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IRS targets NJ on property tax credits

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The Internal Revenue Service said Wednesday it will issue new rules that could thwart efforts by New Jersey and New York officials to get around a provision of the new federal tax code that hurts their states more than most other states.

Leaders of both states accused President Donald Trump's administration of playing politics, and vowed to fight.

After the tax overhaul Trump signed in December put a $10,000 cap on the federal deduction for state and local taxes, both states passed laws allowing people to get local tax credits for charitable contributions to local governments.

The new federal tax code does not cap the deduction for charitable contributions, and Rep. Josh Gottheimer, D-Wyckoff, said in January that other states give state tax credits for contributions for such purposes as private school scholarships and those donations are still eligible for a charitable write-off on federal tax returns.

New Jersey Gov. Phil Murphy signed a bill allowing municipalities to issue such tax credits earlier this month. New York Gov. Andrew Cuomo signed a bill in

See TAX, Page 6A

Tax

Continued from Page 1A

April that allowed local governments to set up charitable funds and tried to exploit a different part of the tax code that lets employers write off wage taxes that individuals cannot.

On Wednesday, however, the IRS said it would be proposing new regulations to address state or local tax credits provided in exchange for "taxes that the taxpayer is required to pay."

While the language of the proposed regulations was not released, the IRS appeared to warn taxpayers they could be in trouble if they rely on new state laws to take a federal deduction to which they are not entitled.

"Despite these state efforts to circumvent the new statutory limitation on state and local tax deductions, taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes," the IRS notice said.

"The proposed regulations will make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers," the notice said.

A study by the Tax Policy Center found that 10.2 percent of New Jersey taxpayers will pay higher federal taxes this year because of the new law, a higher rate than any other state. New York ranked fifth-highest, with 8.3 percent, after Maryland, the District of Columbia and California.

Reaction to the IRS ruling, like the support for the tax bill, broke along party lines.

The Republican chairman of the House Ways and Means Committee that played a key role in writing the tax law, Rep. Kevin Brady of Texas, praised the IRS for responding to "gimmicks" proposed by politicians opposed to the new code.

"There are many mayors and governors who do a good job of balancing budgets and creating jobs in their communities without high taxes, and I encourage those few states that are trying to undermine our growing economy to instead focus on how they can lower their own taxes," Brady said.

Brady's comments were echoed by Bob Hugin, the Republican U.S. Senate candidate.

"New Jerseyans don't need gimmicks, they need real action," Hugin said on Twitter.

Sen. Bob Menendez, Hugin's likely Democratic opponent in November, said the tax bill was used by Republicans in Congress "to exact political revenge against so-called blue states" and now the administration was using the IRS "as a political weapon to target New Jerseyans."

"I will not stand for it," Menendez said.

Murphy, a Democrat, said in a statement that if New Jersey's law was not backed by the IRS, it would be because the Trump administration was playing politics.

"For the federal government to permit certain states to allow for charitable deductions, but not others that are following the same principles, is unconscionable," Murphy said. "Once again, President Trump is unfairly targeting the hard-working people of New Jersey."

Cuomo, another Democrat, said it was "particularly ironic that Donald Trump is in Long Island today while the IRS aims its sights on Long Island homeowners."

"Make no mistake: We have been and will continue to fight against this economic missile with every fiber of our being," Cuomo said.

The cap on the deduction was crafted by lawmakers from low-tax states who believed their constituents were being forced to subsidize high-tax states such as New York and New Jersey.

In reality, New Jersey and New York pay more in federal taxes than the states get back in federal spending, and much of that surplus goes to states whose representatives voted for the SALT deduction cap.

"New Jersey is a donor state and enough of our federal taxes already goes to support other states," said Rep. Bill Pascrell, D-Paterson. "Republicans have bragged that they passed the tax scam to deliberately inflict pain upon the Northeast. Enough is enough."

Gottheimer said he was not surprised by the IRS action, but he believes the agency is "in a pickle" because of the other states that give tax credits for charitable donations, including many that get more back in federal spending than they pay in taxes.

"They can't just hose New Jersey taxpayers to the benefit of Moocher States," Gottheimer said. "Now it's off to court where I'm sure we will be joined by the 33 other states, mostly Moocher States, currently utilizing the provision."