

State Tax Observations

IRS Proposes Regulations to Block State Attempts to Bypass the Limit on the SALT Deduction

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On August 23, 2018, the IRS issued proposed regulations, effective after August 27, 2018, to block attempts by New York, New Jersey and Connecticut to allow taxpayers to try to circumvent the new \$10,000 federal income tax cap on state and local tax (SALT) deductions.

In this newsletter, we will summarize the position of various states with respect to the SALT deductions and the responding IRS proposed regulations.

Positions Some States Are Taking

The \$10,000 SALT deduction limit is arguably the most controversial part of the Tax Cuts and Jobs Act (TCJA) which was enacted last December. In response to the TCJA, New York, New Jersey and Connecticut passed laws allowing a tax credit for state-run charitable donation programs, which would accept payments from taxpayers to fulfill their state and local tax liabilities, circumventing the SALT cap. The charitable contribution strategies in these high-tax states were created so taxpayers could write off the full donation amount from their federal taxes. Other states have been considering enacting such programs as well.

New Jersey gives taxpayers a 90% state tax credit for donations made to local municipalities, counties and school districts. New York provides an 85% state credit. Connecticut approved similar legislation.

New York, New Jersey, Connecticut and Maryland sued the federal government last month stating that the SALT deduction cap unfairly targets them. The states claim the tax law overturned more than 150 years of precedent. Many experts have said the suit has little chance of success. This lawsuit is still pending. The IRS newly-proposed regulations are also likely to be contested by those states.

The IRS Response

The IRS proposed regulations are intended to block this type of workaround. Taxpayers will be able to receive a federal tax deduction only equal to the difference between the state tax credits they get and their charitable donations. As an example, if you write a check for \$100,000 as a charitable donation in lieu of paying property taxes and receive a state tax credit worth \$90,000, for federal income tax purposes you may only deduct \$10,000 federally as a charitable deduction.

The proposed regulations also provide for a de minimis exception for a dollar-for-dollar state tax deduction and for a tax credit of 15% or less of the donation. A taxpayer who makes a \$1,000 contribution to an eligible entity is not required to reduce the \$1,000 deduction on the taxpayer's federal income tax return if the SALT tax credit received is no more than \$150.

Comments Requested

The IRS is requesting comments on all aspects of the proposed rules within 45 days after their publication in the Federal Register and is planning to hold a public hearing on November 5, 2018 in Washington, DC.

Likely Outcome

Any contributions made before August 28, 2018 may not be permitted as a tax credit at the percentage allowable by the state — if at all. This is because the IRS proposal makes it clear that the agency considers its position to be settled law. Taxpayers who have made these contributions should consult their tax advisor. The IRS will likely challenge contributions made before the effective date although the proposed regulation is applicable to payments made after August 27, 2018.

Contact Us

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