IRS Kills Deduction Work-Around Plans in High-Tax States

September 7, 2018 - Shortly after congress passed the nation's new tax plan, states with high taxes announced plans to try and circumvent the new law. That's because it limits overall state tax deductions to $10,000 for individuals. The limit is inclusive of property and income taxes. That's a problem for states like New York and California. Anyone with a $1 million home in California has a property tax bill alone of more than $10,000; and they aren't living in the lap of luxury. In fact, in some areas of Los Angeles and San Francisco, $ 1 million won't even buy you 1,000 square feet.

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Shortly after the law passed, several states came up with a grand idea. They were going to allow state residents to make charitable donations to the state. And for every dollar donated, they would reduce the income tax these state residents owed to the state by $1. The theory behind this idea was that even though deductions for state taxes were capped, there was no such cap for charitable donations. Problem solved!

But there was one little issue with these plans, and we told our readers about it at the time. The IRS has sole authority to determine whether or not an organization is a legitimate charity. And there was ample reason at the time to conclude that they wouldn't allow these plans to move forward. Well, now they've announced their decision and it is just what we thought it would be.

The irony in all of this is that all of these high tax states could have avoided the problem if they had just supported the tax plan. But because congress passed the plan on a party-line vote, they ran into a problem. They had a cap on how much any tax plan could increase the deficit. And the only way to keep the deficit down was to place a cap on state tax deductions. Had there been some bipartisan support for the plan, the deficit cap could have been overcome. But that didn't happen. In fact, in the Senate, there wasn't one single vote to support the bill from California, New York or New Jersey - three of the highest tax states in the country.

So, if you live in a high tax state, and you donate to the state's charitable organization, you're still going to be capped at $10,000 for state and local tax deductions. And if you are upset by that, then you should probably let your senators and representatives know how you feel.
byJim Malmberg
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