

# Catalyst Education Fund: Discussion of Tax Treatment

## Tax Treatment for Contributions, 1 of 3

### Oklahoma State Income Tax Credit

A taxpayer receives an Oklahoma income tax credit for their cash contribution to the Catalyst Education Fund equal to 50% of their cash contribution (or 75% of their cash contribution if the taxpayer is willing to make a two-year commitment for the same amount). See 68 Okla. Stat. §2357.206.

### Federal Income Taxes – Charitable Contribution Deduction / Business Expense Deduction

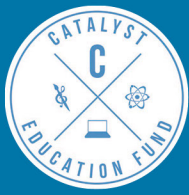
A cash contribution to the Catalyst Education Fund will generally be treated for federal income tax purposes as either (1) a charitable contribution deduction under Internal Revenue Code (IRC) Section 170, or (2) an ordinary and necessary business expense deduction under IRC Section 162.

Normally, a business expense deduction gets a more favorable tax treatment than a charitable contribution deduction. Some of the benefits of having the contribution payment classified as a business expense deduction rather than a charitable contribution deduction can include: (a) no percentage of adjusted gross income (for individuals) or taxable income (for corporations) limitation on the annual deduction exists for IRC Section 162 business expense deductions, while charitable contributions are subject to such restrictions; (b) no need for an individual to itemize deductions to obtain an income tax benefit if the deduction is under IRC Section 162 for a business (other than as an employee) conducted by the taxpayer or which has income flow through to the taxpayer; and (c) the deduction reduces a taxpayer's adjusted gross income (AGI) rather than taxable income, potentially allowing a taxpayer to receive a tax benefit that would not be available or would be reduced if the taxpayer's adjusted gross income (AGI) was higher.

Whether your cash contribution to the Catalyst Education Fund should be treated as a charitable contribution deduction or a business expense deduction will depend on your own facts and circumstances. Generally, your cash contribution will always qualify as a charitable contribution deduction, but it may be able to instead qualify as a business expense deduction. You should consult your own tax advisor regarding your specific circumstance to make this determination. Below is a discussion of the charitable contribution deduction (and its limitations) and the business expense deduction (and the criteria for a cash contribution to a qualified charitable organization to qualify as a business expense deduction).

### Charitable Contribution Deduction

A taxpayer's cash contribution to the Catalyst Education Fund may be treated as a charitable contribution deduction in the amount of such contribution. Charitable contributions to a qualified organization such as the Catalyst Education Fund are deductible by individuals and corporations. Partnership/LLC contributions are passed through to the partners/members. The amount of charitable cash contributions individual taxpayers can deduct on Schedule A as an itemized deduction is limited to a percentage (currently 60% in 2022) of the individual taxpayer's adjusted gross income (AGI). A corporation may deduct qualified cash contributions up to a percentage (currently 10% in 2022) of its taxable income. Contributions that exceed that amount may be carried over to the next tax year.



# Catalyst Education Fund: Discussion of Tax Treatment

## Tax Treatment for Contributions, 2 of 3

### Business Expense Deduction

A taxpayer's cash contribution to the Catalyst Education Fund may be able to be treated as a business expense deduction in certain circumstances. In August 2020, the Internal Revenue Service (IRS) finalized its regulations providing that a contribution payment made by a taxpayer to a qualified charitable organization (such as the Catalyst Education Fund) may qualify for as a business expense deduction under certain circumstances even where the taxpayer (or the taxpayer's partners or members if the taxpayer is a partnership or LLC) receive a state income tax credit for the cash contribution payment. See Treas. Reg. § 1.162-15.

The IRS regulation provides that for the payment to be treated as a business expense deduction, the business (whether it be an individual, a pass-through entity, such as a partnership or a multi-member LLC, or a corporation) must show two things:

- a direct relationship of the contribution payment to the taxpayer's business; and
- the contribution payment was made with a reasonable expectation of a financial return commensurate with the amount of the payment or transfer. See Treas. Reg. Section 1.162-15(a).

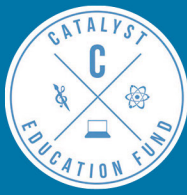
The IRS regulation provides the following examples of applying this rule:

Example 1, Reg. §1.162-15(a)(2)(i):

A, an individual, is a sole proprietor who manufactures musical instruments and sells them through a website. A makes a \$1,000 payment to a local church (which is a charitable organization described in section 170(c)) for a half-page advertisement in the church's program for a concert. In the program, the church thanks its concert supporters, including A. A's advertisement includes the URL for the website through which A sells its instruments. A reasonably expects that the advertisement will attract new customers to A's website and will help A to sell more musical instruments. A may treat the \$1,000 payment as an expense of carrying on a trade or business under section 162.

Example 2, Reg. §1.162-15(a)(2)(ii):

P, a partnership, operates a chain of supermarkets, some of which are located in State N. P operates a promotional program in which it sets aside the proceeds from one percent of its sales each year, which it pays to one or more charities described in section 170(c). The funds are earmarked for use in projects that improve conditions in State N. P makes the final determination on which charities receive payments. P advertises the program. P 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. As part of the program, P makes a \$1,000 payment to a charity described in section 170(c). P may treat the \$1,000 payment as an expense of carrying on a trade or business under section 162. This result is unchanged if, under State N's tax credit program, P expects to receive a \$1,000 income tax credit on account of P's payment, and under State N law, the credit can be passed through to P's partners. (Emphasis Added).



# Catalyst Education Fund: Discussion of Tax Treatment

## Tax Treatment for Contributions, 3 of 3

### Safe Harbor for Certain Payments to Charities in Exchange for State or Local Credits

The IRS regulation provides safe harbor rules for certain charitable contributions for which a business receives a state or local tax credit.

### Safe Harbor for C Corporation

The IRS regulation provides the following safe harbor rule applicable to C corporations: *If a C corporation makes a payment to or for the use of an entity described in section 170(c) and receives or expects to receive in return a State or local tax credit that reduces a State or local tax imposed on the C corporation, the C corporation may treat such payment as meeting the requirements of an ordinary and necessary business expense for purposes of section 162(a) to the extent of the amount of the credit received or expected to be received.* This safe harbor is shorter and simpler than the one for passthrough entities discussed next. A key reason for its simplicity is that virtually all of the taxes paid by C corporation are allowed as a deduction under IRC Section 164 without limitation.

### Safe Harbor for Specified Passthrough Entities

A more involved safe harbor exists for certain passthrough entities, referred to as *specified passthrough entities*. To be a specified passthrough entity eligible to use the safe harbor, all of the following requirements must be satisfied:

- The entity is a business entity other than a C corporation and is regarded for all Federal income tax purposes;
- The entity operates a trade or business;
- The entity is subject to a state or local tax incurred in carrying on its business that is imposed directly on the entity (note that a state income tax imposed on the equity holder for income reported from the entity would not qualify); and
- In return for a payment to a qualified charity, the passthrough entity receives or expects to receive a state or local tax credit that the entity applies or expects to apply to offset a State or local tax described in the previous bullet point.

If an entity meets the above requirements, it is eligible to make use of the following safe harbor to enable a deduction for the amount paid as a §162 business expense: *Except as provided in paragraph (a)(3)(ii)(C) of this section, if a specified passthrough entity makes a payment to or for the use of an entity described in section 170(c), and receives or expects to receive in return a State or local tax credit that reduces a State or local tax described in paragraph (a)(3)(ii)(A)(3) of this section, the specified passthrough entity may treat such payment as an ordinary and necessary business expense for purposes of section 162(a) to the extent of the amount of credit received or expected to be received.* But note the “except as provided” language in the safe harbor. That exception is a significant one for the passthrough entity: *The safe harbor described in this paragraph (a)(3)(ii) does not apply if the credit received or expected to be received reduces a State or local income tax.*

**This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax advice. You should consult your own tax advisors regarding your specific circumstances for a contribution to the Catalyst Education Fund.**