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BREAKING: IRS Bars State SALT Cap Workarounds

By **Maria Koklanaris**

Law360 (June 11, 2019, 4:25 PM EDT) -- The IRS on Tuesday put an end to state attempts to bypass the $10,000 cap on state and local tax deductions while also limiting deductions for charitable donations in which the taxpayer gets a state tax credit.

The IRS building in Washington, D.C. (AP)

The final regulations prohibit the use of programs implemented in some states in which taxpayers receive a credit against their state income taxes for donations made to charitable funds set up by the state in an attempt to reduce the impact of the federal cap on state and local tax deductions.

The guidance also severely limits programs in many states that provide state income tax credits for donations to private charities or private schools. In proposed regulations released last August, the U.S. Department of the Treasury said it could not reasonably distinguish between state SALT cap workaround plans — mainly developed in blue states after passage of the Tax Cuts and Jobs Act — and those long-standing programs in which states give credit for donations to charities or private schools.

On a call with reporters, senior Treasury officials made another announcement -- they issued a notice that they would release proposed regulations within the next two months on a new provision that allows taxpayers to deduct up to $10,000 if they make a donation to a charitable organization, including one run by a state, the same way they would get a deduction if they paid tax directly to the state. Therefore, if a taxpayer itemizes, and pays $4,000 to the state in property tax, and makes a $7,000 contribution to a charity, the taxpayer could deduct from state taxes, all of the property tax, and up to $6,000 of the contribution, for a total of $10,000, the cap provided for in TCJA.

The Treasury officials also said that upcoming proposed rules would include more information on a controversial provision stating that business owners who make payments to nonprofits in exchange for a state tax credit and a federal deduction can continue to do so and deduct the payments as a business expense.

Tax professionals said they found that provision, termed a "clarification," to be confusing instead. They speculated that it also outlined a way for some business owners, particularly sole proprietors, partners or sole owners of limited liability companies, to get around the proposed SALT rules — an option not available to individuals who don't own businesses.

Update: This story has been updated to include IRS Notice 19-12.