

# The CARES Act Charitable Deduction and State Conformity

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In this installment of Classroom Corner, Eze and Ruiz examine a CARES Act provision that provides a deduction for donations made to charitable organizations in 2020 and how state governments have been faced with the difficult decision of whether to incorporate similar provisions in their tax codes.



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In the midst of the coronavirus pandemic, Congress passed the ambitious Coronavirus Aid, Relief, and Economic Security Act to shore up the American economy and soften the blow of stay-at-home orders in various states. One important but little-noted provision of the statute was [section 2204](#) — which provided a \$300 above-the-line deduction for donations made to charitable organizations in 2020. But while [section 2204](#) offers a deduction at the federal level, state governments have been faced with the difficult decision of whether to incorporate similar provisions in their state tax codes. This debate has confronted state governments with two choices: most immediately, whether to incorporate [section 2204](#) in their state tax systems for 2020; and more broadly, whether and how to subsidize charitable giving through state tax law thereafter.

Eighteen states and the District of Columbia practice rolling conformity — their tax provisions automatically revise in accordance with changes made to the Internal Revenue Code.<sup>1</sup> Conformity potentially makes tax compliance more straightforward for individuals, as it spares them the hassle of calculating their income according to two separate legal regimes (federal and state). But while conformity may have its administrative benefits, it also has downfalls. For example, rolling conformity may undermine political accountability by causing voter confusion about which representatives are responsible for which tax policies. And it potentially limits local regulatory experimentation — a distinct benefit of federalism.<sup>2</sup> There are good reasons why a state might want to modify or decouple from the federal tax code. For example, the state may want to raise additional revenues or may have concerns about the local effects of conformity. Federal tax law is often made with a general viewpoint that may overlook local conditions.

In an earlier piece,<sup>3</sup> classmates Rebecca Roman and Sasha Timakova argued that rolling conformity states should decouple from the deferral-of-loss limitations in section 461(1). But decoupling from some aspects of the federal tax code should not necessitate decoupling from the entire federal tax code. In this piece, we argue that rolling conformity states should continue to conform to the federal tax code as it pertains to charitable deduction rules. We use Illinois — the state where we attend law school — as the focus of our analysis, though our arguments apply generally to other rolling conformity states as well.

While conformity to new provisions of the CARES Act is likely to reduce the revenue that Illinois and other conforming states raise in 2020, the effect of decoupling from this provision would be to place undue burdens on low- and middle-income earners. Especially in the wake of the recent economic downturn, we argue that conforming to this aspect of the IRC is the best approach.

## CARES Act [Section 2204](#)

The CARES Act was enacted March 27 to provide stimulus for businesses, nonprofits, and individuals affected by the COVID-19 pandemic. Normally, charitable contribution deductions are below the line and thus available only to taxpayers who itemize. [Section 2204](#) expands that benefit, allowing taxpayers who do not itemize in 2020 to deduct up to \$300 of contributions above the line.<sup>4</sup> If an individual is able to deduct charitable contributions above

the line, that lowers adjusted gross income, which is the starting point for the calculation of state tax liability in conforming states. Thus, [section 2204](#) will reduce tax revenue in conforming states such as Illinois.

With some back-of-the-envelope calculations, we anticipate that Illinois stands to lose \$20 million to \$30 million if it automatically conforms to [section 2204](#).<sup>5</sup> That is no small amount. And it comes at a time that Illinois can ill afford a reduction in revenue. Illinois has had to borrow \$1.2 billion in emergency funds from the Federal Reserve to balance parts of its budget.<sup>6</sup> And Gov. J.B. Pritzker (D) has even asked the heads of state agencies to prepare for 5 percent cuts this year and 10 percent cuts for 2021.<sup>7</sup> With the coronavirus-depressed economy expected to linger on as a recession even after the economy opens back up, every dollar that Illinois can keep for schools, jobs, and infrastructure counts.

Even so, the \$20 million to \$30 million at stake is only about 0.1 percent of the money Illinois expects to receive in income tax revenue in fiscal 2021.<sup>8</sup> We expect that the cost of conforming to [section 2204](#) will be a similarly small percentage of revenue in other states as well. And despite the revenue consequences, we believe that rolling conformity remains the optimal approach here.

The principal beneficiaries of [section 2204](#) will be non-itemizers who donate to charitable organizations. More than likely, such beneficiaries are middle-income taxpayers who donate a few hundred dollars a year to charitable causes they care about. And the deduction may also affect low-income contributors; some data suggest that the average giving by taxpayers who make around \$30,000 annually is around \$450.<sup>9</sup> Conversely, wealthier taxpayers are less likely to reap benefits from [section 2204](#) (and thus states conforming to [section 2204](#)) because they are more likely to itemize.

Because Illinois does not allow a state income tax itemized deduction for charitable contributions, rolling conformity here would produce different treatment between itemizers and non-itemizers. We believe, though, that this differential treatment is tolerable. In Illinois, where the state tax rate is a flat 4.95 percent, the maximum state-level tax benefit from conformity to [section 2204](#) is 4.95 percent x \$300, or \$14.85. In general, \$14.85 means much more to non-itemizing taxpayers, who tend to have lower income, than to itemizers, who tend

to have more income. Rolling conformity to [section 2204](#) adds a small measure of progressivity to what is now a flat rate state income tax structure.

## Policy Considerations

### Distributional Concerns

In the current economic environment, every dollar counts. The \$20 million to \$30 million figure is not easy to dismiss and could make a big difference if used to pay teacher salaries or support a dozen small businesses on the verge of failure.<sup>10</sup> But if Illinois chose nonconformity, we worry about who would bear the brunt of this burden: middle-income taxpayers who don't itemize but donate to good causes.

High-income earners are much more likely to itemize their deductions than middle-income ones.<sup>11</sup> States that decouple from [section 2204](#) will draw that additional revenue from people who are very likely to struggle in the COVID-stricken economy. In other words, the people most likely to benefit from a reduction of taxable income above the line might be those in the middle-income range, for whom up to \$300 of tax deductions (or \$14.85 of tax benefits) would make a difference. If Illinois decouples from this provision, it will be these lower- to middle-income taxpayers who bear the additional tax burden.

### Complexity

Similarly, we might also worry about making the tax code even more complicated for middle-income taxpayers. One benefit of conformity is that the AGI at the federal level carries over into the assessment basis at the state level. But when states do not conform, they add additional work for taxpayers. This additional work is costly, either in terms of added time to fill out the forms or the increased cost of hiring a professional. And again, the burden of this change falls on the taxpayers least well equipped to pay in additional economic/opportunity costs.

### Incentives for Charitable Giving

Along with being less complex and administratively burdensome, conformity here may have a positive, or at least non-negative, impact on charitable giving. Provisions like [section 2204](#)

lower the cost of charitable giving by allowing taxpayers to deduct whatever they contribute from their reported income. State tax conformity lowers the cost of charitable giving further. The worry here is that nonconformity will discourage middle-income people from donating to charitable causes (or, at least, do less to encourage them).

Note that most taxpayers who take the standardized deduction will do so with or without the provision (most taxpayers with incomes under \$100,000 claim the standard deduction).<sup>12</sup> Once taxpayers know they will claim the standard deduction, there is an incentive to find some charitable giving that can lower their tax burdens, because the benefit of a deduction will always be there to claim once they decline to itemize. At the margin, nonconforming may therefore dissuade contributions to nonprofits that are struggling.

## The Value of Giving Charitably Overall

It is also worth looking at the issue on a global scale: Do we want to subsidize charitable giving in the first place? At a time when budgets — and therefore social programs — will be constrained, a dollar in public spending might go a lot further than a dollar spent by a charitable organization. But there are reasons to doubt this is the case here. First, charitable organizations tend to be more nimble than local governments — for example, a church can go from directing donations to a soup kitchen in one month to a homeless shelter the next, depending on need. Governments have a harder time doing that, because they are by their nature political and more vulnerable to infighting and stagnation. Second, people likely *feel* better donating to charitable causes than they do paying more in taxes. At a time of overall low morale, we might value the joy people get from donating to their favorite causes. Lastly, charitable organizations are themselves important parts of the local economy. Nonprofits hire local citizens, spend money with local businesses, and facilitate enterprise between members of the community who otherwise would not cross paths.<sup>13</sup>

## Alternatives

While we recommend that states like Illinois continue to conform to [section 2204](#), we recognize that the potential revenue that could be gained by decoupling may be more persuasive to state officials than our policy arguments listed here. In that case, policymakers keen on decoupling could take a possible middle ground: conforming for charitable contributions made to in-state nonprofits.

While no states adopt this approach now, this middle road could build a sense of solidarity among state residents and encourage them to channel the benefits of charitable giving to their neighbors and communities. This option might become even more attractive if Congress ends up adopting a proposal by a bipartisan group of senators to increase the above-the-line charitable deduction from \$300 to \$4,000 for single taxpayers and \$8,000 for individuals filing jointly.<sup>14</sup> An over-tenfold increase in the above-the-line charitable deduction would make limiting conformity to in-state contributions more attractive. First, an expanded contribution limit would take a bigger chunk out of state revenue. While a state like Illinois can stomach a revenue hit of \$20 million to \$30 million, it would have a harder time giving up revenue well over \$100 million. Second, limiting the deduction to in-state charities could strengthen solidarity within the state and boost the morale of citizens during uncertain times.

We acknowledge three potential concerns regarding this proposal. First, it would increase administrative burdens, because taxpayers would have to calculate their charitable contribution deductions twice (once under the federal rules, once under the state rules). This is, to be sure, a cost of any deviation from rolling conformity. Second, one might also worry that this approach might pit states against one another, especially states that share borders, like Illinois and Indiana or Wisconsin. Illinois-based charities may assist residents of neighboring states and vice versa. But similar concerns will linger over any stimulus proposal that prefers a state's own citizens over another's. Finally, there is the challenge of defining what counts as an in-state charity. One approach would be to look to the state of incorporation, though we note that there are some Illinois-based charities that are incorporated elsewhere (the Obama Foundation, for example, is incorporated in the District of Columbia). No definition will be perfect, however, and the imperfection of a definition is no reason to reject the idea entirely.

## Conclusion

In all, we advise against decoupling state tax law from the charitable contributions provision in [section 2204](#). While the money states could make is nothing to blink at, it is not worth placing the burden of fiscal solvency on low- and middle-income earners. Though it's hard to imagine that decoupling [section 2204](#) would significantly disincentivize charitable giving, we still think those few dollars are better off in the hands of taxpayers, who likely derive joy from giving to their favorite causes.

## FOOTNOTES

<sup>1</sup> These are Alabama, Colorado, Connecticut, Delaware, Illinois, Kansas, Louisiana, Maryland, Michigan, Missouri, Montana, Nebraska, New Mexico, New York, North Dakota, Oklahoma, Rhode Island, Utah, and the District of Columbia. See Jared Walczak, "[Toward a State of Conformity: State Tax Codes a Year After Federal Tax Reform](#)," The Tax Foundation (Jan. 28, 2019).

<sup>2</sup> For more on the advantages and disadvantages of rolling conformity and decoupling, see Ruth Mason, "Delegating Up: State Conformity With the Federal Tax Base," 62 *Duke L. J.* 1268 (2013).

<sup>3</sup> See Roman and Timakova, "[Decoupling From Retroactive Relief](#)," *Tax Notes State*, June 29, 2020, p. 1613.

<sup>4</sup> This is a \$300 deduction for both single and married taxpayers. See Joint Committee on Taxation, "[Description of the Tax Provisions of Public Law 116-136, The Coronavirus Aid, Relief, and Economic Security \('CARES'\) Act](#)," FN 76, 22 (Apr. 23, 2020).

<sup>5</sup> In tax year 2017, the most recent year for which data are available, there were 5,667,774 resident individual income tax returns filed in Illinois. See Illinois Department of Revenue, "Individual Income Tax Returns Filed by Adjusted Gross Income — Tax Year: 2017." The [Penn Wharton Budget Model](#) estimates that takeup of the new above-the-line deduction will be approximately 34.5 percent. The Illinois individual income tax rate is a flat 4.95 percent, so the maximum benefit is 4.95 percent x \$300 = \$14.85. Some filers will claim a smaller benefit because they will make less than \$300 in charitable contributions. So we can think of \$14.85 as the maximum, rather than the midpoint, estimate. With that, we arrive at a figure of 34.5 percent x 5,667,774 x \$14.85 = \$29,037,423. To a first approximation, we might say \$20 million to \$30 million, accounting for individuals who deduct less than the full amount.

<sup>6</sup> See Tracey Tully and Mary Williams Walsh, "[N.J. Will Borrow \\$4.5 Billion as Pandemic Pain Hits States](#)," *The New York Times*, Sept. 24, 2020.

<sup>7</sup> See Dan Petrella, "[With No Help Forthcoming From Washington, Gov. J.B. Pritzker Asks State Agencies to Prepare for 'Nightmare Scenario' of Budget Cuts](#)," *The Chicago Tribune*, Sept. 15,

2020.

<sup>8</sup> See Illinois Executive Office of the Governor, "[April 2020 Revenue Forecast Revision](#)" (Apr. 15, 2020).

<sup>9</sup> See Benjamin A. Priday, "[Rich Folks Aren't That Stingy After All](#)," *The Conversation*, May 7, 2020.

<sup>10</sup> Though there is no evidence that an additional \$20 million would be necessarily allocated to such causes in Illinois or other states considering decoupling from this provision.

<sup>11</sup> See Urban-Brookings Tax Policy Center, Briefing Book, [What Are Itemized Deductions and Who Claims Them?](#)

<sup>12</sup> Lawson Bader, "[3 Reasons Why 2020 May Be the Greatest Giving Year Ever](#)," *Kiplinger*, Aug. 3, 2020.

<sup>13</sup> "[Nonprofit Aims to Revive Restaurant Jobs While Providing Meals to Health Care Workers](#)," NBC Chicago, Apr. 14, 2020.

<sup>14</sup> See Naomi Jagoda, "[Senators Offer Bill to Expand Charitable Giving Tax Break](#)," *The Hill*, June 23, 2020. Congress has considered expanding the charitable deduction several times throughout the negotiations.

## END FOOTNOTES

