July 15, 2021

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The Honorable Janet Yellen
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Ave., NW
Washington DC, 20220

Re: Interim Final Rule, Coronavirus State and Local Fiscal Recovery Funds
Docket No. TREAS-DO-2021-0008-0002

Dear Secretary Yellen:

The New Civil Liberties Alliance (NCLA) submits the following comments in response to the Department of the Treasury's (Treasury) *Interim Final Rule—Coronavirus State and Local Fiscal Recovery Funds*, 31 CFR Part 35. NCLA sincerely appreciates this opportunity to comment and express its concerns about the Interim Final Rule (IFR).

I. INTERESTS OF NCLA

The New Civil Liberties Alliance is a nonpartisan, nonprofit civil rights organization founded to protect constitutional freedoms from violations by the administrative state. NCLA's original litigation, *amicus curiae* briefs, regulatory comments, and other means of advocacy strive to tame the unlawful power of federal agencies. NCLA defends civil liberties by invoking constitutional constraints to limit administrative power. Although Americans still enjoy a shell of their Republic, a very different sort of government has developed within it—a type, in fact, the Constitution's design sought to prevent.

Not only does the administrative state evade constitutional limits through administrative rulemaking, adjudication, and enforcement, but increasingly agencies coerce state and local actors by conditioning receipt of federal funds upon acquiescence to certain policies. Frequently, this coercion directly conflicts with the vesting of authority to set such policies elsewhere, as in this case where the right to set their own tax policies is reserved to the states. Such unconstitutional administrative actions violate more rights of more Americans than any other aspect of American law, which is why they are the focus of NCLA's efforts.

Where agencies are poised to act beyond their lawful powers, NCLA encourages them to curb the illegitimate exercise of such power by establishing meaningful limitations on administrative rulemaking, adjudication, and enforcement. The courts are not the only government bodies with the duty to attend to the law. Even more immediately, agencies and agency heads must examine whether their modes of rulemaking, adjudication, and enforcement comply with the Administrative Procedure Act (APA), laws of Congress, and the Constitution. The Department of the Treasury should do so here before more courts must act to set aside the unlawful IFR.

II. Background

The American Rescue Plan Act of 2021 (ARPA), enacted on March 11, 2021, offers approximately $195 billion to states and their residents to assist with economic recovery from the Covid-19 pandemic. As a condition of acceptance, however, a state must agree not to use ARPA funds "to either directly or indirectly offset a reduction in the net tax revenue of such State … resulting from a change in law, regulation, or administrative interpretation … that reduces any tax." 42 U.S.C. § 802(c)(2)(A). ARPA authorizes the Treasury to recoup any violation of this condition, *id*. § 802(e), which is referred to hereinafter as the "Tax Cut Ban."

On May 17, 2021, Treasury published an interim final rule in the Federal Register that purports to interpret the Tax Cut Ban. 86 Fed. Reg. 26,786 (May 17, 2021) ("IFR"). The IFR sets out a four-step methodology to identify state tax cuts that Treasury might later try to recoup. Boiled to their essence, the four steps are:

> (1) Sum All State Tax Cuts Each Year: Each change in [state] law, regulation, or administrative interpretation is identified that could reduce net tax revenue and those reductions are then summed. "The sum of these values in the year for which the government is reporting is the amount it needs to 'pay for' with sources other than [ARPA] Funds …"
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> (2) De Minimis Safe Harbor: If the total value of the tax reductions for the reported year fall below a 1% de minimis level, then that bucket of tax reductions does not need to be "paid for" and will not be recouped.
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> (3) Comparison to Fiscal 2019 as Baseline Year: "If the recipient government's actual tax revenue is greater than the amount of tax revenue received by the recipient for the fiscal year ending 2019, adjusted annually for inflation," then the state will be deemed not to have reduced its net tax revenue.
>
> (4) Identification of Offsets: The state can then "identify any sources of funds that have been used to permissibly offset the total value of covered tax changes other than [ARPA] Funds."

86 Fed. Reg. at 26,807-09. *See* 31 C.F.R. § 35.8 (b)(1)-(4).

In practice, there is also an unstated fifth step: 31 C.F.R. § 35.10 allows Treasury to identify the amount of tax cuts that, in its judgment, have not been "paid for" using the above methodology. 86 Fed. Reg. at 26,808 & 26,810. The IFR states that Treasury would consider "all relevant facts and circumstances" it deems relevant, "including information regarding planned spending cuts and budgeting assumptions" to determine the amount to recoup, if any. *Id.* at 26,810.

A number of states have challenged the Tax Cut Ban in federal court. NCLA filed *amicus curiae* briefs in support of lawsuits in the Northern District of Alabama and the Southern District of Ohio. These briefs are appended to this comment to provide further reasons why ARPA's Tax Cut Ban and Treasury's IFR interpreting it are unlawful. Most recently, the Southern District of Ohio held the Tax Cut Ban is unconstitutional and permanently enjoined Treasury from enforcing it against Ohio. *Ohio v. Yellen*, 2021 WL 2712220, at *2 (S.D. Ohio July 1, 2021).

III. THE STATE TAX CUT BAN VIOLATES ARTICLE I, SECTION 8'S SPENDING CLAUSE

The Tax Cut Ban disregards numerous restrictions on Congress' Article I, Section 8 Spending Power. *See* U.S. Const. art. I § 8. Among other deficiencies, the Tax Cut Ban is unconstitutionally ambiguous, coercive, and not reasonably related to ARPA's purposes. While mutually reinforcing, each of these defects is sufficient to render the Tax Cut Ban unconstitutional.

First, as the Southern District of Ohio held, the Tax Cut Ban is unconstitutionally ambiguous. *Yellen*, 2021 WL 2712220, at *15. A Spending Clause condition must provide sufficient clarity to make states "cognizant of the consequences" of accepting the funds, or else it is unconstitutionally vague. *South Dakota v. Dole*, 483 U.S. 203, 210 (1987). Here, it is impossible for states to determine the exact nature of the consequences associated with accepting ARPA funds. The mandate that states may not "indirectly offset a reduction in net tax revenue" is incurably ambiguous. *State of Ohio v. Yellen*, 2021 WL 1903908, at *12 (S.D. Ohio May 12, 2021) ("Despite poring over this statutory language, the Court cannot fathom what it would mean to indirectly offset a reduction in net tax revenue of a State"). Given this ambiguity, states cannot possibly "understand their obligations" and act according to them. *See Sch. Dist. of City of Pontiac v. Sec'y of U.S. Dept. of Educ.*, 584 F.3d 253, 277 (6th Cir. 2009).

Treasury's IFR cannot cure the Tax Cut Ban's unconstitutional vagueness because the requisite clarity of a Spending Condition must be supplied by "Congress," not an administrative agency. *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17, (1981) (requiring that "Congress speak with a clear voice"); *Bennett v. Kentucky Dep't of Educ.*, 470 U.S. 656, 663 (1985) ("Congress must express clearly its intent to impose conditions."); *Com. of Va., Dep't of Educ. v. Riley*, 106 F.3d 559, 567 (4th Cir. 1997) (en banc) (adopting panel-stage dissenting opinion's conclusion that only the statutory language enacted by Congress, rather than an agency's regulation, matters for Spending Clause clarity purposes). Even if Treasury could cure the ambiguity with the IFR—which it cannot—the IFR only further complicates how to determine whether an unlawful, indirect offset has occurred. In particular, the power Treasury conferred on itself to consider "all relevant facts and circumstances" to determine if a state tax cut has been "paid for" using ARPA funds renders Treasury's system a black box for the states trying to navigate it. 86 Fed. Reg. at 26,808 and 26,810. In making tax and spending decisions, states have no way of knowing *ex ante* what facts and circumstances Treasury will fixate on to determine whether a reduction in the net tax revenue was "indirectly" paid for using ARPA funds. In other words, Treasury knows an indirect offset when it sees one. While this "standard" may pass muster with unelected bureaucrats in Washington who desire *carte blanche* control over state tax policy, it fails to clarify states' obligations in connection with accepting ARPA funds since Treasury will consider "all relevant facts"—without clearly defining ahead of time what Treasury might find relevant. Instead of curing the original constitutional defect, Treasury's IFR has only exacerbated the ambiguity problem. The Constitution demands clearer standards for spending conditions than

either ARPA or the innovations the IFR works on the ARPA scheme provide. *South Dakota*, 483 U.S. at 210.

Second, the Tax Cut Ban is unconstitutionally coercive. While Congress may condition federal funding, it may not use those conditions to coerce a state into "adopting a federal regulatory system as its own." *NFIB v. Sebelius*, 567 U.S. 519, 578 (2012). A condition is coercive when states have "no choice" but to accept the conditioned funding. *Id.* Congress, via ARPA, unconstitutionally coerces the states into adopting its preferred taxation framework by conditioning funds states have "no real choice" but to accept. *See id.* at 587. COVID-19 wreaked unprecedented fiscal damage to states and their budgets, making it impossible for states to refuse the funds.[1] Now, upon receipt of those funds, states can stave off economic damage and even enjoy temporary surpluses. This is unsurprising, since available ARPA funds represent "5% to more than 20% of annual spending" in each state.[2] In *NFIB*, the Supreme Court held that "[t]he threatened loss of over 10 percent of a State's overall budget … is economic dragooning that leaves the States with no real option but to acquiesce." 567 U.S. 519. ARPA funds represent the same or even greater levels of economic coercion and thus also present states with two options: economic ruin, or else accept the funds but acquiesce to Washington's current preference for higher taxation. This is not a real choice or "mild encouragement"— "it is a gun to the head." *NFIB*, 567 U.S. at 581. As a result, the condition is clearly coercive and exceeds the limit of Congress' ability to condition funding.

Finally, the Tax Cut Ban bears no reasonable relation to ARPA's purpose. *South Dakota*, 483 U.S. at 207 (observing that conditions on federal funding may be "illegitimate if they are unrelated… to the interest in particular national projects…"). ARPA funds must be used for a range of pandemic-related purposes, including, *inter alia,* responding to "negative economic impacts" by providing "assistance to households, small businesses, and nonprofits, or aid to impacted industries, such as tourism, travel, and hospitality." 42 U.S.C. § 802(c)(1)(A). Tax relief is one of the most obvious and direct means of providing such assistance to targeted groups, one that ARPA itself uses extensively.[3]

ARPA attempts to monopolize the tool of tax cuts so that the political benefits of providing those cuts flow only to the federal government's legislative and executive branches. This aim is clear from the fact that the federal stimulus monies provided through ARPA have been so highly

[1] *See* The World Bank, *Covid-19 to Plunge Global Economy into Worst Recession since World War II* (June 8, 2020), WorldBank.org. For example, prior to the availability of ARPA funding, states cumulatively faced $127 billion in budget shortfalls and lacked the reserves to address them. Congressional Research Service, *State and Local Fiscal Conditions and COVID-19* (Dec. 7, 2020) Crsreports.congress.gov. Given that states, subject to varying restrictions, must balance their budgets, these shortfalls would have resulted in devastating budget crises with disastrous impacts to states and their populations. Josh Goodman, *How States Can Use Federal Stimulus Money Effectively* (May 11, 2021), PewTrusts.org.

[2] Barb Rosewicz, *How Far American Rescue Plan Dollars Will Stretch Varies by State* (June 28 2021), PewTrusts.org.

[3] ARPA contains countless tax cuts, including, *inter alia*, tax-free stimulus checks of up to $1,400 per person; health care tax credits; expanded child tax credits; additional child-and-dependent care tax credits; expansion of the earned income tax credit; and tax relief for individuals whose student loans were discharged. *See* Sidney Kess, Joseph Buble, and James R. Grimaldi, Tax Changes for Individuals in the American Rescue Plan Act, CPA Journal, June 2021.

touted. *See, e.g.*, White House, https://www.whitehouse.gov/american-rescue-plan/ (first blue plus-sign on the President's ARPA Plan: "$1,400 per-person checks"). But this political rationale does not equate to a rational basis under Article I for denying state tax relief to American families and businesses, particularly in light of the need for federalism to protect state spheres of autonomy. For the mere existence of federal "tax cuts for COVID" makes clear that the federal government does not object *as a general matter* to providing COVID relief by reducing tax burdens (a neutral principle); it just wants to make sure that the valuable tool of providing COVID relief via the tax code is *uniquely unavailable to the states*. Additionally, in light of this problem, it is even more irrational for the IFR to *expand on* the limited scope of the Tax Mandate as framed in ARPA's text. Yet, Treasury does exactly that by trying in the IFR to confer on itself the ability to engage in a case-by-case assessment of whether each state in any given year has cut its taxes *too much*, exposing such states to recoupment actions whenever its officials see fit.

Prohibiting states from providing tax-relief assistance is not merely unrelated to ARPA's core purpose, it actively undermines it. This contradiction is all the more stark considering that Congress took no steps to prevent fungible ARPA monies from being used to *indirectly* offset spending on any other purpose. In fact, the only other express restriction Congress placed on the expenditure of ARPA monies by states is that they cannot directly fund pension liabilities. *Id.* Conspicuously, though, a restriction on *indirect* funding of pensions is not present. *Id.* This demonstrates that states can use ARPA funds to indirectly finance spending unrelated to ARPA's purposes, including funding pensions, but not apparently to provide tax-relief "assistance to households, small businesses, and nonprofits." Thus, instead of imposing reasonable restrictions necessary to effectuate ARPA's purpose, Congress made state tax cuts *verboten* out of an apparent disdain for lower state taxes. Because the Tax Cut Ban bears no reasonable relation to ARPA's ostensible purposes and for the reasons set forth above, the Tax Cut Ban violates the Spending Clause.

IV. ALLOWING TREASURY TO INTERPRET THE STATE TAX CUT BAN VIOLATES THE NON-DELEGATION DOCTRINE

The Tax Cut Ban is an unconstitutional delegation of Congress' Spending Power. *See Whitman v. Am. Trucking Assocs.*, 531 U.S. 457, 473 (2001) ("Article I, Section 1, of the Constitution vests all legislative Powers … in a Congress … This text permits no delegation of those powers."). Congress may only delegate legislative power if it provides an "intelligible principle" an agency must adhere to when exercising the delegated legislative power. *Gundy v. United States*, 139 S. Ct. 2116 (2019). Here, Congress provided no such principle. Even worse, by failing to define "net tax revenue," when a state experiences a "reduction" in revenue "resulting from a change in law, regulation, or administrative interpretation," or to specify how Treasury should determine whether a reduction was "directly or indirectly offset" by ARPA funds, Congress has passed a "vague law" that "impermissibly" delegates these "basic policy matters" to Treasury. *See Grayned v. City of Ruckford*, 408 U.S. 104, 108-09 (1972). Treasury cannot define these terms itself, as doing so requires Treasury to use Congress' legislative power without an intelligible principle to guide the exercise. *F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 536 (2009) ("Congress must clearly delineate the general policy an agency is to achieve and must specify the boundaries of the delegated authority") (cleaned up).

Treasury cannot cure the unconstitutional delegation with the Interim Final Rule. "The idea that an agency can cure an unconstitutionally standardless delegation of power" is "internally

contradictory." *Whitman*, 531 U.S. at 473. This is because "[t]he very choice of which portion of the power to exercise—*i.e.*, the prescription of the standard that Congress omitted—would itself be an exercise of … legislative authority." *Id.* The ambiguity in the condition described above means Treasury cannot discern Congress' intent for how the condition ought to be interpreted. Treasury's attempt to cure this ambiguity with the Interim Final Rule required it to choose interpretations among multiple competing possibilities, based solely on its own policy preferences. This choice, however, itself represents an exercise of Spending Clause power that Congress may not lawfully delegate to Treasury. Thus, Treasury's attempt to cure ARPA's ambiguities runs afoul of the non-delegation doctrine.

Even if some "intelligible principle" could be extracted from the Tax Cut Ban's incurably vague text—despite no such principle existing—Treasury still would lack authority to issue the IFR. The Tax Cut Ban presents questions of deep "economic and political significance," and if Congress intended for Treasury to answer such "major questions," it must say so clearly. *FDA v. Brown & Williamson*, 529 U.S. 120, 159 (2000). Any authority to infringe on state sovereignty, such as allowing Treasury to interpret the Tax Cut Ban, must also be made "plain to anyone reading the [statute]." *Gregory v. Ashcroft*, 501 U.S. 452, 467 (1991). ARPA contains no such clear statement empowering Treasury to decide "major questions" or infringe upon state sovereignty. As such, Treasury has not been delegated authority to issue the IFR. *Yellen*, 2021 WL 2712220, at *20 ("[E]ven assuming that Congress can outsource to an agency the obligation to provide the answers needed to meet the Spending Clause clarity requirement, Congress made no such delegation in ARPA.").

V. THE INTERIM FINAL RULE VIOLATES THE ADMINISTRATIVE PROCEDURE ACT

Treasury's choice of 2019 as the base year to determine whether a tax or spending cut has taken place violates the Administrative Procedure Act's prohibition against arbitrary and capricious decision-making. 5 U.S.C. Section 706(2)(A). An agency decision is arbitrary and capricious when it lacks a "rational connection" between the "facts found and the choice made." *Encino Motorcars, LLC, v. Navarro*, 136 S. Ct. 2117, 2125 (2016); *see also Fox*, 556 U.S. at 537 (explaining that it is a "duty of agencies" under the APA to provide a "reasoned explanation" for their policy choices). Here, no rational basis exists for requiring states not to fall below their tax revenue levels for 2019. *See* 86 Fed. Reg. at 26,823. Consider two states, A and B, that each experience the same reduction in tax revenue from $20 billion in 2020 to $18 billion in 2021. State A's 2019 revenue was $17 billion while State B's revenue was $19 billion. While both states experienced identical tax revenue reductions, only State B would be deemed to have experienced a tax reduction.

The IFR attempts to reconcile this nonsensical result by explaining that 2019 "is the last full fiscal year prior to the COVID-19 public health emergency." 86 Fed. Reg. 26,808. But that is irrelevant in defining the statutory text of "reduction in the net tax revenue." The IFR also states that 2019 is "consistent" with "ARPA sections 602(c)(1)(C) and 603(c)(1)(C), which identify the 'most recent full fiscal year of the [State, territory, or Tribal government] prior to the emergency'; as the comparator for measuring revenue loss." But those two provisions concern the use of ARPA funds to address shortfalls in tax revenue attributable to the COVID-19 pandemic and are wholly irrelevant in determining whether a prohibited tax cut occurs. The most natural way to measure changes in tax revenue is a year-to-year comparison. That is precisely how Treasury reports its

own receipt of tax revenue. The IFR contains no rational explanation for departing from this commonsense method and instead adopting 2019 as a baseline year.

The IFR's use of 2019 as a baseline is even more irrational in the context of determining whether a state may pay for tax cuts with its own spending cuts, thus obviating the need for any "indirect or direct offset" using ARPA funds. Such spending cuts must, however, be measured "relative to total spending for the recipient's fiscal year ending in 2019, adjusted for inflation." 86 Fed. Reg. at 26,810. Consider a state that increased spending on small business assistance from $80 million in 2019 to $100 million in 2020 to provide additional relief during the COVID-19 pandemic. If it now cuts spending back to $80 million, it could not use the $20 million spending cut to pay for a tax reduction because, under the IFR, spending did not decrease relative to 2019 levels. The IFR contains no answer for such an absurd outcome. This omission violates one of Treasury's most basic responsibilities under the APA, and it demonstrates the arbitrary nature of many of Treasury's choices in the IFR.[4]

VI. The Tax Cut Ban Undermines Federalism and Encourages Arbitrary Enforcement

The Tax Cut Ban blatantly disregards tenets of federalism inherent in our constitutional order. *See NFIB*, 567 U.S. at 522-23 ("The Constitution simply does not give Congress the authority to require states to regulate …" and doing so "runs counter to this Nation's system of federalism."). Here, Congress' attempt to hijack state tax policy is particularly egregious. A "strong … principle" exists "against federal interference with state taxation." *National Private Truck Council, Inc. v. Oklahoma Tax Com'n*, 515 U.S. 582, 589 (1995). Faced with the ambiguity of the state Tax Cut Ban, states might choose to forgo tax cuts to avoid being hit with a ruinous recoupment action from Treasury.[5] In effect, the coercive influence of the Tax Cut Ban means Congress, and not the states, controls state taxation. The United States' system of federalism exists in large part to ensure a diffusion of sovereign power and prevent consolidation of policymaking in an omnipotent, potentially tyrannical, leviathan. *See New York v. U.S.*, 505 U.S. 144, 166 (1992) (Congress may not "outright coerce" the states); *see generally* Federalist No. 46 (Madison) (States retain strong "means of opposition" to "unwarrantable measure[s] of the federal government."). A unified system of state tax policy overseen by unelected, unaccountable bureaucrats at Treasury represents a grave, new threat to individual liberty and should be rejected. *See McCulloch v. Maryland*, 17 U.S. 316, 431 (1819) ("The power to tax involves the power to destroy"). The United States' system of federalism demands better than bad-faith attempts to commandeer state tax policy by unaccountable bean counters and bureaucrats seeking to impose their proclivity for excessive taxation on the states.

A particularly insidious aspect of the Tax Cut Ban is that Treasury retains substantial discretion as to how it will enforce it. Because executive enforcement choices are given deference

[4] The one percent *de minimis* standard Treasury has imposed is subject to the same critique. *See* 86 Fed. Reg. 26,808, 31 C.F.R. Part 35. Treasury states the one percent level "reflects historical effects of state-level tax policy changes in state EITCs implemented to effect policy goals other than reducing net tax revenues." 86 Fed. Reg. 26,809. But nothing in the statutory text of the Tax Cut Ban limits its application to reductions of net tax revenue that are intended as policy goals. To the contrary, the rest of the IFR's Tax Cut Ban provisions makes clear that it is the actual or anticipated *effect* rather than *intent* that matters when measuring tax revenue reductions. *Id.* at 26,823.

[5] *See* Jared Walczak, *ARPA's Tax Cuts Limitation Is a Problem for More States Than You Think* (April 5, 2021), TaxFoundation.org.

and are often non-reviewable, little would stop Treasury from exercising more scrutiny over states which are perceived to hold views dissenting from Treasury's pro-tax dogma. *See Heckler v. Chaney*, 470 U.S. 821, 833 (1985) ("[A]gency decision[s] not to take enforcement action should be presumed immune from judicial review under the" APA). This is especially true where an action is "committed to agency discretion by law." *Casa De Maryland v. U.S. Department of Homeland Security*, 924 F.3d 684, 697 (4th Cir. 2019). Given the ambiguities in the Tax Cut Ban described above, Treasury retains substantial discretion over how, when, and against which states it will choose to claw back funding or otherwise enforce it. Treasury's ability to arbitrarily enforce the Tax Cut Ban is not hypothetical—executive agencies possess a track record of harassing political enemies[6] and disregarding civil liberties.[7] It is not hard to imagine a scenario where Treasury would choose to exercise more oversight of compliance with this powerful spending condition against states perceived to be politically opposed to the White House. This policy reason alone requires that Congress provide clearer enforcement standards to ensure Treasury's oversight of the Tax Cut Ban is even-handed and not abused. No one watches over Treasury's enforcement decisions, and there is nowhere for a state to turn if that power is used for political or other illegitimate purposes.

CONCLUSION

For the above reasons, and those stated in the attached briefs that NCLA hereby incorporates by reference, NCLA opposes the Interim Final Rule.

Very truly yours,

/s/ Sheng Li

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[6] The Internal Revenue Service employed "'heightened scrutiny and inordinate delays' and demanded unnecessary information as it reviewed applications for tax-exempt status" of conservative leaning non-profits during President Obama's administration. Peter Overby, *IRS Apologizes for Aggressive Scrutiny of Conservative Groups* (Oct. 27, 2017), NPR.org.

[7] *See generally*, Philip Hamburger, IS ADMINISTRATIVE LAW UNLAWFUL? (2014).