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The Legality and Ethicality of Taking State and Local Taxes as a Charitable Contribution

Luke Holcomb
lch29@zips.uakron.edu

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The University of Akron

Abstract

The Tax Cut and Jobs Act (TCJA) of 2017 fundamentally altered the tax system for corporations and individuals. One of the main objectives of the TCJA with respect to individuals is to increase simplicity by encouraging more taxpayers to take the standard deduction instead of itemizing their deductions. This was set to be largely achieved by doing two main things. First, the TCJA nearly doubled the standard deduction. The second way was to eliminate or limit the deductions that taxpayers that normally itemize can deduct on their tax return. Prior to the changes, the state and local tax (SALT) deduction had no limit and was one of the most commonly claimed deductions for those filers who itemized their deductions. However, the TCJA limits the SALT deduction to $10,000 for both single and married filers. As a workaround many high-tax states passed measures that would allow individual taxpayers to make a "charitable contribution" to state charitable funds in lieu of paying state income taxes.

The ethicality and legality of this possibility has been called into question and will be examined throughout the course of this paper. It is concluded that the common workaround of giving a credit in return for a contribution to a state charitable fund should be effective in avoiding the SALT deduction limitation due to the case law backing this method. The impacts of considering SALT as a charitable contribution would cost the federal government a significant amount of revenue and benefit mostly the wealthy. The most effective solution to the whole matter is for Congress to address these concerns, but for now this method that the states have created to allow individual taxpayers to circumvent the SALT limitation should stand.

The Affects and Legality of Taking State and Local Taxes as a Charitable Contribution

The Tax Cuts and Jobs Act (TCJA) made significant changes to the taxation of individuals, from changing the tax rate brackets to the deductions that a taxpayer can take. The drastic changes that the TCJA had on individuals can also be seen on the corporate side as well, but in this paper the focus will be exclusively on the effects seen to individuals. This legislation was passed through Congress largely on a party line basis by the Republican party. The TCJA was signed into law by President Trump on December 22, 2017 and amends the Internal Revenue Code (IRC) of 1986. The TCJA is a net tax cut of $1.35 trillion, an increase of $4.60 trillion and a cut of $6.58 trillion (Tax Foundation, 2017).

The background information on the purpose and motivation behind the TCJA are important to understand before looking into some of the issues that have arisen under this reform. The overall goal of this reform is to lower the taxes for individuals and to simplify the individual tax return process. Simplification measures include approximately doubling of the standard deduction to $12,000 per taxpayer and eliminating or limiting specific itemized deductions. It is estimated that these changes will decrease the number of individuals who itemize deductions from 31% to 12% (The Joint Committee on Taxation, 2018, p. 5). This simplification could not be achieved without limiting or eliminating certain deductions, most notably limiting the deduction for state and local income taxes (SALT).

The SALT deduction was first enacted in 1862 (Tax Analysts, 2017). The purpose of the deduction was to avoid double taxing citizens since taxpayers had already been paying state and local taxes when the federal system was created (Tax Analysts, 2017).

The charitable contribution deduction was enacted to encourage charitable giving. By offering this tax incentive to taxpayers who itemize their deductions, the federal government hopes to encourage charitable giving to private organizations and government funds.

Methodology

The paper relies primarily on the Internal Revenue Service's (IRS) documents including memorandums and regulations as well as the IRC. In addition to this literature, a variety of other scholarly articles weighing in on this topic will be used. More important than these other articles are the court cases and portions of the IRC that these articles point to in justification for their views. Lastly, resources will also be utilized from various organizations and think tanks such as Pew Research Center, Tax Foundation, and Tax Policy Center. This topic is currently unfolding as of the writing of this paper, and as it unfolds the issue may become clearer as Congress and the courts weigh in.

Pre-Tax Reform Deductions

As previously mentioned, the TCJA altered many of the deductions that individuals can take when they choose to itemize. One of the largest deductions altered is the state and local income taxes (SALT) deduction. This impact will vary from taxpayer to taxpayer depending on the state and local income tax rates to which they are subject to.

SALT Deduction

Reference to the SALT deduction includes: state and local income taxes, general sales taxes, real estate taxes, and personal property taxes. Although, each is not proportionally represented under the deduction. Table 1 shows the average claim amount for each specific component of the SALT deduction and how many people claimed the deduction by adjusted gross income.

Table 1. Average State and Local Tax Deductions Amount and Percent Claimed, Tax Year 2016

Adjusted Gross Income	Income Tax Option	Sales Tax Option	Real Estate Tax Option	Personal Property Tax Option
$0 to 20K	$1,364 2%	$658 2%	$3,712 3%	$441 2%
$20k to $50k	$1,825 10%	$1,139 6%	$3,276 12%	$493 6%
$50K to $100K	$3,619 36%	$1,669 7%	$3,728 39%	$439 20%
$100K to $200K	$7,259 63%	$2,457 12%	$5,153 69%	$541 35%
$200K to $500K	$17,372 78%	$4,017 14%	$8,425 86%	$633 42%
$500K to $1 million	$46,918 80%	$5,455 13%	$14,575 88%	$851 37%
>$1 million	$273,335 81%	$15,274 10%	$29,396 87%	$1,217 34%

Source: IRS Statistics, Taxable Year 2016

Examining Table 1 reveals that a majority of taxpayers earning more than $100,000 in AGI claimed some portion of the SALT deduction. In addition, the percentage of taxpayers claiming the SALT deduction continues to increase as AGI increases, mainly due to the real estate and income tax options.

Prior to the TCJA, individuals who chose to itemize would in large part choose to do so because of the SALT deduction which is available under Sec. 164 of the IRC (Lowry, 2017). A deduction for SALT has always been available since the inception of the federal income tax in 1913 (Tax Analysts, 2017). At least some individual taxpayers in every state claimed this deduction, but the largest concentration of taxpayers claiming this deduction reside in the Northeast and the West (Tax Foundation, 2017). Typically, the regions where more taxpayers claim this deduction also claim a higher deduction than other regions due to generally higher taxes. (Bankman et al., 2018). For example, Table 2, below, outlines the top-ten counties in the US for SALT in 2016.

Table 2: Top Ten Counties for State and Local Deductions (2016)	
New York County, NY	$25,627
Marin County, CA	$19,334
San Mateo County, CA	$16,779
Westchester County, NY	$15,678
Santa Clara County, CA	$14,969
Fairfield County, CT	$14,575
San Francisco County, CA	$13,925
Nassau County, NY	$12,414
Morris County, NJ	$12,286
Somerset County, NJ	$11,773

Source: IRS SOI Tax Stats – County Data, Tax Foundation (2016). https://taxfoundation.org/state-and-local-tax-deduction-by-county-2016/

Prior to the TCJA, however, approximately a third of taxpayer's chose to itemize their deductions, rather than take the standard deduction (The Joint Committee on Taxation, 2018). Of those taxpayers who choose to itemize their deductions, most of them took advantage of the SALT deduction. Taxpayers earning in excess of $200,000 in adjusted gross income (AGI) claimed the SALT deduction more than 90% of the time (Lowry, 2017). The significance of this to States is outlined in Sec. 3 of this report.

Most high-income taxpayers that claimed this deduction were able to reduce their tax liability by such a large amount that they were forced to pay the alternative minimum tax (AMT) and could not take the full advantage of this deduction (Colinvaux, 2018).

Calculating a taxpayer's SALT deduction is straightforward and continues to be under the TCJA. The amount is equal to the greater of general sales tax or state and local income tax plus real estate taxes, personal property taxes, or any mandatory contributions. General sales tax is calculated either as an actual amount or based on the optional sales tax tables provided by the IRS and is generally only utilized by taxpayers who live in states that do not have an income tax (Tax Policy Center, 2017).

The administrative mechanism for claiming the SALT deduction is relatively simple since taxpayers also file with their state and municipality. Taxpayers can deduct their taxes paid along with any mandatory contributions. Mandatory contributions are only applicable in certain states, and are contributions to unemployment or workmen's compensation funds, state-related disability funds, or family leave programs. Depending on the state, some taxpayers may have more expense from sales tax and may choose to deduct that expense. The sales tax deduction option was added in 2004. This can be done based on actual receipts or an estimate for their major purchases made that year. While the deduction was almost unlimited there was one restriction. The taxpayer can elect to deduct state and local general sales taxes instead of state and local income taxes, but the taxpayer cannot do both (Internal Revenue Service, 2016).

In addition to income taxes, individuals can also deduct their real estate taxes paid during the year. It is important to note that taxpayer's who own a business do not deduct any real estate taxes associated with their business on Schedule A. Rather, the taxpayer can deduct taxes that are applied to their real property used for general community or governmental purposes as a business expense. The last state and local tax that can be deducted on Schedule A is personal property taxes based on the property's value. For example, car registration based solely on the value of the vehicle (Internal Revenue Service, 2016).

Charitable Contribution

The deduction for charitable contributions is available under the Sec. 170 of the IRC, and, like the SALT deduction, is widely taken by taxpayers who choose to itemize. Charitable contributions are not only amounts contributed to nonprofit organizations, such as churches, educational institutions, and other charitable entities. There are a variety of other qualifying institutions – governmental entities being of particular interest. Sec. 170(c)(1) describes the qualifying governmental entities as:

> A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

Deductible charitable contributions can be made in either cash or property. Determining the value of a cash contribution is a relatively straightforward process, as the fair market value is already determined. If contributing property, then the “fair market value” must be assessed. But, in some instances (such as when basis is lower than fair market value for a vehicle), then “basis” can be used depending upon the recipient organization. There are several special provisions and regulations to consider when deciding whether the contribution should be considered based on fair market value or basis, but in order to stay focused on the issue at hand any property contributed will be assumed to be taken at its fair market value unless otherwise stated.

There are several limitations on charitable contribution deductions. Of significant relevance to this paper are the regulations that contain a quid pro quo provision. This provision limits amounts contributed to be reduced by any benefit received in return (i.e. thank-you gifts). In addition, the overall combined amount of deductions, in general, cannot be greater than 50% of the taxpayer’s adjusted gross income, but in some cases may be limited to 30% or 20%

depending on the nature of the contribution. It is important to keep in mind that donations to governmental organizations fall under the 50% limitation and not the 30% or 20% limitation. The IRS has even temporarily suspended limits on charitable contributions for certain events such as hurricanes and other natural disasters in order to have more funds assisting in recovery (Internal Revenue Service, 2017).

In addition to the federal deduction most states also offer their own charitable contribution deduction. In most states these deductions mirror the federal deduction in using the fair market value of property. States also contain their own similar quid pro quo provisions. It is notable however that neither state or federal filings require taxpayers to reduce their charitable contributions by the tax benefits received from either their federal or state tax returns (Bankman et al., 2018). No taxpayer has ever been required to reduce their federal deduction by the value of the state charitable contribution deduction, possibly indicating that the federal government does not consider the state deduction for charitable contributions to be a quid-pro-quo arrangement. This will become evident in memorandums issued by the IRS that will be addressed later in this paper.

One final important point is that in order for charitable contributions to be deductible, a charitable intent must be present. Whereas a tax is mandatory, a charitable contribution is done voluntarily and sacrificially. Determining charitable intent has been a question that both the IRS and case law have addressed which will be assessed later in this paper.

The Tax Cuts and Jobs Act

As stated in the introduction, one of the biggest changes brought by the TCJA was the change in the standard deduction. Prior to this piece of legislation, the standard deduction for a single individual or married taxpayer filing separately was $6,350. The standard deduction prior to the TCJA for a married couple filing jointly was $12,700. The TCJA has increased the standard deduction to $12,000 for a single taxpayer or a married taxpayer filing separately, and $24,000 for taxpayers filing married jointly. A major consideration in making this change was to allow some people who would normally itemize their deductions to take the standard deduction instead, thereby increasing simplicity (Center on Budget and Policy Priorities, 2018).

Increasing the standard deduction is projected to reduce government revenue by $720.4 billion over the years 2018 – 2027. At the same time, the repeal or limitation of itemized deductions, including the $10,000 limit on state and local taxes, is expected to increase government revenues by $668.4 billion over the same time period for those taxpayers who will still itemize their deductions (The Joint Committee on Taxation, 2017). Given this new $10,000 limit on state and local taxes, individuals who will still itemize their deductions are looking for ways to avoid this limitation. It is these attempts that are the focus of this paper.

Post-Tax Reform Deductions

The focus of this research is on the changes to the SALT deduction and some of the political considerations on the new limitation. This limitation on the SALT deduction is one of the most controversial components of the TCJA both ethically and feasibly (Beebe, 2018). Politicians and legislators in states with low income tax rates and low property taxes claim the SALT deduction is a subsidy for those taxpayers who reside in states with income and property taxes. Conversely, politicians and legislators in high tax states argue that they charge higher taxes due to reduced federal funding and therefore need the extra revenue to keep their governments operating (Colinvaux, 2018).

SALT Deduction

The significant limitation on the SALT deduction is the motivation for this paper. The limitation is $10,000 per tax return. As previously mentioned, this includes state and local income, real estate, personal property and sales taxes. This means that if a single person paid $25,000 in SALT property and income taxes, they can only deduct up to $10,000 of their taxes on their federal tax return. Unlike the charitable contribution, the taxpayer cannot roll forward the unused amount to future returns (Oliff & Samms, 2018).

One of the controversial issues with the new limitation is that it adversely affects married taxpayers, especially those moderate-income taxpayers who claim under $20,000 jointly. There are many marriage bonuses and penalties under the current system. These can range from the progressive tax rate structure that sometimes pushes two married taxpayers into a higher tax bracket than each would be subjected if they were not married to the amount they are eligible to take for certain deductions. The SALT deduction limitation is one of these marriage penalties. A single taxpayer and a married couple filing jointly both have the same $10,000 limitation for the SALT deduction. Note that this limitation cannot be avoided by the married couple filing separate returns - if the married couple tries to file separately, they each will then have a limitation of $5,000.

Charitable Contributions

Charitable contributions remain largely unchanged by the TCJA. The most notable change is the change in the total amount of charitable contributions that can be deducted. Instead of being limited, in general, to 50% of a taxpayer’s income the limit is now 60% of a taxpayer’s adjusted gross income for cash contributions only. For charitable contributions that aren’t deductible due to the percentage limitation taxpayers can still carryforward any unused deduction for five years.

There could be several reasons for the increase in the limit for charitable contributions, especially in the face in many more itemized deduction limitations. First of course is that the government continues to want to encourage taxpayers to make charitable contributions despite the increase in the standard deduction. Another thought is that since the marginal benefit of all deductions decreased due to reduced tax rates for individuals, the increased percentage limitation will encourage taxpayers to utilize this deduction. Lastly, unlike the SALT deduction the charitable contribution is not affected by geography, so all taxpayers have an equal opportunity to take this tax deduction, whereas the SALT deduction is heavily dependent on the state in which a taxpayer resides (Beebe, 2018).

Workarounds Created by the States

Table 2 above outlined some of the counties most affected by SALT. However, there are many more counties and states that will also be greatly affected by the new SALT deduction limitation. For these states most affected there is political pressure to find workarounds to circumvent the SALT deduction limitation. Tables 3 and 4 further illustrate the significance of the SALT deduction as a percentage of AGI for all taxpayers, and the value of the SALT deduction by state as a percentage of AGI.

Table 3: Value by Income of the SALT Deduction as a Percentage of AGI		
AGI	**State and Local Deduction Value as Percent of AGI**	**Percentage of Filers Itemizing**
$0 – $24,999	2.30%	5.90%
$25,000 – $49,999	2.00%	19.10%
$50,000 – $99,999	3.80%	44.30%
$100,000 – $499,999	6.70%	80.20%
$500,000+	7.70%	93.10%

Source: Tax Foundation, Internal Revenue Service - "Statistics of Income Tax Stats, Tax Year 2016: Historic Table 2, 'Total File, All States,'" https://taxfoundation.org/salt-deduction-benefit/

Table 4: Value by State of the SALT Deduction as a Percentage of AGI					
	State	**Deduction as Percent of AGI**	**State Share**	**AGI Per Filer**	**Percent of Itemizers**
Top States	New York	9.40%	13.10%	$80,260	34.90%
	New Jersey	8.80%	5.90%	$84,472	41.80%
	Connecticut	8.50%	2.50%	$92,782	41.60%
	California	8.10%	20.70%	$79,332	35.20%
	Maryland	7.90%	3.20%	$76,069	46.40%
	Oregon	7.20%	1.60%	$65,038	37.00%
	District of Columbia	7.10%	0.40%	$93,023	40.20%
	Massachusetts	6.40%	3.50%	$88,393	37.40%
	Minnesota	6.30%	2.20%	$71,467	35.40%
	Rhode Island	6.10%	0.40%	$64,162	33.20%
Bottom States	Mississippi	2.90%	0.30%	$48,362	24.10%
	Texas	2.80%	4.00%	$64,335	24.20%
	Louisiana	2.80%	0.60%	$56,886	24.60%
	Alabama	2.70%	0.60%	$55,598	26.40%
	Florida	2.60%	2.80%	$61,988	23.90%
	Nevada	2.20%	0.40%	$64,588	26.00%
	Tennessee	1.90%	0.60%	$58,457	20.30%
	South Dakota	1.80%	0.10%	$61,450	17.90%
	Wyoming	1.80%	0.10%	$69,484	22.20%
	North Dakota	1.80%	0.10%	$66,250	19.10%

Source: Tax Foundation, Internal Revenue Service, "Statistics of Income Tax Stats, Tax Year 2016: Historic Table 2, 'Total File, All States,'" https://taxfoundation.org/salt-deduction-benefit/

Therein, several of the most affected states have enacted workarounds or are in the process of enacting workarounds (Davison, Browning, & Steverman, 2018).

Reference to the term “workaround” simply means a method for overcoming an issue. For example, an example of a workaround has been to create state charitable funds set up to benefit the public. In return for the taxpayer contributing to the government-linked charity their tax liability is reduced by the amount contributed. The way that some of the specifics play out vary from state to state, and we will evaluate some of the most prominent workarounds. In addition to the specific states listed below California, Illinois, and a handful of other states also have these workarounds in place and depending on the outcomes that these states experience more states are likely to join them or decide to not take the same actions. It is important to note that the legality of these workarounds is an ongoing question. Specific examples are discussed in the paragraphs below.

New York

New York is probably the most cited example when it comes to this workaround. They were the first state to pass legislation to maintain their revenues and at the same time help their wealthiest taxpayers. One of New York’s biggest fears is losing some of their wealthiest taxpayers due to the increased cost of living in the state since taxpayers would not be able to deduct their SALT expenses. If their wealthiest residents were to move out of the state, then both the state and local governments would see their tax base, and therefore their revenues start to diminish.

New York actually implemented three different workarounds to enable their residents to avoid the new SALT limit. The first two changes are thought of as the more general approach that states have taken. First, the state sets up a state administered charitable fund that benefits a variety of public initiatives. Taxpayers who contribute to this fund can receive an income tax credit equal to 85% of their charitable contribution. When this law was passed, legislators claimed that taxpayers could fully deduct the amounts from their federal tax return if they itemize, thereby avoiding the $10,000 limitation. The second change was similar to the first, and authorized local governments to create their own funds. In return for taxpayers contributing to these funds they would receive a property tax credit equal to 95% of their contribution (Pedersen, 2018).

The third change is substantially different from the first two and involves the taxpayer's employer. The option is to increase payroll tax on an employee's wages above $40,000. This would result in a decrease of the employee's net pay. The employees would get an income tax credit on their state tax return to compensate the difference, and their income would be lower for their federal tax return. Employers in return would also be able to deduct this amount since employer-paid payroll taxes remain fully deductible for employers. It is unclear how many companies would be willing to choose this option mainly due to the administrative issues likely to come with it (Sammartino, 2018).

New Jersey

New Jersey, like New York, is also a high-tax state and therefore wants their wealthiest residents to be able to deduct their state and local taxes on their federal tax return. New Jersey's attorney general, Gurbir Grewal, was already suing to overturn the SALT deduction limitation imposed by the TCJA before the passage of this legislation to try to circumvent the deduction limitation. With their new legislation they issued this notice, "The Division of Local Government Services makes no representations with respect to how the IRS will treat property tax creditable-contributions to a charitable fund." New Jersey's attorney general has already indicated that they are willing to see their legislation through as far as possible when it is challenged (Reitmeyer, 2018).

Similar to New York's second mechanism, New Jersey will allow local governments, counties, and school boards to set up new civic groups. The taxpayer then gets a credit equal to 90% of their contribution. This credit can then be applied to the taxpayer's property tax bill. This contribution, in theory would be deductible as a charitable contribution rather than as a SALT deduction, and the property tax portion typically made up the majority of New Jersey residents' SALT deduction at an average of $8,700 since New Jersey has the highest property tax rates in the nation (Gordon, 2018).

Connecticut

Connecticut was third state to pass workaround legislation for the SALT limitation. Per the Tax Policy Center, the average SALT deduction taken in Connecticut was for $19,665 (Gordon, 2018). Under the TCJA this would mean that the average taxpayer would only be able to take about half of the SALT deduction that they used to be able to take prior to the passage of the TCJA. Like other states they claim that the tax is targeted at Democratic leaning states, and that most of their taxpayers will not be expecting the new limitation and will not know about it until they go to file their taxes. This will be examined further when taking a deeper look at the politics and ethics of the SALT limitation later in this paper.

The first method is similar to New York and New Jersey. Local communities, counties, and school districts can setup certain charitable fund for public use. When taxpayers contribute, they will get a property tax credit equal to 90% of their contribution, which the taxpayer can then use this deduction to lower their property tax liability (Davison, Browning, & Steverman, 2018).

The second method is, however, unlike either New York or New Jersey. The plan imposes a 6.99% tax on the net income of partnerships, S corporations, and limited liability corporations (that file as a partnership on their federal tax return). This amount is still deductible for the business, lowers the distribution for the members of the entity, and gives the members a credit in the amount of the tax. Bloomberg (2018) published an easy to follow example of what this would look like in practice:

> For example, if a Connecticut partnership has two partners and $1 million in income in total, it would pay the state $69,000 under the new pass-through entity tax. That would leave $931,000 of taxable income to pass along to the two partners. The two partners could deduct 93 percent of that $69,000, or $32,085 each, from their federal tax bills -- an offset that could compensate for the SALT cap.

This method would only benefit taxpayers who are members of a pass-through entity. Based on the method, the members would virtually end up in the same position that they were in before the SALT limitation was enacted by the TCJA (CT S.B. 11, 2018).

Effects of the SALT Limitation

The effects of the SALT limitation on the SALT deduction for state and local governments are not likely to be so much economic, but rather political and also ethical. It is hard to imagine that taxpayers are going to leave their houses and jobs in high tax states to go somewhere else where they will not pay as much in taxes. The cost to move and possibly find new jobs in different states will likely be enough to prevent a large migration of wealthy taxpayers (Steverman & Foxman, 2018). However, this does not mean that these taxpayers will gladly take this increase in their federal tax liability.

Political pressure will most likely be their main means for pushing for changes (Tax Analysts, 2018). This is partially why state governments are likely to continue to try to find alternate workarounds if the current workarounds do not work (Pedersen, 2018). If unsuccessful, wealthy taxpayers in high-tax states may begin to support politicians who will enact lower taxes. While the economic cost to states due to the SALT limit may not be substantial unless it causes wealthy taxpayers to move out of state, there are still significant costs to states in terms of political pressure. As discussed above, the limit is believed to disproportionately affect high-income taxpayers in high-tax, Democratic-leaning states. This political pressure could divide states and cause upheaval in state government if changes are not forthcoming.

IRS Memorandums

Memorandums issued by the IRS can give the public some insight into the logic used by the IRS takes behind specific tax issues. Concerning the issue being examined there have been several relevant memorandums issued. An important note to keep in mind when examining Chief Counsel Advice (CCA) memorandums is that they do not set any precedent except for the specific case examined. However, these memorandums do offer insight as to how the IRS has addressed this issue over time and whether their interpretations have changed or largely remained unchanged.

CCA 200238041 – Colorado Easement Credit

This CCA memorandum involves a Colorado taxpayer during the 2000 calendar year. A Colorado state income tax credit is available for the donation of all or a portion of the value of a conservation easement in gross by the taxpayer. If the charitable contribution deduction is claimed on the taxpayer’s federal tax return, in the amount of the donation, then they must add back to determine the taxpayer’s state taxable income. The credit cannot exceed $100,000 and can be carried forward for up to 20 years. The taxpayer can also have the credit refunded or transferred under certain situations.

There are two issues that this case precipitates. The main issue is whether the contribution can be considered a charitable contribution under Sec. 170. A central question part of this issue whether the use, transfer, or refund of the credit should be considered a quid pro quo that would reduce the federal deductible charitable contribution amount. The second issue is whether the benefit of the credit is, in substance, an amount realized from the transfer of the easement under Sec. 1001.

With the first issue of the potential charitable contribution the examination must being whether there was any expected quid pro quo. Case law demonstrates that the benefit does not need to come from the done and the benefit does not need to be known at the time of transfer. In this CCA memorandum, the IRS Chief Counsel stated (p. 4):

> Under the return benefit analysis, we will need to consider the fact that the tax benefit of a federal or state charitable contribution deduction is not viewed as a return benefit that reduces or eliminates a deduction under § 170 or violates charitable intent.

The second, and less consequential finding in this memorandum is regarding the disposition under Sec. 1001.

To summarize there are several elements that must be considered when evaluating if the contribution constitutes a disposition. These elements include: refunds, credits, transfers, bargain sale, timing, and transfers to charity. Whether in this fact pattern the issuance of a state tax credit and how it affects the federal deductibility under Sec. 1001 is unknown. However, it seems unlikely that the receipt of a state tax credit would preclude the deduction of the easement (Internal Revenue Service, 2002).

CCA 200435001 – Oregon Child Care Contribution Credit

Oregon provides a credit against Oregon personal and corporate income tax or corporate excise tax for certain contributions made to the Oregon Child Care Division. The Child Care Division of the Employment Department and an advisory committee established by the department allocate tax credit certificates to taxpayers that make qualified contributions (Internal Revenue Service, 2004). The department and committee establish a fixed percentage for the credit. In addition, they then decide how to distribute the contribution to qualified child care providers. This program has several purposes; the first is to encourage contributions to the Oregon Child Care Division by providing a financial return on contributions. Other goals include achieving specific goals for targeted communities, set standards for quality and affordable child care, and strengthening child care providers while making child care more affordable for low- and moderate-income families (Internal Revenue Service, 2004).

This 2004 CCA memorandum addresses whether contributions to the Oregon Child Care Tax Credit Program can be deductible as a charitable contribution deduction on the taxpayer's federal tax return. Another question addressed by this memorandum is whether is whether the taxpayer can take a deduction for the payment of state tax. In the summary, the 2004 IRS memorandum the IRS Chief Counsel states:

> [P]ayment for which a benefit of receiving a state income tax credit may be expected raises serious concerns as to the deductibility of such a payment as a charitable contribution on the contributor's federal income tax return (p. 2).

The CCA memorandum then goes on to say that if the contribution is not deductible as a charitable contribution then it would likely be deductible as under Sec. 164 as a payment of state tax.

As a charitable contribution, the transfer must be a gift to either a charitable organization or governmental entity, such as the state of Oregon in the fact pattern of this CCA memorandum. The deductible amount must again be deducted by any return benefit with a caveat. “The tax benefit of a federal charitable contribution deduction is not regarded as a return benefit that negates charitable intent, reducing or eliminating the deduction itself” (Internal Revenue Service, 2004, p. 4). Similarly, state deductions for state tax purposes are treated the same. However, the situation of a state tax credit is arguably distinguishable from receiving just a deduction.

The analysis around the deduction as a payment of state tax centers around its deductibility as a charitable contribution. If the credit is viewed as a quid pro quo that would eliminate the necessary charitable intent to claim it on the taxpayer’s federal tax return. If this were the case that there is a disqualifying benefit, then arguably the contribution should be viewed as a payment of state tax. This would then be deductible as a federal deduction under Sec. 164. In the views of this official, they could not come up with a definitive answer, but only provide the advice given.

It should be noted that in both the 2002 and 2004 CCA memorandums, the IRS Chief Counsel recommended that this complex issue be addressed in official published guidance.

CCA 201105010

The issue was addressed again in 2010 where the IRS Chief Counsel explained that official published guidance was not expected, so this CCA was intended to offer further advice to taxpayers. The taxpayer being analyzed in this situation contributed to four different state tax credit programs. First, the taxpayer contributed money or property to W Fund for a credit equal to a% of the contribution. This credit can be applied to their state income tax and carried for up to five years or transfer the credit for a certain percentage. The second is a contribution to the X

Program and is like the first. The credit is equal to d% of the contribution, but with no option to transfer the credit. The credit again is for state income tax and can be carried forward for five years. The third is a contribution of money or property to the Y Program. With the credit equal to e% of property and f% of monetary and applicable to state income taxes and can be carried forward for five years. The last is a contribution of cash, stock, bonds, or other marketable securities. In exchange the receive a credit for state income taxes equal to g% of the contribution, and it can be carried forward for up to four years.

The first issue in question is whether a cash payment to a state agency can be considered a charitable contribution under Sec. 170 or a payment of state tax can be deductible under Sec. 164. The second issue was nearly identical but dealt with property rather than cash. The conclusion in this case was that both the cash and the property is considered a charitable contribution and deductible under Sec. 170, but not under Sec. 164.

In reaching this conclusion, it was first noted that, “A transfer is not made with charitable intent if the transferor expects a direct or indirect return benefit commensurate with the amount of the transfer” (Internal Revenue Service, 2011, p. 3).

It is then noted that the charitable contribution amount should be deducted by any return benefit received. Then the key finding is stated, “The tax benefit of a federal or state charitable contribution deduction is not regarded as a return benefit that negates charitable intent, reducing or eliminating the deduction itself” (Internal Revenue Service, 2011, p. 4). The memorandum then references existing case law, and it should be noted that this memorandum along with prior memorandums suggested the issue be addressed in official published guidance. The memorandum concludes that it qualifies under Sec. 170 rather than Sec. 164 because in general a state and local benefit is regarded as a reduction in tax liability, not an alternative payment.

CCA 201147024 – Massachusetts Credit Programs

The state of Massachusetts offers a variety, five in this case, of incentive programs for taxpayers to contribute to certain funds. The first is the Brownfields Tax Credit which is non-refundable and is given for environmental response actions that protect the public from certain hazards in exchange they receive a credit for 25% or 50% of the costs.

Second is the Motion Picture Tax Credit where a taxpayer can claim a 25% tax credit for payroll and production expenses within the state. The taxpayer can receive a 90% refund of this credit.

Third is the Historic Rehabilitation Tax Credit for taxpayers incurring rehabilitation expenditures of a qualified historic structure. The credit for 20% of costs can be carried forward for five years or transferred but not refunded.

Fourth is the Low-Income Housing Tax Credit which is available for qualified low-income housing projects in the state. The credit is based on availability and is not refundable, however it may be transferred, sold, or assigned to other taxpayers eligible for the federal low-income housing credit.

Fifth is the Medical Device Tax Credit which can be claimed by a medical device company for 100% of the fees paid to the US Food and Drug Administration for qualifying projects. The credit is nonrefundable, but can be transferred for private financial assistance, as long as the assistance provided by the transferee is equal to at least 75% of the medical device tax credit amounts eligible to transfer (Internal Revenue Service, 2011).

The official identifies five issues to be addressed by this memorandum. They center surrounding the treatment of transferred or sold tax credits. This includes basis, recognizing gain, and the taxability of any sale. However, for the purposes of this paper we will only examine the question of the taxability of the sale of a tax credit.

In determining that the sale of one of these tax credits is taxable a sale for purposes of Sec. 1001 the officer discuss some of the federal deductibility questions. In this case the official states, “we do not agree that such a reduction in a taxpayer's potential tax liability is the equivalent of a payment to the taxpayer” (Internal Revenue Service, 2011, p. 4). Rather the official says that it simply enters in the taxpayer’s SALT liability and is reflected in the amount that amount of the taxpayer’s SALT deduction.

Given the deductibility of SALT on federal returns the argument is that there is no real return benefit since the state benefit is offset by the lower SALT deduction available to the taxpayer. This view may give some deeper insight to why the IRS has never held the state and local benefit to be a return benefit for federal taxation purposes.

Case Law

Despite the prominence of this issue currently, it has long gone untouched by the IRS except for the CCA memorandums addressed above, and as noted previously these memorandums carry no precedence except in the specific case being examined. However, several court cases have ruled on the issue charitable contribution and SALT deductions and were utilized as the underlying reasoning for the determinations made in these memorandums. Therefore, it is important to have an understanding of these cases since they do carry more weight and are cited in the IRS memorandums as part of coming to a conclusion.

Commissioner v. Duberstein

This case came before the United States Supreme Court in 1960 and was a landmark case in determining that a donor’s intent must be considered when determining whether a payment should be treated as a gift or as taxable compensation. The case presented two fact patterns, the first being the namesake of the ruling. Duberstein, the taxpayer, was president of Duberstein Iron & Metal Company received a Cadillac from Berman who was the president of Mohawk. Duberstein provided Burman with information on customers, and Berman offered the Cadillac for the information. Duberstein did not want to accept the car, but eventually did so. Mohawk deducted the car as a business expense, but Duberstein did not include the car in his gross income. The Commissioner asserted a deficiency with respect to Duberstein and this was affirmed by the Tax Court.

Also, as part of this case was the fact pattern from Stanton v. United States. Stanton was employed as the comptroller of Trinity Church and had worked there for ten years. He resigned to go to go into business for himself and received a $20,000 “gratuity.” The Commissioner assessed a deficiency which Stanton paid while suing for a refund in Federal District Court. That judge ruled in favor of Stanton that the amount was a gift, but this was reversed by the Court of Appeals (United States Supreme Court, 1960).

There are two central issues at play in this case, one for each fact pattern. With respect to Duberstein was the Cadillac a gift excludable from income? With respect to Stanton, was the gratuity a gift excludable from income or part of some severance agreement?

In each scenario, the court had to determine whether the payment should be treated as a nontaxable gift or as taxable compensation. The court was fairly clear and concise on the question relating to Stanton. All but Justice Douglas believed that the Cadillac given to Duberstein was not receiving a gift, but rather Duberstein was receiving a payment for the information that he provided. With regard to Stanton the court was split and remanded the case back down to the trial court to make the determination whether the payment was a gift or payment for work performed previously. In determining that the Cadillac was not a gift to Duberstein, they looked at the intention behind the exchange of the gift. Duberstein in his own testimony testified that he did not believe he would have received the Cadillac if he had not supplied Berman with the information. Intent is a question of fact and must be decided on a case by case basis (United States Supreme Court, 1960). This case was a landmark ruling in determining that a gift must have donative intent.

Singer Co. v. United States

This case did not make it all the way to the Supreme Court but was decided in the U.S Court of Claims in 1971 and stands in contrast of the Duberstein case. The plaintiff, The Singer Company, is attempting to recover a little over half a million dollars plus interest in alleged overpayments. Singer claimed that it should be allowed a deduction for their contribution of sewing missions at a discount to sewing schools and other charities (non-school related). They sold these products at a discount to sewing schools with the intention of securing future sales to these students. Their donations to other charitable organizations, such as the Red Cross, were not donated to try to secure future sales (United States Court of Claims, 1971).

Similar to the *Duberstein* case, the main issue in question here is the intent behind the contribution. Do contributions with the intent of generating future sales constitute a quid pro quo and therefore destroy the deductibility of the contribution? Does the expected benefit have to come directly from the donee organization (the sewing schools versus their students) to be considered a quid pro quo? This was one of the first cases following the *Duberstein* ruling, and was seen as one of the early cases that rejected the *Duberstein* approach.

Instead of focusing on intent as was done in *Duberstein*, the Court of Claims instead decided to apply another test to the contribution. It is not clear why they did not follow the precedent presented in *Duberstein*. They instead used a quid pro quo test to determine the deductibility of a contribution. The court decided that a quid pro quo in which benefits received, or are expected to be received, are “substantial” then charitable contribution deduction may be denied. The court also held that for corporations distinguishing between direct and indirect benefits was too restrictive, instead all benefits should be examined. As such, all benefits that are received or expected to be received should be considered whether they came directly from the donee organization or some other source. Thus, the gifts to the schools were not deductible as charitable contributions since Singer expected those students to become future purchasers, and this destroyed the charitable intent. The other gifts were allowed to be deductible since there was not a significant quid pro quo (United States Court of Claims, 1971).

Browning v. Commissioner

This case that was heard by the United States Tax Court in 1997. Charles and Patricia Browning asserted that they made a bargain sale of the easement of their property to Howard County. They claimed that they were entitled to a charitable contribution in the amount of the difference between the fair value and realized amount. The Commissioner, however, did not believe that the fair market value exceeded the amount realized from the sale of the easement to Howard County. Both parties agreed that all other components needed to satisfy Sec. 170 have been satisfied. The only issue in question then in this case was how the fair market value of this easement should be calculated.

Browning has an expert testify that the value of the easement on the conveyance date was $563,000. The Commissioner stated that the fair market value of the easement should be equal to that of what the county paid the Brownings, based upon the fact that the Howard County generally paid the same amount for easements under the county’s program. Alternatively, the

Commissioner argued that the fair market value was $367,000. Regardless of the fair market value, the charitable contribution deduction must be reduced by the payment received from the county. Notably in this case, however, was the fact that the Commissioner argued that the charitable contribution deduction should also be reduced by the anticipated charitable contribution deductions. Judgement was entered in favor of the Brownings at a slightly smaller fair market value derived from an additional scenario provided by the Brownings' expert. This judgement reaffirms how a charitable contribution of property should be calculated (United States Tax Court, 1997). That is, the fair market value of the property less any benefits received, and those benefits do not include the value of charitable contribution deduction

IRS Proposed Regulation – REG-112176-18 24

As expected by several states when they passed their SALT workaround legislation, the IRS was quick to issue guidance, in the form of a regulation, to put a stop to these workarounds (Internal Revenue Service, 2018). The proposed regulation was formally published on August 27, 2018 and a public hearing on the issue was scheduled for November 5, 2018. The amendment would apply to contributions made after August 27, 2018. This regulation is expected to be finalized, and shortly afterwards some of the affected states are expected to begin pleading their cases through the judicial system.

After giving some background information on the issue being addressed, the regulation begins by discussing the charitable contribution deduction. It cites several court cases in how the federal charitable contribution deduction amount should be calculated. The regulation notes that while some charitable contributions may trigger a quid-pro-quo benefit, any contribution amount that exceeds the fair market value of the benefit should still be an allowable deduction if the excess amount was transferred with intent of making a gift. The proposed regulation further notes that any benefit received by the contributing taxpayer does not not have to come directly from the donee or be quantifiable at the time of transfer (Internal Revenue Service, 2018). The next section of the regulation addresses state and local tax credit programs.

A majority of the beginning discussion on these credit programs discusses the past issuance of the CCA memorandums that we have reviewed. The most detail that they go into on the actual programs is the following:

> In recent years, it has become increasingly common for states and localities to provide state or local tax credits in return for contributions by taxpayers to or for the use of certain entities listed in section 170(c) (Internal Revenue Service, 2018, p. 43564).

While they do not particularly address why their view is different from those memorandums, they do point out that the fact that the characterization of the amount as a SALT deduction or as a charitable contribution did not constitute a material change in the taxpayer's liability prior to the $10,000 limitation enacted by the TCJA.

The proposed regulation then states that while court cases have addressed whether a state and local tax credit constitutes income under Section 61 or an amount realized under Section 1001, no formal guidance has been issued on the charitable contribution deduction aspect of these programs, by stating:

> The application of sections 61 and 1001 to state or local tax credits presents different issues than the application of section 170, and none of these cases addressed whether a taxpayer's expectation or receipt of a state or local tax credit may reduce a taxpayer's charitable contribution deduction under section 170 (Internal Revenue Service, 2018, p. 43564).

Following discussion of the credit programs, the focus shifts to the new limitations imposed on the SALT deduction. The discussion again begins by discussing why the distinction was largely unnecessary before the TCJA unless the taxpayer is subject to the alternative minimum tax. The main aim of this section appears to be to explain why the IRS is now choosing to take up this issue. They are well aware that this classification issue exists stating that:

> [S]tate and local tax credit programs now give taxpayers 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 (Internal Revenue Service, 2018, p. 43564).

This sets the stage for the actual presentation of the regulation.

The regulation states that IRS, along with the Treasury Department, believe that the receipt of a state or local tax credit in return for a contribution to a government fund constitutes a quid pro quo that may preclude the taxpayer from deducting the full amount as a charitable contribution for federal tax purposes. As such, the workarounds created by the states with respect to contributions to certain exempt entities will not prove to be viable, given that these regulations are expected to become finalized. However, it is expected that the states will plead their case against this regulation should it be finalized.

In applying the quid pro quo doctrine, the IRS and Treasury do not believe it is appropriate to "categorically exempt state or local tax benefits from the normal rules that apply to other benefits received by a taxpayer in exchange for a contribution" (Internal Revenue Service, 2018, p. 43565). These contributions would need to be reduced by the return benefit amount. Additionally, the IRS and Treasury are proposing to amend regulations under Sec. 170

to provide for a de minimis exception to the general rule along with other conforming amendments. The IRS and Treasury argue that not doing so would precipitate revenue losses that would undermine and be inconsistent with the limitation imposed on the SALT deduction and undermine the intent of Congress in enacting Sec. 170.

The regulation identifies several perceived benefits of this proposed regulation. The first benefit is that it would reduce economically inefficient choices motivated by potential tax benefits by diminishing the incentive to engage in socially wasteful tax-avoidance behavior. In addition, the regulation would reduce the complexity for states and taxpayers who would engage in charitable contributions solely for the purpose of reducing their SALT liability. The regulation would also make the federal system more neutral to decisions regarding donations and reduce this economic distortion that exists between charitable organizations and government run funds. Lastly, the regulation would provide certainty surrounding this issue.

On the other hand, the regulation also notes some of the costs that will likely arise under this regulation. The most obvious costs are to those taxpayers who would need to track their state tax credits and reduce the amount of their charitable contribution deduction by those tax credits. In addition to this there will also be increased compliance costs for those organizations that directly issue tax credit. The large majority of taxpayers will go unaffected by this regulation since most taxpayers will not itemize under the TCJA. For those affected by the new SALT limitation this will alter how they think about their charitable contributions and their SALT payments (Internal Revenue Service, 2018).

Discussion of Evidence

Given the authority listed above, that authority will now be analyzed, and alternatives are presented. Even though the IRS has issued a proposed regulation, various states are still using their workarounds to allow taxpayers to avoid the $10,000 limit on the SALT deduction. It is likely that resolution of moot questions identified in the aforementioned cases and preceding discussion will remain within the judicial domain.

Support for Workarounds

There are various forms of support for the general workarounds of issuing state credits for charitable contributions. The stronger form of support comes from various precedents established through case law. These judicial rulings have been cited numerous times by the IRS themselves when tackling this issue. There are several cases discussed above where the full deduction rule is supported. Courts in the US have not held deductions as quip pro quo benefits that reduce the amount of the charitable contribution. The judiciary have held that state tax credits do not constitute payments, but rather confer a lesser tax detriment to the taxpayer. These two elements are essential to the question of the legality of these workarounds, and the consensus from case law is clear on the issue.

The second and weaker support for these workarounds comes from the IRS memorandums described above. While this will not help these states justify their programs' legality in the face of other IRS regulations, they may be an important part in arguing their case against the SALT limitation altogether, as New Jersey's Attorney General has argued. The IRS has a demonstrated history of favoring the full deduction rule in CCA memorandums based on case law. Notably, the deduction received for a contribution does not negate any charitable intent or reduce the amount of the charitable contribution deduction. The IRS has never held the reduction in the state tax liability as a payment of tax liability and therefore has never considered it to be a quid pro quo that would reduce the taxpayer's charitable contribution deduction.

The IRS has even applied this same principle to a variety of other situations involving similar circumstances. For instance, there are several examples in which a taxpayer is entitled to a state tax credit. In all of these other instances in which a tax credit is issued, it is regarded as a reduction in tax liability and not as a payment from the taxpayer's state. The line where some state tax credits would be regarded as a payment of a tax liability and some tax credits simply as conferring a lesser tax detriment would be complex and could have unintended consequences. Some of these programs include: contributions to educational entities in Idaho in return for a 50% income tax credit up to $500 per taxpayer, and in Indiana contributions to Individual Development Account Funds earn a 50% income credit capped statewide at $200,000 (Bankman et al., 2018). These are just two examples of dozens of such programs across the country. For the IRS and the Treasury Department to now begin treating these credits as quid pro quo and therefore a reduction of the taxpayers' charitable contribution deduction is inconsistent with the previous treatment of these credits

Support Against Workarounds

The most immediate and strongest opposition for these SALT workarounds is the proposed regulation issued by the IRS (2018). While the CCA memorandums issued by the IRS were informative, the proposed regulation sets precedent and guides all taxpayers when filing their tax returns. The regulation in place addresses the general workaround, but not some of the other workarounds put in place. The regulation is likely to be challenged in court by the states but seems unlikely to be struck down by the courts.

It is important to note that the proposed regulation addresses the general workaround of recharacterizing a state tax liability payment as a charitable contribution, but not some of the other workarounds put in place, such as Connecticut's pass-through entity tax workaround.

The second piece of evidence against the workarounds is addressed in Sec. 170. It would be unlikely that if a 100% state tax credit were offered in return for a contribution to a certain state charitable fund that it would be deductible as a charitable contribution deduction for federal tax purposes (Colinvaux, 2018). The code does not have an exclusion for benefits administered by the state government, if seen as quip pro quo return.

Costs

As discussed earlier in the introduction to the workarounds enacted by the states there are potentially high costs for individual taxpayers related to the SALT limitation. If the cost were shifted from these individuals it would present a significant funding issue to the government.

The costs of these workarounds to the federal government if totally effective are estimated to be hundreds of billions of dollars over ten years if the limitation is essentially lifted. That would represent a significant increase in the total cost of the TCJA (Gordon, 2018). It is apparent that most of the benefits would be received by the wealthiest taxpayers. While high tax states certainly will not see their revenues drop by this much, they are in danger of losing a significant amount of money if their wealthiest taxpayers decide to move. The costs associated with this new SALT limit have been shifted to wealthy taxpayers, and time will tell how the states adapt if they cannot effectively shift the burden back to the federal government.

The main options for the states being either reducing their state taxes (not likely) or letting their wealthiest taxpayers pay higher federal income taxes for living in their state. This demonstrates why so many states have pledged to file a lawsuit if the workarounds are countered by the IRS (Reitmeyer, 2018).

Non-Tax Implications

The implications on the legality of these workarounds depend heavily on a taxpayer's income level and where they reside. This is where the political considerations also begin to come into play. Low tax states argue that they essentially subsidize their high tax counterparts. The counter argument by the high tax states is that their higher state taxes allows them to fund more of their own programs without federal assistance. It is important to remember that the TCJA legislation was passed largely on party lines, and most of the tax cost of the new SALT limitation is born by wealthy taxpayers in Democratic-leaning states. It is for this reason that some states have already challenged the legality of the new SALT limitation. One implication of this new law is that similar laws could be passed in the future which are also disguised political taxes, an idea which is addressed later in the paper.

Alternate Workarounds

The discussion has centered around the standard workaround proposed by the majority of the states. However, the IRS may have a harder time limiting the effects that come from programs such as New York's increased payroll tax and Connecticut's pass-through entity tax. These programs are not likely to save as much money for the affected taxpayers, and Connecticut's alternative is limited to how many people will be able to claim it. However, if the IRS were to regulate this workaround it would be much more complicated to and could have more adverse effects.

The difficulty in regulating these programs are how their mechanisms of getting around the SALT limitation differ from the standard workaround. Instead of relying on a deduction to essentially double dip to reduce a taxpayer's income these alternate programs essentially provide a reduction in the taxpayer's income for federal tax purposes. It seems unlikely, however, that the IRS would have these taxpayers increase their federal taxable income for taxes paid by their companies, so it appears that the only option would be to figure out how to change the deductibility on the business side.

Ethicality of the SALT Limitation

In addition to the legal argument, there is also an ethical argument to be made on the issue. There are several lenses through which this topic can be viewed when discussing the ethics of creating and/or utilizing a workaround to avoid the new SALT deduction limitation. The strength and weaknesses of these arguments will be discussed.

The first ethical lens to view the SALT deduction through is by analyzing the taxpayers who are affected by this limitation. Only wealthy taxpayers, whose total itemized deductions exceed the increased standard deduction and who pay more than $10,000 in state and local taxes, are affected by this provision. As seen earlier in Table 1, high-income taxpayers in the past were more likely to deduct more than $10,000 in state and local taxes. By putting this limitation in place, it essentially is a tax increase on the wealthiest taxpayers. An argument in favor of the limitation is that those who make the most should pay higher taxes. This is the strongest ethical consideration supporting the SALT deduction limitation.

The second issue to consider is the original purpose of the SALT deduction. Since a taxpayer's income is taxed at both the federal and state levels, the federal government decided to allow a federal tax deduction for state and local taxes paid in order to mitigate some of the effects of this double taxation (Tax Analysts, 2017). Taking this view, it seems illogical to put a limit on the amount that is excludable from double taxation. The weakness in this issue is that most taxpayers do not realize this was the original intent of the SALT deduction, and it is now viewed as a benefit instead of a compensating deduction. Being informed on the original intent of this deduction provides strong support opposing the limiting of the SALT deduction

The last ethical issue to consider is whether or not this deduction was put in place to target Democratic-controlled states. While there will likely never be a definitive answer on whether Democratic-leaning states were targeted, it seems unlikely that the Republican party would have imposed such a tax consequence if the majority of the most affected wealthy taxpayers were in Republican-leaning states. Assuming that this law was politically motivated, it sets a dangerous precedent. Politicians should not be deciding to tax people based on their political affiliation. It is easy, however, for Republicans to argue that it wasn't politically motivated and that they are just trying to limit a deduction allowed high-income taxpayers in high-tax states to take a tax deduction, which caused taxpayers in low-tax states to pay more in federal income taxes. While it would be unethical and dangerous if the new SALT limitation was politically motivated, it is currently too gray of an area to use to oppose the limitation on the SALT deduction.

Overall, it appears that the original intent of the deduction should hold the highest weight when discussing the ethicality of the SALT limitation. It is easy to lose sight of the past, but it is important to keep in mind. From the viewpoint of minimizing the effect of double taxation, this deduction isn't really a tax break for the rich. This almost completely negates the strongest ethical basis in support of the SALT limitation that the wealthiest should pay the most in taxes. Like most issues, the ethics involved tend to be debatable, but in this case it appears to be in favor of an unlimited SALT deduction.

Conclusion

The SALT limitation imposed by the TCJA is likely to stay through the end of 2025 unless this provision is extended. Likewise, the states are not likely to stop creating new workarounds for their taxpayers. The final decision is ultimately to be decided not by the IRS or the states, but by the courts. There will certainly be court cases initiated, as some state's spokespersons have already stated that they intend to pursue this avenue. Given the significant amount of money to be saved by taxpayers who utilize the workarounds, it is possible that these court cases may be taken up to the Supreme Court level.

Currently there are three main workarounds in play, and they have varying chances in succeeding. However, the workaround address in this paper, which involves state credits issued in return for contributions to state charitable funds should be ruled to be an adequate workaround. There is a significant amount of case law supporting the full deduction of these contributions. And, although the CCA memorandums do not hold precedential value, the IRS has a demonstrated history of siding with the full deduction rule and the precedent set by the courts. Lastly, the ethical support for the workarounds is weaker for a SALT limitation than for it. The original intent, to eliminate double taxation, of the deduction must be considered when discussing the issue. While the courts will have the last say on these workarounds, the ruling should be against the IRS for this workaround, regardless of the proposed regulation that they have issued.

The effects of the deduction may be more political than economic if these workarounds are defeated in the courts. It is unlikely that most wealthy taxpayers will be willing to move out of state to lower their tax bill. However, the cost to the federal government if these workarounds remain in place could be substantial. If this were the case, then Congress would be forced to look for a different place for additional revenues or accept an even larger deficit. The charitable contribution will also not be the only attempt to circumvent the limitation on the SALT deduction, and these other alternatives could also cost the government a significant amount of revenue.

Workarounds involving the two unique methods as mentioned above will likely be just as complex. There is not a clear way that the IRS could regulate state payroll taxes or taxes that are imposed on a passthrough entity. The most straightforward prevention for both of these issues would have to come from Congress and change the deductibility on the business side for these taxes, as it does not appear that there is a simple way for the IRS to issue a regulation on the issue without significantly altering current law.

There is a lot at stake for both taxpayers and the federal government on this issue of the SALT limitation and potential workarounds. While it does appear that the charitable contribution workaround should work, that does not mean that taxpayers can count on states winning their case against the IRS proposed regulation. Additional taxes assessed to the employer that would reduce the tax bill for taxpayers certainly appear to be legal and therefore should be supported by the courts, but administrative issues may be insurmountable on the employer and employee side of the transaction making this solution unfeasible. Though the charitable contribution workaround should be allowed to stand, it is likely states will continue attempt to circumvent the SALT limitation no matter what the outcome of the pending regulation and ensuing legal action.

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