

The IRS is About to Lower the Boom on New Jersey's Effort to Make State Taxes Deductible for Federal Purposes

On May 4, 2018, Governor Murphy signed into law legislation which permits local New Jersey taxing authorities to establish charitable funds the purpose of which, if the plan works, is to help NJ taxpayers avoid the recently-enacted federal law which limits an individual's deduction for state and local taxes to \$10,000 per year.

Under NJ's new law, individuals would make federally-tax-deductible "charitable contributions" to these "charitable funds" in lieu of paying taxes. In return, they would receive "property tax credits."

In other words, rather than making a direct "payment of taxes" (the deductibility of which is now limited), individuals would, if respected by the IRS, be treated as having made charitable contributions (the deductibility of which is not limited by the recent federal tax legislation).

As the old saying goes, "if it sounds too good to be true, it probably is."

It is possible that the IRS will accept these charitable contribution deductions, but we are not confident that the IRS will respect them for the simple reason that a deductible charitable contribution is one that is made without the expectation of anything in return. Here, there is a clear expectation of a valuable return - the receipt of a "property tax credit" which will allow the "donor" to avoid paying some or all of his property taxes.

The IRS is aware of these sorts of efforts, which are now sponsored by several states. Earlier this week, the IRS issued Notice 2018-54 in which it announced that it will be issuing regulations which address the federal income tax treatment of payments for which taxpayers receive a credit against their state and local taxes:

"In response to this new limitation [on the deductibility of state and local taxes] some state legislatures are considering or have adopted legislative proposals that would allow taxpayers to make transfers to funds controlled by state or local governments, or other transferees specified by the state, in exchange for credits against the state or local taxes that the taxpayer is required to pay. The aim of these proposals is to allow taxpayers to characterize such transfers as fully deductible charitable contributions for federal income tax purposes, while using the same transfers to satisfy state or local tax liabilities.

"Despite 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.

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"The proposed regulations will make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers." (Emphasis added).

It is our advice that people not make contributions to the New Jersey or other state charitable funds until such time as the IRS issues the proposed regulations, which hopefully will clearly articulate the rules governing the deductibility of these "charitable contributions."

If you have any questions in this regard, please do not hesitate to contact [Tiffany Donio](mailto:tdonio@archerlaw.com) at tdonio@archerlaw.com or [Gordon F. Moore](mailto:gmoore@archerlaw.com) at gmoore@archerlaw.com or any member of our [Tax Group](#) in Haddonfield, N.J., at (856) 795-2121, in Princeton, N.J., at (609) 580-3700, in Hackensack, N.J., at (201) 342-6000, in Philadelphia, Pa., at (215) 963-3300, New York, N.Y. at (212) 682-4940 or in Wilmington, Del., at (302) 777-4350.

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