

What you should know about the proposed regulation changes to charitable deductions related to state and local tax credits.

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Summary of Proposed Regulations: On August 23, 2018 the IRS released proposed regulations on Charitable Contributions in Exchange for State and Local Tax Credits. The proposed regulations were introduced to offset some of the recent actions of states to dampen the effect of the state and local tax limitation in the Tax Cuts and Jobs Act.

According to an IRS release, under the proposed regulations, taxpayers who make payments or transfer property **after August 27, 2018** to an entity eligible to receive tax deductible contributions, must reduce their charitable contribution deduction by the amount of any state or local tax credit the taxpayers receive or expect to receive. For example, if a state grants a 70 percent state tax credit and the taxpayer donates \$1,000 to an eligible charity, the taxpayer must reduce the \$1,000 charitable contribution by the \$700 state tax credit, leaving an allowable contribution deduction of \$300 on the taxpayer's federal income tax return.

The proposed regulations provide exceptions for this reduction in the charitable contribution deduction if the state tax credit is no more than 15 percent of the payment amount or market value of property transferred. Therefore, a taxpayer who makes a \$1,000 contribution to an eligible entity is not required to reduce the \$1,000 charitable contributions deduction on the taxpayer's federal income tax return if the state or local tax credit received or expected to be received is no more than \$150.

Impact to North Dakota Charities: The proposed regulations, if finalized as they are written, may have an impact on North Dakota charities. The proposed regulations would result in a reduction of the charitable contribution deduction allowed for donors when a state tax credit in excess of 15 percent is

provided. The affected North Dakota state tax credits include: the Nonprofit Private School Contributions Credit, the Planned Gift Tax Credit, and the Endowment Fund Contribution Credit.

When looking closer at the impact to North Dakota charities, it should be noted that only donors who itemize deductions will be impacted by the proposed regulations. Historically, in North Dakota, a low percentage of taxpayers itemize deductions on their personal tax returns. Data released by the PEW Research Center indicates that the number of North Dakota taxpayers that itemized deductions on their personal returns was less than 20 percent in 2015. With the increase in the standard deduction, as a result of the Tax Cut and Jobs Act, it is anticipated the number of North Dakota taxpayers who itemize will be even lower in the future. As such, the overall impact of the proposed regulations will be somewhat limited.

The following is an example of the implications of the reduced charitable contribution on a \$10,000 charitable contribution qualifying for a 40 percent ND state tax credit under the proposed regulations:

2018 charitable contribution (40% credit) impact on itemized deductions prior to proposed regulations

Donation amount	ND Tax Credit	Allowable itemized charitable contribution	Federal tax bracket	Maximum reduction in Federal taxes*
\$10,000	\$4,000	\$10,000	10%	\$1,000
\$10,000	\$4,000	\$10,000	12%	\$1,200
\$10,000	\$4,000	\$10,000	22%	\$2,200
\$10,000	\$4,000	\$10,000	24%	\$2,400
\$10,000	\$4,000	\$10,000	32%	\$3,200
\$10,000	\$4,000	\$10,000	35%	\$3,500
\$10,000	\$4,000	\$10,000	37%	\$3,700

2018 Charitable contribution (40% credit) impact on itemized deductions after proposed regulations

Donation amount	ND Tax Credit	Allowable itemized charitable contribution	Federal tax bracket	Maximum reduction in Federal taxes*
\$10,000	\$4,000	\$6,000	10%	\$600
\$10,000	\$4,000	\$6,000	12%	\$720
\$10,000	\$4,000	\$6,000	22%	\$1,320
\$10,000	\$4,000	\$6,000	24%	\$1,440
\$10,000	\$4,000	\$6,000	32%	\$1,920
\$10,000	\$4,000	\$6,000	35%	\$2,100
\$10,000	\$4,000	\$6,000	37%	\$2,220

*Please note that these numbers are provided for illustrative purposes and individual donor results may vary.

The proposed regulations would also apply to payments made by trusts or estates in determining the amount of their charitable contribution deduction.

Next steps: Our recommendation is to talk with your donors and advise them of the changes and possible outcomes. At this time, it appears that the impact will be greatest to the donors that are taking advantage of the Nonprofit Private School Contributions Credit, the Planned Gift Tax Credit, and the Endowment Fund Contribution Credit.

It is important to note the regulations are proposed regulations and the IRS and Treasury are currently looking for comments on the impact before they are finalized. Any organization that wants to provide comments to the IRS on the impact of the regulations may do so. Written and electronic comments or requests to speak must be received by October 11, 2018. Any requests to speak must be accompanied with an outline of the topics to be discussed. A public hearing is scheduled for November 5, 2018. Submissions should be sent electronically via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-112176-18) or can be mailed to:

Internal Revenue Service
CC:PA:LPD:PR (REG-112176-18)
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