

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Associate Area Counsel
(Small Business/Self-Employed)
CC:SB:7:POR:1

from: Acting Chief, Branch 1
Office of Associate Chief Counsel
(Income Tax and Accounting)
CC:ITA:1

subject: Oregon Child Care Credit

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

We understand that your office is assisting a local IRS office in preparing an information letter to be issued under the provisions of section 2.04 of Rev. Proc. 2004-1, 2004-1 I.R.B. 1, 7. Previously, your office forwarded draft text for our review. We reviewed that text and recommend some revisions. The text in the section below reflects our revisions, and we recommend that it be used for the body of the information letter, with appropriate modifications. For example, the local IRS office will need to insert a closing paragraph with contact information.

Text for Letter

This information letter responds to your inquiry concerning whether contributions made under the Oregon Child Care Tax Credit Program (Or. Rev. Stat. § 657A.700 et seq.) qualify for a charitable contribution deduction under § 170 of the Internal Revenue Code. Section 2.04 of Revenue Procedure 2004-1, 2004-1 I.R.B. 1, 7, describes an “information letter” as a statement issued by the Internal Revenue Service that calls attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts. An information letter is advisory only and has no binding effect on the Internal Revenue Service.

To summarize the following discussion, a payment for which a benefit of receiving a state income tax credit may be expected raises serious concerns as to the deductibility of such a payment as a charitable contribution on the contributor's federal income tax return. However, if a charitable contribution deduction under § 170 of the Internal Revenue Code is not allowable for federal income tax purposes, it is possible that an equivalent deduction may be allowable under I.R.C. § 162 or § 164, as a payment of state tax. The Service's national office has been informed of this Oregon credit because it is studying various issues concerning the federal tax treatment of state tax credits and whether such issues should be addressed in official published guidance.

Description of Oregon credit

The state of Oregon provides for a credit against Oregon personal and corporate income tax, or corporate excise tax, for certain contributions made to the Oregon Child Care Division. Generally, the law provides that a taxpayer may make a contribution to the Child Care Division or a selected community agency, and apply for a tax credit certificate with the contribution.

Section 657A.703(1) of the Oregon Revised Statutes provides that the Child Care Division of the Employment Department, in collaboration with an advisory committee established by the Child Care Division, shall establish a program to:

- (a) Allocate tax credit certificates to taxpayers that make qualified contributions to the Child Care Division; and
- (b) Distribute to child care providers moneys from qualified contributions and other contributions.

Section 657A.700(4) of the Oregon Revised Statutes provides that a "qualified contribution" means a contribution made by a taxpayer to the Child Care Division of the Employment Department or a selected community agency for the purpose of promoting child care, and for which the taxpayer will receive a tax credit certificate under section 657A.706 of the Oregon Revised Statutes. Section 657A.700(2) provides that a "community agency" means a nonprofit agency that: (a) provides services related to child care, children and families, community development or similar services; and (b) is eligible to receive contributions that qualify as deductions under section 170 of the Internal Revenue Code.

Section 657A.703(2) of the Oregon Revised Statutes provides that the purposes of the program are to:

- (a) Encourage taxpayers to make contributions to the Child Care Division by providing a financial return on qualified contributions and by soliciting other contributions.
- (b) Achieve specific and measurable goals for targeted communities and populations.

- (c) Set standards for the child care industry concerning the cost of providing quality, affordable child care.
- (d) Strengthen the viability and continuity of child care providers while making child care more affordable for low and moderate income families.

Section 657A.706(3)(a) of the Oregon Revised Statutes provides that the Child Care Division shall issue tax credit certificates in the chronological order in which the contributions are received by the division. The division shall issue tax credit certificates to contributors until the total value of all certificates issued by the division for the calendar year equals \$500,000. Each certificate shall state the value of the contribution being certified as eligible for the tax credit allowed under section 315.213 of the Oregon Revised Statutes. Except as provided in rules adopted under section 657A.706(2), the certified value shall equal the amount of the contribution.

Section 657A.706(2) provides that the Child Care Division may adopt rules that establish a fixed percentage that is less than 100 percent by which the amount contributed by a taxpayer will be certified for a tax credit by the division. That section also states that “[t]he purpose of the grant of rulemaking authority under this subsection is to permit the division to calibrate the amount of the tax credit to interpretations of the deductibility of qualified contributions under section 170 of the Internal Revenue Code for federal tax purposes.”

Section 657A.706(4) provides that a taxpayer that receives a notice of denial of a tax credit certificate or that receives a tax credit certificate issued for an amount that is less than the amount contributed may request a refund for the amount contributed within 90 days of the denial or issuance of the certificate.

Section 315.213(1) of the Oregon Revised Statutes provides a credit against personal income taxes or, if the taxpayer is a corporation, against corporate income and excise taxes for certified contributions made to the Child Care Division under section 657A.706. The credit is not "refundable": Section 315.213(3) provides that the credit may not exceed the tax liability of the taxpayer for the tax year in which the credit is claimed. Section 315.213(4) provides that if the amount claimed as a credit is allowed as a deduction for federal tax purposes, the amount allowed as a credit shall be added to federal taxable income for Oregon tax purposes. Section 315.213(6) provides that any credit otherwise allowable that is not used by the taxpayer in a particular tax year may be carried forward and offset against the taxpayer's tax liability for the next succeeding tax year, up to a period of four years.

Discussion

Charitable contribution deduction

Section 170(a)(1) of the Internal Revenue Code provides the general rule that, subject to certain limitations, there shall be allowed as a deduction any charitable contribution

(as defined in § 170(c)) payment of which is made within a taxable year. See also section 1.170A-1 of the federal income tax regulations.

Generally, to be deductible as a charitable contribution under I.R.C. § 170, a transfer to a charitable organization or government unit must be a gift. A gift for this purpose is a transfer of money or property without receipt of adequate consideration, made with charitable intent. A transfer is not made with charitable intent if the transferor expects a direct or indirect return benefit commensurate with the amount of the transfer. If a taxpayer receives a benefit in return for a transfer to a charitable organization, the transfer may be deductible as a charitable contribution, but only to the extent the amount transferred exceeds the fair market value of the benefit received, and only if the excess amount was transferred with the intent of making a gift. See United States v. American Bar Endowment, 477 U.S. 105, 116-118 (1986); Hernandez v. Commissioner, 490 U.S. 680, 689-691 (1989); Treas. Reg. § 1.170A-1(h)(1) and (2).

A leading authority in this area observed that if the benefits received, or expected to be received by a donor are substantial (that is, greater than those incidental benefits that inure to the general public from transfers for charitable purposes), then the transferor has received, or expects to receive a quid pro quo sufficient to remove the transfer from the realm of deductibility under I.R.C. § 170. Singer Co. v. United States, 449 F.2d 413, 422-423 (Ct. Cl. 1971).

The tax benefit of a federal charitable contribution deduction is not regarded as a return benefit that negates charitable intent, reducing or eliminating the deduction itself. Similarly, the fact that states typically provide for a similar deduction in determining the taxable income base for state tax purposes does not affect the federal deduction under I.R.C. § 170. However, that situation is arguably distinguishable from one in which, as a result of a payment a taxpayer makes to a governmental or charitable body, a state offsets the taxpayer's state tax liability with a credit.

Deduction for payment of state tax

Section 164 of the Internal Revenue Code provides generally for an itemized deduction for the payment of certain taxes, including state income tax. See I.R.C. § 164(a)(3). Similarly, taxpayers engaged in a trade or business may deduct certain tax payments as business expenses under I.R.C. § 162.

As discussed above, a charitable contribution deduction under I.R.C. § 170 may not be allowable for a payment that qualifies for the Oregon Child Care Tax Credit, if the credit is viewed as a quid pro quo benefit that eliminates the necessary charitable intent for federal tax purposes. However, if receipt of the credit from the state is viewed as a disqualifying benefit, arguably the taxpayer's transfer of the credit to the state to satisfy the state tax liability should be viewed as a payment of state tax, for purposes of the federal deduction for tax payments in I.R.C. § 164 or § 162.

Other considerations

In addition to these two questions, other issues are raised by certain features of the Oregon Child Care Credit, such as the fact that the contributions may be refundable under certain circumstances, and the fact the credit may not be issued in the same year as the taxpayer's contribution.

After consideration, I believe that the federal tax issues raised by the Oregon Child Care Credit are significant and should be considered by the Service's national office, along with the other issues related to the federal tax treatment of state tax credits currently under study. This will allow full consideration of concerns that have been identified with respect to the tax treatment of these and other state tax credits, and help ensure uniform treatment of taxpayers. Please be aware that the decision to issue published guidance must be approved at higher levels.

Pending resolution of these issues, I cannot furnish definitive advice on the questions you raised. However, I have attempted to highlight the areas of concern which might affect the deductibility of payments to the Child Care Division.

End of Text for Letter

Please call (202) 622-4950 if you have any questions.