# COMMENTS

## JUST A PINCH OF SALT IS NOT ENOUGH*

### I. INTRODUCTION

Controversial changes in the Tax Cuts and Jobs Act (TCJA) are causing an intragovernmental showdown over tax revenue. This Comment focuses on the capping of the individual deduction for state and local taxes (SALT). Section 164(a) of the Internal Revenue Code (the Code) provides for a deduction in the year of payment or accrual of the following taxes: "(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[; and] (4) The [generation-skipping transfer] tax imposed on income distributions."[1]

This deduction is available to all taxpayers who do not take the standard deduction and instead itemize their deductions.[2] The SALT deduction has been incredibly popular with taxpayers.[3] According to Internal Revenue Service (IRS) data, 30.64% of all individual taxpayers chose to itemize their deductions in 2017.[4] While the average total itemized deductions each tax filer claimed was $29,925.54,[5] the average SALT deduction was $13,456.98.[6] Therefore, of the approximately one-third of taxpayers who itemized, state and local taxes paid made up 45% of their total deductions. These statistics are likely to change dramatically as a result of the TCJA,

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1. I.R.C. § 164(a) (2018).

2. *See id.* § 63.

3. *See, e.g.*, Scott Horsley, *SALT Reduction Becomes Major Sticking Point in Tax Overhaul. So What Is SALT?*, NPR (Oct. 28, 2017, 7:00 AM), http://www.npr.org/2017/10/28/560413409/salt-reduction-becomes-major-sticking-point-in-tax-overhaul-so-what-is-salt [https://perma.cc/BJB9-XUFU].

4. *See* INTERNAL REVENUE SERV., STATISTICS OF INCOME, INDIVIDUAL INCOME TAX RETURNS COMPLETE REPORT 6–7 tbl.A (2019), http://www.irs.gov/pub/irs-pdf/p1304.pdf [https://perma.cc/GLL7-2SMK]. This figure was calculated as "Total itemized deductions: Number of returns" divided by "All Returns." For additional statistics on the impact of the SALT deduction, see generally GOV'T FIN. OFFICERS ASS'N, THE IMPACT OF ELIMINATING THE STATE AND LOCAL TAX DEDUCTION (2017), http://www.gfoa.org/sites/default/files/RCC%20Report%20on%20SALT%20Deduction-092017_Final.pdf [https://perma.cc/LM7M-86JR].

5. *See* INTERNAL REVENUE SERV., *supra* note 4, at 7 tbl.A. This figure was calculated as "Amount" divided by "Total itemized deductions: Number of returns."

6. *See id.* at 21 fig.C. This figure was calculated as "Amount" divided by "Number of returns" for Taxes Paid.

which Congress enacted on December 22, 2017, and took effect on January 1, 2018.[7] This legislation changed several fundamental aspects of the Code, one of which was the imposition of a $10,000 limit on the deduction for state and local taxes for individual taxpayers.[8]

This Comment provides a comprehensive assessment of the approaches various states have taken to mitigate the SALT deductions their citizens lost as a result of the $10,000 deduction cap. Section II provides readers with information on the history of the SALT deduction and how the cap came to be. Section III explores the reactions of some states to the enactment of the $10,000 cap on SALT deductions, and the Treasury's subsequent responses. Some states—mainly high tax, traditionally democratic states—have enacted legislative "workarounds."[9] These efforts will provide their citizens with a means of satisfying their state and local tax obligations while maintaining the same, or a similar, level of deductions taken in previous years.[10] Four states have also sued the federal government, arguing that the SALT deduction cap is unconstitutional.[11] Section IV synthesizes this information and suggests that states pursue the employee payroll and pass-through entity tax workarounds in the short term. The Section also suggests that states should consider longer-term solutions to provide their taxpayers with relief from the SALT deduction cap by reviewing their own tax systems and focusing their efforts on strategies to amend the Code, not work around it.

## II. THE SALT DEDUCTION THROUGH TIME

To understand states' initial reactions to the enactment of the $10,000 cap on the SALT deduction, as well as the Treasury's subsequent reaction, one must understand how the limit came to be. The deduction's controversial nature among tax theorists did not suddenly arise in late 2017. On the contrary, the cap simply thrust the deduction into the spotlight and made it a hot-button issue.[12] This Section provides relevant context to the SALT deduction cap by exploring the deduction's history as well as the legislative history behind the cap's enactment.

This Section proceeds in two Parts. Part II.A offers a brief history of the SALT deduction, discussing its origin and the arguments both for and against the deduction. Part II.B explains the political context surrounding the TCJA's introduction and passage. It then reviews the amendment to Section 164 and discusses why these changes occurred.

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7. *Actions Overview H.R.1—An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018*, CONGRESS.GOV, https://www.congress.gov/bill/115th-congress/house-bill/1/actions [hereinafter *Actions Overview H.R. 1*] (last visited Feb. 1, 2020).

8. Pub. L. No. 115-97, § 11042(a), 131 Stat. 2054, 2085–86 (2017) (codified at I.R.C. § 164(b)(6)(B) (2018)). The cap applies to individual taxpayers but not to entities. *Id.* In the case of a married individual filing a separate return, the cap is $5,000. *Id.*

9. Lawrence Zelenak, *SALT Ceiling Workarounds and Tax Shelters*, 160 TAX NOTES 521, 521 (2018).

10. *Id.*

11. New York v. Mnuchin, 408 F. Supp. 3d 399, 401 (S.D.N.Y. 2019), *appeal docketed* No. 19-3962 (2d Cir. Dec. 20, 2019).

12. *See* Gladriel Shobe, *Disaggregating the State and Local Tax Deduction*, 35 VA. TAX REV. 327, 329 (2016). See *infra* Part II.A for a discussion of the history of and tax theorists' opinions on the SALT deduction.

### A. *History of the SALT Deduction*

Congress has the power to lay and collect federal taxes independent of state taxes.[13] However, deductions for paid state and local taxes are as old as the federal income tax system itself.[14] Congress has provided a deduction for all, or a significant part of, SALT taxes paid in every federal income tax law enacted since 1861 because it has recognized "federalism constraints on its taxing power and the concurrent tax authority of the sovereign States."[15] The deduction served as "a bulwark against the possibility that 'all the resources of taxation might by degrees become the subjects of federal monopoly, to the entire exclusion and destruction of state governments.'"[16] When Congress permanently established the modern federal income tax following the ratification of the Sixteenth Amendment in 1913, it contained a SALT deduction.[17] Indeed, the SALT deduction, in one form or another, has remained a constant feature of federal income tax law.[18]

The types of taxes eligible for the SALT deduction have changed over time.[19] The 1913 provision included a broad range of taxes eligible for the deduction, permitting deductions for "all national, State, county, school and municipal taxes paid within the year, not including those assessed against local benefits."[20] Revenue Act of 1964 contained the next important SALT deduction development. The Act amended the deduction to list the types of taxes that were deductible, thereby narrowing the scope of eligible taxes to income taxes, real property taxes, personal property taxes, and sales taxes, and disallowing deductions for other state and local taxes paid.[21]

In 1986, Congress further altered the SALT deduction by eliminating the deduction for state sales taxes as part of a larger effort to broaden the federal tax base in exchange for reduced tax rates.[22] However, in 2004, Congress gave taxpayers the

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13. *See* U.S. CONST. art. I, § 8.

14. Complaint for Declaratory and Injunctive Relief at 2, New York v. Mnuchin, 408 F. Supp. 3d 399 (S.D.N.Y. 2019), 2018 WL 3437090 [hereinafter N.Y. v. Mnuchin Complaint].

15. *Id.* at 4; *see also* Sarah F. Liebschutz & Irene Lurie, *The Deductibility of State and Local Taxes*, 16 PUBLIUS: J. FEDERALISM 51, 59 (1986) ("Tax deductibility is thus viewed as an appropriate incentive, or trade-off, to states to continue to maintain the federal-state bargain.").

16. JARED WALCZAK, TAX FOUND., THE STATE AND LOCAL TAX DEDUCTION: A PRIMER 3 (2017) (quoting THE FEDERALIST NO. 31, at 189–92 (Alexander Hamilton)).

17. In 1913, Congress passed the Sixteenth Amendment: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST. amend. XVI. Following the ratification of the amendment, President Woodrow Wilson signed the Revenue Act of 1913, which reinstituted the federal income tax. Revenue Act of 1913, § 2, 38 Stat. 114, 166.

18. *See* BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 32.1.1, Westlaw (database updated Aug. 2019).

19. *See id.*

20. Revenue Act of 1913, § 2(B), 38 Stat. at 167.

21. Revenue Act of 1964, Pub. L. No. 88-272, § 207, 78 Stat. 19, 40 (1964).

22. STAFF OF JOINT COMM. ON TAXATION, 99TH CONG., General EXPLANATION OF THE TAX REFORM ACT OF 1986, at 47 (Comm. Print 1987), http://www.jct.gov/jcs-10-87.pdf [https://perma.cc/WK8L-GVYX]; *see also* WALCZAK, *supra* note 16, at 4 (discussing the SALT deduction debate in 1986).

option of deducting their state sales taxes in lieu of state income taxes.[23] In short, except for this 2004 amendment, "legislation enacted during the past 50 years has gradually limited the [state and local tax] deduction for those who choose to itemize and claim it."[24] The evolution of stricter limits on deductibility suggests that Congress has not seen a constitutional issue with the complete elimination of the SALT deduction.[25] When considered in this light, the 2017 enactment of the SALT deduction cap is consistent with prior congressional actions.[26]

The SALT deduction has always been very controversial.[27] While some tax scholars and government officials view the deduction as a federal subsidy to states by making higher state taxes more acceptable,[28] others see it as essential to ensuring equality among taxpayers.[29] In general, Section 164 can be "regarded as a crude form of revenue sharing, making state and local taxes somewhat more palatable (or, at least, less painful) by reducing their net cost to the citizenry."[30] As the Senate Finance Committee explained in 1964:

> In the case of State and local income taxes, [the] continued deductibility [of these taxes] represents an important means of accommodation where both the State and local governments on one hand and the Federal Government on the other hand tap this *same revenue source* . . . . A failure to

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23. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418, 1520 (codified at I.R.C. § 164(b)(5) (2018)); *see also* STAFF OF JOINT COMM. ON TAXATION, 113TH CONG., PRESENT LAW AND BACKGROUND INFORMATION RELATED TO FEDERAL TAXATION AND STATE AND LOCAL GOVERNMENT FINANCE 1 (Comm. Print 2013) [hereinafter JCT, PRESENT LAW], http://www.jct.gov/publications.html?func=startdown&id=4512 [https://perma.cc/E985-7HND].

24. CONG. BUDGET OFFICE REPORT, PUB. NO. 2906, THE DEDUCTIBILITY OF STATE AND LOCAL TAXES 4 (2008); *see also* Shobe, *supra* note 12, at 329 n.3 (discussing the gradual limitation of the SALT deduction and the one exception in the American Jobs Creation Act).

25. Liebschutz & Lurie, *supra* note 15, at 53.

26. *See supra* notes 20–24 and accompanying text.

27. *See* Shobe, *supra* note 12, at 329.

28. *See* Brian Galle & Jonathan Klick, *Recessions and the Social Safety Net: The Alternative Minimum Tax as a Countercyclical Fiscal Stabilizer*, 63 STAN. L. REV. 187, 214 (2010) ("A local taxpayer facing the choice between savings, private consumption, and consumption of government services (i.e., higher taxes) should prefer government services because a dollar's worth of government services costs her only $0.65, while a dollar's worth of savings or private consumption costs $1.").

29. *See* Brian Galle, *Federal Fairness to State Taxpayers: Irrationality, Unfunded Mandates, and the "SALT" Deduction*, 106 MICH. L. REV. 805, 807–08 (2008) ("When proponents say that the deduction is necessary to treat taxpayers fairly, they mean to invoke one of the basic norms of the tax system, the notion of horizontal equity—the claim that the tax system should treat similarly situated taxpayers similarly. Under the traditional view of § 164, two people who make the same amount of money are not equal if one pays more state tax than the other." (footnote omitted)); Liebschutz & Lurie, *supra* note 15, at 54 (describing horizontal inequities between homeowners and renters and those citizens who live in jurisdictions where "local services, such as garbage collection are provided privately rather than publicly"); *see also* H.R. REP. NO. 88-749, at 48 (1963), *as reprinted in* 1964 U.S.C.C.A.N. 1313, 1357, 1963 WL 4727 (noting that the SALT deduction also helps maintain equality between citizens in other manners such as in the case of property taxes because "any denial of deductions in such cases would result in an important shift in the distribution of Federal income taxes between homeowners and nonhomeowners"); Joel S. Newman, *Pass Back the SALT – It's Really Good for You*, LEXIS FED. TAX J. Q. § 2.02 (2018) (discussing the SALT deduction's ability to "mitigate disparity" at the state level).

30. BITTKER & LOKKEN, *supra* note 18, ¶ 32.1.1.

> provide deductions in this case, could mean that the combined burden of the State, local, and Federal income taxes might be extremely heavy.[31]

Theoretically, through the SALT deduction, the federal government allows each itemizing citizen to reduce her federal tax bill by one dollar multiplied by her marginal tax rate for every dollar of taxes paid to state and local entities.[32] In this way, the deduction is a concession from the federal government acknowledging that paying state as well as local taxes reduces a taxpayer's income and thus her ability to pay federal taxes.[33]

Put another way, by permitting taxpayers to deduct state and local taxes paid, "the federal government pays for a portion of the goods and services provided by states and local governments."[34] Accordingly, the SALT deduction "affects the demand for, and the supply of, public benefits."[35] Those in favor of the SALT deduction argue that many state and local benefits are targeted at low-income citizens who pay little in tax so "it is likely more difficult for states to raise the requisite funds to provide a sufficient level of state benefits, and these benefits are therefore more likely to be undersupplied."[36] Thus, the SALT deduction empowers states to supply a more optimal level of public services because higher taxes are more palatable. Allowing citizens to claim a federal deduction for state and local taxes paid enables states to "determine the appropriate mix and level of public investments to make on behalf of their residents, as well as the authority to choose how to raise revenue to pay for those investments."[37]

In contrast, opponents see as a detriment what other see as a benefit—the SALT deduction allows state and local governments to impose higher taxes.[38] Additionally, because the SALT deduction requires itemization, the wealthy unfairly reap the resulting tax benefits because wealthier individuals pay enough in state and local taxes and other deductible expenses to exceed the standard deduction and benefit from

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31. H.R. REP. NO. 88-749, at 48–49 (1963) (emphasis added).

32. Galle & Klick, *supra* note 28, at 214. Marginal tax rate is "the rate at which tax is incurred on each additional dollar of income." Alicia Tuovila, *Marginal Tax Rate Definition*, INVESTOPEDIA (Oct. 3, 2019), http://www.investopedia.com/terms/m/marginaltaxrate.asp [https://perma.cc/9D28-QZH5]. For example, the Galle & Klick article notes, "for a taxpayer in the top federal bracket, each dollar of state income tax reduces federal tax by $0.35." Galle & Klick, *supra* note 28, at 214. However, the authors wrote that article in 2010. Today, a taxpayer in the top federal tax bracket would reduce her federal tax liability by $0.37. *See* I.R.C. § 1(j) (2018).

33. *See* Eric A. San Juan, *The Distributive State and the Function of Tax Expenditures*, 71 TAX LAW. 673, 713 (2018).

34. Shobe, *supra* note 12, at 329–30.

35. *Id.* at 351.

36. *Id.* at 354. The deduction is justified when state and local governments use revenues from higher taxes to provide services that would otherwise be undersupplied. *Id.* at 352.

37. N.Y. v. Mnuchin Complaint, *supra* note 14, at 3.

38. *See* Newman, *supra* note 29, § 2.03 ("All deductions have regressive effects, in that one dollar of deduction is worth 35 cents to a 35% bracket taxpayer, while that same dollar of deduction is worth only 25 cents to a 25% bracket taxpayer."); Kirk J. Stark, *Fiscal Federalism and Tax Progressivity: Should the Federal Income Tax Encourage State and Local Redistribution?*, 51 UCLA L. REV. 1389, 1394 (2004) (explaining that the SALT deduction's features "give state and local governments an incentive to raise revenues through property and income taxes on high-income taxpayers").

itemizing.[39] The result is an incentive for state and local governments to enact "suboptimal redistributive" tax structures.[40] High levels of local public expenditures may be undesirable if they lead to an overprovision of government services—that is, "certain government services [that] are provided beyond the point at which significant public benefits are reaped."[41] If there are significant spillover benefits, some rationalize that perhaps the federal government should provide the service rather than state and local governments.[42] Others are opposed to the SALT deduction because state and local taxes are generally personal consumption expenditures paid in exchange for the government services provided, and consumption is a component of income that should be taxed.[43]

Prior to the TCJA's enactment, the arguments against the SALT deduction centered on benefit distribution and which sovereign is the ultimate provider of those benefits based on tax incidence.[44] However, since 2017, federal lawmakers have justified and defended the cap primarily because the SALT deduction subsidizes state expenditures.[45] This shift resulted from the context of the TCJA: the legislation focused on reducing tax rates, the bill's proponents needed an offset, and an unlimited SALT deduction results in the federal government's receipt of less tax revenue.[46]

### B. *Public Law No. 115-97*

To understand the changes to Section 164 it is critical to understand the political and social context that led to tax reform in 2017. This Part proceeds by first discussing how the TCJA made its way from the congressional floor to the President's desk in Part II.B.1. Part II.B.2 then discusses the TCJA's change to the SALT deduction.

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39. *See* Stark, *supra* note 38, at 1394. Each taxpayer may either deduct the standard deduction ($12,000 for an individual taxpayer in 2018) or itemize their deductions. I.R.C. § 63(c)(7) (2018). Taxpayers only itemize their deductions when the sum of their itemized deductions (state and local taxes, mortgage interest, charitable contributions, and certain medical expenses) exceeds the standard deduction. *What Are Itemized Tax Deductions?*, INTUIT TURBOTAX, http://turbotax.intuit.com/tax-tips/tax-deductions-and-credits/what-are-itemized-tax-deductions/L1peC8cg0 [https://perma.cc/CHA8-WW2A] (last visited Feb. 1, 2020).

40. Stark, *supra* note 38, at 1394.

41. JCT, PRESENT LAW, *supra* note 23, at 25.

42. *Id.*

43. *See* BITTKER & LOKKEN, *supra* note 18, ¶ 32.1.1; Liebschutz & Lurie, *supra* note 15, at 54–55; San Juan, *supra* note 33, at 708 ("S[A]LTs pay for goods and services received by residents, (*e.g.,* roads and schools).").

44. *See supra* notes 38–42 and accompanying text.

45. *See, e.g.*, Jeff Cox, *Mnuchin: We Can't Have Federal Government Keep Subsidizing the States*, CNBC (Oct. 12, 2017, 8:04 AM), http://www.cnbc.com/2017/10/12/treasury-secretary-mnuchin-says-state-and-local-tax-breaks-a-major-loophole-that-were-trying-to-close.html [https://perma.cc/FA5M-SX5T] (quoting Secretary Mnuchin, who views the SALT deduction as a "loophole").

46. *Id.*

1. An Overhaul of the Tax System

Tax reform has been an especially hot issue since the 2016 presidential election campaign.[47] Then-presidential candidates Donald Trump and Hillary Clinton's platforms both contained tax law changes, and each candidate debated the merits of their proposed changes at length.[48] Even so, after winning the election, President Trump did not launch his formal campaign for tax reform until August 2017.[49] President Trump vowed to pass a measure that was "pro-jobs, pro-workers and pro-American."[50] The two main goals of President Trump's proposal were to simplify the Code and to lower rates.[51] In a fact sheet, the White House emphasized "jumpstart[ing] America's economic engine by making it the most desirable country in the world for businesses to invest and grow" and that "[b]y lowering taxes, President Trump is helping boost take-home pay for all American workers."[52] Looking for a major legislative win, particularly after his failure to repeal the Affordable Care Act,[53] the President urged Congress to act quickly.[54]

One focus of the Trump administration's approach to tax reform was the reduction of the corporate income tax rate.[55] To reduce corporate and individual income tax rates

47. *E.g.*, Scott Greenberg & Tom VanAntwerp, *Comparing the 2016 Presidential Tax Reform Proposals*, TAX FOUND. (July 30, 2016), http://taxfoundation.org/comparing-2016-presidential-tax-reform-proposals [https://perma.cc/PC8W-QCJR].

48. *See* Aaron Blake, *The Final Trump-Clinton Debate Transcript, Annotated*, WASH. POST (Oct. 19, 2016), http://www.washingtonpost.com/news/the-fix/wp/2016/10/19/the-final-trump-clinton-debate-transcript-annotated [https://perma.cc/8H9Z-P2RE].

49. Matthew Cooper, *In Missouri, Trump Launches Campaign for Tax Reform*, NEWSWEEK (Aug. 30, 2017), http://www.yahoo.com/news/missouri-trump-launches-campaign-tax-200910382.html [https://perma.cc/T48Z-NUPE].

50. *Id.*

51. *See Fact Sheet: President Donald J. Trump Tackles Our Broken Tax System*, WHITE HOUSE (Aug. 30, 2017), http://www.whitehouse.gov/briefings-statements/fact-sheet-president-donald-j-trump-tackles-broken-tax-system/ [https://perma.cc/KNJ7-WLEL] ("The tax code has increased so much in length and complexity that hundreds of pages in instructions are necessary to file even the most basic tax returns."); *see also* Cooper, *supra* note 49 (discussing the main goals of President Trump's tax reform plan); Jeremy Diamond, *Trump Pitches Tax Reform to "Bring Back Main Street,"* CNN (Aug. 31, 2017, 12:36 AM), http://www.cnn.com/2017/08/30/politics/trump-tax-reform-springfield-missouri/index.html [https://perma.cc/5XRY-JJYZ] (explaining the Trump administration's desire to "simplify[] the tax code, creat[e] a more competitive tax code, deliver[ ] tax relief for the middle class and repatriat[e] offshore profits").

52. *Fact Sheet: President Donald J. Trump Tackles Our Broken Tax System*, *supra* note 51. The fact sheet also noted, "We believe every-day Americans know better how to spend their own money than the federal bureaucracy, and we want to help them keep as much of that hard-earned money as we can." *Id.*

53. Amber Phillips, *Why President Trump Is so Antsy for Tax Reform*, WASH. POST (Sept. 13, 2017, 1:40 PM), http://www.washingtonpost.com/news/the-fix/wp/2017/09/13/why-president-trump-is-so-antsy-for-tax-reform/ [https://perma.cc/ZYM7-3279].

54. *See* Donald J. Trump (@realDonaldTrump), TWITTER (Sept. 13, 2017, 4:28 AM), http://twitter.com/realDonaldTrump/status/907928888587808768 [https://perma.cc/ZZ5X-WA59] ("The approval process for the biggest Tax Cut & Tax Reform package in the history of our country will soon begin. Move fast Congress!"); Donald J. Trump (@realDonaldTrump), TWITTER (Sept. 13, 2017, 5:36 AM), http://twitter.com/realDonaldTrump/status/907946177022369792 [https://perma.cc/3FJV-KYNU] ("With Irma and Harvey devastation, Tax Cuts and Tax Reform is needed more than ever before. Go Congress, go!").

55. Damian Paletta et al., *Trump's Push for Tax Cuts Is Coming Up Against a Familiar Challenge: Divided GOP*, WASH. POST (Sept. 12, 2017), http://www.washingtonpost.com/powerpost/trumps-

and minimize the budgetary impact of these changes, congressional Republicans chose to cut deductions and credits to offset the decrease in tax revenue.[56] To this end, they began to target several popular and significant deductions, including the state and local tax deduction.[57]

The plan to reduce income tax rates became possible in September 2017, when the U.S. Government Budget Resolution for Fiscal Year 2018 "allow[ed] the [Senate] Finance Committee to reduce revenues and change outlays to increase the deficit by not more than $1.5 trillion over the next 10 years."[58] This resolution provision effectively created the maximum amount by which any tax legislation could result in lost tax revenue.[59] To avoid a filibuster, the Republican-led Senate used reconciliation[60] to approach tax legislation, which allowed the bill to pass with a simple majority.[61]

On November 2, 2017, the Chairman of the House Ways and Means Committee, Congressman Kevin Brady, introduced the Tax Cuts and Jobs Act.[62] Chairman Brady's announcement stated, "We're lowering rates, eliminating costly deductions that drive up taxes, and significantly increasing the standard deduction to protect more of each

push-for-tax-cuts-is-coming-up-against-a-familiar-challenge-divided-gop/2017/09/11/bd7a875c-9763-11e7-82e4-f1076f6d6152_story.html [https://perma.cc/3AVN-EGDJ].

56. *E.g.*, *id.*

57. *See id.*

58. STAFF OF S. COMM. ON THE BUDGET, 115TH CONG., CONCURRENT RESOLUTION ON THE BUDGET FISCAL YEAR 2018, at 23 (Comm. Print 2017), http://www.govinfo.gov/content/pkg/CPRT-115SPRT27001/html/CPRT-115SPRT27001.htm [https://perma.cc/FNX6-YHP3]; *see also* H.R. Con. Res. 71, 115th Cong., §§ 2001–02 (2018), http://www.congress.gov/115/bills/hconres71/BILLS-115hconres71enr.pdf [https://perma.cc/C7VL-7RNF]; Alan Rappeport & Thomas Kaplan, *Senate Republicans Embrace Plan for $1.5 Trillion Tax Cut*, N.Y. TIMES (Sept. 19, 2017), http://www.nytimes.com/2017/09/19/us/politics/senate-republicans-tax-cut.html [https://perma.cc/3F9A-K5RN].

59. Individual income taxes comprise just over half of federal revenues. *Policy Basics: Where Do Federal Tax Revenues Come From?*, CTR. ON BUDGET & POL'Y PRIORITIES (June 20, 2019), http://www.cbpp.org/research/federal-tax/policy-basics-where-do-federal-tax-revenues-come-from [https://perma.cc/692L-C6KL]. Therefore, practically any lost individual tax revenue causes the budget deficit to increase. *See id.*

60. Reconciliation serves "to change substantive law so that revenue and mandatory spending levels are brought into line with budget resolution policies." BILL HENIFF JR., CONG. RESEARCH SERV., RL30862, THE BUDGET RECONCILIATION PROCESS: THE SENATE'S "BYRD RULE" 1 (2016), http://fas.org/sgp/crs/misc/RL30862.pdf [https://perma.cc/QAT4-Q3LH]. Where tax legislation needs to go through the standard process of bicameral approval with presidential signature like other legislation, reconciliation serves as a way to fast-track revenue and spending legislation. *See What Is Reconciliation?*, TAX POL'Y CTR., http://www.taxpolicycenter.org/briefing-book/what-reconciliation [https://perma.cc/DJ7L-WUB8] (last visited Feb. 1, 2020).

61. *See* Tori Gorman, *Reconciliation Debate, Byrd Rule, 2016 Budget Process*, BUDGET BULLETIN, SENATE COMM. ON BUDGET (June 23, 2015), http://www.budget.senate.gov/imo/media/doc/Reconciliation%20BB062315%5b1%5d.pdf [https://perma.cc/2JEQ-8M8N]. The 2017 Senate was comprised of fifty-one Republicans, two Independents, and forty-seven Democrats, thus a presumed vote along party lines would only yield fifty-one votes in favor of the tax legislation. *115th United States Congress*, BALLOTPEDIA, http://ballotpedia.org/115th_United_States_Congress [https://perma.cc/J5NK-H277] (last visited Feb. 1, 2020).

62. *Kevin Brady Introduces Tax Cuts and Jobs Act, Receives Kudos from President Donald Trump*, U.S. CONGRESSMAN KEVIN BRADY (Nov. 3, 2017), http://kevinbrady.house.gov/news/documentsingle.aspx?DocumentID=400863 [https://perma.cc/9EJH-HCQ2].

paycheck from taxes."[63] Spinning the reduced SALT deduction as a positive change, Chairman Brady explained that the TCJA "[e]liminates special-interest deductions that increase rates and complicate Americans' taxes—so an individual or family can file their taxes on a form as simple as a postcard . . . [and c]ontinues to allow people to write off the cost of state and local property taxes up to $10,000."[64] The Senate's initial plan for tax reform, announced on November 9, 2017, attempted to eliminate the personal SALT deduction entirely, but the Senate added the $10,000 cap at the last minute to accommodate Republican Senator Susan Collins.[65]

After almost two months and several revisions,[66] President Trump signed Public Law No. 115-97 on December 22, 2017.[67] The legislation was a $1.5 trillion overhaul of the Code,[68] which the President fondly referred to as a Christmas gift to the American people.[69] In signing the bill, President Trump boasted: "It's going to [do] a tremendous thing for the American people . . . . It's going to be fantastic for the economy."[70] In particular, corporations looked positively upon the reduction in rates.[71] Certain favorable deductions, however, had to be amended or removed—and certain changes sunset in a few years—to ensure the legislation added no more than $1.5 trillion to the federal government deficit.[72]

63. *Id.*

64. *Id.*

65. Newman, *supra* note 29, § 2.04 (2018). Senator Collins was a holdout "Yes" vote on the bill, but Republicans needed her vote to obtain the necessary majority in the Senate for the bill to pass. *See id.* (citing Alan Rappeport, *Dueling Tax Plans: Here's What the Senate and House Have to Resolve*, N.Y. TIMES (Dec. 1, 2017), http://www.nytimes.com/2017/12/01/business/dueling-tax-plans-heres-what-the-senate-and-house-have-to-resolve.html [https://perma.cc/96KF-AU97]); Jim Tankersley et al., *Senate Republicans Pass Sweeping Tax Bill*, N.Y. TIMES (Dec. 1, 2017), http://www.nytimes.com/2017/12/01/us/politics/senate-tax-bill.html [https://perma.cc/9EHK-MCH8]). Collins's interest in maintaining the deduction stemmed from a desire to protect middle-class homeowners and to avoid the double taxation a full repeal would cause. Robert King, *Susan Collins: Senate Tax Bill Will Include Bigger Medical Expense Deduction,* WASH. EXAMINER (Dec. 1, 2017, 2:17 PM), http://www.washingtonexaminer.com/susan-collins-senate-tax-bill-will-include-bigger-medical-expense-deduction [https://perma.cc/M65B-PYHE]; Marisa Schultz, *Susan Collins' Critical Vote on Tax Bill Hinges on This*, N.Y. POST (Nov. 30, 2017, 11:19 AM), http://nypost.com/2017/11/30/susan-collins-critical-vote-on-tax-bill-hinges-on-this/ [https://perma.cc/7BA7-YBC3].

66. *See Amendments H.R. 1—An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018*, CONGRESS.GOV, http://www.congress.gov/bill/115th-congress/house-bill/1/amendments [https://perma.cc/K652-893C] (last visited Feb. 1, 2020).

67. *Actions Overview H.R. 1*, *supra* note 7.

68. John Wagner, *Trump Signs Sweeping Tax Bill into Law*, WASH. POST (Dec. 22, 2017, 11:32 AM), http://www.washingtonpost.com/news/post-politics/wp/2017/12/22/trump-signs-sweeping-tax-bill-into-law [https://perma.cc/JG8B-DJJJ].

69. *See* President Donald Trump, Remarks on Tax Reform at the Sheffer Corporation, Blue Ash, Ohio (Feb. 5, 2018), http://www.whitehouse.gov/briefings-statements/remarks-president-trump-tax-reform-3/ [https://perma.cc/T24Y-CJ9P].

70. Wagner, *supra* note 68.

71. *See, e.g.*, *id.* (quoting President Trump after signing the bill stating, "Corporations are literally going wild").

72. *See* STAFF OF JOINT COMM. ON TAXATION, 115TH CONG., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT" 2, 8 (Comm. Print 2017) [hereinafter JCT, ESTIMATED BUDGET EFFECTS], http://www.jct.gov/publications.html?func=startdown&id=5053 [https://perma.cc/8GT7-GLAF]. The Joint Committee on Taxation estimated the net total cost of the TCJA to be $1.456 trillion, which includes a $668 billion increase in revenue that results from limiting itemized

2. Change to Section 164

The 2017 tax legislation temporarily changed several fundamental aspects of the federal income tax law that impact individuals, including raising the standard deduction, removing personal exemptions, and eliminating many itemized deductions.[73] The deduction for state and local taxes was one of the itemized deductions that survived—but in an altered state.[74] Under prior law, an individual could deduct the entire amount of state and local taxes paid.[75] However, for taxable years 2018 through 2025, the legislation capped the SALT deduction at $10,000 for individual taxpayers.[76]

Since a key feature of the TCJA was the reduction in tax rates, Congress was forced to derive revenue elsewhere to stay within the $1.5 trillion reconciliation limit. The House Report on the TCJA explained the rationale behind the SALT deduction cap as follows: "The Committee believes that scaling back existing tax incentives, including the deduction for State and local taxes, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates."[77] According to the Joint Committee on Taxation, the TCJA's changes to the SALT deduction and other itemized deductions will raise revenues by $668.4 billion between 2018 and 2027.[78] Indeed, the driving factor behind the changes to all itemized deductions was that their elimination or reduction generated revenue and acted as a counterweight to the static revenue loss projected from other aspects of the TCJA.[79]

While some commentators argue that the $10,000 cap on the SALT deduction will make it harder for state and local governments to pay their bills, ultimately creating pressure for these governments to lower tax rates,[80] several states' reactions have indicated they would rather fight the cap than make this change. Senator Cory Booker spoke out against the SALT deduction cap arguing that "[t]his tax bill is designed to

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deductions. *Id.* Without the changes to itemized deductions, the bill would have exceeded the $1.5 trillion maximum permitted. *See id.*

73. *See* Pub. L. No. 115-97, §§ 11021, 11041, 11042(a), 11045, 131 Stat. 2054, 2072, 2082–86, 2088 (2017).

74. *See* I.R.C. § 164 (2018).

75. *Id.* § 164(a). Though not explicitly stated in the law, prior to the TCJA amendment, Section 164 did not contain a limit on how much could be deducted.

76. Pub. L. No. 115-97, § 11042(a), 131 Stat. at 2085–86 (codified at I.R.C. § 164(b)(6)(B)).

77. H.R. REP. NO. 115-409, at 165 (2017).

78. JCT, ESTIMATED BUDGET EFFECTS, *supra* note 72, at 2.

79. *Updated Details and Analysis of the 2017 House Tax Cuts and Jobs Act*, TAX FOUND. (Nov. 3, 2017), http://taxfoundation.org/2017-tax-cuts-jobs-act-analysis/ [https://perma.cc/S4QJ-YFED]. In addition to the SALT deduction cap, the changes to the itemized deductions include limiting the mortgage interest deduction, I.R.C. § 163(h)(3)(F); increasing the limitation for cash charitable contribution, *see id.* § 170(b)(1)(G); limiting personal casualty losses to federally declared disasters, *id.* § 165(h)(5); and repealing all miscellaneous itemized deductions, *id.* § 67(g).

80. *See* Shriram T. Eachambadi, Note, *Leave It to the Feds—Eliminate the State and Local Income Tax: Proposing a Move Toward a Single-Layer Income Tax System*, 15 PITT. TAX REV. 215, 259 (2018) (discussing how the federal government could use the SALT deduction as "soft coercion" to change its taxing policies); Andrea Louise Campbell, *The Republican Tax Bill Will Make It Harder for States and Cities to Pay Their Bills*, WASH. POST (Dec. 21, 2017, 2:31 PM), http://www.washingtonpost.com/news/monkey-cage/wp/2017/12/21/the-republican-tax-bill-will-make-it-harder-for-states-and-cities-to-pay-their-bills/ [https://perma.cc/UXK8-ZMF6].

hurt hardworking New Jerseyans . . . . [F]amilies in high-cost states like New Jersey are being forced to pay the bill, as millions will lose critical middle class benefits like the state and local income tax deduction."[81] New York Governor Andrew Cuomo echoed this sentiment stating that "[t]he federal government is hell-bent on using New York as a piggy bank to pay for corporate tax cuts and I will not stand for it."[82] Booker's and Cuomo's comments underscore the crux of the argument emanating from high tax blue states—that the TCJA is "a massive tax giveaway to the largest corporations and wealthiest individuals at the expense of those who need tax relief the most."[83] Thus, the TCJA's goals of simplifying the Code and lowering rates do not have the same weight or appeal to citizens who lost large tax benefits to offset these rate reductions.[84]

## III. THE ONGOING SALT DEBATE

The TCJA is "tremendously controversial, and the SALT ceiling may be its most controversial feature."[85] The SALT deduction cap in particular can feel like a targeted measure to "states with both progressive income taxes and especially wealthy taxpayers."[86] How states have reacted is informed by their attention to their residents over federal policy concerns.[87]

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81. Press Release, Cory Booker, U.S. Senator for N.J., VIDEO: Booker on GOP Tax Plan: "This Bill is Designed to Hurt Hardworking New Jerseyans" (Nov. 6, 2017), http://www.booker.senate.gov/?p=press_release&id=694 [https://perma.cc/SQ95-EDAC]. The SALT deduction is popular in New Jersey as nearly two million families claimed an average deduction of over $17,000 in 2015. Cory Booker, Opinion, *Booker: Trump's Unfair Tax Plan Will Harm Average New Jerseyans*, NJ.COM (Nov. 2, 2017), http://www.nj.com/opinion/index.ssf/2017/11/booker_trumps_tax_plan_will_harm_new_jerseyans_opi.html [https://perma.cc/EHT9-BFH5]. Congressman Josh Gottheimer, also from New Jersey, 42.75% of taxpayers in his district claim the SALT deduction. Jad Chamseddine, *Final Rules Coming Soon on SALT Cap and Charitable Deductions*, 163 TAX NOTES 1418, 1418–19 (2019).

82. Darla Mercado & Sarah O'Brien, *Blue States File Suit Against Federal Government Over SALT Caps*, CNBC (July 17, 2018), http://www.cnbc.com/2018/07/17/blue-states-file-suit-against-federal-government-over-new-tax-law.html [https://perma.cc/5PM3-ZTDW] (quoting Governor Cuomo).

83. Booker, *supra* note 81.

84. See *supra* notes 4–6 and accompanying text explaining the benefit of the SALT deduction to those who claimed it.

85. Zelenak, *supra* note 9, at 534.

86. David Gamage & Darien Shanske, *The Future of SALT: A Broader Picture*, 88 ST. TAX NOTES 1275, 1276 (2018) [hereinafter Gamage & Shanske, *The Future of SALT*]. According to the Tax Policy Center:

> Without the limit on the SALT deduction the national average individual income tax cut in 2018 would increase from about $1,300 to about $1,700 and the average increase in after-tax income would rise from 1.8 to 2.3 percent. There would be very little change, on average, for taxpayers in the four lowest income-quintiles. For taxpayers in the top quintile the average individual income tax cut would increase by $2,500 from about $6,200 to about $8,700, and the average increase in after-tax income would rise from 2.4 to 3.3 percent. For taxpayers with income in the top one percent, the average individual income tax cut would also rise substantially from $40,100 to $71,000, and the average increase in after-tax income would rise from 2.6 to 4.7 percent.

FRANK SAMMARTINO ET AL., TAX POLICY CTR., THE EFFECT OF THE TCJA INDIVIDUAL INCOME TAX PROVISIONS ACROSS INCOME GROUPS AND ACROSS THE STATES 9 (2018), http://www.taxpolicycenter.org/sites/default/files/publication/154006/the_effect_of_the_tcja_individual_income_tax_provisions_across_income_groups_and_across_the_states.pdf [https://perma.cc/YT5J-5W5N].

87. David Gamage, *Charitable Contributions in Lieu of SALT Deductions*, 87 ST. TAX NOTES 973, 974 (2018).

This Section discusses various states' reactions to the enactment of the SALT deduction cap, as well as the subsequent reaction from the United States Treasury Department. Part III.A discusses the variable impact of the SALT deduction on states. Parts III.B and III.C review the two categories of state responses: (1) state-level legislation, and (2) lawsuits filed against the Treasury. Part III.D explains the Treasury's regulations to combat the charitable contribution workaround—the most common of the state-level legislative efforts enacted to mitigate the SALT deduction cap.

### *A. SALT Deduction Cap Impact on States*

The large increase in the standard deduction and the limitations on itemized deductions were predicted to lead many previously itemizing taxpayers to take the standard deduction.[88] The IRS's mid-July 2019 filing statistics indicate that approximately 126.1 million taxpayers claimed the standard deduction for 2018 and 14.7 million taxpayers elected to itemize,[89] compared to 98 million and 42.2 million, respectively, for 2017.[90]

How one views the impact of the SALT deduction cap may depend largely on where she lives and her income level. Taxpayers in states with particularly high tax rates will be affected more than those with lower rates, as Figure 1, a map of 2014 SALT deductions as a share of adjusted gross income, depicts.[91]

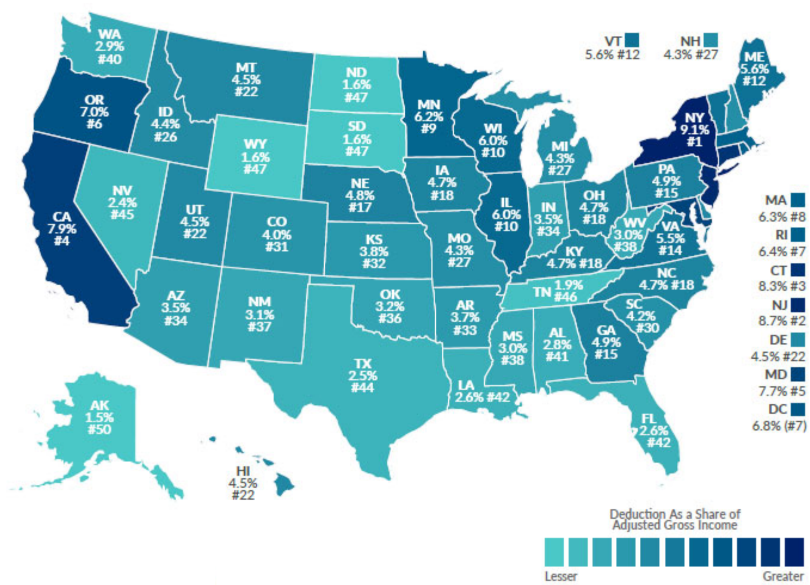
88. SAMMARTINO ET AL., *supra* note 86, at 7–11; Arpita A. Shroff, *The Tax Cuts and Jobs Act—Individual Tax Reform*, 129 J. TAX'N 30, 36 (2018). See SAMMARTINO ET AL., *supra* note 86, at 7–11 for a comparison of the different impacts the TCJA will have on a taxpayer in New York, Virginia, and Texas.

89. *Filing Season Statistics*, IRS, http://www.irs.gov/statistics/filing-season-statistics [https://perma.cc/RK87-H97U] (last visited Feb. 1, 2020) (publishing the Mid-July Filing Season Statistics by AGI for 2019).

90. *Id.* (publishing the Mid-July Filing Season Statistics by AGI for 2018).

91. WALCZAK, *supra* note 16, at 8 fig.2; *see also* David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1474 (2018) (citing Tracy Gordon, *The Price We Pay for Capping the SALT Deduction*, TAX POL'Y CTR.: TAXVOX (Feb. 15, 2018), http://www.taxpolicycenter.org/taxvox/price-we-pay-capping-salt-deduction [https://perma.cc/S2RR-963M]) ("In many parts of the country, however, millions of taxpayers regularly pay state and local taxes well in excess of the $10,000 cap.").

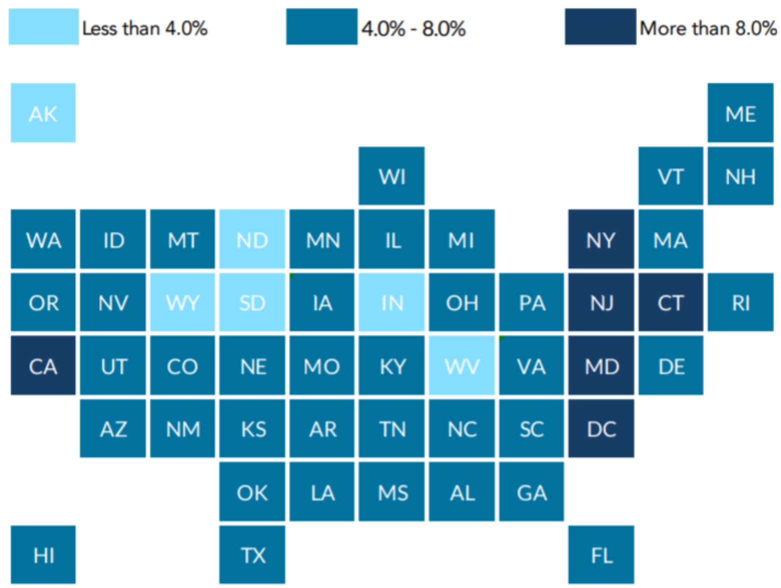
FIGURE 1
STATE AND LOCAL TAX DEDUCTION AS A SHARE OF
ADJUSTED GROSS INCOME BY STATE




Below, Figure 2, which the Tax Policy Center created, shows the breakdown of the percentage of taxpayers with tax increases per state.[92]

92. SAMMARTINO ET AL., *supra* note 86, at 6 fig.2.

FIGURE 2
PERCENTAGE OF TAXPAYERS WITH TAX INCREASES, 2018




In Figure 1, the states with the largest percentage increase in tax units as a result of the TCJA (New York, New Jersey, Connecticut, California, and Maryland) are also the states with the most taxpayers facing a tax increase in Figure 2.[93]

As the Figure 2 data show, the percentage of taxpayers facing a tax increase in 2018 ranges from less than 4% in six states to more than 8% in other states.[94] A significant driver of this difference is the SALT deduction cap.[95] While some argue that the deduction cap has forced states to "recognize their onerous tax burdens,"[96] the opposite effect seems to be occurring—states are digging in their heels.[97] The states with 8% to 10% of taxpayers facing a tax increase—New York, New Jersey, Connecticut, California, and Maryland[98]—have either enacted workaround legislation or pursued litigation, as discussed below.[99]

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93. *Compare* WALCZAK, *supra* note 16, at 8 fig.2, *with* SAMMARTINO ET AL., *supra* note 86, at 6 fig.2.

94. SAMMARTINO ET AL., *supra* note 86, at 6 fig.2.

95. *Id.* at 7.

96. ADAM N. MICHEL, THE HERITAGE FOUND., TAX REFORM 2.0: PRIORITIES AFTER THE TAX CUTS AND JOBS ACT OF 2017, at 4 (2018), http://www.heritage.org/sites/default/files/2018-03/BG3296.pdf [https://perma.cc/3KXT-L8YV].

97. See *infra* Parts III.B and III.C for a discussion of how states aided their residents given the federal tax changes while maintaining their high state tax rates.

98. SAMMARTINO ET AL., *supra* note 86, at 6 fig.2, 15–16 tbl.A2.

99. See *infra* Part III.B and Part III.C for a discussion about states' legislative responses and court challenges to the SALT deduction cap.

### B. State Legislative Responses

Several states acted to protect their citizens from the effects of the SALT deduction cap.[100] These states' efforts to preserve the deductibility of all state and local taxes paid seek to "prod members of Congress to reconsider what was a foolish decision from the outset."[101] The $10,000 cap burdens taxpayers who live in states that use progressive taxes to fund public services.[102] Taxpayers who reside in states with low or no state taxes are relatively unaffected,[103] but for those that reside in the darkest states in Figure 1—California, Connecticut, Illinois, New Jersey, New York, and Oregon[104]—the change could be sizeable.[105] Pre-enactment TCJA analyses regarding the legislation's impact on federal revenues did not factor in the zeal with which certain affected states would respond.[106]

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100. The state and local actions this Comment discusses are state actions, but cities have also begun to initiate their own legislation in response to the SALT deduction cap. Several cities have enacted workarounds. *See, e.g.*, Katie Honan, *NYC Councilman Aims To Set Up Charity To Help Taxpayers Avoid Federal Cap on Deductions*, WALL STREET J. (Oct. 29, 2018, 7:56 PM), http://www.wsj.com/articles/nyc-councilman-aims-to-set-up-charity-to-help-taxpayers-avoid-federal-cap-on-deductions-1540852531 [https://perma.cc/9BUZ-6M7Y]. On April 26, 2019, New York's Suffolk County became the first county in the state to pass a workaround by creating a charitable fund that allows donors to receive a 95% tax credit for any donations. Paige Jones, *New York County's SALT Workaround Becomes Law*, 83 EXEMPT ORG. TAX REV. 448, 448 (2019). Most notably, New York City is considering legislation to create a charitable fund. On October 30, 2018, New York City Councilmember Ritchie Torres tweeted: "The Trump tax law imposes significant financial hardship on NYC taxpayers. I'm introducing new legislation that would mitigate the law's impact & establish a city-operated charity that taxpayers could donate to." Ritchie Torres (@RitchieTorres), TWITTER (Oct. 30, 2018, 6:14 AM), http://twitter.com/RitchieTorres/status/1057259550372519936 [https://perma.cc/9VVN-Z24M].

101. Daniel Hemel, *States and Localities Can Offset Federal Tax Law's Impact on Their Residents*, BLOOMBERG TAX: DAILY TAX REPORT: STATE, Jan. 12, 2018, at 1, 3 [hereinafter Hemel, *States and Localities*], http://papers.ssrn.com/sol3/papers.cfm?abstract_id=3100992 [https://perma.cc/H3NK-79NA] ("Yet the revenue losses to the federal government should not stop states and municipalities from acting. The new tax law reflects a misguided policy choice: Congress has decided to deliver massive tax benefits to multinational corporations and high-income households while also making it more difficult for state and local governments to raise revenue.").

102. Kamin et al., *supra* note 91, at 1475 (citing Daniel Hemel, *Why States Should Seek To Offset the Effects of the SALT Rollback*, MEDIUM: FROM WHATEVER SOURCE DERIVED (Feb. 2, 2018), http://medium.com/whatever-source-derived/why-states-should-seek-to-offset-the-effectsof-the-salt-rollback-8a53fc23cbeb [https://perma.cc/QGS2-KTCX]).

103. For example, Texas residents must pay sales and property tax, but the state does not levy state income tax on its residents. Shroff, *supra* note 88, at 32. Florida also does not impose a state income tax on its residents. Mark Scott & Scott L. Goldberger, *The Tax Cuts and Jobs Act: Still Waiting for that Postcard*, 92 FLA. BAR J. 38, 38–39 (2018). However, there could be side effects such as a "mass exodus" of taxpayers from high tax states to low tax states. *See id.* Alaska, Nevada, South Dakota, Washington, and Wyoming are other states that do not impose an income tax. Shroff, *supra* note 88, at 36.

104. This is not to say residents of other states will not be impacted or that the effect on their taxes will be inherently smaller. For a description of the impact on Delaware residents, see Richard J. A. Popper & Vincent C. Thomas, *How the Federal Tax Law Will Impact Delaware*, 35 DEL. LAW. 14, 15 (2018).

105. *See* SAMMARTINO ET AL., *supra* note 86, at 6 fig.2.

106. Kamin et al., *supra* note 91, at 1443 ("Taking into account the gaming opportunities described . . . , we expect that the actual distributional and revenue costs of the legislation will likely significantly exceed these projections."); *see also* Lee A. Sheppard, *The Frivolous Challenge to the SALT Deduction Cap*, 90 ST. TAX NOTES 7, 10 (2018) ("Why do the state politicians care? Because the affected taxpayers are influential wealthy citizens—and the professionals who work for them.").

### 1. Charitable Contributions

The most common state legislative "fix" is the charitable contribution workaround. New York,[107] New Jersey,[108] Connecticut,[109] and Oregon[110] enacted different versions of this donation-for-credit structure. The California legislature also passed a bill that would increase the percent credit received for a charitable contribution to the state's College Access Tax Credit,[111] but the Governor vetoed it in October 2018.[112] The charitable contribution workaround utilizes Section 170 of the Code, which provides for an unlimited deduction for charitable contributions made to eligible entities, to ameliorate the impact of the $10,000 SALT deduction cap.[113] In effect, the workaround "recharacteriz[es] . . . nondeductible state tax payments as deductible charitable contributions."[114]

Section 170 defines a charitable contribution as "a contribution or gift to or for the use of" any of a variety of entities enumerated in the statute.[115] For the workaround to function, the state government creates a "charitable fund" with one or more specified

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107. Act of Apr. 12, 2018, ch. 59, Part LL, 2018 N.Y. Laws 229, 265–72. New York was the earliest state to enact a workaround for the SALT deduction, enacting their bills in April 2018. *Governor Cuomo Announces Highlights of the FY 2019 Budget*, N.Y. ST. (Mar. 30, 2018), http://www.governor.ny.gov/news/governor-cuomo-announces-highlights-fy-2019-budget [https://perma.cc/8PDD-4KC6]; *see also* Richard C. Call et al., *New York's Response to Federal Tax Reform: Charitable Contributions Credit*, MCDERMOTT WILL & EMERY (Apr. 18, 2018), http://www.mwe.com/en/thought-leadership/publications/2018/04/ny-federal-tax-reform-charitable-contributions [https://perma.cc/7JR2-UZJT] (explaining the mechanics of the New York legislation).

108. Act of May 4, 2018, ch. 11, § 2, 2018 N.J. Sess. Law. Serv. Ch. 11 (West). New Jersey was the second state to enact legislation to provide a workaround for the SALT deduction, enacting its bill on May 4, 2018. *See id.*

109. Act of May 31, 2018, Pub. Act No. 18-49, § 10(b), 2018 Conn. Legis. Serv. Pub. Act No. 18-49 (West). The Connecticut legislature enacted this bill on May 31, 2018. *Id.*; *see also* Teresa Callahan, *Connecticut Enacts SALT Relief Bill Including Pass-through Entity Tax*, 28 J. MULTISTATE TAX'N 28, 28–29 (2018).

110. Act of Apr. 13, 2018, ch. 108, 2018 Or. Laws 2696, 2696–98.

111. S. 539, 2017–2018 Leg., Reg. Sess. § 2 (Cal. 2018). The California legislature tried to pass the bill after the Treasury Department released proposed regulations for I.R.C. § 170 that would prevent the charitable contribution workaround from functioning as designed. Part III.D discusses the proposed regulations further. The California legislature's commitment to Senate Bill 539 indicated that "legislators think the rules may be amended in such a way that they ultimately allow some charitable deduction workarounds to the SALT deduction cap." Paul Jones, *California SALT Cap Bypass Heads for Vote Despite IRS Regs*, TAX NOTES: ST. TAX TODAY (Aug. 29, 2018), http://www.taxnotes.com/tax-notes-today-state/charitable-giving/california-salt-cap-bypass-heads-vote-despite-irs-regs/2018/08/29/28czj [https://perma.cc/GQ99-RJVT].

112. Letter from Jerry Brown, Governor of Cal., to the Members of the Cal. State Senate (Sept. 29, 2018) ("This measure started as a bold idea but because of adverse changes in the federal tax law, it now confuses an already complicated scheme and could invite intervention by the Internal Revenue Service."); Paul Jones, *California Governor Vetoes SALT Deduction Cap Workaround*, TAX NOTES: ST. TAX TODAY (Oct. 2, 2018), http://www.taxnotes.com/tax-notes-today-state/tax-preference-items-and-incentives/california-governor-vetoes-salt-deduction-cap-workaround/2018/10/02/28gx8 [https://perma.cc/CQ6E-5BB8].

113. *See* I.R.C. § 170(a)(1) (2018) ("There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year.").

114. Roger Colinvaux, *Failed Charity: Taking State Tax Benefits into Account for Purposes of the Charitable Deduction*, 66 BUFFALO L. REV. 779, 781 (2018).

115. I.R.C. § 170(c).

public purposes.[116] Then, the taxpayer contributes to the charitable fund and receives a state tax credit equal to a certain percentage of her contribution.[117] The state tax credit reduces the individual taxpayer's state income tax liability while also giving rise to a charitable contribution at the federal level.[118] That is, the taxpayer pays into a state charitable fund, in lieu of paying a portion of her state income taxes, and deducts the payment as a charitable contribution, rather than as state taxes paid, for federal income tax purposes.[119]

Though the charitable contribution workaround has been the response to which the most attention has been paid—and the one that elicited a response from the Treasury[120]—it is not new; hundreds of similar programs already existed in thirty-three states.[121] In particular, the California bill mentioned above merely expanded an existing

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116. *See, e.g.*, Act of May 4, 2018, ch. 11, § 2(a)–(c), 2018 N.J. Sess. Law. Serv. Ch. 11 (West). The specified purposes will vary depending on the government entity that creates the fund and a single government entity may have multiple charitable funds. *See, e.g.*, *Governor Cuomo Announces Highlights of the FY 2019 Budget*, *supra* note 107 ("The FY 2019 Budget creates two new state-operated Charitable Contribution Funds to accept donations for the purposes of improving health care and education in New York."). The Connecticut legislation states that the donations should be made to a "community supporting organization," which is an "organization that is . . . organized solely to support municipal expenditures for public programs and services, including public education." Act of May 31, 2018, Pub. Act No. 18-49, § 10(a), 2018 Conn. Legis. Serv. Pub. Act No. 18-49 (West). The charitable contribution structure that Oregon enacted in Senate Bill 1528 is slightly different as the Department of Revenue and the Higher Education Coordinating Commission conducted an auction of the tax credits, as opposed to taxpayers simply contributing to a fund. Act of Apr. 13, 2018, ch. 108, § 2, 2018 Or. Laws 2696, 2696. The auction took place over four days. Paul Jones, *Oregon Tax Credit Auction Successful, Despite Proposed IRS Regs*, TAX NOTES: ST. TAX TODAY (Sept. 5, 2018), http://www.taxnotes.com/tax-notes-today-state/tax-cuts-and-jobs-act/oregon-tax-credit-auction-successful-despite-proposed-irs-regs/2018/09/05/28d9h [https://perma.cc/FK84-264R]. "Taxpayers bid on credits sold in $500 increments, with the revenue generated by the auction going to a state fund to pay for college scholarships. Taxpayers can claim the amount they pay for credits as a federal charitable deduction, which isn't subject to the SALT cap." *Id.* According to State Senator Mark Hass, "the bids received for the credits totaled approximately $19 million." *Id.*

117. *See* Gamage, *supra* note 87, at 973. No state has enacted a 100% tax credit workaround. *See id.* The New Jersey bill creates a property tax credit equal to 90% of the amount contributed to the state charitable funds. Act of May 4, 2018, § 2(d)(1). The New York and Connecticut bills create an 85% tax credit. Act of May 31, 2018, § 10(b)(1); Act of Apr. 12, 2018, ch. 59, Part LL, § 1, 2018 N.Y. Laws 229, 269. Even receiving a credit of less than the full contribution amount, taxpayers still "come out ahead after tax for making a qualifying donation." Gamage, *supra* note 87, at 973. By granting a credit of less than 100%, it "is a transparent attempt, on the part of the state and its participating taxpayers, to disguise the substance of a state income tax payment in the form of a charitable contribution." Zelenak, *supra* note 9, at 525. For a larger discussion regarding how a less than 100% credit given can help the donation-for-credit programs defeat the economic substance doctrine, see *id.*

118. *See* Zelenak, *supra* note 9, at 524–25.

119. *See id.*

120. *See infra* Part III.D.

121. *See* Joseph Bankman et al., *State Response to Federal Tax Reform*, 83 ST. TAX NOTES 433, 557–89 app. (2018) (enumerating the state programs in existence prior to the TCJA in an appendix to the article); *see also* Kamin et al., *supra* note 91, 1478 ("We are aware of over 100 programs in 30 states that already had generous credits of this type in place prior to the passage of the new tax legislation."); Joseph Bankman & Darien Shanske, The Full Deduction Rule and the Substance Over Form Doctrine 3 (Aug. 20, 2018) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=3235978 [https://perma.cc/97M8-LHYW] ("The new donation credit proposals are based on existing donation credit programs that have been blessed by the IRS and are presumably known to Congress. They are less generous

donation-for-credit program.[122] These donation-for-credit programs benefit a wide range of public services, such as natural resource preservation, education, and shelters for victims of domestic violence.[123] Prior to the SALT deduction cap, "state tax benefits were ignored for charitable deduction purposes."[124]

The IRS indeed blessed the donation-for-credit model in its 2010 Chief Counsel Advice 201105010 (2010 CCA).[125] The 2010 CCA indicated the IRS's view that "the state tax benefit was not a return benefit for charitable deduction purposes because the state benefit comes at a cost in the form of a reduced SALT deduction."[126] In other words, the reduced state tax liability resulting from the charitable contribution also "cost" the taxpayer in the form of a smaller SALT deduction; thus, the benefit was not a quid pro quo.[127] As the tax benefits from the charitable contribution did not "negate donative intent nor constitute a return benefit that reduces the amount of the deduction,"[128] some tax scholars termed this concept the "full deduction rule."[129] These scholars believe that the full deduction rule is supported "by decades of precedent and a host of policy considerations," including the 2010 CCA.[130] Therefore, in enacting legislative workarounds, the states operated under the premise that the

than many existing plans in one respect (they provide less than 100% credit for donations) and are usually more generous in others (they apply to a larger set of donations and have larger, or no, caps).").

122. *See* CAL. REV. & TAX CODE § 12207 (West 2019) (effective until Dec. 1, 2023). Taxpayers are currently able to claim a credit equal to 50% of the amount contributed to the College Access Tax Credit Fund. *Id.* § 12207(a). Senate Bill 539 would have expanded the tax credit to 75% of the amount contributed. S. 539, 2017–2018 Leg., Reg. Sess. § 2(a)(2) (Cal. 2018).

123. Joseph Bankman et al., *State Responses to Federal Tax Reform: Charitable Tax Credits*, 159 TAX NOTES 641, 641–42 (2018).

124. Colinvaux, *supra* note 114, at 782.

125. *See* IRS Chief Counsel Advice 201105010, 2011 WL 343983 (Oct. 27, 2010) ("Is a payment of cash to either a state agency or a charitable organization considered a charitable contribution under § 170 of the Internal Revenue Code or a payment of state tax possibly deductible under § 164 if, instead of a state tax charitable deduction, the payment entitles the taxpayer to a transferable state tax charitable credit? . . . In the instant case, the payment is considered a charitable contribution under § 170, not a payment of tax possibly deductible under § 164."); s*ee also* Bankman & Shanske, *supra* note 121, at 1 ("In designing these new donation credit programs, the states were guided by dozens of donation credit programs that predated the TCJA. . . . These programs had been analyzed by the IRS and the courts, and were found to provide the taxpayers with the tax treatment they wanted."). *But see* Contributions in Exchange for State or Local Tax Credits, 84 Fed. Reg. 27,513, 27,516 (June 13, 2019) [hereinafter Final Regulations] (codified at 26 C.F.R. § 1.170A-1(h)(3) (2019)) (rejecting the 2010 CCA); Zelenak, *supra* note 9, at 530 ("[B]eyond the fact that [CCA] 201105010 is a low-level nonprecedential IRS pronouncement, the problem with relying on it for the proposition that there is no analytical difference between a state tax credit for a donation to the state and a credit for a donation to a private charity is that the memorandum's attempted explanation of the rationale for the [full deduction rule] is deeply unpersuasive.").

126. Colinvaux, *supra* note 114, at 797. See *id.* at 796–800 for a larger discussion and examples of the full deduction rule and the 2010 CCA.

127. *Id.* at 797–98.

128. *Id.* at 795.

129. The "full deduction rule" is defined as a scenario in which "the amount of the donor's charitable contribution deduction is not reduced by the value of state tax benefits." Bankman et al., *supra* note 123, at 642.

130. *Id.* at 642, 644–45. In explaining the policy considerations, Bankman and colleagues said, "[T]he rule reduces arbitrariness and significant computational and administrative difficulties. . . . The full deduction rule is consistent with the fundamental principles that underlie the concept of taxable income." *Id.* at 654.

donation-for-credit model worked.[131] Yet this view is not universal—some tax scholars view these programs as "a kind of tax shelter" that should not be permitted.[132]

Before the TCJA, the Treasury was not likely interested in combatting donation-for-credit programs because whether a taxpayer deducted the relevant amount as a charitable contribution or as state taxes paid did not appreciably impact tax revenues, as neither deduction had a limit.[133] This, however, is no longer the case, so the Treasury responded.[134]

The Treasury published proposed regulations that prohibited deductions of payments made pursuant to donation-for-credit programs for any contributions made after August 27, 2018.[135] Taxpayers who made contributions to state charitable funds or auctions prior to that date are permitted to deduct the amount contributed.[136] As discussed in Part III.D, any taxpayer who deducted contributions to state charitable funds after that date made a risky decision that did not pay off—the final regulations generally retain the terms of the proposed regulations.[137] Nevertheless, other workarounds exist that have not yet been disallowed.

2. Employee Payroll Tax

New York enacted a second type of workaround—the creation of an employee payroll tax.[138] A Connecticut commission also explored the benefits of an employee payroll tax, but a bill that would have established this measure failed to gain traction in 2019.[139] This Part, though, focuses on New York's system.

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131. *See* Letter from Gurbir S. Grewal, N.J. Att'y Gen., to David J. Kautter, Comm'r, IRS (May 24, 2018), http://nj.gov/oag/newsreleases18/2018-0524_Letter-from-AG-Grewal.pdf [https://perma.cc/F7TA-9N4M].

132. *See, e.g.*, Zelenak, *supra* note 9, at 522. However, Professor Kirk Stark responded to Zelenak's article using a comparison of gifting a classic children's book to both a private and public preschool to critique the conclusion. Kirk J. Stark, *Tax Credit, Tax Credit: What Do You See?*, 160 TAX NOTES 691, 691 (2018).

> For Zelenak, Dora will be allowed to deduct the full $10,000, but only if the donee preschool is a private nonprofit. . . . When a taxpayer makes a gift to a public preschool—or any other donee that is somehow impermissibly 'identified with the state'—Zelenak sees a tax shelter and moral condemnation ensues. But curiously, the same tax credit for the same gift of *Brown Bear, Brown Bear* books to a private preschool gets a green light.

*Id.* at 692. Professors Joseph Bankman and Darien Shanske also critiqued the "tax shelter" designation. *See* Bankman & Shanske, *supra* note 121, at 3–4 (discussing why the charitable contribution workaround should not be viewed through the same lens as other tax shelters).

133. *See* Colinvaux, *supra* note 114, at 783–84 ("[A] federal charitable deduction for the value of the state tax benefit was offset by a lower SALT deduction.").

134. *See infra* Part III.D.

135. Contributions in Exchange for State or Local Tax Credits, 83 Fed. Reg. 43,563, 43,563 (proposed Aug. 27, 2018) [hereinafter Proposed Regulations] (final regulations codified at 26 C.F.R. § 1.170A-1 (2019)), http://www.federalregister.gov/documents/2018/08/27/2018-18377/contributions-in-exchange-for-state-or-local-tax-credits [https://perma.cc/BZE3-QT7F].

136. *Id.* at 43,565–66.

137. *See* Final Regulations, *supra* note 125, at 27,514.

138. Act of Apr. 12, 2018, ch. 59, Part MM, 2018 N.Y. Laws 229, 273–79; *see also Governor Cuomo Announces Highlights of the FY 2019 Budget*, *supra* note 107.

139. Lauren Loricchio, *Connecticut Commission Examines Payroll Tax To Mitigate SALT Cap's Impact*, TAX NOTES: ST. TAX TODAY (Aug. 5, 2019), http://www.taxnotes.com/tax-notes-today-

New York created the Employer Compensation Expense Program (ECEP), which provides employers with the option of paying a state payroll tax on wages paid to each "covered employee."[140] The ECEP also contains a corresponding individual state income tax credit for covered employees based on their wages subject to the tax.[141] In 2019, the credit was calculated using a formula that involved the employee's wages, the taxes imposed before any credits were applied, and the employee's taxable income.[142] The individual is still subject to the SALT deduction cap, but the credit reduces the individual's state income tax liability.[143]

The payroll tax option keeps state revenue flat by simply shifting the state tax incidence from the employee to the employer and facilitates a full deduction of state income tax paid at the federal level.[144] The change to Section 164 did not impose a cap on the deductibility of state or local taxes that businesses paid.[145] Because a payroll tax is incurred in carrying on a trade or business, an employer can deduct the full value paid under Section 162.[146] By reducing individual state income taxes that employees paid, the program seeks to allow an individual who works for a participating company to remain under the $10,000 cap at the federal level, in theory, so she can claim a full deduction for her state and local taxes paid while still allowing her employer an unlimited deduction.[147]

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state/income/connecticut-commission-examines-payroll-tax-mitiigate-salt-caps-impact/2019/08/05/29t2k [https://perma.cc/4QLV-95B4].

140. Act of Apr. 12, 2018, ch. 59, Part MM, § 1 (codified at N.Y. TAX LAW § 852 (McKinney 2019)). A payroll tax is a "tax withheld from an employee's salary by an employer who remits it to the government on [the employee's] behalf." Julia Kagan, *Payroll Tax*, INVESTOPEDIA (Nov. 25, 2019), http://www.investopedia.com/terms/p/payrolltax.asp [https://perma.cc/73LR-X6DD]. The newly created payroll tax phases in over three years and is paid on compensation to covered employees that exceeds $40,000 per year. Act of Apr. 12, 2018, ch. 59, Part MM, § 1. For more information regarding the technical aspects of New York's employee payroll tax, see N.Y. STATE DEP'T OF TAX'N AND FIN., TSB-M-18(1)ECEP, EMPLOYER COMPENSATION EXPENSE PROGRAM (2018), http://www.tax.ny.gov/pdf/memos/ecep/m18-1ecep.pdf [https://perma.cc/SQ3P-2FM8].

141. Act of Apr. 12, 2018, ch. 59, Part MM, § 1 (codified at N.Y. TAX LAW § 855); *see also* Kamin et al., *supra* note 91, at 1481–82.

142. Act of Apr. 12, 2018, ch. 59, Part MM, § 2 (codified at N.Y. TAX LAW § 606(ccc)). In 2019, the credit was equal to the employee's wages in excess of $40,000, multiplied by 1.5%, multiplied by "one minus a fraction, the numerator of which shall be the tax imposed on the covered employee . . . before the application of any credits for the applicable tax year and the denominator of which shall be the covered employee's taxable income." *Id.*

143. *See id.* § 1.

144. Hemel, *States and Localities*, *supra* note 101, at 1–2. State revenue collection remains flat because employers that elect into the ECEP in essence pay the tax for their employees, and for those employers that do not, resident employees continue paying their state taxes unchanged. *See id.*

145. *See* I.R.C. § 164(b)(6) (2018).

146. I.R.C. § 162(a); Welch v. Helvering, 290 U.S. 111, 115 (1933) (elaborating on deductibility of "ordinary and necessary [business] expenses"); *Deducting Business Expenses*, IRS, http://www.irs.gov/businesses/small-businesses-self-employed/deducting-business-expenses [https://perma.cc/5GF6-WY3F] (last updated Jan. 16, 2020) (listing "various federal, state, local, and foreign taxes directly attributable to your trade or business" as deductible business expenses).

147. *See* Hemel, *States and Localities*, *supra* note 101, at 2.

This payroll tax workaround preserves state and local governments' ability to fund public services with dollars that the federal government does not tax.[148] It also creates benefits for nonitemizing taxpayers because an individual's state tax burden would decrease regardless of whether she itemizes or claims the standard deduction.[149] But this workaround is not without drawbacks. Nominal wages are "notoriously sticky"; if employers do not adjust wages downwards, the tax would thus increase costs for employers.[150] This is a problem because increased costs may deter employers from opting into this payroll tax system.[151] Further, it remains unclear how this tax will impact taxpayers who work but do not live in New York—their state may not provide a comparable tax credit for New York payroll taxes.[152] Lastly, substituting a progressive income tax for a flat payroll tax generally will impact the overall progressivity of a state's tax system.[153]

### 3. Pass-through Entity Tax

Connecticut,[154] Wisconsin,[155] Rhode Island,[156] and Louisiana[157] enacted a third type of workaround—the creation of an entity-level tax on pass-through entities. The Michigan legislature also passed a pass-through entity tax in December 2018,[158] but the Governor vetoed it.[159]

A pass-through entity generally does not pay tax itself. Items of income, gain, deduction, loss, and credit are calculated at the entity level, but the tax liability for these items is passed through to the individual members.[160] The member pays tax on her share of the entity's income on her individual return. The pass-through entity tax workaround, however, creates an entity-level tax that applies to S corporations and all

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148. *Id.*

149. *Id.* at 1–2.

150. *Id.* at 2; Richard C. Call et al., *New York's Response to Federal Tax Reform: Optional Payroll Tax*, McDermott Will & Emery (Apr. 18, 2018), http://www.mwe.com/en/thought-leadership/publications/2018/04/ny-federal-tax-reform-optional-payroll-tax [https://perma.cc/8UFT-UCW6] ("Needless to say, lowering wages, albeit in a way that is intended to help employees, may be a tough sell to the employees.").

151. Hemel, *States and Localities*, *supra* note 101, at 2. Hemel also provides solutions to this problem, namely phasing in the employee payroll tax at the inflation rate and allowing employers to opt out. *Id.*

152. *See* Call et al., *supra* note 150.

153. *See* Kamin et al., *supra* note 91, at 1482.

154. Act of May 31, 2018, Pub. Act No. 18-49, § 10(b)(1), 2018 Conn. Legis. Serv. Pub. Act No. 18-49 (West).

155. Act of Dec. 14, 2018, Act 883, § 11, 2017–2018 Wis. Legis. Serv. Act 368 (West).

156. Act of July 5, 2019, ch. 19-88, art. 5, § 8, 2019 R.I. Adv. Legis. Serv. Ch. 19-88 (West).

157. Act of June 22, 2019, Act 442, § 1, 2019 La. Sess. Law Serv. Act 442 (West).

158. Jad Chamseddine, *Michigan Passes SALT Cap Workaround for Passthroughs*, Tax Notes: St. Tax Today (Dec. 21, 2018), http://www.taxnotes.com/tax-notes-today-state/partnerships-and-other-passthrough-entities/michigan-passes-salt-cap-workaround-passthroughs/2018/12/21/28q25 [https://perma.cc/9HRB-SA9X].

159. Letter from Rick Snyder, Governor of Mich., to the Michigan House of Representatives and Michigan Senate (Dec. 28, 2018), http://content.govdelivery.com/attachments/MIGOV/2018/12/28/file_attachments/1130290/Veto%20Letter%201170.pdf [https://perma.cc/2PWP-N9JK].

160. I.R.C. § 701 (2018).

entities treated as partnerships for federal tax purposes.[161] These business structures are termed "pass-through entities," which are currently the dominant form of business organizations in the United States.[162] As a result, a number of the taxpayers impacted by the SALT deduction cap receive some or all of their income from pass-through entities.[163]

Though many states have enacted pass-through entity workarounds, they vary in their implementation. The Connecticut workaround creates a 6.99% entity-level tax on a pass-through entity's income derived from or connected with sources within the state.[164] The entity-level tax is fully deductible at the federal level as a trade or business expense.[165] Each shareholder, member, or partner, in turn, receives a state tax credit equal to 93.01% of her share of the taxes that the entity paid.[166]

In contrast, the Wisconsin act creates an optional pass-through entity tax of 7.9% and excludes the member's share of the entity's income from her adjusted gross income.[167] Rhode Island's pass-through entity tax allows entities to elect to pay a 5.99% tax at the entity level and creates a state tax credit in the amount of the tax that the entity paid, which is passed through to the members on a pro rata basis.[168] Louisiana's workaround allows a pass-through entity to elect to be taxed as a C corporation for state-tax purposes.[169] Lastly, and most recently, New Jersey passed

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161. *See, e.g.*, Act of May 31, 2018, § 1(b)–(c). "Partnership" is defined in § 1(a) of the bill as "ha[ving] the same meaning as provided in Section 7701(a)(2) of the Internal Revenue Code, as defined in section 12-213 of the general statutes, and regulations adopted thereunder." *Id.* § 1(a). The Act "creates a pass-through entity tax (PET), which taxes partnerships, S corporations, limited liability partnerships (LLPs) and limited liability companies (LLCs) treated as partnerships at the entity level." Callahan, *supra* note 109, at 28.

162. *See* INTERNAL REVENUE SERV., STATISTICS OF INCOME, CORPORATION INCOME TAX RETURNS COMPLETE REPORT 2013, at 2, http://www.irs.gov/pub/irs-soi/13coccr.pdf [https://perma.cc/TUN2-E7Q4]. In 2013, "[o]f the 5.9 million active corporations for Tax Year 2013, approximately 4.3 million were passthrough entities." *Id.* The number of partnerships grew 4.4% from 2013 to 2014 and 2.9% from 2014 to 2015, with partnerships filing 3,715,187 returns. Ron DeCarlo & Nina Shumofsky, *Partnership Returns, Tax Year 2015*, STAT. INCOME BULL., Spring 2018, at 1, http://www.irs.gov/pub/irs-soi/soi-a-copa-id1803.pdf [https://perma.cc/3UTJ-MR78].

163. Kamin et al., *supra* note 91, at 1483.

164. Act of May 31, 2018, § 1(c); *see also* Callahan, *supra* note 109, at 28 (discussing how taxable income is calculated for purposes of the tax).

165. As the taxpayer in this instance is a business, the entity is not subject to the $10,000 cap. *See* I.R.C. § 164(b)(6).

166. Act of May 31, 2018, § 1(g)(1)(A). Taxpayers can also receive credits for taxes paid to another state or the District of Columbia that are substantially similar to the tax imposed in Connecticut. *Id.* § 1(g)(1)(B).

167. Act of Dec. 14, 2018, Act 883, § 11, 2017–2018 Wis. Legis. Serv. Act 368 (West).

168. Act of July 5, 2019, ch. 19-88, art. 5, § 8, 2019 R.I. Adv. Legis. Serv. Ch. 19-88 (West); *see* Lauren Loricchio, *Rhode Island Enacts Budget with SALT Workaround for Passthroughs*, TAX NOTES: ST. TAX TODAY (July 8, 2019), http://www.taxnotes.com/tax-notes-today-state/tax-cuts-and-jobs-act/rhode-island-enacts-budget-salt-workaround-passthroughs/2019/07/08/29pww [https://perma.cc/9R6H-E7XL].

169. Act of June 22, 2019, Act 442, § 1, 2019 La. Sess. Law Serv. Act 442 (West); *see also* Andrea Muse, *Louisiana Governor Signs SALT Cap Workaround, Tax Refund Changes*, TAX NOTES: ST. TAX TODAY (June 27, 2019), http://www.taxnotes.com/tax-notes-today-state/corporate-taxation/louisiana-governor-signs-salt-cap-workaround-tax-refund-changes/2019/06/27/29nn8 [https://perma.cc/44MZ-LTER].

an optional pass-through entity tax effective January 1, 2020.[170] This presents a fifth way of implementing this type of tax—a four-tier, graduated tax rate structure dependent on the amount of "distributive proceeds" the pass-through entity generates in the taxable year.[171]

In the absence of this workaround, a pass-through entity member would pay tax on her allocated share of the entity's taxable income.[172] Including her share of the entity's taxable income in her personal income creates higher state and federal income tax liabilities, which increases the likelihood that members will run into the SALT deduction cap.[173] Thus, like the employee payroll tax workaround, this pass-through entity workaround allows individuals to decrease their state and local taxes by shifting the incidence of tax to another entity that is allowed an unlimited deduction and with which they have a relationship.[174]

Unlike New York's employee payroll tax[175] and the Wisconsin[176] and Rhode Island[177] pass-through entity taxes, the Connecticut pass-through entity tax is mandatory.[178] Overall, this pass-through entity tax received a generally favorable response[179]—about 110,000 pass-through entities participated in 2018.[180] However, like the payroll tax, the pass-through entity tax is not without its drawbacks. As only entities that file a return in that state fall under the scope of the tax, ambiguity remains regarding how the tax works for members who are not residents of the state that created

170. S. 3246, 218th Leg., Reg. Sess. § 3 (N.J. 2019); *see also* Carolina Vargas, *New Jersey Enacts SALT Cap Workaround*, TAX NOTES: ST. TAX TODAY (Jan. 15, 2020), https://www.taxnotes.com/tax-notes-today-state/tax-cuts-and-jobs-act/new-jersey-enacts-salt-cap-workaround/2020/01/15/2bs45? [https://perma.cc/S3NG-6P54].

171. N.J. S. 3246, § 2. The bill defines "distributive proceeds" as "the income, dividends, and gain of a pass-through entity, derived from or connected with sources within the State, and upon which tax is imposed and due on a member of the pass-through entity." *Id.*

172. *See, e.g.*, OFFICE OF LEGISLATIVE RESEARCH, OLR BILL ANALYSIS: sSB 11, AN ACT CONCERNING CONNECTICUT'S RESPONSE TO FEDERAL TAX REFORM 2 (2018), http://www.cga.ct.gov/2018/BA/pdf/2018SB-00011-R000624-BA.pdf [https://perma.cc/65VU-P5L9] ("Under current law, pass-through businesses doing business in the state do not pay income tax at the entity level; instead, their profits 'pass-through' to their owners and are taxed as part of the owners' personal income tax returns.").

173. *See* Callahan, *supra* note 109, at 28.

174. *See* OFFICE OF LEGISLATIVE RESEARCH, *supra* note 172, at 2 ("Paying taxes at the entity level as required under the bill, instead of at the personal income tax level, may provide pass-through income with favorable federal tax treatment, given recent tax changes that limit the amount of state and local taxes (SALT) that can be deducted for federal personal income tax purposes . . . .").

175. *See supra* Part III.B.2.

176. *See* Act of Dec. 14, 2018, Act 883, §§ 4, 11, 2017–2018 Wis. Legis. Serv. Act 368 (West) (explaining that an entity level tax will be assessed only "[i]f persons who hold more than 50 percent of the shares on the day on which an election under this paragraph is made consent").

177. *See* Act of July 5, 2019, ch. 19-88, art. 5, § 8, 2019 R.I. Adv. Legis. Serv. Ch. 19-88 (West).

178. *See* Timothy P. Noonan & Elizabeth Pascal, *The Nuts and Bolts of Connecticut's New Passthrough Entity Tax*, 90 ST. TAX NOTES 601, 604 (2018).

179. *See* FIN., REVENUE AND BONDING COMM., JOINT FAVORABLE REPORT (2018), http://www.cga.ct.gov/2018/JFR/s/pdf/2018SB-00011-R00FIN-JFR.pdf [https://perma.cc/JWN7-LWV2].

180. Amy Hamilton, *110,000 Entities Participate in Connecticut SALT Cap Workaround*, TAX NOTES: ST. TAX TODAY (July 29, 2019), http://www.taxnotes.com/tax-notes-federal/tax-cuts-and-jobs-act/110000-entities-participate-connecticut-salt-cap-workaround/2019/07/29/29s6x [https://perma.cc/Y8SP-ZJHK].

the pass-through entity tax.[181] Other states may need to enact credits to achieve the "SALT parity" that the entity-level tax advertises.[182] Only one state has considered such a measure so far.[183] Given the popularity of the pass-through entity tax,[184] and the disallowance of the charitable contribution workaround,[185] all states should consider the impact on out-of-state members of entities that pay the tax. Furthermore, the population of people who can use this workaround (members of pass-through entities) is significantly smaller than the charitable contribution workaround, which was available to all.[186]

### *C. Challenging the Cap in Court*

The second form of state action attempting to mitigate the effects of the SALT deduction cap is litigation.[187] New York, Connecticut, Maryland, and New Jersey filed a complaint on July 17, 2018, against the Secretary of the Treasury, the Treasury, the Commissioner of the IRS, and the IRS seeking to invalidate the $10,000 cap on the federal SALT deduction.[188] While the legislative workarounds seek to provide relief to taxpayers in specific states, the lawsuit sought to provide relief to all taxpayers.[189]

These four states argued that the SALT cap violates states' rights under the Tenth and Sixteenth Amendments.[190] The plaintiffs contended that the cap disproportionately harms them, as high tax states, compared to other states by making "it more difficult for the Plaintiff States to maintain their taxation and fiscal policies, hobbling their sovereign authority to make policy decisions without federal interference."[191] Further, the states argued that the SALT cap violates the principle of equal state sovereignty

181. *See* Noonan & Pascal, *supra* note 178, at 604.

182. *See* Mass. Dep't of Revenue, *Directive 19-1: Application of the Massachusetts Personal Income Tax Credit for Taxes Paid to Another Jurisdiction to the Connecticut Pass-Through Entity Tax*, MASS.GOV (Sept. 19, 2019), http://www.mass.gov/directive/directive-19-1-application-of-the-massachusetts-personal-income-tax-credit-for-taxes-paid [https://perma.cc/K9HD-X4XW] (allowing a Massachusetts resident who is a member of an entity subject to Connecticut's pass-through entity tax to claim credits for the taxpayer's distributive share of the pass-through entity tax paid to Connecticut); *see also* Jennifer McLoughlin, *Massachusetts Credit Available for Connecticut Passthrough Entity Tax*, TAX NOTES: ST. TAX TODAY (Sept. 23, 2019), http://www.taxnotes.com/tax-notes-today-state/tax-cuts-and-jobs-act/massachusetts-credit-available-connecticut-passthrough-entity-tax/2019/09/23/29yzc [https://perma.cc/P63U-XHE2].

183. *See* Mass. Dep't of Revenue, *supra* note 182.

184. *See* Hamilton, *supra* note 180.

185. See *infra* Part III.D for a discussion of the Treasury's response to the charitable contribution workaround.

186. See *supra* Part III.B.1 for a discussion of the charitable contribution workaround.

187. *See* New York v. Mnuchin, 408 F. Supp. 3d 399 (S.D.N.Y. 2019).

188. N.Y. v. Mnuchin Complaint, *supra* note 14, at 1.

189. In arguing that the cap is unconstitutional, the states hope to eliminate the cap, versus working around it. *See infra* notes 190–193.

190. *See* N.Y. v. Mnuchin Complaint, *supra* note 14, at 2 ("[T]he SALT deduction is essential to prevent the federal tax power from interfering with the States' sovereign authority to make their own choices about whether and how much to invest in their own residents, businesses, infrastructure, and more—authority that is guaranteed by the Tenth Amendment and foundational principles of federalism.").

191. *Id.* at 3; *see also id.* at 5 ("As a percentage of each State's population, more taxpayers in the Plaintiff States will experience a tax increase relative to taxpayers in other States because of the 2017 Tax Act.").

because "Congress acted with the purpose and effect of forcing [them] to change their taxation and fiscal policies."[192] By arguing that the SALT deduction cap violates the Constitution, the states hoped to bar the cap's enforcement.[193]

As an initial matter, it was unclear if the states had standing to sue.[194] Some scholars argued that the states' argument is flawed: "[T]he injury alleged isn't to their sovereign (or quasi-sovereign) interests, but to the interests of the state legislators who have mistakenly, if understandably, conflated their own interests with the states' [interests]."[195] The reactions of state government officials from the plaintiff states lend themselves to this idea.[196] Some have argued that the complaint reads "more like a stump speech," directing the arguments to constituents instead of the court.[197] As a result, some commentators called for the federal government to file a motion for summary judgment if the suit advances beyond the standing question.[198]

More generally, some criticized the lawsuit as frivolous.[199] Some scholars rejected several of the legal theories that the states could argue, such as the intergovernmental tax immunity theory, political animus, and the Constitution's Uniformity Clause.[200] Further, "[i]t has never been understood that either the national or a state government is forbidden to make distinctions that treat some individuals arguably more harshly than others . . . so long as a protected group isn't involved and the distinction has a reasonable basis."[201]

Despite these criticisms, these states remained committed to attacking the SALT cap from all angles and trying to ensure that their taxpayers can deduct all state and local taxes paid.[202] In court documents, the four plaintiff states described pressure on

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192. *Id.* at 7.

193. *Id.* at 8.

194. *See* Marie Sapirie, *State Involvement in Federal Tax Policy, Part 2: SALT and Donors*, 160 ST. TAX NOTES 1359, 1359–60 (2018). *See generally* David A. Nagdeman, Comment, *Sovereign Ephemera: State Standing Against the Federal Government for Injuries to Quasi-Sovereign Interests*, 90 TEMP. L. REV. 53 (2017) ("[T]he prevailing presumption has been against recognizing states' standing to sue the federal government, either on the basis of federal supremacy or on the basis of the political question doctrine." (footnotes omitted)).

195. Sapirie, *supra* note 194, at 1359. "[I]t's easy for state representatives to confuse their political interests with the state's sovereign interests. Rigorous application of the standing doctrine keeps those two interests separate and ensures that legislators remain accountable for policy decisions." *Id.*

196. *See, e.g.*, *Governor Cuomo and AG Underwood File Lawsuit Against Federal Government for Unconstitutional Tax Law That Targets New York*, N.Y. ST. (July 17, 2018), http://www.governor.ny.gov/news/governor-cuomo-and-ag-underwood-file-lawsuit-against-federal-government-unconstitutional-tax [https://perma.cc/FZ3D-2XDG] [hereinafter *Gov. Cuomo and AG Underwood File Lawsuit*]. New York State Attorney General Barbara Underwood said, "We will not allow partisans in Washington to hurt our people or interfere with our policies. We've filed suit against this unconstitutional attack on New York and our state's fundamental rights—because we won't stand by and let Washington pick the pockets of New Yorkers." *Id.*

197. Sapirie, *supra* note 194, at 1361.

198. *E.g.*, Sheppard, *supra* note 106, at 13.

199. *E.g.*, *id.* at 9.

200. *See, e.g.*, Erik M. Jensen, *Is Capping the Deduction for State and Local Taxes Unconstitutional?*, 35 J. TAX'N INV. 27, 27–32 (2018).

201. *Id.* at 31.

202. *See Gov. Cuomo and AG Underwood File Lawsuit*, *supra* note 196. See *supra* Part III.B for a discussion of state legislative responses to the SALT cap.

the states to depart from their current taxation and fiscal policies as "severe" and like a "'gun to the head' that 'leaves the States with no real option' but to respond."[203]

On November 2, 2018, the IRS and the Treasury Department filed a motion to dismiss the suit.[204] The federal government argued that "[t]he Court need not reach the merits of their claims . . . because there are threshold jurisdictional issues barring this suit,"[205] such as the previously discussed standing question[206] and the Anti-Injunction Act, which prevents "suits seeking injunctions against the application of federal tax laws."[207] The federal government also alleged that the suit failed to state a claim because it failed to state a violation of the Tenth or Sixteenth Amendments or Article I, Section 8 of the Constitution.[208]

The court granted the government's motion to dismiss on September 30, 2019, but surprisingly not on procedural grounds.[209] The court found that the states had standing to sue by "alleg[ing] an injury that, if proved, would give them a sufficiently concrete stake in the outcome of this suit to establish their standing."[210] The court also determined that the Anti-Injunction Act did not prevent the suit as "the parties here have identified no mechanism other than an injunctive suit by which the States might 'on [their] own behalf' challenge the legality of the SALT cap."[211] That is, the states sought to protect their own interests, not the interests of their taxpayers.[212] The political question doctrine also did not prevent the court from reaching the merits because "[t]his is not a case that asks the courts to resolve a matter of opinion. . . . Nor yet is it a case in which there is simply no law to apply."[213]

Advancing beyond the procedural obstacles, the court dismissed the states' case on the merits.[214] The court concluded that Congress's plenary power to lay and collect

203. Memorandum of Law in Opposition to Defendants' Motion to Dismiss and in Support of Plaintiffs' Cross-Motion for Summary Judgment at 8, New York v. Mnuchin, 408 F. Supp. 3d 399 (S.D.N.Y. 2019) (quoting Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 581–82 (2012)).

204. Memorandum of Law in Support of the Government's Motion to Dismiss, New York v. Mnunchin, 408 F. Supp. 3d 399 (S.D.N.Y. 2019).

205. *Id.* at 3.

206. *Id.* at 3–4, 9–14.

207. *Id.* at 4, 14–17.

208. *See id.* at 19–38. The relevant clause of Article I, Section 8 reads, "The 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 . . . ." U.S. CONST. art. I, § 8, cl. 1.

209. New York v. Mnuchin, 408 F. Supp. 3d at 399.

210. *Id.* at 410 (citing Lujan v. Defs. of Wildlife, 504 U.S. 555, 561 (1992)). The court, however, did state that it was applying a "lenient" standard as the case was at the pleading stage. *Id.* (quoting Baur v. Veneman, 352 F.3d 625, 636–37 (2d Cir. 2003)). One tax scholar called the court's determination "a novel premise for state standing." Marie Sapirie, *A Shaky Leg To Stand On in the SALT Limit Challenge*, 94 TAX NOTES ST. 231, 234 (2019).

211. New York v. Mnuchin, 408 F. Supp. 3d at 411 (alteration in original) (quoting South Carolina v. Regan, 465 U.S. 367, 381 (1984)).

212. *Id.* at 410–13. The court did mention, however, that "[i]t may well be the case that the States' taxpayers will have incentive to challenge the SALT cap in individual refund suits." *Id.* at 412.

213. *Id.* at 414.

214. *See id.* at 415.

taxes allows it to impose an income tax with a limitless SALT deduction.[215] Analogizing the SALT deduction to a prior tax exemption for interest earned on state-issued bearer bonds, the court found no constitutional flaw in limiting the deduction because "nothing in the Constitution itself *mandated* the longstanding [deduction] that Congress had previously seen fit to offer as a matter of grace."[216] Further, the court found that the SALT deduction cap does not interfere with the states' exercise of their sovereign tax powers because they were unable to demonstrate that "Congress has been responding to a constitutional imperative rather than making an accommodating policy choice."[217] Lastly, the court rejected the states' argument that "the purpose and effect of *this* SALT cap is to coerce certain targeted states" to amend their tax laws.[218] The court declined to speculate as to Congress's motives behind the cap and found that Congress's attempts to "influence" states do not violate the Tenth Amendment because the claimed harms were insufficient to establish coercion.[219]

The states were disappointed with the decision because it "makes it harder . . . to protect [their] taxpayers from the disproportionately harmful effects" of the SALT deduction cap.[220] The states are appealing the district court's decision to the Second Circuit.[221]

### *D. Treasury's Response*

In response to the states' workarounds, the Treasury began examining the effect of the charitable contribution workarounds. The Treasury implements the TCJA through regulations.[222] In contrast to what the states' representatives would have people believe,[223] the IRS has expressed that it is conscious of the cap and the impact it will have on those who choose to itemize their deductions.[224] However, the IRS must, first and foremost, administer and enforce the Code.[225]

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215. *Id.* at 416–17.

216. *Id.* at 417 (citing South Carolina v. Baker, 485 U.S. 505, 527 (1988)).

217. *Id.* at 418.

218. *Id.*

219. *See id.* at 418–21.

220. Andrea Muse, *Federal Judge Dismisses SALT Deduction Cap Lawsuit*, TAX NOTES: ST. TAX TODAY (Oct. 1, 2019), http://www.taxnotes.com/tax-notes-today-state/litigation-and-appeals/federal-judge-dismisses-salt-deduction-cap-lawsuit/2019/10/01/29ztq [https://perma.cc/RA5G-CL9H] (quoting Connecticut Attorney General William Tong).

221. Notice to Appeal at 1, New York v. Mnuchin, 408 F. Supp. 399 (S.D.N.Y. 2019).

222. *See* DEP'T OF THE TREASURY & OFFICE OF MGMT. AND BUDGET, MEMORANDUM OF AGREEMENT, THE DEPARTMENT OF THE TREASURY AND THE OFFICE OF MANAGEMENT AND BUDGET REVIEW OF TAX REGULATIONS UNDER EXECUTIVE ORDER 12866 (2018).

223. See *supra* notes 81–82 for examples of government officials' comments regarding the SALT cap deduction.

224. *See* I.R.S. Notice 2018-63, 2018-34 I.R.B. 318, http://www.irs.gov/pub/irs-irbs/irb18-34.pdf [https://perma.cc/VTE8-PTP6]; Jonathan Curry, *IRS Offers Some SALT Cap Relief to Struggling Homeowners*, 160 TAX NOTES 1035, 1036 (2018).

225. *See* I.R.C. § 7801(a)(1) (2018); *see also* I.R.S. Notice 2018-54, 2018-24 I.R.B. 750, 750, http://www.irs.gov/pub/irs-drop/n-18-54.pdf [https://perma.cc/H5A3-E789] ("Despite these state efforts to circumvent the new statutory limitation on state and local tax deductions, taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes.").

In May 2018, the IRS released Notice 2018-54, "Guidance on Certain Payments Made in Exchange for State and Local Tax Credits."[226] In the Notice, the IRS addressed the charitable contribution workaround and announced that it "will make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers."[227] The high tax blue states accused the IRS of targeting them.[228] The following day, the New Jersey Attorney General urged the IRS not to go down this "misguided road" as "[t]he statute is explicit that such contributions include gifts given to state governments and their political subdivisions."[229]

The Treasury released proposed regulations to the public weeks later, and, consistent with Notice 2018-54, closed the door on the charitable contribution workaround.[230]

> Thus, the Treasury Department and the IRS believe 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, just as it is reduced for many other benefits. . . . Disregarding the tax benefit would also undermine the intent of Congress in enacting section 170, that is, to provide a deduction for taxpayers' gratuitous payments to qualifying entities, not for transfers that result in economic returns. The Treasury Department and the IRS believe that appropriate application of the *quid pro quo* doctrine to substantial state or local tax benefits is consistent with the Code and sound tax administration.[231]

The proposed regulations are grounded in previous U.S. Supreme Court cases defining a "charitable contribution"[232] and public policy considerations.[233] The regulations

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226. I.R.S. Notice 2018-54, *supra* note 225, at 750; *see also IRS Announces Intent to Curtail State Efforts to Circumvent Limitation on SALT Deduction*, 129 J. TAX'N 40, 40–41 (2018); Alan Rappeport & Jim Tankersley, *I.R.S. Warns States Not To Circumvent State and Local Tax Cap*, N.Y. TIMES (May 23, 2018), http://www.nytimes.com/2018/05/23/us/politics/irs-state-and-local-tax-deductions.html [https://perma.cc/3JNB-TUK5].

227. I.R.S. Notice 2018-54, *supra* note 225, at 750–51.

228. *See* Letter from Robert Menendez and nine other United States Senators to Mr. Charles Rettig, Nominee for Comm'r, Internal Revenue Serv. (Aug. 21, 2018), http://www.menendez.senate.gov/imo/media/doc/20180820%20Ltr%20to%20Rettig%20Re%20IRS%20Political%20Targetting%20FINAL%20SIGNED.pdf [https://perma.cc/C9R9-5FJV] ("The IRS announcement that it intends to specifically target state tax credit programs developed after passage of P.L. 115-97 is fundamentally unfair and raises serious suspicions of political targeting. The nation's tax laws must be applied fairly and equally, not used as a partisan weapon to punish perceived political opponents.").

229. Letter from Gurbir S. Grewal, *supra* note 131.

230. *See* Proposed Regulations, *supra* note 135, at 43,565.

231. *Id.*; *cf.* Colinvaux, *supra* note 114, at 806–08 (describing and containing examples of how permitting a charitable deduction for a state tax benefit creates an incentive to profit).

232. Proposed Regulations, *supra* note 135, at 43,563 ("In 1986, the Supreme Court . . . held that the '*sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration'—that is, without the expectation of a *quid pro quo*." (quoting United States v. Am. Bar Endowment, 477 U.S. 105, 116–18 (1986))); *see also* Colinvaux, *supra* note 114, at 785–89 (describing the "donative intent" of a charitable contribution and the notion of a contribution as a sacrifice).

233. Proposed Regulations, *supra* note 135, at 43,569 ("After passage of the Act, which significantly increased the standard deduction, it is estimated that ninety percent of taxpayers will not claim itemized deductions of any kind. Those taxpayers are entirely unaffected by these proposed regulations. . . . The

explained that the charitable contribution workaround is not consistent with federal tax policy under the TCJA because a substantial amount of revenue would be lost.[234] The regulations also dismissed any reliance on the 2010 CCA as the document does not have the effect of law.[235]

The proposed regulations were met with mixed reactions, particularly due to the broad scope of the deduction-for-credit programs impacted. Tax scholars acknowledged the Treasury's evenhanded approach with respect to treating older programs, traditionally in red states, the same as new programs in blue states.[236] In contrast, several red states with longstanding donation-for-credit programs disliked the broad scope of the regulations.[237] The IRS had permitted the donation-for-credit programs until states used them on a much larger scale and with a different purpose in mind.[238] Some charitable organizations opposed the proposed regulations because of the impact the changes would have on their donor base.[239] Some states and

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Treasury Department and the IRS believe . . . that the proposed regulations will have at most a highly limited, marginal effect on taxpayer decisions to donate to tax credit programs that pre-date TCJA, including educational scholarship programs.").

234. *See id.* at 43,565 n.1; *see also id*. at 43,564 ("[A]s a result of the new limit on the deductibility of state and local taxes under section 164(b)(6) (as added by the Act), treating a transfer pursuant to a state or local tax credit program as a charitable contribution for federal income tax purposes may reduce a taxpayer's federal income tax liability.").

235. *Id.* at 43,564 ("Although CCAs are released to the public for information purposes, it should be noted that CCAs are not official rulings or positions of the IRS, are not ordinarily reviewed by the Treasury Department, and are not precedential.").

236. *E.g.*, David Kamin, *Treasury's SALT Regulations*, MEDIUM: WHATEVER SOURCE DERIVED (Sept. 4, 2018), http://medium.com/whatever-source-derived/treasurys-salt-regulations-9a7e121531ce [https://perma.cc/C5GB-FTZU] ("To be sure, the SALT cap is still deeply flawed, but, here, Treasury went in a reasonable direction given the mess it was handed. Key is that Treasury chose to treat the old tax credit programs in often 'red' states the same as the new tax credit programs in the 'blue' states.").

237. *See, e.g.*, Letter from Rob Woodall et al., Members of Cong. from Ga., to Steven T. Mnuchin, Sec'y of the Treasury, and Comm'r Charles Retting, Internal Revenue Serv. (Oct. 11, 2018), http://woodall.house.gov/sites/woodall.house.gov/files/wysiwyg_uploaded/Letter%20to%20Treaury%20and%20IRS%20on%20Proposed%20Rule.pdf [https://perma.cc/3SP8-MSK2].

238. *See* Amy Hamilton, *Proposed Federal SALT Rules Would Close Private School Donation Strategy*, TAX NOTES: ST. TAX TODAY (Aug. 27, 2018), http://www.taxnotes.com/tax-notes-today-state/tax-cuts-and-jobs-act/proposed-federal-salt-rules-would-close-private-school-donation-strategy/2018/08/27/28crz [https://perma.cc/5G8G-NF7Z] [hereinafter Hamilton, *Proposed Federal SALT Rules*] ("'If I were a red state government official, I might be very mad,' said University of Iowa law professor Andy Grewal. 'I would have had a good game going and the IRS was willing to let me play. But then the blue states got involved (on a bigger scale) and the IRS took away everyone's game pieces.'").

239. *E.g.*, Statement from John Schilling, President, Am. Fed'n for Children (Aug. 23, 2018), http://www.federationforchildren.org/american-federation-children-statement-proposed-irs-rule/ [https://perma.cc/5NBV-7QCM] ("The proposed IRS rule issued by the Treasury Department will harm state tax credit scholarship programs that are currently benefitting more than 250,000 students, most of whom are from lower-income and minority families. This will reduce charitable contributions to scholarship granting organizations (SGOs), reduce the number of scholarships available, and potentially force thousands of students into the low performing schools they were fortunate to escape."); Hamilton, *Proposed Federal SALT Rules*, *supra* note 238 ("[The IRS] apparently view[s] these totally different organizations, formed long before the TCJA, as mere collateral damage." (quoting Bruce Ely, *Collateral Damage*, LINKEDIN (Aug. 24, 2018), https://www.linkedin.com/pulse/collateral-damage-bruce-p-ely/?published=t [https://perma.cc/46MN-77RM])). *But see* Letter from Dan Barker & Annie Laurie Gaylor, Co-Presidents, Freedom from Religion Found., to Internal Revenue Serv. (Oct. 3, 2018), http://ffrf.org/images/SALTcommentIRS.pdf

municipalities stopped creating charitable funds that the state legislation had authorized them to create.[240] In response, New York Governor Cuomo requested an investigation of "improper politically-driven efforts" of IRS officials and challenged the agency's fairness.[241]

The IRS issued a clarification on September 5, 2018, which ultimately resulted in more confusion.[242] The IRS sought to draw a distinction between business and individual charitable contributions and stated, "Business taxpayers who make business-related payments to charities or government entities for which the taxpayers receive state or local tax credits can generally deduct the payments as business expenses."[243] The Treasury Department wanted this "longstanding rule" to remain in force.[244] However, there is no such longstanding rule;[245] thus, the language ultimately created a loophole for individual members to continue working around the SALT deduction cap.[246] On December 28, 2018, the IRS published a Revenue Procedure that further clarified the proposed regulations and allowed any C corporation and pass-through entity that is "regarded for all federal income tax purposes as separate from its owners" to deduct charitable contributions.[247]

The new charitable contribution treatment took effect on August 27, 2018.[248] The IRS accepted comments through October 11, 2018,[249] and held a public hearing on

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[https://perma.cc/EQ5E-5Y7R] (urging the IRS to maintain the aspect of the proposed regulations that "prohibits taxpayers from profiting by donating to educational scholarship programs").

240. *See, e.g.*, David McKay Wilson, *Gov. Andrew Cuomo's Anti-Trump Tax Plan Crumbling in Face of IRS Regulations*, LOHUD (Sept. 11, 2018, 5:45 AM), http://www.lohud.com/story/money/personal-finance/taxes/david-mckay-wilson/2018/09/11/cuomo-anti-trump-tax-plan-crumbling-westchester/1156424002/ [https://perma.cc/N33T-ZRVS] ("[T]he cold reality of the IRS proposed rules chilled Scarsdale's resistance. The board voted unanimously to close down its charitable fund before it received a single contribution.").

241. Letter from Andrew M. Cuomo, Governor of N.Y., to J. Russell George, Inspector Gen. for Tax Admin. (Sept. 9, 2018), http://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/GAMC_Letter_to_TIGTA_re_SALT_regs_9.9.2018.pdf [https://perma.cc/3NZX-ZF2K].

242. *See* News Release, Internal Revenue Serv., Clarification for Business Taxpayers: Payments Under State or Local Tax Credit Programs May Be Deductible as Business Expenses, IR-2018-178 (Sept. 5, 2018), http://www.irs.gov/newsroom/clarification-for-business-taxpayers-payments-under-state-or-local-tax-credit-programs-may-be-deductible-as-business-expenses [https://perma.cc/GRK2-TFKT] [hereinafter News Release, Clarification for Business Taxpayers]; Jad Chamseddine, *IRS SALT Clarification May Need Further Clarification*, 89 ST. TAX NOTES 1204, 1204 (2018).

243. News Release, Clarification for Business Taxpayers, *supra* note 242.

244. Press Release, U.S. Dep't of Treasury, Treasury Secretary Mnuchin Statement on Clarification for Business Taxpayers: Contributions Under State and Local Tax Credit Programs Generally Deductible as Business Expenses (Sept. 5, 2018), http://home.treasury.gov/news/press-releases/sm472 [https://perma.cc/L35U-FFKK].

245. Daniel Hemel, *Secretary Mnuchin's SALT "Clarification": A Lesson in Political Geography?*, MEDIUM: WHATEVER SOURCE DERIVED (Sept. 8, 2018), https://medium.com/whatever-source-derived/secretary-mnuchins-salt-clarification-a-lesson-in-political-geography-54cd1603a835 [https://perma.cc/K77M-9W8R] [hereinafter Hemel, *Secretary Mnuchin's SALT "Clarification"*].

246. *See* Chamseddine, *supra* note 242; Hemel, *Secretary Mnuchin's SALT "Clarification*,*" supra* note 245.

247. Rev. Proc. 2019-12, 2019-04 I.R.B. 401, 402; *see also* Emily L. Foster, *IRS Clarifies SALT-Related Business Deduction Rules*, 162 TAX NOTES 102, 102 (2019).

248. Proposed Regulations, *supra* note 135, at 43,566.

November 5, 2018,[250] at which twenty-five people requested to speak.[251] The hearing focused on the proposed regulations' impact on contributions to private scholarship-granting organizations and their broad reach beyond inhibiting states' workaround attempts.[252] The Attorneys General of New Jersey, California, Connecticut, and New York submitted comments to the Treasury regarding the proposed rule and expressed their commitment to fighting the "arbitrary and capricious" regulations.[253]

The Treasury published the final regulations on June 13, 2019.[254] The final regulations generally retained the proposed amendments.[255] Most notably, the final regulations did not exempt tax credit programs that state and local governments established before Congress created the SALT deduction cap.[256] The IRS and the Treasury based this decision on "longstanding federal tax law principles that apply equally to all taxpayers"; treating all programs the same ensures fair and consistent treatment.[257] Thus, "there is something to upset everyone" in the final regulations.[258]

In conjunction with the release of the final regulations, the IRS and Treasury issued guidance proposing a safe harbor for individuals who itemize their deductions but are under the $10,000 SALT cap and who, "under the quid pro quo requirements in the final rule, would be ineligible to take a federal charitable contributions deduction for payments they make to charitable organizations for which they receive a state tax credit."[259] Notice 2019-12 expressed the IRS's intent to amend Treasury Regulation § 1.164-3 to allow an individual who makes a payment to a charitable organization in return for a state or local tax credit to treat the payment as that of state or local tax to the extent the credit offsets the individual's state or local tax liability.[260] The Treasury referenced the safe harbor throughout the final regulations and recognized the safe

249. The Treasury received over 7,700 comments. Final Regulations, *supra* note 125, at 27,514. All comments are available at *Contributions in Exchange for State or Local Tax Credits (REG-112176-18)*, REGULATIONS.GOV, http://www.regulations.gov/docket?D=IRS-2018-0025 [https://perma.cc/Q7JY-8TRB] (last visited Feb. 1, 2020).

250. Proposed Regulations, *supra* note 135, at 43,563.

251. Final Regulations, *supra* note 125, at 27,514.

252. Amy Hamilton, *Proposed Regs on SALT Cap Workaround Overly Broad, Speakers Say*, TAX NOTES: ST. TAX TODAY (Nov. 6, 2018), http://www.taxnotes.com/tax-notes-today-state/credits/proposed-regs-salt-cap-workaround-overly-broad-speakers-say/2018/11/06/28kzd? [https://perma.cc/Y9HE-K794] [hereinafter Hamilton, *Proposed Regs Overly Broad*].

253. Comments of the Att'ys Gen. of N.J., Cal., Conn., and N.Y. to Mr. Charles P. Rettig, Comm'r, Internal Revenue Serv. (Oct. 11, 2018) [hereinafter AGs Comments to IRS], http://www.nj.gov/oag/newsreleases18/IRS-REG-112176-18_Comment-of-NJ-CA-CT-NY-AGs.pdf [https://perma.cc/L2KD-2LP2].

254. Final Regulations, *supra* note 125, at 27,513.

255. *Id.* at 27,514.

256. *Id.* at 27,522.

257. *Id.*

258. Amy Hamilton, *'Something to Upset Everyone' in IRS's Final SALT Cap Regs*, 163 TAX NOTES FED. 1874, 1874 (2019) [hereinafter Hamilton, *Something to Upset*] (discussing reactions to the IRS's final regulations).

259. Amy Hamilton, *IRS Releases Final SALT Cap Rule, Proposes Safe Harbor*, 163 TAX NOTES FED. 1873, 1873 (2019).

260. I.R.S. Notice 2019-12, 2019-27 I.R.B. 57, 57–58, https://www.irs.gov/pub/irs-drop/n-19-12.pdf [https://perma.cc/X67T-GDKB].

harbor as "substantially diminish[ing]" the incentive for state and local governments "to fund governmental activities through entities that are eligible to receive deductible contributions and to establish tax credits"—something the IRS identifies as "economically inefficient tax-avoidance behavior."[261]

The preamble to the final regulations notes that "[a]pproximately 70 percent of commenters recommended that the Treasury Department and the IRS finalize the proposed regulations without change."[262] Despite this stated support, the fight is far from over.[263] The states held true to their word—New Jersey, New York, and Connecticut filed a lawsuit against the IRS challenging the final regulations within days of their publication.[264] The Village of Scarsdale, New York, also sued.[265] During the notice and comment period, a coalition of municipalities, school districts, and state and county groups from New York and New Jersey indicated that they are prepared to sue the IRS as well.[266]

Other stakeholders have also expressed their disapproval of the final regulations. Several members of Congress introduced joint resolutions expressing their disapproval of the rule.[267] Senate Democrats attempted to repeal the final regulations with a majority vote using the Congressional Review Act, but the resolution failed to obtain

261. Final Regulations, *supra* note 125, at 27,527.

262. *Id.* at 27,515.

263. *See* Lauren Loricchio, *New Jersey AG Drafting Response to Federal SALT Workaround Regs*, 82 EXEMPT ORG. TAX REV. 325, 325 (2018) ("We are prepared to fight back tooth and nail against any attempts by the IRS or the Trump administration to block localities from setting up charitable funds to help New Jersey taxpayers preserve their deductibility. . . . We are closely examining all legal avenues against the federal government to protect New Jersey taxpayers from being unfairly targeted by the President." (omission in original) (quoting Statement, Phil Murphy, Governor of N.J. (Aug. 23, 2018))).

264. Complaint for Declaratory and Injunctive Relief at 1, New Jersey v. Mnuchin, No. 1:19-cv-06642 (S.D.N.Y. July 17, 2019) [hereinafter N.J. v. Mnuchin Complaint]. The complaint alleges the IRS is breaking with "historical precedent and practice," *id.* at 2, and the final rule "is unlawful under the Administrative Procedure Act . . . because it is inconsistent with the plain meaning of Section 170, and it is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law'; and 'in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.'" *Id.* at 2–3 (citing 5 U.S.C. § 706(2)(A), (C) (2018)); *see also* Lauren Loricchio, *States, Locality Sue to Overturn IRS SALT Regs*, 164 TAX NOTES 590, 590 (2019).

265. Complaint for Declaratory and Injunctive Relief at 1, Village of Scarsdale v. IRS, No. 7:19-cv-6654 (S.D.N.Y. July 17, 2019).

266. *See, e.g.*, Letter from Baker & McKenzie LLP, on behalf of the Coalition for the Charitable Contribution Deduction (3CD), to Steven T. Mnuchin, Sec'y of the Treasury, et al. (Oct. 11, 2018), http://members.nytowns.org/images/Documents/Announcement/3CD%20Comment%20Letter_REG-112176-18.pdf [https://perma.cc/4KC6-9M8V]; *see also* Hamilton, *Something to Upset*, *supra* note 258, at 1875; Paige Jones, *New York Governor Urges Taxpayers To Take Advantage of SALT Workarounds*, 82 EXEMPT ORG. TAX REV. 325, 325 (2018).

267. H.R.J. Res. 72, 116th Cong. (2019); S.J. Res. 50, 116th Cong. (2019); Press Release, Charles E. Schumer, U.S. Senator for N.Y., Schumer Unveils New Effort To Restore NYs' Ability to 'Workaround' Part of Fed Tax Law That Takes Aim at LI by Eliminating a Homeowners' SALT Tax Deduction, Costing Them Tens-of-Thousands; Senator Will Deploy Special Legislative Power To Overturn IRS Rule & Once Again Make LI'ers Eligible for Full SALT Deduction (July 15, 2019), http://www.schumer.senate.gov/newsroom/press-releases/schumer-unveils-new-effort-to-restore-nys-ability-to-workaround-part-of-fed-tax-law-that-takes-aim-at-li-by-eliminating-a-homeowners-salt-tax-deduction-costing-them-tens-of-thousands-senator-will-deploy-special-legislative-power-to-overturn-irs-rule-and-once-again-make-liers-eligible-for-full-salt-deduction_ [https://perma.cc/VC2E-3XT7].

the majority support needed to pass.[268] Contrary to the Treasury's statement in the preamble that charitable giving incentives for the vast number of taxpayers remain unchanged,[269] certain organizations have reported markedly lower pledges.[270] Moreover, the Treasury's response may continue to evolve. The Treasury did not specifically address the employee payroll tax and pass-through entity tax workarounds in the regulations, but IRS could always issue future guidance disallowing their use.[271]

## IV. PROPOSED STATE ACTION

States have spared no expense fighting to protect their citizen-taxpayers from the effects of the SALT deduction cap. And, despite the Treasury's response, the fight continues. All of the aforementioned workarounds have vulnerabilities; none provide complete protection for individual taxpayers to mitigate the effect of the SALT deduction cap.[272] Part IV.A evaluates the workarounds discussed in Section III and suggests the methods that are most likely to withstand scrutiny. Part IV.B then recommends that states should also seek a longer-term solution.

### *A. The Best of the Workarounds*

Given the Treasury's reaction to the charitable deduction workaround, taxpayers should abandon any attempts to work around the cap through charitable donations to state funds.[273] Though state and local entities challenged the final regulations, there is no guarantee that the rule will be found to be arbitrary and capricious.[274] The arguments raised in the states' complaint challenging the rule are similar to those raised in comments to the proposed rule, yet the Treasury moved forward with the rule anyway.[275] Even if a court invalidates the final regulations, it is impossible to know when the court would issue that opinion. Thus, donating to state charitable funds and hoping the rule will change is a gamble; taxpayers who donate may never get the corresponding credit they seek.

268. *See* Naomi Jagoda, *Senate Rejects Dem Measure To Overturn IRS Rules on SALT Deduction Cap*, HILL (Oct. 23, 2019, 3:44 PM), http://thehill.com/policy/finance/467158-senate-rejects-dem-measure-to-overturn-irs-rules-on-salt-deduction-cap [https://perma.cc/3M77-VUZ4].

269. Final Regulations, *supra* note 125, at 27,528.

270. Hamilton, *Something to Upset*, *supra* note 258, at 1875–76.

271. *See* INTERNAL REVENUE SERV., 2018-2019 PRIORITY GUIDANCE PLAN 2 (2019) (listing "[g]uidance on applying the state and local deduction cap under §164(b)(6) to passthrough entities" as an action item); *see also* Eric Yauch, *Practitioners Urge Caution in Passthrough SALT Cap Planning*, 161 TAX NOTES 111, 112 (2018) (referencing Bruce P. Ely's statement expressing his concerns about the IRS challenging the pass-through entity workaround on audit).

272. See *supra* Part III.D for a discussion of the Treasury Department's reaction to the charitable contribution workaround. As Treasury and the Office of Information and Regulatory Affairs are tasked with implementing the TCJA, similar action could close the door on any or all workarounds. *See* DEP'T OF THE TREASURY & OFFICE OF MGMT. AND BUDGET, *supra* note 222, at 1.

273. *See* Proposed Regulations, *supra* note 135, at 43,563–64.

274. *See supra* notes 263–267 and accompanying text.

275. *Compare* N.J. v. Mnuchin Complaint, *supra* note 264, at 1–3, *with* Proposed Regulations, *supra* note 135, at 43,563.

Though taxpayers should avoid the charitable contribution workaround for the time being, states are not without means to work around the SALT deduction cap.[276] To date, there has been no federal government response to the employee payroll tax or pass-through tax workarounds.[277] Bills from Minnesota[278] and Arkansas,[279] which would create pass-through entity taxes similar to those in Connecticut, Wisconsin, Rhode Island, Louisiana, and New Jersey, reflect this reasoning.[280] Further, a new set of proposed regulations regarding safe harbors under the SALT deduction did not include any comments or language precluding the employee payroll tax or the pass-through entity tax.[281] In fact, scholars have interpreted this agency silence as "a green light for more states to adopt the approach."[282]

Though potentially viable, these two workarounds have drawbacks. New York is phasing in its optional employee payroll tax over several years.[283] It takes a few years to fully implement a successful employee payroll tax, and the political scene may change during that period of time.[284] Further, in order for the workaround to function as intended, the state needs employers to participate.[285] In 2018, only 0.01% of the two million businesses in New York opted into the ECEP.[286] With respect to the pass-through entity tax, there is the "SALT parity" concern for members who do not reside in the state assessing the pass-through entity tax, as well as the natural limitation as to those who can benefit from such a workaround—only taxpayers who are members

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276. *See supra* Parts III.B.2 and III.B.3.

277. *See, e.g.*, Lauren Loricchio, *Uncertainty Remains Despite Guidance on Connecticut Passthrough Entity Tax*, TAX NOTES: ST. TAX TODAY (Aug. 29, 2018), http://www.taxnotes.com/tax-notes-today-state/credits/uncertainty-remains-despite-guidance-issued-connecticut-passthrough-entity-tax/2018/08/29/28czp? [https://perma.cc/6FHQ-NNEE].

278. S. 304, 91st Leg., Reg. Sess. (Minn. 2019); Aaron Davis, *Minnesota Bill Would Create SALT Workaround for Passthroughs*, TAX NOTES: ST. TAX TODAY (Jan. 24, 2019), http://www.taxnotes.com/tax-notes-today-state/alternative-minimum-tax/minnesota-bill-would-create-salt-workaround-passthroughs/2019/01/24/292q5? [https://perma.cc/VB2E-QN5Y].

279. H.R. 1714, 92d Gen. Assemb., Reg. Sess. (Ark. 2019); Lauren Loricchio, *Arkansas Lawmakers Consider SALT Workaround Bill*, TAX NOTES: ST. TAX TODAY (Nov. 29, 2018), http://www.taxnotes.com/tax-notes-today-state/partnerships/arkansas-lawmakers-consider-salt-workaround-bill/2018/11/29/28ms4? [https://perma.cc/SC2D-JZ47]; Lauren Loricchio, *Arkansas Tax Reform Panel Recommends Draft Legislation*, TAX NOTES: ST. TAX TODAY (Dec. 21, 2018), http://www.taxnotes.com/tax-notes-today-state/individual-income-taxation/arkansas-tax-reform-panel-recommends-draft-legislation/2018/12/21/28pdg [https://perma.cc/DGJ2-P7PF].

280. See *supra* Part III.B.3 for a discussion of the pass-through entity taxes states have enacted.

281. Amy Hamilton, *IRS Silent on Passthrough Workarounds in SALT Cap Proposed Rule*, 85 EXEMPT ORG. TAX REV. 19, 19 (2019) [hereinafter Hamilton, *IRS Silent*]. The proposed safe harbors are not new, but the Treasury and IRS felt it was appropriate to publish them in proposed regulations and request comments. *Id.* For more on the proposed safe harbors, see Treatment of Payments to Charitable Entities in Return for Consideration, 84 Fed. Reg. 68,833 (proposed Dec. 17, 2019).

282. Hamilton, *IRS Silent*, *supra* note 281, at 19.

283. *See supra* note 140 and accompanying text.

284. See *supra* Part III.B.2 noting the potential challenges to implementation, such as sticky wages and the potential to opt out.

285. *See supra* note 151 and accompanying text.

286. *See* Paige Jones, *262 Businesses Opt In to New York's Voluntary Payroll Tax System*, TAX NOTES: ST. TAX TODAY (Dec. 4, 2018), http://www.taxnotes.com/tax-notes-today-state/tax-system-administration/262-businesses-opt-new-yorks-voluntary-payroll-tax-system/2018/12/04/28n8k [https://perma.cc/YV2J-6QCV].

of pass-through entities.[287] Further, a member cannot get relief on any income that is generated outside of the pass-through entity.[288] Despite the drawbacks, these workarounds provide more relief than the charitable contribution workaround.[289]

Using the employee payroll tax and pass-through entity tax are thus less risky options, but taxpayers should not consider them "safe." These methods remain open to IRS challenge,[290] and proposed regulations that address the pass-through entity tax are possible,[291] even if met with silence thus far.[292] However, the federal government would have a harder time challenging these workarounds because any changes would require a larger shift in policy. Business taxes and the deductibility of business expenses are foundational elements of the tax system,[293] in contrast to charitable contributions, where quid pro quo and the definition of a donation have been less controversial.[294] State taxes grounded in fundamental tax policies rather than appearing as workarounds have a better chance at surviving an IRS challenge. Thus, states interested in creating a pass-through entity tax should follow Wisconsin's structure and exclude the entity's taxable income from the partner's income, rather than creating a corresponding tax credit.[295] Alternatively, states could follow the Minnesota bill and the Rhode Island law by allowing pass-through entities to file as C corporations for state tax purposes so that income is taxed at the entity level and not passed through to the individual members.[296]

The employee payroll tax and pass-through entity tax workarounds can act as short-term fixes, but states should also pursue a longer-term solution in order to help their taxpayers through 2025,[297] or forever if the cap does not ultimately sunset. As previously explained, the litigation discussed in Part III.C did not pass muster at the

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287. See *supra* Part III.B.3 for a discussion of pass-through entity taxes and their limitations.

288. See *supra* notes 160–163 and accompanying text for an explanation of the tax base of the pass-through entity tax.

289. Compare *supra* Part III.B.1, with *supra* Parts III.B.2 and III.B.3, given the IRS's regulatory response to the charitable contribution workaround.

290. *See* Amy Hamilton, *IRS Working on Guidance for Applying SALT Cap to Passthroughs*, 164 TAX NOTES FED. 730, 730 (2019); Glenn Newman, *New York Guidance on Payroll Tax Workaround to $10,000 SALT Deduction Limitation Issued*, GREENBERG TRAURIG (July 12, 2018), http://www.gtlaw.com/en/insights/2018/7/new-york-guidance-on-payroll-tax-workaround-to-10000-salt-deduction-limitation-issued [https://perma.cc/5J8S-7BSL].

291. *See* Kristen A. Parillo, *Carried Interest, SALT Among Imminent TCJA Guidance*, 94 TAX NOTES ST. 593, 593 (2019).

292. Hamilton, *IRS Silent*, *supra* note 281, at 19.

293. *See* Noonan & Pascal, *supra* note 178, at 605 (predicting that the IRS will focus its efforts on "low-hanging fruit" and not "go down this road" of denying a deduction for the pass-through entity).

294. *See, e.g.*, United States v. Am. Bar Endowment, 477 U.S. 105, 116–18 (1986) (discussing aspects of charitable contributions from Section 170 of the Internal Revenue Code, such as that the contributor cannot expect a substantial benefit in return); *Charitable Contributions–Quid Pro Quo Contributions*, IRS, http://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contributions-quid-pro-quo-contributions [https://perma.cc/NEX5-9JWV] (last updated Jan. 8, 2020).

295. *See supra* note 167 and accompanying text.

296. *Compare* S. 304, 91st Leg., Reg. Sess. (Minn. 2019), *with* Act of July 5, 2019, ch. 19-88, art. 5, § 8, 2019 R.I. Adv. Legis. Serv. Ch. 19-88 (West).

297. The cap applies to taxes paid for years 2018–2025. *See* I.R.C. § 164(b)(6) (2018).

district court level.[298] As the court reached the merits of the claim (as opposed to summarily dismissing the action for a jurisdictional issue), it is unlikely the appeal to the Second Circuit would lead to a different outcome.[299] The litigation challenging the final regulations discussed in Part III.D is not in a much better position,[300] though the breadth of the opposition (blue states, red states, and charitable organizations) creates a plaintiff base diverse in their arguments and ultimate concerns.[301]

These states argue that the regulations are arbitrary and capricious.[302] The Supreme Court in *Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co.*[303] explained that an agency's rule is typically arbitrary and capricious if

> the agency [1] has relied on factors which Congress has not intended it to consider, [2] entirely failed to consider an important aspect of the problem, [3] offered an explanation for its decision that runs counter to the evidence before the agency, or [4] is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.[304]

Plaintiffs make a cogent argument that the second factor is met by disputing the impact on longstanding donation-for-credit programs.[305] The plaintiffs also argue that the third factor is met by referencing the 2010 CCA, case law precedent, and the treatment of donations to state charitable funds as charitable contributions in past years.[306] Beyond legal arguments, it is unclear how long this litigation will take to advance through the courts, and appeals will almost certainly follow given the parties' commitment to the case. Further, if the IRS takes regulatory action regarding the pass-through entity workaround, the legal dance would simply begin again.

### B. *Longer-Term Relief*

Given that the IRS may continue to preclude the use of other workarounds,[307] the states should find other ways to provide their taxpayers with permanent relief. Part IV.B.1 discusses how, although it would strike at the core of the SALT deduction cap,

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298. See *supra* Part III.C for a discussion of the district court's reasoning in dismissing the lawsuit.

299. *See supra* Part III.C.

300. *See* Paige Jones, *Final Federal SALT Rules Could Face Litigation from States*, TAX NOTES: ST. TAX TODAY (Jan. 30, 2019), https://www.taxnotes.com/tax-notes-today-state/code-and-regulations/final-federal-salt-rules-could-face-litigation-states/2019/01/30/2936m [https://perma.cc/3X5M-PQ5S] (quoting Kirk Stark saying, "It's still a very, very high hurdle to overcome to actually convince a federal court [to overturn] a reg project that's gone through notice and [comment] and taken into account the 7,700 comments that were received and duly noted . . . ." (first alteration in original)).

301. See *supra* Part III.B.1 and notes 237–239 for an explanation of why each of these parties are interested in challenging the regulations.

302. N.J. v. Mnuchin Complaint, *supra* note 264, at 2–3.

303. 463 U.S. 29 (1983).

304. *State Farm*, 463 U.S. at 43.

305. *See, e.g.*, N.J. v. Mnuchin Complaint, *supra* note 264, at 9; Letter from Rob Woodall et al., Members of Cong. from Ga., to Steven T. Mnuchin, Sec'y of the Treasury, and Comm'r Charles Retting, Internal Revenue Serv., *supra* note 237.

306. N.J. v. Mnuchin Complaint, *supra* note 264, at 7–8.

307. *See* INTERNAL REVENUE SERV., *supra* note 271, at 2.

federal legislation is not feasible at this time. Part IV.B.2 then discusses the best option states have for long-term relief: state legislation that makes them less "high tax."

1. Federal Legislation

Federal legislation is the option would bring the most widespread, long-term relief because it would repeal, amend, or replace the SALT deduction cap in the Code. The coalition of members of Congress in favor of restoring full SALT deductibility is large and growing;[308] beyond the states that have taken legislative or adjudicative action, the governors of Hawaii, Illinois, and Washington are also working with their congressional representatives and House Speaker Nancy Pelosi.[309] The House Select Revenue Measures Subcommittee called a hearing in June 2019 to explore the cap's impact on communities, schools, first responders, and housing values.[310] The testimony largely indicated that municipalities are already feeling the strain of the cap; residents are considering leaving high tax areas and local governments believe they need to reduce local taxes to offset lost deductions.[311] This forces cities and towns to develop new means of raising revenue to fund critical public services.[312] A Joint Committee on Taxation report indicated that repealing the SALT deduction cap is estimated to lower 13.1 million taxpayers' tax liabilities.[313]

Unfortunately, the only method that completely nips the SALT deduction cap in the bud—changing it—is not possible in the 2020 partisan political climate.[314] Several members of Congress announced their intent to reintroduce the SALT deduction in the

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308. See *infra* notes 316–317 and accompanying text for a list of relevant bills that have been introduced to amend or repeal the SALT deduction cap.

309. *Governor Cuomo Announces States Join Campaign To Fight for Tax Fairness*, N.Y. ST. (Feb. 22, 2019), http://www.governor.ny.gov/news/governor-cuomo-announces-states-join-campaign-fight-tax-fairness [https://perma.cc/9U64-MN2M].

310. Paige Jones, *SALT Cap Spells Trouble for Cities, Local Officials Warn Congress*, 164 TAX NOTES FED. 95, 95 (2019).

311. *See Hearing on How Recent Limitations to the SALT Deduction Harm Communities, Schools, First Responders, and Housing Values: Hearing Before the Subcomm. on Select Revenue Measures of the Comm. on Ways & Means*, 116th Cong. 24, 28, 40 (2019), http://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/GPO%20Draft.pdf [https://perma.cc/2UH8-6W5T].

312. *See id.*

313. STAFF OF JOINT COMM. ON TAXATION, 116TH CONG., BACKGROUND ON THE ITEMIZED DEDUCTION FOR STATE AND LOCAL TAXES 14 (Comm. Print 2019) [hereinafter JCT, SALT BACKGROUND], http://www.jct.gov/publications.html?func=startdown&id=5206 [https://perma.cc/8ZD2-B83B]; Paige Jones, *SALT Cap Deduction Would Mostly Favor High Earners, JCT Says*, TAX NOTES: ST. TAX TODAY (June 25, 2019), http://www.taxnotes.com/tax-notes-today-state/exemptions-and-deductions/salt-cap-deduction-would-mostly-favor-high-earners-jct-says/2019/06/25/29nbz? [https://perma.cc/7KKJ-UXK4]. The largest criticism about repealing the cap is that it will only help wealthy taxpayers. *See* JCT, SALT BACKGROUND, *supra*, at 14 ("The repeal is estimated to result in a decrease in tax liability for 13.1 million taxpayers, 94 percent of which have $100,000 or more of economic income."); Kyle Pomerlau & Huaqun Li, *Analysis of the "SALT Act*,*"* TAX FOUND. (Mar. 11, 2019), http://taxfoundation.org/salt-act/ [https://perma.cc/PJ7F-5FDR] (explaining that the SALT Act "would also almost exclusively provide tax relief to the top 20 percent of income earners, the largest tax cut going to the top 1 percent of earners").

314. *See supra* Part IV.A.

116th Congress[315] and on January 3, 2019, representatives from New York introduced a bipartisan bill to remove the cap.[316] Throughout 2019, Congresspeople introduced several other bills that would repeal the limitation,[317] as well as bills that seek a middle ground—raising the cap from $10,000 to $15,000[318] or changing the cap to an amount equal to the basic standard deduction.[319] On December 10, 2019, after a few months of the preparation, Congressman Thomas Suozzi from New York introduced the Restoring Tax Fairness for States and Localities Act.[320] Congress passed the bill on December 19, 2019, making it the best chance at quick, short-term federal relief.[321]

Early in 2019, President Trump said that he was "open to thinking about" changing the SALT deduction cap.[322] He also met with Governor Cuomo to discuss the revenue shortfall in New York and, according to Governor Cuomo, the President "suggested that he was open to a change . . . because he understands [that if y]ou hurt New York, you hurt California, [then] you hurt the economic engines of the nation."[323] But this friendly atmosphere no longer exists—the White House threatened to veto the Restoring Tax Fairness for States and Localities Act a day before Congress voted on it.[324] The Office of Management and Budget again voiced concern about an unlimited

315. *With Dems Winning The House, N.J. Lawmakers Push To Save SALT Deductions*, CBS (Nov. 19, 2018, 7:51 PM), http://newyork.cbslocal.com/2018/11/19/with-dems-winning-the-house-n-j-lawmakers-push-to-save-salt-deductions/ [https://perma.cc/L72N-BJUK].

316. SALT Deductibility Act, H.R. 188, 116th Cong. (2019); *see also* Lauren Loricchio, *Bipartisan Bill Would Remove SALT Deduction Cap*, 162 TAX NOTES 119, 119 (2019).

317. *See* Stop the Attack on Local Taxpayers (SALT) Act of 2019, H.R. 1142, 116th Cong. (2019); State and Local Tax Deduction Fairness Act of 2019, H.R. 515, 116th Cong. (2019); SALT Fairness Act of 2019, H.R. 257, 116th Cong. (2019). The corresponding bill in the Senate is SALT Act, S. 437, 116th Cong. (2019). For an in-depth analysis of the SALT Act, see Pomerlau & Li, *supra* note 313. In contrast, less popular bills have sought to permanently extend the $10,000 cap. *See* To Amend the Internal Revenue Code of 1986 To Make Permanent the Individual Tax Provisions of the Tax Reform Law, and for Other Purposes, S. 1162, 116th Cong. (2019).

318. Save the State and Local Tax Deduction for Middle Class Families Act of 2019, H.R. 2984, 116th Cong. (2019); To Amend the Internal Revenue Code of 1986 To Increase the Limitation on the Amount Individuals Can Deduct for Certain State and Local Taxes, H.R. 1757, 116th Cong. (2019).

319. SALT Relief and Marriage Penalty Elimination Act of 2019, H.R. 2624, 116th Cong. (2019).

320. Restoring Tax Fairness for States and Localities Act, H.R. 5337, 116th Cong. (2019); *see also* Jad Chammseddine, *House Dems Finally Release Short-Term SALT Cap Repeal*, TAX NOTES: ST. TAX TODAY (Dec. 11, 2019), https://www.taxnotes.com/tax-notes-today-state/exemptions-and-deductions/house-dems-finally-release-short-term-salt-cap-repeal-bill/2019/12/11/2bnxw [https://perma.cc/QG8V-ND8R]. The bill would eliminate the marriage penalty by raising the SALT deduction cap to $20,000 for 2019 for joint returns, H.R. 5337 § 2, and eliminate the cap for 2020 and 2021, *id.* § 3. As a trade off, the top marginal individual income tax rate would increase to 39.6%. *Id.* § 4.

321. Naomi Jagoda & Juliegrace Brufke, *House Votes to Temporarily Repeal Trump SALT Deduction Cap*, HILL (Dec. 19, 2019, 4:12 PM), http://thehill.com/policy/finance/475352-house-votes-to-temporarily-repeal-trump-salt-deduction-cap [https://perma.cc/NU2B-JU54].

322. Paige Jones, *Cuomo, Trump SALT Summit Fizzles*, TAX NOTES: ST. TAX TODAY (Feb. 13, 2019), http://www.taxnotes.com/tax-notes-today-state/politics-taxation/cuomo-trump-salt-summit-fizzles/2019/02/13/294ky [https://perma.cc/CJA2-QZZU].

323. *Id.*

324. *Naomi Jagoda*, *White House Threatens To Veto Bill To Temporarily Repeal SALT Deduction Cap*, HILL (Dec. 18, 2019, 6:31 PM), https://thehill.com/policy/finance/475206-white-house-threatens-veto-bill-to-temporarily-repeal-salt-deduction-cap [https://perma.cc/W93Z-EK6Y].

cap subsidizing the wealthy and said that raising the tax rate to 39.6% "would stifle economic growth by placing an undue burden on thousands of small businesses."[325]

Senators and representatives from high tax blue states tried to take advantage of the deduction cap's publicity to change the provision, but they did not have the votes. This failure was not unexpected—on February 7, 2019, Senate Finance Committee Communications Director Michael Zona said that the committee "won't be revisiting the SALT deduction reforms made in the Tax Cuts and Jobs Act under Chairman Grassley's leadership." [326] Further, Senate Democrats' failed attempt at repealing the final regulations made clear that there is currently not enough support in the Senate to pass a bill that lifts or revises the SALT deduction cap.[327]

Federal legislation is not likely to be successful until both Congress and the Senate are Democrat-controlled. Proposed bills that amend the SALT deduction cap will likely sit untouched until that time, but if there is a shift after the 2020 election, they will hopefully be revisited. Congresspeople from red states should support repealing the cap because eliminating the charitable contribution workaround would allow them to argue that long-standing deduction-for-credit programs should remain legal.[328] Further, the focus on blue states ignores the fact that "[m]any affected taxpayers live in states (and ZIP codes) that are reliably Republican."[329]

Because full reinstatement or raising the cap is not feasible, there are other tax reform routes that Congress could pursue. If Congress is concerned about raising revenue, enacting "a credit-invoice [value added tax] that the states could piggyback on"[330] or a more aggressive percentage limit instead of a flat dollar value cap on the SALT deduction[331] would be better options. Though the SALT deduction cap "mitigates the incentives for economic segregation by reducing the deduction's federal subsidy for wealthy neighborhoods," these other alternatives serve the same purpose but are better from a policy perspective.[332] Congresspeople could pursue one of these

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325. *Id.*

326. Paige Jones, *U.S. Senate Finance Committee Will Not Revisit SALT Deduction Cap*, TAX NOTES: ST. TAX TODAY (Feb. 8, 2019), http://www.taxnotes.com/tax-notes-today-state/exemptions-and-deductions/us-senate-finance-committee-will-not-revisit-salt-deduction-cap/2019/02/08/2944f [https://perma.cc/88YK-3MB7].

327. *See* Jagoda, *supra* note 268 (explaining that the resolution that would have repealed the regulations did not pass by a vote of 43–52).

328. *See* Hamilton, *Proposed Regs Overly Broad*, *supra* note 252.

329. Manoj Viswanathan, *Hyperlocal Responses to the SALT Deduction Limitation*, 71 STAN. L. REV. ONLINE 294, 298 (2019) ("In Forsyth County, Georgia, for instance, approximately 15% of its 67,000 taxpayers will be affected by the SALT deduction limitation. This is a greater percentage of affected taxpayers than in forty-six states, including California. Forsyth County is not anomalous. With the exception of Alaska, all states contain at least one ZIP code with at least 13% of taxpayers affected." (footnote omitted)).

330. Gamage & Shanske, *The Future of SALT*, *supra* note 86, at 1277; *see also* David Gamage & Darien Shanske, *Tax Cannibalization and Fiscal Federalism in the United States*, 111 NW. U. L. REV. 295, 309–34 (2017) (discussing theory further).

331. Gamage & Shanske, *The Future of SALT*, *supra* note 86, at 1276.

332. *See* Paul Caron, *Shobe Presents Economic Segregation, Tax Reform, and the Local Tax Deduction Today at Loyola-L.A.*, TAXPROF BLOG (Nov. 19, 2018), http://taxprof.typepad.com/taxprof_blog/2018/11/shobe-presents-economic-segregation-tax-reform-and-the-local-tax-deduction-today-at-loyola-la.html [https://perma.cc/JC7J-LF4Z] (quoting Gladriel Shobe, Loyola Tax Policy Colloquium: Economic Segregation, Tax Reform, and the Local Tax Deduction (Nov. 19, 2018)).

methods, but the fate of the Restoring Tax Fairness for States and Localities Act remains a cautionary tale until there is a shift in control.

2. State Legislation

State legislation is the best place for taxpayers to focus their energy and efforts. As mentioned earlier, state governments are already feeling the fiscal impact of the SALT deduction cap.[333] Beyond the actions mentioned above that involve fighting the cap, states should review their own tax laws. There are only a few high tax blue states—New York, Connecticut, New Jersey, Maryland—that are leading this fight; though a few others have passed workaround legislation, several of the fifty states are not now engaged.[334] These few high tax states are spending time and money to fight the federal government over the SALT deduction cap and these efforts are not being met with success.[335] It is imperative that they determine if there are internal ways to assist their citizens, particularly if the workarounds and legislative challenges do not end in their favor. High tax blue states should review the tax laws and general revenue provisions of the states with lower tax rates to determine what these other states do such that the SALT deduction cap does not impact their citizens to the same degree.

Further, discussions about the high taxes in these blue states are not new.[336] The federal government may have just given high tax states' politicians cover to make some (potentially) less favorable decisions.[337] State governments may now be able to exercise options to lower their state tax rates that have always existed but may not have been palatable to state residents until now, such as consolidating school systems, raising state tax rates on businesses, or taxing tourism.[338] Businesses are viewed as the winners under the TCJA, so states that value the SALT deduction could look to extract some of that financial benefit to offset a decrease in state and local tax rates.[339] States

333. *See Governor Cuomo and Comptroller DiNapoli Deliver Update on State Revenues and the Impact of SALT*, N.Y. ST. (Feb. 4, 2019), http://www.governor.ny.gov/news/governor-cuomo-and-comptroller-dinapoli-deliver-update-state-revenues-and-impact-salt [https://perma.cc/H8KJ-C78D] (quoting New York State Comptroller Thomas P. DiNapoli saying the SALT deduction cap caused "the most serious fiscal shock [the] state has faced in years").

334. *See supra* Parts III.B and III.C. See also *supra* notes 91–95 highlighting the differences in state and local tax impacts on the various states.

335. See *supra* Part III.C reviewing the states' litigation approach to combating the effects of the SALT deduction cap.

336. *See, e.g.*, Aaron Davis, *Connecticut's Property Tax Burden Third-Highest in Nation*, TAX NOTES: ST. TAX TODAY (Aug. 29, 2019), http://www.taxnotes.com/tax-notes-today-state/property-taxation/connecticuts-property-tax-burden-third-highest-nation/2019/08/29/29wjn [https://perma.cc/JZ54-M8WH]; Colleen O'Dea, *Why Property Taxes Are So High in New Jersey*, WHYY (Mar. 3, 2015), http://whyy.org/articles/why-property-taxes-are-so-high-in-new-jersey/ [https://perma.cc/GPD5-ZUEC].

337. *See* Brad Tuttle, *8 Reasons Your Property Taxes Are So Damn High*, TIME MONEY (Apr. 20, 2015), http://time.com/money/3824157/property-taxes-why-so-high/ [https://perma.cc/5AG3-9LRV] (discussing several factors behind why New Jersey has high property taxes).

338. *See id.*

339. *See* Lauren Loricchio, *Increased State Tax Activity Expected in 2019*, TAX NOTES: ST. TAX TODAY (Nov. 9, 2018), http://www.taxnotes.com/tax-notes-today-state/benefits-and-pensions/increased-state-tax-activity-expected-2019/2018/11/09/28l8t [https://perma.cc/M563-UMM8].

fear migration of the wealthy, and while debated, the fear is not unfounded.[340] However, another option to raise revenue is for states to make their tax systems more progressive so that some of the burden is removed from the middle class, coupled with a change to the estate tax to combat the corresponding migration from the state.

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There has been so much development on this topic since Congress enacted the TCJA that this Comment has gone through several iterations. There is a chance a large part of the discussion could be moot the moment it goes to print. Even if it is not, with the attention that has now been paid to the SALT deduction cap, the Code is likely to change at some point in the future. The TCJA is only one chapter in the history of the Code; states should not let an amendment to Section 164(b)(6) stop the conversation. State and federal legislators must continue until they reach a long-term solution so that a provision that means so much to their constituents does not cause the same trouble if a SALT deduction cap returns in a future tax reform bill.

## V. CONCLUSION

The TCJA's creation of a $10,000 cap on individual state and local tax deductions was a controversial political choice enacted as a way to raise revenue. Two years after Congress passed the law, states remain committed to working around the cap with legislation and fighting the cap with litigation. Though the IRS has begun, and will likely continue, to respond to these efforts, the coalition of states opposed to the SALT deduction cap is strengthening. Several other states have joined the few high tax states that initially took action—Connecticut, New Jersey, New York, and Oregon; as of December 2019, 30% of states have taken, have tried to take, or have indicated an intent to take action of some kind.[341] By continuing to develop less risky legislative workarounds for their citizens, states can provide various routes to deductibility. However, a longer-term solution at the federal level coupled with changes to state tax policies is the key to solving the problem.

340. *See, e.g.*, Brittany De Lea, *Florida To See Population Boom Over Coming Years as SALT Deductions Remain Capped*, FOX BUS. (Aug. 13, 2019), http://www.foxbusiness.com/economy/florida-population-boom-taxes [https://perma.cc/64JK-VX9X].

341. New York, New Jersey, Connecticut, Oregon, Wisconsin, Rhode Island, Louisiana, and Maryland have taken action. *See supra* Parts III.B and III.C. Minnesota and Arkansas are trying to take action. *See supra* notes 278–279. California and Michigan tried to take action. *See supra* notes 111–112, 158–159. Hawaii, Illinois, and Washington are working with Congress to restore full deductibility. *See supra* note 309.