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Eight States May Follow New York's Workaround for SALT Deduction Limits.

WASHINGTON — While New York has become the first state to enact a workaround of the \$10,000 cap on the federal deduction for state and local taxes, eight other states are moving in that same direction, according to the National Conference of State Legislatures.

Congress capped the deduction of state and local taxes (SALT) to pay for other tax cuts enacted in December, including a reduction in the corporate tax rate to 21% from 35%.

In high tax states, the new cap will reduce the federal tax deduction for a significant number of households.

Local governments and school districts in New York levy a total of about \$55 billion in property taxes annually.

New York Gov. Andrew Cuomo and the New York State Legislature reached agreement on March 30 to allow charitable trusts to accept tax deductible payments in lieu of state and local income taxes as well as local and school district property taxes.

The deduction allows 85% to 95% of the donations to be deductible on federal tax returns.

In addition, employers are allowed to implement a 5% payroll tax as a way of paying some of their employees' state income taxes. The policy is targeted at employees with annual incomes of \$40,000 or more.

"The employer has the option of paying a payroll tax on the salary they pay, which is still fully deductible rather than the employee paying an income tax," Cuomo said Thursday at an Association for a Better New York event in Manhattan. "To defray the cost of the property tax increase we set up charitable entities, so that rather than paying a property tax, you can pay a charitable contribution which is still tax deductible."

"At least eight other states are considering creating or expanding charitable funds that would allow tax payments to be converted into charitable contributions," said Jackson Brainerd, a policy associate at NCSL.

They are: California, Illinois, Maryland, Nebraska, New Jersey, Rhode Island, Virginia and Washington.

New York led the way in large part because it begins its fiscal year on April 1 while most states which begin theirs on July 1.

New York's law makes the establishment of the trusts voluntary. Any governmental entity that sets one up is required to issue a tax receipt for any payments.

New York City and Yonkers have local income taxes that are levied on top of the state income tax.

Property taxes in New York are levied by counties, cities, towns, villages, school districts and special taxing districts such as libraries and fire districts.

The U.S. Treasury Department did not immediately respond to a request for comment about this workaround. Though in January Treasury Secretary Steven Mnuchin said deducting property taxes as charitable contributions would be “ridiculous.”

But the Internal Revenue Service and federal courts have issued rulings previously in support of the federal deductibility of state tax credits, according to a January paper released by eight law professors.

Those rulings have involved more narrow applications in the 33 states that have enacted them.

The law professors, who teach at Stanford University, UCLA, the University of Chicago and other schools, said most of the state tax credits cover only a fraction of the donations. But a few states, including Montana, Oregon and South Carolina, offer 100% tax credits with a limit on the donations.

The conservative Tax Foundation has questioned the legality of New York’s move. Jared Walczak, a senior policy analyst, described the New York law in an April 2 blog as a “charade” that the IRS is unlikely to go along with. “This is not a gift; it is a tax avoidance scheme,” he wrote.

Kim Reuben, director of the state and local finance initiative at the Tax Policy Center, said the New York law “isn’t that different from a number of the tax credits states already have.”

“I feel like the precedent is in the direction of what states are doing and I feel like they have a good shot,” Reuben said. “I feel ultimately that states can set their own tax policy and what’s best for them.”

New York will allow not only the state and New York City to set up charitable trusts, but also all other cities, towns and villages around the state as well as all 680 school districts.

School districts will be able to set up charitable trusts through passage of a school board resolution. A voter referendum is not required.

Most municipal governments and school districts in New York are expected to take a cautious approach toward the new law.

“We supported what the governor proposed and we particularly supported having it optional,” said David Albert, spokesman for the New York State School Boards Association.

The number of school districts that create the charitable trusts “will be largely dependent on what each board hears from taxpayers,” Albert said.

The school districts with the highest property taxes are generally on Long Island and in the lower Hudson Valley.

Stephen Acquario, executive director of the New York State Association of Counties, said his organization is taking a neutral position.

The counties most likely to consider establishing charitable trusts are Westchester and Suffolk located in the high income downstate region adjacent to New York City.

“We are cautiously optimistic about this plan,” Acquario said, but he emphasized that local governments will need guidance from the state and the IRS on how to proceed.

“It’s a little early to say whether or not there will be a widespread use of this new fund,” Acquario said. “There’s a lot of logistical components to it and a lot will depend on the taxpayer base in the region.”

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