Aug. 30, 2018

New proposed regulations just issued by the IRS throw a roadblock into efforts by governments in several "blue" states to sidestep new tax law limits for state and local tax (SALT) deductions ((Prop. Reg. REG-112176-18, 8/23/18). However, the proposed regs could have a side effect of hurting other programs, including some being offered in traditional "red" states.

Generally, itemizers can deduct contributions to qualified charitable organizations, if properly substantiated, on Schedule A of Form 1040. Furthermore, taxpayers who itemize may claim a Schedule A deduction for SALT payments, including any combination of (1) property taxes and (2) income taxes or sales taxes. However, under the Tax Cuts and Jobs Act (TCJA), SALT deductions are limited to $10,000 a year for 2018 through 2025, among other related changes for individual taxpayers.

The new limit for SALT deductions raised an outcry in several parts of the country, particularly in high-tax taxes like New York and New Jersey. Some state legislators claimed that the provision would cost their residents billions in annual tax deductions. When the federal government turned a deaf ear to the protests, a few states took matters into their own hands.

One method of circumventing the rules is to offer a means of making charitable contributions to a state-created entity and, in turn, receiving credits to offset certain state income taxes. In other words, the state effectively shifts payments that would have qualified for a SALT deduction to payments qualifying as charitable donations. By doing so, residents can write off more than the $10,000 amount currently allowed by the TCJA.

This technique isn't exactly brand-new, but the IRS had previously remained silent on the issue of charitable deductions wrapped inside a SALT paper. But now the new proposed regulations foil the workaround. Under the regs, a taxpayer must reduce

charitable contributions. According to Representative Josh Gottheimer (Dem.-NJ), at least 33 other states have such programs, including many with conservative leanings. These programs will be similarly affected by the crackdown contained in the new proposed regs.

Prior to the regulations being issued, New Jersey governor Phil Murphy had proposed a program whereby a resident would qualify for a 90% write-off for charitable contributions that offset local taxes. Now this idea is being put on hold. On a related front, New Jersey recently joined with there other blue states – Connecticut, Maryland and New York – to sue the federal government, arguing that the SALT cap is unconstitutional.

Congress could still resolve the issue before the end of 2018. Lawmakers in New York and New Jersey, as well as others in high-tax blue states, have been pushing for an outright repeal of the SALT cap. We will keep an eye on developments through the mid-term elections.