SALT IN THE WOUNDS: ISSUES AND SOLUTIONS SURROUNDING THE TCJA SALT DEDUCTION CAP

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I. INTRODUCTION

"The United States Senate just passed the biggest in history Tax Cut and Reform Bill. Terrible Individual Mandate (ObamaCare)Repealed [sic]. Goes to the House tomorrow morning for final vote. If approved, there will be a News Conference at The White House at approximately 1:00 P.M."[1] And with a tweet, sent out shortly after 1:00 a.m., Donald Trump announced one of the most expansive legislative enactments of his presidency thus far, tax legislation informally known as the Tax Cuts and Jobs Act (the "TCJA"). This enactment would be the first major change to the tax code since the Tax Reform Act of 1986.[2]

Unlike most tax bills, the TCJA made its way through both the House of Representatives (the "House") and the Senate at near record speed, with its referral to the House Committee on Ways and Means on November 2, 2017,[3] and its signature into law on December 22, 2017.[4] Its meteoric rise left most taxpayers and members of Congress completely in the dark as to the impact these reforms would have, both on those paying the tax and the national government relying on the tax revenue. Time has also failed to further elucidate the short- and long-term impacts these changes will have. Nowhere, however, is this uncertainty as compelling as with the amendments to the state and local tax ("SALT") deductions.[5]

This Comment will examine the new SALT deduction cap and its impact. In light of the potential consequences, it will argue that changes to

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1 Donald J. Trump (@realDonaldTrump), TWITTER (Dec. 20, 2017, 1:09 AM), https://twitter.com/realdonaldtrump/status/943362605258813441.

2 *See infra* Part III.

3 Tax Cuts and Jobs Act, H.R. 1, 115th Cong. (2017).

4 An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054, 2054 (2017) [hereinafter Tax Cuts and Jobs Act].

5 Tax Cuts and Jobs Act, *supra* note 4, at 2085–86.

the new SALT amendments are necessary. Because the attempts being made by various states to circumvent the law are likely to fail, the best alternative is amendment of the Internal Revenue Code ("IRC" or "the Code"). Instead of just applying a blanket cap of $10,000 on all SALT deductions, the deduction should instead phase out based on the taxpayer's adjusted gross income ("AGI") to the capped deduction of $10,000. Part II will provide background on deductions generally and the SALT deduction specifically. Part III will look at the differences between the new and the old deduction and examine the legislative intentions behind each. Part IV will look at the potential and current impact of the cap on taxpayers, states, and businesses. Part V will examine the various legislative workarounds that high-property-value states have enacted to lessen the impact on their taxpayers through legislation. Part VI will examine the lawsuit that high-property-value states have filed against the Secretary of the Treasury to invalidate the provision. Part VII, considering the likely impact of the cap and the remote chance that any other attempt at reform will affect the Code, will propose a more equitable reformation of the current tax code that will not hurt certain geographic areas the way the current law does. Finally, Part VIII will conclude.

II. BACKGROUND

Under the United States' progressive income tax system, taxes are computed as a graduated percentage of individual's taxable income at increasing rates.[6] Taxable income comprises the taxpayer's gross income less applicable deductions.[7] This taxable income is then taxed at "increasing marginal rates of tax; for example, 10% on the first $10,000 of taxable income, 15% on the second $10,000, 30% on the third $10,000, and so forth."[8] The resulting amount, less any credits the taxpayer may have, is his or her tax obligation.[9] Deductions function to lower the taxpayer's taxable income, and thus his or her overall tax obligation.[10]

"Above-the-line" deductions are subtracted from gross income to reach the taxpayer's AGI.[11] Common "above-the-line" deductions include student loan interest[12] and trade or business expenses.[13] These deductions

6 STAFF JOINT COMM. ON TAX'N, 115TH CONG., OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2018 3 (Comm. Print 2018) [hereinafter "JCT Overview"].

7 *Id.*

8 Martin J. McMahon, Jr. & Alice G. Abreu, *Winner-Take-All Markets: Easing the Case for Progressive Taxation*, 4 FLA. TAX REV. 1, 12 n.31 (1998).

9 JCT Overview, *supra* note 6, at 3.

10 *Id.*

11 26 U.S.C. § 62(a) (2018).

12 *Id.* § 221(a).

13 *Id.* § 162(a).

can be taken regardless of whether the taxpayer ultimately utilizes the standard deduction or itemizes "below-the-line."[14]

After determining AGI, the taxpayer can take a "below-the-line" deduction, in addition to "above-the-line" deductions.[15] The first option for the taxpayer's "below-the-line" deduction is the standard deduction, which is an applicable standard amount that corresponds to the taxpayer's filing status.[16] In 2018, for those "filing single" the deduction was $12,000.[17] For "married, filing jointly" the deduction was $24,000.[18] For "married, filing separately" the deduction was $12,000.[19] Finally, for "head of household" the deduction was $18,000.[20] For every filing status, these deductions are almost a twofold increase over the prior year's standard deduction amounts.[21]

The other option for the taxpayer's "below-the-line" deduction is to itemize personal deductions, which allows the taxpayer to add together certain qualifying expenses, such as charitable contributions,[22] medical expenses,[23] state income and property taxes,[24] and mortgage interest[25] and deduct this amount from his or her AGI. Certain deductions have floors, which means that only the excess over a set percentage of the taxpayer's AGI is deductible.[26] Others have ceilings, which limit the amount that can be taken to a percentage of the taxpayer's AGI.[27] Taxpayers may take either the standard deduction or they may itemize, but not both.[28] The determination will turn on whether the taxpayer's allowable itemized

[14] JCT Overview, *supra* note 6, at 4.
[15] *Id.*
[16] *Id.*
[17] 26 U.S.C. § 63(c)(7).
[18] *Id.*
[19] *Id.*
[20] *Id.* § 63(c)(2)(A).
[21] *Id.* § 63(c)(2).
[22] *Id.* § 170 (allowing deduction of contributions to qualifying charitable entities but limited to a percentage of the taxpayer's AGI depending on the character of the contribution).
[23] 26 U.S.C. § 213 (allowing deductions for qualifying expenses in excess of 10% of AGI as of January 1, 2019).
[24] *Id.* § 164 (allowing up to a $10,000 deduction for state property and income taxes paid).
[25] *Id.* § 163 (allowing a deduction for the interest paid on the acquisition indebtedness up to $750,000 for a qualifying residence).
[26] *See, e.g.*, *id.* § 213(a) (floor for medical interest deductions is 7.5% of AGI for 2018 and 10% of AGI thereafter).
[27] *See, e.g.*, *id.* § 170 (allowing a deduction for charitable contributions subject to a ceiling based on the taxpayer's AGI and the type of property donated).
[28] *Id.* § 63(b).

deductions exceed the applicable standard deduction.[29]

The TCJA, with a focus on simplification, has greatly increased the amount of the standard deduction, making it more likely that taxpayers will utilize this method over itemization.[30] Prior to the TCJA, in 2014, thirty percent of taxpayers itemized and the rest took the standard deduction.[31] While the number of taxpayers that will itemize is expected to decrease because of the TCJA, it is still anticipated that around 20.4 million taxpayers will itemize in 2018.[32] Thus, changes to IRC regarding itemization still have the potential to impact many taxpayers.[33]

Under the IRC, by means of the itemized personal deductions discussed above, taxpayers are permitted to deduct expenditures on state and local taxes.[34] These deductions consist of payments to state and local government for real estate and personal property taxes, in addition to either income taxes or general sales taxes, which are "tax[es] imposed at one rate with respect to the sale at retail of . . . items."[35] Most notably, the deduction for these payments is widely taken in states with high income taxes, high property taxes, or both, like New Jersey, New York, Maryland, and Connecticut.[36] The fact that property tax payments in these states are higher means that the itemization of deductions is likely to be greater than the use of the standard deduction for those states' taxpayers. For example, Maryland, New Jersey, Connecticut, and New York came in first, second, third, and thirteenth, respectively, in the nation in the overall percentage of tax returns that itemized in 2005.[37]

While the SALT deduction has long been a part of the IRC, debate continues as to whether the deduction should continue and, if so, whether

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[29] JCT Overview, *supra* note 6, at 4. *See also* 26 U.S.C. § 63(b).

[30] JCT Overview, *supra* note 6, at 4. In addition to increasing the amount the average taxpayer will get to deduct, the new standard deduction provision will allow for greater deductions for the elderly and blind. *Id.* By Joint Committee on Taxation calculations, it will be an additional deduction of $2,600 or $3,200 as applicable for those taxpayer groups. *Id.*

[31] Chenxi Lu, *Itemized Deductions*, TAX POL'Y CTR. (Jan. 27, 2017), https://www.taxpolicycenter.org/publications/itemized-deductions/full.

[32] JCT Overview, *supra* note 6, at 4.

[33] *Id.*

[34] ALAN PRIGAL, 1 RABKIN & JOHNSON, FED. TAX GUIDEBOOK § 1.03 (2019), LexisNexis.

[35] 26 U.S.C. § 164(a) (2018); *see also id.* §164(b)(5)(B).

[36] Scott Ahroni et al., *Congress and the SALT Deduction Past, Present, and Future*, CPA J. (Jan. 2018), https://www.cpajournal.com/2018/01/22/congress-salt-deduction/. *See also* Gerald Prante, *Most Americans Don't Itemize on Their Tax Returns*, TAX FOUND. 1 (July 23, 2007), https://files.taxfoundation.org/legacy/docs/ff95.pdf. This fact will have particular impact on the current legal challenge to the law. *See* discussion *infra* Part VI.

[37] Prante, *supra* note 36, at 1.

full deductibility is still justified.[38] On the one hand, opponents of the SALT deduction's inclusion in the tax code argue that these deductions are really just payments for personal services received and, therefore, should not be deductible.[39] This argument relies on the assumption that those taxpayers in high-tax states are receiving more and/or better services and should have to pay accordingly.[40] There is also the concern that allowing the deduction cuts against the federalist make-up of our government based on the idea that, if states are allowed higher spending through what is essentially a federal subsidy (in the form of this deduction), there will be decreased ability for federal spending.[41] Finally, there is the argument that, as with any deduction, it benefits the wealthy more than any other group of taxpayers.[42] This argument relies on the assumption that those with a greater wherewithal to pay should be taxed accordingly.[43] Therefore, the tax system should target benefits towards those with lower incomes.

On the other side of the debate, proponents of the SALT deduction argue that because these taxes are not really disposable income, disallowing the deduction would equate to double taxation, as taxpayers are being taxed on the same income twice.[44] Additionally, there is the idea, fundamental to the US tax structure, that similarly situated taxpayers should be taxed similarly.[45] If two people in the same income bracket, but in different states, were paying differing amounts of state tax, they would not be taxed similarly. Further, on the other side of the federalism argument entertained by the SALT deduction's opponents, disallowing deductibility would reduce a high-tax state resident's wherewithal to pay high state and local

[38] *See* Brian Galle, *Federal Fairness to State Taxpayers: Irrationality, Unfunded Mandates, and the "SALT" Deduction*, 106 MICH. L. REV. 805, 807 (2008).

[39] *Id.* at 808. *See also* Louis Kaplow, *Fiscal Federalism and the Deductibility of State and Local Taxes Under the Federal Income Tax*, 82 VA. L. REV. 413, 422 (1996) (articulating the view held by some commenters that the more related to services received the more like consumption and, thus, ineligible for a deduction).

[40] Kaplow, *supra* note 39, at 422.

[41] Galle, *supra* note 38, at 809. *See also* Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 UCLA L. REV. 1389, 1411 (2004).

[42] *See* Gladriel Shobe, *Disaggregating the State and Local Tax Deduction*, 35 VA. TAX REV. 327, 335 (2016). The value of a deduction to a taxpayer is the amount times the rate at which their last dollar is taxed. *See* Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept and the Budget Reform Act of 1974*, 17 B.C. INDUS. & COM. L. REV. 679, 693 n.43 (1976). Because higher income will result in the last dollar taxed at a higher amount, the value of the deduction will be higher for those with more income. *See id.* This concept is usually referred to as an "upside-down" subsidy. *See id.*

[43] *See* Surrey & McDaniel, *supra* note 42, at 693.

[44] Ahroni, *supra* note 36.

[45] Galle, *supra* note 38, at 807. *But see* Randall J. Gingiss, *Forcing Tax Fairness in State Taxation*, 33 OHIO N.U. L. REV. 41, 52 (2007) (arguing that fairness cuts the other way and the deduction forces those in low-tax states to subsidize those in high-tax states).

taxes.[46] This deprives the states of revenue and limits their ability to run their governments in a manner of their choosing. In the same vein, it is argued that eliminating the SALT deduction could lead to a less progressive state tax system, as it would inhibit states' ability to tax their very wealthy.[47] Finally, there is the argument that these higher taxes are paid for receipt of services. The counterargument, however, is that those with higher incomes or higher property values living in the same locality as taxpayers with lower income and lower property values receive the same services.[48] Thus, state and local taxes cannot truly be said to be received for services.[49]

Irrespective of which argument is ultimately correct, lawmakers have clearly felt that preserving the deduction serves the aims of taxation, as it has remained an enduring component of the American tax system since the first federal income tax in 1913.[50] To illustrate, in 2015, of the thirty percent of taxpayers that itemized, ninety-five percent of them utilized the SALT deduction.[51] Considering the endurance and importance of this deduction, any change to it merits careful examination for any unintended consequences it may cause, as well as the clear impact it will have on taxpayers and localities.

III. OLD LAW VERSUS NEW LAW

In order to understand the impact of the cap, it is important to first analyze how the TCJA changed the SALT deduction and also the intent behind both the new and the old versions of the SALT deduction. Section A will look at the IRC's treatment of the SALT deduction prior to the TCJA and Section B will examine the legislative intent behind the prior law. Section C will examine the IRC's treatment of the SALT deduction after the TCJA's enactment and Section D will discuss the legislative intent behind the TCJA and the SALT deduction amendment.

A. *Pre-TCJA SALT Deduction*

Formerly, section 164 of the IRC explained that:

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46 Tracy Gordon, *The Price We Pay for Capping the SALT Deduction*, TAX POL'Y CTR. (Feb. 15, 2018), https://www.taxpolicycenter.org/taxvox/price-we-pay-capping-salt-deduction.

47 *Id.*

48 Kaplow, *supra* note 39, at 423.

49 *Id.*

50 Julianna Surane, *Legislative History of The SALT Deduction*, A.B.A. SEC. TAX'N 2018 MID-YEAR MEETING, SAN DIEGO 1–2 (2018), https://www.americanbar.org/content/dam/aba/events/taxation/taxiq/mid18/taxiq-18mid-tps-perspectives-lang-paper.pdf.

51 Lori Robertson, *The Facts on the SALT Deduction*, FACTCHECK.ORG (Nov. 9, 2017), https://www.factcheck.org/2017/11/facts-salt-deduction/.

> [e]xcept as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued: (1) State and local, and foreign, real property taxes. (2) State and local personal property taxes. (3) State and local, and foreign, income, war profits, and excess profits taxes. (4) The [general sales tax] imposed on income distributions. . . .[52]

Personal property taxes are *ad valorem*, meaning those taxes are "based on criteria other than value,"[53] and are imposed on an annual basis in respect to all personal property.[54] State or local taxes are the taxes "imposed by a State, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia."[55]

This section of the Code also provids that taxpayers can deduct state and local sales tax instead of state and local income tax.[56] General sales tax is defined as "a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items," and there is no deduction for sales tax imposed "at a rate other than the general rate of tax" unless there is a lower tax rate in the case of food, clothing, medical supplies, and motor vehicles.[57] Under this regime, there was no strict cap imposed on the amount of such taxes that could be deducted.

B. *Legislative Intent Behind Previous SALT Deduction*

The SALT deduction has been a part of the United States' taxation scheme since the first federal income tax.[58] Even before that, however, the Tariff Act of 1862 imposed a national tax.[59] Intended to finance the Civil War efforts, the Tariff Act of 1862 provided for a tax on income and allowed certain deductions, one of which was for state and local taxes on property and income.[60] In 1913, when the Sixteenth Amendment was ratified, removing the constitutional barrier to the federal income tax, the deductibility of state and local taxes remained.[61] This included federal income tax, state income and property tax, and miscellaneous excises on

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52 26 U.S.C. § 164(a) (2018).

53 7 MERTENS LAW OF FED. INCOME TAX'N § 27:7 (Westlaw 2019) [hereinafter MERTENS].

54 26 U.S.C. § 164(b)(1).

55 *Id.* § 164(b)(2).

56 *Id.* § 164(b)(5)(A).

57 *Id.* § 164(b)(5)(B)–(D).

58 Surane, *supra* note 50, at 2.

59 *Id.*

60 *Id. See also* Daniel Hemel, *The Death and Life of the State and Local Tax Deduction*, 72 TAX L. REV. (forthcoming 2019) (manuscript at 3).

61 *See* Tariff of 1913, Pub. L. No. 63-16, § II (B), 38 Stat. 114, 167 (1913).

liquor, tobacco, gasoline, and sales tax.[62] The deduction for federal income tax was quickly eliminated in 1917, however.[63]

In 1921, the Revenue Act provided for the general deductibility of taxes with a number of exceptions.[64] This broadened the deduction by covering taxes not covered by specific exceptions under the prior regime.[65] Prior to 1942, the states lacked uniformity with regard to taxing methods, as some imposed different mixtures of property, income, and sales taxes.[66] In the 1942 Act, Congress responded to these variations by creating a deduction for state and local retail taxes.[67] Further, with the highest brackets between the years 1942 and 1963 ranging anywhere from eighty-eight to ninety-four percent, the deduction for state and local taxes was thought necessary to prevent taxes "from exceeding 100 percent" of income.[68]

The Revenue Act of 1964 marked the first major, but ultimately unsuccessful, attack on the SALT deduction.[69] It did, however, succeed in limiting the deduction further than any amendment had previously done, as it eliminated the deduction for miscellaneous taxes for excises on liquor and tobacco.[70] Initially, Congress did feel that allowing the deduction of other state and local taxes was more burdensome for the taxpayers considering that these taxes were difficult to keep track of and there was a favorable tradeoff in sacrificing these deductions for a lower tax rate.[71] The final iteration of this bill, however, allowed the deduction of "state and local taxes on real property, personal property, income, general sales, and gasoline and other motor fuels."[72] This underscored their importance in preventing a shift of the federal tax burden between homeowners and non-homeowners and avoided putting a heavy burden on the taxpayers.[73] Congress also slated the state and local gasoline tax for elimination in 1978, but it ultimately survived after its proposed elimination faced strong dissent from those that feared the adverse impact it would have on the

62 ROBERT M. WILLAN, INCOME TAXES: CONCISE HISTORY AND PRIMER I-3 (1994).
63 *Id. See generally* Surane, *supra* note 50.
64 Revenue Act of 1921, Pub. L. No. 67-98, §214(a)(3), 42 Stat. 227, 239–40 (1921).
65 *See id.*
66 MERTENS, *supra* note 53, § 27:2. *See also* Revenue Act of 1942, Pub. L. No. 77-753, 56 Stat. 798 (1942).
67 MERTENS, *supra* note 53, § 27:2.
68 Surane, *supra* note 50, at 4.
69 WILLAN, *supra* note 62, at I-3. *See generally* Revenue Act of 1964, Pub. L. No. 88-272, § 207, 78 Stat. 19, 40–43 (1964).
70 WILLAN, *supra* note 62, at I-3.
71 Surane, *supra* note 50, at 5.
72 Surane, *supra* note 50, at 6.
73 Surane, *supra* note 50, at 4–5.

middle-income taxpayers who itemized.[74]

The Tax Reform Act of 1986 ushered in the biggest change to both the tax code and the SALT deduction prior to the TCJA.[75] The goals of this reform were purportedly simplicity, fairness, and growth and would entail a decrease in tax rates with an attempt to broaden the tax base.[76] President Reagan initially proposed elimination of the SALT deduction, as he felt the federal government was essentially subsidizing state and local cost expenditures and that this would be a good way to broaden the tax base.[77] Opponents of the SALT deduction also felt that there were equitable concerns, in that this deduction was more beneficial to those in high-tax states.[78] Additionally, there was no longer the need for the deduction to prevent the tax rate from going over 100 percent that there previously was, as the rates were being lowered at this time.[79] Finally, opponents of the SALT deduction argued that this was not double taxation because taxpayers could change the amount of local taxes they paid either through elections or by moving out of that jurisdiction.[80]

Arguments against repealing the deduction focused on the fact that it both indirectly benefitted the poor and directly benefitted middle-income taxpayers.[81] Lawmakers were also concerned about these changes incentivizing residents to move to low-tax jurisdictions.[82] Both sides expressed concerns, on the one hand about how the influx would burden the system and on the other, how less residents would affect the high-tax states' economies.[83] Congress ultimately considered both that the deduction lowered voter resistance to higher taxes and that these higher taxes provided beneficial social services,[84] and in the end, found the SALT deduction valuable enough to retain to a large extent, keeping all but state and local sales tax deductions.[85]

The Joint Committee on Taxation stated that this change was justified

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[74] Surane, *supra* note 50, at 6–7.

[75] *See generally* Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

[76] *Federal Income Tax Deduction for State and Local Taxes: Hearing Before the S. Subcomm. on Intergovernmental Relations of the Comm. on Governmental Affairs*, 99th Cong. 1 (1985) [hereinafter "Senate Hearings 1985"]; STAFF JOINT COMM. ON TAX'N, 99TH CONG., GENERAL EXPLANATION ON THE TAX REFORM ACT OF 1986, 47–48 (Comm. Print 1987) [hereinafter "JCT Bluebook"].

[77] Senate Hearings 1985, *supra* note 76, at 36. *See also* Surane, *supra* note 50, at 7–8.

[78] Senate Hearings 1985, *supra* note 76, at 36–37.

[79] Surane, *supra* note 50, at 7.

[80] Surane, *supra* note 50, at 8.

[81] Senate Hearings 1985, *supra* note 76, at 50, 88.

[82] Senate Hearings 1985, *supra* note 76, at 18–19.

[83] Senate Hearings 1985, *supra* note 76, at 20.

[84] Surane, *supra* note 50, at 9.

[85] JCT Bluebook, *supra* note 76, at 7.

by improved consistency and the unfairness of the deduction on sales tax because it favored certain consumption patterns.[86] This change did not last, however. In 2004, the SALT provisions would again allow an election between the deduction of the general sales tax and income tax.[87] The new election created a more equitable system that took into account the different states' methods of taxing.[88]

Thus, throughout its history, the SALT deduction has focused on striking a balance of fairness across states, while also minimizing the burden the middle-class would face because of taxation at the state and federal level. Up until the TCJA, however, the latter concern was the usual winner.

C. *Post-TCJA SALT Deduction*

The revised section 164 under the TCJA provides, in the relevant part, "for years 2018–2025 the aggregate amounts accounted for under paragraphs (1), (2), and (3) of subsection (a) and paragraph (5) for any taxable year shall not exceed $10,000, or $5,000 in the case of a married individual filing separately."[89] In other words, an individual's state, local, and foreign real property taxes; state and local personal property taxes; and state and local and foreign, income, war profits, and excess profit taxes and general sales taxes are only deductible up to $10,000 or $5,000, depending on filing status.[90]

In essence, taxpayers went from being able to deduct the full amount of their state and local property and income taxes under section 164 to being capped at $10,000 regardless of their AGI or other unique tax features. While this provision will phase out in 2025,[91] it could create problems in the intervening years.[92]

D. *Legislative Intent Behind the TCJA*

The main goals behind the TCJA were "bringing tax cuts for hardworking, middle-income Americans; eliminating unfair loopholes and deductions; and slashing business taxes so employers can create jobs, raise wages, and dominate their competition around the world."[93] In fact, these

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[86] *Id.*

[87] MERTENS, *supra* note 53, § 27:2; Hemel, *supra* note 60, at 5.

[88] MERTENS, *supra* note 53, § 27:2.

[89] 26 U.S.C. § 164(b)(6) (2018).

[90] *Id.*

[91] *Id.*

[92] Additionally, TCJA Phase 2 could make these changes permanent if passed. Renu Zaretsky, *TCJA Phase 2 and a Tariff Affirmation*, TAX POL'Y CTR. (July 25, 2018), https://www.taxpolicycenter.org/daily-deduction/tcja-phase-2-and-tariff-affirmation.

[93] Press Release, Donald Trump, Statement from the President on the Tax Cuts and

tax goals were foreshadowed by speeches that President Trump made on his campaign trail.[94]

These goals played a prominent role in discussions when the TCJA finally came before Congress.[95] Specifically, discussions behind the SALT provision centered around striking a balance of fairness to the middle-class and fairness among states.[96] While these two were separate themes to an extent, there was a lot of interaction between them.[97] Generally, the cap on the SALT deduction will affect the middle-class more in states with higher income taxes and higher property values than it will in lower income states with lower property values because it is unlikely that this cap would affect many outside the high-income earners in the lower income states.[98] In congressional discussions, tensions arose between low- and high-tax states, with low-tax states arguing that higher taxes were simply payment by the taxpayers for receiving the more plentiful services the high-tax states provide, such as free garbage pick-up, better roads, and better education systems.[99] On the other side of that, though, senators from high-tax states pushed back because of the very real impact the cap would have on residents of those states, many of them middle-income-earners.[100] In making these arguments, the senators underscored the fact that businesses would not face this cap and the fact that much of the money paid by high-tax state taxpayers went towards subsidizing low-tax states.[101]

Jobs Act (Nov. 2, 2017), https://www.whitehouse.gov/briefings-statements/statement-president-tax-cuts-jobs-act/.

[94] *See, e.g.*, Donald Trump, Remarks to the Detroit Economic Club (Aug. 8, 2016) (discussing plans for tax reform to benefit middle-class tax payers and the simplification of tax preparation); Donald Trump, Remarks to the Economic Club of New York at the Waldorf Astoria in New York City (Sept. 15, 2016) (discussing tax effect on families and complexity of tax preparation).

[95] *See generally* 163 CONG. REC. S7653 (daily ed. Dec. 1, 2017); 163 CONG. REC. S7507, 7542 (daily ed. Nov. 30, 2017); 163 CONG. REC. H9602 (daily ed. Dec. 4, 2017); 163 CONG. REC. H9380 (daily ed. Nov. 16, 2017).

[96] 163 CONG. REC. S7653, 7663, 7682 (daily ed. Dec. 1, 2017).

[97] 163 CONG. REC. S7507, 7542 (daily ed. Nov. 30, 2017).

[98] *Id.*

[99] *Id.* at 7542 (Senator Toomey of Pennsylvania questioned "how it could possibly be fair to force [his] constituents . . . [that] have relatively modest services and pay a modest amount of taxes [to] pay more in income taxes to subsidize someone who gets to live in a multimillion dollar condo in the Upper West Side of Manhattan.").

[100] 163 CONG. REC. S7653, 7663, 7662–63 (daily ed. Dec. 1, 2017) (Senator Menendez of New Jersey underscored that "[i]n 2015 alone, nearly 1.8 million New Jersey households deducted a combined $32 billion in State, local, and property taxes from their Federal tax bill. These families aren't living large. These are middle-class folks who had to work hard for every dollar they have.").

[101] *Id.* at 7663 (Senator Menendez of New Jersey pointing out that if the SALT deduction is important enough to be preserved for businesses, "Republicans should understand why it is so important for middle class families."). *See also* 163 CONG. REC. H9602, 9607 (daily ed. Dec. 4, 2017); 163 CONG. REC. H9380, 9392 (daily ed. Nov. 16,

Based on these discussions, it appears that the main intent of the SALT cap provision, as enacted, is to avoid inordinately burdening middle- and lower-income taxpayers, while simultaneously preventing high-tax states from shifting the cost of the services they provide to their residents onto the federal government or other states.[102] The contrary position is that this cap will unduly burden certain groups of taxpayers and create unintended consequences for those taxpayers and the country at large.

Finally, on the federal level, there is the concern of bringing in enough revenue to support the government. Considering the other numerous changes enacted in this legislation that have the potential to decrease revenue, provisions to counteract that are of great importance. Overall, in light of both these concerns and justifications, Congress enacted the cap.[103]

IV. IMPACT OF THE TAX REFORM

While it is unclear exactly what the impact of the SALT deduction cap will be, projections envision the effects reaching taxpayers, both individuals and corporations, as well as governmental bodies.[104] Section A will look at the impact of the cap on taxpayers and Section B will look at the impact on governmental agencies.

A. *Impact on Taxpayers*

Among taxpayers, the deduction cap will have different implications because the SALT deduction remains in full force for businesses, while it is limited to $10,000 for individual taxpayers.[105] Subsection 1 will look at the anticipated impact on individuals and subsection 2 will look at the anticipated impact for corporations.

1. Individuals

Clearly, the reform will mean a higher tax bill for some taxpayers.[106] For example, thirteen percent of New York taxpayers, eleven percent of New Jersey taxpayers, twelve percent of Maryland taxpayers, and nine percent of Connecticut taxpayers will see a tax hike in 2019.[107]

2017).

[102] 163 CONG. REC. S7653, 7542 (daily ed. Nov. 30, 2017).

[103] Tax Cuts and Jobs Act, *supra* note 4, at 2085–86.

[104] *See infra* Parts IV.A and IV.B.

[105] 26 U.S.C. § 164(b)(6) (2018).

[106] *The Final Trump-GOP Tax Bill: National & 50-State Analysis*, INST. TAX'N & ECON. POL'Y tbl. 2 (Dec. 2017), https://itep.org/wp-content/uploads/Trump-GOP-Final-Bill-Report.pdf.

[107] *Id.*

Representative Josh Gottheimer of New Jersey expects the SALT cap to "kill" property values in his state.[108] According to Moody's Analytics, Essex County, New Jersey is anticipated to be among one of the hardest hit counties affected by the new tax law.[109] Essex County has a median household income of $76,000 but residents pay on average more than $10,000 in property tax.[110] Thus, many of those who will experience a tax increase are middle-income taxpayers, as well.

Moody's Analytics is also anticipating the cap to impact home prices nationally by 2019, with home prices four percent lower than if there were no tax bill.[111] Furthermore, would-be homeowners may be hesitant to purchase because of the increased cost of maintaining a home.[112] This also means decreased construction as fewer people build homes, especially in high-tax areas.[113] While the impact of the TCJA will be national, some areas like California and the Northeast will bear more of the burden.[114]

Some also anticipate diminished job growth and possibly fewer jobs in high-tax areas, outside just the loss of construction jobs. Comparing "11 high-tax states . . . with 20 low-tax states . . . shows that private sector job growth in the first six months of the year [since the TCJA] is 80 percent higher in the low-tax states."[115] This is likely not directly due to the SALT deduction cap, as these taxes still remain deductible as an expense for businesses, but rather it is a result of the new tax provisions generally.[116] The response could also be in anticipation of higher taxes leading to decreased disposable income.[117] This means that taxpayers in the high-tax states will have less to spend on non-necessities and businesses anticipate this shift in spending abilities. Regardless, it is likely to heavily impact

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[108] Michelle Fox, *Tax Bill Will Make Home Prices Plunge, Says NJ Congressman*, CNBC (Dec. 5, 2017, 3:59 PM), https://www.cnbc.com/2017/12/05/tax-bill-will-make-nj-home-prices-plunge-says-rep-josh-gottheimer.html.

[109] Aimee Picchi, *Where the GOP Tax Bill Won't Help: Housing Prices*, CBS NEWS (Dec. 21, 2017, 1:46 PM), https://www.cbsnews.com/news/gop-tax-bill-wont-help-housing-prices/.

[110] *Id.*

[111] Andres Carbacho-Burgos & Mark Zandi, *Housing Takes a Hit*, MOODY'S ANALYTICS (2018), https://www.moodysanalytics.com/webinars-on-demand/2018/housing-takes-a-hit.

[112] Opposition to Defendant's Motion to Dismiss and Cross-Motion for Summary Judgment at 26, New York v. Mnuchin, No. 18-CV-6427 (JPO), 2019 U.S. Dist. LEXIS 168754 (S.D.N.Y. Sep. 30, 2019) [hereinafter Opposition].

[113] *Id.*

[114] *Id.*

[115] Chuck DeVore, *New York and Other High-Tax States Sue Over SALT Deduction Cap While Jobs Follow Lower Taxes*, FORBES (July 26, 2018, 5:57 PM), https://www.forbes.com/sites/chuckdevore/2018/07/26/new-york-and-other-high-tax-states-sue-over-salt-deduction-cap-while-jobs-follow-lower-taxes/.

[116] *Id.*

[117] *Id.*

taxpayers in high-tax states because there will be higher taxes with less opportunity for financial growth.[118]

2. Corporations

Because the SALT deduction cap does not apply to corporations, which can still deduct state and local taxes as a business expense,[119] states and localities may be incentivized to place a higher proportion of the SALT burden on those businesses. Additionally, as discussed above, taxpayers in high-tax states will have less disposable income because of their increased tax bills.[120] This may already be reflected in the increasingly bad business climates in certain high-tax states, like New York, New Jersey, and Connecticut.[121]

There is also the potential harm to charities and nonprofit corporations because of the TCJA.[122] First, there is the fear that if state and local governments have to cut spending, these organizations will receive fewer funds.[123] Charities are also concerned that, because of recent Internal Revenue Service (IRS) guidance regarding charitable contribution workarounds for the cap, individuals will donate less money.[124]

B. *Impact on Governmental Agencies*

While the diminished growth in business will impact taxpayers, it is likely to have a greater impact on state governments. As businesses are more likely to move to low-tax states, the high-tax states will lose these major sources of tax revenue.[125] Further, while states and localities could previously provide tax incentives to retain these businesses, in the wake of the harm that the SALT deduction cap will cause states and localities may have to prioritize individual tax incentives instead.[126]

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118 *Id.*

119 26 U.S.C. § 164(b)(6)(B) (2018).

120 *See supra* Part IV.A.1.

121 *See* Jared Walczak et al., *2019 State Business Tax Climate Index*, TAX FOUND. (Sept. 26, 2018), https://taxfoundation.org/publications/state-business-tax-climate-index/.

122 *See* National Council of Nonprofits, *Tax Cuts and Jobs Act, H.R. 1 Nonprofit Analysis of the Final Tax Law*, COUNCIL OF NONPROFITS (Apr. 5, 2018), https://www.councilofnonprofits.org/sites/default/files/documents/tax-bill-summary-chart.pdf.

123 *Id.*

124 *See* discussion *infra* Part V.

125 *See* Walczak, *supra* note 121, at 9–10.

126 *See, e.g.*, Howard Gleckman, *Could States Fix the SALT Deduction Cap by Taxing Pass-Throughs and Giving Their Owners a Credit?*, TAX POL'Y CTR. (Feb. 27, 2018), https://www.taxpolicycenter.org/taxvox/could-states-fix-salt-deduction-cap-taxing-pass-throughs-and-giving-their-owners-credit (discussing a similar idea as applied to pass-through entities).

Another impact on the high-tax states will be a loss of residents.[127] For example, New Jersey, Connecticut, and New York had some of the highest outbound migration rates for 2018, with tax policy decisions playing a factor.[128] In the future, without being able to deduct the full amount of the SALT being paid, more high-income residents may seek to move to low-tax states.[129] This will create problems for the high-tax states because it will mean a smaller revenue base.[130] This will force high-tax states into the solution they may have sought to avoid, namely cutting the services they provide.[131] On the other side, the influx of high-tax state residents into other states will strain the resources of those states, which are limited by their low tax rates.[132]

There is also the concern for the national economy, as economists predict "that if fewer Americans moved to places like New York City and the San Francisco Bay Area the US economy would shrink by about 9 percent a year . . . ."[133] Thus, the impact is not limited to just high-tax states, but to the nation as a whole.

V. LEGISLATIVE ATTEMPTS BY STATES TO MITIGATE THE CAP

With New York as the trailblazer and New Jersey and Connecticut following suit, states have been enacting different forms of legislation to try to mitigate the effect of the SALT cap on their taxpayers.[134] Noticeably, these are all high-tax states that are likely to feel the effects of the cap most harshly and include the bulk of the states currently suing the federal government over this cap.[135] Part A will discuss the first form of legislation—the payroll workaround—and Part B will look at the second form of legislation—the charitable contribution workaround.

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[127] *See* DeVore, *supra* note 115.

[128] Katherine Loughead, *Where Did Americans Move in 2018?*, TAX FOUND. (Jan. 3, 2019), https://taxfoundation.org/where-did-americans-move-in-2018/.

[129] *Id.*

[130] *See* DeVore, *supra* note 115.

[131] *Id.*

[132] In fact, this concern was voiced by a Senator from Florida, which lacks a state income tax, back when the SALT deduction came on the chopping block in 1986. *See* Senate Hearings 1985, *supra* note 76. This still remains a concern today.

[133] Gordon, *supra* note 46.

[134] Frank Sammartino, *How New York State Responded to the SALT Deduction Limit*, TAX POL'Y CTR. (May 14, 2018), https://www.taxpolicycenter.org/taxvox/how-new-york-state-responded-salt-deduction-limit.

[135] *See infra* Part VI.

A. *Payroll Tax Workaround*

One of the options available to taxpayers in New York is to give employers the choice to collect and pay a five percent payroll tax for employees with more than $40,000 in annual wages.[136] This would reduce the taxpayers' wages but it would also enable employees to take a tax credit that would be subtracted from their taxes payable.[137]

To illustrate, if a taxpayer had a salary of $100,000 and paid state income tax on this of $10,000, the employer would be permitted to reduce the employees' pay to $90,000, leaving him with the same tax base he would have had if his state tax was fully deductible.[138] The state would then assess a corresponding income tax on the employer of $10,000 that the employer would be legally obligated to pay.[139] Finally, the taxpayer would get either a credit against his state income tax for the amount of that payroll tax or he could reduce his state income tax base by the amount of salary that is subject to the new payroll tax.[140] By swapping employees' pay for an income tax credit, this plan would keep states' revenues essentially unchanged and would not largely impact the taxpayer's income.[141] Although it would decrease the amount of income the taxpayer took home, he would pay less federal income and payroll tax.[142] Businesses would not be harshly impacted either because they would be able to deduct the amount as a business expense.[143] Finally, by limiting this option to those earnings above $40,000, the legislation ensures that the taxpayers will be eligible for the tax credit.[144] New York has been the only state thus far to adopt this form of legislation.[145]

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[136] Employer Compensation Expense Program, 2018 N.Y. LAWS 59, § 852 (LexisNexis 2018). *See also* Rodha Mohan & Lai King Lam, *Why IRS Will Struggle to Respond to State SALT Cap Bypass*, LAW360 (May 31, 2018), https://www.law360.com/newjersey/articles/1048972/why-irs-will-struggle-to-respond-to-state-salt-cap-bypass; Joseph C. Mandarino, *Evaluation of Efforts to Combat the SALT Deduction Cap*, 158 ST. TAX NOTES 689, 691 (Feb. 19, 2018), https://www.taxnotes.com/tax-notes-state/charitable-giving/evaluation-efforts-combat-salt-deduction-cap/2018/02/19/26sz8?highlight=Evaluation%20of%20Efforts%20to%20Combat%20the%20SALT%20Deduction%20Cap.

[137] Mandarino, *supra* note 136, at 691.

[138] *Id.*

[139] *Id.*

[140] *Id.*

[141] *Id.*

[142] *Id.*

[143] Mandarino, *supra* note 136, at 691.

[144] Sammartino, *supra* note 134.

[145] *Id. See also* Employer Compensation Expense Program, 2018 N.Y. Laws 59, § 852 (LexisNexis 2018).

While this legislation is less likely to run afoul of the IRS, it relies completely upon employer participation.[146] At the moment, it appears to have little traction with that group.[147] This may be because it offers no real incentive to participate.[148] It could also be that, if the IRS were to issue guidance disallowing this structure, it could create a headache for the companies that have participated. This also presents problems in figuring out the burden to match to the withholding[149] and would cause administrative difficulties for the IRS, for companies involved, and possibly for the taxpayers that utilize this method. These difficulties could translate into increased preparation costs for taxes. Finally, workers may be reluctant to take advantage of this program because it will mean a smaller paycheck.[150]

B. *Charitable Contributions Tax Workaround*

Under the charitable contribution workaround, which has been enacted by New York, New Jersey, and Connecticut in one form or another, the states create state-administered trust funds, to which residents can contribute.[151] Taxpayers that contribute receive a credit against their state income taxes equal to a set percentage of their contribution in the year after the contribution.[152] States can offer full-credit programs, that allow taxpayers a dollar-for-dollar credit for amounts paid.[153] Alternatively, states can offer partial credit, granting taxpayers credits for less than 100 percent of their charitable contributions or the states can offer a private credit model, in which taxpayers give to private organizations to receive credit.[154] So far, no state has offered a full-credit option and the partial-credit method seems to be the predominant method in attempting to get around the SALT deduction cap.[155]

146 *See* Sammartino, *supra* note 134.
147 *Id.*
148 *Id.*
149 Mandarino, *supra* note 136, at 691.
150 *Id.*
151 *See* 2018 N.Y. Laws 59 § 850 (LexisNexis 2018) (New York); N.J. STAT. ANN. § 54:4-66.9 (LexisNexis 2018) (New Jersey); 2018 Conn. Acts 49 (LexisNexis 2018) (Connecticut). *See* Timothy M. Todd, *Exogeneity vs. Endogeneity in Section 170's Quid Pro Quo Test*, 161 TAX NOTES 65, 66–67 (Oct. 1, 2018), https://www.taxnotes.com/tax-notes-state/tax-policy/exogeneity-vs-endogeneity-section-170s-quid-pro-quo-test/2018/10/01/28d98; Amandeep Grewal, *The Charitable Contribution Strategy: An Ineffective SALT Substitute*, 38 VA. TAX REV. 203, 205–09 (2018).
152 Todd, *supra* note 151, at 38.
153 Grewal, *supra* note 151, at 208–10.
154 Grewal, *supra* note 151, at 208–09.
155 *Id.*

The idea behind this plan is that, while there are limits to the charitable contribution deduction taxpayers are allowed to take in the new tax code, the limits are much higher than the $10,000 deduction allowed for SALT.[156] By "donating" the money to a charitable fund instead of paying the same amount via taxes, taxpayers would be able to deduct it as a charitable contribution.[157] On the state and local end, the preference for partial credit is predicated on the idea that keeping the deduction below 100 percent allows the states to make up for the increased administrative expenses.[158] Even though the taxpayer does not receive credit for the full amount, they still receive considerable benefits.[159]

Many states have used this method to provide credits for taxpayer contributions to or for the use of entities listed under the charitable contribution section of the code previously.[160] Prior to these SALT workarounds, there was no official ruling or position either for or against these credits by the IRS, and informal guidance had been on the side of allowing these credits.[161] This new state legislation, however, would expand these provisions to a place likely not contemplated by the informal guidance. Therefore, in June 2018, the Treasury Department and the IRS announced their intention to regulate treatment of these contributions based on "longstanding federal tax law principles."[162]

The IRS issued a notice of proposed rulemaking to disallow the charitable contribution workaround stating that, "[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return."[163] The IRS recognized the dual character of some payments, even where the taxpayer receives a "nominal benefit" less than the value of the payment.[164] The IRS's position allows the deduction "but only to the extent the amount donated or the fair market value of the property transferred by the taxpayer exceeds the fair market value of the benefit received in return, and only if the excess amount was

[156] Amandeep Grewal, *The Proposed SALT Regulations May Be Doomed*, 103 IOWA L. REV. ONLINE 75, 75 (2018). *See also* 26 U.S.C. § 170(b) (2018) (setting the limitations on individual's charitable contribution deduction, with cash contributions being limited to 60% of the taxpayer's AGI and contributions of capital gains property being limited to 30% of AGI subject to other additional limitations).

[157] Grewal, *supra* note 156, at 75.

[158] Sammartino, *supra* note 134.

[159] *Id.*

[160] Grewal, *supra* note 151, at 205, 210.

[161] Grewal, *supra* note 151, at 211–12.

[162] Contributions in Exchange for State or Local Tax Credits, 83 Fed. Reg. 43,563, 43,565 (Aug. 27, 2018) (to be codified at 26 C.F.R. pt. 1) [hereinafter IRS Guidance].

[163] *Id.* at 43,563 (quoting United States v. Am. Bar Endowment, 477 U.S. 105, 116 (1986)).

[164] *Id.*

transferred with the intent of making a gift."[165] This means that very few, if any, transfers under this workaround will actually qualify for charitable deductibility.

The IRS also addressed the fact that many of these states have offered credits for charitable contributions prior to this legislation.[166] The IRS, however, noted that, because there was no cap on the SALT deduction in those systems, the increased charitable contribution deduction necessarily entailed a decreased SALT deduction because the taxpayers were receiving credits lowering their state and local tax bills.[167] Therefore, there was no tangible difference. Under new legislation, this system would enable taxpayers to get around legislatively enacted limits in a way that was not a concern before.[168]

In light of this, the Treasury Department and the IRS stated that "when a taxpayer receives or expects to receive a state or local tax credit in return for a payment or transfer to any entity listed in section 170(c) [the charitable contribution deduction section], the receipt of this tax benefit constitutes a *quid pro quo* that may preclude a full deduction."[169] These rules would apply regardless of whether the taxpayer was taking advantage of a pre-existing charitable contribution provision or one enacted in the wake of the newest tax reform.[170] Thus, the rule going forward is that "the amount otherwise deductible as a charitable contribution must generally be reduced by the amount of the state or local tax credit received or expected to be received."[171] This effectively eliminates all benefits the states are attempting to bestow on their taxpayers and makes the new SALT workaround provisions useless with respect to their intended purpose.[172]

The IRS's proposed regulation is already concerning many parties, as it implicates not only the credits given related to the SALT workaround, but also the credit programs that were in place before.[173] Many states that have utilized these credits in the past have written to the Treasury Department and the IRS raising concerns regarding the probable effects on

165 *Id.* (citing United States v. Am. Bar Endowment, 477 U.S. 105, 117 (1986)).
166 *Id.* at 43,564.
167 *Id.*
168 IRS Guidance, *supra* note 162, at 43,565.
169 *Id.*
170 *Id.*
171 *Id.*
172 *Id. But see* Joseph Bankman et al., *State Responses to Federal Tax Reform: Charitable Tax Credits*, 87 ST. TAX NOTES 433 (2018) (arguing that this approach goes against the weight of legal authority as the value of the deduction has not been treated as an item of income under section 61).
173 IRS Guidance, *supra* note 162, at 43,571.

organizations and taxpayers in the states.[174] Particularly notable is the tension between states that have attempted to newly implement workarounds and those that have pre-existing state tax credit schemes caught in the crosshairs.[175] Charitable organizations have also expressed their concerns over the anticipated decrease in contributions.[176] The proposed changes, however, have found support to the extent that they prevent states from circumventing the SALT cap in place, and also for the reallocation of values caused by the disallowance of pre-existing credits.[177] Thus, even attempts to clarify have left numerous holes in the general understanding of section 170 deductions and how the IRS will actually apply the new rule remains uncertain.[178]

VI. JUDICIAL ATTEMPT BY STATES TO MITIGATE CAP

In July 2018, four states—New York, New Jersey, Connecticut, and Maryland—(collectively the "Plaintiff States") filed suit against Steven Mnuchin, in his official capacity as the Secretary of the U.S. Department of the Treasury; the U.S. Department of Treasury; David Kautter, in his official capacity as the Acting Commissioner of the IRS; the IRS; and, finally, the United States itself (collectively the "Defendants").[179] The suit was brought in the United States District Court for the Southern District of

[174] *See* Letter from Andrew Cuomo, Governor, State of N.Y., to Charles P. Rettig, Comm'r, IRS (Oct. 11, 2018), https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/RettigLetter2018.pdf; Letter from Michael Hartman, Exec. Dir., Colo. Dep't Revenue, to the IRS (Oct. 11, 2018), https://s3.amazonaws.com/pdfs.taxnotes.com/2018/2018-40988_xColorado-DOR-salt.pdf.

[175] *Compare* Letter from Rob Woodall, Member of Cong., et al., to Steven T. Mnuchin et al. (Oct. 11, 2018), https://woodall.house.gov/sites/woodall.house.gov/files/wysiwyg_uploaded/Letter%20to%20Treaury%20and%20IRS%20on%20Proposed%20Rule.pdf, *with* Letter from Andrew Cuomo to Charles P. Rettig, *supra* note 174.

[176] Letter from Kristi Knous, President, Cmty. Found. of Greater Des Moines, et al., to the IRS (Oct. 11, 2018), https://s3.amazonaws.com/pdfs.taxnotes.com/2018/2018-41102_2018-10-11-Hamond-Jeff-in.pdf.

[177] *See* Letter from Rob Woodall to Steven T. Mnuchin, *supra* note 175; Letter from Cindi McDonald, Superintendent, Waukee Cmty. Sch. to Merrill Feldstein, Senior Counsel, IRS (Sept. 13, 2018), https://s3.amazonaws.com/pdfs.taxnotes.com/2018/2018-42888_x_0145_-for-regs-schools-WCS-_Cindi-McDonald_.pdf (supporting the new guidance because it will disincentivize contributions to private schools over public schools).

[178] *See generally* Todd, *supra* note 151. Todd argues that the IRS should make an exogenous-endogenous distinction when determining deductibility, such that benefits that arise independently of or outside a specific taxing authority (exogenous) would reduce the deductible amount and benefits that arise from within a specific taxing authority (endogenous) would not be considered in determining deductibility. *Id.* This approach would solve at least one problem that plagues the new IRS guidance, in justifying the now contradictory system of allowing federal deductibility despite the *quid pro quo* nature of the federal deduction. *Id.*

[179] Complaint at 8–10, New York v. Mnuchin, No. 18-CV-6427 (JPO), 2019 U.S. Dist. LEXIS 168754 (S.D.N.Y. Sep. 30, 2019) [hereinafter Complaint].

New York and was dismissed on September 30th, 2019.[180] The Plaintiff States had been seeking a declaratory judgment stating that the new cap on SALT deductions violated the United States Constitution and an injunction to bar the cap's enforcement.[181] This part examines the issues the Plaintiff States faced with regard to jurisdiction and the merits of their claims.[182] Each subsection looks at the arguments advanced by both parties and the district court's resolution of these arguments.

A. *Jurisdiction*

This section examines issues the Plaintiff States faced in regard to jurisdiction. It will first examine the arguments put forth by the Plaintiff States and the Defendants and then examine the district court's disposition of these issues.

1. The Parties Arguments

The Plaintiff States based their standing on the fact that they "and their residents will suffer legally cognizable harm because of the new cap on the SALT deduction, and an order invalidating the new cap would redress the Plaintiff States' injuries."[183] While the complaint included allegations that could reasonably meet the minimum constitutional requirements for standing—namely injury, causation and redressability[184]—the Defendants' motion to dismiss questioned whether the Plaintiff States themselves had suffered an injury in fact or whether their harm was secondary to that of their citizens.[185] Further, the Defendants argued that even if the injury alleged was in fact an injury to

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180 *Id.* at 1; New York v. Mnuchin, No. 18-CV-6427 (JPO), 2019 U.S. Dist. LEXIS 168754 (S.D.N.Y. Sep. 30, 2019).

181 Complaint, *supra* note 179, at 8. The Defendants never filed a reply to the complaint. Instead, the Defendants filed a motion to dismiss the complaint, both for lack of standing and for failing to state a claim for which relief can be granted. Motion to Dismiss, New York v. Mnuchin, No. 18-CV-6427 (JPO), 2019 U.S. Dist. LEXIS 168754 (S.D.N.Y. Sep. 30, 2019) [hereinafter Motion to Dismiss]. This motion is discussed throughout the remainder of Part VI. The Plaintiff States replied to this and made a cross-motion for summary judgment, which will also be relied on throughout Part VI. Opposition, *supra* note 112.

182 As of the time of publication, it is unclear whether the Plaintiff States will appeal this decision, although New York's governor has indicated it is a possibility. Jonathan Stempel, *Judge Dismisses U.S. States' Challenge to Trump Tax Cap on SALT Deductions*, REUTERS (Sept. 30, 2019), https://www.reuters.com/article/us-usa-taxes-lawsuit/judge-dismisses-u-s-states-challenge-to-trump-tax-cap-on-salt-deductions-idUSKBN1WF1OB?utm.

183 Complaint, *supra* note 179, at 9.

184 *See, e.g.*, Massachusetts v. EPA, 549 U.S. 497, 515 (2006) (discussing these requirements for standing). *See also* Complaint, *supra* note 179.

185 Motion to Dismiss, *supra* note 181, at 3–4.

the states, it was not concrete enough.[186]

The Plaintiff States, in their reply to the Defendants, pointed to three particular, potential sovereign harms: (1) the cap would cause them to depart from their current taxation and fiscal policies; (2) it would cause the Plaintiff States to lose specific sources of revenue, like sales tax and real estate transfer taxes; and (3) because it targeted specific states, the principle of equal sovereign immunity was violated.[187] In response, the Defendants argued that: (1) this tax does not force the states to make any choice, as they can keep taxing and spending as they wish and taxpayers will simply have a larger tax bill; (2) these revenue sources are not specific enough to confer standing; and (3) this tax does not treat states differently, but rather treats all taxpayers the same.[188]

Both parties also addressed the issue of the political question doctrine. This doctrine is implicated when a policy determination is best left to branches of government other than the judiciary.[189] The Defendants pointed to the "especially rigorous" standing inquiry used when the court must determine the constitutionality of another branches' action.[190] While the Plaintiff States attempted to contest this characterization, the Defendants argued the Plaintiff States ultimately failed to provide a standard by which to judge the fairness of the cap.[191] Finally, the Defendants challenged the Plaintiff States' request for injunctive relief.[192] The Defendants claimed that injunctive relief is barred by the Anti-Injunctive Act (AIA), which provides that no suit to restrain the assessment or collection of any tax can be maintained by a court.[193] Thus, overall the Plaintiff States faced numerous issues even showing the district court had the ability to hear this matter.

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186 Motion to Dismiss, *supra* note 181, at 8–9.

187 Opposition, *supra* note 112, at 6–9.

188 Reply and Opposition to Cross-Motion for Summary Judgment at 3–6, New York v. Mnuchin, No. 18-CV-6427 (JPO), 2019 U.S. Dist. LEXIS 168754 (S.D.N.Y. Sep. 30, 2019) [hereinafter Reply].

189 Motion to Dismiss, *supra* note 181, at 4. *See also* Baker v. Carr, 369 U.S. 186 (1962) (discussing political questions as an impediment to standing).

190 Motion to Dismiss, *supra* note 181, at 10 (quoting Clapper v. Amnesty Int'l USA, 568 U.S. 398, 408 (2013)).

191 Reply, *supra* note 188, at 8–9. This is especially important because they did not claim that any cap on the SALT deduction would be invalid, just that this cap is invalid. Reply, *supra* note 188, at 9–10.

192 Motion to Dismiss, *supra* note 181, at 14.

193 *Id.*

2. District Court's Resolution

The district court ultimately found that the Plaintiff States had standing.[194] It relied upon the Plaintiff States' second alleged harm, namely that the cap could potentially cause the Plaintiff States to lose a specific source of revenue.[195] The court relied upon *Wyoming v. Oklahoma*, in which the Supreme Court held that a state could establish a direct injury in the form of loss of a specific tax revenue.[196] In this case, the Plaintiff States identified one such revenue in the form of real estate transfer taxes.[197] The court further found that this allegation was not too speculative as there was "no reason to doubt the basic economic logic" of this prediction.[198]

As to the political question doctrine, the district court pointed to the fact that the Plaintiff States were not asking the court to resolve a matter of opinion nor were they asking the court to make an unprecedented intervention in the political process.[199] The Plaintiff States were simply asking the court to use familiar tools of constitutional interpretation.[200] Further, the lack of standard to judge the tax's fairness went to the merits of the case.[201] Thus, the doctrine was not implicated. Finally, in regard to the AIA, the court found that the statute did not bar the Plaintiff States' suit as Congress provided no other means to challenge this tax.[202] Therefore, there was no jurisdictional bar to the Plaintiff States' claims

B. *The Merits of the Plaintiff States' Claims*

This subsection will examine the merits of the Plaintiff States' claims, first by looking at their allegations, the Defendants' response to those allegations, and any other case law that could impact the case if it does go forward. This part will then look at the disposition of these claims by the district court.

1. Sixteenth Amendment Argument

The Sixteenth Amendment gives the federal government the power to collect income tax and reads, "[t]he Congress shall have power to lay and

[194] New York v. Mnuchin, No. 18-CV-6427 (JPO), 2019 U.S. Dist. LEXIS 168754, at *23 (S.D.N.Y. Sept. 30, 2019).
[195] *Id.* at *19.
[196] *Id.* at *20 (citing Wyoming v. Oklahoma, 502 U.S. 437 (1992)).
[197] *Id.* at *21.
[198] *Id.* at *22.
[199] *Id.* at *32–33.
[200] *Mnuchin*, 2019 U.S. Dist. LEXIS 168754, at *33.
[201] *Id.*
[202] *Id.* at *24–25 (citing South Carolina v. Regan, 465 U.S. 367 (1984)).

collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."[203] The Plaintiff States argued that the federal government had violated this Amendment by capping the SALT deduction.[204] The complaint discussed the long history behind the passing of this Amendment and the fierce opposition it faced from states at the time of ratification.[205] Specifically, states at that time were wary of the Amendment because they feared the ability of the federal government to interfere with the states' taxation of its citizens.[206] The Plaintiff States argued that the legislative history in conjunction with the Plaintiff States' reliance on the perpetuity of the SALT deduction in all former legislation caused the current limitation to run afoul of this Amendment.[207]

The Defendants, on the other side, denied that the Sixteenth Amendment limits Congress's authority to set taxes based merely on the history of its ratification and without any textual support.[208] The Sixteenth Amendment makes no provision for the states, either explicit or implicit.[209]

The Plaintiff States, in their reply to the Defendants' motion to dismiss, did not focus as heavily on the Sixteenth Amendment argument and seemed to shift gears to argue "the States' original and sovereign 'power of taxation,' which predates the Founding . . . was incorporated into our constitutional structure."[210] The Plaintiff States then relied on the history of the SALT deduction and the continued allowance of a "near-total" SALT deduction to argue that the departure from this past was telling.[211] They argued if Congress actually had the power to extensively narrow SALT's deductibility, it would have done so before now.[212] The Defendants, however, pointed out that, throughout its history, the SALT deduction has been limited in one way or another.[213]

The Defendants also underscored the fact that while there was push-back against the ratification of the Amendment by the states, the SALT deduction was never even brought up.[214] Overall, the Plaintiff States faced a major issue in the lack of protection the Sixteenth Amendment provides,

[203] U.S. CONST. amend. XVI.
[204] Complaint, *supra* note 179, at 49.
[205] Complaint, *supra* note 179, at 42.
[206] *See id.*
[207] Complaint, *supra* note 179, at 41–42.
[208] *See* Motion to Dismiss, *supra* note 181, at 21–20.
[209] *See* Motion to Dismiss, *supra* note 181, at 20–26; *see also* U.S. CONST. amend. XVI.
[210] Opposition, *supra* note 112, at 17–18.
[211] *Id.*
[212] Opposition, *supra* note 112, at 15.
[213] Reply, *supra* note 188, at 12. *See also supra* Part III.
[214] Motion to Dismiss, *supra* note 181.

as even a broad reading could fail to implicate the states' interest in maintaining a tax base with the ability to pay.

It is important to note, aside from these arguments, that the Plaintiff States' broad reading of the protections the Sixteenth Amendment provides goes against prior Supreme Court precedent that has stated "that the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived."[215] Additionally, state tax courts have also found that states have a right to impose an income tax independent of the Sixteenth Amendment and that a state's ability to impose a tax arises out of a sovereign right and not from the Sixteenth Amendment.[216]

2. Tenth Amendment Argument

The Tenth Amendment prohibits the federal government from invading the sovereign authority of the states and also requires the federal government to respect the equal sovereignty of the states.[217] The Plaintiff States argued that the federal government had violated this Amendment through the SALT deduction cap.[218] The heart of this contention was that, by eliminating the full deduction, the federal government was forcing certain states to choose between changing their tax policies or foregoing the benefits of the TCJA.[219]

There are of course limits to the extent to which the federal government can impose its will on states via fiscal policies. In *Garcia v. San Antonio Metropolitan Transit Authority*, the Court held that the check on the federal government should come from the political process.[220] In essence, the state's representation in the federal government should represent its interests in a manner that conforms with the Tenth Amendment.[221] This, however, advances the Plaintiff States' argument that they were denied a fair political process in this matter because of the rushed, highly partisan way in which the tax bill was passed.[222]

Another factor here is the coercive nature of the federal government's

215 Brushaber v. Union Pac. R.R. Co., 240 U.S. 1, 18 (1916). It is notable that this case comes from early in the federal income taxes' history and at that time it was thought of as merely a way around apportionment to the states. This could suggest a history contrary to, and almost as deep rooted as, the one argued by the Plaintiff States.

216 Hanson v. Comm'r of Revenue, 2002 Minn. Tax LEXIS 23, at *6–7 (Minn. T.C. Oct. 15, 2002).

217 Motion to Dismiss, *supra* note 181, at 29–30.

218 Motion to Dismiss, *supra* note 181, at 29.

219 *See* Motion to Dismiss, *supra* note 181, at 10–12.

220 469 U.S. 528, 554 (1985).

221 *See id.*

222 Complaint, *supra* note 179, at 45.

enactment. *New York v. United States* involved a state challenge against the sanctions and incentives provided by the federal government to encourage compliance with a federal regulatory program.[223] The Court in that case pointed out that fiscal incentives by the federal government would be upheld, but they could not be coercive to the states.[224] The major concern in that case was political accountability;[225] when the federal government forces the states to give effect to federal legislative policy, the state governments have no autonomy but remain accountable to their constituents.[226] The SALT deduction cap could be viewed, and has been expressed to be, an incentive to get certain states to change their fiscal policies.[227] Thus, the SALT deduction cap goes to the heart of the accountability of the Tenth Amendment argument.

The Defendants, on the other hand, relied on *New York v. United States* to support their argument that if a power is delegated to Congress, such as the taxing power, then the Tenth Amendment will disclaim the reservation of this power to the state.[228] They argued that the SALT deduction cap is an exercise of that taxing power and "that is the end of the matter."[229]

The Defendants also argued that the SALT deduction cap is in no way impeding the states' ability to continue taxing their citizenry, nor is it actually impairing their ability to spend how they wish.[230] They relied on *South Carolina v. Baker*, in which the court upheld a tax-based incentive that was provided to states to alter their bond issuing practices.[231] Thus, the Defendants similarly argued that the cap may be making state taxation more difficult.[232] This is either because people may not want to continue to pay the taxes required to maintain the level of public service without receiving a deduction or if the states do cut the rates, they will not have the requisite funds.[233] Despite this, the Defendants argued that the federal government is still leaving the states with a choice and are not exerting impermissible force because of this.[234]

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223 505 U.S. 144, 152–54 (1992).
224 *See id*. at 176.
225 *Id.* at 168–69.
226 *Id.*
227 *See* Complaint, *supra* note 179, at 6.
228 Motion to Dismiss, *supra* note 182, at 13, 31.
229 *Id.*
230 Motion to Dismiss, *supra* note 182, at 14, 31.
231 Motion to Dismiss, *supra* note 182, at 32 (citing South Carolina v. Baker, 485 U.S. 505, 513–15 (1988)).
232 *Id.*
233 *Id.*
234 *See* Motion to Dismiss, *supra* note 182, at 31.

In replying to the Defendant's motion to dismiss, the Plaintiff States argued that the coercion used here is the same that was expressly disallowed in *National Federation of Independent Business v. Sebelius*, where the court held that Congress cannot "put so much pressure on States as to effectively undermine their sovereignty."[235] That is what the Plaintiff States claimed was occurring.[236] Additionally, the Plaintiff States pointed to comments made in the news and by lawmakers regarding the SALT cap.[237] Many involved attacks on how the Plaintiff States' governments are run and expressed a desire to challenge those states.[238] The Defendants, however, in their reply, pointed to the fact that these comments do not affect the constitutionality of the provision, meaning it is constitutional regardless of the true intent behind them.[239]

3. Article I, Section 8 of the U.S. Constitution Argument

Article I, Section 8 of the Constitution states that "[t]he Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States . . . ."[240] This concern did not come up explicitly in either of the parties' arguments, perhaps because the federal income taxes at issue were, by their nature, not uniform throughout the states. Despite that, it merits mention as it could play a more important role on appeal.

4. District Court's Resolution

The district court interpreted all three of the above as one claim, resting on two separate arguments.[241] The Plaintiff States' first argument, in the court's interpretation, was that any attempt to eliminate or substantially curtail the SALT deduction upsets the constitutional balance.[242] While the court agreed with the Plaintiff States that the change to the SALT deduction was unprecedented and the court may properly consider historic understanding and practice in ruling on constitutionality, the court held that novelty is not fatal in this context, it merely informs the

[235] Opposition, *supra* note 112, at 26 (quoting Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 576–77 (2012)).
[236] *Id.*
[237] *Id.*
[238] Opposition, *supra* note 112, at 29–30.
[239] Reply, *supra* note 188, at 19.
[240] U.S. CONST. art. I, § 8.
[241] New York v. Mnuchin, No. 18-CV-6427 (JPO), 2019 U.S. Dist. LEXIS 168754, at *34–35 (S.D.N.Y. Sept. 30, 2019).
[242] *Id.* at *35.

courts understanding of structural limitations.[243] Rather, the court found it must ask if the failure of the federal government to previously impose a condition comes from such a structural limitation.[244] The court relied upon *South Carolina v. Baker* for the proposition that just because a certain tax had always been exempt from federal taxation does not mean the exemption is frozen, as long as there is no constitutional bar to it.[245] The court further relied on *Brushaber v. Union Pacific Railroad Company*.[246] and *Lyeth v. Hoey*[247] to find that the federal government has plenary power of taxation and as the Plaintiff States did not point to any constitutional principal that would bar Congress in this instance, there was no constitutional bar to the SALT cap enactment.[248] Therefore, the Plaintiff States claim failed in regard to this argument.[249]

The Plaintiff States' second argument, in the court's interpretation, was that the cap was "an unlawful effort by Congress to wield its regulatory authority in a way that coerces specifically targeted states."[250] The court, however, declined to look into the motives of Congress in enacting the cap as "an otherwise valid federal law does not offend the Constitution simply because it seeks to affect state policies."[251] Thus, the court looked to the effects of the cap, not the motive behind it.[252] The court ultimately found that the harms here did not rise to the level of a constitutional violation because the consequences were not so harmful that the States had "no real option but to acquiesce."[253] Thus, the Plaintiff States' claims survived attacks on the district court's jurisdiction to hear their claim, but the claims ultimately failed on the merits.

While there is some resolution of this matter now, there is the possibility of appeal.[254] Thus, it is important to understand the limitations of the Plaintiff States' case moving forward on appeal in order to understand the small likelihood the case has of advancing. Further, even if the Plaintiff States do ultimately prevail, and the cap is repealed, there will still be a hole in the budget that the increased revenue the cap provided was

[243] *Id.* at *35–37.
[244] *Id.* at *38.
[245] *Id.* at *40–41.
[246] 240 U.S. 1 (1916).
[247] 305 U.S. 188 (1938).
[248] *Mnuchin*, 2019 U.S. Dist. LEXIS 168754, at *38–39.
[249] *Id.* at *43–44.
[250] *Id.* at *35.
[251] *Id.* at *45 (citing South Dakota v. Dole, 483 U.S. 203 (1987)).
[252] *Id.* at *49.
[253] *Id.* at *50–53 (quoting Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 582 (2012)).
[254] *See* Stempel, *supra* note 182.

supposed to fill. Therefore, some other method of reform would be necessary.

VII. STATUTORY REFORM AS AN ALTERNATIVE

It is clear, based on the impact the TCJA is likely to have, that the SALT provision, as it stands, cannot endure.[255] It is also clear that the legislative actions by the states and municipalities have either failed or are unlikely to succeed in getting around the new SALT cap.[256] Additionally, the judicial attempt by New York, New Jersey, Connecticut, and Maryland is not likely to succeed, as the case has been dismissed and faces some very serious issues on appeal.[257] Yet, even if the Plaintiff States do succeed and the provision is repealed, it would perhaps be better to alter the statute instead of eliminating any kind of limitations on SALT, considering legislative intent and concerns over creating an even greater national deficit.[258] Reports regarding the TCJA show that this cap, in addition to other tax law changes, will raise about $688 billion.[259] The Joint Committee on Taxation expects federal expenditures[260] for SALT deductions to decrease from $100.9 billion to $24.4 billion from fiscal year 2017 to fiscal year 2020, making this a large revenue raiser in the TCJA.[261] Therefore, the best option available is to amend the SALT provision.

The current law applies a blanket cap of $10,000 on taxpayers regardless of income.[262] Instead of imposing a cap on deductions *from income*, which does not account for *differences in income*, the SALT provision should be amended so that the SALT deductions phase out based on the taxpayers AGI to a minimum $10,000 deduction. AGI is the total income subject to tax, minus "above-the-line deductions," which do not include itemized deductions.[263] The use of AGI to determine the amount of

255 *See supra* Part IV.

256 *See supra* Part V.

257 *See supra* Part VI.

258 *See supra* Part III.

259 STAFF JOINT COMM. ON TAX'N, 115TH CONG., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R.1, THE "TAX CUTS AND JOBS ACT" (Dec. 18, 2017), https://www.jct.gov/publications.html?func=startdown&id=5053.

260 A tax expenditure is defined as "the deductions, credits, exclusions, exemptions, and other tax preferences that represent departures from a 'normal' tax code." William McBride, *A Brief History of Tax Expenditures*, TAX FOUND. (Aug. 22, 2013), https://files.taxfoundation.org/legacy/docs/ff391.pdf. This idea was first introduced by Stanley Surrey, who noted that many tax preferences resemble spending. *Id.*

261 STAFF JOINT COMM. ON TAX'N, 115TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2017–2021, tbl. 1 (Comm. Print 2018).

262 26 U.S.C. § 164(b)(6)(B) (2018). There is, however, a $5,000 limit if the taxpayer's filing status is married, filing jointly. *Id.*

263 JCT Overview, *supra* note 6, at 4.

deduction that can be taken is common to many phase-outs within the IRC and is utilized in other deductions.[264] By having it phase out to a minimum of $10,000, however, it preserves the deduction to some extent even for those with a high AGI.

Utilizing this method will redistribute some of the impact from geographical locations. Just because the taxpayers are in a high-property-tax state does not mean the SALT provision will necessarily impact them. Rather, it will only impact them if they have a corresponding higher level of income. The counterargument to this is that the same states will still be impacted more harshly because income tends to be higher in these areas. While this is a valid concern, this method is still a better alternative because it honors the goal of a progressive income taxation: higher taxes for those with higher income.

This plan would also better reflect certain limitations that were placed on the SALT deduction prior to the TCJA. Before the reforms, high-income and some upper-middle-income taxpayers were subject to the Alternative Minimum Tax (the "AMT").[265] The AMT limited the amount of the deductions taxpayers could take if they made over a certain income level to ensure that these taxpayers would not have an inordinately small tax bill.[266] With the TCJA, the amount of income needed to run afoul of the AMT is much higher, meaning it impacts fewer taxpayers now.[267] By implementing an AGI-based phase-out, high-income taxpayers that did not get the deduction before because of their income levels will likely not get it now, maintaining the status quo, and strictly middle-class taxpayers that likely should have gotten the deduction but were disallowed because of the formerly broad reach of the AMT will be able to take it, creating a more equitable tax system.[268]

Overall, this is a better alternative than what is currently in place because it provides a workable compromise that will limit the impact on high-property tax states but also, to some extent, allow the government to recover some of the revenue lost in other tax cuts in the TCJA. This alternative strikes a compromise between the high- and low-tax states in terms of where the tax burden falls, without a disproportionate burden on the middle-class taxpayers of high-tax states. Thus, while the increase in the cap protects those that cannot pay, because there still is a cap, there will

[264] *See* 26 U.S.C. § 221 (for phase out for student loan interest deduction); former 26 U.S.C. § 68 (prior to the TCJA taxpayers faced a phase out of itemized deductions based on the AGI).

[265] 26 U.S.C. § 55.

[266] *Id.*

[267] *Id.* § 55(d)(4).

[268] Scott Ahroni, *Congress and the SALT Deduction*, CPA J. (Jan. 2018), https://www.cpajournal.com/2018/01/22/congress-salt-deduction/.

be the decreased federal tax expenditure, which is necessary to support the other changes under the TCJA.

In *New York v. Mnuchin*, both parties pointed out that there is another option that would mitigate the harm caused by the SALT deduction cap: namely, the states most affected could cut spending and subsequently cut taxes for their citizens.[269] This could disincentivize migration caused by the SALT deduction cap and cure that specific revenue issue for high-tax states.[270] Proponents of this also feel that by re-examining budgets, high-tax states would still be able to provide "high-value service at minimum cost."[271]

While this option may be lucrative from a strictly fiscal standpoint, it completely disregards the spirit of federalism. If the states were to cut spending, it would not be because of any sovereign choice of their own, but rather in spite of their own choices.[272] The citizens of those states made the choice to live in the state and pay higher property and income taxes because they wanted the increased social services, such as better school systems.[273] For example, high-tax states like New Jersey, Connecticut, and Maryland are among the top ten states with the best school systems.[274] On the other hand, low-tax states dominate the lower spots on the ranking.[275] It would be wrong for the federal government to step in and force the hand of both the state governments and the citizens of those states.[276]

Finally, and perhaps most importantly, high-tax states cutting their budgets could have a large-scale impact on the national economy.[277] This is because high-tax states generally receive a fraction of the state's baseline contribution of federal taxes.[278] On the other hand, many low-tax states receive a multiple of their contribution.[279] For example, Mississippi and Louisiana rank first and second for percentage of federal aid that makes up

269 *See supra* Part VI. *See also* Chris Edwards, *Tax Reform and Interstate Migration*, CATO INST. (Sept. 6, 2018), https://www.cato.org/publications/tax-budget-bulletin/tax-reform-interstate-migration.

270 Edwards, *supra* note 269.

271 *Id.*

272 *Policy Basics: Where Do Our State Tax Dollars Go?*, CTR. ON BUDGET AND POL'Y PRIORITIES (July 25, 2018), https://www.cbpp.org/research/state-budget-and-tax/policy-basics-where-do-our-state-tax-dollars-go.

273 *See* Renee Morad, *States with the Best Public School Systems*, FORBES (July 31, 2018, 9:24 PM), https://www.forbes.com/sites/reneemorad/2018/07/31/states-with-the-best-public-school-systems/#487eff213897.

274 *Id.*

275 *See id.*

276 *See* Gordon, *supra* note 46.

277 *See generally* Complaint, *supra* note 179.

278 Complaint, *supra* note 179, at 36.

279 Complaint, *supra* note 179, at 36–37.

state revenue respectively, and both are low-tax states.[280] On the other hand, New Jersey and Connecticut rank forty-first and forty-second respectively[281] and both are high-tax states. By cutting taxes and spending, these high-tax states would be remitting less, having a big impact on low-tax states.[282] Further, the fact that these low-tax states would benefit from what amounts to a federal subsidy cuts against their prior opposition to the SALT deductions on the grounds that it was a federal subsidy to high-tax states.[283]

Therefore, while there might be other alternatives to the issues caused by the SALT deduction cap, they are fraught with issues that the AGI phase-out is not.[284] Namely, the AGI phase-out would not create a disparity in detriment among the states and would not force states to make difficult choices that undermine their sovereignty.[285] It would also be less likely to have unforeseen consequences regarding the distribution of federal money among states, nor will it have a major impact on federal revenues.[286]

VIII. CONCLUSION

The new SALT deduction cap has created a number of issues in its wake. It appears that the cap has great potential to impact many different constituencies and in unexpected ways. Those most impacted are a number of high-tax states, as well as residents of those states and businesses located within those states.[287] The potential harm that could be caused ranges from decreases in property values, to fewer social services provided in the high-tax states.[288] There is also the potential for less federal revenue overall if states cut back on their taxes. Additionally, the IRS response to workarounds for this cap will potentially impact charitable funds nationwide.[289] Considering the state of the situation, there needs to be some form of change to the SALT deduction cap.

A number of high-tax states, starting with New York, have passed state legislation to circumvent the effects of the cap.[290] While the payroll workaround will likely not be disallowed by IRS regulation, it is unlikely

[280] Katherine Loughead, *Which States Rely the Most on Federal Aid?*, TAX FOUND. (Jan. 9, 2019), https://taxfoundation.org/federal-aid-reliance-rankings/.
[281] *Id.*
[282] *See id.*
[283] Galle, *supra* note 38, at 809.
[284] *See supra* Part VII.
[285] *See* Gordon, *supra* note 46.
[286] *See supra* Part VII.
[287] *See supra* Part IV.
[288] *Id.*
[289] IRS Guidance, *supra* note 162, at 43,565.
[290] Mandarino, *supra* note 136, at 689.

employers will utilize this, making it an ineffective solution.[291] States have also attempted to provide state and local tax credits for taxpayers' payments to charitable contributions.[292] This legislative mechanism, however, has already run afoul of the IRS, which will only allow charitable contribution deductions to the extent that no tax credit was received for it.[293] This interpretation has also subsequently created numerous issues. Thus, this is also an ineffective solution.

Finally, high-tax states New York, New Jersey, Maryland, and Connecticut have sought relief from the cap through the courts.[294] They argue that the cap violates their legally protected rights under the Tenth Amendment, the Sixteenth Amendment, and Article 8 Section 1 of the Constitution.[295] While they make some arguments for their case, their complaint has already been dismissed and their success on appeal is not likely.[296] Further, looking at the consequences, their unlikely victory would mean the invalidation of this new limitation in the IRC. Because the federal government makes up a large amount of the revenue lost due to other tax cuts in the TCJA through the SALT provision, this could have serious implications for the national deficit.[297] If the states are not successful, however, all of the above unintended consequences of the new provision have a high likelihood of coming to pass.

Therefore, the best possible option is legislative reform of the IRC and a phase-out of the SALT deduction based on AGI would best serve the goals sought to be accomplished through this reform.[298] Because it would be based solely on income, this phase-out would avoid over-taxing lower- and middle-income taxpayers, one of the main pitfalls of the current, unworkable deduction cap. Further, this reform would effectuate a compromise that is workable for both high- and low-tax states,[299] meaning that, in the end, no state would be left with salt in its wounds.

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[291] *Id.*

[292] 2018 N.Y. Laws 59 § 850 (LexisNexis 2018) (New York); N.J. STAT. ANN. § 54:4-66.9 (LexisNexis 2018) (New Jersey); 2018 Conn. Acts 49 (LexisNexis 2018) (Connecticut).

[293] IRS Guidance, *supra* note 162, at 43,565.

[294] Complaint, *supra* note 179.

[295] *Id.*

[296] *See supra* Part VI.

[297] STAFF JOINT COMM. ON TAX'N, 115TH CONG., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R.1, THE "TAX CUTS AND JOBS ACT" (Dec. 18, 2017), https://www.jct.gov/publications.html?func=startdown&id=5053.

[298] *See supra* Part VII.

[299] *See supra* Part VII.