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IRS Proposed Regulations Erode South Carolina Conservation Easement Tax Credit.

On August 23, 2018 the Internal Revenue Service issued [Proposed Regulations](#) regarding the \$10,000 cap on the deductibility of state and local taxes imposed under the Bipartisan Budget Act of 2018 (Code Section 164(b)(6)).

The Proposed Regulations were issued in response to a work around proposed by states with high state and local tax rates. For example, to avoid the new \$10,000 cap on the deductibility of state and local income taxes, New York adopted legislation that permitted property taxpayers to make a charitable contribution to state or municipal governmental entities in exchange for a credit against state or municipal taxes. Under this statutory scheme taxpayers could convert a state and local tax deduction, which is capped at \$10,000, into a charitable contribution deduction with no cap.

The Proposed Regulations provide that if a taxpayer makes a payment to an entity which would otherwise entitle the taxpayer to a charitable deduction and the taxpayer in return receives or expects to receive a state or local tax credit in exchange for such payment, the tax credit constitutes a return benefit, a quid pro quo, which reduces the charitable deduction. Specifically the Proposed Regulations provide that the amount of any charitable deduction otherwise available to a taxpayer is reduced by the amount of any state or local tax credit that the taxpayer receives or expects to receive in consideration for the taxpayer's payment or transfer.

The Proposed Regulations provide a de-minimis exception if the state tax credit does not exceed 15% of the amount paid ("contributed") by the taxpayer or 15% of the fair market value of the property transferred by the taxpayer.

South Carolina provides a state tax credit equal to the lesser of 25% of the charitable deduction resulting from the gift of a qualified conservation contribution or \$250 per acre of property to which the qualified conservation contribution applies. Under the Proposed Regulations, a South Carolina taxpayer may lose a portion of their charitable contribution deduction as a result of their receipt of the state tax credit.

For example, if a taxpayer owns a 1,000 acre farm with a value before the conservation easement of \$3,000,000 and a value of \$1,800,000 after placing a conservation easement on the farm the charitable deduction will be \$1,200,000 and the state tax credit will be \$250,000 (\$250,000 is less than \$1,200,000). The 15% safe harbor under the Proposed Regulation is \$180,000 ($1,200,000 \times 15\% = \$180,000$). The state tax credit \$250,000 exceeds the 15% safe harbor amount (\$180,000) and accordingly the taxpayer's charitable deduction is reduced by \$70,000.

The regulations, which are in proposed form but are applicable to gifts made after August 22, 2018, suggest that that upon issuance of the final regulations the IRS may allow the taxpayer to decline state or local tax credits and receive full deduction for their charitable contribution.

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