

Alert | State & Local Tax



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Taxpayers Bear Risk of State's Proposals to Counter Elimination of SALT Deduction

Several states are considering proposals in an attempt to reduce the impact of federal tax reform's \$10,000 limit on state and local tax (SALT) deductions. In New York, the Governor's budget proposal includes establishing two charitable organizations (one for health care and one for education) that will enable taxpayers to make a contribution to those funds and receive a credit for 85 percent of the amount donated to offset SALT liabilities. California's SB 227 similarly creates a charitable organization (California Excellence Fund) and provides a credit against the California income tax for contributions made. Oregon has a similar proposal pending and New Jersey's Governor indicated that his state is looking into such a plan as well. All of these proposals would give taxpayers the opportunity to make the charitable contribution and get a federal tax deduction and reduce their SALT liability which would be subject to the \$10,000 limitation.

These attempts to 'work around' the new federal limitation are based upon an IRS chief counsel advice memorandum ([CCA 201105010](#)). This memorandum allows a charitable deduction for donations to a state agency or a charitable organization as a deductible charitable contribution, notwithstanding that a tax credit is provided and the amount of the tax credit will not reduce the charitable contribution. Of course, this guidance was given at a time when the law allowed for deductions for both charitable contributions and SALT. It is not clear if the IRS will withdraw that advice, issue guidance to address these proposals, or seek legislation to shut them down.

A taxpayer taking advantage of such a program would file their federal tax return and take a deduction for the charitable contribution and then be able to reduce their state taxes owed and possibly have their total state and local taxes reduced to \$10,000 or at least minimize the excess over that amount. If the IRS were to challenge the legitimacy of the charitable contribution, the taxpayer would have to fight that disallowance or lose the benefit of that deduction—the states would bear none of the risk of disallowance.

Tax experts have differing opinions as to whether these ideas will survive IRS scrutiny, any subsequent guidance or legislative fix. There are some that believe that providing less than a credit of 100 percent of the contribution may make the proposal more defensible (hence, NY's 85 percent credit). Others are quite sure the IRS and Congress will react quickly to preserve the federal revenue associated with the limitation of the SALT deduction.

In any event, if these proposals are enacted by the states, it is the taxpayers who will have to decide whether to risk an audit and disallowance of the charitable contribution or take the hit on the SALT limitation on deductions. For some, the prospect of an audit will deter them from opting to make the charitable donation. For others, the threat of an audit or disallowance is still better than just taking the reduced SALT deduction.

We will continue to monitor these legislative proposals. Taxpayers need to consult with their tax advisors before making decisions with regard to these proposals if they are enacted. Taxpayers may wish to wait until the very end of 2018 to see if the IRS provides additional guidance on this matter.

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