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IRS Moves to Block Blue States From Getting Around GOP Limits on Tax Deductions.

The Trump administration has delivered another blow to California.

The Internal Revenue Service and Treasury Department on Thursday moved to block efforts by lawmakers in California and other Democratic-controlled states to help their residents avoid a new limit on state and local tax deductions.

The proposed rule targets legislation in those states that would allow taxpayers to claim a charitable deduction for state and local tax payments above the $10,000 limit set in the tax cuts passed by Congress last year.

The Treasury Department said the legislation being considered in various state s amounts to a tax dodge for wealthier Americans.

“Congress limited the deduction for state and local taxes that predominantly benefited high-income earners to help pay for major tax cuts for American families,” Treasury Secretary Steven T. Mnuchin said.

“The proposed rule will uphold that limitation by preventing attempts to convert tax payments into charitable contributions,” he said.

The IRS will accept comments on the rule through Oct. 11 and then will hold a public hearing on it Nov. 5.

Thursday’s announcement escalated a partisan battle over the tax-cut law that was pushed through by President Trump and congressional Republicans with no Democratic support.

California and New York are among the states that have been looking for ways around the limit on state-and-local tax deductions that Republicans included in the $1.5-trillion tax-cut law that took effect Jan. 1.

Many of the states hardest hit by the limit are high-tax ones controlled by Democrats, and leaders there have complained the tax bill targeted the deduction for political reasons.

A bill from state Sen. Kevin de Leon (D-Los Angeles) would allow California residents to circumvent the new $10,000 deduction limit through a complicated process involving state tax credits for contributions to school districts, charter schools, child-care centers operated by local educational agencies and community college districts.

Under the bill, taxpayers would be able to deduct 100 percent of the contributions on their federal tax returns because there are no limits on charitable deductions.

But the Treasury rule released Thursday would require taxpayers to reduce the federal charitable tax deduction they are claiming by the amount of any credit they receive on their state and local taxes. That would effectively prevent taxpayers from circumventing the cap through the workaround programs.

It also would hit some existing, limited programs in dozens of states that offer federal charitable deductions for contributions to fund schools and other programs.

The federal state-and-local tax deduction had been unlimited until this year, with the new limit projected to generate billions of dollars a year in additional revenue to the U.S. Treasury to help offset money lost by the bill’s cuts to corporate and individual rates.

Rep. Kevin Brady (R-Texas), a lead author of the tax bill, cheered the new rule.

“These Treasury regulations rightly close the door on improper tax evasion schemes conjured up by state and local politicians who insist on brutally taxing local families and businesses,” he said.

However, the limits on state-and-local tax deductions will hit some families hard. The average state-and-local deduction taken by the 6.1 million California residents who filed for it in 2015 was $18,438, according to the Tax Policy Center. Only New York and Connecticut had a higher average deduction.

Eight tax experts released a 44-page research paper in January arguing that California and other states would be allowed to turn state and local tax payments into charitable contributions based on previous IRS rulings and court opinions.

Some tax law experts also have said that it would be very difficult for the IRS to prohibit efforts designed to circumvent the state-and-local tax-deduction limit without also disallowing the federal tax deduction for contributions to more than 100 existing charitable programs in 33 states.

Those programs, many of them in Republican-controlled states, fund state-supported activities such as public schools and college scholarship programs.

The Treasury Department said Thursday that it expected some spillover effect on those other programs, but that only about 1 percent of taxpayers would see an effect on tax benefits for donations to school tax credit programs.

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