



**Preserving Virginia's scenic, natural, historic, recreational,
and open-space lands for future generations.**

To: Board of Trustees

From: Brett Glymph

Re: Federal treatment of charitable gift of easements and land preservation tax credits

Date: September 6, 2018

Please see IRS announcement and proposed new regulation of charitable contributions that receive state and local tax credits. As a part of the 2017 overhaul of the tax code, state and local taxes (SALT) are no longer fully deductible. As a consequence of the SALT limit, the IRS is revisiting the question of whether charitable contributions in exchange for SALT credits are fully deductible for federal income tax purposes. As of August 28, of this year, the IRS has determined, on a preliminary basis, that contributions that receive SALT credits are reduced by the SALT credit award for federal income tax purposes.

Many in the land conservation community are concerned that reducing the full deductibility of SALT credit transfers may have an adverse impact on landowners' interest in donating charitable gifts of conservation easements that receive land preservation tax credits. However, we have also heard from some attorneys and accountants that opine that it will not affect their clientele or that the impact will not be dramatic. Please review the enclosed matter for a discussion at the upcoming Board meeting.

you notify your principal inspector, or lacking a principal inspector, the manager of the local flight standards district office or certificate holding district office before operating any aircraft complying with this AD through an AMOC.

(h) Additional Information

The subject of this AD is addressed in European Aviation Safety Agency (EASA) AD No. 2017-0011, dated January 25, 2017. You may view the EASA AD on the internet at <http://www.regulations.gov> in the AD Docket.

(i) Subject

Joint Aircraft Service Component (JASC)
Code: 6510 Tail Rotor Driveshaft.

Issued in Fort Worth, Texas, on August 10, 2018.

Lance T. Gant,

Director, Compliance & Airworthiness
Division, Aircraft Certification Service.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-112176-18]

RIN 1545-BO89

Contributions in Exchange for State or Local Tax Credits

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notification of public hearing.

SUMMARY: This document contains proposed amendments to regulations under section 170 of the Internal Revenue Code (Code). The proposed amendments provide rules governing the availability of charitable contribution deductions under section 170 when a taxpayer receives or expects to receive a corresponding state or local tax credit. This document also proposes amendments to the regulations under section 642(c) to apply similar rules to payments made by a trust or decedent's estate. This document provides notification of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by October 11, 2018. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for November 5, 2018, must be received by October 11, 2018.

ADDRESSES: Send submissions to Internal Revenue Service, CC:PA:LPD:PR (REG-112176-18), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (REG-112176-18), Courier's Desk, 1111 Constitution Avenue NW, Washington, DC 20224, or sent electronically, via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-112176-18). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, Merrill D. Feldstein and Mon Lam at (202) 317-4059; concerning submission of comments and requests for a public hearing, Regina Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 170(a)(1) generally allows an itemized deduction for any "charitable contribution" paid within the taxable year. Section 170(c) defines "charitable contribution" as a "contribution or gift to or for the use of" any entity listed in that subsection. Section 170(c)(1) includes a contribution or gift to or for the use of a State, a possession of the United States, or any political subdivision of the foregoing, but only if the contribution or gift is made exclusively for public purposes. Section 170(c)(2) includes, in general, a contribution or gift to or for the use of certain corporations, trusts, or community chests, funds, or foundations, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

Section 164 generally allows an itemized deduction for the payment of certain taxes, including state and local, and foreign, real property taxes; state and local personal property taxes; and state and local, and foreign, income, war profits, and excess profits taxes. Section 164(b)(6), as added by section 11042 of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" (the Act), Public Law 115-97, limits an individual's deduction for the aggregate amount of state and local taxes paid during the calendar year to \$10,000 (\$5,000 in the case of a married individual filing a separate return). This new limitation applies to taxable years beginning after

December 31, 2017, and before January 1, 2026.

I. The Charitable Contribution Deduction

In 1986, the Supreme Court interpreted the phrase "charitable contribution" in section 170. See *United States v. American Bar Endowment*, 477 U.S. 105, 116-118 (1986). The Court held that the "sine qua non of a charitable contribution is a transfer of money or property without adequate consideration"—that is, without the expectation of a *quid pro quo*. *Id.* at 118. A "payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return." *Id.* at 116. The Court recognized that some payments may have a "dual character"—part charitable contribution and part *quid pro quo*—whereby the taxpayer receives some "nominal benefit" of lesser value than the payment. *Id.* at 117. In such cases, the Court reasoned, "it would not serve the purposes of § 170 to deny a deduction altogether." *Id.* Instead, the Court held, the charitable contribution deduction is allowed, but only to the extent the amount donated or the fair market value of the property transferred by the taxpayer exceeds the fair market value of the benefit received in return, and only if the excess amount was transferred with the intent of making a gift. *Id.*

For the benefit received in return to reduce the allowable charitable contribution deduction under section 170, the benefits received, or expected to be received, by a donor need only be greater than those benefits that inure to the general public from transfers for charitable purposes. See, e.g., *Singer Co. v. United States*, 449 F.2d 413, 422-423 (Ct. Cl. 1971); *American Bar Endowment*, 477 U.S. at 116-17 (citing *Singer*); *Hernandez v. Commissioner*, 490 U.S. 680 (1989). In addition, the benefits received need not come directly from the donee to reduce the allowable deduction, nor do they need to be specifically quantifiable at the time of transfer. See, e.g., *Singer*, 449 F.2d at 422. The Treasury Department and the IRS have incorporated many of these principles into regulations under section 170. Section 1.170A-1(h)(1) of the Income Tax Regulations provides, for example, that no part of a payment that a taxpayer makes to or for the use of an organization described in section 170(c) that is in consideration for (as defined in § 1.170A-13(f)(6)) goods or services (as defined in § 1.170A-13(f)(5)) is a contribution or gift within the meaning of section 170(c) unless the taxpayer (i) intends to make a payment

in an amount that exceeds the fair market value of the goods or services; and (ii) makes a payment in an amount that exceeds the fair market value of the goods or services. Section 1.170A-13(f)(5) defines goods or services to include cash, property, services, benefits, and privileges, and § 1.170A-13(f)(6) provides that a donee provides goods or services in consideration for a taxpayer's payment if, at the time the taxpayer makes the payment to the donee organization, the taxpayer receives or expects to receive goods or services in exchange for that payment.

II. State and Local Tax Credit Programs

In recent years, it has become increasingly common for states and localities to provide state or local tax credits in return for contributions by taxpayers to or for the use of certain entities listed in section 170(c). As the use of these tax credit programs by states and localities became more common, the IRS Office of Chief Counsel (IRS Chief Counsel), in multiple Chief Counsel Advice memoranda (CCAs), considered whether the receipt of state tax credits under these programs were *quid pro quo* benefits that would affect the amount of taxpayers' charitable contribution deductions under section 170(a). Although CCAs are released to the public for information purposes, it should be noted that CCAs are not official rulings or positions of the IRS, are not ordinarily reviewed by the Treasury Department, and are not precedential.

In CCAs issued in 2002 and 2004, IRS Chief Counsel reviewed programs involving the issuance of state tax credits in return for the transfer of conservation easements and for payments to certain child care organizations. See CCA 200238041 (July 24, 2002); CCA 200435001 (July 28, 2004). In these CCAs, IRS Chief Counsel recognized that these programs raised complex questions and recommended that the tax credit issue be addressed through official published guidance.

In 2010, another CCA explained that published guidance on the issue was not contemplated at that time, but it offered further advice. See CCA 201105010 (Oct. 27, 2010) (the 2010 CCA). This 2010 CCA observed that a payment to a state agency or charitable organization in return for a tax credit might be characterized as either a charitable contribution deductible under section 170 or a payment of state tax possibly deductible under section 164. The 2010 CCA advised that taxpayers may take a deduction under section 170 for the full amount of a contribution made in return

for a state tax credit, without subtracting the value of the credit received in return. The analysis in the 2010 CCA assumed that after the taxpayer applied the state or local tax credit to reduce the taxpayer's state or local tax liability, the taxpayer would receive a smaller deduction for state and local taxes under section 164. The 2010 CCA cautioned, however, that "there may be unusual circumstances in which it would be appropriate to recharacterize a payment of cash or property that was, in form, a charitable contribution as, in substance, a satisfaction of tax liability."

In addition to the CCAs, IRS Chief Counsel has taken the position in the U.S. Tax Court that the amount of a state or local tax credit that reduces a tax liability is not an accession to wealth under section 61 or an amount realized for purposes of section 1001, and the Tax Court has accepted this view. See, e.g., *Maines v. Commissioner*, 144 T.C. 123, 134 (2015) (holding that the non-refundable portion of a state income tax credit, the amount of which was based on previously-paid property taxes, reduced the current year's tax liability and is not taxable or treated as an item of income); *Tempel v. Commissioner*, 136 T.C. 341, 351-354 (2011) (holding that state income tax credits received by a donor for the transfer of a conservation easement and sold by the donor were capital assets, but that the donor had no adjusted basis in the credits), *aff'd sub nom. Esgar Corp. v. Commissioner*, 744 F.3d 648 (10th Cir. 2014). However, the application of sections 61 and 1001 to state or local tax credits presents different issues than the application of section 170, and none of these cases addressed whether a taxpayer's expectation or receipt of a state or local tax credit may reduce a taxpayer's charitable contribution deduction under section 170. Nor has the Treasury Department or the IRS ever addressed this question in published guidance.

III. New Limitation in Section 164

At the time the 2010 CCA was issued, section 164 generally allowed an itemized deduction—unlimited in amount—for the payment of state and local taxes. Accordingly, the question of how to characterize transfers pursuant to state tax credit programs had little practical consequence from a federal income tax perspective because, unless the taxpayer was subject to the alternative minimum tax (AMT) under section 55, a deduction was likely to be available under either section 164 or section 170. Permitting a charitable contribution deduction for a transfer made in exchange for a state or local tax credit generally had no effect on federal

income tax liability because any increased deduction under section 170 would be offset by a decreased deduction under section 164.

However, as a result of the new limit on the deductibility of state and local taxes under section 164(b)(6) (as added by the Act), treating a transfer pursuant to a state or local tax credit program as a charitable contribution for federal income tax purposes may reduce a taxpayer's federal income tax liability. When a charitable contribution is made in return for a state or local tax credit and the taxpayer has pre-credit state and local tax liabilities in excess of the \$10,000 limitation in section 164(b)(6), a charitable contribution deduction under section 170 would no longer be offset by a reduction in the taxpayer's state and local tax deduction under section 164. Thus, as a consequence, state and local tax credit programs now give taxpayers a potential means to circumvent the \$10,000 limitation in section 164(b)(6) by substituting an increased charitable contribution deduction for a disallowed state and local tax deduction. State legislatures are also now considering or have adopted proposals to enact new state and local tax credit programs with the aim of enabling taxpayers to characterize their transfers as fully deductible charitable contributions for federal income tax purposes, while using the same transfers to satisfy or offset their state or local tax liabilities.

In light of the tax consequences of section 164(b)(6) and the resulting increased interest in preexisting and new state tax credit programs, the Treasury Department and the IRS determined that it was appropriate to review the question of whether amounts paid or property transferred in exchange for state or local tax credits are fully deductible as charitable contributions under section 170.

IV. Notice 2018-54

Pursuant to this review, in Notice 2018-54, 2018-24 I.R.B. 750, the Treasury Department and the IRS announced on June 11, 2018, their intention to propose regulations addressing the federal income tax treatment of payments made by taxpayers for which the taxpayers receive a credit against their state and local taxes. The notice stated that federal tax law controls the proper characterization of payments for federal income tax purposes and that proposed regulations would assist taxpayers in understanding the relationship between the federal charitable contribution deduction and the new limitation on the

deduction for state and local tax payments.

Although Notice 2018–54 was issued in response to state legislation proposed after the enactment of the limitation on state and local tax deductions under section 164(b)(6), the rules in these proposed regulations are based on longstanding federal tax law principles, which apply equally to taxpayers regardless of whether they are participating in a new state and local tax credit program or a preexisting one. Accordingly, the proposed regulations, and the analysis underlying the proposed regulations, are intended to apply to transfers pursuant to state and local tax credit programs established under the recent state legislation as well as to transfers pursuant to state and local tax credit programs that were in existence before the enactment of section 164(b)(6).

V. Proposed Regulations

After reviewing the issue, and in light of the longstanding principles of the cases and tax regulations discussed above, the Treasury Department and the IRS believe that when a taxpayer receives or expects to receive a state or local tax credit in return for a payment or transfer to an entity listed in section 170(c), the receipt of this tax benefit constitutes a *quid pro quo* that may preclude a full deduction under section 170(a). In applying section 170 and the *quid pro quo* doctrine, the Treasury Department and the IRS do not believe it is appropriate to categorically exempt state or local tax benefits from the normal rules that apply to other benefits received by a taxpayer in exchange for a contribution. Thus, the Treasury Department and the IRS believe that the amount otherwise deductible as a charitable contribution must generally be reduced by the amount of the state or local tax credit received or expected to be received, just as it is reduced for many other benefits. Accordingly, the Treasury Department and the IRS propose regulations proposing to amend existing regulations under section 170 to clarify this general requirement, to provide for a *de minimis* exception from the general rule, and to make other conforming amendments.

Compelling policy considerations reinforce the interpretation and application of section 170 in this context. Disregarding the value of all state tax benefits received or expected to be received in return for charitable contributions would precipitate significant revenue losses that would undermine and be inconsistent with the limitation on the deduction for state and local taxes adopted by Congress in

section 164(b)(6).¹ Such an approach would incentivize and enable taxpayers to characterize payments as fully deductible charitable contributions for federal income tax purposes, while using the same payments to satisfy or offset their state or local tax liabilities. Disregarding the tax benefit would also undermine the intent of Congress in enacting section 170, that is, to provide a deduction for taxpayers' gratuitous payments to qualifying entities, not for transfers that result in economic returns. The Treasury Department and the IRS believe that appropriate application of the *quid pro quo* doctrine to substantial state or local tax benefits is consistent with the Code and sound tax administration.

Explanation of Provisions

The proposed regulations generally provide that if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit, or *quid pro quo*, to the taxpayer and reduces the charitable contribution deduction.

In addition to credits, the proposed regulations also address state or local tax deductions claimed in connection with a taxpayer's payment or transfer. Although deductions could be considered *quid pro quo* benefits in the same manner as credits, the Treasury Department and the IRS believe that sound policy considerations as well as considerations of efficient tax administration warrant making an exception to *quid pro quo* principles in the case of dollar-for-dollar state or local tax deductions. Because the benefit of a dollar-for-dollar deduction is limited to the taxpayer's state and local marginal rate, the risk of deductions being used to circumvent section 164(b)(6) is comparatively low. In addition, if state and local tax deductions for charitable contributions were treated as *quid pro quo* benefits, it would make the accurate

¹ The Joint Committee on Taxation estimated that the limitation on state and local tax deductions along with certain other reforms of itemized deductions would raise \$668 billion over ten years. A substantial amount of this revenue would be lost if state tax benefits received in exchange for charitable contributions were ignored in determining the charitable contribution deduction. This estimate is not a revenue estimate of the proposed regulations, in part because it includes other reforms of itemized deductions but does not reflect certain other provisions of the Act. See Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 1, The 'Tax Cuts and Jobs Act,'" JCX–67–17, December 18, 2017 available at <https://www.jct.gov/publications.html?func=startdown&id=5053>.

calculation of federal taxes and state and local taxes difficult for both taxpayers and the IRS. For example, the value of a deduction could vary based on the taxpayer's marginal or effective state and local tax rates, making for more complex computations and adding to administrative and taxpayer burden. The proposed regulations thus allow taxpayers to disregard dollar-for-dollar state or local tax deductions. However, the proposed regulations state that, if the taxpayer receives or expects to receive a state or local tax deduction that exceeds the amount of the taxpayer's payment or the fair market value of the property transferred, the taxpayer's charitable contribution deduction must be reduced. The Treasury Department and the IRS request comments on how to determine the amount of this reduction.

To provide consistent treatment for state or local tax deductions and state or local tax credits that provide a benefit that is generally equivalent to a deduction, the proposed regulations include a *de minimis* exception under which a taxpayer may disregard a state or local tax credit if such credit does not exceed 15 percent of the taxpayer's payment or 15 percent of the fair market value of the property transferred by the taxpayer. The *de minimis* exception reflects that the combined value of a state and local tax deduction, that is the combined top marginal state and local tax rate, currently does not exceed 15 percent. Accordingly, under the proposed regulations, a state or local tax credit that does not exceed 15 percent does not reduce the taxpayer's federal deduction for a charitable contribution. The Treasury Department and the IRS request comments on this proposed exception.

In drafting the proposed regulations, the Treasury Department and the IRS also considered whether a taxpayer may decline the receipt or anticipated receipt of a state or local tax credit by taking some affirmative action at the time of the taxpayer's payment or transfer. See Rev. Rul. 67–246, 1967–2 C.B. 104 (allowing a full charitable contribution deduction if the taxpayer does not accept or keep any indicia of a return benefit). Because procedures for declining the state or local tax credit would depend on the procedures of each state and locality in administering the tax credits, the Treasury Department and the IRS request comments regarding a rule that would allow taxpayers to decline state or local tax credits and receive full deductions for charitable contributions under section 170.

Trusts and decedents' estates may claim an income tax deduction for

charitable contributions under section 642(c). For the same reasons provided above, the proposed regulations amend § 1.642(c)-3 to provide that the proposed rules under § 1.170A-1(h)(3) apply to payments made by a trust or decedent's estate in determining its charitable contribution deduction under section 642(c).

Proposed Applicability Date

The amendments to these regulations are proposed to apply to contributions after August 27, 2018.

Special Analyses

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. These proposed regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. OMB has determined that the proposed regulations are subject to review under section 1(b) of the Memorandum of Agreement. These proposed regulations have been reviewed by OMB. These proposed regulations are anticipated to be regulatory actions under E.O. 13771. The analysis below can provide further detail on this designation.

I. Need for Regulations

These proposed regulations provide guidance on the deductibility of charitable contributions when a taxpayer receives or expects to receive a corresponding state or local tax credit. These proposed regulations are intended to clarify the relationship between the federal charitable contribution deduction and the recently-enacted statutory limitation on deductions for state and local taxes paid (the "SALT cap") and to make the federal tax system more neutral with respect to taxpayers' decisions regarding donations. Compelling policy considerations reinforce the interpretation and application of section 170 in this context. Disregarding the value of all state tax benefits received or expected to be received in return for

charitable contributions would precipitate revenue losses that would undermine and be inconsistent with the limitation on the deduction for state and local taxes adopted by Congress in section 164(b)(6).

Pursuant to section 6(a)(3)(B) of Executive Order 12866, the following qualitative analysis provides further details regarding the anticipated impact of the proposed regulations. After identifying a baseline in Part II, this analysis provides illustrative scenarios in Part III. Part III.A describes the tax effects of the contributions prior to enactment of the SALT cap in the Act. Part III.B provides examples comparing the enactment of the SALT cap but absent the proposed rule (the baseline) to the proposed rule. Finally, Part IV provides a qualitative assessment of the potential costs and benefits of the proposed rule compared to the baseline.

II. Baseline

Prior to this proposed rule, there was no authoritative regulatory guidance on the treatment of state or local tax credits arising from charitable contributions to entities listed in section 170(c), and there was no guidance aside from Notice 2018-54 addressing the interaction between section 170 and the newly enacted SALT cap. As a result, there was a degree of taxpayer uncertainty as to whether state and local tax credits are a return benefit that reduces a taxpayer's charitable contribution deduction. For informational and analytical purposes, however, this analysis assumes as a baseline that state and local tax credits are generally not treated as a return benefit or consideration and therefore do not reduce the taxpayer's charitable contribution deduction under section 170(a).

III. Illustrative Scenarios

For the following illustrative scenarios, assume the following facts: Charitable organizations A and B are entities listed in section 170(c) and provide similar public goods. Contributions to charity A are eligible for a dollar-for-dollar state tax credit. Contributions to charity B are ineligible for this credit but are deductible from state taxable income. A taxpayer itemizes deductions, and these itemized deductions in aggregate are at least \$1,000 more than the standard deduction. The taxpayer has the choice to contribute \$1,000 to charity A, and this \$1,000 contribution generates a state tax credit of \$1,000,² that is, the tax

² Note that this analysis only addresses state tax credits offering a 100% benefit. The results may differ for credits offering a lower benefit, but the

credit is dollar-for-dollar but does not otherwise figure into the calculation of the taxpayer's state tax liability. The taxpayer has more than \$1,000 of state tax liability, so that the taxpayer's state tax liability is reduced by the entire \$1,000 of the state tax credit. Finally, if the taxpayer makes the \$1,000 contribution that generates a state tax credit of \$1,000, the taxpayer reduces by \$1,000 the withholdings or other payments of state taxes during the taxable year in question. The state taxes paid by the taxpayer are therefore reduced by the full amount of the state tax credit in the same taxable year as the contribution is made.³ Further assume the taxpayer is in the 24 percent federal tax bracket, itemizes federal tax deductions, and has a state tax rate of 5 percent. If the taxpayer is subject to the AMT, assume an AMT marginal tax rate of 26 percent.

The Act and proposed regulations alter the incentives taxpayers face about whether and how much to give to organizations that receive charitable contributions as well as to which organizations. This is illustrated in the following scenarios, which are also summarized in Table 1 (below).

A. Prior Law: Section 170 Charitable Contributions Prior to the Act

The tax effects of contributions prior to enactment of the Act are illustrated in the columns labeled "Prior Law" in Table 1.

1. Taxpayer Not Subject to AMT

Prior to enactment of the Act, if the taxpayer made a \$1,000 contribution to charity A that generated a state tax credit of \$1,000, the deduction for charitable contributions under section 170(a) increased by \$1,000, and the deduction for state and local taxes paid under section 164 decreased by \$1,000. The taxpayer's itemized deductions, taxable income, and federal tax liability were unchanged from what they would have been in the absence of the contribution.⁴ The taxpayer's state tax liability decreased by \$1,000 because of the state tax credit. The combined federal and state tax benefits of the

comparative results of the below illustrative examples would be similar.

³ The results of the examples are generally unchanged if the taxpayer instead receives the credit as a refund of state taxes paid that were deducted from federal taxable income, as such refund would be includible in federal taxable income in the following year.

⁴ This assumes the taxpayer was not subject to limitations such as the overall limitation on itemized deductions under section 68 or subject to a percentage limitation for the deduction under section 170, an assumption that is maintained throughout the succeeding discussion.

\$1,000 contribution were therefore \$1,000, and the cost to the taxpayer and to the federal government of making the contribution was \$0. This is shown in column A under Prior Law for Example 1 in Table 1 and replicated in the same column for Example 2.

2. Taxpayer Subject to AMT

If the taxpayer were subject to the AMT under section 55, however, there was a net benefit to the taxpayer from contributions to charity A, which provided state tax credits. State and local taxes paid are not deductible expenses in determining taxable income under the AMT, but charitable contributions are deductible expenses in determining taxable income under the AMT. If the taxpayer contributed \$1,000, taxable income under the AMT was reduced by \$1,000 due to the charitable contribution deduction under section 170, but there was no corresponding reduction in the deduction for state and local taxes. Under an AMT marginal tax rate of 26 percent, the federal tax benefit of this \$1,000 contribution would be \$260. Because of the dollar-for-dollar state tax credit, the taxpayer received a combined federal and state tax benefit of \$1,260 for a \$1,000 contribution, a net benefit of \$260. This is shown in column A under Prior Law for Example 3 in Table 1.

3. Comparison of Contributions to Different Organizations Under Prior Law

In combination, state and federal tax laws generally provide a greater incentive to contribute to organizations eligible for state tax credits (charity A) than to other organizations (charity B). The effect of a contribution to charity A are described above.

Prior to enactment of the Act, for a taxpayer not subject to the AMT, a \$1,000 contribution to charity B yielded a smaller combined federal and state tax benefit than to charity A. The state tax benefit was \$50 (\$1,000 times the 5 percent state tax rate). The taxpayer's itemized deductions at the federal level increased by \$950 (the \$1,000 charitable contribution deduction less than \$50 reduction in state taxes paid). The federal tax benefit of this increase was \$228 (\$950 times the 24 percent federal tax rate), resulting in a combined federal and state tax benefit of \$278. The net cost to the taxpayer of the \$1,000 contribution was \$722. This is shown in column B under Prior Law for Example 1 in Table 1 and replicated in the same column for Example 2.

For a taxpayer subject to the AMT, a \$1,000 contribution to charity B yielded a combined federal and state benefit of

\$310—the \$1,000 contribution multiplied by the taxpayer's marginal tax rate under the AMT of 26 percent, or \$260, plus the value of the deduction from state tax, or \$50 (\$1,000 times the 5 percent state tax rate). The net cost to the taxpayer of the \$1,000 contribution was \$690. This is shown in column B under Prior Law for Example 3 in Table 1.

Contributing to either charity A or charity B reduced the taxpayer's combined federal and state tax liability, but the existence of the state tax credit for contributions to charity A made contributions to that organization more attractive. This is seen by comparing the Total Tax Benefit in column A under Prior Law to the corresponding value in column B for each of the three examples. For taxpayers not subject to the AMT, contributions to charity A yielded a combined federal and state tax benefit of \$1,000, compared to a combined federal and state tax benefit of \$278 for a contribution to charity B. The AMT increased the disparity for contributions to charity A versus charity B, resulting in a combined federal and state tax benefit of \$1,260 for a contribution to charity A versus \$310 for a contribution to charity B.

B. Examples Under Baseline (Current Law and Practices Under the Act) and Proposed Rule

The enactment of the SALT cap in the Act has, in limited circumstances, altered the federal tax effects of charitable contributions as described in the following examples. These are illustrated in the columns labeled "Baseline" and "Proposed Rule" in Table 1.

1. Example 1: Taxpayer Is Above the SALT Cap and Not Subject to the AMT

a. Baseline

If a taxpayer that has a state tax liability of more than \$1,000 above the SALT cap and is not subject to the AMT makes a \$1,000 contribution to charity A, the deduction for charitable contributions under section 170(a) increases by \$1,000, but the deduction for state and local taxes paid under section 164 is unchanged. Consequently, itemized deductions increase by \$1,000, and taxable income decreases by \$1,000. If the taxpayer is in the 24 percent bracket, federal liability will decrease by \$240, and state tax liability will decrease by the \$1,000 state tax credit. The combined federal and state tax benefits of the \$1,000 contribution are therefore \$1,240, and the taxpayer receives a \$240 net benefit while the federal government has a loss

of \$240. This is shown in column A under Baseline for Example 1 in Table 1.

b. Proposed rule

If the same taxpayer makes the \$1,000 contribution to charity A under the proposed rule, the entire \$1,000 deduction is not deductible under section 170(a), and the deduction for state and local taxes paid under section 164 is unchanged due to the SALT cap. The taxpayer's itemized deductions, taxable income, and federal tax liability are unchanged from what they would be in the absence of the contribution. The taxpayer's state tax liability decreases by \$1,000 because of the state tax credit. The combined federal and state tax benefits of the \$1,000 contribution are therefore \$1,000, or \$240 less than under the baseline. This is shown by comparing the Total Tax Benefit in column A under Proposed Rule with the corresponding value in column A under Baseline for Example 1 in Table 1. However, the benefit of the contribution for this taxpayer is the same as the taxpayer faced prior to enactment of the Act. This is shown by comparing the Total Tax Benefit under column A under Proposed Rule with the corresponding value in column A under Prior Law for Example 1 in Table 1.

c. Comparison of Contributions to Different Organizations and Proposed Rule

Under the baseline and the proposed rule, for a taxpayer with state and local taxes paid over the SALT cap, the value of a contribution to charity B, that is a contribution that results in a one-for-one state income tax deduction and not a state tax credit, is slightly higher than it was pre-Act. This increase is because the state deduction does not reduce the federal deduction for state and local taxes for a taxpayer above the SALT cap. As shown in the Total Tax Benefit row under the B columns for Example 1, under the baseline and the proposed rule, the value of a \$1,000 contribution to charity B is \$290—the charitable contribution deduction from federal tax (\$1,000 times the 24 percent federal tax rate, or \$240), plus the value of the deduction from state tax (\$1,000 times the 5 percent state tax rate, or \$50)—compared to \$278 for contributions under prior law (described above). By comparison, as shown in the Total Tax Benefit row under the A columns for Example 1, a contribution to charity A, eligible for a state tax credit, yields a \$1,240 tax benefit under the baseline and a \$1,000 benefit under the proposed rule.

2. Example 2: Taxpayer Is Below the SALT Cap and Not Subject to the AMT

a. Baseline

If a taxpayer that has state and local taxes paid below the SALT cap and is not subject to the AMT makes the \$1,000 contribution to charity A, the deduction for charitable contributions under section 170(a) increases by \$1,000, and the deduction for state and local taxes paid under section 164 decreases by \$1,000. The taxpayer's itemized deductions, taxable income, and federal tax liability are unchanged from what they would be in the absence of the contribution. The taxpayer's state tax liability decreases by \$1,000 because of the state tax credit. The combined federal and state tax benefits of the \$1,000 contribution are therefore \$1,000, and the cost to the taxpayer and to the federal government of making the contribution was \$0. This situation is identical to prior law or what taxpayers faced prior to enactment of the Act. This is shown in column A under Baseline and Prior Law for Example 2 in Table 1.

b. Proposed Rule

If the same taxpayer makes the \$1,000 contribution to charity A under the proposed rule, the entire \$1,000 contribution is not deductible under section 170(a), but the deduction for state and local taxes paid under section 164 still decreases by \$1,000 because of the \$1,000 state tax credit. If the taxpayer is in the 24 percent bracket, the federal tax liability will increase by \$240. The taxpayer's state tax liability decreases by the \$1,000 state tax credit. The combined federal and state tax benefits of the \$1,000 contribution are therefore \$760, or \$240 less than the baseline. This is shown by comparing the Total Tax Benefit in column A under Proposed Rule with the corresponding value in column A under Baseline for Example 2. In this case, the proposed rule has the effect of increasing the taxpayer's federal taxable income compared to the baseline if the taxpayer makes a contribution to charity A.

c. Comparison of Contributions to Different Organizations, Under Prior Law, Baseline, and Proposed Rule

Under prior law, and both the baseline scenario and the proposed rule, the tax benefit of charitable contributions to charity B, which are not eligible for a state tax credit but are deductible from both federal and state taxable income, is unchanged from prior law for taxpayers below the SALT cap. Thus, in this example, the benefit of

making a contribution to charity B remains \$278, as described above for contributions under prior law. This is shown in the Total Tax Benefit row under the B columns for Example 2. By comparison, as shown in the Total Tax Benefit row under the A columns for Example 2, a \$1,000 contribution to charity A, eligible for a state tax credit, yields a \$1,000 tax benefit under the baseline and a \$760 benefit under the proposed rule.

3. Example 3: Taxpayer is Subject to the AMT⁵

a. Baseline

If a taxpayer subject to the AMT makes a \$1,000 contribution to charity A, the contribution reduces the taxpayer's taxable income under the AMT by \$1,000. Under an AMT marginal tax rate of 26 percent, the federal tax benefit of this \$1,000 contribution is \$260. Because of the dollar-for-dollar state tax credit, the taxpayer would receive a combined federal and state tax benefit of \$1,260 for a \$1,000 contribution, or a \$260 net benefit. This result is identical to the result under prior law (prior to enactment of the Act). This is shown in the A columns under Baseline and Prior Law for Example 3 in Table 1.

b. Proposed Rule

If the same taxpayer makes the \$1,000 contribution to charity A under the proposed rule, the entire \$1,000 is not deductible under section 170(a). Therefore, the taxpayer's taxable income and federal tax liability under the AMT would be unchanged from what they would be in the absence of the contribution. The taxpayer's state tax liability decreases by \$1,000 because of the state tax credit. The combined federal and state tax benefits of the \$1,000 contribution are therefore \$1,000, or \$260 less than under the baseline and under the law prior to enactment of the Act. This is shown by comparing the A columns of Example 3 in Table 1. However, under the proposed rule, taxpayers subject to the AMT are in the same position as taxpayers with state and local taxes paid above the SALT cap who are not subject to the AMT. This is shown by comparing the Total Tax Benefit amount under column A for the Proposed Rule for Example 3 to that for Example 1.

⁵ The Act increased the amount of income exempt from AMT. We estimate that only about 150,000 taxpayers will be subject to the AMT under the Act, compared to more than 4 million under prior law.

c. Comparison of Contributions to Different Organizations, Under Prior Law, Baseline and Proposed Rule

Under the baseline and the proposed rule, the treatment of charitable contributions that are deductible from both federal and state taxable income is unchanged from prior law for taxpayers subject to the AMT. This is shown in the B columns for Example 3 in Table 1. In this example, the benefit of making a contribution to charity B remains \$310, as described above for contributions under prior law. By comparison, a contribution to a charity A, eligible for a state tax credit, yields a \$1,260 tax benefit under the baseline and a \$1,000 benefit under the proposed rule. This is shown in column A under Baseline and Proposed Rule for Example 3 in Table 1.

IV. Expected Benefits and Costs

A. Benefits

These proposed regulations likely reduce economically inefficient choices motivated by the potential tax benefits described above if these proposed regulations were not promulgated. Under the prior law and baseline scenarios, state and local governments have an incentive to fund governmental activities through independent entities that are eligible to receive deductible contributions and to establish tax credits. This incentive is particularly strong under a SALT cap scenario where state and local governments may do so solely to enable some taxpayers to circumvent the SALT cap. These proposed regulations substantially diminish this incentive to engage in socially wasteful tax-avoidance behavior. As a result, it is expected that fewer such credit programs would be established in the future under the proposed regulations than under the baseline.

To the extent this result occurs, the Treasury Department and IRS estimate that the proposed regulations would reduce overall complexity and paperwork burden for states and for taxpayers who would otherwise engage in charitable contributions solely for the purpose of reducing their state and local tax liability. In addition to reducing paperwork burden, the Treasury Department and IRS anticipate that the proposed regulations will also spare some taxpayers compliance costs associated with complex tax planning designed to avoid the SALT cap.

In addition, these proposed regulations are expected to make the federal tax system more neutral to taxpayers' decisions regarding donations. Under the baseline scenarios,

the combined federal and state tax benefits favor contributions to organizations which give rise to a state tax credit for taxpayers, particularly for taxpayers above the SALT cap. Under the proposed regulations, this economic distortion is expected to be reduced. The Treasury Department and the IRS request comments from the public on the potential extent of this expected reduction in economic distortion.

Finally, these proposed regulations provide more certainty to taxpayers by clarifying the rules governing the amount that they can claim as a charitable contribution deduction when they receive a state tax credit or a dollar-for-dollar state tax deduction in exchange for the contribution.

B. Costs

The proposed regulations may result in some increase in compliance costs for taxpayers who make contributions that generate state tax credits. Under the baseline, for purposes of the charitable contribution deduction under section 170(a), taxpayers did not need to address state tax credits received for purposes of claiming a charitable contribution; however, they would know the amount of credits received as part of the filing process for state returns. In contrast, under the proposed regulations, taxpayers making a contribution to an organization listed in section 170(c) will need to determine the amount of any state tax credits they will receive or expect to receive in order to reduce their charitable contribution deduction under section 170(a). This additional step will generate some additional compliance costs.

The compliance burden for recipient organizations that directly issue tax credits may increase under the proposed

regulations. In order to take a charitable contribution deduction of \$250 or more, a taxpayer must have a contemporaneous written acknowledgment (CWA) from the donee entity, usually provided in the form of a letter. The CWA includes the amount received by the entity or a description of property received. The CWA must also disclose whether the donee provided any goods or services in consideration for the contribution and a description and good faith estimate of the value of those goods or services provided. State and local tax credits are not generally provided by the donee entity, but there may be situations in which the entity would be providing the credit and would need to include it in the CWA provided to the donor. The Treasury Department and the IRS request comments on whether additional guidance is needed on substantiation and reporting requirements for donors and donees making or receiving payments or transfers of property in return for state and local tax credits and the extent to which entities do provide tax credits under certain circumstances.

The Treasury Department and the IRS request comments on other potential compliance savings, compliance costs, costs related to increased tax planning and other avoidance behavior, or any effects on charitable contribution decisions that may occur as a result of these proposed regulations. In particular, the Treasury Department and the IRS request comments as to how the proposed regulations might alter incentives regarding contributions to state and local tax credit programs.

Based on an analysis of confidential taxpayer return data and forecasts using

that data, the Treasury Department and the IRS note that these proposed regulations will leave charitable giving incentives entirely unchanged for the vast majority of taxpayers. After passage of the Act, which significantly increased the standard deduction, it is estimated that ninety percent of taxpayers will not claim itemized deductions of any kind. Those taxpayers are entirely unaffected by these proposed regulations. It is estimated that approximately five percent of taxpayers will itemize and will have state and local income tax deductions above the SALT cap; these taxpayers will receive the same federal tax benefits under the proposed regulations as they received prior to the Act. See Example 1 above. It is estimated that approximately five percent of taxpayers will itemize but will not have state and local income tax deductions above the SALT cap. The federal tax benefits available to this fraction of taxpayers could be affected by the proposed regulations only if they contribute to programs that entitle them to state tax credits of greater than 15 percent. See Example 2 above. The Treasury Department and the IRS believe that most taxpayers in this third category have never used any state tax credit programs affected by the proposed regulations, and that the proposed regulations will have at most a highly limited, marginal effect on taxpayer decisions to donate to tax credit programs that pre-date TCJA, including educational scholarship programs.⁶ The Treasury Department and the IRS request comments on this important consideration and any potential unintended consequences of the proposed regulations not addressed here.

TABLE 1—TAX TREATMENT OF \$1,000 CONTRIBUTION TO (A) ORGANIZATION THAT GIVES RISE TO \$1,000 STATE TAX CREDIT AND (B) ORGANIZATION FOR WHICH CONTRIBUTION IS DEDUCTIBLE AT THE STATE LEVEL

Change in	Prior law		Baseline		Proposed rule	
	A	B	A	B	A	B
Example 1: Taxpayer Above the SALT Cap, Not Subject to the AMT						
State Income Tax Liability	- 1,000	- 50	- 1,000	- 50	- 1,000	- 50
Federal Income Tax:						
Charitable Contribution Deduction	1,000	1,000	1,000	1,000	0	1,000
Deduction for State and Local Taxes	- 1,000	- 50	0	0	0	0
Itemized Deductions	0	950	1,000	1,000	0	1,000
Taxable Income	0	- 950	- 1,000	- 1,000	0	- 1,000
Federal Tax Liability	0	- 228	- 240	- 240	0	- 240
Total Tax Benefit (Federal + State)	1,000	278	1,240	290	1,000	290
Net Cost to Taxpayer of \$1,000 Contribution	0	722	- 240	710	0	710

⁶ The Treasury Department and the IRS are aware of potential concerns about educational scholarship programs in particular. Based on projections for

2018, most taxpayers in the third category described above do not reside in states that offer educational scholarship tax credit programs affected by the

proposed regulations, and the vast majority of them have never used such programs.

TABLE 1—TAX TREATMENT OF \$1,000 CONTRIBUTION TO (A) ORGANIZATION THAT GIVES RISE TO \$1,000 STATE TAX CREDIT AND (B) ORGANIZATION FOR WHICH CONTRIBUTION IS DEDUCTIBLE AT THE STATE LEVEL—Continued

Change in	Prior law		Baseline		Proposed rule	
	A	B	A	B	A	B
Example 2: Taxpayer Below the SALT Cap, Not Subject to the AMT						
State Income Tax Liability	- 1,000	- 50	- 1,000	- 50	- 1,000	- 50
Federal Income Tax:						
Charitable Contribution Deduction	1,000	1,000	1,000	1,000	0	1,000
Deduction for State and Local Taxes	- 1,000	- 50	- 1,000	- 50	- 1,000	- 50
Itemized Deductions	0	950	0	950	- 1,000	950
Taxable Income	0	- 950	0	- 950	1,000	- 950
Federal Tax Liability	0	- 228	0	- 228	240	- 228
Total Tax Benefit (Federal + State)	1,000	278	1,000	278	760	278
Net Cost to Taxpayer of \$1,000 Contribution	0	722	0	722	240	722
Example 3: Taxpayer Subject to the AMT						
State Income Tax Liability	- 1,000	- 50	- 1,000	- 50	- 1,000	- 50
Federal Income Tax:						
Alternative minimum taxable Income	- 1,000	- 1,000	- 1,000	- 1,000	0	- 1,000
Federal Tax Liability	- 260	- 260	- 260	- 260	0	- 260
Total Tax Benefit (Federal + State)	1,260	310	1,260	310	1,000	310
Net Cost to Taxpayer of \$1,000 Contribution	- 260	690	- 260	690	0	690

Assumptions: The taxpayer itemizes deductions and has more than \$1,000 of state tax liability. Under prior law, the taxpayer is not subject to the overall limitation on itemized deductions under section 68. The taxpayer faces a 24 percent marginal rate under the federal income tax. If the taxpayer is subject to the AMT, the taxpayer faces a 26 percent marginal rate. A \$1,000 contribution to charitable organization A generates a \$1,000 state tax credit. A \$1,000 contribution to charitable organization B is ineligible for a state tax credit but is deductible under the state's income tax. The taxpayer faces a 5 percent marginal rate under the state's income tax. The baseline assumes continuation of the IRS administrative position that state and local tax credits are not reflected as a return benefit or consideration and therefore do not reduce the taxpayer's charitable contribution deduction under section 170(a). Total Tax Benefit refers to the absolute value of the reduction of the taxpayer's combined federal and state tax liability.

Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because the proposed regulations primarily affect individuals and do not impose costs, including a collection of information, on small entities. Therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before the regulations proposed herein are adopted as final regulations, consideration will be given to any electronic and written comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations including: (1) Whether there should be recognition of gain or loss when property is transferred in consideration for state or local tax credits that are not *de minimis*; (2) determination of the basis of a transferable tax credit that a taxpayer sells or exchanges; (3) procedures by which a taxpayer may establish that the taxpayer declined receipt of the state or

local tax credit; (4) substantiation and reporting requirements for donors and donees making or receiving payments or transfers of property in return for state and local tax credits; (5) for a taxpayer that receives or expects to receive a state or local tax deduction in an amount that exceeds the amount of the taxpayer's payment or the fair market value of the property transferred to an entity listed in section 170(c), suggestions for calculating the reduction to the charitable contribution deduction; and (6) whether and in what manner the regulations should address other state or local tax benefits, such as tax exclusions, that may be provided as consideration for certain payments or transfers to an entity listed in section 170(c). Finally, the Treasury Department and the IRS request comments on alternative regulatory approaches that would effectively prevent circumvention of the new statutory limitation on state and local tax deductions, consistent with applicable law.

All comments submitted will be made available at www.regulations.gov or upon request. A public hearing has been scheduled for November 5, 2018, beginning at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC 20224. Due to building security

procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic by October 11, 2018. Submit a signed paper or electronic copy of the outline as prescribed in this preamble under the **ADDRESSES** heading. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are personnel from the Office of the Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS

and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.170A-1 is amended by redesignating paragraphs (h)(3) through (h)(5) as paragraphs (h)(4) through (h)(6), and adding a new paragraph (h)(3) to read as follows:

§ 1.170A-1 Charitable, etc., contributions and gifts; allowance of deduction.

* * * * *

(h) * * *

(3) *Payments resulting in state or local tax benefits.* (i) *State or local tax credits.* Except as provided in paragraph (h)(3)(v) of this section, if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), the amount of the taxpayer's charitable contribution deduction under section 170(a) is reduced by the amount of any state or local tax credit that the taxpayer receives or expects to receive in consideration for the taxpayer's payment or transfer.

(ii) *State or local tax deductions.* (A) *In general.* If a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a state or local tax deduction that does not exceed the amount of the taxpayer's payment or the fair market value of the property transferred by the taxpayer to such entity, the taxpayer is not required to reduce its charitable contribution deduction under section 170(a) on account of such state or local tax deduction.

(B) *Excess state or local tax deductions.* If the taxpayer receives or expects to receive a state or local tax deduction that exceeds the amount of the taxpayer's payment or the fair market value of the property transferred, the taxpayer's charitable contribution deduction under section 170 is reduced.

(iii) *In consideration for.* For purposes of paragraph (h)(3)(i) of this section, the term *in consideration for* shall have the meaning set forth in § 1.170A-13(f)(6),

except that the state or local tax credit need not be provided by the donee organization.

(iv) *Amount of reduction.* For purposes of paragraph (h)(3)(i) of this section, the amount of any state or local tax credit is the maximum credit allowable that corresponds to the amount of the taxpayer's payment or transfer to the entity listed in section 170(c).

(v) *State or local tax.* For purposes of paragraph (h)(3) of this section, the term *state or local tax* means a tax imposed by a State, a possession of the United States, or by a political subdivision of any of the foregoing, or by the District of Columbia.

(vi) *Exception.* Paragraph (h)(3)(i) of this section shall not apply to any payment or transfer of property if the amount of the state or local tax credit received or expected to be received by the taxpayer does not exceed 15 percent of the taxpayer's payment, or 15 percent of the fair market value of the property transferred by the taxpayer.

(vii) *Examples.* The following examples illustrate the provisions of this paragraph (h)(3). The examples in paragraph (h)(6) of this section are not illustrative for purposes of this paragraph (h)(3).

Example 1. A, an individual, makes a payment of \$1,000 to X, an entity listed in section 170(c). In exchange for the payment, A receives or expects to receive a state tax credit of 70% of the amount of A's payment to X. Under paragraph (h)(3)(i) of this section, A's charitable contribution deduction is reduced by \$700 (70% × \$1,000). This reduction occurs regardless of whether A is able to claim the state tax credit in that year. Thus, A's charitable contribution deduction for the \$1,000 payment to X may not exceed \$300.

Example 2. B, an individual, transfers a painting to Y, an entity listed in section 170(c). At the time of the transfer, the painting has a fair market value of \$100,000. In exchange for the painting, B receives or expects to receive a state tax credit equal to 10% of the fair market value of the painting. Under paragraph (h)(3)(vi) of this section, B is not required to apply the general rule of paragraph (h)(3)(i) of this section because the amount of the tax credit received or expected to be received by B does not exceed 15% of the fair market value of the property transferred to Y. Accordingly, the amount of B's charitable contribution deduction for the transfer of the painting is not reduced under paragraph (h)(3)(i) of this section.

Example 3. C, an individual, makes a payment of \$1,000 to Z, an entity listed in section 170(c). In exchange for the payment, under state M law, C is entitled to receive a state tax deduction equal to the amount paid by C to Z. Under paragraph (h)(3)(ii)(A) of this section, C is not required to reduce its charitable contribution deduction under section 170(a) on account of the state tax deduction.

(viii) *Effective/applicability date.* This paragraph (h)(3) applies to amounts paid or property transferred by a taxpayer after August 27, 2018.

* * * * *

§ 1.170A-13 [Amended]

■ **Par. 3.** Section 1.170A-13(f)(7) is amended by removing the cross-reference “§ 1.170A-1(h)(4)” and adding in its place “§ 1.170A-1(h)(5)”.

■ **Par. 4.** Section 1.642(c)-3 is amended by adding paragraph (g) to read as follows:

§ 1.642(c)-3 Adjustments and other special rules for determining unlimited charitable contributions deduction.

* * * * *

(g) *Payments resulting in state or local tax benefits—*(1) *In general.* If the trust or decedent's estate makes a payment of gross income for a purpose specified in section 170(c), and the trust or decedent's estate receives or expects to receive a state or local tax benefit in consideration for such payment, § 1.170A-1(h)(3) applies in determining the charitable contribution deduction under section 642(c).

(2) *Effective/applicability date.* Paragraph (g)(1) of this section applies to payments of gross income after August 27, 2018.

Kristen Wielobob,

Deputy Commissioner for Services and Enforcement.

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ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA-R03-OAR-2017-0598; FRL-9982-85—Region 3]

Approval and Promulgation of Air Quality Implementation Plans; Maryland; Regional Haze Five-Year Progress Report

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: The Environmental Protection Agency (EPA) is proposing to approve a state implementation plan (SIP) revision submitted by the State of Maryland. Maryland's SIP revision, the Regional Haze Five-Year Progress Report, addresses Clean Air Act (CAA) provisions that require the State to submit periodic reports addressing reasonable progress goals (RPGs) established for regional haze and to make a determination of the adequacy of