TAX TIPS: Latest Developments in State and Local Tax Cap or SALT Cap

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Some New Yorkers successfully prepaid some of their property taxes at the end of last year in a bid to ease the hit from a new federal cap on state and local tax deductions. Those who want to try to ease the pain this year may have had the window just close on them.

The Internal Revenue Service took an important step on August 27 toward blocking the charitable workarounds that high-tax states like New York approved in response to the tax law's $10,000 limit.

The so-called SALT cap limit is one of the most disputed provisions of President Donald Trump's tax law. The tax overhaul created a $10,000 limit for state and local tax deductions, a pittance for Northeastern states like New York that have high property taxes.

While some New York State municipalities had been awaiting IRS guidance before creating funds and accepting donations, others went ahead and established them. For example, the Village of Scarsdale, New York, set up a charitable fund earlier this year for residents. Still, taxpayers should be cautious about contributing to funds before August 27 because the IRS proposal makes it clear that the agency considers its position to be settled law.

After August 27, taxpayers who itemize will only be eligible for a federal deduction that's a small fraction of their charitable donations for property tax payments, according to proposed regulations issued by the Treasury Department on Thursday. The charitable contribution strategies in high-tax states like New York were created so taxpayers would be able to write off the full donation amount from their federal taxes.

The Treasury regulations say taxpayers can receive a federal tax write-off equal to the difference between the state tax credits they get and their charitable donations. That means a New York taxpayer who makes a $20,000 charitable donation to pay property taxes and receives a $17,000 state tax credit would only be able to write off $3,000 on a federal tax bill.

It isn't the first time municipalities have been caught off guard by the SALT deduction changes. Taxpayers stood in line outside county offices at the end of last year, rushing to prepay their 2018 real estate tax bills in the hopes they could apply it to their 2017 tax return, which allowed for unlimited SALT deductions. Only those who already had their taxes assessed ended up qualifying for the additional tax write-off for their 2017 tax bills following IRS guidance on the matter.

Earlier this year, New York Governor Andrew Cuomo signed legislation allowing local governments to set up charitable organizations to accept property tax payments. In turn, homeowners receive credits for those donations to offset federal taxable income. New York provides an 85 percent state credit, so under the Treasury rules only 15 percent of the donation amount would be eligible for a federal tax break.

The IRS rules released Thursday, August 23 are likely to be contested by New York State. Governor Cuomo is also spearheading a lawsuit to have the SALT cap struck down, which legal experts believe have little chance of success.

As always, please consult your tax advisor should you have any questions.