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Honorable Janet Yellen
Secretary of the Treasury
1500 Pennsylvania Avenue N.W.
Washington, DC 20220

Re: Request for Guidance on Treasury Department Interpretation of American Rescue Plan Act State Tax Cut Provision, and Request for Timeline

Dear Secretary Yellen,

I write to request that your office provide public guidance as quickly as possible interpreting a recently enacted provision requiring the clawback of relief funds provided to states who subsequently enact tax reductions or delays.

On March 11, 2021, President Biden signed the American Rescue Plan Act of 2021 (ARPA) into law, and Subtitle M, Section 9901 amends 42 U.S.C. § 602(c)(2)(A) to read:

> In general.—A State or territory shall not use the funds provided under this section or transferred pursuant to section 603(c)(4) 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.

This provision is ambiguous:

- Some read it as a complete ban on state tax cuts through 2024. For example, the *New York Times* reported Senator Joe Manchin (D-WV) as pushing for

the language because he believes "states should not be cutting taxes at a time when they need more money to combat the virus. He urged states to postpone their plans to cut taxes." Alan Rappeport, "A Last Minute Add to Stimulus Bill Could Restrict State Tax Cuts," *New York Times* (Mar. 12, 2021), https://www.nytimes.com/2021/03/12/us/politics/biden-stimulus-state-tax-cuts.html.

- Some read it as allowing states to cut taxes but only on condition of surrendering aid dollar-for-dollar. For example, Nicholas Johnson of the Center on Budget & Policy Priorities (CBPP) writes, "It says they can't use federal dollars to do that, either directly or indirectly. If a state chooses to enact a net tax cut, it will forgo the equivalent amount of federal aid provided through the Act's Coronavirus State Fiscal Recovery Fund." Nicholas Johnson, "Rescue Plan Protects Against Using Federal Dollars to Cut State Taxes," CBPP (Mar. 11, 2021), https://www.cbpp.org/blog/rescue-plan-protects-against-using-federal-dollars-to-cut-state-taxes.

- A third reading was provided by your office on March 23, 2021, in a letter to Arizona Attorney General Mark Brnovich, in which you state that the provision "simply provides that funding received under the Act may not be used to offset a reduction in net tax revenue resulting from certain changes in state law. If States lower certain taxes but do not use funds under the Act to offset those cuts—for example, by replacing the lost revenue through other means—the limitation in the Act is not implicated."

Five lawsuits have been filed challenging the provision. On March 17, the State of Ohio filed in federal court seeking a preliminary injunction restraining the provision from going into effect. On March 25, Arizona filed suit in federal court against the Treasury Department, seeking a declaratory judgment that the provision is unconstitutionally vague in violation of the Due Process Clause and unconstitutionally coercive in violation of the Tenth Amendment. On March 29, Missouri filed suit in federal court, asking for a narrowing interpretation of the provision, or alternatively, its invalidation as ambiguous and beyond Congress's power. On March 31, 13 states filed suit in the U.S. District Court for the District of Alabama, seeking a declaratory judgment that the condition on federal funds is ambiguous, unrelated to the purpose of the federal grant, and amounts to coercion in violation of the Spending Clause and the Tenth Amendment; and that the congressional adoption of mandatory state tax policy amounts to federal coercion of the states in violation of the Tenth Amendment. On April 6, Kentucky and Tennessee filed suit in federal court seeking an injunction against the provision, on grounds that the condition is unconstitutionally ambiguous, not reasonably related to the purpose of the Act (and in fact works against the COVID-19 relief purposes of the Act), is coercive, and violates the anti-commandeering doctrine.

In Congress, several bills have been introduced to repeal the provision: S. 730 by Sen. Mike Braun (R-IN), S. 743 by Sen. Mike Crapo (R-ID) and ten others, H.R. 2002 by Rep. Dan Bishop (R-NC) and 40 others, and H.R. 2189 by Rep. Kevin Brady (R-TX) and 23 others.

Additionally, I and others have been in touch with officials in multiple states as they struggle to understand how this provision might affect pre-existing, planned, and future state tax policy changes. Questions have included whether states would have to forfeit relief funds if used to replenish depleted unemployment insurance trust funds where a side effect would be to prevent otherwise automatic tax increases on employers; whether a state could use relief funds to match the federal government's recent policy decision to exempt from tax the first $10,200 in unemployment benefits for each recipient; whether other conformity or correction provisions that may have incidental but negative effects on state tax revenue trigger the provision's clawback; whether the delay of a tax increase enacted, not yet effective, but now not needed to address a budget shortfall triggers the provision; baseline questions; and questions of the breadth of the word "indirectly."

Needless to say, immediate and detailed guidance by your department could moot all of this speculation and provide much-needed clarity. We are encouraged by the Department's position in the letter of March 23 and promise of future guidance, as it is narrower and clearer than the interpretations put forward in the *New York Times* article or by CBPP. It also matches what we have heard from Members of Congress that the intent of the provision was not to prevent states from setting their tax policy, so long as ARPA funds were not directly used.

We believe that Treasury Department guidance would build upon this and clarify several outstanding matters:

- The guidance should make clear **what baseline** the Treasury Department will use to determine if there has been a "reduction in net tax revenue." The formula presumably would be the snapshot of current tax revenues or a projection of future tax revenues as compared to tax revenues at a time in the past. States vary greatly in their capacity and practice of projecting tax revenues, and methodologies vary greatly between states. One intent of ARPA relief funds is to backfill state budgets for pandemic-related revenue losses, so any baseline above the pandemic revenue low point (not counting federal aid) would prevent ARPA funds from being used as intended. The provision should also not preclude reductions of certain taxes where overall state revenues have not fallen below the pandemic low.

- The guidance should make clear **who** will determine whether a reduction has occurred. The Treasury Department does not currently monitor state tax revenues or revenue projections. The U.S. Census Bureau does collect this

information drawn from submissions by state authorities, but on a great time lag. Other organizations, such as the National Conference of State Legislatures or the National Association of State Budget Officers, rely on submissions from state authorities. Since none of these existing data sources is sufficient to establish an accurate baseline in a timely fashion, the Treasury Department should rely on certifications from appropriate state authorities as the mechanism of determination.

- The guidance should state that **previously enacted, announced, or introduced** tax law changes prior to March 11, 2021 should not be subject to the provision. It is logical that a state is not using ARPA funds to offset tax reductions if the reductions were in the works prior to ARPA.

- The guidance should provide that state tax cuts that **conform to CARES or ARPA or federal law generally**, or **state tax cuts that further ARPA objectives** are not subject to clawback. If a state conforms to the federal government's new exclusion of unemployment benefits from income tax, or enacts tax incentives to spur rehiring or retraining of employees, or provides assistance to individuals or businesses similar to the assistance programs in ARPA, such assistance that furthers ARPA goals should not be precluded. For example, replenishing a state's unemployment trust fund reserves so as to keep paying out benefits and effectively reimburse for past benefits paid out, should be specifically excepted even where an ancillary result will be preventing an otherwise automatic tax increase on business payrolls precisely at the worst economic moment. Avoiding these tax increases is consistent with the purpose of ARPA.

- The guidance should exclude state tax changes that result from a **court-ordered refund or invalidation of state law**. Maryland, for instance, has enacted a digital advertising tax that is likely violative of the federal Internet Tax Freedom Act (ITFA) and several constitutional protections. If a court ultimately invalidates an enactment, the "loss" of that revenue should not subject a state to clawback.

- The guidance should **specify the action the Treasury Department will take** if it determines a state is violating the ARPA provision, including the process it will use in making that determination and whether the remedy the Department will seek is the forfeiture of all ARPA funds or only a portion of funds relative to the amount found to be impermissible tax cuts. Forfeiture of all ARPA funds would likely be held to be unconstitutionally beyond Congress's spending power. *See, e.g.*, *NFIB v. Sebelius*, 567 U.S. 519 (2012) (invalidating a congressional condition that forfeited all Medicaid funds); *South Dakota v. Dole*, 483 U.S. 203 (1987) (upholding a congressional condition that forfeited 5 percent of transportation funds). The process for

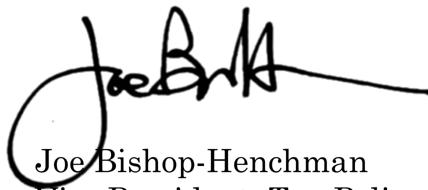
clawing back funds should include the ability for states to receive advance verification that a tax proposal would not subject them to clawback. The process should also include a dispute resolution mechanism in addition to expedited court remedies.

- Generally, guidance should **specify that "directly or indirectly" in the statute is limited and narrowly construed**, with "directly" meaning legislation that directs the use of ARPA funds for tax reductions, and "indirectly" meaning legislation spending ARPA funds and legislation reducing taxes passed simultaneously to obviously be connected. Treasury should make clear that "indirectly" does not mean attenuated links of causation that would encompass all state tax policy. A broad interpretation of "indirectly" would, because of the inherent fungibility of funds in state budgets, likely result in the statute being held to be unconstitutionally coercive.

Due to the statute's ambiguity, a lack of clear guidance will likely result in protracted and expensive litigation across the country with the ultimate result of the entire ARPA provision being invalidated as vague. *See, e.g.*, *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981) ("[I]f Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously."); *Connally v. General Construction Co.*, 269 U.S. 385 (1926) ("[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process of law."). Every day that passes without this guidance, as state legislatures meet and taxpayers fill out their tax returns, is a day imposing enormous costs on millions of Americans. The promise made in your previous letter that states would have guidance prior to certification is helpful, but states and taxpayers would benefit from a more definite time frame. We would be grateful for immediate direction from your office regarding the projected timeline of any future guidance.

We welcome the opportunity to discuss these concerns with you further. I can be reached at jbh@ntu.org or (202) 766-5019.

Respectfully submitted,



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