New York, New Jersey, and Connecticut v. the United States: A Preview of the SALT Limit Constitutional Challenge

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Key Findings

• New York Governor Andrew Cuomo has announced that his state and others will file a lawsuit challenging the federal tax law’s $10,000 cap on the state and local tax (SALT) deduction.

• Governor Cuomo and his spokespersons have offered two main legal arguments: the SALT deduction cap violates the Equal Protection Clause, and the cap violates the Tenth Amendment.

• The Equal Protection Clause protects against certain government classifications that burden or benefit one class of persons to the exclusion of others. But the SALT cap involves no facial classification, and does not in effect classify. Even if it did, the standard for evaluation would be rational basis review which the federal tax bill easily meets.

• The Tenth Amendment protects against federal laws designed to compel or commandeer states into implementing a federal law. The federal SALT deduction cap does not commandeer state legislative processes nor compel it to adopt a federal policy. While there may be pressure on a state to lower its taxes in response, this pressure is not so large as to deprive state policymakers of any choice in the matter.
New York Governor Andrew Cuomo has announced that his state, along with Connecticut and New Jersey, will file a lawsuit against the federal government. The lawsuit will challenge the federal tax law's imposition of a $10,000 cap on the state and local tax (SALT) deduction on federal tax returns. New York and other states are also proposing workarounds such as “charitable” contributions-in-lieu-of-taxes and imposing optional payroll taxes that would be fully deductible. Our colleague Jared Walczak critiqued the structure and workability of these proposed SALT workarounds for high-income taxpayers and analyzed their resultant distributional regressivity.

Here, we focus solely on the legal arguments of New York’s anticipated lawsuit. Cuomo and his spokespersons have offered two main legal arguments: the SALT deduction cap violates the Equal Protection Clause, and the cap violates the Tenth Amendment. These arguments are unlikely to succeed under existing precedents.

**Equal Protection Clause**

The Fourteenth Amendment provides “[n]o State shall make or enforce any law which . . . deny to any person within [the State’s] jurisdiction the equal protection of the laws.” While the Fourteenth Amendment applies only to state legislation, the Supreme Court has held that “the Due Process Clause of the Fifth Amendment provides guarantees against the Federal Government that are essentially identical to those provided against the States by the Fourteenth Amendment’s Equal Protection Clause.” Thus, federal legislation cannot deny persons the equal protection of the laws.

Laws by their very nature divide people into different categories and subject them to differing treatment, but not all laws violate the Equal Protection Clause. Consequently, the Equal Protection Clause prohibits government action only when it involves violation of “a specific prohibition of the Constitution, such as those of the first ten amendments… legislation which restricts those political processes which can ordinarily be expected to bring about repeal of undesirable legislation… [or] prejudice against discrete or insular minorities….”

To determine whether there is an equal protection violation, there must first be a government classification, as the equal protection clause applies only to government classifications. Government classifications occur when government action imposes a burden or confers a benefit on one class of persons to the exclusion of others. Government classifications may be “facial” or “in effect.” If the classification appears on the face of a statute, the Equal Protection Clause applies. Similarly, if the government action is neutral on its face but has the effect of distributing burdens or benefits unequally, equal protection requirements must be satisfied. In cases of “in effect” classification,
the challenger must introduce evidence to show a discriminatory purpose. Once a government classification has been identified, the classification must satisfy means-end scrutiny. There are three levels of scrutiny: (1) strict scrutiny, (2) intermediate scrutiny, and (3) rational basis.

**Strict Scrutiny.** Strict scrutiny is the highest level of review. Under this test, the government must show that the classification is narrowly tailored to achieve a compelling government interest. In proving the existence of a compelling objective, the government cannot simply assert such an interest; it must show that the compelling objective is the real reason for its actions. “Narrowly tailored” means the government’s activity is the least restrictive to civil liberties possible to advance the state interest. This standard of review is used when the classification includes (1) race, (2) national origin, (3) alienage, and (4) classifications burdening fundamental rights. In *Fisher v. University of Texas*, two white individuals were denied admission to the University of Texas at Austin (UT), and argued that they had been discriminated against based on their race. The University’s admission policy guaranteed admission for students who graduated in the top 10% of their high school class, with the remaining spots filled by consideration of a number of factors, race among them. Because the admissions process used race as a classification, the Supreme Court reviewed the policy under strict scrutiny, to determine whether it was the least restrictive means to advance a compelling state interest. The Court concluded that diversity in education has long been held a compelling state interest, and, because there are no other available and workable race-neutral alternatives that would ensure diversity within academia, the UT admissions system was narrowly tailored and therefore valid.

**Intermediate Scrutiny.** Intermediate Scrutiny is the second highest level of review. Under this test, the government must show that the classification substantially related to the accomplishment of an important governmental objective. Intermediate scrutiny is used when the classification includes gender or illegitimacy. In *Craig v. Boren*, for example, the Supreme Court struck down as unconstitutional two Oklahoma statutes which prohibited the sale of nonintoxicating 3.2 percent alcohol beer to men under the age of 21 and women under the age of 18. The Supreme Court established that gender-based classifications must serve an important government objective and be substantially related to the achievement of such objective. David Boren, the governor of Oklahoma, argued that the important government interest being protected was traffic safety, as 2 percent of men were drunk drivers while less than 1 percent of women were drunk drivers. While traffic safety is an important interest, the Court concluded that the sex-based law restricting the purchase of one type of alcohol was not an accurate proxy for the regulation of driving, and thus not substantially related to increasing traffic safety.
Rational Basis Scrutiny. Rational Basis Scrutiny is the final level of review. Under this test, the claimant must show that the classification used was not rationally related to any legitimate means.\textsuperscript{17} The legitimate interest of the state need not be one that motivated legislators to enact the legislation, but just one that exists. This standard is used for economic regulations and all other classifications not subject to intermediate or strict scrutiny.\textsuperscript{18} In 	extit{Williamson v. Lee Optical}, for example, the Supreme Court upheld an Oklahoma statute that prevented persons who were not licensed optometrists or ophthalmologists from fitting lenses for eyeglasses. Since this was a statute regulating economic activity, the Court used rational basis standard of review and concluded the challengers had not met their burden demonstrating the law was irrational or unrelated to a legitimate interest. While using rational basis, the Court gave great deference to the Oklahoma legislature. The Court even noted that the Oklahoma law “may exact a needless, wasteful requirement, but it is for the legislature, not the courts, to balance the advantages and disadvantages of the new requirement.”\textsuperscript{19}

In this case, the provision capping deductions for state and local taxes is unlikely to be considered a classification meriting strict or intermediate scrutiny. The SALT deduction cap provision neither facially classifies nor in effect classifies. Had the provision stated that the cap only applied to Democrats (or Republicans), then this could be a facial classification, but it does not. The provision also does not classify “in effect.” While the effect of the cap impacts high-tax states (many of which, but not all, tend to vote Democratic), the burdens of the cap are a result of income, property ownership, and the interplay of the tax system, and are indifferent to one’s state of residence or party affiliation.\textsuperscript{20}

Additionally, even in the presence of a classification, the provision would still be valid. Challengers may argue that this provision allegedly classifies based on political affiliation, but this is not a suspect or semi-suspect classification like race, national origin, alienage, or sex. The standard of review would therefore be rational basis. Moreover, under \textit{United States v. Carolene Products}, the standard of review is rational basis because the provision is an economic one.

Under rational basis review, New York and other states would have to show that there is no legitimate purpose for the law, or that it has a legitimate purpose but does not rationally advance it. The government can argue that the purpose of the SALT deduction cap provision is to raise revenue to help pay for other TCJA provisions, or that it sought to eliminate a tax deduction primarily used by high-income taxpayers. Other legitimate rationales that the federal government could cite for enacting the law could include increasing take-home income for taxpayers, increasing economic growth or economic competitiveness, and distributional progressivity. Even if these purposes were not the stated motivation for enacting the provision by those who voted for it, under rational basis review the government only needs to demonstrate that legitimate rationales for the provision exist. Raising revenues is a legitimate purpose for government action, and the enactment of this provision is rationally related to it. Therefore, it is unlikely that this argument would succeed on the merits.

\textsuperscript{17} \textit{Williamson v. Lee Optical Co.}, 348 U.S. 483 (1955).
\textsuperscript{18} \textit{United States v. Carolene Products Co.}, 304 U.S. 144, fn. 4 (1938).
\textsuperscript{19} \textit{Williamson}, 348 U.S. 483, 487.
\textsuperscript{20} Six states—California, New York, New Jersey, Illinois, Texas, and Pennsylvania—have claimed more than half the value of the deduction in the past. Texas is usually considered a “red” state, Pennsylvania a “purple” state, and the others “blue” states.
Tenth Amendment

The Tenth Amendment provides, “The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.” The Tenth Amendment is especially relevant in cases where the federal government is acting outside its delegated powers. However, the power to levy an income tax is a valid federal power. There is no provision of the Constitution, nor an interpretation of the Constitution adopted by the Supreme Court, that requires the federal government to provide an uncapped deduction for state and local taxes.

A separate line of cases evaluates federal laws designed to “compel” or “dragoon” states into implementing a federal law, in violation of the Tenth Amendment’s limitations on federal intrusion on state power. The courts have generally not left such matters to the elected branches, because the nature of federal law directing state officials to implement an unpopular federal policy may result in the state official being incorrectly blamed by voters. For example, in New York v. United States, the Supreme Court struck down as unconstitutional a federal law directing each state to adhere to a federal radioactive waste disposal program or else gain title to all waste generated within the state’s borders. The Court ruled that Congress can provide financial or other incentives or pursue joint programs, but cannot engage in “outright coercion” by “commandeering the legislative processes of the states by directly compelling them to enact and enforce a federal regulatory program.”

Additionally, while Congress may attach conditions to states receiving and spending federal funds that pressure states to adopt federal policies, those conditions violate the Tenth Amendment if “pressure turns into compulsion.” A state must be able to voluntarily accept or reject the terms. In South Dakota v. Dole, Congress directed the Secretary of Transportation to withhold 5 percent of federal highway aid to states with drinking ages lower than 21. The Supreme Court found that because the amount of federal highway aid withheld was small, this condition did not violate the Tenth Amendment. In the case which upheld the Affordable Care Act, National Federation of Independent Businesses v. Sebelius, the law originally withheld 100 percent of federal Medicaid funds from any state that declined to expand Medicaid eligibility to cover those who earned up to 133 percent of the poverty line. The Supreme Court declared this aspect of the ACA unconstitutional: the plurality opinion by Chief Justice Roberts declared that this crossed the line from pressure to compulsion, terming it “economic dragooning.”

A case that may be especially relevant to New York’s argument here is the case which upheld the Social Security Act as constitutional, Steward Machine Co. v. Davis. Under the Act, Congress imposed

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21 Const. Amend. X.  
22 Const. Amend. XVI.  
23 The SALT deduction was limited to income taxes only in 1986, and then to either income or sales taxes in 2004.  
25 Id. at 161.  
27 Id. at 576-77.  
29 Id. at 206.  
30 Sebelius, 567 U.S. at 582.  
31 301 U.S. 548 (1937).
federal taxes on employers to fund Social Security and unemployment insurance spending. Employers who paid a state unemployment tax received a dollar-for-dollar credit against up to 90 percent of the federal unemployment tax paid (effectively reducing the 3 percent federal tax to 0.3 percent), creating enormous pressure for states to adopt their own unemployment taxes and redirect this money from Washington to themselves. Every state quickly did so. The Supreme Court expressed concerns about a taxing system being used as “undue influence” to adopt a federal policy, but upheld the tax as constitutional.

In this case, the federal SALT deduction cap does not commandeer state legislative processes nor compel it to adopt a federal policy. The states may argue that because the cap reduces a tax benefit currently enjoyed by some residents of states that generally have higher taxes, there may be implicit pressure on policymakers in those states to reduce state taxes. This pressure, however, is not so large as to deprive state policymakers of any choice in the matter, as demonstrated by the wide variety of state actions in its wake and the lack of any specific direction by Congress on how states should conform to the new federal tax code. The federal government can also argue that the pressure and negative reaction ultimately derives from state action adopting high state taxes, not due to the federal decision to pare back federal subsidization of those taxes.

**Conclusion**

The threatened lawsuit may be more a political exercise than a legal one, as a judge is unlikely to rule that the SALT deduction cap violates either the Equal Protection Clause or the Tenth Amendment. The concern that high state taxes might harm the competitiveness or attractiveness of a state like New York or Connecticut is a valid one, but the solution lays with revisiting those state tax rates rather than meritless litigation.