

## IRS Proposed Rule For State & Local Tax Credits: A Threat to Land Conservation In Virginia



### **Background:**

On August 27, 2018 the IRS proposed new regulations (83 FR 43563) that would characterize state income tax credits (such as the Virginia Land Preservation Tax Credit “LPTC”) that are received when taxpayers make charitable gifts as a payment or *quid quo pro* for the donation. If this rule passes, landowners who donate conservation easements (and recipients of similar tax credits) would have to reduce their federal income tax deduction by the value of the state tax credits received.

This would be a significant departure from long standing federal tax treatment of these types of state credits and would negatively impact the rate of land conservation in Virginia and other states with similar tax credit programs. There is a 45-day comment period that began on August 27, 2018 and ends on October 11, 2018. You can comment on this proposal online at:

<https://federalregister.gov/d/2018-18377>

The proposed rule is an IRS response to state workarounds that allow taxpayers to use tax credits to circumvent a provision in the Tax Cuts and Jobs Act of 2017 that places a \$10,000 cap on the deductibility of state and local tax (SALT) payments. These states grant tax credits to taxpayers in exchange for charitable “donations” that would otherwise be paid by the taxpayer as SALT. Since charitable gift deductions are not subject to the \$10,000 SALT cap, taxpayers can exceed the cap by disguising a SALT payment as a charitable gift.

### **Piedmont Environmental Council Position on Proposed Rule:**

The IRS rushed through a rule making process with a one size fits all approach and reversed their own past guidance (see CCA 201105010) instead of taking the time to find a solution that specifically targets state programs designed to circumvent the SALT cap. State-run “charities” that are set up to circumvent the new SALT cap should be shut down but not at the expense of long running state tax credit programs that are designed to incentivize charitable donations with genuine public purpose and benefit.

Since 1969, Congress has repeatedly and consistently singled out voluntary land conservation for special treatment in the Tax Code. Most recently, in 2015, Congress continued that treatment and further enhanced the federal deduction available to conservation easement donors. The effect of the proposed rule is contrary to that Congressional mandate and Qualified Conservation Contributions under 170(h) should be excluded from the rule.

If the IRS chooses to move forward with this rule anyway, the following specific changes should be made to the proposal:

- *De Minimis “Cliff”*: The proposed de minimis rule creates a discriminatory and punitive “cliff” that allows taxpayers receiving a 15% or smaller tax credit to deduct their entire donation without *quid pro quo* treatment, but taxpayers receiving a larger credit must treat the entire value of their credit as *quid pro quo*. Instead of making this an on/off switch, the first 15% in value of any state income tax credits should be excluded from the *quid pro quo* rule. All taxpayers, regardless of the size of the tax credit they are offered by their state or locality should be treated equally.
- *Tax Credit Basis*: Since the proposed rule would re-characterize the value of state tax credit as *quid pro quo*, those credits should be accorded a tax basis that is equal to the same value. Under past IRS guidance and Tax Court case law such credits were a capital asset with zero basis – the proposal should explicitly change this policy at the same time.
- *Effective date*: Conservation Easement donations are generally the result of long-term negotiations that require substantial investment of time and financial resources on both the part of the donor and the donee. The effective date of this proposal has now called into question many projects where significant investment has been made. In order to give these transactions already in progress time to close, the effective date for 170(h) contributions should be no sooner than January 1, 2020.

The proposed rule is contrary to long-established Congressional policy and established tax law. Pre-existing state tax credit programs, like the Virginia’s LPTC, provide an incentive for taxpayers to preserve and protect natural resources in their community and make donations that have genuine public purpose and benefit. This important public benefit distinguishes conservation easement donations and the related state tax credit program from the recent efforts to simply circumvent the new SALT cap. Existing state tax credit programs that provide clear public benefit should be excluded from the proposed rule.