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New York Towns Gearing Up to Fight IRS Ruling on Local Taxes.

New federal code capped state and local tax deductions at $10,000, hurting some residents in the high-tax suburbs

An emerging coalition of New York municipalities is preparing to challenge proposed Internal Revenue Service regulations that clouded the ability of cities and towns to set up funds that allow residents to pay their local taxes as charitable contributions.

The group of municipalities—which includes Westchester County—will file public comments with the IRS and is considering a lawsuit, according to Assemblywoman Amy Paulin, a Democrat who lives in Scarsdale.

The new federal tax code signed into law by President Trump in December put a $10,000 cap on state and local tax deductions, a change that has hurt some residents in New York's high-tax suburbs.

State lawmakers approved a bill in March that allowed the creation of the charitable funds. Under New York's law—which is similar to legislation adopted in New Jersey and Connecticut—localities can issue a taxpayer a credit against their property taxes for up to 95% of the amount donated to a designated charitable fund. New York may issue credits against state income tax for up to 85% of a donation.

Fourteen New York municipalities have set up the charitable funds, according to a database of local laws and interviews with municipal officials. Charitable deductions against federal income aren't limited, but the IRS rule would block the relief intended by New York lawmakers by requiring taxpayers to subtract the value of the state credits from the amount of their donation.

Daniel A. Rosen, a partner at Baker & McKenzie who is working with the coalition, said the IRS proposal is contrary to the agency's earlier treatment of donation-and-credit systems in states such as Alabama that provide state incentives for taxpayers who donate to funds supporting community college programs.

"State and local tax benefits have never been viewed, by the federal government, like a tote bag," Mr. Rosen said in an interview. He said he is considering a pre-enforcement challenge to the regulations, which could be finalized after a Nov. 5 public hearing.

A spokesman for the IRS, Dean Patterson, said he declined to comment because the proposed regulations remain open for public comment.

But the IRS ruling in August that declared the charitable-donation structure unlawful has had a chilling effect, according to Gerry Geist, executive director of the state's Association of Towns and a member of the coalition.

The Village of Rye Brook collected $21,169 from six taxpayers this summer, but Mayor Paul Rosenberg expects the fund will be dissolved.

Ithaca set up a fund in June but no taxpayers used it, according to Mayor Svante Myrick. He attributed the lack of participation to the ability of taxpayers to pre-pay their 2018 city taxes in the last days of 2017, before the new deduction caps took effect.

“We’re accepting contributions,” Mr. Myrick, a Democrat, said. “Frankly I’d rather keep their money here in New York state than use it to finance this tax cut for millionaires and billionaires.”

Scarsdale Public Schools moved to set up a fund but waved off. David Albert, a spokesman for the New York State School Boards Association, said he was “warning districts to wait until we received more guidance.”

Different types of localities collect taxes at different times: Towns and counties generally issue bills in January; school districts in September. Some villages send tax bills in June and July, and were able to collect donations and issue credits before the proposed IRS regulations were published in the federal register on Aug. 27.

The state-level funds remain open, according to state Budget Division spokesman Morris Peters, and are part of Gov. Andrew Cuomo’s multi-pronged challenge to the federal tax law.

In July, New York State Attorney General Barbara Underwood filed a lawsuit along with three other states saying the tax law unfairly targeted New York and other high-tax states governed by Democrats.

Representatives for the IRS and Treasury Department have said they are reviewing the suit.

Mr. Peters said figures of how many taxpayers have donated to the state aren’t available. But at least one donor was Ms. Paulin, who said she and her husband contributed $100,000 to the state fund and $10,000 to the Village of Scarsdale fund.

“It’s monetary, but it’s also a protest,” Ms. Paulin said. “I worry that the changes to SALT are going to destroy our way of life in our state, and I want to be part of an effort to preserve that.”

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By Jimmy Vielkind

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