U.S. TAX LITIGATION UPDATE — THE PRESIDENT'S TAX RETURNS AND THE NEW S.A.L.T. CAP

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TRUMP TAX RETURNS

The political battle between the Democrats in the House of Representatives and President Trump concerning the release of tax returns has moved to the courts.

President Trump has sued to block the Democrat-led U.S. House Ways and Means Committee from obtaining his tax records from New York State under the T.R.U.S.T. Act, in the latest attempt to keep his personal financial information out of public view.[1] N.Y.'s T.R.U.S.T. Act compels the state's tax department to comply with the Ways and Means Committee's records requests. The president is suing as a private citizen claiming the right to privacy that is enjoyed by citizens of the U.S.

The lawsuit comes three weeks after the Committee, led by a Massachusetts Democrat, sued to force the U.S. Treasury Department and I.R.S. to hand over Trump's tax records from the past six years. That suit was filed after Treasury Secretary Steven Mnuchin rebuffed earlier requests for the information.

In an August 20, 2019, filing with the U.S. District Court for the District of Columbia, lawyers for House Ways and Means Democrats asked Judge Trevor McFadden to grant a motion for summary judgment. House lawyers said in the filing that there is no genuine dispute as to the facts of the case and that they are entitled to a judgment as a matter of law.[2]

Obtaining President Trump's New York State tax returns would expose his business relationships in years prior to his election to the Office of President, as the New York State tax return would contain Federal tax information. There is currently no requirement that this information be disclosed, but all elected presidents since Richard Nixon have routinely done so. It should be remembered that many presidents reported significant income only after their terms in office were completed. President Trump differs from his counterparts in that regard.

On July 30, 2019, a Joint Status Report was filed, in summary, stating:

> Following yesterday's hearing and this Court's minute order, the parties have met and conferred in good faith 'to determine whether they can reach an agreement regarding how best to proceed in light of [the court's] three goals' of (1) 'ensuring that Mr. Trump's claims do not become moot before they can be litigated,' (2) 'treading as lightly as possible, if at all, on separation of powers and Speech or Debate

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1 *Trump v. Committee on Ways and Means*, U.S. House of Representatives, 19-cv-2173, U.S. District Court, District of Columbia (Washington), July 23, 2019.

2 As reported by *Reuters*, August 20, 2019.

> Clause concerns,' and (3) 'adjudicating the issues in this dispute only when it is actually ripe and has a fuller record than presently exists.' . . . Notwithstanding their best efforts, the parties are unable to reach agreement.

On another front, the State of California has passed a law requiring any candidate for president to disclose previously filed tax returns as a condition of appearing on California's primary ballot.[3]

The president sued the California secretary of state on August 6, 2019, in the U.S. District Court of the Eastern District of California, asking for Declaratory and Injunctive relief.[4] The suit states that California's Presidential Tax Transparency and Accountability Act is unconstitutional and that the Constitution sets the qualifications for president, vice president, the Senate, and the House of Representatives. The suit also states that according to the Constitution, states are limited in placing restrictions on candidates and that states are barred from passing laws in order to "retaliate" against a person, which the president contends is the purpose of California's law.[5]

S.A.L.T. DEDUCTION

New York, Connecticut, and New Jersey (the "Plaintiff States"), as well as the town of Scarsdale, N.Y., sued the I.R.S. and Treasury Department on July 17, 2019, over final rules meant to curb state workarounds to the $10,000 cap on state and local tax ("S.A.L.T.") deductions.[6] The June final rules[7] prohibit workarounds that states, including New York and New Jersey, established to combat the cap by allowing state tax credits for donations to newly created "charitable funds" aimed at a variety of state programs.

Change of Law

According to the Plaintiff States' complaint:

> Congress has historically provided a federal individual income tax deduction for state and local taxes, including an unrestricted deduction for all state and local income and property taxes (the 'SALT deduction'). On December 22, 2017, Congress made a radical break with that precedent, capping the SALT deduction at $10,000

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[3] On July 30, 2019, California Governor Gavin Newsom signed into law the Presidential Tax Transparency and Accountability Act, also known as SB27. The law requires all candidates for president to disclose their previous five years of tax returns as a condition of appearing on a primary ballot.

[4] Case 2:19-at-00705 Document 1 Filed 08/06/19.

[5] On September 19, 2019, it was reported that U.S. District Judge Morrison England Jr. issued a temporary injunction from the bench, saying he will make a final ruling in the coming days but that Trump and other candidates could face "irreparable harm without temporary relief."

[6] *N.J. v. Mnuchin*, S.D.N.Y., No. 1:19-cv-06642, complaint filed 7/17/19 and *Village of Scarsdale, N.Y. v. I.R.S.*, S.D.N.Y., No. 7:19-cv-06654, complaint filed 7/17/19.

[7] T.D. 9864.

for individuals and married taxpayers filing jointly, and at $5,000 for married taxpayers filing separately.

This S.A.L.T. cap disproportionately harms taxpayers in the Plaintiff States and harms the states directly. The cap puts pressure on the Plaintiff States in a number of ways – making it more difficult as a practical matter for them to impose state taxes, depressing home equity value, reducing state tax revenue, and more. It also forces states to be accountable when authorizing cash expenditures when the Federal deduction for state income taxes is capped.

The S.A.L.T. limitation also has a spillover effect. The *Chronicle of Philanthropy* on July 22, 2019, reports that the proportion of individuals who claimed charitable deductions fell to 8.5% in 2018 from 24% in 2017. This is due to the fact that with the elimination of the S.A.L.T. deduction, fewer people are itemizing their deductions and are not claiming a charitable deduction.

Additionally, wealthy taxpayers relocating to so-called sunshine states with low or no state taxes has become popular, reflecting an easy means of self help. Exit taxes at the state level have issues under the Federal Constitution.

Evolution of State Countermeasures

To ease the burden on state taxpayers, the Plaintiff States amended their respective tax laws to enable taxpayers to make contributions to state- or locality-affiliated charitable funds in return for state or local tax credits. Under the programs, taxpayers receive a state or local tax credit for their contributions, thereby reducing their state tax liability. Under longstanding judicial and I.R.S. precedent, taxpayers may also deduct charitable contributions made pursuant to these programs in full from their Federal individual income taxes. Furthermore, because the programs do not provide dollar-for-dollar tax credits, they generate a net increase in revenue for state and local governments.

For years, states have maintained similar charitable tax credit programs. At least 33 states have created more than 100 such programs, and the I.R.S. has always permitted taxpayers to claim the full Federal charitable deduction for donations made pursuant to these programs. Of course, it is one thing for a state to provide a charitable deduction to finance designated eleemosynary activity. It may be another thing when the sole purpose of the "charity" is to get around a cap on a Federal tax deduction, as often stated by governors of the Plaintiff States.

In their complaint, the Plaintiff States say the final rules from the I.R.S. violate the Administrative Procedure Act, which provides rules on how executive agencies issue regulations, and the Regulatory Flexibility Act, which requires agencies to assess how regulations impact small government jurisdictions and other small entities.

Significantly, the Plaintiff Sates claim that the rules erroneously treat a S.A.L.T. credit as a quid pro quo, or direct exchange, when the taxpayer receives it in return for having made a charitable contribution. Tax credits are not actually "a thing of value" in gross income under the tax code and so cannot be treated as a return benefit. The Plaintiff States also argue that the new rules arbitrarily distinguish between tax benefits that come as deductions and benefits that come as credits and between donors who do and do not receive tax credits worth over 15% of the underlying donation.

Other Responses

Rep. Bill Pascrell (D-N.J.) and Sen. Bob Menendez (D-N.J.) introduced a bill in February to repeal the S.A.L.T. deduction cap and raise the top individual tax rate from 37% to its pre-tax law level of 39.6%. Reps. Sean Casten (D-I.L.) and Lauren Underwood (D-I.L.) wrote a bill that would not fully repeal the cap but would increase it to $15,000 for single filers and $30,000 for married couples.[8]

CONCLUSION

Politics on the national and local level in the U.S. have become a form of blood sport with no holds barred. Seeking publication of confidential tax returns, limiting tax deductions on the Federal level for state income taxes, and adopting workarounds as charitable activity are only the latest iterations.

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[8] As reported by Naoi Jagoda, *The Hill*, 5/24/19.

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