Economic Impact Analysis
Virginia Department of Planning and Budget

22 VAC 40-41 – Neighborhood Assistance Tax Credit Program
Department of Social Services
March 30, 2006

Summary of the Proposed Regulation

The Board of Social Services (board) proposes to amend the Neighborhood Assistance Tax Credit Program (program) by capping the tax credits available to any one eligible organization in a given year at $500,000, requiring organizations that apply for inclusion into the program expend at least 75% of revenues received in any given year for ongoing programs during that year and limiting the tax credit that can be taken by businesses that donate goods for sale, auction or raffle to the lesser of either Internal Revenue Service (IRS) valuation or actual proceeds generated for the eligible organization. The proposed regulation also promulgates several points of long standing policy into regulation.

Result of Analysis

There is insufficient data to determine if the benefits of these regulatory changes will outweigh the extra compliance costs that participating charities will accrue. Detailed analysis of these benefits and costs can be found in the next section.

Estimated Economic Impact

The Neighborhood Tax Credit Program allows approved neighborhood charitable organizations that offer services to poor people to offer tax credits to businesses and individuals from whom they receive donations. These tax credits, because they represent a dollar for dollar reduction in tax liability, provide a greater economic incentive to donate than do the standard tax deductions allowed by the Commonwealth. This program was authorized by the legislature during the 1981 legislative session and is currently slated to end after fiscal year (FY) 2009. The Department of Social Services' Office of Community Services expects the program to be reauthorized so that tax credits may be issued beyond 2009.

The current regulation, and relevant sections of the Code of Virginia, that govern the Neighborhood Tax Credit Program do not place a limit on the amount of tax credit dollars that will be available to any one eligible organization; this proposed regulation will cap available tax credits at $500,000. Right now, no eligible organization has received tax credits in excess of the proposed cap, but several organizations were allotted over $400,000 this past fiscal year. The board believes that this cap, along with other provisions in current regulation, will insure that there are tax credits available for new organizations that apply for inclusion into the program and will better reflect the intent of the legislature which has directed the board to "provide for the equitable allocation of the available… tax credits".

Since all participating organizations receive tax credits that fall short of the cap right now, this change should not disrupt current fundraising efforts. Eligible organizations will, however, have to adjust their future fundraising plans to reflect this new limitation. This new provision is likely to allow more neighborhood organizations to participate in the program but may also, to the extent that larger neighborhood organizations can take advantage of economies of scale to provide services more cheaply and to more individuals, reduce the number of impoverished people served as a result of the program's incentives.

The current regulation is also silent as to when donations to eligible organizations must be used. The board proposes to ensure that monies donated to these organizations are used in a timely fashion by mandating that 75% of revenues be expended on current programs during the fiscal year in which they were donated. The board does not require that participating organizations keep donations for which tax credits are issued separate from other revenue that these organizations may receive. Because of this, the board cannot, at this time, narrow its focus and control by imposing the 75% spending requirement on just tax credit donations. This requirement will insure that impoverished aid recipients get a more immediate benefit from donations meant to help them; this requirement will also, because of its emphasis on already existing programs and spending rather than saving, tend to suppress long term planning and deferred spending that might benefit those recipients more. This requirement, for example, might encourage an organization that provides medical services to seek out more patients now rather than saving money for new facilities or equipment that would tend to expand and improve the services available to existing patients. An emphasis on short term spending and existing programs to the detriment of long term planning and possible new programs may harm the long term health of a neighborhood organization; these organizations are, however, perfectly able to avoid the 75% spending requirement by not participating in the program.

Currently, businesses that contribute goods for sale, auction or raffle are able to receive, from the neighborhood organization to which they are donating, tax credits equal to wholesale fair market value of the goods donated; this is the valuation used by the IRS for charitable contributions. The proposed regulation will only allow contributors to receive tax credits equal to the lesser of either Internal Revenue Service (IRS) valuation or actual proceeds generated for the eligible organization. Since the proceeds generated by donated goods for eligible organizations is likely very frequently below fair market value for those goods, this new rule will likely decrease the value of the tax credit issued to any given donor.

Eligible organizations will likely be able to offer tax credits to more donors as the value of each individual’s tax credit eligibility decreases and, so, may be able to solicit more donations under the proposed regulation. This effect will be mitigated by any decrease in individual donations that is caused by the decrease in the value of tax credits available to donors. It is unclear which of these effects will override the other since the motivation to donate to charity is affected by many factors besides the tax effects of any possible donation.

In addition to the requirements enumerated above that also represent new policy, several long-standing policies of the board are being promulgated into regulation with this action. For the last three years, when eligible neighborhood organizations apply for inclusion in the program, they have been required to provide proof that they have been in operation 12 months and that at least 60% of their target service population is impoverished. All participating organizations have had to provide the results of an annual audit to the Office of Community Services. This audit must be performed by an independent auditor, but that auditor’s services may be donated to the organization. Since these have been policy for the last three years, affected organizations should not see any additional economic effects, for good or for ill, as the proposed regulation is promulgated into the Administrative Code.

Businesses and Entities Affected

During FY 2004, 220 eligible neighborhood charitable organizations participated in the Neighborhood Assistance Tax Credit Program; 222 organizations participated during FY 2005.

This proposed regulation will affect current program participants, organizations who are eligible to participate in this program but do not currently do so and current and potential donors.

Localities Particularly Affected

All localities in the Commonwealth will be affected by the proposed regulation.

Projected Impact on Employment

If implementation of the proposed regulation has a less positive impact on donations to neighborhood charitable organizations than has been seen under the present regulation, employment opportunities in those organizations may grow more slowly than they otherwise would have or may even shrink. It is by no means certain that this employment effect will occur, however, since individuals and businesses that make charitable contributions are motivated by a number of factors other than the tax implications of their donations.

Effects on the Use and Value of Private Property

The proposed regulation will likely discourage eligible neighborhood organizations from saving for future capital improvement and program needs. This lack of savings, in the long run, may decrease the value of these organizations capital stock and property.

Small Businesses: Costs and Other Effects

Donations made by small businesses under this proposed regulation may have less positive tax consequences for donors than donations made under the current regulation have had.

Legal Mandate

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.H of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.H requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. Further, if the proposed regulation has adverse effect on small businesses, Section 2.2-4007.H requires that such economic impact analyses include (i) an identification and estimate of the number of small businesses subject to the regulation; (ii) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the regulation, including the type of professional skills necessary for preparing required reports and other documents; (iii) a statement of the probable effect of the regulation on affected small businesses; and (iv) a description of any less intrusive or less costly alternative methods of achieving the purpose of the regulation. The analysis presented above represents DPB’s best estimate of these economic impacts.