taxnotes® state

Volume 102, Number 5 ■ November 1, 2021

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Reprinted from *Tax Notes State*, November 1, 2021, p. 515

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In this article, Salis explores why many states are still struggling to catch up to their pre-COVID-19 budget levels while others are staying ahead.

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It is a well-established historical fact that the road to economic recovery and growth after a crisis is generally muddled with broad legal challenges and local economic adjustments. This is particularly so in our current polemical and partisan environment. Although several states are recovering from the COVID-19 pandemic at an unexpected pace, many others struggle to catch up to their pre-pandemic budget levels. However, some states still have budgetary hurdles to overcome and continue to rely on the federal government's support to fill those fiscal gaps until their local and regional recovery is firmer and economic growth ensues.

The Coronavirus State Fiscal Recovery Fund Launched by ARPA

On March 11 the American Rescue Plan Act of 2021[1] created a state and local recovery fund to be applied over the next four years to cover the costs of the continuing COVID-19 crisis, comprising $350 billion in fiscal relief support for states, territories, tribal governments, counties, cities, and smaller municipalities. The funds are primarily intended for wide-ranging use to cover the costs of the pandemic crisis and provide ample support for states and municipalities. $195.3 billion in assistance is projected to help states recover from the economic downturn. Under ARPA:

> The funding was intended to "provide needed relief to state, local, and Tribal governments to enable them to continue to support the public health response and lay the foundation for a strong and equitable economic recovery."

Further, it aims to support state governments in tackling the costs and revenue losses they experienced because of the economic recession. It also supports state, local, and tribal governments' crucial investments in infrastructure and public services. For some states, this creates a dilemma between accepting the ARPA funds or providing tax cuts or other offsets for taxpayers, including small and medium-size enterprises, already hard-hit by the COVID-19-related recession.

However, although ARPA contains a healthy, broad menu on the eligible state uses of recovery funds, Congress affixed some critical conditions and constraints on the "utilization" of these funds. Principally, one drawback (among other

[1] American Rescue Plan Act of 2021, P.L. 117-2, section 9901 (codified at 42 U.S.C. sections 802-805).

restrictions) is section 9901, which provides that states and territories cannot "either directly or indirectly offset a reduction in their net tax revenue resulting from a change in law, regulation, or administrative interpretation that reduces 'any tax' or delays the imposition of any tax or tax increase." This implies that during the next four years, state and local governments cannot use or apply any COVID-19 relief funds for the purpose of reducing taxes, in any form. Further, the federal government can demand the return of the used funds (clawback), up to the amounts of lost revenue, should any state improperly use the funds to offset tax revenue, and so forth.

Ohio v. Yellen

Within days of ARPA's passage, on March 16, 21 state attorneys general sent a letter[2] to U.S. Treasury Secretary Janet Yellen requesting clarification regarding section 9901. The attorneys general contended that this section, which they termed the "tax mandate," which restricts the application of federal funds for offsetting or reducing state net tax revenue or for other tax relief measures, could be broadly construed as a federal intervention of state sovereignty in setting its own tax policy. Yellen responded to the attorneys general by stating that "it is well established that Congress may place such reasonable conditions on how States may use federal funding," and that although the preventive provision forbids ARPA funds from being applied to offset revenue reductions caused by specific changes in state law, it does not "deny States the ability to cut taxes in any manner whatsoever."[3]

Thereafter, Ohio's attorney general filed a lawsuit,[4] petitioning the federal district court for injunctive and declaratory relief for Ohio. Later, Alabama, Alaska, Arkansas, Arizona, Florida, Iowa, Kansas, Kentucky, Missouri, Montana, New Hampshire, Oklahoma, South Dakota, South Carolina, Tennessee, and Utah also filed suit.[5] Twenty in all have filed so far, and perhaps others may still join. Nonetheless, on May 10 the U.S. Treasury issued guidance on the "interim final rule"[6] for establishing a Coronavirus State Fiscal Recovery Fund framework, allocating $219.8 billion for determining eligibility and the use of funds for state, local, and tribal government programs and services. The rule became effective May 17.

In her response letter to the attorneys general, Yellen argued that the tax mandate is a "straightforward exercise" of Congress's authority that "preserves its control over the use of federal funds."

Federal courts in Ohio and Missouri have since denied the injunctions. Although the lawsuit can proceed in Ohio, the U.S. District Court for the Eastern District of Missouri dismissed the case outright on essential procedural grounds.

At the Heart of the Matter — The Tax Mandate

At the center of the controversy is a crucial question generally found in cases involving the federal spending clause, which grants Congress the power to "lay and collect Taxes, Duties, Imposts, and Excises, to pay the Debts and provide for the Common Defence and the general Welfare of the United States."[7] The centuries-old enduring debate involves the scope of Congress's spending authority and the meaning of the term "general welfare." This case is no exception. The central questions in the instant cases are whether the restrictive section 9901 provision (tax mandate) constitutes or can be construed as interference with the tax policy rights reserved to states, thereby obstructing the states (10th Amendment), and whether the spending clause of the Constitution can authorize Congress to attach controlling conditions to the ARPA funds directly.

[2] Offices of the Attorneys General of Georgia, Arizona, and West Virginia, letter to Treasury Secretary Janet Yellen, "Re: Treasury Action to Prevent Unconstitutional Restriction on State's Fiscal Policy Through American Rescue Plan Act of 2021" (Mar. 16, 2021).

[3] Treasury, letter to Attorney General Mark Brnovich from Treasury Secretary Janet Yellen (Mar. 23, 2021).

[4] *Ohio v. Yellen*, Case No. 1:21-cv-181 (S.D. Ohio May 12, 2021).

[5] *Missouri v. Yellen*, Case No. 4:21CV376 HEA (E.D. Mo. May 11, 2021); *State of Arizona, v. Yellen*, CV-21-00514-PHX-DJH (D. Ariz. July 22, 2021); *Texas v. Yellen*, No. 2:21-cv-00079-Z (N.D. Tex. May 3, 2021); *West Virginia v. U.S. Department of Treasury*, No. 7:21-cv-00465 (N.D. Ala. Mar. 31, 2021); and *Kentucky v. Yellen*, No. 3:2021-cv-00017 (E.D. Ky. Apr. 6, 2021).

[6] Coronavirus State and Local Fiscal Recovery Funds, Interim Final Rule, 31 CFR part 35, RIN 1505-AC77 (2021).

[7] U.S. Const. Art. I, section 8, cl. 1.

Consequently, the states argue that Congress has no direct authority to "require the States to govern according to Congress['s]" chosen tax regime, and that although the spending clause of the Constitution authorizes Congress to "provide for . . . the general Welfare," Congress may not use its influence under the spending clause to coerce or compel the states to adopt Congress's tax preferences. By doing so, they argue, Congress is coercing the states into accepting an intrusion on their sovereign authority as a condition for accepting vital federal funds. Thus, the states continue to assert that they are being held "hostage" by Congress, as the relief funds are badly needed.

Despite the recent dismissal, the ARPA funding dispute continued in federal courts, with other lawsuits still undecided. However, on July 1 Judge Douglas Cole of the U.S. District Court for the Southern District of Ohio ruled for Ohio's attorney general and the plaintiff states, finding that:

- it has jurisdiction;
- Ohio met its burden of establishing that the tax mandate, because of its ambiguity, exceeds Congress's authority under the spending clause; and
- Treasury's interim final rule does not cure that constitutional violation.

Moreover, according to the attorney general and the court, Ohio is suffering irreparable harm because of that violation. Accordingly, the court permanently enjoined the U.S. Treasury from enforcing the tax mandate against Ohio.[8]

From Another Perspective

Notwithstanding the fundamental constitutional dispute at hand, delays in providing critical support and economic relief to states and municipalities can be disruptive to broader relief efforts. If left unresolved for long, this contrived dispute may rapidly develop into a quandary for states. It could force them to choose between post-pandemic, deficit-induced tax and spending cuts to support taxpayers and spread economic support versus the inevitability of tax base expansion financed through (subsequent) tax increases, furthering the prevention of "real-time" local economic growth. Not all state economies are in the same position, and significant disparity remains between them. Should the constitutional conflict be flexibly resolved based on a dynamic need-based adjustment approach to each locality, actual progress can be made, and recovery sustained toward eventual growth.

Recent crises and recessions have revealed that fluctuations in the amount of relief (stimulus) revenue and subsequent changes in local tax policy can influence business and economic activity. Whether those implications have a progressive, long-term growth effect, or lead to a contraction of the same, is the real question. From a pragmatic economic perspective, any unnecessary lag in funding and resource support can quickly become a barrier to recovery and hinder local economic development and eventual expansion. Much remains at risk at this crucial moment of revitalization. Although restoration and improvement are well underway, and many states closed 2020 with revenue gains,[9] with most "flush with federal cash,"[10] the public health threat is not entirely over.

But then, another twist: On August 11 the U.S. Senate endorsed easing the state and local tax deduction cap in exchange for revoking the ARPA tax mandate, eliminating some tax cut limits, and rescinding the provision that would claw back COVID-19 relief funds from states if they use the money to cut taxes.[11] Senators voted 86 to 13 to get rid of the provision; Senate doyens speculate that this bargaining chip was timely, given the legal standing of the challenges against the tax mandate provision. Consequently, the following day, Kentucky and Tennessee petitioned for a permanent bar on the same constitutional grounds as Ohio, and on September 27 the federal

[8] *Ohio v. Yellen*, Case No. 1:21-cv-181.

[9] Barb Rosewicz, Justin Theal, and Alexandre Fall, "States Close Out 2020 With Widespread Tax Revenue Gains," Pew Charitable Trusts (July 27, 2021).

[10] Amanda Albright and Danielle Moran, "Billions From Biden Aid Plan Left Untapped by Cash-Flush States," *Bloomberg*, Aug. 17, 2021; *see also* Reid Wilson, "States Now Flush With Cash After Depths of Pandemic," *The Hill*, May 2, 2021.

[11] Maria Koklanaris, "Senators Endorsed Easing the SALT Cap in Exchange for Revoking the ARPA Tax Mandate, Some Tax Cut Limits," *Law360*, Aug. 11, 2021.

court held in favor of the states and that Tennessee and Kentucky may use and distribute the funds from ARPA "as they deem necessary."[12]

Nevertheless, from a fiscal policy perspective, it is refreshing and "stimulating" to read Judge Gregory F. Van Tatenhove's judgment in this case. He accurately reminds us that the "old conversation between Thomas Jefferson and Alexander Hamilton" regarding the mutual obligation of state and federal (intergovernmental) trust remains not only valuable and relevant, but also perhaps even more essential in these times of uncertain "political economy," especially today in the near-post-COVID-19 era. His excerpt:

> Out of all of the powers reserved to the States, there is no power more central to a state government's sovereignty than the power to tax, *Dep't of Revenue v. ACF Indus., Inc.*, 510 U.S. 332, 345 (1994), which the Supreme Court, long ago, recognized as "indispensable to [the States'] existence." *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 199 (1824).
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> In fact, the "power of self-government . . . cannot exist distinct from the power of taxation." *Providence Bank v. Billings*, 29 U.S. (4 Pet.) 514, 546, 548 (1830).[13]

We would do well to keep these worthy notions in mind and apply them in the near future. Still, little has been resolved on the constitutional question, and the controversy continues. ■

[12] *Kentucky v. Yellen*, No. 3:2021-cv-00017, document 42 (E.D. KY. Sept. 24, 2021).

[13] *Commonwealth of Kentucky v. Yellen*, No. 3:2021-cv-00017-GFVT, Opinion & Order (E.D. Ky. Apr. 6, 2021), at 1 and 12.