Daily Tax Report: State

SALT Cap Pass-Through Workaround Holds Up After New IRS Rules

By Sam McQuillan

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- New IRS guidance makes no mention of popular workaround
- Connecticut was first state to adopt strategy in 2018

Tax professionals noted that recent rules tied to the $10,000 cap on state and local tax deductions are perhaps most notable for what they don't say.

The rules (T.D. 9907), officially published on Tuesday, address a safe harbor for businesses donating to a charitable fund in exchange for a state tax credit. The IRS didn't reference a strategy enacted by Connecticut, New Jersey, and other states that allows owners of pass-through entities to blunt the impact of the SALT cap by paying income tax at the entity level instead of on their personal taxes.

Lawmakers in high-tax states have tried to find a way around the cap, established in the 2017 tax law, but the IRS has cracked down on some of those efforts. The IRS in 2019 curbed state efforts that allowed residents to create charitable funds and get a state tax credit in exchange.

The absence of regulations limiting the pass-through workaround is a good sign for states, tax practitioners said, because the longer the agency goes without cracking down on them, the more likely it is they won't.

"The longer they remain silent the better chance that these statutes have of either not being touched or withstanding later scrutiny," said Bruce Ely, a senior partner at Bradley Arant Boult Cummings LLP in Alabama.

The IRS didn't return a request for comment on whether it will issue additional guidance on the issue. The IRS last year said it wasn't done examining SALT workarounds.

States' Strategy

The IRS' silence is a good sign for the owners of pass-through entities in the states with the tax said, Marc Finer, a Hartford-based tax attorney at Murtha Cullina LLP, who last year warned that benefits from Connecticut's workaround could be temporary.

Connecticut—the first state to enact the pass-through workaround—has had its law in place since 2018. It created a tax on the entities, which gets offset by a corresponding personal income tax credit. The amount of the tax is a deductible expense on their federal return.

“The fact that the IRS has spent so much time attacking the charitable workarounds and no time at all mentioning the pass-through workarounds and now it’s two and a half years later, I think it solidifies the notion that the pass-through entity workarounds are going to be okay,” said Tim Noonan, a tax attorney at Hodgson Russ LLP in Manhattan.

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