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P.O. Box 12219, Des Moines, Iowa, 50312 – 515.323.0687 – www.iowaace.org

IRS Regulations on Federal Deductibility of Charitable Donations and Impact on STO donors

Disclaimer

This Fact Sheet is not intended to provide tax or legal advice. If you are considering a donation to an Iowa School Tuition Organization and you have specific questions about your tax impact, please seek guidance from a tax professional or an attorney. This document is subject to change.

In June 2019, the IRS released the final regulations addressing the State and Local Tax (SALT) workarounds enacted by some states in response to the Federal Tax Cuts and Jobs Act of 2017. School Tuition Organizations are not the target of this regulation, but unfortunately, they are impacted by it.

Before we get into details, here are the important considerations for Iowa STO donors to keep in mind:

- The state income tax credit of 65% for a donation to an STO is NOT affected. Donors will still get a 65% state income tax credit on their STO donation, as they have since the beginning of the program.
- Donors will still get some Federal tax benefit, just perhaps not as much as before.
- Students still need support in order to afford and attend Iowa's nonpublic schools, and your donation is very valuable to families and communities in Iowa.

What does the final regulation on charitable donations mean?

The final rules require individual taxpayers making donations to a charitable organization in exchange for a state tax credit (which includes a donation to an STO) to reduce their federal charitable contribution deduction by the amount of that credit.

In Iowa, STO donors receive a 65% state income tax credit, so under this rule STO donors will be entitled to a federal deduction on the remaining 35% of the total STO donation.

For example: A taxpayer donates \$1,000 to an STO and gets the 65% state income tax credit. Rather than claim the entire \$1,000 as a charitable contribution deduction on his or her federal return, the donor must reduce the \$1,000 donation by the amount of the state tax credit received. The donor received a 65% state income tax credit amounting to \$650, so they may only claim \$350 as a charitable contribution deduction.

What is the SALT cap?

The SALT cap went into effect for the 2018 tax year and limits the value of state credits. On a federal return, individual taxpayers may now only deduct up to \$10,000 in state and local taxes paid, whereas previously a taxpayer could deduct the total amount paid in state and local taxes. Some states have no state income tax and have lower property taxes and are not affected much by this. Iowans - who pay significant state income tax and property taxes - are greatly affected.

Some states enacted “workarounds” to this cap, which brought about this federal regulation limiting deductions on charitable contribution.

Is there any other way STO donors could get full Federal deductibility as before?

Yes – but it is very limited. STO donors who don’t exceed the SALT cap (\$10,000 in state and local tax obligations) may still be able to get the full Federal deduction for their STO donation, but by another method.

A “safe harbor” was provided for taxpayers who 1) itemize deductions *and* 2) owe less than \$10,000 in state and local taxes (SALT), which includes state income tax, property taxes and other state and local taxes. *(Because the amount of the standard deduction was recently doubled, far fewer taxpayers are itemizing now.)*

These taxpayers who itemize and owe less than \$10,000 in state and local taxes may elect to treat the portion of their donation to the STO as a payment of state tax up to the \$10,000 SALT deduction limit.

Example:

An STO donor pays \$5,000 in state and local taxes. The donor donates \$1,000 to an STO and receives a 65% state tax credit. Because the donor has not reached the \$10,000 cap in state tax, the donor may include the entire donation amount of \$1,000 to the STO as a payment of state tax. The donor will be allowed to deduct a total of \$6,000 from his or her federal return for state tax paid.

The bottom line?

- ALL STO donors will receive the substantial benefit of a 65% state income tax credit on their donation to an Iowa School Tuition Organization
- Most Iowa STO donors will be able to claim at least 35% of their donation as a Federal charitable contribution.
- Some Iowa STO donors (those who itemize and pay less than \$10,000 in state and local taxes) will be able to claim some or all of the STO donation as a Federal charitable contribution by treating it as state tax paid
- Iowa children will benefit from your donation!