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UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

STATE OF ARIZONA,
Plaintiff,
v.
JANET YELLEN, in her official capacity as Secretary of the Treasury et al.;
Defendants.

No. 2:21-cv-00514-DJH

NOTICE AND RESPONSE TO NOTICE OF INTERIM RULE (DOC. 35)

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On May 11, 2021, Defendants filed a Notice of Interim Final Rule, attaching an Interim Final Rule implementing the relevant portions of the American Rescue Plan Act of 2021 ("ARPA"). *See* ECF No. 35. As the Notice states, the Interim Final Rule implements the Tax Mandate, the portion of the statute challenged in this case, which prohibits States from using ARPA funds to "either directly or indirectly offset a reduction in the net tax revenue … resulting from" changes in state law. 42 U.S.C. § 802(c)(2)(A). Arizona files this Response in order to correct and clarify how the Interim Rule impacts (or fails to impact) this litigation.

The Interim Rule provides a "framework" for applying the Tax Mandate. *See* Coronavirus State and Local Fiscal Recovery Funds, 86 Fed. Reg. 26786 (May 17, 2021). Notably, that framework abandons the arguments that Defendants made to this Court in their initial opposition—which stated that a State could only transgress the limitations in the Tax Mandate by "active[ly] employ[ing]" federal funds to balance a tax cut. *See* Defs.' Opp'n, ECF No. 31 at 18. Instead, acknowledging that "money is fungible," the Interim Rule sets out a four-step process for detecting indirect offsets that violate the Mandate. First, States must "identify and value" any actions which could reduce tax revenue. *See* 86 Fed. Reg. at 26807. Second, States must determine the total value projected to be lost, and if that figure is less than a "*de minimis* level," there is no need to identify any way to pay for the changes. *Id.* Third, at the end of the fiscal year, if a state's annual tax revenue exceeds than the amount received for fiscal year ending in 2019 (adjusted annually for inflation), they are in a "safe harbor" and do not violate the tax mandate. *Id.* Fourth, if the loss is not *de minimis* or the State is not within the safe harbor, then the State must "identify any sources of funds" that have been used to offset the total value of the tax changes. *Id.*

The Interim Rule here is relevant (or irrelevant) in three important respects: to standing, the ambiguity of the Tax Mandate's language, and the Interim Rule's ability to cure the constitutional infirmities of the statutory language.

Article III Standing. The Interim Rule further makes plain the State's Article III

standing. The Interim Rule notably imposes a framework upon the States to regulate their fiscal affairs—and no one else's. There is thus no doubt that the States are the "object[s] of the action (or forgone action) at issue." *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 561 (1990). And where the Plaintiff is the object of the challenged action, "there is ordinarily little question that the action or inaction has caused him injury, and that a judgment preventing or requiring the action will redress it." *Id.* at 561-62. So it is here: as the objects of the Interim Rule implementing the Tax Mandate, the State is an "object" of the Interim Rule—further underscoring its standing.

Ambiguity of the Tax Mandate. In attempting to answer the myriad ambiguities in the Tax Mandate's language—*i.e.*, the "host of thorny questions" in the Secretary's own description, Makar Decl. Ex. Y—the Interim Rule actually makes the ambiguity of the Tax Mandate's language more apparent.

That ambiguity is perhaps demonstrated most clearly by the apparent inability of the Treasury Department and Department of Justice to agree—even amongst themselves—on what the Tax Mandate means. Notably, DOJ attorneys told this Court that the word "indirectly" in the Tax Mandate was incapable of modifying the word "offset": "Both 'directly' and 'indirectly' are adverbs that cannot 'alter the meaning of the word' that they modify (here, 'offset')." Doc. 31 at 9 (citation omitted). But the Treasury Department's interpretation, embedded in the Interim Rule, has a diametrically opposed reading. Specifically, the Interim Rule "recognizes that, because money is fungible, even if Fiscal Recovery Funds are not explicitly or directly used to cover the costs of changes that reduce net tax revenue, those funds may be used in a manner inconsistent with the statute *by indirectly being used to substitute* for the State's or territory's funds that would otherwise have been needed to cover the costs of the reduction." 86 Fed. Reg. at 26, 807. The Interim Rule then establishes a convoluted four-part process to ascertain whether the State has "indirectly … offset" tax cuts with ARPA funds.

The upshot is that—even as interpreted just by the federal government—"indirectly" in the Tax Mandate is either (1) a complete nullity that adds nothing to "offset,"

or (2) has such sweeping effect that it mandates the creation of extensive federal monitoring and micro-management of state fiscal affairs. That profound and irreconcilable disagreement within the federal government itself underscores how the Tax Mandate's language cannot possibly be "unambiguous."

Moreover, the Interim Rule's attempt to spell out what "indirectly … offset" means only serves further to demonstrate its ambiguity. In particular, to make the Tax Mandate enforceable, the Secretary was forced to make countless judgment calls on which the Tax Mandate did not supply the slightest guidance. The necessity of the Secretary conjuring requirements *ex nihilo* underscores the Tax Mandate's ambiguity.

For example, Interim Rule never explains how statutory language of ARPA permits the *de minimis* exception, the 2019 baseline, or a host of other exemptions that the Secretary has simply invented wholecloth. The Interim Rule's many departures from the statutory language further demonstrate how the ambiguous Tax Mandate presents the State with an unconstitutional choice: if Treasury ever changes its mind, the State could be on the hook—the statute provides them with no protection, and no deal which they can "knowingly" accept. As the State has already explained, under the Secretary's interpretation: "Acceptance of ARPA funds thus places States at the mercy of the Secretary, who retains the power to redefine *unilaterally* what they have 'agreed' to at any time." Doc. 32-1 at 12

***No Curing Of Constitutional Infirmity*.** The Secretary also attempts to rely upon the Interim Rule to supply the necessity clarity that the Spending Clause demands, but the Tax Mandate fails to provide. However, the Interim Rule cannot cure the Tax Mandate's unconstitutional ambiguity for three reasons.

First, an agency interpretation can *never* cure unconstitutional ambiguity in a statutory Spending Clause condition, no matter how clear the regulation. This is because an ambiguous spending condition is in excess of Congress's spending power, and an agency cannot cure a constitutional defect by interpretation. *See Pennhurst State School and Hospital v. Halderman*, 451 U.S. 1, 17 (1981). The few courts to consider this or analogous questions have confirmed this judgment. *See Va. Dep't of Educ. v. Riley*, 106

F.3d 559, 567 (4th Cir. 1997) (*en banc*) ("It is axiomatic that statutory ambiguity defeats altogether a claim … that Congress has unambiguously conditioned the States' receipt of federal monies in the manner asserted.") (Luttig, J., dissenting below) (adopted by *en banc* court); *cf. Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 472 (2001) ("We have never suggested that an agency can cure an unlawful delegation of legislative power by adopting in its discretion a limiting construction of the statute.").

Second, even if a regulation could cure an unconstitutional ambiguity, this one does not. The Interim Rule provides some clarity—albeit clarity entirely divorced from the statutory text—but still leaves many significant questions open. Perhaps most importantly, the Interim Rule provides that the only spending cuts that can validly "offset" tax revenue reductions are those "in areas where the recipient government has not spent Fiscal Recovery Funds." 86 Fed. Reg. at 26810. But the Interim Rule does not define "areas," and does not explain how the State is to know whether ARPA funds are spent in a particular area, or when a tax cut is in a particular area. This is fundamentally the same puzzle inherently created by the ARPA's prohibition on "indirect offsets," demonstrating that the Interim Rule has failed to solve the fundamental ambiguity at the core of the Tax Mandate.

Third, by its inherently temporary nature, the Interim Rule cannot supply any clarity given its inherently ephemeral nature. As the court in *Ohio v. Yellen* explained, the Interim Rule was "published without notice and comment proceedings, and [is] subject to revision after publication. Accordingly, Ohio may be able to successfully argue that, if Ohio were to file its certification before those regulations became final, those new regulations would not apply to the funding Ohio receives here." *Ohio v. Yellen*, No. 21-CV-181, 2021 WL 1903908, at *13 (S.D. Ohio May 12, 2021).

RESPECTFULLY SUBMITTED this 18th day of June, 2021.

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