



District of Columbia

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Charitable Contributions - Timeline

TCJA Signed Into Law
(Most Changes
Effective Jan. 1 2018)



Dec. 22 2017

Early 2018



State Workarounds
Introduced

IRS Proposed Regs
+ Notice



Aug. 22 2018

Jun. 11 2019



IRS Final Regs



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TCJA SALT Cap – IRC § 164(b)(6)

(6) Limitation on individual deductions for taxable years 2018 through 2025 In the case of an individual and a taxable year beginning after December 31, 2017, and before January 1, 2026—

(A) ...

(B) [Individual's deduction for the aggregate amount of state and local taxes] for any taxable year **shall not exceed \$10,000** (\$5,000 in the case of a married individual filing a separate return).



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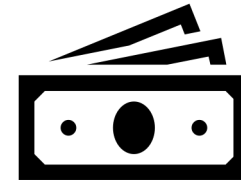
State Workaround



Taxpayer:
State and Local Tax
Liability > \$10k



Public Service Funds:
Charitable Contribution
Within the Meaning of § 170(c)



SALT Tax Credit +
Deductions on
Federal Returns
beyond \$10k

Taxpayer Receives State Tax
Credit in Exchange for
Charitable Contribution



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Current State Tax Credits

Connecticut: 85% residential real property tax credit.

New Jersey: 90% real property tax credits.

New York: 95% real property tax credits.

District of Columbia: 90% income tax credit proposed but not adopted.



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State Workaround - Example

A State provides a credit against state income tax liability for 90% of contributions to the Public Service Funds.

- A taxpayer with a \$20,000 SALT liability would get to deduct only \$10,000: at 20% effective federal tax rate, the taxpayer's tax would be \$2,000 more.
- Taxpayer contributes \$10,000 to a Public Service Fund. Charitable contribution deduction results in taxpayer paying \$2,000 less federal tax.
- Taxpayer claims \$9,000 credit on state tax return.



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State Workaround - Example

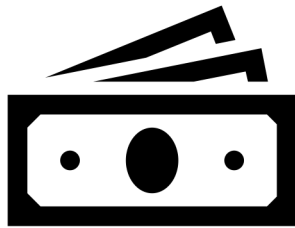
A State provides a credit against state income tax liability for 90% of contributions to the Public Service Funds.

- Under this regime, the taxpayer pays \$2,000 less federal tax and \$1,000 more to the State (through the contribution).
- The State's income tax revenue goes down by \$9,000, but fund contributions increase by \$10,000. Net State revenue increases by \$1,000.
- Federal revenue goes down by \$2,000. Taxpayer wins, state wins, Feds lose.



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The *Quid Pro Quo* Principle



SALT Tax Credit

The *Quid Pro Quo* Principle

“[A] payment of money generally **cannot** constitute a charitable contribution if the contributor **expects a substantial benefit** in return.”

United States v. American Bar Endowment, 477 U.S. 105 (1986)



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New IRS Regulations

Rule 1: If a taxpayer receives or expects to receive a **state or local tax credit** in return for such payment, the tax credit constitutes a *quid pro quo*, reducing the taxpayer's charitable contribution deduction by the amount of the credit.

Exception 1: Rule 1 does not apply if the state or local tax credit does not exceed **15 percent** of the taxpayer's payment.

Exception 2: **Business taxpayers** who make business-related payments to charities for which the taxpayers receive state or local tax credits can generally deduct the payments as business expenses.



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New IRS Regulations

Rule 2: A taxpayer generally is not required to reduce his or her charitable contribution deduction on account of the receipt of **state or local tax deductions**.

Exception: A taxpayer must reduce his or her charitable contribution deduction if he or she receives or expects to receive state or local tax deductions in excess of his or her payment or the fair market value of property transferred by the taxpayer.

Example: Taxpayer pays \$1,000 to a § 170(c) entity, a qualified donee, and receives a state tax deduction of \$700. He or she can still deduct \$1,000 from his or her federal return. If he or she receives a state tax deduction of \$1,200, he or she must reduce the federal charitable contribution deduction.



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Safe Harbor

IRS Notice 2019-12, issued December 28, 2018, announces that the IRS intends to publish a proposed regulation providing a “safe harbor” under § 164 (relating to federal deductions for taxes).

A taxpayer who itemizes deductions and who makes a payment to a § 170(c) entity in return for a state or local tax credit may treat as a payment of state or local tax for purposes of § 164 the portion of such payment for which a charitable contribution deduction under § 170 is or will be disallowed under final regulations.

This “safe harbor” is intended to ameliorate the effect, for example, where state and local tax liability is less than \$10,000 and the taxpayer could not otherwise be able to use the full \$10,000 credit.



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Court Challenges

New York v. Mnuchin I (filed in 2018)

- Challenge under the Tenth Amendment

New York v. Mnuchin II (filed in July 2019)

- Challenge under the Administrative Procedure Act and the Regulatory Flexibility Act

Scarsdale v. IRS (filed on July 17, 2019)

- Challenge under the Administrative Procedure Act



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Background on *qui tam* Actions

Qui tam actions

- Are brought by an informer, under a statute that establishes a penalty for the commission or omission of a certain act
- Provide that such penalties may be recovered in a civil action
- Awards a part of the penalty to the “whistleblower” who brings the action (with the remainder going to the state or some other institution)



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Background on *qui tam* Actions

Federal False Claims Act (FCA) first enacted in 1863

- Crack down on suppliers in the Civil War
- Provides for private enforcement actions against those alleged to have defrauded the federal government

31 USC §§ 3729-3733

- Prohibits any person from defrauding the government by false claims, records, or statements
- Excludes allegedly fraudulent tax claims



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Types of *qui tam* actions

Traditional FCAs

- False claims for payment from the state

Reverse FCAs

- False statements to avoid or reduce payments to the state

Reverse false claims actions give rise to *qui tam* actions for tax



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Elements of *qui tam* actions—generally

- Defendant made or used a false statement
- To avoid or reduce payment owed to the state
- Defendant knew or should have known statement was false
 - “Knowledge” can be actual, but also includes deliberate ignorance or reckless disregard
 - Specific intent to defraud not required
 - Legal dispute as to interpretation of law should negate scienter



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Elements of *qui tam* actions—generally

- Proper relator:
 - Direct and independent knowledge of false statement
 - No publicly available knowledge unless relator is “original source”



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Timeline of a *qui tam* action

- The relator (plaintiff) investigates
 - Direct and independent knowledge of false statement
 - No publicly available knowledge unless relator is original source and gathers evidence
- The relator (plaintiff) gives notice to the attorney general
 - The relator files the complaint filed under seal



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Timeline of a *qui tam* action

- The attorney general investigates and:
 - Intervenes and takes over, dismisses, dismisses to pursue alternate state remedy, or
 - Does not intervene and allows the relator to proceed
- The complaint is unsealed and summons issues to the defendant



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Typical *qui tam* actions

- Unclaimed property
 - Lawsuits for failing to remit unused amounts on prepaid calling cards
 - Actions against MetLife and Prudential for allegedly failing to turn over unclaimed life insurance funds
- Sales and use tax collection
 - Lawsuits against remote or internet sellers:
 - Direct mail and online retailers
 - Investigate nexus, returns, affiliates
 - Shipping and handling charges
 - Liquor licenses



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DC False Claims Act – Intro

- The District’s False Claims Act (“FCA”) allows court actions to be taken against those making false claims to the District government for the purpose of improperly obtaining or retaining government funds
- Tax matters are expressly exempted in the District and Federal False Claims Act
- Issue: should the DC False Claims Act (Qui Tam or whistleblower statute) be amended to apply to “taxation”?
- The District already offers a reward for supplying information regarding tax violations. D.C. Code § 47-4111. Rewards for Informants.



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DC False Claims Act – Rewards

Statutes	Type of Action	Recovery
IRS Whistleblower Law <u>26 U.S.C. § 7623</u>	Government Action	15% to 30%
	Recovery based on news media, etc.	10%
Federal False Claims Act <u>31 U.S.C. § 3730</u>	Government Action	15% to 25%
	No Government Action	25% to 30%
D.C. Tax Code: Reward for Informants <u>D.C. Official Code § 47-4111</u>	Any type of action	10%
D.C. False Claims Act of 2019 <u>D.C. Official Code § 2-381.02(d)</u> False Claims Amendment Act of 2017 Bill 22-166 False Claims Amendment Act of 2019 Bill 23-35 <i>[Proposed amendment does not change the recovery rate]</i>	Government Action	15% to 25%
	No Government Action	30%
	Recovery based on news media, etc.	10%



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DC False Claims Act - Amendments

- Bill 22-166 and current Bill 23-35 would amend the FCA to make it applicable to taxation matters above certain thresholds
- False claims actions would be allowed only where the taxpayer has:
 - Net income, sales, or revenue of \$1 million or more; and
 - The damages alleged are \$350,000 or more



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DC False Claims Act - Challenges

- The Bill may infringe on the CFO's Exclusive Authority for "levying and collection of all taxes" D.C. Code § 1-204.24d(10).
- This authority was given to the CFO by Congress
- Issue: can the D.C. Legislature change this grant of authority from Congress?



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DC False Claims Act - Challenges

- The proposal Bills may lead to problematic, parallel enforcement action for tax cases which are unnecessary and redundant
- Example
 - Office of Attorney General (“OAG”) accepts an Audit/FCA case
 - Separate cause of action proceeds in a parallel manner to enforcement and litigation by CFO through OTR



DC False Claims Act –MTC, ABA

- MTC and ABA oppose including “taxation” in FCA since they result in non-tax agencies conducting tax administration.
- ABA position: including “taxation” may encourage under-collection by vendors to avoid false claims actions against them which may subject them to audit assessments.
- Overcollection or collection in wrong jurisdiction may engender lawsuits by purchasers or invite consumer protection actions.
- May increase cost of collection and discourage retailers from voluntarily collecting tax



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DC False Claims Act - Challenges

- Allowing tax matters to be subject to False Claims actions has led to numerous questionable lawsuits in other jurisdictions.
- Examples:
 - Sales tax in Illinois
 - All taxes in New York state



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Taxpayer Advocate – Goals

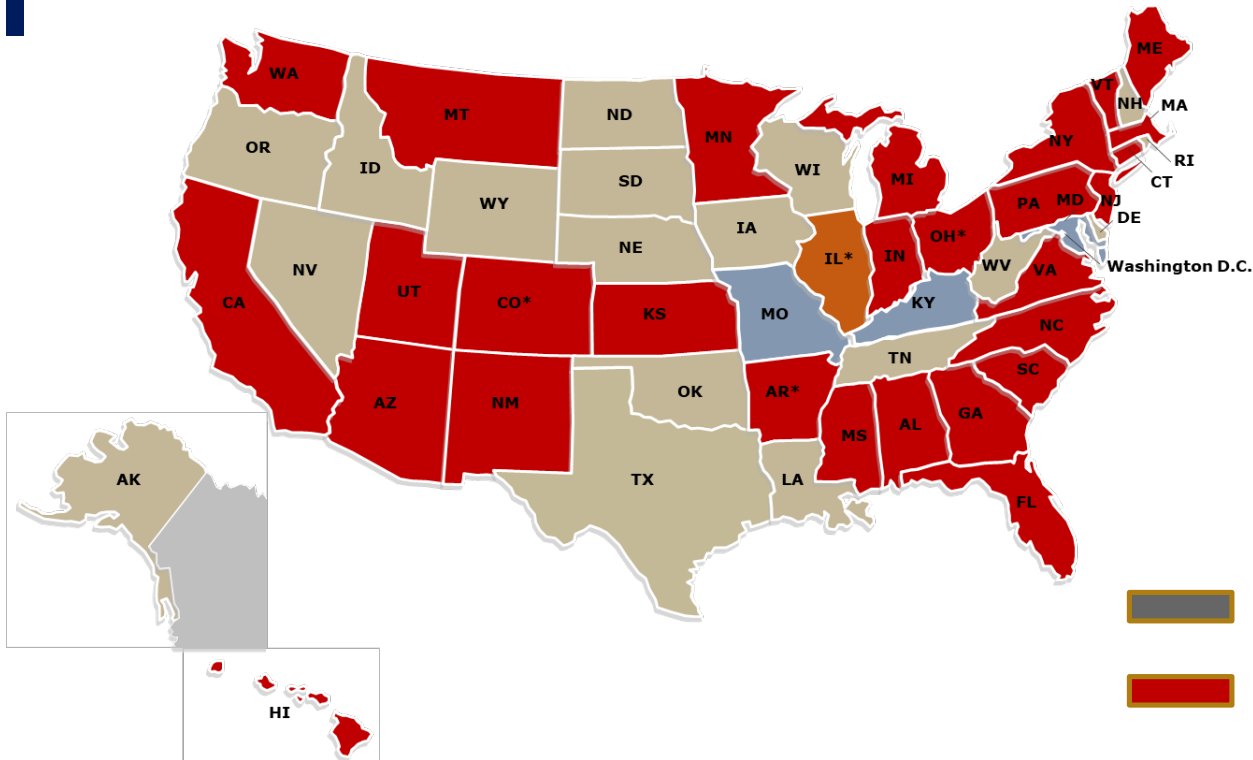
In DC, proposed legislation followed the IRS National Taxpayer Advocate framework.





Proposed legislation sought to establish an independent agency, outside of the tax administrator, appointed by the Mayor.



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Taxpayer Advocate – Map



-  Taxpayer Ombudsman
-  Taxpayer Advocate
-  Illinois Board of Appeal functions like a Taxpayer Advocate
-  No Specific Information Online

Colorado*: Citizens' Advocate

Arkansas, Ohio *: Problem Resolution Office



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Taxpayer Advocate – Purpose

- Problem Solving: Resolve complex problems that have not been resolved through “normal channels”
 - Helping taxpayers navigate tax offices
 - Helping taxpayers understand tax issues
 - Helping expedite return processing
- Impartiality
 - Assurance of an independent review or perspective
- Identify taxpayers’ problems dealing with the State or local jurisdiction



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Taxpayer Advocate – Purpose

- Propose administrative changes to Chief Financial Officer and legislative changes to legislative body.
 - The Taxpayer Advocate will submit an annual report to the D.C. Council.
- Not a replacement for other administrative remedies.



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Taxpayer Advocate – Issues

- Efficiency
 - OTR Service Center
 - OTR Problem Resolution Office
- Legal and tax administrative authority
 - In states with Taxpayer Advocates, the Taxpayer Advocate office is housed within the Revenue Department.
- Taxpayer's right to confidentiality
 - The tax administrator is limited in the information that it can share outside of its office.
 - The Taxpayer Advocate under the Mayor's Office (or governor's office) would not have the authority to access any taxpayer records.



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Taxpayer Advocate – Experience

What's your experience with Taxpayer Advocate in your state?