

May 23, 2018

## Tax Reform and State and Local Taxation

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### IRS Issues Notice of Intent to Propose Regulations on the Federal Tax Treatment of Contributions to State-Sponsored Charitable Funds

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#### SUMMARY

Today, the Internal Revenue Service (“IRS”) issued Notice 2018-54 (the “Notice”), informing taxpayers that the Department of the Treasury (the “Treasury Department”) and the IRS intend to propose regulations addressing the federal income tax treatment of payments made by taxpayers to funds controlled by state and local governments (or other state-specified transferees) for which taxpayers can receive a credit (in whole or in part) against their state and local taxes.

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#### DISCUSSION

Federal tax reform enacted in December 2017 limited the ability of individuals and trusts to deduct state and local taxes (“SALT”) for federal income tax purposes.<sup>1</sup> Certain states with high SALT rates have reacted by proposing or adopting legislation aimed at mitigating the costs to taxpayers of the limitation on the SALT deduction, including legislation providing for the creation of state-sponsored charitable funds.<sup>2</sup> Under such proposals, taxpayers would receive full or partial state or local tax credits against such taxpayers’ SALT liability for contributions to such charitable funds, and the contributions are intended to be fully deductible for federal tax purposes. New York State, for example, provided for the creation of such charitable funds in its recently enacted State Budget for Fiscal Year 2019.<sup>3</sup>

The Notice provides that the Treasury Department and the IRS intend to propose regulations addressing the federal income tax treatment of transfers to funds controlled by state and local governments (or other state-specified transferees) that the transferor can treat in whole or in part as satisfying SALT obligations. The Notice further explains that the proposed regulations will be informed by substance-over-form principles to clarify the relationship, under the Internal Revenue Code, between the federal charitable contribution deduction and the limitation on deduction for SALT payments. The Notice warns taxpayers

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that “[d]espite these state efforts to circumvent the new statutory limitation on state and local tax deductions, taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes.” While not explicitly reaching a conclusion, the Notice suggests that the IRS will assert that some, or all, of charitable contributions made pursuant to newly enacted state legislation providing for state or local tax credits for the contributions will not be deductible for federal income tax purposes.

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### ENDNOTES

- <sup>1</sup> P.L. 115-97 (2017). For more information on federal tax reform’s impact on individuals, see the Sullivan & Cromwell publication, dated January 8, 2018, titled “U.S. Tax Reform: Individual Taxation,” *available at* [https://www.sullcrom.com/siteFiles/Publications/SC\\_Publication\\_U.S.\\_Tax\\_Reform\\_Individual\\_Taxation.pdf](https://www.sullcrom.com/siteFiles/Publications/SC_Publication_U.S._Tax_Reform_Individual_Taxation.pdf).
- <sup>2</sup> For more information on reactions by states to federal tax reform’s limitation on state and local tax deductions, see the Sullivan & Cromwell publication, dated March 5, 2018, titled “Tax Reform and State and Local Taxation: Recent State Tax Proposals Relating to the Limitation on State and Local Tax Deductions Enacted by Federal Tax Reform,” *available at* [https://www.sullcrom.com/siteFiles/Publications/SC\\_Publication\\_Tax\\_Reform\\_and\\_State\\_and\\_Local\\_Taxation\\_03\\_05\\_18.pdf](https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Tax_Reform_and_State_and_Local_Taxation_03_05_18.pdf).
- <sup>3</sup> New York State Budget for Fiscal Year 2019, S.7509-C; A.9509-C. See also the Sullivan & Cromwell publication, dated April 13, 2018, titled “New York State Tax: Recent Developments in New York State Tax Law Including Tax Provisions in the Recently Enacted Budget,” *available at* [https://www.sullcrom.com/siteFiles/Publications/SC\\_Publication\\_New\\_York\\_State\\_Tax\\_04\\_13\\_2018.pdf](https://www.sullcrom.com/siteFiles/Publications/SC_Publication_New_York_State_Tax_04_13_2018.pdf).

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