Honorable David J. Kautter
Commissioner of the IRS
1111 Constitution Ave., NW
Washington, DC 20224

May 24, 2018

Dear Commissioner Kautter:

I urge you, in the strongest terms, not to upend 100 existing state charitable programs in 33 states. Unfortunately, IRS Notice 2018-54—which your Office released yesterday—suggests that your Office plans to do so.

By way of background, New Jersey recently joined other states in providing taxpayers the option to make charitable contributions to their municipal governments, and to receive property tax credits when they do so. *See* NJ S1893, codified at P.L. 2018, c.11. That recent law expressly "[a]uthorize[d] municipality, county or school district[s] to establish charitable funds for specific purposes" and "permit[ted] property tax credit[s] for certain donations." *Id.* Taxpayers can get up to a 90% tax credit against municipal property taxes when contributing to such a fund.

New Jersey was not alone in taking this approach, and other state models informed New Jersey's decision. As tax law experts have identified, 33 states collectively have 100 programs under which "taxpayers receive tax credits for donations to governments, government-created funds, and nonprofits." Joseph Bankman et al., "Federal Income Tax Treatment of Charitable Contributions Entitling Donor to a State Tax Credit" at 1 (last revised Mar. 13, 2018), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3098291. They run the gamut, including "natural resource preservation through conservation easements, private school tuition scholarship programs, financial aid for college-bound children from low income households, shelters for victims of domestic violence, and numerous other state-supported programs." *Id.*

But in an unprecedented move, the IRS announced plans to end the deductibility of such contributions to state agencies. Under the Tax Code, "[t]here shall be allowed as a deduction any charitable contribution … payment of which is made within the taxable year." 26 U.S.C. § 170(a)(1). The statute is explicit that such contributions include gifts given to state governments and their political subdivisions. *Id.* § 170(c)(1). The only remaining issue is whether such gifts are deductible if the contributor gets a tax credit in return. Notice 2018-54 suggest that the IRS plans to tell states and taxpayers alike that the answer is no.

I ask you to think twice before going down that misguided road. The IRS's longstanding approach, supported by precedent and policy, supports what New Jersey has done.

Indeed, Notice 2018-54 ignores a key fact: federal law has long embraced state statutes like these. In a 2011 memorandum, the IRS resolved the precise question that this rulemaking is purportedly going to address: "Is a payment of cash to [a] state [or local] agency … considered a charitable contribution under § 170 … [if] the payment entitles the taxpayer to a transferable state tax charitable credit?" *See* Memorandum, Office of the Chief Counsel, IRS, No. 201105010

(Feb. 4, 2011), at 2. The IRS answered that question resoundingly in favor of laws like S1893: "Taxpayers may take a § 170 deduction for the full amount of their charitable contributions." *Id.* at 5. Notice 2018-54 gives no reason for the IRS's sudden about-face.

The IRS's longstanding position is the only reasonable interpretation of federal law, as courts have confirmed. There is a long history of judicial decisions finding that "[t]he tax benefit of a federal or state charitable contribution *deduction* is not regarded as a return benefit that negates charitable intent." *Id.* at 4 (emphasis added). Indeed, were it otherwise, § 170 could not function—if the deduction § 170 provides was a benefit that could defeat charitable intent, it would "reduc[e] or eliminat[e] the deduction itself." *Id.* That cannot be what Congress intended. But tax *credits* are not any different than *deductions*; there is "no reason under [the] case law to distinguish between the value of a state tax deduction, and the value of a state tax credit." *Id.* at 5. As such, neither is "consideration that might constitute a *quid pro quo*, for purposes of § 170." *Id.* at 4. And as tax experts noted, "the U.S. Tax Court and at least two federal courts of appeals … have effectively endorsed th[is] Rule, fortifying the legal underpinnings of the determination reached by the IRS." Bankman, *supra*, at 9 (citations omitted); *see also id.* at 1 ("Under current law, expressed through [these] court opinions …, the amount of the donor's charitable contribution deduction is *not* reduced by the value of state tax benefits.").

Not only is this approach right under the law, but it also makes good sense. For one thing, the rule is easily administrable; charitable donations to state agencies are always deductible. Any other approach raises questions regarding which donations were truly charitable—a subjective question that the IRS is ill equipped to answer—and will force the IRS to come up with empty distinctions between tax deductions and tax credits. The IRS's apparent plan also raises serious federalism concerns. Indeed, states like New Jersey use these charitable programs to encourage contributions to state programs, and they typically provide less than a full tax credit in return. (Indeed, New Jersey only provides a 90% tax credit.) These programs thus leave 33 states better off financially—unless and until the IRS suddenly changes position. And as a practical matter, the IRS's plan will upend over 100 state programs in a single rule—a nightmare for both states and the IRS. None of that will happen if the IRS simply stands by its 2011 decision.

The IRS should not play politics; instead, it must confirm its longstanding interpretation of federal law. Should the IRS and Treasury Department continue down this path, New Jersey will have no choice but to challenge the new rule in court.

Sincerely,

Gurbir S. Grewal
Attorney General