



# DONATIONS

## BUSINESS EXPENSE DEDUCTION AND STATE TAX CREDIT?

Recently released Federal Tax Regulations provide a potential dual benefit for individual owners of specified pass-through business entities (“PTEs”) who donate to scholarship granting organizations (“SGOs”).

Under the Final Regulations, a payment made by C corporations and PTEs to a charitable organization may qualify as an ordinary and necessary business expense deduction. By characterizing a charitable donation to an SGO as a business expense, C corporations and PTEs reduce their taxable income at the entity-level, and the individual owners of PTEs receive state and local tax (“SALT”) credits. The SALT credit generated by the business’s donation can be applied to the individual’s state tax liability, providing possible relief from the federal cap of \$10,000 on the SALT deduction.

### WHEN DOES A CHARITABLE DONATION QUALIFY AS A BUSINESS EXPENSE?

If the payment is a reasonable, ordinary and necessary expenditure incurred in carrying on the trade or business, and the entity “reasonably believes the program will generate a significant degree of name recognition and goodwill in the communities where it operates and thereby increase its revenue,” then the donation may qualify as a business expense.

The Regulations provide an example stating a business may be entitled to a business expense deduction for payments made “for use in projects that improve conditions in the state.” Therefore, a donation to an SGO may be deductible as a business expense since the payment assist in providing greater educational opportunities, and greater educational opportunities improve educational outcomes. Improved educational outcomes in the state allow for fiscal and economic savings, and attract business to the state.

Tax benefit of contributing \$8,000 to Scholarships for Kids for Alabama income tax credit if contribution payment qualifies as business expense of pass-through entity owned by donor:

### 2020 FEDERAL INCOME TAX

	NO CREDIT	WITH CREDIT
WAGES	90,000	90,000
SCHEDULE E - S CORP	327,000	319,000 <sup>(1)</sup>
ADJUSTED GROSS INCOME	417,000	409,000
20% QBI DEDUCTION	(65,400)	(63,800)
STATE INCOME TAXES PAID	(6,000)	(6,000)
REAL ESTATE TAXES	(3,000)	(3,000)
MORTGAGE INTEREST	(14,500)	(14,500)
CHARITABLE CONTRIBUTIONS	(2,500)	(2,500)
ITEMIZED DEDUCTIONS	(26,000)	(26,000)
PERSONAL EXEMPTIONS	-	-
TAXABLE INCOME	325,600	319,200
INCOME TAX	<b>66,303</b>	<b>64,767</b>
TAX CREDIT - DONATION TO SFK	-	-
INCOME TAX WITHHELD	8,000	8,000
ESTIMATED PAYMENTS	10,000	10,000
INCOME TAXES PAID 2020	18,000	18,000
TAXES OWED (REFUNDED) 2021	48,303	46,767

### 2020 ALABAMA INCOME TAX

	NO CREDIT	WITH CREDIT
WAGES	90,000	90,000
SCHEDULE E - S CORP	327,000	327,000 <sup>(2)</sup>
ADJUSTED GROSS INCOME	417,000	417,000
FEDERAL TAX DEDUCTION	(66,303)	(64,767)
FICA/MEDICARE TAX DEDUCTION	(6,885)	(6,885)
REAL ESTATE TAXES	(3,000)	(3,000)
MORTGAGE INTEREST	(14,500)	(14,500)
CHARITABLE CONTRIBUTIONS	(2,500)	(2,500)
ITEMIZED DEDUCTIONS	(26,885)	(26,885)
PERSONAL EXEMPTIONS	(3,000)	(3,000)
TAXABLE INCOME	320,812	322,348
INCOME TAX	<b>15,961</b>	<b>16,037</b>
TAX CREDIT - DONATION TO SFK	-	8,000
INCOME TAX WITHHELD	4,000	4,000
ESTIMATED PAYMENTS	-	-
INCOME TAXES PAID 2020	4,000	12,000
TAXES OWED (REFUNDED) 2021	11,961	4,037

**WITHOUT DONATION:** Federal Taxes: \$66,303 / State Taxes: \$15,961 = Total Expenses Paid: \$82,264

**WITH DONATION:** Federal Taxes: \$64,767 / State Taxes: \$8,037 <sup>(3)</sup> / Scholarships for Kids Donation: \$8,000 = Total Expenses Paid: \$80,804

**Conclusion: \$1,459 Total Savings**

1) Reduced by donation of \$8,000 to Scholarships for Kids as an ordinary business expense 2) Assuming the \$8,000 donation deducted as a business expense by the S Corp for federal tax purposes must be added back for state income tax purposes in order to receive the tax credit against the Alabama income tax liability 3) State income tax liability of \$16,037 less \$8,000 credit for donation received

The projections above are for illustrative purposes only, not intended as tax advice applicable to an actual situation. Please consult your tax advisor.