The Problem

A healthy democracy requires citizens to be active and engaged. But our system for funding political campaigns has left voters disillusioned, discouraged and disaffected. Trust in the government is near record lows. 80 percent of Americans think that the influence of money in politics is worse now than at any other time in their lives, and more than 90 percent believe that elected officials listen more to deep-pocketed donors than regular voters.¹

The problem is not that campaigns cost money to run, but that the vast majority of campaign funds come from an incredibly small group of people. Only one-half of one percent of Americans make a political contribution of $200 or more to any federal candidates, and are responsible for more than 70 percent of the money that is donated to federal candidates, parties and PACs — to say nothing of super PACs and dark money groups.² When elected officials are reliant on so few individuals, who can blame Americans for feeling left out of the process? In short, too few Americans give political contributions and thus they are not invested in the process and do not have the ears of their elected officials.

There is good reason for Americans to feel alienated and disinvested from our election system. Policies supported by the donor class are far more likely to be enacted by the federal government than policies supported by the middle-class.³ Elected officials who spend hours calling donors and asking for large contributions are naturally going to tailor their message to the interests of their donors instead of average Americans. As one senator who was fed up with dialing for dollars put it, “I talked a lot more about carried interest inside of that call room than I did in the supermarket.”⁴

The U.S. needs new policies to incentivize more individuals to participate in the election process by giving modest campaign contributions. If additional Americans are encouraged to give and be involved, the politicians on the receiving end of those contributions will be more
likely to pay attention to their views, the government will be more responsive to the concerns of a broader swath of the population, and the public will have some renewed faith in their elected leaders. One way to help achieve this is to enact a tax credit or rebate for modest political contributions.

How Tax Credits and Tax Rebates Work

The basic concept behind tax credits and rebates is relatively simple: incentivize more taxpayers to make eligible political contributions by creating a system that allows them to get some of their money back. However, there are many specific details that affect how the program functions, including credits versus rebates, what percentage of a contribution is covered and at what amounts, which recipients qualify and others. The goal of any federal tax credit or rebate program should be to encourage more Americans to give contributions to candidates or parties to help counteract politicians' reliance on large donors and wealth interests. This ISSUE ONE EXPLAINER provides an overview of how the programs function and discusses several details that can have a major impact on whether a program is successful and effective.

Tax credits reduce a taxpayer’s tax liability just like a payment made to the IRS. To benefit from a tax credit an individual must file a federal tax return. Unlike a tax credit which requires individuals to wait for a refund when they file their taxes, a tax rebate system allows them to receive their refund for the amount they have contributed at any given time. To receive a rebate, an individual does not have to file a federal tax return, meaning a rebate program could benefit some additional individuals in populations who do not file, like the elderly who primarily live off social security, without increasing their paperwork burden. A tax rebate system is an especially attractive policy option because (a) it allows donors to give their contribution directly to the candidate of one's choice, (b) it is available to individuals regardless of whether they file tax returns and (c) it is not necessary to wait for the rebate long after the contribution is given.

Tax credit or rebate programs have been tested and they work. Starting in 1972, the federal government offered a tax credit of 50 percent of a contribution to a federal, state or local candidate or political party up to $25 — a credit of $12.50, or about $72.17 in 2016 dollars. Promoted by President John F. Kennedy’s bipartisan Commission on Campaign Costs, the tax credit was politically popular; it was endorsed by former presidents Eisenhower and Truman and passed the U.S. Senate by a vote of 82 to 17. The amount of the credit was increased in 1975 and 1979, eventually ending up at 50 percent of contributions up to $100. Unfortunately, the credit became the victim of the Tax Reform Act of 1986 and was eliminated along with many other credits and deductions.
Four states currently have tax credits for political contributions — Arkansas, Ohio, Oregon and Virginia — and Minnesota has a rebate program. Arkansas, Ohio and Oregon each have a $50 credit, although they differ on what type of contributions qualify based on who the money is given to (and Oregon limits the credit to individuals making under $100,000), while Virginia has a 50 percent credit for contributions up to $50.9 Minnesota’s rebate is up to $50 and covers contributions to state candidates and state political parties.10

<table>
<thead>
<tr>
<th>State</th>
<th>Start</th>
<th>Type</th>
<th>Maximum Value</th>
<th>Covers Contribution To</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arkansas</td>
<td>1996</td>
<td>Nonrefundable full tax credit</td>
<td>$50 individual / $100 joint-filers</td>
<td>State and local candidates, state parties, and state PACs</td>
</tr>
<tr>
<td>Minnesota</td>
<td>1992</td>
<td>Rebate</td>
<td>$50 individual / $100 joint-filers</td>
<td>State candidates and state political parties</td>
</tr>
<tr>
<td>Ohio</td>
<td>1995</td>
<td>Nonrefundable full tax credit</td>
<td>$50 individual / $100 joint-filers</td>
<td>State candidates</td>
</tr>
<tr>
<td>Oregon</td>
<td>1969</td>
<td>Nonrefundable full tax credit</td>
<td>$50 individual /$100 joint-filers (AGI must be equal to or less than$100,000 single / $200,000 joint)</td>
<td>Candidates, major political parties, and PACs all at the state, local and federal levels, and state minor parties</td>
</tr>
<tr>
<td>Virginia</td>
<td>2000</td>
<td>Nonrefundable partial tax credit</td>
<td>$25 individual /$50 joint-filers</td>
<td>State and local candidates</td>
</tr>
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When the government offers tax credits, tax filers tend to take advantage of them. Participation in the federal political contribution tax incentive programs (which originally included an option for either a tax credit or a tax deduction) started at 3.5 percent of tax filers and rose to 4.4 percent in 1979 after the credit amount was increased — keeping in mind that in the 1970s over half of all federal tax filers were married couples filing jointly, so these numbers likely underreport how many individuals took advantage of the tax credit.11 Participation peaked at 5.8 percent of all tax filers in 1980, and remained around 5 percent for much of the '80s until the credit was eliminated.12

While these participation numbers may seem low at first blush, they must be put in context of the current campaign finance system. Since the vast majority of money raised by federal candidates, parties, and PACs comes from the 0.5 percent of Americans making contributions of more than $200, increasing the number of Americans who give small-dollar contributions by even a few overall percentage points means there will be millions more Americans who are small-dollar donors. That could mean hundreds of millions of dollars donated from main-street Americans towards the candidates of their choice. As explored further on, this means candidates and elected officials are incentivized to listen to opinions of small-dollar donors and align themselves to that group's policy wishes.
Additionally, the effectiveness of a tax credit or rebate program is strongly shaped by its design, implementation, and the context of other campaign finance laws. One major factor affecting participation rates is whether the program is publicized and promoted by the state or political entities which can utilize it. For example, candidates, parties and other entities in Minnesota and Oregon regularly promote the credit, and those states have higher participation rates. By contrast, in Arkansas, the tax credit was introduced as part of a much wider reform package that was seriously curtailed by a court decision, leaving the tax credit something of an orphan that is not promoted by candidates, parties or the state government. Any new federal tax credit or rebate program is likely to be easier to promote than the earlier tax credits, due to technology like the internet, social media and online giving programs, meaning it is likely to be more effective than the past system.

Technical aspects of the program can also have a big impact. For instance, for years the Ohio tax credit was only claimable on the longer individual tax return form, meaning many low- and middle-income filers who used the shorter, simpler form were left out. In Virginia, the tax credit is only a partial credit, which is less of an incentive than a full credit. The structure of the surrounding campaign finance system is also important. For example, Virginia does not have any campaign contribution limits, meaning politicians and parties do not need to actively seek the small donations that the tax credit promotes. Likewise, the campaigns in Ohio that could benefit from tax credit can accept contributions of over $12,500, which means the relative value of a $50 contribution is much less than in a system with lower limits, like the federal government or Minnesota. A new federal tax credit or rebate program could be designed to avoid the above pitfalls, and would exist within a system that does not have high contributions limits, both of which would likely increase how many Americans utilize it.

The Impact of the Policy

The impact of the federal tax credit can be gauged by looking at the overall number of individuals who make political contributions. During the years that the federal government offered a tax credit for contributions, there is a correlation with the number of Americans who report that they monetarily supported a candidate for office or a political party. According to the American National Election Studies (ANES), in the years before the federal tax credit was enacted, the average number of individuals who said they made a political contribution was 7.9 percent. But between 1972 and 1986, when the federal tax credit was in place, an average of 10.25 percent of ANES respondents said they gave to a candidate or political party. After 1986, that number fell to 8 percent, before rising to around 13 percent in the mid-to-late 2000’s as small-dollar internet fundraising took off.

It should be reiterated that the federal tax credit and the ANES survey questions both covered contributions to candidates and parties on the federal, state and local level, which is a wider scope than a tax credit or rebate program focused solely on federal candidates. Additionally,
while the ANES is good way to get a sense of trends, it is possible that the survey over-reports the number of individuals who give a political contribution in an election cycle.

Of course, nearly as important as whether people participate is who participates. A critical goal of a tax credit or rebate program is to change donor demographics, to incentivize regular Americans to make contributions. The data indicates that tax credits and rebates do just that. A study by the Campaign Finance Institute that looked at Minnesota donors found that of those who made $40,000 or less, 62 percent said the rebate affected their decision to give, while 49 percent of those who made between $40,000 and $100,000 said the program affected their decision. Actual tax data from Oregon and Ohio — which release tax credit usage broken down by adjusted gross income (AGI) — indicates a similar story. In Ohio, an average of 45.8 percent of tax filers claiming the credit since 2005 have reported an AGI of under $60,000. In Oregon, the comparable figure is 37 percent.

It is true that in both states the largest number of taxpayers claiming the credits make between $100,000 and $250,000, but it is important to note that, by far, most returns in that AGI level are married couples — an average of 83 percent of returns in Ohio since 2005, and 86 percent in Oregon. In fact, since Ohio breaks out its data on tax credits by filing status, we know that married couples that made between $100,000 and $250,000 represented an average of 19 percent of all tax filers that claimed the political credit due that time period. While those couples are still relatively well off, they are not the same wealthy interests that members of Congress spend hours calling and asking for thousands of dollars.

Another major goal of any tax credit or rebate program is to change the fundraising behavior of elected officials themselves. Data from Minnesota’s rebate program is encouraging. When candidates were asked whether the rebate encouraged them to solicit contributions from less affluent individuals that they would not have otherwise, 81 percent of incumbents and 88 percent of non-incumbents said that it did. And large majorities of candidates said that low- and middle-income donors were very or extremely likely to participate in the program, which is important because it changes the political calculation candidates make when evaluating policies. Either consciously or subconsciously, the more reliant on less-affluent donors candidates become, the more likely they are to promote policies favored by those groups.

Cost of a Tax Credit or Rebate Program

When the federal tax incentive regime was in place, the cost ranged between $79 million and $270 million (in 1972 and 1980, respectively) — or between $455 million and $790 million in 2016 dollars. However, the cost of a program depends largely on the particular design and there are cost reduction measures that can be taken:
a. **Only federal candidates**: The federal credits covered federal, state and local contributions to candidates and parties, so limiting a credit/rebate to only federal entities or only candidates for the U.S. House and Senate would reduce costs.24

b. **Only in-state or in-district contributors**: Limiting a credit/rebate to contributions from individuals who live in the state would help incentivize candidates to interact with their potential voters and make in-roads in reducing the role of out-of-state money.

c. **Only non-wealthy contributors**: Another cost reduction measure would be to limit a credit or rebate to tax-filers whose income is under a certain amount, like Oregon does. A tax credit proposed by the American Enterprise Institute of $200 for individual filers and $400 for joint-filers, both for households that did not make more than $100,000 was estimated to cost $775 million per year (fluctuating plus or minus a few hundred million depending on whether it was an election year, with a maximum estimated cost of $998 million).25

A program costing even $1 or 2 billion would per year would be one-half of one percent or less of total federal spending, which is projected to be a little over $4 trillion in 2017.26 All federal tax credits, deductions and exclusions combined cost the government around $1.2 trillion per year.27 It is more than conceivable to pay for a tax credit or rebate program for small-dollar contributions by reducing federal spending in a different area or eliminating some other tax expenditure.

There are also a variety of ideas for generating revenue to pay for a tax credit or rebate program. The Center for Governmental Studies has laid out numerous approaches that could be applicable at the federal level, such as enacting a spectrum use fee applied to broadcast stations for using the public airwaves, increasing Federal Election Commission fines, starting a federal lottery or selling federal bonds.28 Additionally, any increased revenue could be initially placed into an endowment so that in 5–10 years the interest on the endowment could be used to pay for the tax credit or rebates.

**Conclusion**

The federal and state experience indicates that credit or rebates can be effective at increasing participation of more Americans and changing the behavior of candidates and elected officials. Any program will have to be carefully tailored to maximize its effectiveness and impact. If done properly, a tax credit or tax rebate for small-dollar contributions could be an important part of repairing the public’s faith in Washington and returning the government to the American people.
Endnotes


5. A tax credit can be either refundable or nonrefundable. Refundable tax credits can reduce tax liability below zero, meaning that the IRS will send taxpayers a refund if the credit exceeds the liability, while nonrefundable credits can only reduce the amount of taxes you owe and cannot go below zero. As an example, if a taxpayer has a $50 tax liability and makes a $100 political contribution, with a refundable credit they would get a check for $50 from the IRS, while under a nonrefundable credit they would simply not owe any money.


8. A version of the program for congressional candidates was almost restored via an amendment to the TRA, passing the House, but did not survive in conference.


12. The participation rates of the state programs vary widely, which is not surprising considering the differences in how programs are designed and administered. Oregon has a participation rate averaging 5.3 percent of tax filers since 1994 (the earliest public data is available) and peaking at 7.4 percent in 2008. Oregon Department of Revenue, Personal Income Tax Reports and Statistics (author’s calculations), http://www.oregon.gov/DOR/programs/gov-research/Pages/research-personal.aspx. In Ohio, the participation rate since 2005 is 1.2 percent on average (the earliest data is available), peaking at 1.4 percent in 2008. Ohio Department of Taxation, Tax Data Series, State Individual Income Tax-By Class, (author’s calculations), http://www.tax.ohio.gov/tax_analysis/tax_data_series/individual_income/publications_tds_individual.aspx. There is a dearth of data on Virginia and Arkansas, but the respective participation for Virginia since 2010 is roughly 0.5 percent, Virginia Department of Taxation, Annual Reports, (author’s
calculations), http://www.tax.virginia.gov/content/annual-reports, while reports near the start of Arkansas’s program peg the rate at 2 percent. Rosenberg, infra note 13, p. 54. Likewise, data on participation rates for Minnesota’s rebate program is hard to find, but indications from the early 2000’s have the rate at 3.5 percent of taxpayers. Rosenberg, infra note 13, p. 37.


18 The ANES Guide to Public Opinion and Electoral Behavior, Table 6B.5, November 11, 2015, available at http://www.electionstudies.org/nesguide/toptable/tab6b_5.htm. The ANES has asked respondents biennially since 1952 whether they made a political contribution. save for a few skipped years in the initial third of the survey’s life.


21 Compiled from data from Ohio Department of Taxation and Oregon Department of Revenue, supra note 12. The labels on the AGI tranches is based on the data as presented by the states.


24 According to the Center for Responsive Politics, congressional campaigns in 2016 raised $1.1 billion from individuals while presidential campaigns raised another $1 billion, but since much of that was from large donors any tax credit or rebate program would be far less. Center for Responsive Politics, Election Overview, 2016, https://www.opensecrets.org/overview/index.php?display=T&type=A&cycle=2016.
