SB 969

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

Senate Bill 969 (Senator Colburn)
Budget and Taxation

Income Tax Subtraction Modification - Charitable Donations - Partial Interests in Property

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This bill creates a subtraction modification against the State income tax for an in-kind donation of rental space to a nonprofit organization that is a partial interest to which Section 170(F)(3)(A) of the Internal Revenue Code (IRC) applies. The amount of the subtraction modification is equal to the fair market value of the eligible donation if the donation is not allowed under Section 170 of the IRC.

The bill takes effect July 1, 2009, and applies to tax year 2009 and beyond.

Fiscal Summary

State Effect: General fund revenues will decrease significantly beginning in FY 2010 due to subtraction modifications claimed against the personal and corporate income tax. Transportation Trust Fund (TTF) revenues may decrease beginning in FY 2010 due to subtraction modifications claimed against the corporate income tax. General fund expenditures increase by $40,400 in FY 2010 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

Local Effect: Local revenues may decrease significantly beginning in FY 2010 due to a reduction in local income tax revenues and local highway user revenues. Expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Current Law: Maryland conforms to the federal income tax treatment of partial interest donations of rental space to nonprofit organizations. Only donations that qualify under the federal income tax can be taken for State income tax purposes.

Background: Subject to certain limits, Section 170(a) of the IRC allows as a deduction any charitable contribution made during the tax year. In order to be deductible, the contribution must qualify as a gift in the common law sense of being a voluntary transfer of property by the owner to another without consideration. If the donor receives, or can reasonably expect to receive, a financial or economic benefit commensurate with the money or property transferred, no deduction under Section 170 is allowed.

Section 170(F)(3)(A) denies taxpayers a charitable contribution deduction for certain contributions of partial interests in property. Section 170(F)(3)(A) provides, in part, that in the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall only be allowed if such interest had been transferred in trust. A contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

Section 170(F)(3)(B) and income tax regulations provide, as an exception, that a deduction is allowed under Section 170 for a contribution not in trust of a partial interest that is less than the donor's entire interest in property if the partial interest is an undivided portion of the entire interest. An undivided portion of a donor's entire interest in property must consist of a fraction or percentage of each and every substantial or right owned by the donor in such property and must extend over the entire term of the donor's interest in such property and in other property into which such property is converted. A charitable contribution in perpetuity of an interest in property not in trust where the donor transfers some specific rights but retains other substantial rights will not be considered a contribution to which Section 170(F)(3)(A) does not apply. A donor is not entitled to a charitable contribution if the donor has retained substantial rights in the contributed property.

Section 170(F)(3)(A) and federal income tax regulations treat a contribution of the right to use property that the donor owns, such as a contribution of a rent-free lease, as a contribution of less than the taxpayer's interest in the property. The Internal Revenue Service stated in *Revenue Ruling 2003-28* that in enacting Section 170(F)(3) the U.S. Congress was concerned with situations in which taxpayers might obtain a double benefit by taking a deduction for the present value of a contributed interest while also excluding from income subsequent receipts from the donated interest. Concern also existed with situations in which, because the charity does not obtain all or an undivided portion of significant rights in the property, the amount of a charitable contribution deduction might not correspond to the value of the benefit ultimately received by the charity.

State Revenues: The bill will decouple the State income tax from federal income tax treatment of partial interest donations of rental space to charities. Taxpayers can claim a subtraction modification beginning in tax year 2009 equal to the fair market value of the eligible donation of rental space. As a result, general fund and TTF revenues may decrease beginning in fiscal 2010. However, the amount of the revenue loss cannot be reliably estimated and depends on the number of entity sales that qualify for the subtraction modification and the income resulting from these sales. This amount may be significant in any given year.

Exhibit 1 illustrates the potential State and local revenue loss from a business that makes a qualifying donation of 1,000 square feet of office rental space in Annapolis to a nonprofit organization under the corporate income tax, and for pass-through entities that file under the personal income tax.

Exhibit 1
Potential Impact of Exemption Claimed by One Qualifying Business

Corporation		**Pass-through Entity**	
General Fund	$2,037	State Income Tax (General Funds)	$1,519
Transportation Trust Fund	521	Local Income Tax	930
MDOT	*365*		
Local Highway Revenues	*156*		
Total Revenues	**$2,558**	**Total Revenues**	**$2,449**

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $40,400 in fiscal 2010 to add the subtraction modification to the personal and corporate income tax returns. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

Local Revenues: Local income tax revenues may decrease by about 3% of the total subtraction modification claimed against the personal income tax and local highway user revenues may decrease as a result of subtraction modifications claimed against the corporate income tax.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Cushman and Wakefield, Internal Revenue Service, Department of Legislative Services

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