Parents of special needs children in South Carolina are urging the IRS to finalize guidance they say would lift a funding roadblock for scholarship programs.

The IRS’s proposed rules, tied to the tax law’s $10,000 cap on state and local tax (SALT) deductions, would give businesses a break by clarifying that pass-through entities and corporations that donate to charitable funds in exchange for a state tax credit can deduct those costs.

That Dec. 13 guidance is crucial to shield South Carolina scholarship programs such as the Educational Credit for Exceptional Needs Children from a drop in donations, more than a dozen commenters told the IRS in recent days. They urged the agency and Treasury Department to finalize the rules as soon as possible.

Since the SALT limit, the IRS has been trying to rein in state efforts to skirt the cap. In June, it issued final rules (T.D. 9864) aimed at state-created charitable funds used as workarounds of the cap. Those rules came after states including New York passed laws that let residents donate to a state-created fund instead of paying property taxes. That meant they could write off the donation for federal tax purposes and get a state tax credit for some of the amount.

“The confusion created by the ruling has frozen financial advisors and accountants who have advised their clients that they should not give to our program any longer,” Sherrie Holt—the parent of child with dyslexia, high-functioning autism, and attention deficit hyperactivity disorder—wrote in a comment letter to the IRS.

The SALT cap has rankled lawmakers in high-tax states since its enactment. It has recently drawn concern from the likes of Sen. Lindsey Graham (R-S.C.) who in October warned that donations would slow to state funds like the South Carolina Research Authority, which supports entrepreneurs.

“Unfortunately, the final regulation did not resolve my concerns with the treatment of contributions to state-based charities” prior to the passage of the tax law, Graham said in a letter to Treasury. His office didn’t return requests for additional comments.

The Treasury Department didn’t return requests for comment.

Safe Harbor Options

The proposed rules would let a business deduct its donation to a charitable fund as a business expense, just like it may do so with advertising expenses, said Hayes Holderness, an assistant law professor at the University of Richmond School of Law specializing in state and local taxation.

“The proposed regulations address a concern among the business community that the SALT deduction cap would be read broadly to cover certain donations by businesses to charities,” Holderness said.

Some in the nonprofit sector had hoped to see Treasury exempt state-run charities that existed prior to the
2017 tax law, known as the Tax Cuts and Jobs Act. The proposed rules don’t satisfy that desire, said Frank Sammartino, a senior fellow at the Urban Institute.

“State charities that existed before the TCJA are still subject to the quid pro quo limitation,” he said.

Give Us a Chance

The 25,000-member National Council of Nonprofits has yet to hear whether nonprofits like the proposed rules. The organization plans to submit comments by the end of the month, said David Thompson, the organization’s vice president of public policy.

Multiple parents in comment letters said the South Carolina scholarship gives their children the chance to attend schools they otherwise couldn’t afford. Finalizing the rules would “go a long way in giving hope” to parents and children, Elizabeth Krawczyk said in a comment letter.

“Recent changes in the tax law severely hampered our state’s program and its ability to secure donations. With no donations, there are no scholarships, and with no scholarships, this severely overlooked segment of our population will continue to be overlooked,” she said.

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