How Businesses Can Dual Benefit From Donating to a Scholarship Granting Organization

Introduction
The Alabama Accountability Act, an educational choice program that began in 2013, provides low income students opportunities previously unavailable. The AAA reformed the public-education system of Alabama in several ways, but perhaps its most important reforms were the creation of scholarships for students and tax credits for parents, both of which allow students to escape the state’s worst schools.

The AAA enables students in Alabama’s worst-performing schools to receive a scholarship to cover the costs of attending a better school. Those scholarships are funded by private donations from individuals and corporations to Scholarship Granting Organizations.

For individuals who donate, it costs nothing to give, as each donor receives the standard dollar-for-dollar state tax credit. For business owners, however, it is an altogether different situation.

A contribution made from a business owner may receive both the standard dollar-for-dollar tax credit as well as a deductible business expense on the federal side. Essentially, business owners may make money from a contribution.

How to Receive a Business Expense Deduction and the State Tax Credit
According to Maynard Cooper & Gale and Scholarships for Kids, 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 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, 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 assists 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.

For more information, please see a memo from Maynard Cooper & Gale that can be viewed here: https://alabamapolicy.org/wp-content/uploads/2020/11/Maynard-Cooper-Gale-Memo.pdf. Scholarships for Kids contributed to this report.