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IRS, Treasury have set their sights on blue states' tax workarounds

- The Tax Cuts and Jobs Act limits the deduction for state and local income taxes to $10,000.
- New York, New Jersey and Connecticut recently passed workarounds to permit homeowners to contribute to local charitable funds and still get a federal break.
- Treasury and IRS announced upcoming proposed regulations to address these plans.

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May 23, 2018

The Internal Revenue Service and Treasury Department will release new rules to address workarounds by high-tax states that are designed to help their residents manage new caps on federal tax deductions.

The IRS announced the move in a notice on Wednesday, without specifying details.
This year, the Tax Cuts and Jobs Act places a $10,000 cap on the amount of state and local taxes (SALT) that filers can deduct on their federal returns.

To help residents deal with the pain of losing that deduction, New York,New Jersey and Connecticut recently passed laws to create a workaround: Municipalities will be allowed to establish charitable funds to pay for local services and offer property tax credits to incentivize homeowners to make contributions.

In turn, filers who itemize can also claim a charitable tax deduction on their federal returns and do so beyond the $10,000 SALT cap.

The IRS has set its sights on these strategies.

"Despite these state efforts to circumvent the new statutory limitation on state and local tax deductions, taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes," the IRS wrote in its notice.

"It's no surprise that the Trump administration is once again targeting Connecticut taxpayers," wrote Leigh R.J. Appleby, press secretary for Connecticut Gov. Dannel P. Malloy, in an e-mail. "The legislation proposed by the Governor and passed overwhelmingly by the General Assembly gives municipalities a workable option to ensure their residents aren't double taxed because of the Trump/GOP tax law," Appleby wrote.

The proposed rules likely will clarify how the IRS will treat these transfers for tax purposes.

"The proposed regulations will assist taxpayers in understanding the relationship between the federal charitable contribution deduction and the new statutory limitation on the deduction for state and local tax payments," according to the IRS notice.

To put things in perspective, New Yorkers who claimed the SALT tax break took an average deduction of $22,169 in 2015, according to theTax Policy Center. In New Jersey and Connecticut, those amounts were $17,850 and $19,665, respectively.

Even though state legislators have given their blessing — and have signaled that they're willing to fight the federal government in court — tax lawyers have told clients to hold off on making contributions to municipalities' charitable funds for now.

"I think for everybody that we've dealt with in the states with the workarounds, we've expressed our concern that Treasury may not go along with this," Michael D'Addio, a principal at Marcum LLP, told CNBC earlier.

Attorneys and critics of the workarounds said that the IRS requires that there be "charitable intent" in order for a contribution to be deductible.

Municipalities' decision to offer donors a credit for giving to a charitable fund may also be seen as fishy, critics and lawyers said.

"Also, if you make a contribution that imposes a liability on the recipient, then the liability disallows the contribution," Jared Walczak, senior policy analyst at the Tax Foundation, said in an earlier interview with CNBC.

"In this case, the liability is the local or state government offering a tax credit, which zeroes out the actual charity," he said.

For individuals who are questioning whether to make a contribution to their municipality's charitable fund instead of paying the property tax as they usually do, attorneys have advised them to sit tight for now.

"The caveat we give clients is that it remains to be seen from the IRS' point of view," Seth Rabe, senior manager of the state and local tax services group at Mazars USA, said in an earlier interview with CNBC. "You could potentially be subject to back taxes and your contribution isn't viewed as a gift."

To play it safe, filers could always try maxing out the available $10,000 SALT deduction prior to making charitable contributions to state funds, Walczak said.