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State Responses to Federal Tax Reform: Charitable Tax Credits

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In this report, the authors explain how a long-standing principle of federal tax law provides authority for donors to claim a full charitable contribution deduction for gifts entitling them to a state tax credit. They argue that it thus may be possible for states to give their residents a way to preserve the effects of a state and local tax deduction, at least in part, by granting a charitable tax credit for federally deductible gifts, including gifts to the state or one of its political subdivisions.

For a partial inventory of state charitable tax credits, see the appendix in an upcoming issue of *State Tax Notes*. The appendix describes more than 100 state charitable tax credits in 33 states.

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I. Introduction

Many states provide tax incentives for charitable giving, typically to encourage private donations to targeted activities, such as natural resource preservation,¹ private school tuition

scholarships,² college financial aid, shelters for victims of domestic violence, and various other state-supported programs. Under these programs, taxpayers receive state income tax credits for donations to governments, government-created funds, and nonprofits.

Before the enactment of the Tax Cuts and Jobs Act (P.L. 115-97) in late December, state charitable tax credits operated largely under the radar. Subsequently, these programs garnered new attention because of the tax advantage of making federally deductible gifts that reduce one's state tax liability. This tax advantage derives from the fact that the TCJA imposes new limits on the deductibility of state and local taxes, capping them at a maximum of \$10,000 per return.³ However, the law imposes no such limits on the deductibility of charitable contributions. This disparity in treatment — between nondeductible taxes and deductible gifts — raises a critical legal question for funding state and local governments after the TCJA: Can donors claim a full charitable contribution deduction for gifts entitling them to a state tax credit?

If the answer is yes, as we believe it is, it may be possible for states to provide their residents a means of preserving the effects of a SALT deduction, at least in part, by granting a charitable tax credit for federally deductible gifts, including gifts to the state or one of its political subdivisions. This is a highly controversial conclusion, one that Treasury Secretary Steven Mnuchin has derided as "ridiculous."⁴ As we explain, however, legal

¹ See Jeffrey O. Sundberg, "State Income Tax Credits for Conservation Easements: Do Additional Credits Create Additional Value?" Lincoln Institute of Land Policy, at 26, Table 1 (2011) (Table 1 lists state tax credits as of 2011).

² See Carl Davis, "State Tax Subsidies for Private K-12 Education," Institute on Taxation and Economic Policy (Oct. 2016).

³ TCJA section 11042 (amending section 164(b) to limit the SALT deduction for tax years 2018 through 2025).

⁴ Augree Eliza Weaver, "Mnuchin: Deducting Property Tax as Charity Is 'Ridiculous,'" *Politico*, Jan. 11, 2018.

authority on this matter does not support Mnuchin's view. Under current law, expressed through both court opinions and IRS rulings, the amount of the donor's charitable contribution deduction is not reduced by the value of state tax benefits. We refer to this feature of current law as the "full deduction rule."

The full deduction rule has been applied to credits that completely offset the pretax cost of the contribution. In most cases, however, the state credits offset less than 100 percent of the cost. We believe that, at least in this latter and more typical set of cases, the full deduction rule represents a correct and long-standing trans-substantive principle of federal tax law. According to judicial and administrative pronouncements issued over several decades, nonrefundable state tax credits are treated as a reduction or potential reduction of the credit recipient's state tax liability rather than as a receipt of money, property, contribution to capital, or other item of gross income. As discussed in greater detail later, the full deduction rule is supported not only by decades of precedent but also by a host of policy considerations. Those considerations include federal respect for state initiatives and allocation of tax liabilities, and near-insuperable administrative burdens posed by alternative rules.

It is possible to devise alternatives to the full deduction rule that would require donors to reduce the amount of their charitable contribution deductions by some or all of the federal, state, or local tax benefits generated by making a gift. Whether those alternatives could be accomplished administratively or would require legislation depends on the details of any such proposal. We believe that Congress is best situated to balance the many competing interests that changes to current law would necessarily involve. We also caution Congress that a legislative override of the full deduction rule would raise significant administrability concerns and implicate important federalism values. Congress should tread carefully if it seeks to alter the full deduction rule by statute.

II. The Charitable Contribution Deduction

A. Availability of Deduction

Section 170(a) provides for a deduction for charitable contributions as defined in section 170(c). Deductible contributions include donations not only to familiar nonprofit organizations, such as those qualifying for tax-exempt status under section 501(c)(3), but also "a State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purpose."⁵ Donations can be made in either cash or property.

B. Amount of Deduction

The amount of the deduction is generally the amount of cash or the fair market value (or in some instances the basis) of property contributed to the qualifying entity. Treasury regulations provide that the amount deductible may not exceed the excess of:

(A) the amount of any cash paid and the fair market value of any property (other than cash) transferred by the taxpayer to an organization described in section 170(c); over

(B) the fair market value of the goods or services the organization provides in return.⁶

Because of this quid pro quo provision, a taxpayer who makes a \$100 gift to public radio and receives a tote bag in return must reduce the amount of the deduction by the FMV of the tote bag. For example, if the value of the tote bag is estimated to be \$20, the taxpayer may claim a deduction of only \$80.⁷

⁵Section 170(c)(1).

⁶Reg. section 170A-1(h)(2)(i).

⁷This example assumes that the cost of the tote bag exceeds \$10.90 and thus is not treated as an "insubstantial benefit" under Rev. Proc. 90-12, 1990-1 C.B. 471, as adjusted for inflation under Rev. Proc. 2017-58, 2017-45 IRB 489, section 2.30(2).

C. Federal Deduction for Charitable Contributions

The basic logic underlying the quid pro quo regulation is that the deduction should be limited to the actual net cost of the gift to the taxpayer — that is, the gross amount of the gift minus the value of goods or services received in exchange for the gift. Although this “net cost to the taxpayer” principle makes intuitive sense, federal tax law ignores (and has always ignored) the value of the federal charitable contribution deduction itself. These tax savings are often substantial. For a taxpayer subject to a 37 percent marginal tax rate, a \$100 gift results in a \$100 deduction, even though that deduction reduces the net cost of the gift to \$63. In other words, in making the quid pro quo determination, federal tax law ignores the \$37 of tax savings arising from the gift. If instead of cash the taxpayer donates \$100 value property with a zero basis, she not only secures a \$100 deduction but also avoids federal income tax on the \$100 of built-in gain, saving her (assuming the property is a capital asset held for more than a year) another \$20 in federal income tax liability. In this case, the net cost of the gift to the taxpayer — after backing out the federal tax savings — would be only \$43. And yet federal tax law allows (and has always allowed) a deduction for \$100, even though the net cost to the taxpayer is only \$43. In effect, because of the long-standing rule that tax savings do not constitute a quid pro quo requiring the donor to reduce the amount of the deduction, the taxpayer ends up satisfying \$57 of her otherwise nondeductible federal income liability⁸ by making a deductible charitable gift.

D. State Tax Benefits for Charitable Contributions

Like the federal government, state governments commonly provide tax benefits for charitable gifts. These benefits take many forms, including both deductions and credits allowable in calculating the taxpayer’s state income tax liability. Like the FMV of goods or services received in return for making a gift, as well as the federal charitable contribution deduction, state tax benefits reduce the net cost of the gift to the donor. The availability of these benefits raises the

question of what effect, if any, these state tax benefits should have on the amount of the taxpayer’s federal deduction for the gift. Should they be treated like “the value of goods and services the organization provides in return” under the quid pro quo analysis? Or should they be ignored in the same way that federal tax benefits are ignored?

III. State Tax Benefits and the Federal Deduction

Under current law, a donor is not required to reduce the amount of a federal charitable contribution deduction by the value of state tax benefits generated by the gift. This treatment is evident in the fact that taxpayers have never been required to reduce the amount of a federal charitable contribution deduction by the value of any state deduction to which the contribution may also entitle them. Thus, for example, if a taxpayer makes a donation of \$100 that entitles her to a charitable contribution deduction on both her federal and state income tax returns, the amount of the federal deduction is \$100, undiminished by the reduction in tax liability flowing from either the federal or state charitable contribution deduction. The result is the same when the state tax benefit takes the form of a credit rather than a deduction. Thus, if a taxpayer makes a \$100 donation to a charitable organization, including a state or its political subdivision, and the donation entitles the taxpayer to a \$70 credit against her state income tax liability, the amount of the federal charitable contribution deduction would be \$100, undiminished by the value of the tax credit.

The legal authority supporting the full deduction rule is summarized in ILM 201105010, an IRS memorandum published in early 2011. The facts presented in the memorandum concern contributions to a state agency or other qualifying organization, in a state (apparently Missouri⁹) where four separate programs entitle donors to state tax credits with unspecified credit percentages. For each of the four programs

⁸Section 275(a)(1).

⁹Although Missouri is not named in the memorandum, the addressee is the associate area counsel in Kansas City, and Missouri has several tax credit programs that match the descriptions in the memorandum. See Missouri Department of Revenue, “Miscellaneous Tax Credits” (Jan. 2, 2017).

considered, donors may contribute cash or other property.

The legal analysis in ILM 201105010 is straightforward. It first provides an overview of the treatment of charitable contributions when the donor receives some benefit in return, noting (consistent with the analysis above) that the deduction is allowable “only to the extent the amount transferred exceeds the fair market value of the benefit received, and only if the excess amount was transferred with the intent of making a gift.”¹⁰ Citing judicial holdings in *McLennan*,¹¹ *Skripak*,¹² and *Allen*,¹³ the memorandum reaffirms the well-established conclusion that the “tax benefit of a federal or state charitable contribution deduction is not regarded as a return benefit that negates charitable intent, reducing or eliminating the deduction itself” (emphasis added). Also, citing *Browning*,¹⁴ the memo observes that the value of the deduction “has not been treated as an item of income under section 61, in the form of an amount realized on the transfer under section 1001.”¹⁵

In each of the court cases cited in ILM 201105010, the value of a state tax deduction is not treated as a payment from the state or as property received from the state but rather as a reduction or potential reduction of state tax liability. In other words, when a charitable gift entitles the donor to a state charitable contribution deduction, the full deduction rule applies and the donor is not required to reduce the amount of the federal

charitable contribution deduction under reg. section 170A-1(h)(2)(i)(B).

The central question ILM 201105010 aims to address is whether “a state tax benefit in the form of a state tax credit, or a transferable state tax credit, is distinguishable from the benefits of a state tax deduction.”¹⁶ This was not an issue of first impression for the IRS Office of Chief Counsel; it faced the issue in at least two previous advisory memoranda. In 2002 chief counsel issued a memorandum concerning the treatment of the Colorado conservation easement credit, which entitles a donor of a conservation easement to a credit up to \$260,000 against Colorado income tax liability.¹⁷ And in 2004 chief counsel issued a memorandum concerning the treatment of the Oregon child care tax credit program, which entitles a donor to the Oregon Child Care Division to a credit against Oregon income tax liability.¹⁸ In both cases, the IRS cited the long-standing rule that a state charitable contribution deduction “is not viewed as a return benefit that reduces or eliminates a deduction under section 170, or vitiates charitable intent.”¹⁹ However, both memoranda declined to address whether the same rule should apply for state tax credits, instead concluding that this issue should be addressed by the IRS National Office.

ILM 201105010 concludes that the full deduction rule applies not only to state charitable contribution deductions but also to state charitable contribution credits, noting that “taxpayers may take a section 170 deduction for the full amount of their charitable contributions of cash and appreciated stock, assuming the requirements of section 170 are otherwise met.” The memorandum summarizes the legal basis for that conclusion as follows:

Based on our analysis of existing authorities, we conclude that the position reflected in *McLennan*, *Browning*, and similar case law generally applies. There

¹⁰ ILM 201105010 at 4.

¹¹ *McLennan v. United States*, 23 Cl. Ct. 99 (1991), subsequent proceedings, 24 Cl. Ct. 102, 106 n.8 (1991), *aff'd*, 994 F.2d 839 (Fed. Cir. 1993) (noting that “a donation of property for the exclusive purpose of receiving a tax deduction does not vitiate the charitable nature of the contribution”).

¹² *Skripak v. Commissioner*, 84 T.C. 285, 319 (1985) (noting that “a taxpayer’s desire to avoid or eliminate taxes by contributing cash or property to charities cannot be used as a basis for disallowing the deduction for that charitable contribution”).

¹³ *Allen v. Commissioner*, 92 T.C. 1, 7 (1989) (quoting *Skripak*, 84 T.C. at 319).

¹⁴ *Browning v. Commissioner*, 109 T.C. 303, 325 (1997) (“Respondent’s argument suggests that a taxpayer making a gift of stock worth \$100 to a charitable organization may be entitled to a charitable contribution deduction of some lesser amount on account of the economic value of the deduction. That suggestion is untenable. The regulations provide explicitly that, if a charitable contribution is made in property, the amount of the contribution is the fair market value of the property.”).

¹⁵ ILM 201105010 at 4.

¹⁶ *Id.*

¹⁷ ILM 200238041.

¹⁸ ILM 200435001.

¹⁹ ILM 200238041 at 5-6; ILM 200435001 at 4 (“The fact that states typically provide for a similar deduction in determining the taxable income base for state tax purposes does not affect the federal deduction under I.R.C. section 170.”).

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. Generally, however, a state or local tax benefit is treated for federal tax purposes as a reduction or potential reduction in tax liability. As such, it is reflected in a reduced deduction for the payment of state or local tax under section 164, not as consideration that might constitute a quid pro quo, for purposes of section 170, or an amount realized includible in income, for purposes of sections 61 and 1001.

Beyond the *McLennan* and *Browning* decisions, ILM 201105010 specifically refers to two additional sources of authority for the full deduction rule: (1) Rev. Rul. 79-315, 1979-2 C.B. 27, Holding 3; and (2) the Sixth Circuit's decision in *Snyder*.²⁰ Both of those precedents represent instances in which a state tax credit was treated as a reduction or potential reduction in tax liability (rather than as a payment from the state) and thus support the full deduction rule.

A. Rev. Rul. 79-315, Holding 3

In Rev. Rul. 79-315, the IRS described the federal income tax treatment of income tax rebates paid by Iowa to its residents in 1979. Because of legislation enacted in May 1979, Iowa determined that individuals subject to the state's income tax in 1978 should receive a rebate of a portion of their 1978 state income tax liability. Holdings 1 and 2 concern taxpayers for whom the 1979 rebate took the form of a refund of 1978 taxes paid on returns that had already been filed. In those cases, the treatment of the refund turned on the application of the familiar tax benefit rule under which the refund was (1) taxable if the taxes refunded were deducted on the individual's 1978 federal income tax return, but (2) not taxable if the taxes refunded were not deducted on the individual's 1978 federal income tax return.

Holding 3 — the one relevant to the current analysis — concerns taxpayers for whom the Iowa

rebate took the form of a credit against 1978 income taxes not yet paid:

If all or a portion of an individual's refund is credited against tax due for 1978, *the amount credited is treated as a reduction of the outstanding tax liability*. The amount credited against unpaid 1978 tax is neither includible in the individual's gross income for 1979 nor deductible under section 164(a)(3) of the Code as a state income tax paid in 1979.²¹

The intuition underlying Holding 3 is that when a state grants a taxpayer an income tax credit on the state tax return, that credit is not treated as the receipt of cash or other item of value; instead, it merely represents an adjustment to the taxpayer's as-yet-undetermined state income tax liability. This may seem like a formal distinction, but there are many instances throughout all of U.S. tax law in which substantive outcomes turn on formal distinctions.²² In this case, the formality of being granted a state tax credit rather than receiving a cash refund from the state results in the taxpayer simply treating the amount as a reduction or potential reduction in as-yet-undetermined tax liability rather than going through the process of applying the tax benefit rule.

In effect, Holding 3 concludes that for taxpayers receiving a credit instead of a cash refund, the final amount of their 1978 state income tax liability is not yet known and the credit is simply applied in making that determination. Accordingly, Holding 3 supports the conclusion of ILM 201105010 that the granting of a state tax credit is not treated as the payment of money, or receipt of property, that might be regarded as a quid pro quo, but rather merely represents an adjustment of the taxpayer's as-yet-undetermined tax liability.

B. *Snyder*

The Sixth Circuit's 1990 opinion in *Snyder*²³ adopted the same logic as Holding 3. *Snyder*

²⁰ *Snyder v. Commissioner*, 894 F.2d 1337 (6th Cir. 1990) (unpublished opinion), *vacating and remanding* T.C. Memo. 1988-320.

²¹ Rev. Rul. 79-315, Holding 3 (emphasis added).

²² See, e.g., section 199A(d)(2)(A).

²³ 894 F.2d 1337.

involved a taxpayer who was a partner in a partnership that operated a horse racing track near Cleveland. Under Ohio law in effect at the time, all racetracks were required to collect and remit to the state parimutuel taxes based on the gross amount wagered at the track each day. Ohio law also provided for a credit against those taxes equal to 70 percent of the amount of specified capital improvements made to the racetrack property as certified by the state. The partnership made certified capital improvements to its racetrack in an amount sufficient to entitle it to a tax credit of \$534,712, which was used to reduce its parimutuel tax obligations in 1976 (\$252,826) and 1977 (\$281,886).

The question addressed by the court in *Snyder* was how the partnership should treat those state tax credits for federal income tax purposes. In proceedings before the Tax Court, the government argued that because the partnership was an accrual-method taxpayer, it was required to include the full value of the tax credits in income in the year the credits were certified. Under that view, the partnership would be entitled to deduct the full amount of the parimutuel taxes rather than treat the tax credits as a reduction in the amount of tax owed. The Sixth Circuit rejected that approach, concluding instead that the proper treatment of the tax credits was simply “to reduce the deductions available to the [partnership] for its pari-mutuel tax obligations, which reduced deductions accrued as those taxes become due.”

The Sixth Circuit’s decision on this question expressly rejected two alternative views: (1) the value of the tax credits was income to the partnership;²⁴ and (2) the partnership’s basis in the improvements should be reduced by the amount the credits.²⁵ In rejecting those alternatives, the court embraced the same logic that later formed the basis of the 2011 memorandum on charitable

tax credits — that state tax credits are not treated as a payment from the government but instead merely represent an adjustment or potential adjustment to the recipient’s state tax obligations.

IV. Court Cases Supporting the Full Deduction Rule

When ILM 201105010 was issued, there was no judicial authority directly addressing the full deduction rule. Although the *Snyder* holding embraced the underlying logic of the full deduction rule (that state tax credits are not a payment from the state but merely an adjustment to state tax owed), the case concerned state tax credits granted in exchange for making specified capital improvements, rather than the charitable gift context. More recently, however, the Tax Court (in *Tempel*,²⁶ *Route 231*,²⁷ and *SWF Real Estate*²⁸) and at least two federal courts of appeals (the Tenth Circuit in *Esgar*²⁹ and the Fourth Circuit in *Route 231*³⁰) have effectively endorsed the full deduction rule, fortifying the legal underpinnings of the conclusion reached by the IRS in its 2011 memorandum.

A. *Tempel*

Tempel involved taxpayers who had donated a conservation easement on 54 acres in Colorado in 2004. Under state law, the donation of a perpetual conservation easement entitled the donor to a transferable state income tax credit. For 2004 the amount of the charitable tax credit was equal to 100 percent of the value of the donation, up to \$100,000, plus 40 percent of the value exceeding \$100,000, up to a maximum allowable credit of \$260,000. Because the value of the perpetual conservation easement donated by the taxpayers was \$836,500, they claimed the maximum allowable credit of \$260,000. In the two weeks immediately after their receipt of the credits from the state, the taxpayers sold a portion of them

²⁴The view that the tax credits were income to the partnership was advanced by the government and accepted by the Tax Court, but that position was ultimately rejected not only by the Sixth Circuit but also by the government (“The Commissioner concedes that he and the Tax Court were wrong on this point, and the Snyders were right.”).

²⁵The taxpayers initially maintained that the partnership’s basis in the capital improvements (the completion of which generated the credit) should be reduced by the amount of the tax credit. However, as the Sixth Circuit noted, all the parties agreed that this treatment was erroneous (“It is undisputed that the partnership’s treatment of the pari-mutuel tax reduction was wrong.”).

²⁶*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).

²⁷*Route 231 LLC v. Commissioner*, T.C. Memo. 2014-30, *aff’d*, 810 F.3d 247 (4th Cir. 2016).

²⁸*SWF Real Estate LLC v. Commissioner*, T.C. Memo. 2015-63.

²⁹*Esgar*, 744 F.3d 648 (affirming *Tempel*).

³⁰*Route 231*, 810 F.3d 247 (affirming the Tax Court).

(representing \$110,000 of credits) to unrelated third parties for \$82,500. The central question raised in *Tempel* was the appropriate federal income tax treatment of the sale of the Colorado tax credits, in particular whether the gain from that sale was capital gain or ordinary income.

The court's focus on the tax consequences of selling the credits is important because it reveals the parties' (and the court's) agreement on the logically prior question of how to treat the receipt of state charitable tax credits. As the Tax Court noted early in its opinion, the government asserted (and the taxpayers agreed) that the taxpayers' "receipt of State tax credits as a result of their conservation easement contribution was neither a sale or exchange of the easement *nor a quid pro quo transaction.*"³¹ This is, of course, the exact view expressed in ILM 201105010, so it is no surprise that the government would advance this position in litigation. Since there was no disagreement on this point, the court devoted little of its analysis to the quid pro quo question, focusing instead on its holding that the credits were capital assets whose sale gave rise to short-term capital gain equal to the sale proceeds received by the taxpayers in exchange for the credits. Nevertheless, in reaching that conclusion, the Tax Court offered some relevant legal guidance regarding the federal income tax treatment of the receipt of state charitable tax credits. Two elements of the Tax Court's holding in *Tempel* deserve mention.

First, in considering one of the government's arguments regarding the character of the gain from the sale of the credits, the court offered its own view of the tax consequences of the receipt of a state charitable tax credit. It was necessary for the court to address this question because the IRS maintained that the tax credits represented the "economic equivalent of ordinary income." The agency's theory was that "if an individual taxpayer who sells credits itemizes deductions (ignoring phase-outs), that taxpayer's section 164 Federal income tax deduction is greater than it would have been had the taxpayer retained and used the credits." In other words, the IRS was arguing that because the taxpayer's failure to use

the credits preserved a deduction that would reduce ordinary income, the sale of the credit should be treated as giving rise to ordinary income.

Importantly, the Tax Court not only rejected that argument but also used the opportunity to emphasize that the receipt of a state charitable tax credit is a nonevent and that the reduction in state tax liability that the credit enables does not create income. The court first observed that a "reduction in a tax liability is not an accession to wealth. Consequently, a taxpayer who has more section 164 deductions has not received any income." Citing Rev. Rul. 79-315, the court noted that "even [the commissioner] recognizes that a reduction in taxes does not create income." The court then observed that "the parties and this Court agree that the receipt of a State tax credit is not an accession to wealth that results in income under section 61." In two additional passages, the court further underscored that point:

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.

And:

Credits do not increase a donor's wealth, as long as they are used to offset or reduce the donor's own State tax responsibility. A reduced tax is not an accession to wealth. It is only, as occurred in the instance case, when the donor sells or exchanges a State tax credit to a third party for consideration that an accession to wealth has occurred.

Those passages reflect the same logic underlying Rev. Rul. 79-315 and *Snyder*. As *Tempel* confirms, when a state grants a taxpayer a tax credit, the state is not regarded as making a payment to the taxpayer or transferring an item of value to the taxpayer, but rather is merely exercising its sovereign power to "tax one taxpayer at a lower rate than another taxpayer." The tax credit is simply the mechanism by which a state government decides to impose a "lesser tax detriment" on one party because of its actions or attributes. The credit does not involve a reduction

³¹ *Tempel*, 136 T.C. at 344 (emphasis added).

of a past or even existing liability but rather is one of the many variables that the state, in its sovereign capacity, has decided to consider in determining the final amount of the taxpayer's as-yet-undetermined tax liability.

The second element of the *Tempel* holding relevant to the quid pro quo analysis is the Tax Court's discussion of the taxpayers' basis in the tax credits granted to them by virtue of the charitable gift. Because the taxpayers eventually sold the credits rather than using them to reduce their own tax liability, it was necessary to determine their basis in the credits to calculate the amount of any gain or loss on the sale.³² Again, the holding endorses the full deduction rule in finding that the taxpayers' basis in the charitable tax credits was zero. Recall that the value of the donated easement was \$836,500 and the amount of the credits granted by Colorado was \$260,000. Under a quid pro quo analysis, that transaction would be regarded as (1) a gift of property worth \$576,500 and (2) a purchase of state tax credits for \$260,000. That is the essence of the quid pro quo analysis — a bifurcation of the transaction into its gift and non-gift components. Recall that when a donor of \$100 to 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.

Consistent with the view that the receipt of a state charitable tax credit is not a quid pro quo transaction, the Tax Court in *Tempel* rejected the quid pro quo approach, concluding instead that the taxpayers "did not acquire the State tax credits by purchase"³³ and that they therefore had no basis in their state tax credits. In reaching that conclusion, the court emphasized that "it was the State's unilateral decision to grant [the taxpayers] the State tax credits as a consequence of their compliance with certain State statutes."³⁴ In other words, the Tax Court's view is that a state charitable tax credit is not regarded as consideration for the gift, but rather flows from the unilateral decision by the state government to confer a lesser tax detriment on those who make

qualifying gifts of conservation easements. The Tax Court's decision in *Tempel* was later affirmed by the Tenth Circuit.³⁵

B. Route 231

In another case involving state charitable tax credits, the Tax Court and the Fourth Circuit also touched on whether those credits should be regarded as a quid pro quo. *Route 231*³⁶ involved a limited liability company formed in 2005 by Raymond E. Humiston III and John D. Carr to acquire and operate real property in Albemarle County, Virginia. The LLC acquired real property in June 2005. Carr and Humiston then engaged a consultant to determine whether and how to devote some portion of the property to conservation purposes. On December 27, 2005, the parties amended the LLC's operating agreement to admit a new member, Virginia Conservation Tax Credit FD LLLP (Virginia Conservation) in exchange for a capital contribution of \$3,816,000. On December 30, 2005, the LLC made charitable contributions, including two gifts of conservation easements (one to the Nature Conservancy and the other to the Albemarle County Public Recreational Facilities Authority, which is a governmental body of Albemarle County and a political subdivision of the Commonwealth of Virginia) and a gift of a fee interest (to the Nature Conservancy). Under Virginia law in effect at the time, the donor of a conservation easement was entitled to a state charitable tax credit equal to 50 percent of the FMV of the property donated. Based on an appraisal undertaken at the time of the gift, the taxpayers were allocated state tax credits totaling roughly \$7.4 million. Under the terms of the amended LLC operating agreement, \$7.2 million of those credits were allocated to Virginia Conservation.

The central tax question in *Route 231* was whether the combined capital contribution by Virginia Conservation and the subsequent allocation of the lion's share of the tax credits to it should be treated as a disguised sale of the credits under section 707 of subchapter K. The Tax Court determined that this was indeed a disguised sale,

³² Section 1001(a).

³³ *Tempel*, 136 T.C. at 353.

³⁴ *Id.* (emphasis added).

³⁵ *Esgar*, 744 F.2d 648.

³⁶ *Route 231*, T.C. Memo. 2014-30, *aff'd*, 810 F.2d 247.

and the Fourth Circuit agreed. For our purposes, the relevant aspect of the *Route 231* outcome concerns the federal income tax consequences of that sale. That is, once the determination is made that the substance of the transaction is a sale of the credits from Route 231 LLC to Virginia Conservation on December 30, 2005, what are the federal income tax consequences of that sale to the LLC?

We know that the LLC reported that it had made noncash charitable contributions for tax year 2015 of \$14,831,967, representing the full value of the three charitable gifts, undiminished by the \$7,415,983 worth of state charitable tax credits granted by Virginia because of the gifts. We also know that the IRS did not challenge that return position but rather took the view that the taxpayer sold tax credits with a zero basis on December 30, 2005. Here again we see the same analysis as applied in the *Tempel* opinion. When a donor makes a gift entitling her to a state charitable tax credit, (1) the amount of the federal charitable contribution deduction is the full value of the gift, undiminished by the state tax credits, and (2) any subsequent sale of the credits is treated as a sale of a zero-basis asset, because the credits are not acquired by purchase but rather result from the unilateral action of the government to confer a lesser tax detriment on the party who has chosen to make the charitable transfer. In summary, this application accords with the full deduction rule expressed in ILM 201105010 and *Tempel*.

C. SWF Real Estate

In a separate but virtually identical case, the Tax Court in *SWF Real Estate*³⁷ addressed the same issues raised in *Route 231*. As with *Route 231*, the taxpayer purchased real estate in Albemarle County. Relying on the same Virginia statute (the Virginia Land Preservation Tax Credit Program), on December 29, 2005, SWF Real Estate LLC executed a deed of conservation easement conveying the easement to the Albemarle County Public Recreational Facilities Authority. According to an appraisal undertaken in early December 2005, the easement had a value of

\$7,398,333, meaning that its donation to the government would generate state tax credits of \$3,699,167. On its federal income tax return for 2005, SWF reported a noncash charitable contribution of \$7,398,333 — that is, the full amount of the gift, undiminished by the state tax credits generated by the gift.

As in *Route 231*, the primary question in *SWF Real Estate* concerned whether an allocation of the tax credits to a new partner (again, Virginia Conservation) should be treated as a disguised sale under section 707. Also as in that prior case, the court determined that there was in fact a disguised sale of the state tax credits to Virginia Conservation. For our purposes, however, the more relevant holding of *SWF Real Estate* concerns the amount of the charitable contribution deduction allowed for 2005. While the taxpayer had claimed a noncash contribution of \$7,398,333, the Tax Court considered alternative appraisals and determined that the appropriate amount of the charitable contribution deduction was \$7.35 million. Although this allowed deduction was slightly lower than the claimed amount, it is noteworthy that the court did not reduce the amount of the deduction by the state tax credits. Thus, as in *Tempel* and *Route 231*, the Tax Court in *SWF Real Estate* applied the full deduction rule in determining the amount of the allowable charitable contribution deduction.

D. Maines

One final post-ILM 201105010 judicial opinion deserves mention. Although it does not involve charitable contributions, the Tax Court's opinion in *Maines*³⁸ is significant because of its discussion of the federal income tax treatment of state tax credits. The taxpayers in *Maines* owned interests in an S corporation and a partnership, both of which had made investments in New York entitling them to three state tax credits: the Empire Zones (EZ) investment credit, the EZ wage credit, and the Qualified Empire Zone Enterprise (QEZE) credit for real property taxes. Eligibility for those credits required investment in impoverished areas designated by the state. While eligibility depended on the entity's meeting

³⁷ *SWF Real Estate*, T.C. Memo. 2015-63.

³⁸ *Maines v. Commissioner*, 144 T.C. 123 (2015).

the investment requirements, the credits passed through to the taxpayers on their individual returns.

The EZ investment credit, equal to 8 percent of specified qualifying investments in tangible property, could be claimed against income tax or corporate franchise tax, and the taxpayer could carry forward any unused portion or receive half the excess as a refund. Similarly, the EZ wage credit was first used to reduce corporate franchise or income tax liability, with any excess credit either carried forward or partially refunded at the taxpayer's election. Finally, the QEZE real property tax credit was calculated by reference to real property taxes previously paid by the qualifying business, but the credit was claimed by the taxpayers on their individual income tax returns.

The Tax Court's holdings in *Maines* are consistent with the approach outlined in Rev. Rul. 79-315. First, when a credit entitles the taxpayer to a refund of a prior year's tax liability, the taxability of the refund is determined under the tax benefit rule. That holding, which applied to the QEZE real property tax credit, is consistent with holdings 1 and 2 of Rev. Rul. 79-315. Second, when a credit is applied to reduce the current year's tax liability, the credit is not taxable or otherwise treated as an item of income but rather simply reduces a tax obligation. That holding, which applied to the nonrefundable portions of the EZ investment credit and the EZ wage credit, is consistent with Holding 3 of Rev. Rul. 79-315. The court also concluded that the taxpayers must include in income the refundable portion of the credits.³⁹

Thus, the holdings in *Maines* illustrate an important limitation on the principle underlying the full deduction rule: If a state charitable tax credit is refundable, entitling a donor not only to reduce her state tax liability but also to secure a refund to the extent that the credit exceeds tax owed, the refundable portion of the credit might be treated as a payment from the state rather than

as a mere reduction or potential reduction in tax liability.

E. *Randall*

To our knowledge, the Supreme Court has addressed the federal income tax treatment of tax credits in only one case: *Randall*.⁴⁰ The petitioners purchased interests in a limited partnership formed by the respondent to build and operate a motel. The respondent marketed the scheme as a tax shelter and promised substantial after-tax returns for investors in the top income tax brackets. Although the partnership generated tax benefits for the petitioners in its early years, the enterprise ultimately failed, and the petitioners successfully sued the respondent for securities fraud. The issue before the Supreme Court concerned the damages to which the petitioners were entitled. The relevant provision of the Securities Act of 1933, section 12(2), provides for recovery in some cases equal to "the consideration paid for such security with interest thereon, less the amount of any income received thereon."⁴¹ The question for the Court was whether the petitioners' damages should be reduced by the value of the tax benefits they received from their investment.⁴²

By an 8-1 vote, the Court found for the petitioners. According to the Court, "section 12(2)'s offset for 'income received' on the security does not encompass the tax benefits received by defrauded investors by virtue of their ownership of the security, because such benefits cannot, under any reasonable definition, be termed 'income.'"⁴³ The Court went on to say:

The "receipt" of tax deductions or credits is not itself a taxable event, for the investor has received no money or other "income" within the meaning of the Internal Revenue Code. See 26 U.S.C. section 61. Thus, we would require compelling evidence before imputing to Congress an intent to describe the tax benefits an investor derives from tax deductions or

³⁹ *Id.* at 136 (holding that the "excess portion that remains after first reducing state-tax liability and that may be refunded is an accession to the Maineses' wealth, and must be included in their federal gross income under section 61").

⁴⁰ *Randall v. Loftsgaarden*, 478 U.S. 647 (1986).

⁴¹ 15 U.S.C. section 771(a).

⁴² *Randall*, 478 U.S. at 649-655.

⁴³ *Id.* at 656.

credits attributable to ownership of a security as “income received thereon.”⁴⁴

Randall's holding is about a provision of securities law, and thus this passage about the income tax treatment of credits is dicta. Further, *Randall* does not address the central question of whether a tax credit should be treated as a quid pro quo return benefit for purposes of section 170. Nevertheless, *Randall* clearly addresses — and clearly dismisses — the possibility that the amount of a credit should be includable in income for purposes of section 61. In this respect, the case provides solid support for the conclusion common to Rev. Rul. 79-315, *Snyder, Tempel, Maines*, and ILM 201105010 that tax credits are not an item of income. Put another way, the Court's statement that tax benefits “cannot, under any reasonable definition, be termed ‘income,’” although dicta, would loom large over any effort by the IRS to argue otherwise. As we explain later, there are good reasons for so many authorities to reach the same conclusion.

F. Winn

One additional Supreme Court decision deserves mention because of its extended discussion of state charitable tax credits. *Winn*⁴⁵ involved an establishment clause challenge to Arizona's system of providing 100 percent charitable tax credits for donations to school tuition organizations (STOs) that fund tuition scholarships to private schools, including religious schools. A group of Arizona taxpayers challenged the constitutionality of this program, but the Supreme Court dismissed their challenge on the basis that the taxpayers lacked the required standing under Article III of the Constitution. The Court's analysis of the standing issue involved considering an earlier standing case, *Flast*.⁴⁶ In making their argument that they had standing under *Flast*, the respondents in *Winn* alleged that Arizona's 100 percent tax credits were “best understood as a governmental expenditure” and that by making donations entitling them to 100

percent state income tax credits, donors to STOs were “in effect . . . paying their state income tax to STOs.”

In his opinion for the majority, Justice Anthony M. Kennedy rejected both of those arguments. Whether state tax credits should be understood as a government expenditure, the Court noted simply “that is incorrect” and said instead that tax credits are an instance of “the government declin[ing] to impose a tax.” The Court did not characterize the granting of state tax credits as a transfer of money or other property to the taxpayer (the essential elements of a quid pro quo transfer). Rather, Kennedy wrote, “when Arizona taxpayers choose to contribute to STOs, they are spending their own money, not money the State has collected from respondents or from other taxpayers.” The Court also emphasized that donations to Arizona STOs were fully voluntary, concluding that “respondents and other Arizona taxpayers remain free to pay their own tax bills, without contributing to an STO” or, alternatively, they could “contribute to an STO of their choice, either religious or secular” or “other charitable organizations, in which case respondents may become eligible for a tax deduction or a different tax credit.” Significantly, the point here seems to be that when an individual makes a gift to an STO, the Supreme Court regards that act as a wholly voluntary private decision, even though the gift generates a 100 percent tax credit, reducing the donor's tax liability dollar for dollar.

The second element of the Court's analysis is perhaps even more relevant to the full deduction rule. Recall that in ILM 201105010, when the IRS embraced the full deduction rule, it noted that “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.” In *Winn*, the Supreme Court appears to express the view that donations generating a 100 percent state tax credit are not one of those circumstances:

Like contributions that lead to charitable tax deductions, contributions yielding STO tax credits are not owed to the State and, in fact, pass directly from taxpayers to private organizations. Respondents' contrary position [that a tax credit

⁴⁴ *Id.*

⁴⁵ *Arizona Christian School Tuition Organization v. Winn*, 563 U.S. 125 (2011).

⁴⁶ *Flast v. Cohen*, 392 U.S. 83 (1968).

donation constitutes a satisfaction of a tax liability] assumes that income should be treated as if it were government property even if it has not come into the tax collector's hands.

While one might argue that the Court's characterization of STOs as "private organizations" is an essential element of its analysis here, the "private" aspect of these organizations cannot be essential to the holding. First, Congress has determined that both public and private organizations are entitled to receive deductible charitable donations under section 170(c). There is no favored "private" category. Second, treating tax credits as a quid pro quo only in the case of donations to public entities (but not in the case of donations to private organizations) would run afoul of long-standing precedent that the "return benefit" in quid pro quo transfers need not come directly from the donee organization but can also consist of indirect benefits.⁴⁷ The tax credits in *Winn* and other such cases were given only to organizations that satisfied extensive state criteria, as the Court clearly understood.⁴⁸ If a credit for donations to a state-established fund is a problem (and it is not), why should a credit for donations to a state-blessed fund not also be a problem? In both cases, the donated resources are directed to services and activities determined by the state. Thus, any claim that state charitable tax credits constitute a quid pro quo only in the case of gifts to public entities is inconsistent with current law, and any claim that those credits should be uniquely disfavored does not rest on a solid analytic distinction. Finally, and most crucially, as explained above, federal tax law has addressed this specific issue and has never regarded any tax benefits, either federal or state, and whether in the form of deductions or credits, as a quid pro quo benefit requiring a reduction in the taxpayer's federal charitable contribution deduction.

Thus, *Winn* confirms two essential insights regarding the fundamental nature of state charitable tax credits: (1) When the government grants charitable tax credits to a donor, it is not

transferring money, property, or anything of value to the donor; and (2) a voluntary donation of the donor's resources to a state-designated organization does not constitute the "satisfaction of tax liability," even when the donation results in a dollar-for-dollar state tax credit.⁴⁹ Although *Winn* is not a tax case, it should be clear that these two insights are in full accord with all the other judicial and administrative pronouncements supporting the full deduction rule.

V. State Tax Credits as a 'Lesser Tax Detriment'

Beyond the several cases discussed above, there are many other situations in which a taxpayer is entitled to a state tax credit for one reason or another. In all those instances, it is necessary to determine the federal income tax consequences of a taxpayer's receipt of the state tax credit. Because the situations are so numerous and varied, it is impossible to describe them here. It bears noting, however, that in each of these instances the IRS has relied on the exact same principle underpinning the full deduction rule — the principle that nonrefundable tax credits should be regarded merely as conferring a "lesser tax detriment" rather than as a payment from the state.

For example, the IRS concluded that the nonrefundable portion of a Minnesota state income tax credit granted to any resident that is or was in active military service should be treated as a reduction in state tax liability rather than as a payment from the state.⁵⁰ Similarly, the IRS concluded that the nonrefundable portion of a Massachusetts state income tax credit granted to some low-income taxpayers who paid real estate taxes or rent should be treated as a reduction in state tax liability rather than as a payment from the state government.⁵¹ In another memorandum concerning Massachusetts, the IRS considered the federal income tax consequences of five separate state tax credit programs: (1) the brownfields tax

⁴⁹ As explained later, we have some doubts whether that second point is a reasonable conclusion. Nevertheless, the Supreme Court's views on this issue are certainly relevant in determining the circumstances when a voluntary gift generating state credits should be regarded as, in substance, the payment of a tax.

⁵⁰ ILM 200708003.

⁵¹ ILM 201423020.

⁴⁷ See, e.g., *Singer Co. v. United States*, 449 F.2d 413, 422 (Ct. Cl. 1971).

⁴⁸ *Winn*, 563 U.S. at 130-131.

credit, (2) the motion picture tax credit, (3) the historic rehabilitation tax credit, (4) the low-income housing tax credit, and (5) the medical device tax credit. Here again the IRS recited the long-standing principle discussed above:

The taxpayer that originally receives — that is, qualifies for — one or more of the described credits is not viewed as having received property in a transaction that results in the realization of gross income under section 61. Generally, a state tax credit, to the extent that it can only be applied against the original recipient's current or future state tax liability, is treated for federal income tax purposes as a reduction or potential reduction in the taxpayer's state tax liability, not as a payment of cash or property to the taxpayer that is includible in gross income under section 61.⁵²

In one particularly revealing passage, appearing in the first footnote of ILM 201147024, the IRS stated:

We do not agree that a such a reduction in a taxpayer's potential tax liability is the equivalent of a payment to the taxpayer . . . ; instead, as stated in the text, *in the hands of the taxpayer that originally qualifies for the benefit, it simply enters into the computation of the taxpayer's state or local tax liability and is reflected in the amount of the taxpayer's section 164 deduction.*⁵³

It should be apparent that this italicized passage is not anomalous. Rather, this principle has surfaced repeatedly throughout federal tax law, in a variety of settings, whenever a question concerning state tax credits arises. This is the sense in which the principle is trans-substantive — that is, it applies not only in the context of charitable contributions generating state tax credits but in a wide range of other contexts as well.

⁵² ILM 201147024.

⁵³ *Id.* at 4, n.1 (emphasis added).

VI. Policy Supports the Full Deduction Rule

As noted above, the full deduction rule is discussed and supported in cases involving odd fact patterns, such as the sale of tax credits in *Tempel, Route 123*, or *SFW Real Estate*. There are no cases challenging the rule in its common application: when a taxpayer takes a full federal deduction despite state tax credits that offset some but not 100 percent of the cost. The rule in that situation appears to be too obvious to be challenged or to need defense. ILM 201105010 confirms the rule but does not discuss its justification. This is also consistent with a view that the rule is well-settled law.

We can think of at least three policy considerations underlying the full deduction rule in those circumstances.

First, the rule reduces arbitrariness and significant computational and administrative difficulties. The most likely alternative rule would limit the deduction by the amount of state tax benefit. Under that rule, the amount of the federal tax charitable deduction would vary from state to state, and from taxpayer to taxpayer within each state. That alone would be arbitrary and cause practical difficulties for taxpayers and tax agencies. A taxpayer would learn the amount of her federal deduction only by doing simulations at the time of filing; first simulating her state tax liability with the contribution and then without it. She would not know the amount of her deduction when making the contribution. The simulations would be burdensome and confusing to taxpayers, and the fact that the amount of deduction could not be known at the time of the contribution would create uncertainty that would likely limit contributions. This alternative rule would also be burdensome to the IRS, because the agency could challenge a deduction only by making similar simulations of the taxpayer's state tax liability.

Those difficulties would be magnified if states adopted the federal approach, such that state benefits were limited by the federal benefits, just as federal benefits were limited by state benefits. At that point, determining the amount of federal or state benefit would require the use of an algebraic formula that took the limitation of both benefits into account. That calculation would be beyond the

comprehension of all but a few taxpayers or return preparers. Variants of this alternative rule — such as denying a deduction when the state tax benefit reached a specified point — would require similarly confusing calculations and have the further disadvantage of arbitrariness, creating a cliff effect for taxpayers who fell just short of the acceptable benefit.

Second, the full deduction rule is consistent with the fundamental principles that underlie the concept of taxable income. The federal tax laws have historically recognized the entirety of some state taxes as a deduction. However, federal law has never tried to go beyond those easily determined figures by inquiring whether the internal calculations of state tax liability generate federal taxable income. There is a good reason for this: It is impossible to know whether the combination of rates, deductions, credits, and state services a taxpayer receives makes her better or worse off in a way that can be recognized by a concept such as federal taxable income. Theories on which to base taxable income, such as the Haig-Simons definition of income, have never been understood to incorporate this determination. The numerous judicial and administrative authorities cited above likewise reflect a judgment not to regard the various credits and deductions allowed in computing state tax liability as producing taxable income.

Finally, the full deduction rule is supported by considerations of federalism. State credits in this context are used to stimulate contributions that affect state programs and state residents. For example, the Colorado conservation credits described earlier put land in the public trust for the benefit of residents (and visitors). Contribution-related credits enacted at the state level serve various goals affecting not only the taxpayers who qualify for the credits but also the wider public. The full deduction rule is properly neutral toward these state initiatives.

In some circumstances states have enacted tax credits that offset 100 percent of the cost of contributions. That is true for school tuition tax credits adopted in several states, as well as the cultural trust credit adopted by Oregon. Those donee organizations appear to take the position that the contributions qualify under the full

deduction rule.⁵⁴ Many of the arguments behind the full deduction rule apply to these credits. For example, the credits increase spending in targeted areas and affect the lives of state residents. Also, the credits would be supported by considerations of federalism. However, other policy considerations supporting full deduction might not apply. For example, a rule that treated these fully offset contributions as the equivalent of a tax would avoid many of the difficult calculation issues described above. (It would, however, create an arbitrary cliff effect because 100 percent offset contributions would be treated as taxes, while other creditable contributions would qualify for a deduction of the full amount, undiminished by the value of the credit.) The administrative considerations supporting the full deduction rule in other cases might not apply here.

Contributions that offset state taxes on a one-to-one basis and that are not targeted to taxpayer-directed areas (such as conservation or education) might also be subject to recharacterization as a tax under common law tax doctrines such as substance over form. In its 2011 memorandum embracing the full deduction rule, the IRS stated, “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.”⁵⁵ We have no way of knowing what sort of unusual circumstances the IRS may have had in mind when it included that passage in ILM 201105010. One could imagine the IRS taking the position that state charitable tax credits set to 100 percent of the amount donated should be treated as, in substance, a satisfaction of tax liability. But since the IRS and the courts have consistently allowed a full deduction for charitable contributions, with no reduction for state tax

⁵⁴ See, e.g., South Carolina Exceptional SC Fund (“Individuals and corporations who pay South Carolina taxes can make a donation to Exceptional SC and claim a dollar for dollar tax credit against their overall South Carolina income tax liability (personal corporate income tax). Donors can deduct contributions made to Exceptional SC on their federal income taxes under IRC Section 170.”) For the 100 percent tax credit for donations to the Oregon Cultural Trust, the language is a bit more hedged (“Under IRC Section 170(c)(1), donations to the Oregon Cultural Trust qualify as deductible charitable contributions on the Federal tax return. Oregon taxpayers should consult with their accredited tax preparer regarding the availability to take the deduction on the Federal return while also taking a credit on the Oregon return for the same donation.”).

⁵⁵ ILM 201105010.

credits, we are left to speculate about what the IRS might have meant.

We take no position on whether the IRS would try to challenge a deduction for a contribution that was 100 percent offset by tax credits or on whether that challenge would be successful. For state charitable tax credits with less than 100 percent offset, more difficult line-drawing questions arise. There is no clear legal basis for differentiating among state charitable tax credits with varying credit percentages and treating all charitable tax credits as a quid pro quo. Requiring the donor to reduce the amount of her federal deduction by the value of the credit would not only be inconsistent with the legal precedent but also entail considerable complexity, both for taxpayers and tax administrators.

Thus, we believe current law supports the full deduction rule for donations when the donor qualifies for state charitable tax credits equal to less than 100 percent of the donation. While legal challenges to charitable contribution deductions arising from those donations cannot be ruled out, in our view those challenges should fail because of the decades of legal precedent supporting the full deduction rule. And although Congress could, of course, reject those legal precedents and require a new approach through changes to the Internal Revenue Code, the policy considerations analyzed above should give Congress pause before doing so. At the very least, lawmakers should think carefully about administrability concerns, federalism values, and the practical effect on the more than 100 existing state charitable tax credit programs in 33 states before upending the well-settled full deduction rule. ■

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