

Final Rule on SALT and State Tax Credit Programs

The U.S. Treasury Department and Internal Revenue Service pre-released late yesterday the final rule on how the federal government will treat charitable donations that individual taxpayers make to nonprofits via giving programs incentivized by state and local tax (SALT) credits. According to [Treasury Decision 9864](#) (which will be formally published June 13, 2019), taxpayers may not claim as federal charitable deductions the portion of donations that generate state or local tax credits. The new restriction applies to donations made to both nonprofits run by governmental entities as well as charitable nonprofits operated independent of government.

In a concession to critics of earlier [draft regulations](#) issued in August 2018, the final rule includes a safe harbor provision that allows federal taxpayers to still deduct the value of the tax credit as payment of state and local taxes, but only up to the \$10,000 cap on SALT deductions enacted in the 2017 tax law. Thus, federal taxpayers with state and local tax bills less than \$10,000 will still be able to deduct the full value of these donations that are encouraged by tax credits, albeit through two separate lines on the federal tax form – for state and local taxes and for charitable donations. Those paying state and local taxes in excess of \$10,000 will no longer be able to deduct the value of the tax credits.

In a Nutshell

- The final rule limits the federal tax deduction for certain charitable giving programs encouraged by state and local governments via tax credits.
- Individual taxpayers may claim a charitable deduction for only the amount of their donation that exceeds the value of any state or local tax credit. For example, a \$1,000 donation that allows the taxpayer to claim a state tax credit of \$400 (40%) may only be counted as a \$600 charitable contribution for federal tax purposes.
- It doesn't matter whether the recipient of the donation is a nonprofit run by a governmental entity or one operated independent of government, as is the case with most charitable nonprofits. But, ...
- A safe harbor provision, added after the initial draft was proposed, clarifies that individual taxpayers may still claim the value of the tax credit (\$400 in the above example) as an itemized deduction for state and local taxes paid, up to the capped amount of \$10,000. Taxpayers who pay state and local taxes higher than the cap get no federal tax benefit for the value of the tax credit and may question the utility of contributing to programs at nonprofits that generate tax credits. Here's another example: if someone donates \$30,000 to a charter school in a state that offers a 50 percent state tax credit, the donor could deduct half as a charitable donation (\$15,000), but could claim no more than \$10,000 as a state and local tax deduction (and probably much less).
- The final rule does have limitations. It does not apply to dollar-for-dollar state tax **deductions** for donations to nonprofits, nor to programs that generate a tax credit of 15 percent or less. The rule only applies to donations by individuals; it does not apply to corporate donations, which are treated more favorably (see [IRS Rev. Proc. 2019-12](#)).
- None of this matters from a tax perspective to individual taxpayers claiming the **standard deduction**; they receive no federal tax benefit from making increased donations to charitable nonprofits and thus are not affected by how donations are listed on Schedule A of the tax form.

Background

The federal tax law enacted at the end of 2017 imposed a cap of \$10,000 on the amount individual taxpayers can deduct for state and local taxes they paid. Several states enacted new tax-credit laws designed to allow taxpayers to circumvent the new limit, such as programs to treat state tax payments as charitable contributions, which are not capped. The Treasury Department and IRS responded to these laws in late August 2018 by [publishing draft regulations](#) designed to change how the federal government will treat donations to charitable organizations that generate state or local tax credits. The proposal reportedly

was intended to target the new workaround tax laws in [Connecticut](#), [New Jersey](#), and [New York](#) that sought to convert some SALT payments into uncapped charitable deductions. As written, however, the draft regulations applied equally to more than 100 [programs in 32 states and the District of Columbia](#) that provide a state or local tax credit when a taxpayer makes a donation to certain nonprofits, such as school choice scholarship funds, nonprofit endowments, and land conservation. The new final rule backs away some from what had been proposed earlier.

What It Means for Charitable Nonprofits

The short answer on impact is that it all depends. Nonprofits benefitting from tax-credit programs may see little effect if they operate in very low-tax states (where people typically don't pay state and local taxes greater than \$10,000) or if their typical donors taking advantage of tax credits are low- to middle-income taxpayers. Nonprofits in higher-tax states with high net-worth donors may see reduced giving through programs incentivized through state or local tax credits.

Some of the adverse economic impact of the regulatory process may have already been felt. The draft regulations published last August clearly stated that donations made after August 27, 2018 would be subject to the rule limiting the value of federal deductions to any of the donations to which it applied. This raises many questions, such as:

- Did individuals stop giving after August 27, 2018 to nonprofits through programs that generated state and local tax credits?
- Has the damage already been done to the missions and services that state and local governments had sought to promote because of federal rulemaking intended to frustrate efforts by some states to work around the cap on state and local taxes?

Presumably individual taxpayers who made donations to the targeted nonprofits may file amended 2018 tax returns and take advantage of the safe harbor, if applicable. But the donations not made after August 2018 cannot be corrected retroactively and services denied last year due to lack of funds will never be restored.

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