October 11, 2018

VIA ELECTRONIC SUBMISSION
(www.regulations.gov)

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

Re: IRS Proposed Rule—Contributions in Exchange for State or Local Tax Credits
(REG-112176-18)

To Whom It May Concern:

Agudath Israel of America is pleased to submit its comments on the above-referenced Notice of Proposed Rulemaking (the “NPRM”) issued by the Department of Treasury ("Treasury") and the Internal Revenue Service ("IRS"). The NPRM proposes certain regulations (the “Proposed Regulations”) that would reduce the amount of a charitable contribution deduction allowed under § 170 of the Internal Revenue Code (the “Code”) by the amount of any state or local tax credit that the donor receives. The Proposed Regulations will cause significant and adverse consequences to young students and their low-income families that rely upon scholarships to attend the schools of their choice.

1. Agudath Israel of America’s Mission and Interest in the NPRM

Agudath Israel of America (“AIA”), founded in 1922, is a national grassroots Orthodox Jewish organization. The overwhelming majority of AIA’s constituents choose to send their children to the more than 700 Orthodox Jewish day schools across the country that collectively educate over 250,000 students. For over 60 years, AIA has served as a liaison between government and the entire spectrum of Orthodox Jewish educational institutions in the United States. AIA is also a member of the Council for American Private Education.

Because Orthodox Jewish day schools have experienced rapid growth over the decades, and because our community has long attached the highest priority to education, AIA has taken a considerable interest – and has been a leader – in the formulation and implementation of
education law and policy. We have been deeply engaged in the national discussion on educational reform and have worked closely with successive presidents and congressional leaders to seek ways to enhance American education – both public and nonpublic. From the original 1964 Elementary and Secondary Education Act through today, there has been virtually no major federal education bill in which AIA has not been involved.

On both the national and state levels, AIA has been a prominent and powerful voice in the school choice movement. We firmly believe that one of the keys to educational excellence is parental involvement and that there is no better way to encourage such involvement, and to ensure educational accountability, than to allow parents to choose the school that is best suited for their children, whether public or nonpublic, secular, or sectarian. Over the last two decades, AIA has advocated for, and helped implement, scholarship tax credit programs in ten states. There are currently an estimated 6,500 students attending Jewish schools in those states as a result of scholarships generated by tax credit programs targeted in the Proposed Regulations. Many of the families of these 6,500 students would be unable to pay their tuition obligations without scholarships from scholarship granting organizations (“SGOs”) that assist families to pay tuition under these scholarship tax credit programs. AIA respectfully submits these comments out of concern that the Proposed Regulations threaten the continued financial vitality of SGOs.

The NPRM states that the Proposed Regulations would affect only a small fraction of donors. Surveys conducted by several SGOs reveal that this small fraction of donors are the very donors who contribute to SGOs.¹ AIA has heard from those SGOs whose comment letters are referenced in the previous footnote, and many others across the country, that the Proposed Regulations will dramatically reduce the number and amount of donations they have historically received. These lost donations represent a significant percent of the SGOs’ total donations.

We therefore believe, and share the belief of others, that the Proposed Regulations will have the unfortunate effect of undermining the very laudable educational objectives – and successes – of programs that states have decided to pursue to help boost student opportunity and achievement. This was neither the purpose nor desire of Treasury and the IRS. And it is in direct conflict with the Trump Administration’s stated policy of promoting and expanding school choice.

2. **Tax Law Background**

The $10,000 limitation on individuals’ deduction of state and local taxes applicable to tax years beginning after 2017 (the “SALT Cap”) was put into place by the Tax Cuts and Jobs Act, which was signed into law on December 22, 2017 (the “2017 Tax Act”). On June 11, 2018, the IRS issued Notice 2018-54, which signaled that it would 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. That Notice was issued in response to perceived abuses of proposed workarounds of the SALT Cap. Such workarounds included state proposals to award a state tax credit in exchange for a contribution to the state itself. To combat those abusive workarounds, the main rule of the Proposed Regulations provides that a charitable contribution

---

deduction must be reduced by the amount of any state or local tax credit that the donor receives or expects to receive in consideration for the taxpayer’s contribution (a “quid pro quo”).

3. **Recommendation #1: Narrow the Scope**

The main rule of the NPRM is unnecessarily overbroad. Treasury and the IRS have used regulations needed to combat the SALT Cap workarounds to change federal tax policy. In so doing, the NPRM—while effectively responding to state SALT Cap workarounds—presents a serious threat to the survival of charities in existence long before the NPRM or the 2017 Tax Act: it would require that donors to these charities also reduce their charitable contribution deduction by the amount of state or local tax credits they receive, despite that these charities are totally independent of state or local governments. As such, we recommend that the Proposed Regulations be revised to limit their scope to the state SALT Cap workarounds only.

a. **The NPRM Reverses Longstanding Tax Policy**

The Proposed Regulations’ main rule would reverse Treasury and IRS tax policy with respect to the federal income tax deduction for charitable contributions. That tax policy is expressly set forth in current Treasury Regulations promulgated in 1996. The first SGO was established in 1998—two years after the current Treasury Regulations—and most were established in the past decade. The Proposed Regulations would also be directly at odds with the IRS’s Chief Counsel Advice (CCA) memorandum 201105010, released on February 4, 2011.

Treasury’s current regulations make clear that the NPRM is altering tax policy, not promulgating rules that conform to existing tax policy or simply combating states’ SALT Cap workarounds. Included in the Proposed Regulations is new § 1.170A-1(h)(3)(iii). That section alters the Treasury Regulations’ current definition of what is considered a quid pro quo for a charitable contribution. It would provide that a benefit received “in consideration for” a contribution need not be received from the donee organization. That is, under Treasury Regulations prior to the NPRM, a donor would not be considered have received a quid pro quo if the donor received the benefit from someone other than the donee organization. The Proposed Regulations, for the first time, treat a benefit received from a third party as a quid pro quo.

Current Treasury Regulation § 1.170A-1(h)(1), in existence since 1996 and unchanged by the Proposed Regulations, provides the definition of “quid pro quo.” That section provides that no part of a payment that a taxpayer makes to a charitable organization that is “in consideration for”

---

3 These regulations are based upon even earlier authorities. See comments of Professor Lawrence Zelenak at www.regulations.gov (ID: IRS-2018-0025-0120), citing to United States v. American Bar Endowment, 477 U.S. 105 (1986) (subjective donative intent requires only that the consideration the donor receives from the donee is worth less than the value the donor transfers to the donee) and Singer Co. v. United States, 449 F.2d 413, 422 (Ct. Cl. 1971) (the benefit Singer received from the donee schools that used the donated Singer machines to train their students was the quid pro quo that negated any charitable deduction, although the dollars that would ultimately flow back to Singer would come from the former students who purchased the machines)—which are both cited by the NPRM as authority for the Proposed Regulations—and concluding “the current quid pro quo regulations do not apply to benefits received by a taxpayer from a third party, and there are no cases or rulings to the contrary.”
goods or services is a contribution or gift within the meaning of § 170. For purposes of Treasury Regulation §1.170A-1(h)(1), “in consideration for” is defined in §1.170A-13(f)(6) as follows:

A *donee organization* 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. Goods or services a *donee organization* provides in consideration for a payment by a taxpayer include goods or services provided in a year other than the year in which the taxpayer makes the payment to the donee organization. [emphasis added]

When Proposed Regulation § 1.170A-1(h)(3)(iii) is read together with existing Treasury Regulations §§1.170A-1(h)(1) and 1.170A-13(f)(6), it is clear that Treasury and IRS are not promulgating rules that conform to existing tax policy or simply combating states’ SALT Cap workarounds. The NPRM also creates a nonsensical distinction: a donor needn’t reduce the donor’s charitable contribution deduction for receiving property or services other than a state or local tax credit in exchange for the contribution, provided a person other than the donee organization provides the property or services, but if the property is a state or local tax credit the deduction must be reduced, even if a third party provides the property or services. It does not make sense to determine whether goods or services constitute a quid pro quo based upon the type of property or service provided in the quid pro quo exchange.

Rather, the current Treasury Regulations correctly state the rule that goods or services are “in consideration for” a donor’s payment only when provided by the donee organization. The Proposed Regulations needlessly broaden the current rule and will create confusion.

In addition to SGOs’ reliance upon the current Treasury Regulations, SGOs and their donors received guidance from CCAs that explicitly or implicitly approved a charitable contribution deduction equal to the full amount of their donation, despite their receipt of state or local tax credits in exchange for the contribution. As the NPRM itself states, the IRS in Chief Counsel Advice memorandum 201105010 (CCA) expressly approved taxpayers’ charitable contribution deduction, despite the receipt of a state or local tax credit in exchange for the contribution. The NPRM then notes that the CCA assumed that after the taxpayer applied the state or local credit, the deduction available under Code § 164 would be reduced. However, if the NPRM is based upon “longstanding principles” of quid pro quo, whether the credit reduces the § 164 deduction or not is irrelevant. Rather, the truth is manifest: now that taxpayers cannot deduct more than $10,000 in state and local tax deductions and tax revenues are threatened by the SALT

---

5 Surprisingly, as of this writing, it appears that only one other comment has raised this concern. See, comments of Professor Lawrence Zelenakat, supra. (first recommendation).

6 CCA 201105010, reasoning from a series of cases dating to 1985 holding that the tax benefit of a federal or state charitable contribution deduction is not regarded as a return benefit that negates charitable intent to reduce or eliminate the deduction, the IRS concluded that there was no reason to distinguish between the value of a state tax deduction and the value of a state tax credit or to draw a bright-line distinction based on the amount of the tax benefit in question.

7 The irrelevance of this point is further discussed below.
workarounds, the Treasury and IRS feel compelled to reverse course and call the receipt of a SALT credit in exchange for a charitable contribution a quid pro quo.

CCAs other than CCA 201105010 did state that whether the receipt of a state or local tax credit constituted a quid pro quo that would reduce the charitable contribution deduction needed to be addressed in official published guidance. Yet, until the NPRM, no such guidance was issued. In the interim, since 1998 state tax credit programs to encourage charitable contributions have proliferated in reliance on these CCAs’ explicit and implicit allowance of a full deduction against a backdrop of government silence on the issue. Now, without any congressional action, any new developments in case law, or any impact study, Treasury and the IRS wish to pull the rug out from under the feet of charitable organizations that have rightfully relied on IRS guidance. That is fundamentally unfair.

b. **Stop the Abuse Without Changing Longstanding Tax Policy**

AIA certainly supports protecting tax revenues. But to protect tax revenues Treasury and the IRS didn’t need to enter the morass which is defining “quid pro quo” for purposes of the charitable contribution deduction. Remember: Notice 2018-54, which signaled the issuance of these Proposed Regulations, was issued in response to perceived abuses by certain states proposing workarounds of the SALT Cap. So, Treasury and the IRS should narrow the scope of the Proposed Regulations to target the perceived abuses. Rather than redefine what is considered a quid pro quo, here’s a simple solution to shut down the abuses which is consistent with longstanding tax policy: distinguish between independent donee charitable organizations and state-controlled charitable organizations.

To make that distinction, we recommend that the Proposed Regulations be revised to provide an additional exception⁸ to the general rule of Proposed Regulation § 1.170A-1(h)(3)(i), which reduces the charitable contribution deduction by the amount of the state or local tax credit. We propose making the general rule applicable only to payments and transfers of property to certain governmental bodies and related entities. To prevent “creativity” and to protect revenues, these related entities are defined using terms borrowed from the definition of “disqualified person” in Code § 4946, which is applicable to private foundations. Our proposed revised language for Proposed Regulation §1.170A-1(h)(3)(vi) is as follows:


(a) Paragraph (h)(3)(i) of this section shall not apply to any payment or transfer of property—

(1) 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, or

---

⁸ As published, Proposed Regulation § 1.170A-1(h)(3)(i) erroneously references an exception in (h)(3)(v); that paragraph contains no exception. The correct reference should be to (h)(3)(vi).
(2) to any organization described in section 170(c) other than a governmental body described in section 170(c)(1) or to an entity (a “donee entity”) that is a section 170(c)(1) related entity.

(b) Section 170(c)(1) related entity. For purposes of paragraph (h)(3)(vi)(a)(2), section 170(c)(1) related entity means any donee entity—

(1) that received an amount from any governmental body (other than the United States) described in section 170(c)(1) that would make such governmental body a substantial contributor to the donee entity, determined in a manner consistent with the principles of section 507(d)(2) and the regulations thereunder by treating the donee entity as a private foundation,

(2) that has as an officer, director, or trustee (or an individual having powers or responsibilities similar to those of officers, directors, or trustees) any person who holds any elective or appointive office in the executive, legislative, or judicial branch of any governmental body (other than the United States) described in section 170(c)(1), any person who holds a position as personal or executive assistant or secretary to any such person, or any member of the family (as defined in section 4946(d) and the regulations thereunder) of any of the foregoing, or

(3) which is effectively controlled (directly or indirectly) by any governmental body (other than the United States) described in section 170(c)(1), determined in a manner consistent with the principles of section 4946(a)(1)(H) and the regulations thereunder by treating the donee entity as a private foundation.

The effect of this language would be to allow a full charitable contribution deduction for any payment or transfer of property to any § 170(c) organization unless the payment or transfer of property is made to either (1) a State, a possession of the United States, or any political subdivision of any of the foregoing, or the District of Columbia; or (2) any entity that receives substantial contributions from, is managed by, or is otherwise controlled by such a governmental body. This language should effectively distinguish between independent donee charitable organizations and state-controlled charitable organizations, thereby preserving a full deduction for payments or property transfers to charitable organizations but preventing the abuse perceived in Notice 2018-54.

c. The True Aim of the Proposed Regulations

Let’s be clear. The Proposed Regulations do not aim to shut down a “tax shelter” or stop “double-dipping,” as some commentators would claim exist under current rules. These commentators claim that it’s abusive for a taxpayer to make an economic outlay that is more than offset by a reduction in combined federal and state income taxes to produce a net economic gain from a charitable contribution. However, there are many state and local tax credit programs that
refund a high percentage of a taxpayer’s economic outlay and, when combined with a federal
deduction—for example the ordinary and necessary business expense or depreciation
deduction—produce a net economic gain for the taxpayer. If Treasury and the IRS were
crned about combined use of state and federal tax benefits to produce a net economic gain,
they would have to issue an entirely different set of proposed regulations, one not limited to the
charitable contribution deduction under § 170.

Commentators decrying as “tax shelters” SGO, environmental, economic, or other tax credit-
fueled charitable giving state incentive programs may fail to appreciate that taxpayer net
economic gain through combining state and local tax credits and federal tax deductions is rather
commonplace. It is also possible that use of such misplaced rhetoric reveals inherent bias toward
private or parochial school education or any of the myriad causes supported by the states. The
federal government would be overstepping the boundaries of federalism to use these Proposed
Regulations as a sword to cut down such programs. And, in fact, the Proposed Regulations do
not intend to accomplish such a purpose. Rather, the Proposed Regulations—unnecessarily
overbroad as drafted—appropriately aim to stop abusive SALT Cap workarounds.

Additionally, a statement in the NPRM has seemingly mislead some commentators and blurred
the anti-abuse focus of the Proposed Regulations. The NPRM notes that, prior to the Act, a
contribution to a 100% state tax credit charity reduced SALT liability by the amount of the
contribution, resulting in a reduced federal SALT deduction under § 164, which was offset by
the amount of the charitable contribution deduction under § 170. Therefore, prior to the Act, a
transfer made in exchange for a state or local tax credit generally had no effect on federal income
tax liability. Under the Act’s SALT Cap, the NPRM notes, the charitable contribution deduction
isn’t offset by a reduction in the SALT deduction for taxpayers over the SALT Cap after the
contribution. While a true statement, it’s irrelevant to taxpayer economic outcomes, which are
either the same or worse after the SALT Cap, as the following simple examples show:

<table>
<thead>
<tr>
<th>Fact Scenario 1</th>
<th>Fact Scenario 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>SALT liability prior to contribution</td>
<td>50,000</td>
</tr>
<tr>
<td>Contribution resulting in state tax credit</td>
<td>20,000</td>
</tr>
<tr>
<td>SALT deduction</td>
<td>Before Act</td>
</tr>
<tr>
<td>30,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Charitable deduction</td>
<td>20,000</td>
</tr>
<tr>
<td>Total deductions</td>
<td>50,000</td>
</tr>
</tbody>
</table>

The SALT Cap itself accomplishes the same reduction in the SALT deduction that a contribution
in exchange for a 100 percent state tax credit accomplished before the SALT Cap. The fact that
the amount of the SALT deduction and the charitable contribution deduction don’t move in
inverse proportions to each other post-Act is irrelevant, unless SALT payments masquerade as
“donations.” So, the real problem is not the post-Act cessation of the inverse relationship
between the § 164 and § 170 deductions; it is the SALT Cap workarounds.

9 See, e.g., Connecticut’s Neighborhood Assistance Act which provides a tax credit against Connecticut tax equal to
100% of the cash invested by businesses that invest in certain energy conservation projects, which could be
combined with a federal depreciation deduction; Mississippi’s cumulative credit of up to $1.2 million to each
taxpayer that uses Mississippi port facilities for loading cargo of a carrier calling at a Mississippi port equal to 100
percent of the export charges, which could be combined with a business deduction under section 162.
4. **Alternative Recommendation #1: Delay Implementation**

If Treasury and the IRS do not accept the Recommendation #1, above, AIA joins others\(^\text{10}\) in asking for staggered implementation of the Proposed Regulations. As mentioned above, if finalized, the Proposed Regulations are certain to result in dramatically reduced scholarships to low-income Jewish students and burden families. Scholarship funds would need to be raised from other sources. Donor development often requires years.

To enable SGOs to adjust to a donor environment that includes the Proposed Regulations, AIA asks that Treasury and IRS provide a three-year delay in the August 27, 2018 effective date currently proposed for SGOs in existence before June 11, 2018, or at the very least, before December 22, 2017. SGOs coming into existence after either of these two dates could be subject to the August 27, 2018 effective date. AIA chooses these dates because the SALT Cap was put into place by the 2017 Tax Act, which was signed into law on December 22, 2017, and the IRS issued Notice 2018-54 in response to perceived abuses of proposed workarounds of the SALT Cap on June 11, 2018.

5. **Recommendation #2: Clarify Treatment of Credit Used to Pay SALT**

Independent of whether Treasury and the IRS accept Recommendation #1, above, AIA joins others\(^\text{11}\) in asking Treasury and the IRS to clarify that a state or local tax credit granted in exchange for a contribution to an SGO, which credit is then used to pay state or local taxes, is deductible under Code § 164 or § 162.

6. **Recommendation #3: Clarify the September 5th Info Release**

Independent of whether Treasury and the IRS accept Recommendation #1, above, AIA also asks Treasury and the IRS to clarify the circumstances under which a payment to a charitable organization that is not a gift may be deductible as an ordinary and necessary business expense under Code § 162.

Some businesses deduct as ordinary and necessary business expenses payments not considered under applicable law to be charitable contributions. Those businesses wondered whether the Proposed Regulations affected their ability to continue to deduct such contributions as business expenses under § 162. On September 5th, the IRS attempted to clarify the scope of the NPRM in an information release (IR-2018-178) and related FAQ (together, the “Info Release”). The Info Release states, “Business taxpayers who make business-related payments to charities or government entities for which the taxpayers receive state or local tax credits can generally deduct the payments as business expenses” and such a business expense deduction is unaffected by the Proposed Regulations. It has come to the attention of AIA that some believe that the Info Release allows every business to deduct the full amount of a donation as a business expense under 162.

---

\(^\text{10}\) See, e.g., letter to Treasury secretary Mnuchin dated September 28, 2018, signed by eight members of the U.S. House of Representatives—Jim Banks, Luke Messer, John Moolenaar, Jeff Duncan, Mark Sanford, Ralph Norman, Todd Rokita, and Joe Wilson—asking Treasury and the IRS to delay implementation of the Proposed Regulations until January 1, 2021.

However, AIA believes that current law does not allow for all payments to charities to be considered deductible business expenses, despite the sweeping language contained in the Info Release.

AIA asks that Treasury or the IRS clarify the Info Release generally. And specifically, whether the § 162 deduction is allowed where a business’s payment to a charity that cannot be considered a charitable contribution is made for no purpose for which a § 162 deduction would be available under Treasury Regulation § 1.162-15 and its decisional law but because the business will receive a state or local tax credit in exchange for the payment.

7. Conclusion

It is respectfully submitted that the scope of the Proposed Regulations be narrowed to avert the adverse and, in certain instances, devastating effect these rules will have on low-income Jewish families and the estimated 6,500 students who now attend the Jewish day school of their choice. We appreciate all of the efforts that the dedicated and thoughtful employees of Treasury and IRS have expended in issuing the NPRM. We thank you for the opportunity to submit this comment letter and appreciate the chance to work with Treasury and the IRS as they move to finalize the Proposed Regulations. Should you have any questions about our comments, we would welcome the opportunity to discuss them with you in greater detail.

Sincerely,

Rabbi Abba Cohen
Vice President for Federal Affairs
Washington Director and Counsel

Rabbi A.D. Motzen
National Director for State Relations

Marc A. Lewin, Esq.
Adler Pollock & Sheehan P.C.
Counsel to Agudath Israel of America