RESPONSE TO PROPOSED NEW REGULATIONS:

Contributions in Exchange for State or Local Tax Credits

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Executive Summary

Purpose of the proposed Regulations.

The Tax Cuts and Jobs Act of 2017 ("TCJA") included a cap on the deduction for payment of state and local taxes ("SALT") (new section 164(b)(6) of the Internal Revenue Code of 1986, as amended – "Code"). Some states have sought to circumvent this cap by allowing taxpayers to substitute charitable contributions for the payment of SALT, allowing a credit against SALT equal to the amount of the contribution. To address this abuse, the Internal Revenue Service ("IRS") proposes a new Regulation (proposed new paragraph 1.170A-1(h)(3)) requiring that all charitable deductions be offset, dollar-for-dollar, by the amount of any credit allowed by a state for the contribution.

The proposed Regulations go far beyond implementing the new tax law; they penalize all donors for whom state credit programs previously existed.

The proposed Regulation "throws the baby out with the bathwater." This is because the offset against charitable deductions applies not only to the attempt by states to circumvent the cap on SALT deductions, but also applies to all existing state tax credit programs for charitable contributions.

In enacting a cap on SALT, Congress did not intend to cap charitable deductions for the 98 state charitable credit programs which currently exist. Fifteen of these programs encourage the charitable contribution of conservation easements. In each of these 15 states, the new Regulation requires an easement donor to reduce the federal (and likely state) charitable deduction allowed by Code section 170(h) by the amount of any state credit received for the contribution. <u>This result is not only unnecessary to implement the cap on SALT provided in the TJCA, it is contrary to long-established Congressional policy and contrary to established tax law.</u> At a minimum, to be consistent with Congressional policy, the proposed offset should not apply to "qualified conservation contributions" under Code section 170(h) for which state tax credits are available.

If the proposed Regulations stand, tax credits received for the contribution of conservation easements should be accorded a tax basis.

The proposed Regulation, in reversing the long-standing treatment of tax credits, seeks to treat charitable contributions for which state tax credits are allowed as "*quid pro quo*" transactions. If this reversal of established law is allowed to stand easement donors receiving tax credits in these transactions should be accorded a basis in those credits derived from the value of the easement.

Such treatment would be consistent with the tax treatment of bargain sales and dual-character contributions.

The proposed Regulations create a "Tax Cliff" that should be eliminated.

Finally, the proposed Regulations create a discriminatory and punitive "Tax Cliff": The proposal allows taxpayers who receive credits up to 15% of the value of their "charitable" contributions to claim a charitable deduction without offset for the credit. However; if the taxpayers are eligible for more than a 15% state tax credit, they must offset the entire amount of the credit against their charitable contribution deduction – not just the credit amount in excess of 15%. This is punitive and discriminatory. If the proposed Regulations stand, then the Tax Cliff should be eliminated, and the so-called "*de minimis*" 15% exception should be applied across-the-board.

ANALYSIS AND RESPONSE

I. Background

On August 23, 2018 the IRS issued proposed Regulations requiring that state or local tax credits granted for charitable contributions be offset against the federal income tax deduction allowed under Code section 170 for charitable contributions. The proposal was made in direct response to efforts by certain states to circumvent the $10,000 cap on SALT imposed by TCJA. However; the proposed Regulations extend far beyond the SALT circumvention and include all previously existing state and local tax credit programs.

As of the date of the proposal, there were in effect approximately 98 state-level tax credit programs, of which 15 were programs intended to encourage voluntary land conservation, such as Virginia's Land Preservation Tax Credit (Va. Code section 58.1-512, *et seq*.). In all of these pre-existing tax credit programs, the proposed Regulation would require that the amount of any credit received by a taxpayer for a charitable contribution be offset dollar-for-dollar against the federal income tax deduction allowed by Code section 170 (section 170(h) in the case of "qualified conservation contributions").

For example, under law existing prior to the proposed Regulations, the contribution of a conservation easement in Virginia worth, for example, $100,000, would allow the donor to claim a federal charitable deduction in the amount of $100,000, a Virginia income tax deduction in the amount of $100,000, and a Virginia Land Preservation Tax Credit in the amount of $40,000. Under the proposed Regulations, the federal deduction for the contribution would be reduced by the amount of the $40,000 credit to $60,000. Because the Virginia deduction is based on the federal deduction it would be reduced to the same amount. The Land Preservation Tax Credit would remain unaffected.

The proposed Regulation exempts from the offset requirement any credit in the amount of 15% or less of the contributed amount. However; if credits allowed are in excess of 15%, the proposed

Regulation requires that the federal deduction be offset by the entire credit allowed, not just the amount in excess of 15%.

The Regulation, proposed August 23, would become effective August 27.

II. Existing Charitable Tax Credit Programs Don't Create Unanticipated Federal Tax Loss

The proposed Regulations are intended to prevent the unanticipated federal revenue loss that would result from the circumventing of the SALT cap by new state tax credit programs. The loss is due to the fact that a charitable deduction for which state tax credits are available will no longer be offset by a corresponding reduction in SALT deductions.

However; existing state charitable tax credit programs do not generate unanticipated revenue losses. This is because their revenue implications of the existing programs were known (or knowable), at the time of the development of the SALT cap, and were (or could have been) considered in revenue projections. Therefore, penalizing existing charitable credit programs to prevent unanticipated losses from the new credit programs intended to circumvent the SALT cap is unjustified from a revenue standpoint.

In fact, applying the proposed Regulations to long-standing state incentives for charitable contributions will generate revenue beyond that which could have been projected during the development of the cap. It was not Congress' intent to raise additional revenue by reducing charitable deductions for existing charitable programs. Thus, the proposed Regulations extend beyond the Treasury Department's authority to implement the TJCA and represent, in essence, legislation by the Treasury Department.

III. Proposed Regulation Exceeds Treasury Department Authority to Implement TCJA

The explanation of the proposed Regulation ("Explanation") admits that it is intended to ". . . alter the incentives taxpayers face about whether and how much to give to organizations that receive charitable contributions . . ." (Explanation, page 16). In undertaking to "alter the incentives" for charitable contributions the proposed Regulations go beyond curbing efforts to circumvent the cap on SALT undertaken by a mere handful of states, and take on the entire field of charitable contributions for which state tax credits are available. This is not only unnecessary to address the immediate problem, but goes beyond the authority of the Treasury Department and IRS to implement the new tax law and is a prime example of "agency legislation."

In other words, the intent of the Regulations to curb circumvention of the cap on SALT has the (presumably) "unintended consequence" of significantly altering incentives for charitable contributions deemed important enough by the states to merit tax credits. Of course, given the

IRS's admission that the proposed Regulation is intended to "alter the incentives" for charitable contributions it may, in fact, be the intent of the Treasury and IRS to curtail all credit-motivated charitable contributions. However; that is a policy decision that is the province of the legislative, not executive, branch.

Treasury and the IRS can easily modify the proposed Regulations to curtail the state circumvention of the TJCA without undermining established state tax incentives for genuine charitable contributions. Here is an example:

> **Requested Revision to Proposed Regulation:** [change in red]
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> "(3) Payments resulting in state or local tax benefits. (i) State or local tax credits. Except as provided in paragraph (h)(3)(v) of this section, if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and if such payment or transfer would have been deductible as a tax described in section 164, subsection (a), paragraphs (1), (2), (3) or (5) but for the provisions of section 164(b)(6), the amount of the taxpayer's charitable contribution deduction under section 170(a) is reduced by the amount of any state or local tax credit that the taxpayer receives or expects to receive in consideration for the taxpayer's payment or transfer."

IV. The Proposed Regulations Undermine Long-standing Congressional Conservation Policies

The proposed Regulations undermine a long history of Congressional support for voluntary land conservation dating back to the Tax Reform Act of 1969, the Conference Report on which included the following statement, allowing the charitable contribution of a conservation easement to be deductible:

> "The conferees on the part of both Houses intend that a gift of an open space easement in gross is to be considered a gift of an undivided interest in property where the easement is in perpetuity." (Conf. Rep. 91-782)

In the Tax Reform Act of 1976, Congress further endorsed conservation easement contributions by including provisions expressly allowing charitable deductions for conservation easement contributions. Congress in the 1977 Tax Reduction and Simplification Act, extended the provisions to 1981. To insure the effectiveness of the conservation being encouraged by the provision the extended law required easements to be perpetual to be eligible for the federal deduction.

In 1980, the Tax Treatment Extension Act underscored Congressional support for voluntary conservation by making the federal deduction for contributions of conservation easements permanent and enacted a number of specific criteria for deductibility.

In 1986 Congress repeated its support for voluntary land conservation by including in the Tax Reform Act of 1986 provisions allowing charitable gift and estate tax deductions for the contribution of conservation easements, regardless of whether the easement satisfied certain of the criteria established in 1980 for the income tax deduction.

In 1997 Congress, in enacting the Economic Growth and Tax Relief Reconciliation Act of 2001, added new section 2031(c) to the federal estate tax code, providing an addition tax incentive for voluntary land conservation in the form of a partial exclusion from estate tax for a decedent's estate containing land protected by a conservation easement.

In 2006, as part of the Pension Protection Act, Congress again increased the incentives for contributions of conservation easements by increasing the amount of deduction the donor of a conservation easement could claim annually from 30% of contribution base to 50%. Furthermore, Congress also allowed easement donors more than 50% of whose income was from the business of farming to use the deduction against 100% of contribution base. In both cases, Congress extended the period during which the donor could carry forward used portions of a deduction for the contribution of a conservation easement from 5 years to 15 years. These "enhanced write-off" benefits were renewed every two years by Congress until 2016 when Congress made the enhanced write-off permanent.

This history, in which Congress has repeatedly and consistently over a period of 42 years, singled out voluntary land conservation for special treatment within the Code, underscores a very clear and strong Congressional policy to encourage voluntary land conservation in the United States. The proposed Regulations undermine this long-standing policy.

V. The Proposed Regulations Undermine Effective State Conservation Policies

From the standpoint of our federal system of government, the proposed Regulations also undermine the effectiveness of state policy by undermining the incentives for charitable contributions that the states consider sufficiently important to support tax credits. These programs have been long-standing in many cases. They reward charitable contributions that are substantive in nature. On the other hand, the handful of states that have created circumventions of the cap on SALT deductions by allowing charitable contributions to substitute for payment of SALT in exchange for credits, are encouraging nothing charitable whatsoever.

Some state programs have been extraordinarily successful in encouraging private land conservation. The Virginia Land Preservation Tax Credit was enacted in 2000 allowing conservation easement donors a state income tax credit equal to 50% (later reduced to 40%) of the value of contributed conservation easements. In 2002, the General Assembly made the credit transferrable. In January, 2012, the Joint Legislative Audit and Review Commission ("JLARC"), a bi-partisan agency of the Commonwealth, published "Review of the Effectiveness of Virginia Tax Preferences" which included a review of the effectiveness of the Land Preservation Tax

Credit. JLARC found that between 2000, when the credit was enacted and 2012 when the Review was completed,

> "more than 2,500 donations of interest in land have been made under the credit since 2,000. The donations cover approximately 540,000 acres in the Virginia . . . and have an appraised value of $2.5 billion. *** An analysis of the change in land preservation over time indicates that the tax credit is effectively achieving its public policy of promoting land conservation." (JLARC Review, page 49)

The JLARC report concluded that "voluntary land preservation in Virginia has increased tenfold since the credit was adopted." (JLARC Review, page 50)

A more recent report published in December, 2017 by the Virginia Department of Conservation and Recreation found that as of August 31, 2017 landowners had permanently protected 819,962 acres since the inception of the Land Preservation Tax Credit.

The proposed Regulations will significantly undermine the tax incentives for voluntary land conservation in Virginia and other states with a credit program encouraging such conservation. For example, for a Virginia resident in the 35% federal tax bracket (married couples with taxable income over $400,000) donating a conservation easement in Virginia valued at $100,000, the proposed Regulations will reduce the combined federal and state charitable deductions by 40% because of the Land Preservation Tax Credit, reducing potential federal and Virginia income tax savings from the deduction by $16,300.

This significant reduction in the tax incentives for voluntary land conservation in Virginia dictated by the proposed Regulations must be considered a "potential [presumably] unintended consequence." Although the proposed Regulations may, as the IRS concludes "have at most a highly limited, marginal effect on taxpayer decisions to donate to tax credit programs that pre-date TCJA", it will impact <u>every conservation easement donor in the Commonwealth of Virginia</u>, and will surely be considered as a discouragement to contributing a conservation easement by every prospective easement donor in the Commonwealth of Virginia. And, most importantly, <u>the proposed Regulations will do this unnecessarily</u>.

VII. The Proposed Regulation Reverses Existing Law

Not only do the proposed Regulations undermine Congressional and state tax policies intended to encourage voluntary land conservation; they are inconsistent with a series of positions regarding the treatment of tax credits taken by the IRS itself. In fact, the proposal acknowledges this history stating that

> ". . . the IRS Office of Chief Counsel (IRS Chief Counsel), in multiple Chief Counsel Advice memoranda (CCAs), considered whether the receipt of state credits under these programs were <u>quid pro quo</u> benefits that would affect the

> amount of taxpayers' charitable contribution deductions under section 170(a). Although CCAs are released to the public for information purposes, it should be noted that CCAs are not official rulings or positions of the IRS, are not ordinarily reviewed by the Treasury Department, and are not precedential."

In other words, the IRS acknowledges that the proposed Regulations run counter to previous IRS thinking about treatment of state tax credits. Nevertheless, this previous thinking, as embodied in published CCAs, reflected careful analysis and reflected the positions taken in several United States Tax Court rulings regarding the nature of state tax credits.

The proposal identified three CCAs dealing with the proper treatment of state tax credits. In none of these Advisories did the IRS take the position that a receipt of a state tax credit was to be treated as a "*quid pro quo*" to be offset against the federal charitable deduction. CCA 201105010 reflects the position taken in all three CCAs.

In CCA 201105010, the IRS addressed the question of how receipt of a state income tax credit that could be used against a taxpayer's state income tax liability, or transferred to another taxpayer, should affect the taxpayer's charitable deduction under Code section 170(a)(1). Citing several Tax Court rulings, the IRS took the position that receipt of a tax credit should be treated no differently than receipt of a deduction against state income tax. In other words, the amount of the credit ". . . is not regarded as a return benefit that negates charitable intent, reducing or eliminating the [charitable] deduction itself."

This CCA also included an important *caveat* cited in the proposal: "There may be unusual circumstances in which it would be appropriate to recharacterize a payment of cash or property that was, in form, a charitable contribution as, in substance, a satisfaction of tax liability."

The effort of several states to circumvent the cap on SALT by, in effect, substituting a charitable contribution for the payment of SALT, would appear to be the "unusual circumstance" referred to the CCA. However; addressing this "unusual circumstance" does not justify a reversal of a position consistently held by the IRS (and the federal courts) with respect to state tax credits over the years. Addressing the "unusual circumstance" represented by recent state actions to substitute charitable contributions for tax payments should be addressed with a scalpel, not a hammer.

The United States Tax Court addressed the nature and treatment of state tax credits in the case of *Tempel v. Commissioner* 136 T.C. 341 (2011), *aff'd sub nom, Esgar Corp. v Commissioner*, 744 F.3d 648 (10th Cir. 2014) (a consolidated appeal of *Tempel* and *Esgar*, T.C. Memo. 2012-35).

At the outset in this case, the IRS agreed that the Tempel's receipt of State tax credits as a result of their conservation easement contribution was neither a sale or exchange of the easement <u>nor a quid pro quo</u> transaction. The fact that the receipt of tax credits didn't constitute a *quid pro quo* transaction is underscored by these findings by the Tax Court:

> “It is without question that a government’s decision to tax one taxpayer at a lower rate than another taxpayer is not income to the taxpayer who pays lower taxes. A lesser tax detriment to a taxpayer is not an accession to wealth and therefore does not give rise to income.”
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> “Petitioners did not acquire the State tax credits by purchase. It was the State’s unilateral decision to grant petitioners the State tax credits as a consequence of their compliance with certain State statutes.” [Emphasis added.]

The Tax Court’s ruling in *Tempel* is that receipt of a tax credit by a taxpayer who has made a charitable contribution for which a tax credit is authorized by the state has not bargained for the credit, but received a benefit “unilaterally” conferred by the state pursuant to its taxing authority. If the credit was not bargained for it could hardly be considered a “quid” for any charitable contribution “quo”.

The Explanation cites *U.S. v. American Bar Endowment*, 477 U.S. 105 (1986), for the established tax rule that something received as part of a *quid pro quo* transaction must be offset against any charitable deduction resulting from the transaction. However; as the IRS conceded in *Tempel*, and as the Tax Court ruled in *Tempel*, the state’s unilateral conferral of tax credits when a specified charitable contribution has been made, is not a *quid pro quo* transaction.

The Tax Court’s ruling in *Tempel* was upheld on appeal by the 10th Circuit. It was also followed by the Tax Court in *Route 231, LLC v. Commissioner*, T.C. Memo. 2014-30, *aff’d*, 810 F. 3d 247 4th Cir. 2016); and *SWF Real Estate LLC v. Commissioner*, T.C. Memo. 2015-63.

Quid pro quo involves a bargained-for exchange of property or cash for property, or *vice versa*. The unilateral conferral of a tax benefit by a state for the charitable contribution of a conservation easement to a third party, wherein the donor has no legal right to compel the state to grant the credit, is simply not a *quid pro quo* transaction. If the state, as it has every right to do, terminates the credit after the taxpayer has contributed the easement, the taxpayer has no legal claim against the state. As the Tax Court pointed out in *Tempel*, the taxpayer has no property right in a credit until it is issued, and that only occurs after the taxpayer has unilaterally changed his position by contributing a perpetual conservation easement which cannot be retracted, and only if the state has not changed its credit policy.

The allowance of tax credits for the charitable contribution of a conservation easement is simply not a *quid pro quo*.

VIII. If the Proposed Regulations Stand, Tax Credits Should Be Accorded a Basis

For all of the reasons described in the preceding Section VII, allowing a tax credit for the charitable contribution of a conservation easement is not a *quid pro quo* transaction. However;

the Explanation, in a <u>complete reversal</u> of the past IRS positions and federal court rulings described above, states

> ". . . the Treasury Department and the IRS believe that when a taxpayer receives or expects to receive a state or local tax credit in return for a payment or transfer to an entity listed in section 170(c), the receipt of this tax benefit constitutes a <u>quid pro quo</u> that may preclude a full deduction under section 170(a)."

Therefore, ***IF*** the receipt of a state tax credit for a charitable contribution is treated as a "*quid pro quo*" transaction by the IRS, then the receipt of a credit and its tax consequences must be reconsidered in that light.

Investopedia provides as good a definition as any of *quid pro quo*:

> "Quid pro quo, Latin for 'something for something,' is used to describe when two parties engage in a mutual agreement to exchange goods or services. In a quid pro quo agreement one transfer is contingent upon a reciprocal transfer. As a term, quid pro quo is used similarly in business and legal contexts to convey that a good or service has been exchanged for something of equal value."

If the grant of a conservation easement for which a tax credit is allowed is a *quid pro quo*, then contribution of the easement and the grant of the credit constitute a "reciprocal transfer" of the easement for the credit, which is the essence of a sale or exchange. *See Helvering v. William Flaccus Oak Leather Co.,* 313 U.S. 247, 249 (1941).

Therefore, the charitable contribution of a conservation easement for which a state tax credit is granted should be viewed as a sale or exchange of the easement in consideration for the credit (a *quid pro quo* transaction). In fact, the proposed Regulations underscore the sale or exchange nature of the receipt of a credit for the contribution of a conservation easement by stating that any credit received for a contribution is received "in consideration for the taxpayer's payment or transfer." (proposed Regulations section 1.170A-1(h)(3)(i).) The proposed Regulations define "in consideration for" by reference to Regulations section 1.170A-13(f)(6) which provides:

> "*In consideration for.* A donee organization provides goods or services <u>in consideration for</u> a taxpayer's payment if, at the time the taxpayer makes the payment to the donee organization, the taxpayer receives or expects to receive goods or services <u>in exchange</u> for that payment." [Emphasis added.]

As recharacterized by the proposed Regulations, the contribution of a conservation easement in exchange for a tax credit becomes the sale of the easement for the credit. If the credit does not equal the fair market value of the easement, then the "sale" becomes "bargain sale" within the meaning of Code section 1011(b) and Regulations section 1.170A-4(c)(2)(ii), which states:

> “The term *bargain sale,* as used in this subparagraph, means a transfer of property which is in part a sale or exchange of the property and in part a charitable contribution, as defined in section 170(c), of the property.”

In the alternative, as recharacterized by the proposed Regulation, the contribution of a conservation easement “in consideration for” a tax credit constitutes a “dual-character contribution” as described in *American Bar Endowment,* as discussed below.

Under either alternative analysis, the credit received “in consideration for” the contribution of a conservation easement must be treated as a “sale” of the easement for the credit be accorded a basis.

The amount of basis of the credit received in such a *quid pro quo* transaction is dictated by Code section 1011(b):

> “If a deduction is allowable under section 170 (related to charitable contributions) by reason of a sale, then the adjusted basis for determining the gain from such sale shall be that portion of the adjusted basis which bears the same ratio to the adjusted basis as the amount realized bears to the fair market value of the property.”

Thus, if a taxpayer contributes a conservation easement worth $100 and receives a tax credit in the amount of $40, the taxpayer’s basis in the credit will be $40. If the taxpayer sells the credit for more than $40 she will realize gain to that extent, if the taxpayer sells the credit for less, then she will realize a loss to that extent.

Because the property sold in exchange for the credit was the conservation easement, the basis adjustment required by Regulations section 1.170A-14(h)(3)(iii) is not relevant as that provision dictates determining the amount by which an easement donor’s basis in the property underlying the easement must be adjusted to reflect the contribution. Because the entire value of a conservation easement (without regard to any payment received in exchange therefore) must be considered in determining the adjustment of the donor’s basis in the underlying property, the donor has already absorbed a reduction in that basis reflecting the full value of the contribution, regardless of how the receipt of the credit is treated.

The alternative to treating receipt of a credit in exchange for the contribution of a conservation easement as a bargain sale is to treat it as a dual-character contribution. This relies on the decision of the Supreme Court in the *American Bar Endowment* case, cited in the Explanation as support for its treatment of the receipt of a credit as part of a *quid pro quo* transaction.

The Supreme Court in *American Bar Endowment* stated

> “The sine qua non of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum

> demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return."

The Court relied on Rev. Rul. 67-246 in which the IRS described a "dual-character" contribution. This Ruling addressed a fundraising event

> "as an occasion for solicitation of gifts in combination with the sale of the admissions or other privileges or benefits involved. In [this type of case] the sale of the privilege or benefit is combined with solicitation of a gift or donation of some amount in addition to the sale value of the admission or privilege.
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> ***
>
> "In showing that a gift has been made, an essential element is proof that the portion of the payment claimed as a gift represents the excess of the total amount paid over the value of the consideration received therefore." [Emphasis added.]

Dual-character contributions, as described in the Revenue Ruling following by the Supreme Court consider such contributions to involve the "sale" of "admissions or other privileges or benefits" for a price in excess of the value of those benefits., provided that the excess is intended by the parties as a charitable contribution from the buyer to the seller. In such a transaction, the buyer has a basis in the benefit received (whether it be a ticket to the ball, a painting purchased at a charity auction, or a tax credit for the contribution of a conservation easement).

In discussing the *Tempel* case a group of tax law professors writing in *Tax Notes*[1] said that if the Tax Court had applied a *quid pro quo* analysis in that case (which it did not), then the transaction in that case would have been

> "regarded as (1) a gift of property worth $576,500 [the amount by which the value of the contributed easement exceeded the value of state tax credits granted] and (2) a purchase of state tax credits for $260,000. That is the essence of a quid pro quo analysis – bifurcation of the transaction into gift and non-gift components. Recall that when the donor of $100 to a public radio receives a tote bag worth $20, she is treated as making a gift of $80 and purchasing a tote bag for $20. In that situation, the donor's basis in the tote bag is $20."

Whether, under the recharacterization provided by the proposed Regulation, the receipt of a credit for the charitable contribution of a conservation easement is treated as a bargain sale or is treated as a dual-character contribution, the credit should be allocated a tax basis based upon the value of the credit received. This can easily be implemented by an amendment to the proposed Regulations as follows:

[1] Joseph Bankman, et al, Special Report: "State Responses to Federal Tax Reform: Charitable Tax Credits," *State Tax Notes*, May 7, 2018.

<u>Requested Revision to Proposed Regulation:</u> [change in red]

Renumber proposed subparagraph 1.170A-1(h)(3)(B)(vii) <u>Examples</u>, to (viii) and add a new (vii) as follows (change shown in red):

"The portion of the value of any payment or transfer made by a taxpayer described in paragraph (3)(i) of this section equal to the amount of any credit the taxpayer receives or expects to receive in consideration therefore, shall be deemed to be the taxpayer's cost of such credit for purposes of section 1012."

IX. The *De Minimis* Exception "Cliff"

Another unusual provision of the proposed Regulations is the *de minimis* 15% exception from the credit offset requirement. The Explanation states (beginning page 11)

> "To provide consistent treatment for state or local tax deductions or local tax credits that provide a benefit that is generally equivalent to a deduction, the proposed regulations include a <u>de minimis</u> exception under which a taxpayer may disregard a state or local tax credit if such credit does not exceed 15 percent of the taxpayer's payment or 15 percent of the fair market value of the property transferred by the taxpayer. The <u>de minimis</u> exception reflects that the combined value of a state and local tax deduction, that is the combined top marginal state and local tax rate, currently does not exceed 15 percent. Accordingly, under the proposed regulations, a state of local tax credit that does not exceed 15 percent does not reduce that taxpayer's federal deduction for a charitable contribution."

The problem with this exception is that it is structured as a "cliff" because once the credit allowed exceeds 15% of the "contributed" amount, the taxpayer loses the exception entirely. If a state allows credits of 15% or less, the recipient of those credits is not required to offset them against a related charitable deduction. However; if the state allows credits of 16% or more, the recipient of those credits must offset the entire amount of the credits, not just the amount in excess of 15% of value of the contribution.

Under this version of the *de minimis* exception, anyone residing in a state providing a tax credit for a charitable contribution in excess of 15% is <u>punished</u> for a state tax provision over which he has no control.

If a similar approach was taken to the cap on SALT provided in TCJA, then anyone whose state and local taxes exceeded the $10,000 cap would be allowed to claim no deduction whatsoever, not just the amount in excess of the cap. Instead, every taxpayer may claim up to $10,000 in SALT deductions, but no one can claim more. This approach should be taken to the 15% *de minimis* exception for tax credits provided in the Proposed Regulation.

Another analogous situation is the annual 30% of contribution base limit on most charitable deductions. It the approach used in applying the 15% *de minimis* exception in the proposed Regulations was applied, anyone who had a charitable contribution deduction in excess of 30% of her contribution base would lose the entire deduction.

A tax cliff such as created by the Proposed Regulation for the *de minimis* exception is discriminatory and punitive and without any rational basis. The proposed exception should apply across-the-board regardless of the amount of state tax credit allowed.

> **<u>Requested Revision to Proposed Regulation:</u>** [change in red]
>
> "(vi) <u>Exception</u>. Paragraph (h)(3)(i) of this section shall ["not" deleted] only apply to any payment or transfer of property ["if" deleted] to the extent that the amount of the state or local tax credit received or expected to be received by the taxpayer ["does not" deleted] exceeds 15 percent of the taxpayer's payment, or 15 percent of the fair market value of the property transferred by the taxpayer."

X. Conclusion

For all of the foregoing reasons, the proposed Regulations should be revised so that they only apply to "contributions" made in lieu of SALT payments. If the proposed Regulations are implemented against all state charitable tax credit programs, not just those intended to circumvent the cap on SALT deductions, they should revised to (1) allocate a basis to credits received equal to the value of the credits, and (2) allow the *de minimis* exception in all cases, not just those for credit programs whose credits don't exceed 15% of the contributed amount.