



*Review of the Issuance Process for
Notice 2018-54*

February 22, 2019

Reference Number: 2019-14-019

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HIGHLIGHTS

REVIEW OF THE ISSUANCE PROCESS FOR NOTICE 2018-54

Highlights

Final Report issued on February 22, 2019

Highlights of Reference Number: 2019-14-019
to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

On December 22, 2017, the President signed Public Law 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA). The TCJA made significant changes to the tax code affecting individuals, businesses, and tax-exempt organizations. One such change limits individual taxpayer deductions for State and local taxes to \$10,000 a year (\$5,000 a year for married filing separate taxpayers). TIGTA estimates that this change could affect more than 10 million taxpayers in Tax Year 2018.

WHY TIGTA DID THE AUDIT

TIGTA initiated this audit based on a request from the Chairman of the U.S. House of Representatives Committee on Ways and Means concerning the prioritization and issuance of IRS Notice 2018-54, *Guidance on Certain Payments Made in Exchange for State and Local Tax Credits*. The overall objective of this audit was to evaluate the process used to prioritize and issue IRS Notice 2018-54.

WHAT TIGTA FOUND

TIGTA determined the IRS began working on guidance for the State and local tax deduction shortly after the TCJA was enacted. Guidance in this area was given priority due to taxpayer impact and emerging issues. In addition, TIGTA found that the process used for the issuance of Notice 2018-54 involved approvals from appropriate officials within and outside of the IRS.

The development of Notice 2018-54 began in January 2018 after the TCJA became law and imposed limitations on State and local tax deductibility. TIGTA found that the IRS Office of Chief Counsel prioritized the issuance of this

guidance because of issues raised in the media and proposed State legislative actions. From January through March 2018, the IRS, in consultation with Department of the Treasury (Treasury) officials, worked to develop the draft guidance. On March 29, 2018, the IRS sent a draft press release announcing forthcoming guidance to Treasury for approval.

Subsequently, Treasury officials reviewed the press release and converted it into an IRS notice. The Notice 2018-54 was reviewed and approved by high-level Treasury officials, including the Secretary of the Treasury, and was sent to the Office of Management and Budget and the National Economic Council for review and approval. Finally, on May 22, 2018, the Acting IRS Commissioner approved the final Notice 2018-54, and the IRS issued it the next day to the public.

IRS and Treasury officials stated that sub-regulatory guidance might include higher-level reviews and approvals depending on the policy implications of the guidance. Because Notice 2018-54 addressed TCJA provisions, which could have a significant impact on taxpayers, Chief Counsel and Treasury officials indicated that expanded reviews were appropriate. Given the potential impact on millions of taxpayers, TIGTA found the review and approval process for Notice 2018-54 to be reasonable.

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations as a result of the work performed during this review.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 22, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Review of the Issuance Process for
Notice 2018-54 (Audit # 201810024)

This report presents the results of our review to assess the process used to prioritize and issue Internal Revenue Service (IRS) Notice 2018-54, *Guidance on Certain Payments Made in Exchange for State and Local Tax Credits*. This audit was requested by the Chairman of the U.S. House of Representatives Committee on Ways and Means. This audit is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Implementing the Tax Cuts and Jobs Act and Other Tax Law Changes.

Copies of this report are also being sent to the IRS managers affected by the report finding. If you have any questions, please contact me or Deann L. Baiza, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations).



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Review of the Issuance Process for Notice 2018-54

Abbreviations

IRS	Internal Revenue Service
OIRA	Office of Information and Regulatory Affairs
SALT	State and Local Tax
TCJA	Tax Cuts and Jobs Act



Background

On December 22, 2017, the President signed Public Law 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA).¹ The TCJA made significant changes to the tax code affecting individuals, businesses, and tax-exempt organizations. Most changes in the new law take effect in Calendar Year² 2018 and will affect tax returns filed in Calendar Year 2019.

One of the TCJA provisions limits individual taxpayer deductions for State and local tax (SALT) payments to \$10,000 a year (\$5,000 for a married person filing a separate return), beginning in Tax Year³ 2018 and expiring at the end of Calendar Year 2025. SALT payments (including income and real property taxes) that exceed those amounts are no longer deductible by individual taxpayers unless the payments are made in pursuit of a trade or business.⁴ This also will affect taxpayers who must choose between taking the standard deduction⁵ or itemizing their deductions on Form 1040, *U.S. Individual Income Tax Return*, Schedule A, *Itemized Deductions*. When the TCJA became law, the standard deduction amounts increased as shown in Figure 1:

Figure 1: Standard Deduction Amounts and SALT Deduction Limitations Before and After the Passage of the TCJA

Filing Status	Tax Year 2017 Standard Deduction	Tax Year 2018 Standard Deduction	Tax Year 2018 SALT Limitation Amount
Single	\$ 6,350	\$ 12,000	\$ 10,000
Married Filing Jointly	\$ 12,700	\$ 24,000	\$ 10,000
Married Filing Separately	\$ 6,350	\$ 12,000	\$ 5,000
Head of Household	\$ 9,350	\$ 18,000	\$ 10,000

Source: IRS Publication 5307, *Tax Reform Basics for Individuals and Families (October 2018)* and Publication 17, *Your Income Tax for Individuals (2017)*.

¹ Pub. L. No. 115-97 (2017).

² The 12-consecutive-month period ending on December 31.

³ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁴ Before the TCJA became law, there was generally no limitation on the amount of SALT payments that taxpayers could deduct assuming the tax was assessed by the taxing authority and paid by the taxpayer.

⁵ The standard deduction is a dollar amount that reduces the amount of income on which you are taxed and varies according to your filing status; taxpayers cannot take the standard deduction if they itemize deductions on Schedule A. The standard deduction is higher if a taxpayer is blind or over age 65.



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To determine the impact of the new cap on SALT deductions, we reviewed Federal tax returns filed in Tax Year 2017 and estimate that, if the SALT limitation had been in place in Tax Year 2017, it would have affected approximately 10.9 million taxpayers who would have been unable to deduct approximately \$323 billion in SALT payments on Form 1040 Schedule A. See Figure 2 for more information.

Figure 2: Estimated Number of Taxpayers Subject to the SALT Limitations, and Amounts of State and Local Taxes Paid Over the SALT Limitations in Tax Year 2018⁶

Filing Status	Number of Taxpayers ⁷	Total Amount Over SALT Limitation
Single	2,151,826	\$ 116,744,057,916
Married Filing Jointly	7,763,869	\$ 185,864,115,484
Married Filing Separately	391,820	\$ 5,772,842,933
Head of Household	573,055	\$ 14,746,499,306
TOTALS	10,880,570⁸	\$ 323,127,515,639⁹

Source: Treasury Inspector General for Tax Administration calculations based on tax returns filed in Tax Year 2017.

Whenever Congress enacts new legislation affecting the tax code,¹⁰ the Internal Revenue Service (IRS) Office of Chief Counsel (hereafter referred to as Chief Counsel) is responsible for determining if guidance is necessary to address the new legislation. Chief Counsel also develops tax-related guidance for the public through its Priority Guidance Plan. While developing the annual Priority Guidance Plan, the IRS and the Department of the Treasury (hereafter referred to as Treasury) solicit recommendations from the public for items to include in the Plan. The type of guidance the IRS issues ranges from publishing informal news or press releases up to issuance of regulations, which are the most authoritative type of guidance.¹¹ Regulations provide

⁶ The estimate is based upon taxpayers claiming the same amount of deductions on Schedule A in Tax Year 2018 as they claimed in Tax Year 2017 and is designed to measure potential impact of the new SALT limitations and standard deduction increases per filing status.

⁷ Based on Tax Year 2017 filings in which the Schedule A amounts exceed the Tax Year 2018 standard deduction.

⁸ We estimated the number of taxpayers that may be subject to the SALT limitations (for Tax Year 2018) by identifying Schedule A returns that claimed more than \$10,000 in real estate, State, and local taxes paid in Tax Year 2017.

⁹ We calculated the cumulative amount of real estate, State, and local taxes that exceeded the \$10,000 SALT limitation (\$5,000 for married filing separately) for each Schedule A tax return filed in Tax Year 2017 to estimate the Tax Year 2018 amount in excess of the SALT limitation.

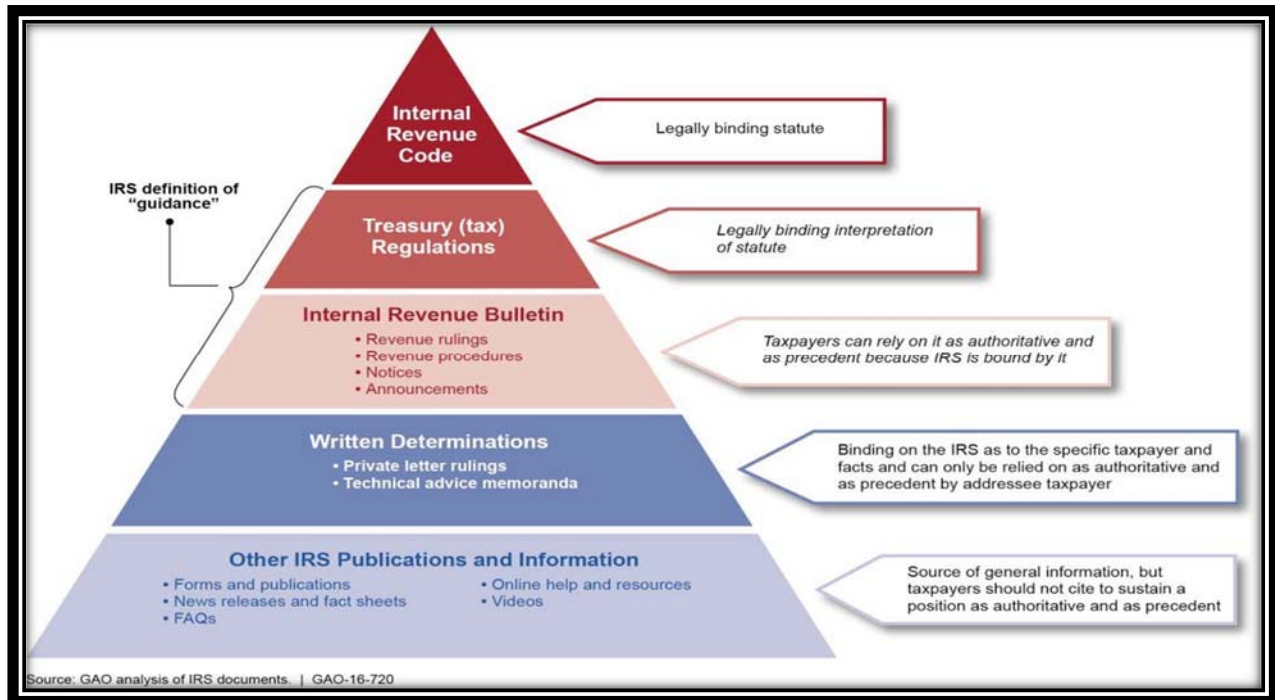
¹⁰ Federal tax law begins with the Internal Revenue Code, enacted by Congress in Title 26 of the United States Code.

¹¹ Regulations are published in both the Internal Revenue Bulletin and the Federal Register.



Treasury's and IRS's official interpretation of tax laws and are binding on taxpayers because they have the force and effect of law.¹² Figure 3 illustrates the hierarchy of authority for IRS guidance.

Figure 3: Hierarchy of Authority for IRS Guidance and Other Information Sources



Source: Government Accountability Office analysis of IRS documents in a September 2016 report.¹³

Published guidance is important because it helps IRS personnel apply the tax laws correctly and uniformly and assists taxpayers with voluntarily complying with the tax laws. In addition, the IRS publishes guidance in the Internal Revenue Bulletin, which is the authoritative instrument for publishing revenue rulings, revenue procedures, notices, and announcements. Anything that is published in the Internal Revenue Bulletin requires three levels of clearance:

- Chief Counsel.
- The IRS Commissioner, to ensure that the proposed guidance is administrable.

¹² Generally, regulations are first published in proposed form in a Notice of Proposed Rulemaking. After public input is fully considered through written comments and even a public hearing, a final regulation or a temporary regulation is published as a Treasury Decision in the Federal Register.

¹³ Government Accountability Office, GAO 16-720, *Regulatory Guidance Processes: Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance* (Sept. 2016). OMB is the Office of Management and Budget.



Review of the Issuance Process for Notice 2018-54

- The Treasury, Office of Tax Policy, to ensure that the proposed guidance covers tax policy.

In addition, Chief Counsel, as the chief legal advisor to the IRS Commissioner on all matters pertaining to the interpretation, administration, and enforcement of the Internal Revenue Laws (as well as all other legal matters), provides legal guidance and interpretive advice to the IRS, Treasury, and to taxpayers.

This review was performed at the IRS National Headquarters in Washington, D.C., in the Office of Chief Counsel during the period June through November 2018. This review was requested by the Chairman of the U.S. House of Representatives Committee on Ways and Means. Based on the request, the scope of this audit was limited to the process followed by the IRS to prioritize and issue Notice 2018-54, and who was involved in the process. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



Results of Review

The Internal Revenue Service Prioritized, Approved, and Issued Notice 2018-54

We determined that Chief Counsel, in collaboration with Treasury, began working on guidance for the SALT limitations shortly after the TCJA was enacted. Chief Counsel gave the SALT issue priority due to the impact on taxpayers, as well as to address proposed legislation by various States designed to circumvent the SALT limitations. This guidance was initially released in the form of Notice¹⁴ 2018-54, *Guidance on Certain Payments Made in Exchange for State and Local Tax Credits*, and later in the form of draft regulations. Notice 2018-54 was circulated for review within Treasury, including various Senior Treasury officials and the Secretary of the Treasury, because of the importance of administering the TCJA provisions and its impact on taxpayers. Additionally, Treasury stated that it forwarded the Notice 2018-54 to the Office of Management and Budget Office of Information and Regulatory Affairs (OIRA)¹⁵ and the National Economic Council¹⁶ for review. After all parties cleared the Notice 2018-54, the IRS issued it to the public on May 23, 2018, via an IRS News Release, IR-2018-122.

The prioritization of Notice 2018-54

The IRS stated that several factors led to Chief Counsel's decision to prioritize the issuance of guidance on the SALT limitations. Specifically, once the TCJA became law, several States began proposing or considering legislation that created workarounds designed to minimize the impact of the SALT limitations. Some State-run programs would allow taxpayers to contribute to various State and local governments in exchange for credits against State taxes.¹⁷ In addition, public concerns and questions about the new SALT limitations were being raised through the media.

According to Chief Counsel, although guidance on the SALT limitations was not in its Priority Guidance Plan until August 2018, Chief Counsel considered it a priority. Chief Counsel stated that development and issuance of guidance on the SALT limitation was a high priority,

¹⁴ A notice is a public pronouncement by the IRS that may contain guidance that involves substantive interpretations of the Internal Revenue Code or other provisions of the law.

¹⁵ The OIRA is a statutory part of the Office of Management and Budget within the Executive Office of the President.

¹⁶ The National Economic Council was created January 25, 1993, by Executive Order 12835, to coordinate the economic policymaking process and advise the President on economic policy.

¹⁷ Charitable contributions are addressed in Internal Revenue Code §170.



Review of the Issuance Process for Notice 2018-54

especially because the new limitations would affect the 2019 Tax Year filing season.¹⁸ As such, a collaborative effort began between Chief Counsel and Treasury to develop regulations concurrent with some type of announcement to the public. The guidance process officially began on January 11, 2018, when Chief Counsel assigned a lead attorney from the Income Tax and Accounting section to research SALT issues.

While Chief Counsel has developed detailed guidance for issuing regulations,¹⁹ the guidance for notices does not specify which offices they should be circulated²⁰ to for review and approval. In this instance, the Notice 2018-54 received expanded reviews by IRS and Treasury personnel, as well as reviews by executive branch agencies that are normally involved in issuing regulations, including the Office of Management and Budget and the National Economic Council.

From January through March of 2018, Chief Counsel in consultation with Treasury officials, worked to develop the draft guidance. After several meetings, Chief Counsel and Treasury decided to notify the public that the IRS was evaluating the SALT issue and formal guidance would be forthcoming.

In March 2018, Chief Counsel at the direction of Treasury began to develop a press release concerning SALT guidance. According to the IRS, the press release was intended to communicate a word of caution because several States had proposed or passed legislation that was designed to circumvent the \$10,000 cap on State and local tax deductions. It was also meant to inform the public that the IRS was working on guidance that would address these State-run programs.

After Chief Counsel and Treasury refined the Notice 2018-54, Treasury approved it for issuance. On May 23, 2018, the IRS released Notice 2018-54 to the public. As shown in Figure 4, it was the 24th guidance item issued concerning the TCJA since the law's enactment.

¹⁸ The filing season is the period from January through mid-April of each year when most individual income tax returns are filed.

¹⁹ Internal Revenue Manual 32.1, Chief Counsel Regulation Handbook (August 2018).

²⁰ Sub-regulatory guidance does not require notices of proposed rulemaking public comment, or any of the other typical states of composing new Federal regulations.



Figure 4: Number of TCJA Guidance Items Issued Before Notice 2018-54

Type of TCJA Guidance	Number of Guidance Items
Proposed or Final Regulations	None
Revenue Rulings	1
Revenue Procedures	7
Notices	14
Frequently Asked Questions	1
Total Guidance Issued by May 22, 2018	23

Source: Office of Chief Counsel, July 2018. Note: Notice 2018-54 was issued to the public on May 23, 2018, via an IRS News Release, IR-2018-122.

Notice 2018-54 stated that Treasury and the IRS intend to propose regulations addressing the Federal income tax treatment of certain payments for which taxpayers receive a credit against their State and local taxes. The Notice 2018-54 also informed the public “the proposed regulations [would] assist taxpayers in understanding the relationship between the Federal charitable contribution deduction and the new statutory limitation on the deduction for State and local tax payments.”

On August 23, 2018, Chief Counsel released proposed regulations addressing contributions in exchange for State and local tax credits associated with the SALT limitations. Chief Counsel advised us that the IRS would allow the public 45 days for submitting comments²¹ due to time constraints and the need to issue the rules in time for the 2019 Filing Season.

The proposed regulations generally provide that “if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a State or local tax credit in return for such payment, the tax credit constitutes a return benefit, or quid pro quo, to the taxpayer and reduces the charitable contribution deduction.”²² See Figure 5 for a timeline for the issuance of Notice 2018-54.

²¹ Internal Revenue Manual 32.1.2.3 (4) a (08-16-2018) states that “the public should generally be afforded a period of at least 60 days to comment on the proposed regulation.” The IRS has stated that the public comment period typically ranges from 30 to 90 days.

²² Proposed REG-112176-18, dated August 23, 2018. We did not audit the process followed to issue the proposed regulations as part of this audit because they were not final at the time of this report. The scheduled public hearing was held on November 5, 2018.



Figure 5: Chronology of Key Events for Notice 2018-54

1/11/18: Chief Counsel assigns Income Tax and Accounting staff to begin work on the SALT deduction limitations and Internal Revenue Code §164 related provisions affected by the TCJA to determine if formal guidance is needed.

1/11/18 through 1/23/18:

Chief Counsel gathers media reports, inquiries from the public, and proposed legislation designed to allow State residents to bypass the SALT limitations. Chief Counsel and Treasury meet to discuss a strategy for upcoming guidance.

1/24/18: Chief Counsel officially establishes a proposed guidance project to determine what type of guidance should be issued.

2/15/18: The Acting IRS Commissioner meets with several members of Congress to discuss the SALT limitation.²³ Chief Counsel briefs Treasury officials.

3/08/18: The Acting IRS Commissioner, Chief Counsel, and Treasury agree that the IRS should quickly issue a notice or announcement.

3/27/18 through 3/29/18

Chief Counsel attorneys prepare a draft press release to address SALT issues and send it to Treasury for review.

5/07/18: Treasury forwards a draft notice to the IRS (Treasury changed Chief Counsel's press release into a notice).

5/16/18: The Treasury Secretary approves issuance of the draft Notice pending discussion with the Office of Management and Budget.²⁴

²³ The Acting IRS Commissioner attended one congressional meeting on February 15, 2018, with two congressional representatives. At the meeting, the representatives shared their concerns regarding the impact the TCJA would have on their State.

²⁴ The Office of Management and Budget forwarded the Notice 2018-54 to the National Economic Council for review and both completed their reviews and cleared the notice by May 18, 2018.



Review of the Issuance Process for Notice 2018-54

- 5/22/18:** The Acting IRS Commissioner approves the Notice and forwards it to Treasury for review. The IRS initiates the process to publish the Notice in the Internal Revenue Bulletin.
- 5/23/18:** After receiving approval from the Treasury, the IRS issues Notice 2018-54 to the public.

Source: Interviews of Chief Counsel personnel and review of supporting documentation.

Reviews and approvals of Notice 2018-54

When Chief Counsel attorneys drafted the press release, and after the Acting Chief Counsel approved it, they sent it to Treasury for review on March 29, 2018. On May 7, 2018, Chief Counsel received a revised document, in the form of an IRS notice, from Treasury. IRS and Treasury officials determined that a notice was a better form of guidance because it is more authoritative than a press release. Chief Counsel advised us that when they received the draft Notice 2018-54 from Treasury, they circulated it within the IRS based on the IRS's standard process for review and approval of sub-regulatory guidance.

Treasury officials indicated that the reviews they performed were extensive because Notice 2018-54 addresses the SALT limitations, which will potentially affect millions of taxpayers and billions of dollars in tax revenue.²⁵ Treasury also stated that sub-regulatory guidance (*e.g.*, notices, announcements) could require a wider range of reviews by higher-level officials depending on the policy implications of the guidance. Treasury also advised us that it does not have written procedures outlining who should review various guidance; however, Treasury is required to send proposed regulations to the OIRA if the anticipated impact is \$100 million or more.²⁶

Treasury's expanded review included various Senior Treasury officials and the Secretary of the Treasury. A Senior Treasury Official, who was involved with issuing Notice 2018-54, explained that Treasury performs a wider review on most TCJA-related guidance.²⁷ Treasury personnel

²⁵ See Appendix V for the offices within the IRS and Treasury that reviewed Notice 2018-54. See Appendix VI for the personnel involved in drafting, reviewing, and approving Notice 2018-54.

²⁶ See Appendix VIII. Based on the April 11, 2018, Memorandum of Agreement between the Treasury and the Office of Management and Budget, the OIRA will review proposed published guidance that may create inconsistencies with actions by other agencies, raise novel legal or policy issues, or have an annual non-revenue effect on the economy of \$100 million or more (measured against a no-action baseline).

²⁷ See Appendix VII for Treasury's review process for guidance not related to the TCJA.



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also advised us that they brief the Treasury Office of General Counsel²⁸ and the Secretary of the Treasury if the guidance relates to a significant policy or if the guidance is part of TCJA implementation.

Treasury also sent the Notice 2018-54 to the OIRA for review, although the Memorandum of Agreement between Treasury and OIRA addresses only proposed regulations, not sub-regulatory guidance such as notices. A Treasury official involved in the review advised that they shared the Notice 2018-54 with the OIRA to ensure compliance with the Memorandum of Agreement. The official explained that they routinely share TCJA-related guidance with the OIRA. Our review confirmed that the Treasury has forwarded other TCJA-related notices to the OIRA for review.

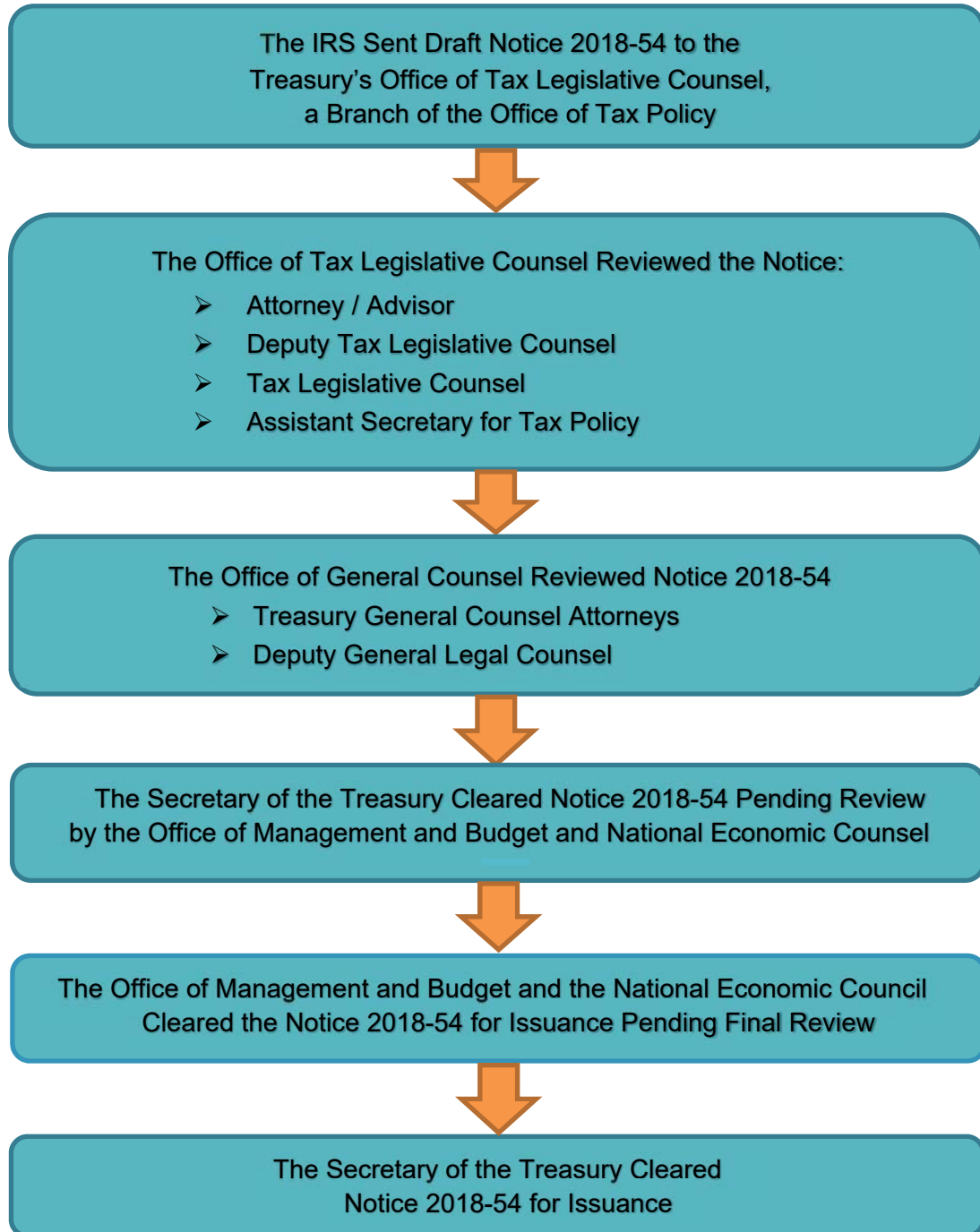
After OIRA reviewed the Notice 2018-54, they forwarded it to the National Economic Council for review. The OIRA and the National Economic Council cleared Notice 2018-54 for issuance and did not have any comments. It appears that the reviews and approvals performed by Chief Counsel and the Treasury were appropriate given the need to notify the public about the potential impact of the SALT limitations.

See Figure 6 for more information about Treasury's review process.

²⁸ Treasury's Office of General Counsel provides legal and policy advice to the Secretary and other senior Treasury officials. The Office of General Counsel also is the head of the Treasury Legal Division, a separate bureau within the Treasury that includes all legal counsels of the Treasury and its staff.



Figure 6: Treasury's Review Process for Notice 2018-54



Source: Interviews with Treasury officials and reviews of supporting documentation.



Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to evaluate the process used to prioritize and issue IRS Notice 2018-54, *Guidance on Certain Payments Made in Exchange for State and Local Tax Credits*. To accomplish our objective, we:

- I. Obtained and reviewed guidance applicable to issuance of IRS notices and other guidance.
 - A. Determined how the IRS prioritizes issuance of notices and other guidance.
 - B. Determined individuals responsible for issuing IRS notices and other guidance.
 - C. Determined the number of taxpayers potentially affected by the new legislation provision related to State and local tax deductibility.
- II. Interviewed staff involved in the issuance of Notice 2018-54, obtained supporting documentation, and gained an understanding of:
 - A. The chronology for issuance of Notice 2018-54.
 - B. The factors involved in deciding to issue Notice 2018-54.
 - C. The staffing involved in the issuance of Notice 2018-54.
 - E. The coordination with the Department of the Treasury, the Office of Management and Budget, and congressional staff regarding the issuance of the Notice 2018-54.
 - F. The status of final regulatory guidance.
- III. Determined whether the IRS followed its established policies and procedures for issuance of Notice 2018-54.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: Chief Counsel's policies and prioritization for issuing notices. We evaluated these controls by reviewing Chief Counsel's guidance, interviewing Chief Counsel and Department of the Treasury personnel, evaluating the documentation related to Notice 2018-54, and analyzing the review process for Notice 2018-54.



Appendix II

Major Contributors to This Report

Deann L. Baiza, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Troy D. Paterson, Director
Jonathan T. Meyer, Director
Janice M. Pryor, Audit Manager
Yasmin B. Ryan, Lead Auditor
Mary F. Herberger, Senior Auditor
Thomas F. Polsfoot, Senior Auditor
Joseph P. Smith, Senior Auditor



Review of the Issuance Process for Notice 2018-54

Appendix III

Report Distribution List

Deputy Commissioner – Attn: Chief of Staff
Chief Counsel
Director, Office of Audit Coordination



Appendix IV

Notice 2018-54

Guidance on Certain Payments Made in Exchange for State and Local Tax Credits

NOTICE 2018-54

SECTION 1. PURPOSE

This notice informs taxpayers that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to propose regulations addressing the federal income tax treatment of certain payments made by taxpayers for which taxpayers receive a credit against their state and local taxes.

SECTION 2. BACKGROUND

Section 11042 of “The Tax Cuts and Jobs Act,” Pub. L. No. 115-97, limits an individual’s deduction under § 164 for the aggregate amount of state and local taxes paid during the calendar year to \$10,000 (\$5,000 in the case of a married individual filing a separate return). State and local tax payments in excess of those amounts are not deductible. This new limitation applies to taxable years beginning after December 31, 2017, and before January 1, 2026.

In response to this new limitation, some state legislatures are considering or have adopted legislative proposals that would allow taxpayers to make transfers to funds controlled by state or local governments, or other transferees specified by the state, in exchange for credits against the state or local taxes that the taxpayer is required to pay. The aim of these proposals is to allow taxpayers to characterize such transfers as fully deductible charitable contributions for federal income tax purposes, while using the same transfers to satisfy state or local tax liabilities.

Despite these state efforts to circumvent the new statutory limitation on state and local tax deductions, taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes.

SECTION 3. GUIDANCE TO BE ISSUED

The Treasury Department and the IRS intend to propose regulations addressing the federal income tax treatment of transfers to funds controlled by state and local governments (or other state-specified transferees) that the transferor can treat in whole or in part as satisfying state



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and local tax obligations. The proposed regulations will make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers. The proposed regulations will assist taxpayers in understanding the relationship between the federal charitable contribution deduction and the new statutory limitation on the deduction for state and local tax payments.

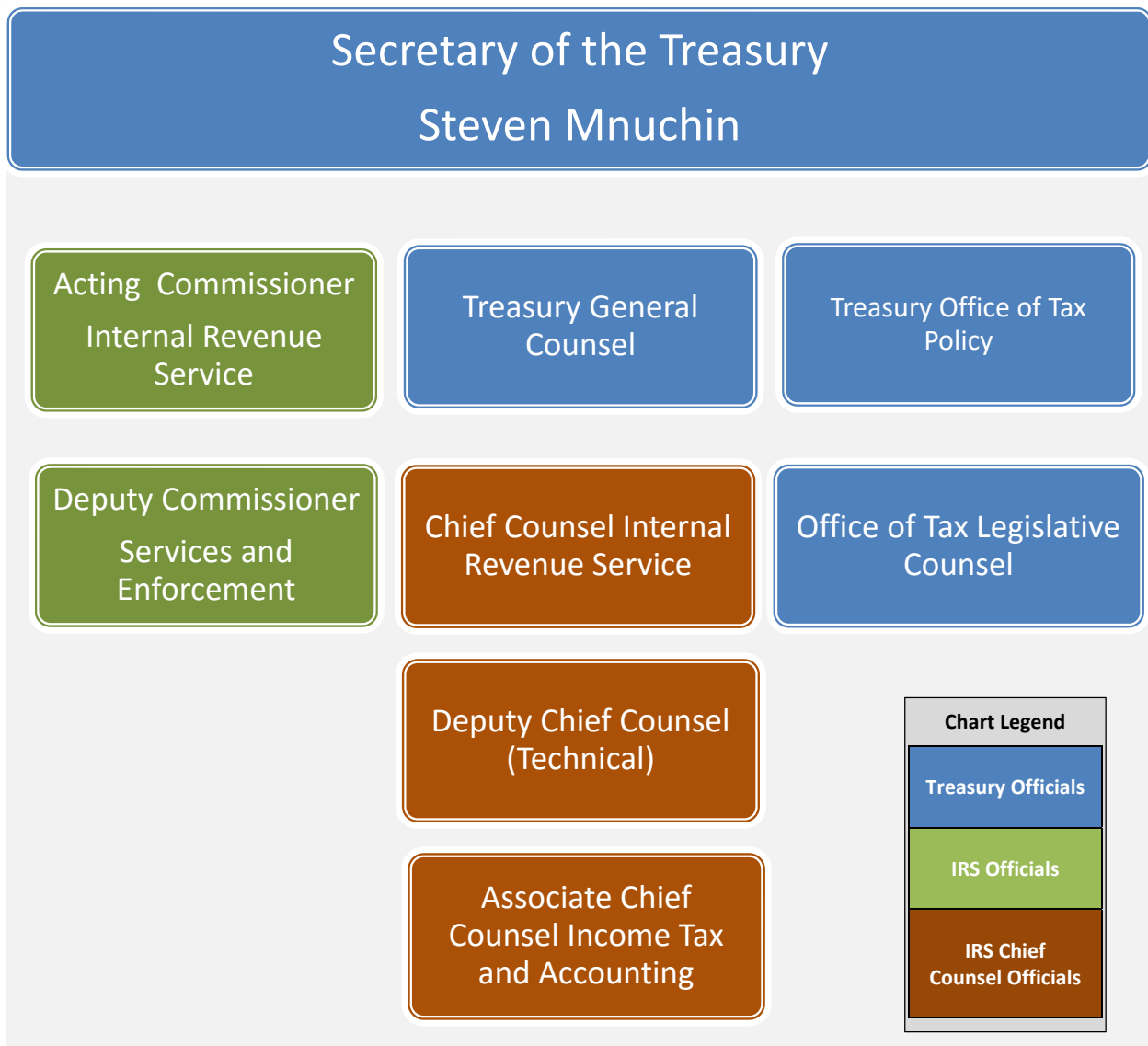
SECTION 4. DRAFTING INFORMATION

The principal authors of this notice are Mon Lam and Merrill Feldstein of the Office of Associate Chief Counsel (Income Tax & Accounting). Other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, contact Ms. Lam or Ms. Feldstein at (202) 317-5100 (not a toll-free call).



Appendix V

Offices Involved in the Issuance of Notice 2018-54



Source: Interviews with Department of the Treasury and IRS officials; review of associated documentation; and U.S. Department of the Treasury, IRS, and Office of IRS Chief Counsel intranet sites.



Appendix VI

Key Internal Revenue Service and Treasury Personnel Involved in Drafting, Reviewing, and Approving Notice 2018-54

Organizations Involved	Offices Involved	Positions Involved	
IRS	Office of the Commissioner	Acting Commissioner	
		Deputy Commissioner, Services and Enforcement	
		Special Assistant to the Commissioner (Reporting to the Deputy Commissioner)	
		Acting Attorney-Advisor to the Deputy Commissioner, Services and Enforcement	
	Office of Chief Counsel	Acting Chief Counsel	
		Special Assistant to the Chief Counsel	
		Associate Chief Counsel, Income Tax and Accounting	
		Deputy Associate Chief Counsel, Income Tax and Accounting	
		Special Counsel, Income Tax and Accounting (2 Employees)	
		Senior Counsel, Income Tax and Accounting (3 Employees)	
		General Attorney, Income Tax and Accounting	
	Treasury	Office of the Secretary	Secretary of the Treasury
		Office of Tax Policy	Assistant Secretary for Tax Policy
Tax Legislative Counsel			
Deputy Tax Legislative Counsel			
Attorney Advisor			
General Counsel		General Counsel	
		Deputy General Counsel	
		Attorney, General Counsel	

Source: Interviews with Chief Counsel and Department of the Treasury officials, as well as reviews of supporting documentation.



Appendix VII

The Department of the Treasury's Review Process for Notices Not Related to the Tax Cuts and Jobs Act



Source: Interviews with Department of the Treasury officials. Note: This process does not apply to proposed regulations. In addition, Department of the Treasury's review process may vary based on policy considerations such as the likely impact of the guidance or a number of other considerations.



Appendix VIII

Memorandum of Agreement Between the Department of the Treasury and the Office of Management and Budget

Memorandum of Agreement The Department of the Treasury and the Office of Management and Budget Review of Tax Regulations under Executive Order 12866

Executive Order 13789 directed the Department of the Treasury and the Office of Management and Budget (OMB) to “review and, if appropriate, reconsider the scope and implementation of the existing exemption for certain tax regulations from the review process set forth in Executive Order 12866 and any successor order.” Treasury and OMB share a commitment to reducing regulatory burdens and providing timely guidance to taxpayers. Accordingly, this Memorandum of Agreement (MOA) provides the general terms under which the Office of Information and Regulatory Affairs (OIRA) within OMB will review tax regulatory actions.¹

1. *OIRA review of tax regulatory actions.* A tax regulatory action will be subject to review by OIRA under section 6 of Executive Order 12866 if it is likely to result in a rule that may:
 - (a) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;
 - (b) raise novel legal or policy issues, such as by prescribing a rule of conduct backed by an assessable payment; or
 - (c) have an annual non-revenue effect on the economy of \$100 million or more, measured against a no-action baseline.
2. *Analysis of tax regulatory actions.*
 - (a) Tax regulatory actions within the scope of paragraph 1 will be subject to the analytical requirements applicable to significant regulations under section 6(a)(3)(B) of Executive Order 12866.
 - (b) Tax regulatory actions with likely effects described in paragraph 1(c) will also be subject to the analytical requirements applicable to economically significant regulations under section 6(a)(3)(C) of Executive Order 12866.
3. *Notification of upcoming tax regulatory actions.* To facilitate the determinations set forth in paragraph 1, Treasury will submit to OIRA a quarterly notice of planned tax regulatory actions that describes each regulatory action; identifies any significant policy changes proposed or resulting from the regulatory action; and articulates the basis for determining whether the regulatory action is covered by paragraph 1 of this MOA. At the election of the OIRA Administrator, Treasury will engage in substantive consultation with OIRA regarding any such regulatory action.
4. *Timing of review.*
 - (a) To provide timely guidance to taxpayers, generally, OIRA review under paragraph 1 of this MOA will conclude 45 days after submission of the

¹ A “tax regulatory action” is a regulatory action (as defined by Executive Order 12866) issued pursuant to Title 26 of the United States Code.



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- information set forth in section 6(a)(3)(B) or (C) of Executive Order 12866, as applicable, subject to extensions mutually agreed upon by Treasury and OMB.
- (b) To ensure timely implementation of the Tax Cuts and Jobs Act of 2017, the Secretary or Deputy Secretary of the Treasury, on a nondelegable basis, may with the concurrence of the OIRA Administrator (not to be unreasonably withheld) designate certain tax regulatory actions for expedited release. Such actions will be reviewed by OIRA for no more than 10 business days, subject to extensions mutually agreed upon by Treasury and OMB.
 - (c) Treasury will respond in a timely manner to requests for information from OIRA during the review period, and any delays attributable to Treasury will be considered in determining whether to extend the review period.
5. Treasury will not publish in the Federal Register or otherwise publicly release any tax regulatory action within the scope of paragraph 1 unless OIRA notifies Treasury that it has waived or concluded its review. In the rare event of a policy disagreement that could not be resolved during the review process, OIRA will facilitate a principals meeting to resolve any remaining issues and, if needed, elevate those issues to the President.
6. This MOA supersedes the 1983 Memorandum of Agreement between Treasury and OMB with respect to tax regulatory actions, and the 1993 letter exchange between the OIRA Administrator and Treasury General Counsel reaffirming that agreement. Further, this MOA supersedes the Guidance for Implementing EO 12866 (M-94-3), Appendix C: Regulatory Actions Exempted from Centralized Regulatory Review, Department of the Treasury (Oct. 12, 1993).
7. The provisions of Executive Order 12866 not explicitly modified in this MOA will apply to the regulatory actions in paragraph 1. In addition, any Treasury regulatory action not discussed above shall be subject to the standard centralized review process under Executive Order 12866 (including the analytical requirements of OMB Circular No. A-4), except that the following regulatory actions will not be subject to such review process:
- (a) All circulars, regulations, and rulings issued by the Bureau of the Fiscal Service that implement, through the exercise of the general borrowing power, the fiscal policies of the United States.
 - (b) Regulations issued by the Office of Foreign Assets Control (OFAC) that implement the President's foreign policy by blocking assets and imposing sanctions on foreign countries or persons, and general and specific licenses issued by OFAC.
 - (c) Regulations concerning the review of transactions by the Committee on Foreign Investment in the United States.
 - (d) Treasury regulations concerning the periodic reporting of portfolio capital positions and transactions pursuant to the International Investment and Trade in Services Survey Act and the Bretton Woods Agreement Act, and the reporting of foreign currency positions of large U.S. business enterprises and their foreign affiliates pursuant to 31 U.S.C. § 5315.



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- (e) U.S. Customs and Border Protection regulations restricting the importation of particular articles.
 - (f) Alcohol and Tobacco Tax and Trade Bureau regulations concerning the establishment or designation of geographical viticultural areas.
8. This MOA will have immediate effect, except that paragraph 2(b) will take effect on the earlier of 12 months from the date of this Agreement or when Treasury obtains reasonably sufficient resources (with the assistance of OMB) to perform the required analyses. Until the effective date of paragraph 2(b), Treasury will provide OIRA with Treasury's economic analysis (rather than full Regulatory Impact Analysis) and provide notification pursuant to paragraph 3.
9. Treasury and OIRA will work in good faith to ensure the practices under this MOA conform to the intent of the signatories.

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Date: April 11, 2018