

S.A.L.T. CAP REPEAL CASE DISMISSED

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THE ARGUMENT

The state and local tax (“S.A.L.T.”) deduction cap that is now in effect was enacted in 2017 as part of the Tax Cuts and Jobs Act. It allows individuals and married taxpayers filing jointly who itemize deductions to deduct only up to \$10,000 annually for state and local income, property, and sales taxes. Married individuals filing separately are capped at \$5,000. Before the cap, S.A.L.T. deductions were unlimited.

Fearing, among other effects, that individual residents of these states would move to lower-income tax states, New York, New Jersey, and Connecticut instituted legal action in Federal district court to invalidate the provision. N.Y. and N.J. argued that the cap infringed upon their constitutional right to tax and that it exceeded Congress’s broad taxing power. They further argued that the cap was intended to harass high-property-tax states, such as N.Y. and California, by coercing them to change their tax policies. The states also claimed that the cap raised property taxes by eliminating the full Federal deduction of property taxes, thus preventing residential sales and decreasing revenues for the states that can tax on those sales.

THE DECISION

In September, the U.S. District Court for the Southern District of N.Y. rejected the claim, holding that there was no violation of Federal principles. The court explained that “the States have cited no constitutional principle that would bar Congress from exercising its authority to impose an income tax without a limitless S.A.L.T. deduction.”¹

The Federal government has the “exhaustive” power to impose and collect income taxes under Article 1, Section 8 of the U.S. Constitution, and that the states can enact their own tax policies as they wish. In particular, the district court stated:

The cap is like any other feature of Federal law, makes certain State and local policies more attractive than others as a practical matter . . . but the bare fact that an otherwise valid Federal law necessarily affects the decisional landscape within which states must choose how to exercise their own sovereign authority hardly renders the law an unconstitutional infringement of State power.

Under the Constitution, states retain the power to impose high taxes but have no constitutional right to a Federal subsidy in the form of a Federal tax deduction.

¹ *State of N.Y. v. Mnuchin*, S.D.N.Y., September 30, 2019, No. 18-CV-6427.

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THE AFTERMATH

Although the legal challenge failed at the level of the district court, the question remains whether this is the end of the battle. According to N.Y. Governor Andrew Cuomo, the states involved in the suit will consider appealing the decision.

Notwithstanding Governor Cuomo's comment, the path forward is likely political. The House Ways and Means Committee, the chief tax-writing committee, is evaluating several bills that would increase the level of the S.A.L.T. cap or eliminate it entirely. One option under consideration would double the S.A.L.T. cap to \$20,000 – either for all filers or for married taxpayers filing jointly. Whichever method is adopted in committee will likely be adopted in proposed legislation in the House of Representatives. If it is missing from a Senate version of the bill, its fate likely will be determined in the give-and-take that accompanies a technical corrections bill at the end of the congressional term.

In addition, certain states had proposed measures to allow taxpayers classify some tax payments as “charitable contributions,” which would not be subject to the cap – however, June final rules issued by the I.R.S prohibit such proposals.²

One aspect of the issue is certain. Like much of the political debate, there seems to be no desire to stop the battle short of the 2020 elections.



² T.D. 9864.