals under consideration in other states. Part III reviews state level charitable giving incentives and their interplay with the Federal charitable deduction, using the NIP credit in West Virginia as a case study. Part IV introduces Professor Paul McDaniel's federal charitable matching grant proposal, first introduced in 1972, which was developed in response to changes in the federal charitable income tax deduction and a growing concern about the role of tax expenditures. The Article proposes that Professor McDaniel's federal matching grant program could be adapted by those states that have repealed (or are considering repealing) their personal income tax but still wish to incentivize charitable giving on the state level. Part V specifically demonstrates how Professor McDaniel's grant program overlaps considerably with the structure of West Virginia's NIP tax credit and could be

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[*] Professor of law, West Virginia University College of Law. Many thanks to my research assistants, Elizabeth Sims and Sean Mullaney. The author is grateful for the initial opportunity to workshop a very early version of this concept as part of the Association of M-career Tax Professors' workshop in 2001, when the state income tax changes were first considered. Thanks to those friends, mentors, and colleagues that suffered through this process with me, especially Atiba Ellis, Jena Martin, Kelly Behre, Amy Cyphert, Kirsha Trychta, and Cody Corliss. Finally, the author would like to thank the Bloom Fund (officially, the Kanawha County Class Action Settlement 2009 Charitable Trust) for its support of this and many other research projects at the West Virginia University College of Law.

easily amended to replace the credit in the event of full personal income tax repeal. The Article concludes by urging West Virginia to be a leader among the states considering income tax repeal by demonstrating the manner in which a matching grants program could replace charitable tax incentives.

I. INTRODUCTION

Early in 2021, West Virginia Governor Jim C. Justice, II announced an ambitious legislative proposal to reform and eventually to repeal the West Virginia state income tax.[1] In response to the Governor's proposal, West Virginia

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[1] Larmie Sanyon, *Gov. Justice Announces Plan to Repeal West Virginia's Income Tax in Town Hall*, WBOY (Mar. 23, 2021, 6:29 PM), https://www.wboy.com/top-stories/gov-justice-announces-plan-to-repeal-west-virginias-income-tax-in-town-hall/. The Governor's proposal initially applied only to wage, retirement, and unemployment income; it was paid for primarily through increases in the sales tax and some excise taxes. Pursuant to an analysis by the Tax Foundation, Governor Justice's proposal cost: "All told, revenue offsets would bring in a projected $902.6 million while tax reductions total $1.09 billion, making the bill a $185 million net tax cut. Tax rates would be as follows, with business and investment income still subject to current rates." Jared Walczak, *Evaluating West Virginia Income Tax Repeal Plans*, TAX FOUND. (Mar. 30, 2021), https://taxfoundation.org/west-virginia-income-tax-repeal/.

House Republicans proposed an incremental reduction in tax rates until the rate reached zero;[2] in the West Virginia Senate, the tax repeal proposal reflected the Governor's proposal but also excluded investment income from taxation.[3]

Simultaneously, the West Virginia legislature was considering the renewal and possible expansion of the state's Neighborhood Investment Program (or "NIP") charitable income tax credit, which was set to expire on June 30, 2021.[4] West Virginia does not have a state income tax deduction for charitable donations; rather, the income tax credit offered through the NIP has been the primary chartable tax incentive in the state income tax code. During its history, the NIP credit has been viewed positively by West Virginia state nonprofits that work in the social service area as it proved to be a lucrative fund-raising tool. Accordingly, nonprofits were eager to see the program renewed,[5] and renewal generally had broad, bipartisan support.[6] Even in an economically challenging time and difficult political atmosphere, there was some momentum to increase the pool of NIP credits available for distribution from $3.0 million to $5.0 million.[7] The NIP credit was renewed, although without an increase in the credit

2 *See* H.B. 3300, 83d Leg., Reg. Sess. (W. Va. 2021) (originating). At the time, the Tax Foundation estimated that under the House Bill, full repeal would occur in 2039, although it could have been as soon as 2033. Walczak, *supra* note 1; *see also* Peter Shirley, *H.B. 3300: Fiscal Note Summary*, W. VA. LEG. (Mar. 24, 2021, 9:40 AM), https://www.wvlegislature.gov/Fiscalnotes/FN(2)/fnsubmit_recordview1.cfm?RecordID=802690681 (". . . assuming a 2 percent per year growth in personal income, the tax would be completely phased out around Fiscal Year 2039; in reality, we expect this to be earlier due to another provision of the bill . . .").

3 The West Virginia Senate did not introduce a new bill but passed an amendment of H.B. 3300 that was a full substitute, to which the House did not agree. H.B. 3300, 83d Leg., Reg. Sess. (W. Va. 2021) (engrossed). The Senate substitute would have reduced income tax rates to zero based on certain triggers based upon certain types of revenue; it also included pass-through business income in the rate reductions. *See* Walczak, *supra* note 1.

4 In 2021, two bills would have renewed and expanded the Neighborhood Investment Program: H.B. 2794 and S.B. 446. The original version of both H.B. 2794 and S.B. 446 would have increased the amount of available NIP credits from $3.0 million to $5.0 million and extended the program through June 30, 2026; the Senate bill also made some technical cross-reference changes. The House Finance Committee amended the original bill to only allow for the extension of the Program, with the credit pool remaining at $3.0 million. House Bill 2794 was eventually passed by both houses and signed by Governor Justice on April 26, 2021. H.B. 2794, 83d Leg., Reg. Sess. (W. Va. 2021) (introduced); H.B. 2794, 83d Leg., Reg. Sess. (W. Va. 2021) (signed enrolled); S.B. 446, 83d Leg., Reg. Sess. (W. Va. 2021); *see also WV Neighborhood Investment Program Renewal & Expansion*, PHILANTHROPY W. VA., https://www.philanthropywv.org/wv-neighborhood-investment-program-renewal-expansion/ (last visited Oct. 13, 2024).

5 *See, e.g.*, Letter from All Saints Catholic Church et al. to Jim C. Justice, the Governor of West Virginia, the West Virginia Senate and the West Virginia House (Feb. 5, 2021) (on file with Philanthropy West Virginia).

6 *WV Neighborhood Investment Program Renewal & Expansion*, *supra* note 4.

7 *See* H.B. 2794, 83d Leg., Reg. Sess. (W. Va. 2021) (introduced); *see* S.B. 446, 83d Leg., Reg. Sess. (W. Va. 2021) (the text of its Senate companion bill); *see also 2021 Neighborhood*

pool, effective until the next regularly scheduled termination of the program on July 1, 2026.[8]

The fact that NIP credit renewal and state income tax repeal proceeded simultaneously evidences a tax policy disconnect. State legislators in West Virginia and elsewhere have repeatedly emphasized the importance of the nonprofit sector to address social ills[9]—for some, there is a strong preference to rely on the private charitable sector to provide social services in lieu of government assistance.[10] The same groups that tend to support the provision of services through private charity appear to also be in favor of income tax repeal in the name of smaller government. If one of the primary ways in which the state encourages charitable giving is through income incentives tax, then repeal of the income tax undermines these charitable incentives, and in turn, the capacity of private charity to fulfill this role.

To compound the issue, there is a significant risk that budget cuts may follow a drastic reduction in state income tax, which will reduce government

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Investment Program Renewal, West Virginia Nonprofit Association, W. VA. NONPROFIT ASS'N, https://wvnpa.org/2021-neighborhood-investment-program-renewal/ (last visited Oct. 13, 2024).

8 H.B. 2794, 83d Leg., Reg. Sess. (W. Va. 2021) (signed enrolled).

9 *See generally*, George H. W. Bush, 41st President, United States of America, Inaugural Address of George Bush (Jan. 20, 1989) ("I have spoken of a thousand points of light, of all the community organizations that are spread like stars throughout the Nation, doing good. We will work hand in hand, encouraging, sometimes leading, sometimes being led, rewarding.").

10 The division between government and private charity has long been a topic of thought by political philosophers. Alexis de Tocqueville warned, "[t]he more government takes the place of associations, the more will individuals lose the idea of forming associations and need the government to come to their help. That is the vicious circle of cause and effect." *Philanthropic Quotes: Alexis de Tocqueville*, PHILANTHROPY ROUNDTABLE, https://www.philanthropyroundtable.org/resource/philanthropic-quotes/#alexis-de-tocqueville (last visited Nov. 12, 2024); similarly, Thomas Paine wrote, "[s]ome writers have so confounded society with government as to leave little or no distinction between them; whereas they are not only different, but have different origins." *Philanthropic Quotes: Thomas Paine*, PHILANTHROPY ROUNDTABLE, https://www.philanthropyroundtable.org/resource/philanthropic-quotes/#thomas-paine (last visited Nov. 12, 2024).

The support for a strong role for private charity in lieu of government action plays a role in modern conservative political thought. *See, e.g.*, MARVIN OLASKY, THE TRAGEDY OF AMERICAN COMPASSION (Regnery Gateway 2022); *see also* John Stossel, C*harity and Capitalism Are Better Than Government*, REASON: CHARITY/PHILANTHROPY (Dec. 28, 2022, 12:10 PM), https://reason.com/2022/12/28/charity-and-capitalism-are-better-than-government/; *see also Quote*, OLL, https://oll.libertyfund.org/quotes/ambroise-clement-draws-the-distinction-between-two-different-kinds-of-charity-true-voluntary-charity-and-coerced-government-charity-which-is-really-a-tax-1852 (last visited Oct. 24, 2024).

In rebuttal, some commentators see a role for government alongside private charity. *See, e.g.*, Mike Konczal, *The Conservative Myth of a Social Safety Net Built on Charity*, ATLANTIC (Mar. 24, 2014), https://www.theatlantic.com/politics/archive/2014/03/the-conservative-myth-of-a-social-safety-net-built-on-charity/284552/; Robert P. Weiss, *Charitable Choice as Neoliberal Social Welfare Strategy*, 28 SOC. JUST. 35, 39–53 (2001); *see generally*, John F. Kennedy, 35th President, United States of America, Remarks of Senator John F. Kennedy at Charleston, West Virginia (Apr. 11, 1960).

funded social services at the same time that funding to the private sector to pick up that burden is reduced by the inefficacy of income tax incentives.[11] While to some this may be a feature instead of a bug by forcing social services from the government into the private sector, it does so in a manner that can leave private social service providers unable to keep up with demand.

One could simply say that renewal of the NIP credit while simultaneously considering state income tax repeal was a pragmatic decision and a creature of circumstantial timing. The Governor's initial repeal proposal was met with skepticism upon its release, from both sides of the spectrum.[12] It was never clear that it was going to pass—at least, not the first time around. Moreover, most of the repeal bills being considered set a path for repeal in the future, not an immediate, full repeal. In addition, the Governor's original proposal continued to tax business pass-through income and investment income.[13] Finally, all of these proposals involved only the state individual income tax; none of them addressed the state corporate income tax (yet.) Given that the income tax was probably not going away immediately, it made sense to continue with NIP credit renewal. While the NIP credit eventually was renewed until 2026,[14] it was clear that income tax repeal would most certainly be back on the table prior to that time.[15]

And so it came to pass. In March 2023, Governor Justice signed into law House Bill 2526,[16] which significantly cut state personal income tax rates

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[11] Given the cost of the House's proposal in 2021, the Tax Foundation predicted that, "The spending cuts this dramatic revenue decline would necessitate" might undermine any potential growth from attracting new taxpayers. Walczak, *supra* note 1. Similarly, the West Virginia Center on Budget and Policy stated that, "[t]he Senate's plan would also create an immediate $200 million gap in the budget, which would grow larger as more income tax cuts are enacted, and the income tax is replaced with slower growing sources of revenue." Sean O'Leary, *Senate Income Tax Cut Plan is More of the Same: Tax Cuts for the Wealthy, Tax Increases and Budget Cuts for Everyone Else*, W. VA. CTR. ON BUDGET & POL'Y: BLOG (Mar. 31, 2021), https://wvpolicy.org/senate-income-tax-cut-plan-is-more-of-the-same-tax-cuts-for-the-wealthy-tax-increases-and-budget-cuts-for-everyone-else/.

[12] Douglas Soule, *Gov. Justices Continues to Promote His Tax Plan, but West Virginia Businesses Are Skeptical*, MOUNTAIN STATE SPOTLIGHT (Mar. 26, 2011), https://mountainstatespotlight.org/2021/03/26/gov-justice-continues-to-promote-his-tax-plan-but-west-virginia-businesses-are-skeptical/.

[13] Walczak, *supra* note 1 ("Rate reductions for wage, retirement, and unemployment income do not extend to business income, investment income, rental income, or other forms of non-wage and non-retirement income.").

[14] *See* H.B. 2794, 83d Leg., Reg. Sess. (W. Va. 2021) (signed enrolled).

[15] Jeff Jenkins, *House, Justice No Closer on Income Tax Reduction as Smoke Clears from Session*, W. VA. METRO NEWS (Apr. 12, 2021, 1:57 PM), https://wvmetronews.com/2021/04/12/house-justice-no-closer-on-income-tax-reduction-as-smoke-clears-from-session/ (statement of House of Delegates Speaker Roger Hanshaw) (". . . the state needs to head down the path of eliminating the tax but work needs to be done on how to do it.").

[16] H.B. 2526, 85th Leg., Reg. Sess. (W. Va. 2023) (signed).

effective retroactively to January 1, 2023.[17] In addition, House Bill 2526 put in place a glide path to income tax repeal—positive state tax receipts (adjusted for inflation) would trigger reductions in the state income tax rate until the rate eventually reaches zero.[18]

During this legislative process, there is no indication that anyone considered the impact of state income tax repeal on charitable giving generally or on the NIP program specifically.[19] It seems obvious, but with no income tax, a charitable income tax credit program is useless. To the extent that one believes income tax credits and deductions successfully incentivize behavior, then the repeal of the state income tax erases all such incentives. Specifically, the whole point of the NIP credit (and similar state level charitable tax incentives nationwide) is that legislators believe that it encourages charitable giving and, presumably, that that is an important result.

Certainly, one can—and many have—debated the efficacy of tax expenditures generally and the incentivizing effects of charitable tax deductions and credits, specifically.[20] But the reality is that a generalized belief in the existence and efficacy of these incentivizing effects influences legislative approaches to a variety of tax issues, including the support of charity. In West Virginia's case, the legislative findings and purpose provisions in the statutory provisions for the NIP credit specifically state as follows:

> It is the intent of the Legislature that this act encouraged private sector businesses and individuals to contribute capital to

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[17] The original version of H.B. 2526 only included a substantial personal income tax rate reduction. H.B. 2526, 85th Leg., Reg. Sess. (W. Va. 2023) (introduced). The bill is technically effective as of March 4, 2023, but the income tax reduction has its own effective date found at W. Va. Code Section 11-21-4g, paragraph (d). H.B. 2526, 85th Leg., Reg. Sess. (W. Va. 2023).

[18] *See* H.B. 2526, 85th Leg., Reg. Sess. (W. Va. 2023) (enacted); W. VA. CODE ANN. § 11-21-4h. (West 2024).

[19] A review of West Virginia legislature and committee agendas does show any indication that this issue was formally discussed and the author has been unable to locate any informal or press discussions of the matter. *See generally Senate Finance Committee – Agenda*, W. VA. LEG., https://www.wvlegislature.gov/committees/senate/Senate_com_agendas.cfm?Chart=fin&input (last visited Mar. 1, 2025); *House Committee on Finance – Agenda*, W. VA. LEG., https://www.wvlegislature.gov/committees/house/house_com_agendas.cfm?Chart=fin&input=10/08/2024.5.

[20] *See generally* Giedre Lideikyte Huber, *Tax Incentives for Charitable Giving as a Policy Instrument: Theoretical Discussion and Latest Economic Research*, 12 WORLD TAX J. 631, 631 (2020) (finding that "incentivizing charitable giving via tax incentives (especially tax deductions) is not the most equitable and/or the most efficient policy option, at least concerning the current forms of tax incentives. Financial incentives structured as direct expenditures, such as matching grants for charitable donations, may be a more suitable policy option"); Brian H. Jenn, *The Case for Tax Credits*, 61 TAX LAW. 549, 588 (2008) ("Like many other tax incentives, the charitable giving deduction has been criticized for producing inequitable and inefficient results.").

> community-based organizations which establish projects to assist neighborhoods and local communities . . . .[21]

In practice, the NIP credit is incredibly important to West Virginia's nonprofit sector. Annually, $3.0 million donated to charity in West Virginia qualified for the NIP credit. While this begs the age-old question of how much of this charitable giving would have occurred absent the credit, there is at least anecdotal support from West Virginia's nonprofit sector that the NIP credit does incentivize some charitable giving, or at least keeps charitable dollars in the state.[22] That significant amount of money is keeping the social service sector of the West Virginia nonprofit community functioning in a time of budget cuts and increased need for services.[23] Charities that receive a NIP credit allocation report a strong universal belief that if the NIP credit were discontinued, their donor base would decline.[24]

If one believes that the NIP credit program really does (at least, in part) incentivize charitable giving in West Virginia, then the repeal of the state income tax comes with an additional, hidden cost. If these things work as intended, then that amount of charitable giving that is incentivized by the credit program will go away. Repealing the income tax and thereby neutralizing the efficacy of

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21 W. VA. CODE ANN. § 11-13J-2 (West, Westlaw through 2024 Reg. Sess., 1st Extraordinary Sess. & 2d Extraordinary Sess.).

22 *See* STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES 223–32 (1973) [hereinafter SURREY, PATHWAYS TO TAX REFORM]; STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES (1985) [hereinafter SURREY, TAX EXPENDITURES]; for examples of the discussion of whether the tax benefits incentivize charitable giving, *see, e.g.*, CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING (1985); Nicolas J. Duquette, Do Tax Incentives Affect Charitable Contributions? Evidence from Public Charities' Reported Revenue, 137 J. PUB. ECONS. 51, 69 (2016); Michelle H. Yetman & Robert J. Yetman, *How Does the Incentive Effect of the Charitable Deduction Vary Across Charities?*, 88 ACCT. REV. 1069 (2013); ROGER COLINVAUX, BRIAN GALLE & EUGENE STEUERLE, EVALUATING THE CHARITABLE DEDUCTION AND PROPOSED REFORMS 8 (Urb. Inst. 2012), https://lira.bc.edu/files/pdf?fileid=f7aeec57-9c8c-4f43-a8c4-59f1c9405da3.

23 Walczak, *supra* note 1 (discussing the proposed House Republican Bill in West Virginia: "For a tax cut of this magnitude, that assumption is surely untrue: all else being equal, lower taxes yield net in-migration and greater economic growth, and tax cuts of this size would certainly have a meaningful effect. That growth would increase revenues over static assumptions, since there would be more economic activity to tax under remaining taxes, but dynamic growth would be nowhere near sufficient to cover a static revenue loss of nearly 50 percent. The spending cuts this dramatic revenue decline would necessitate, moreover, would likely make the state far less attractive to individuals and businesses alike . . . It is exceedingly unlikely that policymakers could—or would want to—identify spending reductions to pair with such large revenue cuts. . . ."). *Id*. (discussing the proposed Senate Bill in West Virginia: "This yields $890 million in offsetting revenue (not counting the $73 million in excise tax increases dedicated to the fund) for an initial $1.09 billion in tax cuts, which the Senate apparently intends to further support by dedicating expected revenue growth to the initial round of tax reductions and trimming the state budget.").

24 In the NIP Report 2018–2023, surveyed organizations repeatedly stated that they believed that their donor base would likely decline if the NIP program were discontinued. See *NIP Report 2018–2023*, *infra* note 130, survey question 15 on pp. 103–108.

charitable tax programs (such as the NIP program) undermines the ability of the private charitable sector to take over the very services that the legislature may be attempting to relocate.

How should state legislatures address reduced charitable giving as an additional cost of state income tax repeal? The reality is that state income tax repeal in West Virginia will likely hurt the West Virginia nonprofit sector if the NIP credit is rendered ineffective and no replacement is enacted. In other states considering repeal, one will need to look to the nature and extent of the charitable tax incentives they provide to determine the extent of the harm. In those states with charitable tax incentives that will be rendered ineffective by income tax repeal, legislators should find an alternative route to support the nonprofit sector and the services they provide.

One such alternative route may come from the lessons of the past. The tension between income tax reform and charitable giving is not new. In 1973, Stanley S. Surrey, in one of his groundbreaking works on tax expenditures, *Pathways to Tax Reform*, discussed this very issue, noting that "[t]ax reform [in the federal charitable deduction area] also requires for its realization a satisfactory alternative solution to the social problem of how to support philanthropy."[25]As part of a set of federal charitable legislative reforms of 1969, Congress was considering significant changes to the federal income tax generally and the charitable deduction specifically.[26] Thus, Congress was faced with the same dilemma in a different context—how do we continue to maintain support for the charitable sector in the face of income tax reforms that reduce the efficacy of charitable giving incentives?

Stanley S. Surrey[27] and his frequent co-author, Paul R. McDaniel,[28] in their joint and individual works on tax expenditures, would continue to consider the efficacy of the charitable deduction during this period. Specifically, in his 1972 work, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*,[29] Professor McDaniel proposed a federal charitable giving matching program to take the place of the federal income tax charitable deduction. Upon review now more than 50 years later, McDaniel's charitable matching program has many of the hallmarks of West Virginia's NIP credit. For those states that care about the impact of tax reform on charitable giving, McDaniel's federal matching grant work may provide a blueprint to an alternative system to incentivize charitable giving and support private charity in the absence of a state level charitable income tax incentives.

This Article starts with a look in greater depth at West Virginia's state

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[25] SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 223.

[26] See *infra* discussion of the Tax Reform Act of 1969 at Part IV.A.

[27] See the biography of Stanley S. Surrey *infra* at note 171.

[28] See the biography of Paul R. McDaniel *infra* at note 175.

[29] Paul R. McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction,* 27 TAX. L. REV. 377 (1972).

personal income tax repeal as well as similar repeal proposals under consideration in other states. With that background, Part II reviews state level charitable giving incentives and their interplay with the Federal charitable deduction, using the NIP credit in West Virginia as a case study. The Article then reviews Professor McDaniel's matching grant proposal to determine if it could be adapted for those states that have repealed (or are considering repealing) their personal income tax but still wish to incentivize charitable giving on the state level. Finally, the Article concludes with some thoughts on how West Virginia could be a case study and leader in demonstrating the manner in which a matching grants program could replace charitable tax incentives, which will address the loss of charitable giving that may result from income tax repeal and describe steps that might be taken to mitigate that impact.

II. THE MARCH OF STATE INCOME TAX REDUCTION AND REPEAL

The last decade (and especially in the COVID and post-COVID period) has witnessed a significant trend of reform, reduction, and repeal in state income tax codes. According to the Associated Press, "[a]bout four-fifths of states passed some sort of income tax break since 2021."[30] In 2023, 11 states reduced their personal income tax rates.[31] Fourteen states will have rate reductions in their individual income tax that become effective in 2024.[32]

This trend was fueled by several different factors. Buoyed by high (sometimes, record high) income tax receipts[33] and COVID relief funds,[34] many

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30 David A. Lieb, *State Tax Cutting Trend Faces Headwinds from Declining Revenues and Tighter Budgets*, ASSOCIATED PRESS (Jan. 3, 2024, 12:08 AM), https://apnews.com/article/tax-cuts-budget-shortfalls-states-5a28a95465296f92ba6dcf31822570a2.

31 Katherine Loughead, Janelle Fritts, Timothy Vermeer & Adam Hoffer, *State Tax Changes Taking Effect January 1, 2023*, TAX FOUND. (Dec. 22, 2022), https://taxfoundation.org/research/all/state/2023-state-tax-changes/ (explaining Arizona, Idaho, Indiana, Iowa, Kentucky, Mississippi Missouri, Nebraska, New Hampshire, New York and North Carolina had individual income tax reductions taking effect on January 1, 2023).

32 Manish Bhatt & Benjamin Jaros, *State Tax Changes Taking Effect January 1, 2024*, TAX FOUND. (Dec. 21, 2023), https://taxfoundation.org/research/all/state/2024-state-tax-changes/.

33 Fiscal years 2021 and 2022 were "the two fastest growing years for general fund revenues" in the history of the fiscal survey undertaken twice annually by the National Association of State Budget Officers. *The Fiscal Survey of States*, NASBO at IX (Spring 2024), https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal%20Survey/NASBO_Spring_2024_Fiscal_Survey_of_States_S.pdf.

34 David A. Lieb & Camille Fassett, *After Huge Pandemic Losses, Governments See Rapid Rebound*, ASSOCIATED PRESS (Jan. 28, 2022, 4:11 PM), https://apnews.com/article/coronavirus-pandemic-business-health-pandemics-personal-taxes-42637f997178a1de4911bf16dbc3f60b?utm_source=copy&utm_medium=share; *see also* Bhatt, *supra* note 32 ("The past several years have seen a wave of significant tax reforms, including rate reductions and tax cuts, as states emerged from the pandemic with revenue surpluses and stared down inflation.").

states had the budgetary opportunity to reduce overall state income tax burdens. In addition, the COVID era demonstrated that businesses and workers can be far more mobile than they had been previously, increasing the number of individuals whose state of residency was different than their state of employment. With that knowledge, some states attempted to attract this more mobile workforce through tax reform.[35] Finally, a number of federal legal changes have triggered state level responses, including the cap on the state and local tax deduction,[36] other federal changes that have caused states to decouple their tax codes,[37] and the fallout from the Supreme Court's decision in *South Dakota v. Wayfair*,[38] expanding state sales tax nexus to remote sellers.

However, the outlook for state tax revenues in 2025 and beyond is less robust. As federal COVID monies are no longer being distributed, state budgets are levelling out.[39] Given flattening budgets, states will feel the impact of income tax cuts that were incrementally instituted and will need to look at new spending reductions[40] to offset existing and scheduled tax reductions. For those states that conditioned tax cuts on revenue targets, cuts may happen in the current or next fiscal year, but the implementation in more distant fiscal years may be in question.[41]

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[35] Loughead, *supra* note 31 ("On January 1, 2023, thirty-eight states have noteworthy tax changes taking effect. Most of these changes represent net tax reductions, the result of an unprecedented wave of rate reductions and other tax cuts in the past two years as states respond to burgeoning revenues, greater tax competition in an era of enhanced mobility, and the impact of high inflation on residents."); *see also* Mitchell Scacchi, *New Hampshire to be Income-Tax-Free in 2025*, JOSIAH BARTLETT CTR. FOR PUB. POL'Y (June 15, 2023), https://jbartlett.org/2023/06/new-hampshire-to-be-income-tax-free-in-2025/ ("Since 2021, 22 states have cut individual income taxes. These states are all competing for residents who will contribute to GDP growth, particularly higher-wealth individuals who are able to invest in their communities and start new businesses.").

[36] *See infra* note 102.

[37] For example, in Senate Bill 189, New Hampshire decoupled its state tax code from the federal code to prevent the limitations on the interest deduction found in Code Section 163(j). Bhatt, *supra* note 32.

[38] South Dakota v. Wayfair, 585 U.S. 162 (2018); *see also* Jennifer W. Jensen, Daniela Wilps, Ferdinand Hogroian & Matthew Gillespie, *South Dakota v. Wayfair – Five Years Later*, TAX ADVISOR (June 1, 2023), https://www.thetaxadviser.com/issues/2023/jun/south-dakota-v-wayfair-five-years-later.html.

[39] *The Fiscal Survey of States*, *supra* note 33, at 1 ("The timing of state spending has been more variable in recent years since the onset of the COVID-19 pandemic, largely due to the sizable amount of one-time expenditures from surplus funds.").

[40] *Id.* at 2. ("According to recommended budgets for fiscal 2025, . . . 22 states are expecting general fund spending to stay flat or decline compared to estimated 2024 spending. Following three consecutive years in which roughly have of the states recorded double-digit percentage increases — it is not surprising that so many state are projecting year-over-year decreases in their fiscal 2025 budget proposal.").

[41] *Id.* at 43. ("Factors contributing to the relatively flat revenue growth recoded for fiscal 2023, estimated for fiscal 2024, and forecasted for fiscal 2025 include the impact of recently enacted tax cuts (both one-time and recurring) . . . .").

A. Ongoing State Personal Income Tax Reform and Repeal

As of 2024, there are seven states that do not have a state level personal income tax: Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, and Wyoming.[42] In addition, Washington[43] only taxes capital gains income,[44] and New Hampshire currently only taxes interest and dividend income, although the New Hampshire investment income tax is on schedule to be repealed fully by 2025.[45] Of these nine states, many of them never had a state level personal income tax.[46] Alaska adopted an individual income tax in 1949, which was repealed in 1979.[47]

Tennessee and New Hampshire are good examples of the more recent trend in income tax reform. Prior to 2016, Tennessee taxed certain personal investment income but not wages.[48] In 2016, the legislature passed a pathway to repeal this tax by reducing the state income tax rate on investments by 1% per year until the tax was eliminated. Under this pathway, full repeal actually occurred in 2021.[49] Similarly, New Hampshire is phasing out its investment income tax. In 2021, New Hampshire adopted a plan that reduced the interest and dividends tax rate by 1% per year, with full repeal expected in 2027.[50]

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[42] Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming. New Hampshire only taxes interest and dividend income. Andrey Yushkov, *State Individual Income Tax Rates and Brackets, 2024*, TAX FOUND. (Feb. 20, 2024), https://taxfoundation.org/data/all/state/state-income-tax-rates-2024/.

[43] WASH. REV. CODE ANN. § 82.87.040 (West 2021).

[44] *Id.*

[45] N.H. REV. STAT. ANN. § 77.1 (2023).

[46] *See generally* Scott Drenkard, *When Did Your State Adopt Its Income Tax?*, TAX FOUND. (June 10, 2014), https://taxfoundation.org/data/all/state/when-did-your-state-adopt-its-income-tax/ (indicating that Florida, Nevada, South Dakota, Texas, Washington, Wyoming never had an income tax.).

[47] COMPILED L. OF ALASKA 1949, https://heinonline.org/HOL/Page?handle=hein.ssl/lwsalask0002&id=1&collection=ssl&index= (last visited Oct. 13, 2024).

[48] TENN. CODE ANN. § 67-2-101 (West, Westlaw through 2024 Reg. Sess. of 113th Gen. Assemb.).

[49] *HIT-4 - Hall Income Tax Rate*, TENN. DEP'T OF REVENUE (Dec. 14, 2022, 3:22 PM), https://revenue.support.tn.gov/hc/en-us/articles/360057355792-HIT-4-Hall-Income-Tax-Rate; *2022 Report Card for Tennessee's Infrastructure*, ASCE (2022), https://infrastructurereportcard.org/wp-content/uploads/2016/10/Report-2022-TN-IRC-FINAL-WEB.pdf.

[50] Phil Sletten, *Repeal of Interest and Dividends Tax Disproportionately Benefits Wealthy NH Households*, N.H. BULL. (Mar. 30, 2023, 4:55 AM), https://newhampshirebulletin.com/2023/03/30/repeal-of-interest-and-dividends-tax-disproportionately-benefits-wealthy-nh-households/ (citing Phil Sletten, *Households with High Incomes Disproportionately Benefit from Interest and Dividends Tax Repeal*, N.H. FISCAL POL'Y INST. (Mar. 14, 2023), https://nhfpi.org/blog/households-with-high-incomes-disproportionately-benefit-from-interest-and-dividends-tax-repeal/).

However, the state budget bill enacted in 2023 accelerated the process, with full phase out now occurring in 2024.[51] "The state budget (H.B. 2), which is currently awaiting a full vote of the Senate, also contains an accelerated phaseout of New Hampshire's tax on interest and dividend income, eliminating the tax by January 2025, rather than 2027."[52] New Hampshire does not have a general charitable deduction or credit against its Interest Dividends ("I&D") tax.[53]

Similarly, there are a number of states that have been incrementally reducing their income tax rates, including rate reductions triggered by budget performance, including Arkansas,[54] Georgia,[55] Indiana,[56] Iowa,[57] Kentucky,[58] and Michigan.[59]

B. A Case Study: West Virginia Income Tax Repeal

West Virginia clearly fits into the narrative established for those states considering repeal. In the last five years, West Virginia has seen a significant increase in state revenue.[60] In addition, West Virginia received about $1.4 million

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[51] Katherine Loughead, *State Tax Reform and Relief Trend Continues in 2023*, TAX FOUND. (June 8, 2023), https://taxfoundation.org/research/all/state/state-tax-reform-relief-2023/#notable.

[52] *Id.*

[53] N.H. CODE ADMIN. R. ANN. Dep't of Rev. Admin. 904.04 (2024) (providing a specific, limited charitable exemption from the I&D tax for the "portion of a trust's income required to be donated by the trust document to a charity.").

[54] Bhatt, *supra* note 32 ("The top marginal individual income tax rate was reduced to 4.9 percent in 2022, and beginning in 2024, this rate will be reduced again to 4.4 percent.").

[55] *Id*. ("Georgia joins a growing number of states that have either adopted or are considering a flat tax. In 2024, the Peach State will collapse its six individual income tax brackets into one at a rate of 5.49 percent, . . . this rate could be reduced by 0.1 percent each year until it reaches 4.99 percent.").

[56] *Id.* (Indiana was considering accelerating the "state's previously enacted rate cuts by reducing the individual income tax rate from 3.15 percent to 3.05 percent in 2024. The same law also repealed associated tax triggers and prescribed further rate reductions.").

[57] *Id.* ("For individual taxpayers, [Iowa] continues its march to a flat income tax rate of 3.9 percent by 2026. In 2024, the top marginal tax rate will be 5.7 percent.").

[58] *Id.* ("In February 2023, Kentucky . . . reduced the state's flat income tax rate from 4.5 percent to 4.0 percent, effective in 2024. This codified a reduction that was triggered per conditions established in 2022 (House Bill 8).").

[59] *Id.* ("In 2015, Michigan . . . instituted automatic triggers that would reduce the flat individual income tax rate if certain economic factors were met. In 2023, these triggers were satisfied, and the rate was reduced to 4.05 percent.").

[60] *Project West Virginia*, URB. INST. (Dec. 2024), https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-fiscal-briefs/west-virginia; Dave Hardy, *West Virginia Department of Revenue Budget Overview–FY 24*, https://www.wvlegislature.gov/legisdocs/misc/budgethearings/2023/Budget%20Presentation%20—%20Revenue%20Department%20(FY2024).pdf; See also *Annual Budget*, W. VA. https://westvirginia.opengov.com/transparency/#/52892/accountType=revenuesVersusExpenses&embed=n&breakdown=types&currentYearAmount=cumulative&currentYearPeriod=years&gr

in state aid under the American Rescue Plan, which needed to be allocated by December 31, 2024, and spent by December 31, 2026.[61]

As discussed previously,[62] West Virginia's process of income tax repeal started in 2021, when Governor Justice introduced the concept in the face of robust state revenues. The personal income tax repeal initiative finally came to fruition in March 2023, when House Bill 2526 passed and was signed by the Governor.[63]

House Bill 2526 significantly cut state personal income tax rates effective retroactively to January 1, 2023, with a 21.25% cut across all six tax brackets.[64] These personal income rates were intended to be a precursor to full repeal. House Bill 2526 put in place a glide path to income tax repeal—positive state tax receipts would trigger reductions in the state income tax rate until it eventually reaches zero.[65] Specifically, on August 15 of each tax year, West Virginia's Secretary of Revenue must calculate whether the state's revenues in the prior fiscal year exceeded the actual revenue for 2019, adjusted for inflation.[66] If state receipts for the prior fiscal year do not exceed the 2019 inflation adjusted level, income tax rates do not change. If, however, state receipts for the prior fiscal year exceed the 2019 inflation adjusted level, a personal income tax rate reduction is triggered.[67] Note that this trigger calculation is based on all general revenue fund collections, not just collections from the personal income tax or income taxes collected from all sources.[68]

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aph=bar&legendSort=desc&proration=true&saved_view=null&selection=845BA725B542CEDF9BF734A9F904C25D&projections=null&projectionType=null&highlighting=null&highlightingVariance=null&year=2025&selectedDataSetIndex=null&fiscal_start=earliest&fiscal_end=latest (last updated Jan. 3, 2025).

61 *Project West Virginia*, URBAN INST. (Oct. 2024), https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-fiscal-briefs/west-virginia.

62 Sanyon, *supra* note 1.

63 H.B. 2526, 85th Leg., Reg. Sess. (W. Va. 2023) (signed).

64 The original version of H.B. 2526 only included a substantial personal income tax rate reduction. *See* H.B. 2526, 85th Leg., Sess. (W. Va. 2023). The bill is technically effective as of March 4, 2023. *See Bill Status H.B. 2526*, W. VA. LEG., https://www.wvlegislature.gov/Bill_Status/bills_history.cfm?INPUT=2526&year=2023&sessiontype=RS (last visited Nov. 11, 2024). However, the income tax reduction has its own effective date found at Code Section 11-21-4(g), paragraph (d). W. VA. CODE ANN. § 11-21-4g(d) (West 2024); *see also* Jack Walker, *State Officials Certify 4 Percent Tax Cut for 2025*, W. VA. PUB. BROAD. (Aug. 16, 2024, 12:31 PM), https://wvpublic.org/state-officials-certify-4-percent-tax-cut-for-2025/; Emily Rice, *Gov. Justice Signs Tax Cut Bill*, W. VA. PUB. BROAD. (Mar. 7, 2023, 2:37 PM), https://wvpublic.org/gov-justice-signs-tax-cut-bill/.

65 *See* W. VA. CODE ANN. § 11-21-4h (West 2024) (as amended by H.B. 2526, 85th Leg., Sess. (W. Va. 2023)).

66 *Id*. § 11-21-4h(b).

67 *Id*. § 11-21-4h(c).

68 *Id*. §§ 11-21-4h(a)(2)–(3).

If the revenue trigger is activated, then the amount of the rate reduction must be calculated.[69] The rate reduction amount is the ratio (expressed as a percentage) of the prior year's personal income tax collections over prior year's excess revenue (that is, the positive difference in actual revenue over the 2019 inflation adjusted base), rounded to the nearest whole percentage.[70] The percentage reduction will be "applied equally across the rates," although it cannot result in greater than a 10% reduction.[71] The Secretary of Revenue and the State Auditor must certify the rate change as soon as possible after August 15 of each year.[72] As a result, the first trigger date of August 15, 2024, resulted in a 4% personal income tax rate reduction, based on the fiscal year 2023 collection data.[73] In addition to the triggered rate cuts, on October 31, 2024, Governor Justice signed Senate Bill 2033, which reduced the personal income tax by an additional 2%.[74] This additional cut is estimated to cost approximately $46 million in foregone revenue.[75]

Between fiscal year 2023 and fiscal year 2024, however, state revenue collections declined by 12%.[76] The West Virginia Revenue Department currently projects a 7.8% revenue decline for the next fiscal year.[77] According to the West Virginia Center on Budget & Policy, these declines in revenues are primarily attributable to the income tax cuts; in the absence of the cuts, the decline over the two fiscal years from 2023 to 2025 would have been only 2.7%.[78]

Simultaneously, according to NASBO's Spring 2024 Fiscal Survey of States, West Virginia is about to experience more volatility in its general fund expenditures. In fiscal year 2023, there was an increase in spending of 19.1%,

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69 *Id*. § 11-21-4h(c).

70 *Id.*

71 *Id.*

72 *Id*. § 11-21-4h(d).

73 *Gov. Justice Announces Another Historic Personal Income Tax Cut for West Virginia*, W. Va. OFF. OF THE GOVERNOR (July 1, 2024), https://governor.wv.gov/News/press-releases/2024/Pages/Gov.-Justice-announces-another-historic-personal-income-tax-cut-for-West-Virginia.aspx; *Gov. Justice Announces Revenue Secretary and State Auditor Certify 4 Percent Income Tax Reduction, File with State Tax Office*, OFF. OF THE GOVERNOR (Aug. 15, 2024), https://governor.wv.gov/News/press-releases/2024/Pages/Gov.-Justice-announces-Revenue-Secretary-and-State-Auditor-certify-4-percent-income-tax-reduction,-file-with-state-tax-offi.aspx.

74 S.B. 2033, 86th Leg., 2d Spec. Sess. (W. Va. 2024).

75 Lori Kersey, *Justice Ceremonially Signs Bill Cutting West Virginia Income Tax*, WEST VIRGINIA WATCH (Oct. 31, 2024) https://westvirginiawatch.com/2024/10/31/justice-ceremonially-signs-bill-cutting-west-virginia-income-tax/

76 Kelly Allen, *Income Tax Cuts Driving Historic Revenue Decline*, W. VA. CTR. ON BUDGET & POL'Y (Sept. 10, 2024), https://wvpolicy.org/income-tax-cuts-driving-historic-revenue-decline/#:~:text=Fiscal%20Year%20(FY)%202024%20marked,pace%20with%20inflationary%20cost%20growth.

77 *Id.*

78 *Id.*

with an expected increase of 16.6% in 2024, but an estimated decrease of 12.8% in 2025.[79] By comparison, the median expected expenditure change for all 50 states was a decrease of 6.2%.[80]

III. The Structure of State Level Charitable Tax Incentives

A. State and Federal Charitable Incentives, Generally

Section 170 of the Internal Revenue Code (the "Code")[81] authorizes a federal charitable income tax deduction for gifts made to qualified charities, subject to certain limitations.[82] For individuals, the federal charitable deduction is an itemized deduction.[83] As a result, individual taxpayers have a choice they can: (1) take the standard deduction or (2) take all of their itemized deductions, including the charitable deduction.[84] As a result, only taxpayers that have aggregate itemized deductions in excess of the standard deduction benefit from the charitable deduction.[85]

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79 *The Fiscal Survey of States*, *supra* note 33, at 9.

80 *Id.*; Just before this article went to publication, West Virginia Governor Patrick Morrisey announced a $400 million state budget shortfall, which will probably require significant cuts to social services. *Governor Morrisey Shares his Findings on the State Budget, Vows to Address Financial Challenges Ahead, Office,* W. Va. Off. of the Governor (Jan. 16, 2025), https://governor.wv.gov/article/governor-morrisey-shares-his-findings-state-budget-vows-address-financial-challenges-ahead. *See also* Caelan Bailey, *The $400 Million Projected Deficit: How W.Va. Got Here*, W. Va. Pub. Broad. (Feb. 11, 2025, 10:28 AM), https://wvpublic.org/the-400-million-projected-deficit-how-wva-got-here/.

81 Unless specifically indicated to the contrary, all references to the "Code" refer to the Internal Revenue Code of 1986, as from time to time amended.

82 *See* I.R.C. § 170 (West 2022). While Code Section 170 authorizes the federal charitable deduction for both individuals and corporations, this Article will focus on the individual income tax deduction, as it is the individual income tax that is subject to repeal in most states. For C Corporations, Code Section 170(b)(2)(A) limits the deduction to 10% of the corporation's taxable income. I.R.C. § 170(b)(2)(A) (West 2022).

83 *See generally Id.* § 62(a) (West 2020) (which does not specifically list the charitable deduction as an above the line deduction); *Id.* § 63(b) (West 2020) (which does not allow the charitable deduction to individuals who itemize); *Id.* § 67(b)(4) (West 2017) (which lists the charitable deduction as an itemized deduction not subject to the limitations on miscellaneous itemized deductions). Section 2204 of the CARES Act, Pub. L. No. 116-136 (2020), added Code Section 62(a)(22), which provided that the first $300 of qualifying cash charitable deduction was not an itemized deduction; that is, it is deductible regardless of whether or not one itemizes. As an "above the line" deduction, this portion of the charitable deduction was essentially available to all taxpayers. The above the line charitable deduction was only effective for tax years 2020 and 2021.

84 *See* I.R.C. §§ 63(a)–(b) (West 2020).

85 Due to compliance burdens, some taxpayers take the standard deduction even when itemizing would be more beneficial. *See* Youssef Benzarti, *How Taxing Is Tax Filing? Leaving Money on the Table Because of Compliance Costs*,
108, 108th Ann. Conf. on Tax'n 1 (2015), https://www-jstor-

Prior to 2018, each taxpayer could choose to take the standard deduction and also take a personal exemption for themselves, their spouse, and each of their dependents (if any).[86] Beginning in 2018 and through 2025, however, the Tax Cuts and Jobs Act ("TCJA") suspended the personal exemption but substantially increased the standard deduction[87] and the child tax credit.[88] The standard deduction for a single taxpayer jumped from $6,350 in 2017 to $12,000 in 2018, which grew even higher in subsequent years due to inflation adjustments.[89]

With the increase in the standard deduction as part of the TCJA, far fewer taxpayers itemized their deductions.[90] At the time, "[t]he Joint Committee on Taxation estimate[d] that the number of filers who itemize will fall from 46.5 million in 2017 to just over 18 million in 2018, meaning that about 88% of the 150 million households that file taxes will take the increased standard deduction."[91] Recent estimates projected a 61% reduction in the number of itemizers nationally, with a decline of 64% specifically in the $100,000 to $200,000 income bracket.[92]

As a result, higher income taxpayers are more likely to itemize post-TCJA, thereby reducing the number of taxpayers that benefit from the federal

org.wvu.idm.oclc.org/stable/pdf/90023226.pdf?refreqid=fastly-default%3A950bb3d693b8b481a4a0c8ae8a4b886c&ab_segments=&initiator=&acceptTC=1.

86 *See generally* I.R.C. § 151 (West 2017) (providing for personal exemptions which are suspended for taxable years 2018 through 2025); *see also id.* § 151(d)(5) (West 2017) (deeming the personal exemption amount to be zero for taxable years beginning after December 31, 2017, and before January 1, 2026).

87 Tax Cuts & Jobs Act, Pub. L. No. 115-97, § 11021, 131 Stat. 2054, 2071–73 (2017) (amending I.R.C. § 63(c)).

88 Tax Cuts & Jobs Act, Pub. L. No. 115-97, § 11022, 131 Stat. 2054, 2073–74 (2017) (amending I.R.C. § 24).

89 For the historical standard deduction from 1992 to present, see *Standard Deduction*, TAXNOTES, https://www.taxnotes.com/research/federal/reference-tables/standard-deduction/1x7yp (last visited Nov. 13, 2024).

90 In addition, the TJCA increased the AGI limitation from 50% to 60% for 2018–2025. *See* Tax Cuts & Jobs Act, Pub. L. No. 115-97, § 11023, 131 Stat. 2054, 2074–75 (2017) (amending Code Section 170 by adding a new Code Section 170(b)(1)(G)).

91 Erica York, *Nearly 90 Percent of Taxpayers Are Projected to Take the TCJA's Expanded Standard Deduction*, TAX FOUND. (Sept. 26, 2018), https://taxfoundation.org/data/all/federal/90-percent-taxpayers-projected-tcja-expanded-standard-deduction/#:~:text=The%20TCJA%20lowered%20individual%20income,much%20simpler%20tax%20filing%20process (citing JOINT COMM. ON TAX'N, JCX-32R-18, TABLES RELATED TO THE FEDERAL TAX SYSTEM AS IN EFFECT 2017 THROUGH 2026 (Apr. 24, 2018), https://www.novoco.com/public-media/documents/x-32-18.pdf).

92 For this tax bracket, the State and Local Tax ("SALT") deduction on average should be worth 6,920,000,000 for 6382,000 households in 2018 compared to 27,878,000,000 / 17650,000 returns. David Altig et al., *Did the 2017 Tax Reform Discriminate against Blue State Voters?* 14 (Fed. Rsrv. Bank Am. Working Paper No. 2019-7, 2019), https://www.frbatlanta.org/-/media/documents/research/publications/wp/2019/07-did-the-2017-tax-reform-discriminate-against-blue-state-voters-2019-04-10.pdf.

charitable deduction.[93]

The structural nature of the federal charitable deduction is important to understanding state charitable income tax incentives. Thirty-one states (including West Virginia) [94] and the District of Columbia start with federal adjusted gross income ("AGI") as the initial tax base.[95] Federal AGI includes all of a taxpayer's federal income reduced by only a certain handful of deductions—those deductions that are not itemized (that is, the deductions that are colloquially referred to as "above the line") deductions.[96] The federal charitable deduction is a "below the line" itemized deduction; that is, it is not taken into account when calculating federal AGI.[97] Therefore, in many states, the initial tax base for a state income tax purpose does not include the federal charitable deduction. In states using this formula, the state income tax code must separately authorize charitable tax incentives if the state wishes to have them.[98]

Not every state that begins with federal AGI as its tax base also has state level charitable incentives.[99] Especially prior to the effective date of the TCJA, states could take the position that the charitable giving incentives, if any, provided by the Federal deduction would be sufficient to influence taxpayer behavior. The impact of additional incentivization by state level tax breaks layered on top of the federal tax benefit might not be sufficient to cause additional giving. With the increase of the standard deduction for federal income tax purposes, however, relying on Federal incentives may not be insufficient because so few taxpayers itemized. In the absence of the Federal tax-level charitable incentive, state level incentivization may need to stand on its own. Finally, some states use the state level charitable incentive to keep tax dollars in

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93 *What Are Itemized Deductions and Who Claims Them?*, TAX POL'Y CTR. (Jan. 2024), https://www.taxpolicycenter.org/briefing-book/what-are-itemized-deductions-and-who-claims-them#:~:text=Taxpayers%20typically%20choose%20to%20itemize,to%20itemize%20(figure%201). This impact is more pronounced in poorer states.

94 W. VA. CODE ANN. § 11-21-12 (West 2024).

95 *How do State Individual Income Taxes Conform with Federal Income Taxes?*, BRIEFING BOOK (Jan. 2024), https://www.taxpolicycenter.org/briefing-book/how-do-state-individual-income-taxes-conform-federal-income-taxes#:~:text=Today%2C%20most%20states%20conform%20through,(AGI)%20as%20of%202023.

96 *See* I.R.C. § 62 (West 2020) (listing deductions taken in calculating adjusted gross income).

97 This discussion focuses primarily on the state income tax base for the application of the individual income tax. As indicated above, Code Section 170 provides for a charitable tax deduction for C Corporations as well. For corporate tax incentives, the question of whether the federal deduction is itemized or not is irrelevant to the discussion of incentivization. The federal corporate charitable deduction is always deductible but subject to the 10% cap on taxable income, subject to some limited adjustments. Accordingly, any state level charitable tax incentive will layer on top of the federal charitable exemption in most instances. The 2019 Treasury Regulations only apply to individual taxpayers.

98 *See, e.g.*, VA. CODE ANN. § 58.1-322.03(1)(a) (West 2024).

99 *State and Local Tax Treatment of Charitable Contributions*, U.S. LEGACY INCOME TRUSTS (May 16, 2024), https://www.uscharitablegifttrust.org/media/32240.pdf.

the state. The NIP credit in West Virginia, for example, is available only to charities registered in West Virginia and administer programs that serve West Virginia citizens.[100]

Another recent change may also highlight the importance of state-level charitable giving incentives. The TCJA placed a cap on the amount that individual taxpayers may deduct under the state and local tax deduction.[101] In response, many states that have high property tax burdens moved to re-classify these payments as charitable gifts to the state as a work around to the state and local tax cap.[102] If a state income tax payment is classified as a charitable gift, query whether any state level charitable incentive should apply to it.

In direct response to state level efforts to avoid the SALT ("State and Local Tax") cap work arounds by reclassifying state tax payments as charitable gifts,[103] the Department of Treasury ("Treasury") released new Regulations effective August 12, 2019.[104] These Regulations discuss the interplay between the federal tax charitable deduction and the state level charitable income tax benefits. As a general rule, taxpayers must reduce their charitable deduction by the value of any benefit received in return for a donation.[105] Under these 2019

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[100] W. VA. CODE ANN. § 11-13J-3 (West 2016) (definition of qualified charitable organization).

[101] Tax Cuts & Jobs Act, Pub. L. No. 115-97, § 11042, 131 Stat. 2054, 2085–86 (2017) (amending Code Section 164); *see generally* Roger Colinvaux, *Failed Charity: Taking State Tax Benefits Into Account for Purposes of the Charitable Deduction*, 66 Buff. L. Rev. 779 (2018).

[102] "Legislatures in New York, New Jersey, and Connecticut—each having a high number of residents whose SALT liability exceeds $10,000—passed laws in response to let their respective taxpayers receive credits on their state or local taxes by donating to state or locally affiliated charities." John Woolley, *States' Challenges to Federal SALT Deduction Cap Thrown Out (1)*, BLOOMBERG TAX (Apr. 1, 2024, 4:01 PM), https://news.bloombergtax.com/daily-tax-report/state-challenges-to-federal-salt-deduction-cap-get-thrown-out.

[103] The Federal Register's preamble to the Regulation states as follows:

> In response to the new limitation under Code Section 164(b)(6) *[the SALT cap]*, some taxpayers are seeking to pursue tax planning strategies with the goal of avoiding or mitigating the limitation. These strategies rely on state and local tax credit programs under which states provide tax credits in return for contributions by taxpayers to or for the use of certain entities described in Code Section 170(c). The use of state or local tax credits to incentivize charitable giving has become increasingly common over the past 20 years. Moreover, since the enactment of the limitation under Code Section 164(b)(6), states and local governments have created additional programs intended to work around the new limitation on the deduction of state and local taxes.

Contributions in Exchange for State or Local Tax Credits, 84 Fed. Reg. 27513, 27514 (June 13, 2019).

[104] *See* 26 C.F.R. § 1.170A-1(h)(3) (2020).

[105] By way of example, if a donor attends a charitable fundraising dinner, the donor may not deduct the full value of the ticket to the event; rather, the donor must reduce the deduction by the fair market value of the dinner provided. Treas. Reg. § 1.170A-1(h); *see also* Hello Glow, *Are Tickets for Fundraising Events Tax-Deductible?*, GLOW GLOBAL EVENTS (Aug. 15, 2022) https://glowglobalevents.com/events/are-tickets-for-fundraising-events-tax-deductible/; *see also* INTERNAL REVENUE SERV., PUBL'N 526, CHARITABLE CONTRIBUTIONS 7 (2023), https://www.irs.gov/pub/irs-pdf/p526.pdf.

Regulations, Treasury will treat a state or local income tax benefit as a benefit received in return for a contribution. As a result, a taxpayer must reduce her federal charitable deduction by the value of state tax incentives received. As a result, taxpayers in these states are left with an explicit choice: (1) take the full federal charitable deduction and ignore the state tax benefits or (2) take the state tax benefits and a reduced federal charitable deduction.

Finally, as previously mentioned, there are currently eight states that do not have a state-level income tax;[106] in addition, New Hampshire only taxes investment income. Accordingly, we can posit that any charitable giving that occurs in these states is not primarily driven by state level income tax charitable incentives—it may be driven, in whole or in part, by federal level charitable incentives. In addition, given the recent increase in the standard deduction for federal purposes, federal charitable incentives may be more important in these states, as high-income taxpayers in those states will have a limited ability to deduct mortgage interest and state income, sales, and property taxes[107] but are subject to the TCJA's cap on state and local taxes. With other popular itemized deductions limited by the TCJA, the federal charitable deduction may arguably have more importance from an incentive point of view for the states.

Of the states with no income tax, Tennessee is the most recent. "Tennessee permits actual charitable contributions to be deducted for the year in which they are made. Accordingly, a subtraction is allowed for actual contributions in excess of the amount allowed as a federal deduction."[108] The repeal of Tennessee's income tax theoretically would have seen an impact in charitable giving if the state level incentive had any incentivizing effect.

For states that choose to offer state level charitable tax incentives, those incentives can take many forms. Some states, such as Virginia, offer a general state-level version of a charitable deduction.[109] Other states offer a variety of tax credit programs, some of which are specifically targeted to specific areas and interest. Many states have specific credits that target endowments or social services.[110] West Virginia's credit program follows this pattern, targeting neighborhood improvement and social service type programs across multiple types of agencies.

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106 Scacchi, *supra* note 35.

107 Taxpayers in these states may, however, be able to deduct state level general sales tax. I.R.C. § 164(b)(5) (West 2022).

108 *Tennessee, Subtraction–Charitable Items*, CCH ANSWERCONNECT, https://answerconnect.cch.com/document/jtn0109013e2c83b4326a/state/explanations/tennessee/subtractions-charitable-items (last visited Nov. 13, 2024) (citing TENN. CODE ANN. §67-4-2006(b)(2)(D) (West 2024); TENN. COMP. R. & REGS. 1320-6-1-.20 (2024)).

109 *See* VA. CODE ANN. § 58.1-322.03(1)(a) (West 2024). For a full listing, see *State and Local Tax Treatment of Charitable Contributions*, *supra* note 99.

110 *See State Charitable Giving Incentives*, NAT'L COUNCIL OF NONPROFITS, https://www.councilofnonprofits.org/trends-and-policy-issues/state-charitable-giving-incentives (last visited Nov. 13, 2024).

B. A Case Study: West Virginia's Neighborhood Investment Program

Originally enacted in 1996, West Virginia's Neighborhood Investment Program ("NIP") tax credit is available to both individual and corporate taxpayers.[111] For individuals, the NIP offers a credit against the personal income tax for gifts to certain West Virginia charitable organizations; similarly, corporate taxpayers may take the credit against the corporate income tax or the business franchise tax.[112] It is important to review the general structure, applicability, and impact of the NIP credit in order to design a replacement system in the event that full personal income tax repeal occurs.

1. General Structure

As more briefly described previously,[113] the preamble to the NIP credit statute sets out the West Virginia Legislature's intent to incentivize state level charitable giving, stating as follows:

> It is the finding of the Legislature that community-based organizations can be a powerful force in community development. However, in West Virginia their effectiveness has historically been weakened by meager resources. Private corporations and individuals in West Virginia possess the resources to aid community-based organizations in their efforts to assist neighborhoods and communities. Due to the lack of clear incentives, the private and not-for-profit sectors have often not taken advantage of opportunities to collaborate with community-based organizations to the full extent possible by investment and participation in local programs.[114]

Under the NIP credit program, the West Virginia legislature allocates a specific dollar amount annually to fund a pool of available credits; thus, the amount of credit available state-wide in any given year is capped at a certain sum.[115] Currently, the total available credit amount is $3 million annually.[116] This provides budgetary certainty to the state in a manner that a charitable deduction

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111 *See* W. VA. CODE ANN. §§ 11-13J-1 to -12 (West). S.B. 243, 72d Leg., Reg. Sess. (W. Va. 2011) (reauthorization March 12, 2011 through July 1, 2016); S.B. 293, 77th Leg., Reg. Sess. (W. Va. 2016) (reauthorization March 12, 2016 through July 1, 2021); H.B. 2794 83d Leg., Reg. Sess. (W. Va. 2021) (reauthorization April 9, 2021 through July 1, 2021).

112 W. VA. CODE ANN. § 11-13J-2 (West, Westlaw through 2024 Reg. Sess., 1st Extraordinary Sess. & 2d Extraordinary Sess.); W. VA. CODE R. §§ 145-7-1 to -15 (2021).

113 W. VA. CODE ANN. § 11-13J-2 (West, Westlaw through 2024 Reg. Sess., 1st Extraordinary Sess. & 2d Extraordinary Sess.).

114 *Id.*

115 *Id*. § 11-13J-6 (West 2011).

116 *Id*. §§ 11-13J-6(c), -8(a) (West 2011).

might not: West Virginia knows that its maximum tax expenditure exposure for the NIP credit is $3 million annually.[117]

The state then allocates this $3 million among qualified West Virginia charities. To obtain an allocation of a portion of the available credit amount, a charitable organization must submit a plan for a project that will assist those individuals or areas targeted by the Program.[118] The West Virginia Community Advancement and Development Office ("Development Office"), with the assistance of the Neighborhood Investment Advisory Board, evaluates the project submissions and allocates the $3 million in available credit among the approved charities. The charity then receives a notification of the amount of the credit that has been allocated to its project. The charity then distributes its allocated amount among its donors as it determines by way of tax credit vouchers, although the minimum eligible contribution for a single donor is $500, and that donor is allowed a credit of 50% of their eligible contribution.[119]

If a charity does not utilize all of the credit allocated to it, the unallocated portion is returned to the state.[120] The state then can re-allocate these returned credits among other projects. Obviously, charities are loath to return credits, not only because it represents a current unused fundraising opportunity, but also because it will be considered by the Development Office when allocating future credits. A charity is eligible for a supplemental credit award if it has already used all of its original allocation and it did not receive its full requested amount through the original allocation.[121] As a result of this recapture and reallocation process, the vast majority of the annual budget allocation credits are typically utilized, although at the end of the year a small amount of the budget allocation might remain.[122]

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117 In actuality, the maximum exposure of the state is less, because there is a project certification fee equal to 3% of the eligible contributions to the Project. W. VA. CODE ANN. § 11-13J-4(b)(1)(A) (West 2016).

118 Described more fully at *infra* Section B.2.

119 W. VA. CODE ANN. § 11-13J-3(b) (West 2016) (defining what qualifies as an eligible contribution in part (D)); *see also Neighborhood Investment Program*, W. VA. CAD, https://wvcad.org/sustainability/neighborhood-investment-program (last visited Nov. 13, 2024).

120 A charity must show that it has used 70% of its credits by March 15 of the Program year. Between March 15 and March 30, the so called "dead period," the state may reallocate unused credits. *See* NIP Procedural Rule §145-7-4.8.b. et seq.

121 W. VA. DEV. OFF., NIP PROGRAM OVERVIEW 78, https://wvcad.org/assets/files/nip/5-2018-workshop-presentation.pdf.

122 In FY 2024, only $47,490 in credits were reallocated. *See* W. VA. DEV. OFF., DEP'T OF ECONOMIC DEV., NEIGHBORHOOD INVESTMENT PROGRAM 85, https://wvcad.org/assets/files/nip/FY25-Workshop-Presentation.pdf. According to the NIP Report 2018–2023, participant organizations utilized a record-setting 100% of the available credit for the seventh year in a row. *NIP Report 2018–2023, infra* note 130.

2. Eligible Charities: Social Service Agencies

By statute, not all charitable organizations or projects are eligible to receive a NIP credit allocation. The West Virginia statute specifically authorizes "neighborhood organizations" to apply for the credit.[123] Additionally, the applicant organizations must indicate "the economically disadvantaged citizens . . . or the economically disadvantaged area" that will benefit from the project.[124]

To fulfill these statutory requirements, the NIP application itself requires the applicant charity to identify the median household income, unemployment rate, and poverty rate of the area served by the project to be funded.[125] The projects funded generally fall into one of four major categories: community service, crime prevention, job training and education, and neighborhood assistance.[126] Other projects may be accepted on a showing that the project serves "low-income individuals and distressed areas."[127] Importantly, in order to receive a NIP credit, the charity must not be a government-controlled entity.[128]

3. Impact of the NIP Credit

By all accounts, the NIP credit program is critical to those West Virginia nonprofits that receive a credit allocation. The NIP credit statute requires an independent review of the program every three years,[129] which may include interviews with some participating charitable organizations.[130] These reports

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[123] W. VA. CODE ANN. § 11-13J-4(a) (West 2016).

[124] *Id.*

[125] NIP PROGRAM OVERVIEW, *supra* note 121, at 39.

[126] W. VA. CODE ANN. § 11-13J-2 (West, Westlaw through 2024 Reg. Sess., 1st Extraordinary Sess. & 2d Extraordinary Sess.) (The preamble to the statute states that the credit is designed to fund projects that "assist neighborhoods and local communities through such services as health care, counseling, emergency assistance, crime prevention, education, housing, job training and physical and environmental improvements.").

[127] NIP PROGRAM OVERVIEW, *supra* note 121, at 41.

[128] In order to be an eligible neighborhood organization, an organization must be described in Code section 501(c)(3); as governmental entities are Code Section 501(c)(1) entities, they do not qualify. W. VA. CODE ANN. § 11-13J-3 (West 2016). Accordingly, many state schools, colleges and universities and state health facilities are not eligible for a credit allocation.

[129] W. Va Code Ann. § 11-13J-12 (West 2021).

[130] *See* Terrell Ellis & Associates, *Assessment of the West Virginia Neighborhood Investment Program FY 2013–2014*, W. VA. STATE AGENCY REPS. 1, 1–2, https://www.wvlegislature.gov/legisdocs/reports/agency/D01_FY_2014_13175.pdf [hereinafter *NIP Report 2013–2014*]; Kris Hopkins, *West Virginia Neighborhood Investment Program Fiscal Year 2016 Annual Report*, W. VA. STATE AGENCY REPS. 1, 9 http://www.wvlegislature.gov/legisdocs/reports/agency/N05_FY_2016_13587.pdf [hereinafter *NIP Report 2016*]; Smith Accounting Services, *Neighborhood Investment Program Independent Assessment (2018–2023)*, W. VA. STATE AGENCY REPS. 3,

provide at least anecdotal evidence of the value of the NIP credit program to West Virginia's nonprofit sector.[131] Most organizations that track trends reported an increase in donations and donors as a result of being awarded credits.[132] West Virginia nonprofits believe that the credit provides a significant source of additional private fundraising—that is, fundraising that is specifically incentivized by the availability of the credit.[133]

Further, these charities believe that "without the NIP legislation they would see significant decline in their donations received. While some felt that donors would continue to give, amounts would decrease . . . ."[134] At least one charity reported that a failure to renew the NIP credit could result in the organization closing its doors.[135] In summary, one charity wrote, "I cannot stress enough the impact and importance of the NIP tax credits for our program's fundraising bottom line. NIP is critical for charitable programs in WV!"[136]

The comments from the surveys conducted in connection with the NIP annual reports show that donors are (or at least, charities think donors are) extremely tax sensitive when it comes to NIP credits. The survey includes the following comments:

- "We have regular donors who ask for tax credits. When we tell people that we have no tax credits left, they sometimes decrease the amount they donate."[137]
- "Certain donors base the amount of their annual gift on whether or not there will be NIP credit available - we expect our overall fundraising to be down by the amount we won't receive in NIP donations."[138]
- "When we have adequate NIP credit our fundraising is traditionally successful. When we have less NIP, we have to increase fundraising

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https://www.wvlegislature.gov/legisdocs/reports/agency/D01_FY_2023_26301.pdf [hereinafter *NIP Report 2018–2023*].

131 *NIP Report 2018–2023*, *supra* note 130, at 3 ("[T]he NIP once again achieved record success and remains a significant incentive for donors to contribute to local nonprofit organizations.")

132 *Id.* at 2.

133 *NIP Report 2013–2014*, *supra* note 130, at 20 ("A majority of our private giving last year was purely because of NIP credits and would not have been donated if we did not have that."); *id.* at 94 (Similarly, one charity stated that in the absence of NIP credits, "I feel certain our private donations would cease.").

134 *Id.* at 2.

135 *Id.* at 21, 92 (Similarly, one charity stated, "[w]ithout the donations we receive as a result of NIPS credits our organization would not be sustainable.").

136 *Id.* at 22.

137 *Id.* at 90.

138 *Id.*

efforts and the focus is taken off clients and placed on fundraising."[139]

In addition, the NIP credit lays the groundwork for establishing fundraising relationships. NIP charities report that donors often come to a charity for the first time to obtain the credit, but thereafter become loyal donors regardless of the tax incentive.[140] In one case, a charity was able to convert business donors attracted by the credit program into individual donors.[141] In addition, the NIP credit program can work as an informal endorsement of an organization (although it is clear that no official endorsement as such exists). Because a charitable organization must go through financial screening with the West Virginia Department of Commerce, some donors see the awarding of NIP credits as a sign of accountability. As one representative of a recipient charity stated, "[b]eing a NIP organization gives credibility to an organization . . . gives positive financial credibility."[142]

4. The Credit Takers: West Virginia's Rural Philanthropists

By most measures, West Virginia is one of the poorest and most rural states in the United States.[143] As indicated previously, the vast majority of West Virginia taxpayers take the federal standard deduction and therefore are not eligible to take the federal charitable deduction.

For individual taxpayers, the NIP credit is a tax credit against West Virginia's personal income tax.[144] A taxpayer's NIP credit is limited to 50% of the taxpayer's eligible contributions.[145] In any one tax year, the minimum eligible gift is $500 and the maximum gift is $200,000.[146] The maximum tax credit allowed in one year to any donor is $100,000, although a donor has the option to

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139 *Id.*

140 *Id.* at 20, 88 ("Donors are loyal to our mission. We have been able to attract new donors because of the tax credits. Once donors have made an initial gift and begin to receive more information about the program, they become loyal donors even if tax credits are not available. A lower amount of tax credits will not give us the ability to attract additional new donors."); *see also NIP Report 2018–2023*, *supra* note 130, at 49 ("Donors participating in NIPS with our organization are mostly repeat donors who are extremely interested in the tax credits offered through NIPS.").

141 *NIP Report 2013–2014*, *supra* note 130, at 2.

142 *Id.* at 2, 19.

143 Craig Benson, *Poverty in States and Metropolitan Areas: 2023*, U.S. CENSUS BUREAU, https://www2.census.gov/library/publications/2024/demo/acsbr-022.pdf.

144 W. VA. CODE ANN. § 11-13J-6 (West 2011). Claimed through filing Form WV/NIPA-2, *West Virginia Neighborhood Investment Program Credit Schedule*, W. VA. STATE TAX DEP'T, https://tax.wv.gov/documents/taxforms/2015/nipa2.pdf. For corporate taxpayers, it can be taken against the business franchise tax or the corporate net income tax.

145 W. VA. CODE ANN. § 11-13J-5(b) (West, Westlaw through 2024 Reg. Sess., 1st Extraordinary Sess. & 2d Extraordinary Sess.).

146 W. VA. CODE ANN. § 11-13J-3(b) (West 2016) (see definition of eligible contribution parts (D) and (E)).

use the credit in the single year or over a five-year period beginning in the year of donation.[147] Any credit that remains unused after five years is forfeited.[148]

The credit can be awarded with respect to contributions of cash, property, or publicly traded stock (however, such stock must be sold within 180 days of receipt.)[149] Interestingly, a NIP credit can also be awarded for the contribution of in-kind professional services, valued at 75% of market value. Unlike the contributions of cash, property, or stock, contributions of in-kind services are not eligible for a federal income tax charitable deduction under Code Section 170.[150]

According to the 2016 NIP report, in 2016 there were 3,584 NIP credit eligible donations[151] totaling $2,973,386,[152] for an average donation of $829.63 per donor. This number is, however, somewhat misleading, as the minimum donation allowed is $500.[153] "Generally, the availability of NIP credits has helped with securing larger donations, and with success at soliciting donations before the influx of end-of-the-year support."[154]

According to the United States Census Bureau, West Virginia had a median household income of $55,217 in 2022 (ranking 49th in the country).[155] Given this median household income, an average donation of over $800.00 is a significant amount of that family's after-tax income. It is not surprising, then, that the vast majority of West Virginia individual taxpayers that take the NIP credit do not take the federal standard deduction.[156] For those individuals that do itemize, statistics indicate that they are generally higher income taxpayers. Forbes estimated that nationwide, the average charitable deduction by AGI limitation for 2016 was $3,620 for $100,000 in AGI and $6,483 for $200,000 in AGI.[157]

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147 W. VA. CODE ANN. § 11-13J-5(c) (West, Westlaw through 2024 Reg. Sess., 1st Extraordinary Sess. & 2d Extraordinary Sess.).

148 W. VA. CODE ANN. § 11-13J-6(c) (West 2011).

149 W. VA. CODE ANN. § 11-13J-3(b) (West 2016).

150 Treas. Reg. § 1.170A-1(g) ("No deduction is allowable under section 170 for a contribution of services.").

151 *NIP Report 2016*, *supra* note 130.

152 *Id.* at 3.

153 W. VA. CODE ANN. § 11-13J-3(D) (West 2016).

154 *NIP Report 2013–2014*, *supra* note 130, at 88.

155 *Project West Virginia*, URB. INST. (Nov. 2024), https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/projects/state-fiscal-briefs/west-virginia.

156 Robert Bellafiore, *The Benefits of the State and Local Tax Deduction by County*, TAX FOUND. (Oct. 5, 2018), https://taxfoundation.org/state-and-local-tax-deduction-by-county-2016/.

157 William Baldwin, *2017 Tax Guide: Deduction and Audit Risk*, FORBES (Feb. 7, 2017, 9:37 AM), https://www.forbes.com/sites/baldwin/2017/01/23/tax-guide-deductions-and-audit-risk/#6f598e6c3876 (note these are pre-TCJA numbers). These numbers track with the estimates on who takes the SALT deduction in West Virginia. The National Association of Realtors found that only 17% of West Virginians took the state and local tax deduction in 2016, with an average

West Virginia charities that are allocated NIP credits must document their Section 501(c)(3) status and confirm their charitable exemption from West Virginia state income tax.[158] Although Code Section 501(c)(3) and 170(c)(2) are not co-terminus, it would be a rare case that a charity that received a NIP credit allocation was not eligible to receive charitable contributions that would be deductible for federal tax purposes. Accordingly, donors that request a NIP credit allocation for a gift are presumably expecting a federal charitable income tax deduction as well.[159] Prior to the TCJA, this would most likely be the result of a donation to a NIP credit recipient charity if the donor itemized. After the TCJA and under the *quid pro quo* rules, however, the tax treatment of such a donation may change both as a legal and a practical matter.[160]

IV. CHARITABLE INCENTIVES AS TAX EXPENDITURES

Tax policy recognizes that Congress can "spend" in two different ways. It can go the traditional route of collecting taxes and then spending those funds to accomplish a policy goal.[161] Alternatively, Congress can simply never collect the taxes in the first place, by designing a tax credit or deduction that accomplishes the stated policy goal. For example, under a traditional view of federal spending, Congress could support higher education by providing a $2,000 grant for tuition from taxpayer funds.[162] Alternatively, Congress could provide a $2,000 income tax credit for higher education funds. In this way, Congress never collects $2,000 in funds through the tax system, but nevertheless directs private

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deduction about $9,247. Recall that for those that itemize, the three largest deductions are the SALT deduction, the home mortgage interest deduction, and the charitable deduction. *The Nonprofit Sector in West Virginia*, INDEP. SECTOR (June 2016), https://independentsector.org/wp-content/uploads/2016/12/West-Virginia.pdf (federal report citing the Joint Committee on Taxation).

158 NIP PROGRAM OVERVIEW, *supra* note 121, at 32.

159 One exception may be for those individuals who take a NIP credit for the donation of professional services. *See* Treas. Reg. § 1.170A-1(g) ("No deduction is allowable under section 170 for a contribution of *services*.") (emphasis added).

160 Joseph Rosenberg & Eugene Steuerle, *Reforming Charitable Tax Incentives: Assessing Evidence and Policy Options*, TAX POL'Y CTR. 2 (Nov. 15, 2018), https://taxpolicycenter.org/sites/default/files/publication/156165/reforming_charitable_tax_incentives_assessing_evidence_and_policy_options.pdf.

161 See *Tax Expenditures*, U.S. DEP'T OF THE TREAS., https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures (last visited Nov. 23, 2024) ("Tax expenditures . . . are often viewed as alternatives to other policy instruments, such as spending or regulatory programs.").

162 For example, low-income students may qualify for direct educational aid in the form of Pell Grants, which can be up to $7,395 for the 2023–2024 academic year. *See Federal Pell Grants*, FEDERAL STUDENT AID, https://studentaid.gov/understand-aid/types/grants/pell (last visited Nov. 23, 2024).

spending towards supporting higher education through the tax credit.[163]

The term "tax expenditure" captures the budgetary impact of Congressional spending through tax deductions and credits to accomplish a policy goal.[164] Technically, tax expenditures are defined as "departures from the normal tax structure . . . designed to favor a particular industry, activity, or class of persons."[165] Of course, it can be difficult to determine what the "normal" tax structure is or should be, and to then determine if a particular tax provision is a departure from that normal structure.[166] For our purposes, however, tax expenditure analysis generally assumes that the charitable deduction is not included in the normative concept of the income tax; accordingly, there is general agreement that charitable tax incentives are, in fact, tax expenditures.[167] As a result, the federal charitable deduction is "clearly a method of federal assistance;"[168] similarly, tax incentives provided by the state as part of its tax system would be charitable assistance.[169] While the end result of a charitable tax expenditure is individual "private support" for charity, the charitable tax provision acts as an incentive and a direction for that private support.[170]

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163 *See, e.g.*, the American Opportunity Tax Credit, which provides a credit of up to $2,000 (plus 25% of expenses that exceed $2,000 but do not exceed $4,000) for qualified tuition and related expenses for higher education. I.R.C. § 25a(b) (West 2020).

164 *See Tax Expenditures*, U.S. DEP'T OF THE TREAS., https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures (last visited Nov. 23, 2024) ("Tax expenditures describe revenue losses attributable to provisions of Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."); *see also* Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, § 3(a)(3), 88 Stat. 297 (Tax expenditures are "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction grom gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.").

165 SURREY, TAX EXPENDITURES, *supra* note 22, at 3.

166 The Department of Treasury and the Joint Committee on Taxation utilize the Haig-Simons definition of income for purposes of setting the tax structure baseline. *See* William McBride, *A Brief History of Tax Expenditures*, TAX FOUND. (Aug. 22, 2013), https://taxfoundation.org/research/all/federal/brief-history-tax-expenditures/ (citing Robert Haig, *The Concept of Income–Economic and Legal Aspects*, *in* THE FEDERAL INCOME TAX 1–28 (Columbia University Press 1921)). *See also* HENRY SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 49 (6th ed. 1970).

167 SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 225 ("The charitable contribution deduction is a special tax provision not required by, and contrary to, widely accepted definition of income applicable to the determination of the structure of an income tax.").

168 *Id.* at 224.

169 The tax expenditure study issued by the state of West Virginia specifically lists the NIP credit as a tax expenditure. *West Virginia Tax Expenditure Study: Corporation Net Income Tax and Personal Income Tax Expenditures,* W. VA. TAX DIV. RSCH. & DEV. 25 (Jan. 2023), https://tax.wv.gov/Documents/Reports/2023/CorporationNetIncomeTaxAndPersonalIncomeTaxExpenditures.January.2023.pdf (listed as a value of $60,000 per year).

170 SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 224.

A. A Short (and Incomplete) History of Tax Expenditures

Stanley S. Surrey[171] first coined the term "tax expenditure" in 1967 in a speech given as the Assistant Secretary for Tax Policy.[172] He fully explored the concept in his 1973 book, *Pathways to Tax Reform: The Concept of Tax Expenditures*.[173] As a result of his influence as a former Treasury official and his efforts as tax scholar in *Pathways* and otherwise, Congress officially adopted the concept of the tax expenditure budget in 1974.[174] At the time of his death in 1984, Surrey was working with his friend and frequent co-author, Professor Paul McDaniel,[175] to write the book *Tax Expenditures*.[176] Published after Surrey's death in 1985, *Tax Expenditures* in many ways laid the groundwork for the grand compromise between rate reduction and base broadening in the Tax Reform Act of 1986.[177] Paul McDaniel continued to write in this and many other areas until his death in 2010.[178]

The timing of Surrey's groundbreaking work regarding tax expenditures is especially relevant in the charitable context. In 1969, after more than a decade of investigations, hearings, and debates regarding the state of the charitable sector,[179] Congress made significant changes to the provisions of the Internal

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[171] Stanley S. Surrey was a Tax Professor, Tax Legislative Counsel in the 1940s, and the Assistant Secretary of Tax Policy through much of the 1960s. Through his roles in both the legislative and executive branches of the Federal government, Surrey saw first-hand how certain types of tax deductions, credits, or benefits were akin to spending from a budgetary perspective. At the end of his time at Treasury in the late 1960s and into the early 1970s, Surrey developed and refined the concept of the "tax expenditure," a phrase first coined publicly in 1967. *See generally* Reuven Avi-Yonah & Nir Fishbien, *Stanley Surrey, the Code and the Regime*, 25 FLA. TAX REV. 119 (2021); *see also* A HALF-CENTURY WITH THE INTERNAL REVENUE CODE: THE MEMOIRS OF STANLEY S. SURREY (Lawrence Zelenak & Ajay K. Mehrotra eds., 2022); Bernard Wolfman, *Tax Expenditures: From Idea to Ideology*, 99 HARV. L. REV. 491 (1985) (reviewing STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES (1985)).

[172] Stanley Surrey, Assistant Secretary of The Treasury for Tax Policy, Nov. 15, 1967, before the Money Marketeers, entitled "The United States Income Tax System – the Need for a Full Accounting." SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 3. In 1968, he introduces the first "Tax Expenditure Budget." Surrey himself references the speech on page vii of Pathways to Tax Reform.

[173] SURREY, PATHWAYS TO TAX REFORM, *supra* note 22.

[174] Avi-Yonah *supra* note 171, at 135; Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, 88 Stat. 297.

[175] Professor Paul McDaniel was a professor of law at Boston College at the time and would join the faculties of NYU and Florida. He is widely regarded as a pre-eminent tax scholar in the areas of tax expenditures, among many other things.

[176] SURREY, TAX EXPENDITURES, *supra* note 22.

[177] Avi-Yonah *supra* note 171, at 134.

[178] *Eminent Tax Scholar and Professor Paul McDaniel Dies at Age 74*, NYU L. NEWS (July 20, 2010), https://www.law.nyu.edu/news/PAUL_MCDANIEL.

[179] *See generally* Thomas A. Troyer, *The 1969 Private Foundation Law: Historical Perspectives on Its Origins and Underpinnings*, 27 THE EXEMPT ORGS. TAX REV. 52, 52 (2000).

Revenue Code regarding the regulation of charities and the charitable income tax deduction. The Tax Reform Act of 1969 ("TRA 1969")[180] introduced a number of changes that remain in the Code today, including the current version of the distinction between private foundations and public charities, and the resulting private foundation excise taxes.[181]

Importantly for our purposes, TRA 1969 considered significant changes to the charitable income tax deduction.[182] Proposals were on the table to do away with the charitable contribution deduction in full, or at least to significantly curtail the charitable deduction as it applies to the built-in gain in a donation of an appreciated asset.[183] While the charitable income tax deduction did indeed survive, the TRA 1969 brought about the general structure of Code Section 170 that we are familiar with today, including, for example, the AGI percentage limitations and the differential treatment of gifts of appreciated assets.[184]

The legislative fury around all things charitable spurred a number of significant works in the area of tax policy by some of the most respected tax lawyers at the time. According to Surrey and McDaniel, "in the 1960s the Treasury had taken a general position against the use of tax incentives to advance particular social policy goals and had instead urged the use of direct programs to provide the needed assistance."[185] This spawned further work in the charitable area by Surrey,[186] McDaniel,[187] and noted tax scholar Boris I. Bittker.[188]

B. Paul McDaniel and the Federal Matching Grant Proposal

As Stanley Surrey stated in *Pathways to Tax Reform*,

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180 Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487.

181 *See* Tax Reform Act of 1969 § 101, now codified in part at I.R.C. §§ 4940–4948; *see also* Paul Arnsberger, Melissa Ludlum, Margaret Riley & Mark Stanton, *A History of the Tax-Exempt Sector: An SOI Perspective*, STAT. OF INCOME BULL., Winter 2008, at 108, https://www.irs.gov/pub/irs-soi/tehistory.pdf.

182 *See* Tax Reform Act of 1969 § 201.

183 *See* Sheldon E. Steinbach, *Tax Reform and the Voluntary Support of Higher Education*, 8 U. RICH. L. REV. 245, 250 (1974).

184 *Id.*; *cf.* I.R.C. § 170(a)–(e) (West 2022); *see also* MARGOT L. CRANDALL-HOLLICK, CONG. RSCH. SERV., R46178, THE CHARITABLE DEDUCTION FOR INDIVIDUALS: A BRIEF LEGISLATIVE HISTORY (2020).

185 SURREY, TAX EXPENDITURES, *supra* note 22, at 2.

186 SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 223.

187 *See* Paul R. McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*, 27 TAX L. REV. 377 (1972) [hereinafter McDaniel, *Federal Matching Grants for Charitable Contributions*] discussed *infra* at Part IV.C. *See also* Paul R. McDaniel, *The Charitable Contributions Deduction (Revisited)*, 59 SMU L. REV. 773 (2006).

188 Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?*, 28 TAX L. REV. 37 (1972).

> the debate *[in 1969]* indicated that the financial concerns of the organizations . . . are strongly felt by the Congress, and the risks involved in making tax changes on the basis thereof seeing what the actual effects would be are too serious to permit that course to be followed. Tax reform must here also turn into the search for an alternative solution.[189]

Clearly, Congress was not inclined to abandon the charitable sector in 1969, despite its concerns. While some advocated for the complete repeal of the charitable deduction,[190] Congress was not willing to go that far. TRA 1969 tried to strike a balance between supporting the charitable sector while making important tax reforms. A similar situation faces any state legislature proposing to repeal its personal income tax—charitable tax income tax incentives will, by definition, be repealed as part of tax reform. If state legislators wish to support the charitable sector, then state tax reform must search for an alternative solution.

In Surrey's mind, the alternative solutions to facilitate government support of charitable giving were twofold: a matching grant program, which would incentivize charitable giving through direct government matches of private giving, or simply, an increase in direct government assistance.[191]

Paul McDaniel took on this issue directly in his 1972 article *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*.[192] At the time, Congress was incrementally raising the standard deduction[193]—similar to what occurred in 2018 with the increase in the standard deduction under the TCJA.[194] Critics argued that the increase in the standard deduction, coupled with the changes made in TRA 1969, would undermine

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[189] SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 228.

[190] McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 379.

[191] SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 231 ("If private choice and public expenditure at private command cannot survive openness, or if a workable matching system cannot be devised, and an alternative solution is still sought, then it must lie in other ways by which direct governmental assistance is given.").

[192] McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187.

[193] In 1969, there were two alternative standard deductions. As part of the Tax Reform Act of 1969, Congress set the minimum standard deduction at an amount equal to the poverty level; an alternative, percentage-based standard deduction was gradually increased starting from 10% of AGI amount capped at $1,000 in 1969 until it reached 15% of AGI with a $2,000 cap in 1973. Thus, at the time of Federal Matching Grants in 1972, the standard deduction was toward the end of the gradual increase set up by the Tax Reform Act of 1969. *See* John R. Brooks, *Doing Too Much: The Standard Deduction and the Conflict Between Progressivity and Simplification*, 2 COLUM. J. TAX L. 203, 213 (2011).

[194] *See* Tax Cuts & Jobs Act, Pub. L. No. 115-97, § 11021, 131 Stat. 2054 (amending Code Section 63(c)).

charitable giving[195]—again, very similar to what occurred in 2018.[196] As someone who witnessed the development of TRA 1969 first hand, McDaniel was also looking for an alternative solution, one that "would satisfy both the legitimate demand for tax reform and the very real and justified insistence on private philanthropy."[197]

To address this concern, McDaniel proposed replacing the federal charitable income tax deduction, a tax expenditure, with a direct expenditure: a federal charitable matching grant program.[198] In broad terms, McDaniel's proposal would work as follows:

(1) The donor would make a gift to a qualified charitable organization;
(2) The federal government would match the donor's gift in part; and
(3) The federal government would pay the matching amount directly to the charity in cash.

The key features of McDaniel's program are (1) a direct government subsidy; (2) resulting in cash in hand to the charity; (3) donor choice in identifying the recipient charity; and (4) an incentivizing effect of the program.

McDaniel's proposal was a direct match of charitable gifts made by individuals. The match would be on a sliding scale based upon the percentage of total income the taxpayer donated to charity.[199] The higher the percentage of income, the higher the percentage match amount. Thus, an individual that donated under 2% of their adjusted gross income would only earn a 5% match; in contrast, an individual that donated over 10% of their adjusted gross income would earn a 50% charitable match.[200] Accordingly, the system would still incentivize charitable giving in larger amounts.

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[195] *See, e.g.*, *Tax Reform Act of 1969: Hearing on H.R. 13270 Before the Comm. on Fin. U.S. S.*, 91st Cong. 78 (1969) (statement of William P. Thompson) ("We favor the separation of charitable contributions from the Standard Deduction, so that taxpayers who do not otherwise choose to itemize their deductions may claim the total of their charitable contributions."), https://www.finance.senate.gov/imo/media/doc/Prttax17.pdf; *see also* McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 382 ("The increase in the standard deduction in 1972 will automatically decrease the federal share for millions of gifts.").

[196] *See, e.g.*, *How Did the TCJA Affect Incentives for Charitable Giving?*, TAX POL'Y CTR. 1, https://taxpolicycenter.org/sites/default/files/briefingbook/how_did_the_tcja_affect_incentives_for_charitable_giving.pdf ("Overall, the TCJA will reduce the marginal tax benefit of giving to charity by more than 30 percent in 2018, raising the after-tax cost of donating by about 7 percent. Unless taxpayers increase their net sacrifice—that is, charitable gifts less tax subsidies—charities and those who benefit from their charitable works, not the taxpayers, will bear the brunt of these changes.").

[197] McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 378.

[198] *Id.*

[199] *Id.* at 397.

[200] *Id.* at 397–98.

Under both the current federal deduction and McDaniel's matching program, the donor chooses the charity. In order to select the charity for the match, McDaniel envisioned that a donor could name the charities to receive matching funds on their income tax return.[201] The current definition of a charitable contribution would remain, with organizations listed in Code Section 170 maintaining their eligibility for the match.[202] Treasury would accumulate all of the matches designated by taxpayers, and forward a check to the charity on a regular basis.[203]

McDaniel set his original percentage tax table in a direct expenditure amount equal to the tax expenditure value of the charitable deduction in the 1971 fiscal year. He envisioned a ten-year appropriation to a matching fund to take into account inflation and variations in the system.[204] As a result, his intent was that the direct matching program would have the same budgetary impact as the charitable deduction as a tax expenditure item.[205]

Although McDaniel's federal charitable matching program never came to pass, the idea did not disappear. As recently as October 2024, Robert McClelland, a senior fellow at the Urban-Brookings Tax Policy Center, wrote an opinion piece in the Chronicle of Philanthropy, suggesting that the sunset of many of the provisions of the TJCA presented an opportunity to radically reform the charitable deduction. In fact, McClelland suggests replacing the charitable deduction with a matching grant program.[206] McClelland's program varies from McDaniel's proposal in its details—for example, charities would report eligible contributions rather than donors and it does not appear that McClelland would adopt McDaniel's sliding match scale. Nevertheless, the idea of matching grants versus charitable incentives has certainly not left the discussion.[207]

C. A Summary of Practical Critiques of Charitable Tax Incentives

Charitable incentives, whether as tax expenditure incentives or direct expenditure matching programs, are not without critics. In fact, Surrey and McDaniel were critics of charitable tax incentives, which lead to the development of the matching program in the first place.[208] Even though the

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201 *Id.* at 398.

202 *Id.* at 399.

203 *Id.* at 398–99.

204 *Id.* at 399.

205 *Id.* at 402.

206 Robert McClelland, *The Case for Doing Away with the Charitable Deduction*, THE CHRON. OF PHILANTHROPY (Oct. 1, 2024), https://www.philanthropy.com/article/the-case-for-doing-away-with-the-charitable-deduction

207 *Id*.

208 *See* McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 379; *see also* SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 223–32.

matching program was designed to address the weaknesses of charitable tax incentives, the matching program was also subject to criticism. At the time, influential tax scholar Boris Bittker wrote his own article in direct response to McDaniel's *Federal Matching Grants* proposal.[209]

It is impossible to review all of the scholarly work on issues such as the influence of charitable tax incentives,[210] tax expenditures,[211] and the relative efficacy of direct grants versus tax incentives[212] that occurred in between TRA 1969 and the present. Hopefully, a brief overview of the issues raised by Surrey, McDaniel, and Bittker will outline the development of a framework that could take the place of state level income tax incentives.

Distinguishing Between Existing and Incentivized Gifts. Bittker noted that one of the primary issues with charitable incentivization provisions is that it is hard to determine which gifts would have occurred in the absence of the tax incentives, and which gifts would not have.[213] McDaniel acknowledged that there may be an incentivizing effect of the federal charitable income tax deduction, although most of his analysis simply assumes its existence for purposes of the article.[214] Paul McDaniel was skeptical of the incentive effect, thinking of the charitable deduction as merely a way to convey a federal subsidy:

> The concern of charity is not that private giving will be reduced if the deduction is repealed; it is that the federal government will reduce the financial support to charity currently made available through the deduction. Indeed, it is difficult to see how

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[209] Bittker, *supra* note 188. Both McDaniel's and Bittker's papers were delivered at a 1971 symposium sponsored by the Tax Institute.

[210] For examples of recent economic research, *see*, e.g., Nicolas Duquette, *Do Tax Incentives Affect Charitable Contributions? Evidence from Public Charities' Reported Revenues*, 137 J. Pub. Econ. 51, 51 (2016) ("A one percent increase in the tax cost of giving causes charitable receipts to fall by about four percent, an effect three times larger the consensus in the literature."); Huber, *supra* note 20, at 631 ("In conclusion, both theoretical and empirical research argues that incentivizing charitable giving via tax incentives (especially tax deductions) is not the most equitable and/or the most efficient policy option, at least concerning the current forms of tax incentives. Financial incentives structured as direct expenditures, such as matching grants for charitable donations, may be a more suitable policy option.").

[211] *See, e.g.*, Daniel N. Shaviro, *Rethinking Tax Expenditures and Fiscal Language* (N.Y.U. Ctr. for L. & Bus., Working Paper No. CLB 03-20, 2003).

[212] *See, e.g.*, Christopher Howard, *Testing the Tools Approach: Tax Expenditures Versus Direct Expenditures*, 55 PUB. ADMIN. REV., 439 (1995); Joel Michael, *Tax Expenditures vs. Direct Expenditures: A Primer*, Minn. House Rsch. (December 2018), https://www.house.mn.gov/hrd/pubs/taxvexp.pdf.

[213] Bittker, *supra* note 188, at 38.

[214] McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 382 ("Assuming the deduction operates as an incentive for charitable giving, it is appropriate to analyze its dimensions as an incentive program"); *see also id.*, at 383–84 ("the proponents of the deduction insist the federal matching grant is an incentive to private giving. Accepting that proposition . . .").

> elimination of the charitable contribution deduction would have an adverse impact on private giving to charity. [215]

McDaniel immediately acknowledged, however, the testimony at 1969 Congressional hearings from representatives of large donors, who indicated that there would be a median reduction in charitable contributions of 75% if the charitable income tax deduction were repealed.[216]

Since that time, there has been some economic work to indicate that state charitable incentives, and specifically state tax credits, do have an incentivizing effect. Researchers examined the impact of two state tax credits—one with a cap of $100 in Michigan and another with a $10,000 cap in North Dakota—for incentivizing impact.[217] This research found that there was an incentivizing effect for credits with higher caps. Another study, looking at credits in Arizona and Iowa, had similar findings.[218]

Because charitable tax incentives are more effective with larger gifts and higher income taxpayers, McDaniel,[219] Bittker,[220] and others have voiced concern over the disproportionate influence wealthy taxpayers have over the distribution of charitable dollars.[221] With the federal charitable deduction, "the amount of public funds which a private person can allocate depends on his marginal tax bracket and hence his income position and wealth generally."[222] With a state credit, this issue may be less pronounced, as many states have a more

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215 *Id.* at 379.

216 *Id.* at 381–86 (". . . the assumption that high bracket donors will reduce their donations by 100 per cent of the increased tax costs resulting from repeal of the deduction is an extreme one, not justified by the verifiable data.").

217 Anubhav Gupta & Thomas L. Spreen, *Do Tax Credits Benefit Charities? Evidence From Two States*, 42 CONTEMP. ECON. POL'Y 1, 94 (2024); see also Nicolas J. Duquette, Alexandra Graddy-Reed & Mark Phillips, *The Effectiveness of Tax Credits For Charitable Giving* (2018), https://ssrn.com/abstract=3201841.

218 Daniel Teles, *Do Tax Credits Increase Charitable Giving? Evidence from Arizona and Iowa* (2016), https://ntanet.org/wp-content/uploads/proceedings/2016/152-teles-tax-credits-increase-paper.pdf.

219 McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 390.

220 Bittker, *supra* note 188, at 42. Bittker sees this issue with both a deduction and a matching grant program ("If the rich now give to private universities and the poor to churches, for example, and the deduction is repealed, the post repeal pattern of charitable receipts would depend on whether these groups respond differently to loss of a tax deduction.").

221 SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 231 (referencing Paul McDaniel's effort "to inject widespread pluralism into the allocation of Government funds going to philanthropy in contrast to the restricted character of the present 'tax pluralism.'").

222 *Id.* at 225.

compressed rate system,[223] or even a flat rate.[224] Accordingly, this is distributional issue shows up in two alternative ways: the difference between those who pay tax and those who do not (for whom a non-refundable credit has no utility)[225] or in minimum gifts to be credited or matched, which may be out of the reach of lower income taxpayers that do not have dollars available to donate the minimum amount.[226]

Budgetary Costs versus Cash in Hand. While there is no doubt that a charitable tax incentive "costs" the government a certain amount, that does not translate directly to charitable organization "receipts." The federal charitable incentive subsidizes giving, but it is only passed to the charity in the form of actionable cash only to the extent that the donor translates that subsidy to donation. Thus, the question of whether the deduction constitutes an incentive becomes critical when one looks at the question of cash in hand to the charity as opposed to total economic outlay to the system.

Impact of Other Tax Items. McDaniel and many others rightfully note that the federal charitable deduction is only available to taxpayers who itemize,[227] so the deduction's incentivizing effect is necessarily limited to those who qualify for it.[228] This criticism is not, however, necessarily true of a state income tax incentive, since many state income taxes begin with federal adjusted gross income (that is, federal income before the standard deduction or itemized

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[223] For example, for 2023, West Virginia had personal income tax rates ranging from 2.36% to 5.12%. *Taxes in West Virginia*, TAX FOUND., https://taxfoundation.org/location/west-virginia/#:~:text=West%20Virginia%20Tax%20Rates%2C%20Collections%2C%20and%20Burdens&text=West%20Virginia%20has%20a%20graduated,percent%20corporate%20income%20tax%20rate (last visited Nov. 25, 2024).

[224] As of February 2024, twelve states have flat personal income tax rate, with a thirteenth state (Iowa) in the process of moving to a flat tax. Jared Walczak & Katherine Loughead, *The State Flat Tax Revolution: Where Things Stand Today*, TAX FOUND. (Feb. 15, 2024), https://taxfoundation.org/blog/flat-tax-state-income-tax-reform/.

[225] According to the Institute on Taxation and Economic Policy, the lowest 20% income tax group, with an income of under $18,100, paid .06% of all personal income taxes. Since this group pays very little in personal income tax, a personal income tax credit would be of little use. *See West Virginia: Who Pays? 7th Edition*, INST. ON TAX'N & ECON. POL'Y (Jan. 9, 2024), https://itep.org/west-virginia-who-pays-7th-edition/.

[226] For example, West Virginia has a minimum contribution amount of $500. W. VA. CODE ANN. § 11-13J-3(b)(D) (West 2016) ("No contribution of cash, stock, property or professional services or any combination thereof contributed in any tax year by any taxpayer having a fair market value of less than $500 qualifies as an eligible contribution.").

[227] I.R.C. § 63(a), (b) (West 2020); *see also* Gupta, *supra* note 217, at 95 ("State-level giving preferences are notable because the majority of federal income taxpayers use the standard deduction, which renders them unable to realize the itemized deduction for charitable contributions.").

[228] Of course, the TCJA also introduced an above the line charitable deduction of up to $300, so this criticism is blunted, to some small effect, about this recent change.

deductions) as the initial tax base.[229] Accordingly, in many instances, the availability of the federal standard deduction is irrelevant to a state incentive analysis.

Another of McDaniel's criticisms of the incentive impact of the federal charitable deduction is that the amount of taxpayer's giving may be limited other issues that are separate from pure charitable considerations. Specifically, for the taxpayer who itemizes, the tax benefit of the deduction will be impacted by the other itemized deductions available to the taxpayer, such as the mortgage interest deduction.[230] Again, while this may be a valid criticism of the federal income tax deduction, it is not as applicable to a state income tax credit. In any case, divorcing charitable giving incentivization from the income tax system means that the collateral impacts of other income tax attributes should mostly be eliminated.

Private Choice and Privacy. One of the greatest concerns about any charitable giving incentive structure is preserving private donor choice and privacy.[231] McDaniel's matching grant program attempts to preserve donor choice by continuing to use the broad base of the existing definition of charitable donations for the income tax deduction, so that element of donor choice should not be compromised.[232] Bittker acknowledges that it could be possible to set up a matching grant system using existing charitable definition, but warns that a matching grant program could be structured to favor or disfavor certain charities.[233] Accordingly, the outlines of any state level matching program should be wary of this concern.

V. A CASE STUDY: CAN MCDANIEL'S CHARITABLE MATCHING GRANTS PROGRAM REPLACE THE NIP CREDIT?

In *Federal Matching Grants*, McDaniel notes that in the TRA 1969 charitable deduction discussions, Congress specifically contemplated a variety of different tax-based mechanisms to address charitable income tax reform, including a federal credit structure. The concern for McDaniel at the time was that tax-based alternatives can "alleviate, but do not eliminate tax inequity."[234]

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[229] As of 2023, thirty-one states, including West Virginia, start with federal AGI as the initial tax base, thereby excluding the standard deduction from the state tax base. *How Do State Individual Income Taxes Conform with Federal Income Taxes?*, TAX POL'Y CTR., https://taxpolicycenter.org/briefing-book/how-do-state-individual-income-taxes-conform-federal-income-taxes#:~:text=Of%20the%2041%20states%20with,(AGI)%20as%20of%202023 (last visited Nov. 25, 2024).

[230] McDaniel, *Federal Matching Grants for Charitable Contributions supra* note 187, at 383.

[231] Bittker, *supra* note 188, at 45.

[232] McDaniel, *Federal Matching Grants for Charitable Contributions supra* note 187, at 398–99.

[233] Bittker, *supra* note 188, at 46.

[234] McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 378.

In the case of state income tax repeal, however, the concern is that none of the deduction or credit-based alternatives that Congress proposed in TRA 1969 work in a system where there is no longer an income tax.

If West Virginia does fully repeal its personal income tax, the NIP credit will no longer be functional as an incentive for charitable giving or as a source of support for West Virginia's nonprofit sector. However, in the NIP credit, West Virginia may have come close to experimenting with Professor McDaniel's matching grant concept on a state level, forming the base for an alternative system post-personal income tax repeal.

West Virginia NIP's credit already has significant similarities with McDaniel's matching grant program proposal. Each program essentially acts as a matching gift, where the government provides a sum certain that is a percentage of the donor's gift to the charity. A matching program that would replace the NIP credit need not adopt McDaniel's sliding scale of matching percentage, which was tied to the donor's income.[235] Rather, a West Virginia program could simply adopt a percentage match that would generate the same economic result as the current credit.

By way of example, with the NIP credit program, the charity receives tax credit vouchers from the government, which the charity exchanged with donors for donations; in turn, the donor exchanges the credit voucher with the state government for a dollar-for-dollar reduction in taxes.[236] For example, using a minimum gift of $500 and the NIP credit's 50% match, the donor donates $500 to an eligible charity, and receives a $250 tax voucher from the charity in return. The donor receives $250 in tax credit against their taxes, paid for by West Virginia. As a result, the charity selected by the donor has $500; the donor has paid $250 in net gift ($500-$250 in returned taxes) and the state paid $250. With a federal matching grant program, the process is actually much simpler. A donor donates $250 to a qualified charity; the state could make a 100% match and pay $250 to the charity. The economic result is the same: the charity has $500, $250 from the donor and $250 from the state. Under both the credit program and the matching grant program, however, the charity actually has cash in hand—not just the promise of increased charitable giving of an indeterminable amount through the inefficient mechanic of a charitable deduction.

In both programs, the process is triggered by a gift from donors to a charity of their choice; thus, both programs emphasize the importance of private donor selection.[237] For donors, a matching program may be administratively simpler—they would trigger the match by simply donating to a qualified charity.

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[235] *Id.* at 399.

[236] *See* Form WV/NIPA-1 (on file with author); Form WV/NIPA-2, *West Virginia Neighborhood Investment Program Credit Schedule*, W. VA. STATE TAX DEP'T, https://tax.wv.gov/documents/taxforms/2015/nipa2.pdf.

[237] Bittker, *supra* note 188, at 39 ("Matching grants have at their core the concept of private choice; the grants are to go to institutions designated by private persons in a particular way, *i.e.*, by putting their money on the line.").

Rather than obtaining the tax credit documentation from the charity and then attaching that documentation to their tax return, the taxpayer would simply donate to an eligible charity. Similarly, charities would not need to be in the messy business of allocating their NIP credit among donors or turning away donors for having insufficient credit;[238] the charity would simply report eligible donations to the Development Office[239] for its allocable portion of the match.

Bittker rightly was concerned that a federally run matching program could be manipulated to serve specific purposes;[240] McDaniel's response to Bittker's concern was that the then existing definition of charitable contributions in Code Section 170 should continue to be utilized.[241] Similarly, the NIP credit program already has a robust definition of eligibility for West Virginia social service agencies; state nonprofits and donors are used to these definitions and the process by which a charity is deemed a qualified recipient.[242] The Development Office has been approving NIP credit recipient organizations since the inception of the program, and ultimately, the current credit only is valuable to the extent a taxpayer chooses to donate to a qualified charity. By importing the existing definition of neighborhood organizations from the current NIP credit program, a matching grants program would give the full range of existing donor choice afforded by the NIP credit, limit Bittker's concern regarding government manipulation, and provide a sense of stability to donors and charities. Moreover, by requiring qualified charities to provide programming in local communities, West Virginia's charitable monies stay in West Virginia.

This is not to say that McDaniel and Surrey would have necessarily approved of the West Virginia NIP credit as it exists—it is, after all, still a tax expenditure program. The minimum donation for the credit—currently, $500—is out of reach of many low-income taxpayers. The current NIP credit does not fully address McDaniel's concern that incentivization through the tax code exacerbates equality and equity concerns, as only wealthier taxpayers generally benefit from the program. The structure of the current NIP credit does, however, minimize the criticisms that McDaniel levels at the federal charitable deduction, as state income tax rates are compressed, and the state income tax begins with AGI.[243] However, McDaniel's equity concerns go away when a credit is replaced with a state matching program. No longer do structural issues inherent in the personal income tax—such as the role of the standard deduction with regard to

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238 See comments of nonprofits, *supra* notes 137–39.

239 For more information on the West Virginia Community Advancement and Development Office, see W. VA. CAD, https://wvcad.org/.

240 See discussion at *supra* note 233.

241 McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 399.

242 See discussion of the definition of neighborhood organizations undertaking community development projects, at *supra* notes 123–29.

243 See discussion at *supra* notes 227–30.

the federal charitable deduction[244]—impact who is incentivized to give by the credit. If desired, a new matching grant program could allow lower and middle-income donors to benefit their local community organizations by lowering the amount of the minimum charitable gift subject to match (for example, lowering the minimum gift from the NIP credit's current floor of $500 to possibly $100). McDaniel observed that increasing participation by lowering the minimum gift eligible for the match would be possible in his proposed federal program, with the primary concern being administrative inefficiency for very small gifts.[245]

The creation of a state level matching program no doubt will raise concerns about funding and creating a new agency to oversee a new program. This will be less of an issue in West Virginia, because the existing, robust NIP credit system with a budget allocation already exists. The NIP credit program is currently funded to the extent of $3 million[246] and overseen by an existing agency, the Development Office, which could take over the administration of the matching gift program. The initial state matching program could be funded with the same $3 million pool of funds currently set aside for the credit. Charities would still need to apply to qualify for the matching program and receive a proportionate allocation of the matching pool. This means that the matching grant program would have essentially the same level and predictable state budget impact as the current credit program.[247] In addition, the existing credit program charges a fee to qualify an organization for credits, which offset existing costs.[248] Similarly, the state could charge an organization a fee to be designated as a neighborhood organization eligible for the charitable match. Finally, as the West Virginia Department of Revenue will no longer be involved as a "middleman" in processing the tax credit, there may be some opportunity to re-direct those resources.

One limit to consider is whether a matching program would be legally limited in the types of programs it could support. As Surrey and McDaniel originally noted, tax expenditures in the form of tax credits or deductions are important where there may be legal limits on the ability of the state to act directly with a grant program. On the federal level, for example, there may be limitations on direct grants to churches under the First Amendment. At the time, Surrey and

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[244] SURREY, PATHWAYS TO TAX REFORM, *supra* note 22, at 227 ("The tax unfairness of the deduction methods in its favoritism for the upper-bracket taxpayers is also evident. Moreover, for many charitable organizations the trend toward expansion of the standard deduction in . . . means the elimination of the explicit recognition of the charitable deduction.").

[245] McDaniel, *Federal Matching Grants for Charitable Contributions*, *supra* note 187, at 397 ("Throughout this article it is assumed for ease of analysis that all contributions, regardless of size, will be matched. Very small gifts, by their sheer numerical volume, might create an unacceptable administrative burden.").

[246] See discussion at *supra* notes 115–16.

[247] See discussion at *supra* note 117.

[248] See W. VA. CODE ANN. § 11-13J-4(b) (West 2016) (generally imposing a 3 percent of the total amount of eligible contributions received).

McDaniel asked whether it would be possible for the state to make a direct grant of state funds to parents who send their children to religious schools, for example[249]—a question that was recently before the Supreme Court.[250] Current Supreme Court jurisprudence would likely support some participation in a state matching grant program by religiously-affiliated entities for purposes unrelated to worship.[251]

VI. CONCLUSION

Many states have considered lowering or repealing their state personal income tax in the name of competitiveness and growth. Even the conservative think tank, The Tax Foundation, recognized that this approach to tax relief comes at a cost. The Tax Foundation observed:

> Reducing reliance on the individual income tax often works in service of that aim, but when the goal is competitiveness and not just income tax relief, the importance of evaluating trade-offs comes more fully into view.[252]

While The Tax Foundation was not referencing charitable tax incentives so much as it was discussing sales tax and other revenue offsets that fund personal income repeal, the impact of income tax repeal on charity should be considered as an additional, if hidden, cost.

That being said, the charitable sector has and will continue to be a vital source of support for community improvement and social services in many states, including those advocating for personal income tax repeal. Bittker noted that the charitable deduction can be premised on the idea that charities "are doing socially essential work that otherwise would have to be carried on by government agencies, but that can be performed with more imagination, diversity, flexibility or economy by private groups."[253] Unfortunately, some of the states considering income tax repeal are disproportionately rural and do not have a significant endowment or donor base compared to more urban counterparts upon which to rely. For these states, continuing to incentivize charity giving in the absence of tax incentives will be of critical importance, but will require some creativity and flexibility.

Although Paul McDaniel's matching grant program was developed in

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[249] SURREY, TAX EXPENDITURES, *supra* note 22, at 28.

[250] *See* Carson v. Makin, 142 S. Ct. 458 (2021) (extending a Maine private school subsidy program for rural students to religiously affiliated schools); Espinoza v. Mont. Dep't of Revenue, 591 U.S. 464 (2020) (extending private school subsidy programs to religiously affiliated schools).

[251] *See, e.g.*, Trinity Lutheran Church of Columbia v. Comer, 582 U.S. 449 (2017) (allowing a religious school to participate in a Missouri state program that provided shredded recycled tires for playground matting).

[252] Walczak, *supra* note 1.

[253] Bittker, *supra* note 188, at 39.

another era to address federal charitable deduction tax issues, it can be used to provide the creativity and flexibility necessary to address each state's specific needs and tax structure. As West Virginia moves toward full personal income tax repeal, it can be a leader in this space. Because of its strong support of the nonprofit sector through the NIP credit, it has the experience and infrastructure to reimagine the tax credit program as a matching grant. Hopefully, West Virginia can demonstrate that charitable tax expenditures aren't the only way to signal the importance of the nonprofit sector in the lives of its citizens.