

UNDERSTANDING THE CHILD CARE CONTRIBUTION TAX CREDIT

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The Child Care Contribution Tax Credit (the CCTC) provides a valuable tax credit against a taxpayer's Colorado state income tax. The credit equals 50 percent of the amount of a contribution made to a qualifying Colorado charitable organization that promotes child care. At the end of August, the IRS issued proposed regulations amending Treas. Reg. Section 1.170A-1. The proposed regulations would limit the deductibility for federal purposes of charitable donations that qualify for a state or local tax credit like the CCTC.

While at a glance the proposed regulations seem to have a negative impact, in reality, for most taxpayers who itemize their federal deductions, the CCTC will remain an effective way to make charitable contributions at a substantially reduced net cost.

The CCTC applies to contributions of cash (contributions of stock do not qualify) to Colorado institutions that support child care for children under 12 and to certain approved charities. Under prior law, these contributions were deductible as charitable contributions for federal and state income tax purposes. In addition, a taxpayer could credit 50 percent of the contribution against the taxpayer's Colorado state income tax liability. These deductions and credits substantially reduced the after-tax cost of such donations to taxpayers. A taxpayer in the 35 percent federal tax bracket and subject to the 4.63 percent Colorado state income tax rate could make a charitable contribution of \$30,000 for a net out-of-pocket cost of \$8,361.

At the end of 2017, Congress passed Pub. L. 115-97, which made substantial changes to the Internal Revenue Code of 1986. One of the changes involved the deductibility of payments made to state and local governments for taxes. Before the 2017 Tax Act, an individual could deduct the full amount of the taxpayer's state income tax liability from the taxpayer's gross income for federal income tax purposes.

The 2017 Tax Act capped the deduction of state and local taxes for individuals for federal income tax purposes at \$10,000. Because of this cap, the federal government was concerned that some states might try to lessen the impact of the loss of state and local tax deductions by "transforming" state income taxes into charitable deductions.

To combat this, the IRS developed the proposed amendments to Treas. Reg. Section 1.170A-1. These amendments state that a taxpayer must reduce the taxpayer's federal charitable deduction for donations to charity by the amount of any state or local tax credit that the taxpayer expects to receive. Thus, in the case of the CCTC, a taxpayer's federal tax charitable deduction for the donation will be reduced by 50 percent of the donation, the amount of the CCTC. There is one exception to the proposed rule. A taxpayer does not have to reduce his federal charitable deduction if the state or local tax credit for the donation does not exceed 15 percent of the taxpayer's payment.

Although the proposed amendments appear to be reducing a taxpayer's federal charitable deduction, taxpayers who have already reached the \$10,000 maximum deduction for state

and local taxes will not experience any additional negative impact from the proposed regulations. Under the proposed amendments to the Treasury Regulations, the cost of a \$30,000 donation eligible for the CCTC for a taxpayer who (a) itemizes his or her federal income tax deductions, (b) is subject to the 35 percent federal tax bracket, and (c) has reached the \$10,000 cap on deduction of state and local taxes is \$8,361 (slightly less than under prior law) as illustrated below.

Although many taxpayers will not be negatively impacted by the proposed regulations, there are three caveats. First, under the 2017 Tax Act and regardless of the proposed amendments to Treas. Reg. 1.170A-1, the loss of the deduction of paid state and local taxes above the \$10,000 cap will require many taxpayers to pay more federal income taxes. Second,

taxpayers who itemize deductions for federal income tax purposes and who have not reached the \$10,000 cap for payment of state and local taxes will lose some benefit from the CCTC for federal tax purposes due to the new regulations. Finally, for taxpayers who do not itemize their deductions for federal income tax purposes, there is no federal income tax benefit related to the CCTC, even though there may be substantial savings for state income tax purposes.

In summary, the CCTC remains a valuable tool for providing large benefits to qualifying charities at a substantially reduced out of pocket cost to most taxpayers. As always, however, donors should consult with their tax professionals to confirm the precise impact of the recent tax law changes to their circumstances.

Illustration of State and Federal Tax Savings from the CCTC

1. DONATION AMOUNT	\$30,000	
2. STATE TAX DEDUCTION SAVINGS	(\$1,389)	<i>\$30,000 x .0463 state tax rate</i>
3. STATE TAX SAVINGS FROM CREDIT	(\$15,000)	<i>\$30,000 x .50 state tax rate</i>
4. FEDERAL TAX DEDUCTION SAVINGS	(\$5,250)	<i>(\$30,000-\$15,000 state tax credit) x .35 federal income tax rate</i>
NET COST TO TAXPAYER		\$8,361