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[IRS Moves to Block New York Plan to Skirt SALT Deduction Cap.]

- **Taxpayers won't get big federal write-off above state credit**
- **Regulations are likely to face challenges from high-tax states**

The Internal Revenue Service put the tri-state area on notice: The charitable workarounds New York, New Jersey and Connecticut approved following the new federal cap on deductions for state and local taxes aren't acceptable to the federal government.

Taxpayers who itemize will only be eligible for a federal deduction that's a small fraction of their charitable donations for property tax payments, according to proposed regulations issued by the Treasury Department on Thursday. The charitable contribution strategies in high-tax states were created so taxpayers would be able to write off the full donation amount from their federal taxes.

President Donald Trump's tax overhaul created a $10,000 limit for state and local tax deductions, a pittance for Northeastern states that have high property taxes. Democratic governors in those states have battled the Republican law's cap, saying they're being unfairly targeted.

"The IRS is hastily proposing politically motivated regulations to further the agenda of the Trump administration and block reforms that deliver relief to New York taxpayers," New York Governor Andrew Cuomo said in a statement. "Make no mistake: we will use every tool at our disposal, including litigation, to fight back."

The Treasury regulations say taxpayers can receive a federal tax write-off equal to the difference between the state tax credits they get and their charitable donations. That means a New Jersey taxpayer who makes a $30,000 charitable donation to pay property taxes and receives a $27,000 state tax credit would only be able to write off $3,000 on a federal tax bill.

"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 Mnuchin said in a statement. "The proposed rule will uphold that limitation by preventing attempts to convert tax payments into charitable contributions."

Earlier this year, Cuomo and New Jersey Governor Phil Murphy signed legislation allowing local governments to set up charitable organizations to accept property tax payments. In turn, homeowners receive credits for those donations to offset federal taxable income.

New Jersey gives taxpayers a 90 percent state tax credit for donations made to local municipalities, counties and school districts. Under the IRS proposal, only 10 percent of the donation amount would now be eligible for a federal tax break. New York provides an 85 percent state credit.

Connecticut approved similar legislation and one of three California bills to allow taxpayers to make charitable contributions has advanced through its first Assembly committee.

The Treasury rules provide some leeway for states that provide credits of 15 percent or less of the donation amount. In those cases, taxpayers can deduct the full charitable contribution on their federal taxes.

Municipalities had been awaiting IRS guidance before creating the charitable funds. The IRS had warned taxpayers in May to proceed with caution after the states approved the maneuvers involving charitable organizations to circumvent the new federal limits. The rules released Thursday are likely to be contested by those states.

“I have no doubt this is going to get challenged,” Stu Gibson, a tax litigator with law firm Schiff Hardin, said before the regulations were released. “State legislatures are being very creative in how they approach this.”

School Voucher Programs

Cuomo is also spearheading a lawsuit by four states to have the so-called SALT cap struck down. He’s said the state is “ready to fight if the IRS takes hasty and politically motivated action” against New York’s efforts to avoid the deduction cap.

New York, New Jersey, Connecticut and Maryland sued the Trump administration in July saying the new cap unfairly targets them. The states claim the tax law overturned more than 150 years of precedent. The state and local tax deduction is essential to prevent federal tax powers from interfering with constitutionally guaranteed state rights, according to the lawsuit. Legal experts have said the suit has little chance of success.

Treasury faced a complex task in creating regulations that block the new SALT workaround proposals while taking into account existing programs in states such as Georgia and Alabama that give donors credits for making contributions to hospitals and schools. More than 30 states have programs that give taxpayers breaks for charitable donations.

Most taxpayers won’t be affected by the new Treasury rules since the majority of Americans don’t itemize, or if they do, their SALT deductions are less than $10,000, according to Treasury officials. But those who make contributions to existing school voucher programs could see some changes to their tax benefits under the proposal.

“The proposed IRS rule issued by the Treasury Department will harm state tax credit scholarship programs that are currently benefiting more than 250,000 students,” John Schilling, the president of the American Federation for Children, a lobbying group for private schools, said in a statement. Taxpayers who previously donated to the programs will likely be advised by their accountants to stop because of a reduced tax benefit, Schilling said.

Regulations that distinguish the SALT credit programs from tax credit arrangements used to fund education vouchers could have put Treasury in a tricky political spot for seemingly preferring red states over blue states, said Glenn Newman, a former president of the New York City Tax Commission.

“In theory, the tax law should be the tax law across the board,” Newman, now a shareholder at law firm Greenberg Traurig, said in an interview prior to the proposal’s release.

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