

September 27, 2018

Internal Revenue Service
CC:PA:LPD:PR (REG-112176-18)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Notice of Proposed Rulemaking/Contributions in Exchange for State and Local Tax Credits

The Council on Foundations is pleased to submit comments in response to the above referenced Notice of Proposed Rulemaking (“Notice”). Specifically, our comments relate to the proposed treatment of certain state and local tax credits received in return for charitable contributions, and the effect the proposed amendments to the regulations would have on existing programs currently benefiting numerous independent public charities. Additionally, the Council encourages an exception for pre-existing programs benefiting public charities, and an increase in the de minimis exception described in section 1.170A-1(h)(3)(vi).

The Council on Foundations is a nonprofit leadership association of grant making foundations and corporations, and a public charity qualified under Section 501(c)(3) of the Internal Revenue Code. Our members include over 700 philanthropic organizations and our mission is to provide the opportunity, leadership, and tools needed by these organizations to expand, enhance and sustain their ability to advance the common good.

These comments were developed by the Government Relations and Legal Affairs staff at the Council on Foundations and reviewed and approved by the Council’s President and CEO. Council staff have daily contact with our numerous members and these comments are informed by the issues and challenges our members express. We appreciate your consideration of these recommendations and welcome the opportunity to discuss these items with you further. If you have any questions, please feel free to contact Suzanne Friday at (703) 879-0705, or Suzanne.Friday@cof.org; or Hadar Susskind at (703) 879-0726 or Hadar.Susskind@cof.org.

Sincerely,



Suzanne Friday
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Hadar Susskind
Sr. Vice President of Government Relations

Background: Pre-existing State and Local Tax Credit Programs Benefitting Public Charities

To appreciate the comments and requests set forth below, it is important to understand the scope of state and local tax (SALT) credit programs that were established prior to the enactment of the new limit on deductibility of state and local taxes under section 164(b)(6), and the degree to which numerous independent public charities rely on these programs for support. For reference, see the special report dated April 30, 2018, in *State Tax Notes* entitled “State Responses to Federal Tax Reform: Charitable Tax Credits” (see appendix), which lists 99 unique charitable tax credit programs in 33 states (including the District of Columbia) that are currently in effect (and were in effect before the enactment of H.R. 1). Each of these programs will likely be affected by the proposed amendments to the regulations, causing a significant loss of financial support for charities across the country. A few specific program examples that are important to the charitable organizations and members of the Council include:

1. Alabama credit for contributions made to a scholarship granting organization (SGO). Taxpayers may receive a credit for up to 50% of the tax liability of the taxpayer for up to 100% of the contribution (not to exceed \$50,000). Ala. Code section 16-6D-9. The state and local tax burden as a percentage of state income in fiscal year 2012 was 8.7% as reported by the Tax Foundation. For the same year, the per capita income reported was \$35,337 and the per capita state and local tax burden was \$3,067.
2. Indiana school scholarship tax credit. Taxpayers may receive a tax credit for up to 50% of a donation made to a SGO that provides vouchers for low income students to attend private schools. Ind. Code section 6-3.1-30.5-7. The state and local tax burden as a percentage of state income in fiscal year 2012 was 9.5% as reported by the Tax Foundation. For the same year, the per capita income reported was \$37,580 and the per capita state and local tax burden was \$3,585.
3. Endow Iowa tax credit. Individual taxpayers are entitled to a tax credit for up to 25% of a charitable gift to an endow Iowa qualified community foundation for a permanent endowment fund to benefit charitable causes in Iowa. Iowa Code section 15E.305. The state and local tax burden as a percentage of state income in fiscal year 2012 was 9.2% as reported by the Tax Foundation. For the same year, the per capita income reported was \$43,878 and the per capita state and local tax burden was \$4,037.
4. Endow Kentucky credit. Taxpayers who donate to permanent endowment funds at qualified community foundations can receive a nonrefundable income tax credit of up to 20% of the gift, not to exceed \$10,000. Ky. Rev. Stat. Ann. Section 141.438. The state and local tax burden as a percentage of state income in fiscal year 2012 was 9.5% as reported by the Tax Foundation. For the same year, the per capita income reported was \$34,782 and the per capita state and local tax burden was \$3,298.

Given the breadth of these tax credit programs, the Council does not share Treasury and IRS’ estimation that taxpayers participating in tax credit programs pre-dating the enactment of H.R. 1, who are acknowledged by Treasury and IRS to be affected by these rules (i.e., taxpayers who are beneath the SALT cap and are not subject to the alternative minimum tax), “have never used any state tax credit programs affected by the proposed regulations, and that the proposed regulations will have at most a highly limited marginal effect on taxpayer decisions to donate to tax credit

programs that pre-date TCJA, including educational scholarship programs.”¹ Given the significant increase in the alternative minimum tax (AMT) exemption and AMT phase-out thresholds that were enacted by H.R. 1, a number of taxpayers residing in states with relatively low taxation overall (and with tax credit programs that will be impacted by the rules proposed in the Notice) will likely find themselves in this exact scenario.

The Council’s members are not simply concerned with such taxpayers who are currently participating in such tax credit programs, but also with taxpayers who may have (but for the rules proposed in the Notice) considered participating in such programs. The Council’s members are also concerned with the overall chilling effect on charitable giving (including, for example, in circumstances where taxpayers are unaware that the relevant credit or deduction program is not in fact subject to the rules of the Notice), which does not appear to have been analyzed as part of the Notice’s cost-benefit analysis prepared by Treasury and IRS.

Recommendations and Requests Regarding the Proposed Regulations:

1. Create an Exception for Taxpayers Falling Below the New \$10,000 SALT Threshold

As illustrated by the examples above, many of these existing SALT credit programs are available in states and localities with average SALT liabilities for taxpayers that would fall below the new \$10,000 threshold under section 164(b)(6). As described in the Preamble to the Notice, under prior law, a taxpayer making a \$1,000 contribution to charity and receiving a \$1,000 state tax credit would receive a combined federal and state tax benefit of \$1,000.² The cost to the taxpayer and the federal government would be \$0. The taxpayer’s itemized deductions, taxable income, and federal tax liability would be unchanged from what they would have been absent the contribution. As further stated in the Preamble to the Notice, under prior law, “permitting a charitable contribution deduction for a transfer made in exchange for a state or local tax credit generally had no effect on federal income tax liability because any increased deduction under section 170 would be offset by a decreased deduction under section 164.”³ However, under the proposed rule, in the circumstance noted above, the deduction allowed under section 170 would be reduced by the amount of the tax credit received in exchange, in addition to the reduction to the section 164 deduction for SALT for taxpayers falling below the new \$10,000 SALT threshold.⁴

It is understandable that Treasury and IRS are concerned about taxpayers who may have a “potential means to circumvent the \$10,000 limitation in section 164(b)(6) by substituting an increased charitable contribution deduction for a disallowed state and local tax deduction,”⁵ but the proposed regulations go further by imposing a new tax burden or “penalty” on taxpayers who, because they would not exceed the \$10,000 limitation in the first place, would not be trying to circumvent that limitation by substituting a charitable contribution deduction. If the purpose of the proposed regulations is to address a potential “loophole,” it is also reasonable to tailor the

¹ Contributions in Exchange for State or Local Tax Credits, 83 Fed. Reg. 43,563, 43,569 (Aug. 27, 2018).

² See, e.g., 83 Fed. Reg. at 43,568.

³ 83 Fed. Reg. at 43,564.

⁴ 83 Fed. Reg. at 43,568.

⁵ 83 Fed. Reg. at 43,564.

regulations narrowly to correct the “loophole” without penalizing taxpayers who would not be in a position to circumvent the \$10,000 SALT threshold with charitable contributions.

2. Create an Exception for State and Local Tax Credit Programs in Existence Prior to January 1, 2018

As explained in the Preamble to the Notice, state legislatures are now considering or have adopted proposals to create new SALT credit programs with the aim of enabling taxpayers to claim charitable contributions that are fully deductible for federal tax purposes, while also providing the taxpayer with a dollar-for-dollar offset of SALT liabilities.⁶ The Preamble to the Notice predicts that failure to amend the regulations would “precipitate significant revenue losses that would undermine and be inconsistent with the limitation on the deduction for state and local income taxes adopted by Congress in section 164(b)(6).”⁷ If new programs created specifically to circumvent the new limitations on SALT deductions are the real concern, the regulations can again be narrowly tailored to address these new programs without undermining pre-existing programs that many charitable organizations have relied on for years. Treasury and IRS must take into consideration the consequences of the proposed regulations on pre-existing tax credit programs and the charities that rely on them. Limiting the applicability of the amended regulations to programs established after December 31, 2017, would be a reasonable rule to adopt.

3. Increase the de minimis Exception Described in Section 1.170A-1(h)(3)(vi)

Many pre-existing tax credit programs do not provide a dollar-for-dollar tax credit in exchange for charitable contributions, but instead allow a state and/or local tax credit based on some percentage of the charitable gift. Rather than establish a de minimis exception based on the combined top marginal state and local tax rate, we urge Treasury and IRS to review pre-existing tax credit programs and determine an appropriate de minimis exception that would preserve the benefits under these pre-existing tax credit programs. Based on the Council’s review of pre-existing tax credit programs, a de minimis exception of 50% would preserve the benefits of a majority (81%) of the programs that use percentages to determine the allowable deduction or credit.⁸ Additionally, an increased de minimis exception would limit the need for many state and local tax credit programs to respond to the new de minimis exception by revising the rules and applicability of their respective programs, thereby eliminating the administrative burden on state and local governments.

4. Create an Exception for Gifts to Narrowly Defined Eligible Charitable Organizations

As drafted, the proposed regulations apply to all charitable contributions to organizations listed in section 170(c). As expressed in the Preamble to the Notice, Treasury and IRS are concerned that state and local governments are now incentivized to create new tax credit programs and direct taxpayer contributions to entities that could be used to fund governmental activities.⁹ Once again,

⁶ *Id.*

⁷ 83 Fed. Reg. at 43,565.

⁸ The Council surveyed the existing SALT credit programs as reported in the *State Response to Federal Tax Reform* report and chose 50% as a number that would preserve the majority of these programs.

⁹ 83 Fed. Reg. at 43,568.

if the primary concern is to discourage state and local governments from establishing new programs and using new or existing charitable organizations as a roundabout way to fund government activities, the proposed regulations can be narrowly tailored to address this. Treasury and IRS should consider an exception to the charitable deduction limitations for gifts to charitable organizations that are not affiliated with a government entity, and that agree not to direct contributions received under SALT credit programs for any government activities.

Conclusion:

Each of these recommendations and requests, if incorporated into new regulations, can preserve much of the benefit of the many existing SALT credit programs while still allowing Treasury and IRS to address concerns about potential state workaround proposals to the SALT cap enacted by H.R. 1. These requests are not intended to be mutually exclusive, and the Council urges Treasury and IRS to consider each request as part of a comprehensive strategy to create regulations that align with the intent of the law.