COMMENT ON PROFESSOR STARK’S PROMPT

By Peter L. Faber

Professor Stark and other economists and academics have drafted a long paper arguing that the charitable contribution/credit mechanism would get around the disallowance of a deduction for state and local taxes.\(^1\) I disagree, and I suspect that the Treasury Department disagrees as well.

The authors rely on an IRS Chief Counsel Advice from 2011,\(^2\) but that memorandum is not precedential and does not necessarily state the IRS’s official position. Indeed, the CCA specifically indicates that the Service did not contemplate issuing published guidance and it acknowledges that there may be circumstances in which a contribution to a state that is creditable against the state income tax may be viewed as a payment of tax and not as a charitable contribution.

Could anyone, including Professor Stark and the other authors of the paper, seriously contend that a direct payment to a state’s general fund that reduced the person’s state income tax liability dollar-for-dollar could be viewed as anything other than an advance payment of tax? It would not be “voluntary” in any sense of the word and it is well-established that a contribution to a charity must be voluntary to be deductible.\(^3\) Making the credit less than 100% would not make the contribution more voluntary, and thus would not change the result. Bills using this approach have been introduced in California and Illinois. They won’t work.

Professor Stark’s “Full Deduction Rule” does not help the situation. It is well-established that the fact that a voluntary charitable deduction produces tax benefits does not make it less of a voluntary contribution.\(^4\) That is not the same as saying that a “contribution” to, or for the benefit of, a government agency that reduces one’s personal income tax liability dollar-for-dollar (or close to that) should be treated as a voluntary contribution. In the latter situation, the taxpayer has paid an amount to finance a state function and would be in exactly the same position as he or she would be if the amount was paid as taxes for which the taxpayer would otherwise have been liable.

Would a payment to a special state fund that was used to finance a specific state function that depended for its funding on similar contributions be viewed as a payment of tax? If a state fund was established to pay the salaries of state legislators and the state made up the difference if contributions to the fund were not sufficient to pay all

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\(^4\) Id.
of the salaries, I could not imagine that this would be viewed as anything other than a payment of tax. Money is fungible and the state is going to spend the same amount of money on the salaries of its legislators regardless of whether part of the money is provided by contributions from the public and the state makes up any deficit in its obligation to the legislators from its general funds.

The technique might work if contributions were made to a special fund for a particular purpose and that purpose was financed entirely by such contributions, or with a contribution from state funds that was equal to a percentage of the contributions received from the public, so that the ability of the state to carry out that function would be limited by the extent to which the public contributed to the special fund. That might conceivably work, but this is not what Professor Stark discusses. He is talking about using “voluntary” contributions to finance functions that the state would perform regardless of whether it received such contributions and that the state would finance by making up any deficit if the contributions were not sufficient to finance the function. For example, if New York State set up a special fund to finance the creation of a public park in the City of Rochester and the creation of the park was financed entirely by contributions and would not happen if the contributions to the fund were insufficient to pay for the project, contributions to the fund might be viewed as charitable contributions. But if New York State decided to create the park and would make up any deficit in the funds if voluntary contributions were insufficient to pay for the project, this would not work.

It is true that many programs designed to support private schools and other non-governmental activities that credit contributions against state income tax have received non-precedential IRS approval in private letter rulings, but these situations are different from those in which the “contributions” are made to support essential government functions. The South Carolina program discussed by Professor Stark seems to fall into the category of a fund that is used to finance projects that the state would not itself finance. Such a program is not the same thing as a program designed to pay the salaries of teachers in the public schools. I have not surveyed all of the programs that have received favorable private letter rulings from the Internal Revenue Service but I suspect that most, and, perhaps, all of them are similar in that they are not used to provide funding for programs that the states would fund in full absent private support. Moreover, the IRS rulings were not issued in the context of a systematic attack by a number of states against a clearly prescribed Congressional policy. The IRS might well take a different view in 2018.

The 2011 Chief Counsel Advice memorandum on which Professor Stark’s paper relies is not precedential and it does not discuss the facts presented in any detail. Revenue Ruling 79-315, also cited in the paper as authority for the Full Deduction Rule, involved an income tax rebate that was not paid in consideration for contributions or any other activity. It simply represented a state tax reduction.

It is unlikely that contributions to a separate 501(c)(3) organization that was required to turn the money over to the state (or that it was understood by all to be

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expected to do that) would be treated differently; the organization would be treated as a conduit which would be ignored, or as an agent of the state.

Practically speaking, I doubt that the IRS would endorse the contribution credit concept proposed in Professor Stark’s prompt. The few authorities that exist do not involve a systematic effort by many states to evade a federal policy that is reflected in an unambiguous statute. I sympathize with the people who are trying to assist the states in mitigating the effects of the federal disallowance of SALT deductions, and, in fact, I have been working with the tax authorities in New York State, New York City, and New Jersey on a pro bono basis toward that end. In addition, I am chairing an American Bar Association Tax Section task force that will be providing guidance to state revenue departments and legislatures about responses to the Tax Cuts and Jobs Act. But the law is what it is and any attempt to mitigate its effects must pass muster under established principles of the common law of taxation.

Professor Stark and his colleagues have made a valuable contribution to the discussion and I do not mean to be critical of them, but the position for which they advocate flies in the face of the well-accepted doctrine in tax law that the substance of an arrangement prevails over its form, and I do not think that their arguments will carry the day with the IRS or the courts.

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