Background on State Tax Cut Provisions in The American Rescue Plan Act
March 22, 2021

This issue brief addresses language in the American Rescue Plan Act of 2021 (ARPA) (H.R. 1319, Pub. Law 117-2) concerning whether a state may reduce its net tax revenue without forfeiting any ARPA funds and associated questions. That language provides that states "shall not use the funds to either directly or indirectly offset a reduction in the net tax revenue."

Please see the Congressional Research Service report for information about the law and a list of additional sources.

ARPA funds for states and territories

ARPA appropriates $192 billion to states and territories (the entire appropriation is about $350 billion and includes localities) for broad, enumerated uses.

ARPA allows state and local recipients to use the funds to cover costs incurred by Dec. 31, 2024, (The covered period is the *earlier* of December 31, 2024 and when all federal funds are expended.) to—

- Respond to the Covid-19 emergency and address its economic effects, including through aid to households, small businesses, nonprofits, and industries such as tourism and hospitality;
- Provide premium pay to essential employees or grants to their employers. Premium pay must not exceed $13 per hour or $25,000 per worker;
- Provide government services affected by a revenue reduction during the pandemic; and
- Make investments in water, sewer, and broadband infrastructure.

The funds must not be deposited into any pension fund.

ARPA does not allow a state or territory to use ARPA funds to offset the cost of a net tax decrease. The full text of this language is —

> *The states and territories "shall not use the [ARPA] funds to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a*

rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase"[1]

The Treasury Department has not yet indicated when regulations under these provisions will be issued. According to reporting from Bloomberg and Law360 on March 18, 2021, during a March 18th phone briefing, a Treasury spokesperson was asked how the Department will enforce the law if states shift money within their budgets. The spokesperson said the agency is in the process of drafting rules that will explain how the restrictions work. The spokesperson also implied that states can indeed cut taxes, but not with federal ARPA funds.[2]

The states must make periodic reports to the Treasury Department to explain how they have used the funds. The remedy for a state that directly or indirectly uses ARPA funds to decrease taxes is that the state must repay the Treasury the amount of the tax reduction. A Treasury spokesperson said that the department will examine state expenditures of funds and tax measures closely.

Procedural history

- According to a March 17th New York Times article, the provision was amended at the last hour without debate.[3] Senator Mike Crapo (R-Id.) introduced an amendment to strike the provision, but his amendment was not brought to a vote.[4]
- The successful no-tax-cut amendment was sponsored by Majority Leader Schumer and co-sponsors Sens. Wyden, Murray, Brown, Peters, Cardin, Cantwell, Stebenow, Tester, Menendez, Schatz, Carper, Leahy, and Sanders.[5]

Opposition to the limit on state tax cuts

U.S. Senator Crapo introduced S. 743 on March 15th to reverse the ARPA language disincentivizing states from lowering their net taxes. The bill text will be available this week.

According to an article in the *Arizona Mirror*, Arizona Governor Ducey (R) campaigned on a platform to reduce the state income tax to as close to zero as possible and is advocating for $600 million in tax cuts during the 2021 session.[6] Arizona's share of the ARPA funds will be at least $12.2 billion. Governor Ducey maintains that the prohibition on tax cuts is an unconstitutional usurpation of state tax authority. Many governors and politicians share his view.

Twenty-one Republican attorneys general (AGs) sent a letter last week to Treasury Secretary Yellen stating that the prohibition is unconstitutional and that she must issue a clarification by March 23, 2021 that the provision does not prohibit a state from using its own funds to reduce taxes. The letter states

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[1] H.R. 1319, Pub. Law. 117-2, sec. 9901, adding sec. 602(c)(2)(A) to the Social Security Act (42 U.S.C. sec. 801 et seq.).

[2] Taxpayer Groups Worry How Stimulus Will Impact Tax Cut Plans, Bloomberg Daily Tax Report, March 18, 2021; NJ Gov. Says Fed. Virus Relief Likely Won't Curb State Tax Breaks, Law 360 Tax Authority, March 18, 2021.

[3] Biden Administration Faces Legal Fight Over State Aid Restrictions on Tax Cuts, New York Times, March 17, 2021.

[4] H.R. 1319 sec. 602 was amended on March 5, 2021 on the Senate floor by S. Amdt 891, introduced as SA 1398, which is found on page 1401 of the Congressional Record of March 5, 2021.

[5] Ibid.

[6] GOP lawmakers, Ducey not deterred on cutting taxes if they take federal COVID cash, Arizona Mirror, March 18, 2021.

that absent such assurance these AGs will "take appropriate additional action to ensure that our States have the clarity and assurance necessary to provide for our citizens' welfare through enacting and implementing sensible tax policies, including tax relief." The letter is signed by the attorneys general of Arizona, Alabama, Idaho, Kentucky, Missouri, Oklahoma, Texas, Georgia, Arkansas, Indiana, Louisiana, Montana, South Carolina, Utah, West Virginia, Florida, Kansas, Mississippi, Nebraska, South Dakota, and Wyoming.

Ohio Attorney General Dave Yost has chosen to not wait until March 23rd. He filed a motion for preliminary injunction on March 17th in U.S. District Court of Southern Ohio arguing that the provision exceeds Congress' authority. Among other arguments, the motion points out that the provision "allows Congress to quietly impose its preferred tax policies without having to pay the full political price for doing so."

The AGs argue in their letter that Treasury guidance allowing the effective prohibition of tax cuts would usurp half of each state's fiscal ledger (i.e., the revenue half) and prohibit tax cuts of any stripe, including—

- A Georgia bill that would extend a tax credit for families who adopt a child out of foster care;
- An Alabama bill that would allow tax exemptions for organizations that provide care for the sick and terminally ill;
- A Kansas bill to decouple from the Internal Revenue Code to end a state-level income tax increase caused by pass-through changes from prior federal tax law revisions; and
- A Montana bill to increase its current education tax credit for families.

The AGs also argue in their letter that none of these common changes to tax policy has any real or direct connection to states' potential receipt of COVID-19 relief funds, yet each change could be deemed a tax "rebate," "credit," or "otherwise" that could result in a "reduction in the net tax revenue" of the state.

The AGs make the point, among others, that a financial inducement must not be so coercive as to pass the point at which "pressure turns into compulsion." *South Dakota v. Dole*, 483 U.S. 203, 207-208 (1987).

Our analysis of the relevant ARPA language indicates that a state would not lose its entire ARPA funding in the event of Treasury guidance adverse to these states, only that portion that is directly or indirectly used to offset a net decrease in revenue through state action. In other words, a state would lose ARPA funding in direct proportion to the amount of its net revenue decrease. A state may choose to reduce net revenue; it would simply give up some of its ARPA funds in that event.

United States House Ways and Means Committee Ranking Member Kevin Brady and members of the committee issued their own letter to support a narrow interpretation of the provision by Treasury. Their questions illustrate what they believe are the vagueness and unanswered questions in the provision. For example, they ask: "If a state decided to align with the federal tax treatment of PPP loan forgiveness by excluding that amount from gross income, would it violate the restriction in ARP?" They also assert that the provision violates the Tenth Amendment.

A partner at McDermott Will & Emery told Law360 that his firm has been asked to look into whether taxpayers have a private right of action against the provision.[7]

Some reporting indicates that state revenues have bounced back from lows during the early part of the pandemic, but cities continue to face budget challenges in large part due to reduced property taxes on account of empty office buildings.[8]

The Biden Administration is not backing down in the face of opposition. The president said on March 17th that the restriction on how states can use their federal funds is constitutional and that state and territorial governments should not use stimulus money meant to combat the corona virus crisis to subsidize tax cuts.[9]

Treasury spokesperson Alexandra LaManna also said on March 17th that, "It is well established that Congress may establish reasonable conditions on how states should use federal funding….Those sorts of reasonable funding conditions are used all the time—and they are constitutional." She continued, "The law does not say that states cannot cut taxes at all, and it does not say that if a state cuts taxes, it must pay back all of the federal funding it received. It simply instructed them not to use that money to offset net revenue lost if the state chooses to cut taxes. So, if a state does cut taxes without replacing that revenue in some other way, then the state must pay back ... funds up to the amount of the lost revenue."[10]

Some considerations—

- The earlier CARES Act (H.R. 748, Pub. Law 116-136) did not have a similar prohibition of tax cuts.

- The anti-commandeering doctrine may apply here. Under this judicial doctrine, Congress cannot directly compel a state political branch to perform regulatory functions on the federal government's behalf.[11] In *Murphy v. Nat'l Collegiate Athletic Ass'n*, 505 U.S. 144 (2018) the U.S. Supreme Court held that a federal statute prohibiting state authorization of sports gambling schemes violates the anti-commandeering rule. "Congress may not simply 'commandeer the legislative process of the States by directly compelling them to enact and enforce a federal regulatory program.'" *Murphy*, citing *New York v. United States,* 505 U.S. 144, 161. MTC staff will undertake further analysis.

  MTC staff will continue to research this issue. We will include additional events and analyses as they happen in our Tuesday legislative newsletters. Please direct any comments or inquiries to MTC legislative advisor Thomas Shimkin, at 202-302-9976 or Tshimkin@mtc.gov.

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[7] GOP AGs Ask Treasury To Not Use Virus Bill To Curb State Tax Cuts, Law360 Tax Authority, March 17, 2021

[8] Empty Office Buildings Squeeze City Budgets as Property Values Fall, New York Times, March 3, 2021.

[9] Biden Administration Faces Legal Fight Over State Aid Restrictions on Tax Cuts, New York Times, March 17, 2021.

[10] *Id.*

[11] Congressional Research Service, May 16, 2018, *The Supreme Court Bets Against Commandeering: Murphy v. NCAA, Sports Gambling, and Federalism*.