24-1499(L)

24-1503(CON)

To Be Argued By:
REBECCA S. TINIO

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket Nos. 24-1499(L), 24-1503(CON)

STATE OF NEW JERSEY, STATE OF NEW YORK,
STATE OF CONNECTICUT,

Plaintiffs-Appellants,

—v.—

JANET LOUISE YELLEN, in her official capacity as Secretary of the United States Department of the Treasury, DANIEL WERFEL,

(Caption continued on inside cover)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANTS-APPELLEES

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in his official capacity as Commissioner of the Internal Revenue Service, UNITED STATES DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE,

Defendants-Appellees.

VILLAGE OF SCARSDALE, NEW YORK,

Plaintiff-Appellant,

—v.—

INTERNAL REVENUE SERVICE, DANIEL WERFEL, in his official capacity as Commissioner of Internal Revenue, UNITED STATES DEPARTMENT OF THE TREASURY, JANET LOUISE YELLEN, in her official capacity as Secretary of the Treasury,

Defendants-Appellees.

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STATE OF NEW JERSEY, STATE OF NEW YORK, STATE OF CONNECTICUT,

Plaintiffs-Appellants,

—v.—

JANET LOUISE YELLEN, IN HER OFFICIAL CAPACITY AS SECRETARY OF THE UNITED STATES DEPARTMENT OF THE TREASURY, DANIEL WERFEL, IN HIS OFFICIAL CAPACITY AS COMMISSIONER OF THE INTERNAL REVENUE SERVICE, UNITED STATES DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE,

Defendants-Appellees.

VILLAGE OF SCARSDALE, NEW YORK,

Plaintiff-Appellant,

—v.—

INTERNAL REVENUE SERVICE, DANIEL WERFEL, IN HIS OFFICIAL CAPACITY AS COMMISSIONER OF INTERNAL REVENUE, UNITED STATES DEPARTMENT OF THE TREASURY, JANET LOUISE YELLEN, IN HER OFFICIAL CAPACITY AS SECRETARY OF THE TREASURY,

Defendants-Appellees.

BRIEF FOR DEFENDANTS-APPELLEES

Preliminary Statement

In 2017, as a means to raise additional revenue as part of a broader tax reform, Congress limited the amount of state and local taxes that federal taxpayers could deduct from their income (the "SALT deduction cap"). Several states and municipalities—including plaintiffs-appellants here—believing that that limit increased their residents' federal taxes, devised a workaround. They created a system where taxpayers could make payments to various charitable funds, and in return their state and local taxes would be reduced by a tax credit, worth as much as 95% of the payment to the fund. The aim of this system was that taxpayers who could no longer deduct the full amount of their state and local tax payments on their federal tax returns (due to the SALT deduction cap) could instead deduct the same amount as a charitable contribution —and therefore their federal tax liability would be the same as if the SALT deduction cap had not been enacted. At the same time, the amount those taxpayers paid as state and local taxes would be essentially unchanged: instead of paying a given amount as state and local taxes, a taxpayer could redirect that money to one of these workaround funds, and that payment would (because of the tax credit received in return) effectively stand in for a state or local tax payment.

By design, then, taxpayers taking advantage of this workaround would reduce their federal taxes to what they would have been with no SALT deduction cap, at essentially no cost in increased money paid to state and local governments or their designated workaround funds. In actual operation, many taxpayers would not only gain those advantages, but would actually profit monetarily: for every $1,000 taxpayers paid through this arrangement, they would receive back, in the form of state, local, and federal tax savings, the whole $1,000 plus several hundred dollars more. That gain to the taxpayer comes entirely at the expense of the federal government.

Recognizing that taxpayers who get more money back than they put in have not made a "gift" to a charity—as required by the Internal Revenue Code ("IRC") for the charitable contribution deduction—and that these workarounds undercut the revenue-raising SALT deduction cap, the Internal Revenue Service responded by promulgating a change to its rules regarding charitable contribution deductions (the "Regulation"). In essence, the Regulation applied a longstanding and familiar principle, endorsed by the Supreme Court, known as the *quid pro quo* rule: the amount of a payment to a charity that taxpayers can deduct on their federal tax returns is equal to the payment minus the value of any benefits received in return. Under the Regulation, state and local tax credits are for the most part treated the same way as any other benefit—tickets to a gala, DVD box sets, etc.—that a charity gives in return for a donation.

That is fully consistent with the text and purpose of the IRC, as well as the case law interpreting it. A "charitable contribution" under the Code is a "contribution or gift," meaning something given without compensation; accordingly, the federal charitable contribution tax deduction must be reduced by the value of benefits received in return for a payment to a charitable entity. The Regulation's application of that principle is valid, especially in light of the Treasury Department's broad authority to interpret and apply the IRC, which expressly includes authority to respond to changes in law and other circumstances.

Plaintiffs sued to enjoin the Regulation. The district court should not have reached the merits because it lacked jurisdiction under the Anti-Injunction Act. Nonetheless, the district court was correct in upholding the Regulation because it represents the best reading of the statute. The judgments should be affirmed.

Jurisdictional Statement

As explained below, the district court lacked jurisdiction over these actions. Plaintiffs invoked jurisdiction under 28 U.S.C. § 1331. The district court entered final judgments on April 1, 2024. (Special Appendix ("SPA") 1-2). Plaintiffs timely filed notices of appeal on May 29, 2024. (Joint Appendix ("JA") 106, 109). This Court has jurisdiction under 28 U.S.C. § 1291.

Issues Presented for Review

1. Whether the district court lacked jurisdiction because the Anti-Injunction Act bars plaintiffs' actions.

2. Whether the Regulation was a valid exercise of the Internal Revenue Service's rulemaking authority.

Statement of the Case

A. Procedural History

Plaintiffs—New York, New Jersey, Connecticut, and the Village of Scarsdale, New York—commenced these actions under the Administrative Procedure Act ("APA") on July 17, 2019. (JA 3, 13). The government moved to dismiss both complaints or, alternatively, for summary judgment; plaintiffs cross-moved for summary judgment. (JA 9, 17). On March 30, 2024, the district court (Paul G. Gardephe, J.) granted the government's motion and denied plaintiffs' cross-motions. (SPA 1-62). These consolidated appeals followed. (JA 106, 109).

B. The Internal Revenue Code and Its Regulations

1. The SALT Deduction and the 2017 Cap

When calculating their taxable income, federal taxpayers may be entitled to deduct certain items, thereby lowering the amount of income tax they owe. 26 U.S.C. § 161. Two such deductions are at issue in this case.

First, state and local taxes paid by a federal taxpayer are deductible. 26 U.S.C. § 164(a)(1)-(3). In 2017, Congress limited that deduction for tax years 2018 through 2025 to $10,000 (or $5,000 for married individuals filing separate returns) in any given year. *Id.* § 164(b)(6)(B); *see* Pub. L. No. 115-97, 131 Stat.

2054 (2017) (the "2017 Tax Act"). Limiting the SALT deduction raises federal revenue by increasing the amount of taxable income; the SALT deduction cap was one of the 2017 Tax Act's revenue-raising provisions that partially offset tax cuts elsewhere in the statute. (JA 533); Cong. Research Serv., *The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law* 3 (Feb. 6, 2018), https://go.usa.gov/xwByW.

In 2018, several states challenged the SALT deduction cap on constitutional grounds. This Court rejected those arguments and upheld the SALT deduction cap. *New York v. Yellen* ("*SALT I*"), 15 F.4th 569 (2d Cir. 2021), *cert. denied*, 142 S. Ct. 1669 (2022).

2. Deductions for Charitable Contributions and Implementing Regulations

The second relevant deduction is in § 170 of the IRC, which allows a federal income tax deduction for charitable contributions. This deduction was originally enacted as part of the War Revenue Act of 1917, ch. 63, § 1201(2), 40 Stat. 300, 330 (deduction for "[c]ontributions or gifts" to various organizations). From the beginning, Congress expressly granted the Internal Revenue Service ("IRS") and its predecessors authority to allow "contributions or gifts" to be deducted under this provision "only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue." *Id.*

The current version of the deduction continues to define a deductible charitable payment as "a contribution or gift" to certain entities. 26 U.S.C. § 170(c). Among those entities are "[a] State . . . or any political

subdivision . . . if the contribution or gift is made for exclusively public purposes." *Id.* § 170(c)(1). Section 170 also continues Congress's express delegation of authority to the Treasury Department: "A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary [of the Treasury]." *Id.* § 170(a)(1).

The implementing regulations require that a taxpayer's payment is not a "contribution or gift"—and therefore not eligible for the deduction—to the extent it is "in consideration for . . . goods or services." 26 C.F.R. § 1.170A-1(h). The charitable contribution deduction is thus limited to the "amount of any cash paid" or value of property transferred, minus the "fair market value of the goods or services received or expected to be received in return." *Id.* § 1.170A-1(h)(2)(i). The "[b]urden [is] on [the] taxpayer to show that all or part of [a] payment is a charitable contribution or gift." *Id.* § 1.170A-1(h)(1). Those rules mirror the ones set out by the IRS in 1967, when the agency stated in Revenue Ruling 67-246 that "an essential element" of showing a gift has been made "is proof that the portion of the payment claimed as a gift represents the excess of the total amount paid over the value of the consideration received therefor." 1967-2 C.B. 104; (JA 1509).

3. Congressional Delegations of Rulemaking Authority

In addition to the rulemaking authority in § 170, Congress has delegated authority to Treasury and the IRS to promulgate regulations in 26 U.S.C. § 7805(a), which provides that "the Secretary [of the Treasury]

shall prescribe all needful rules and regulations for the enforcement of [the IRC], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." The Supreme Court has observed that "Congress has seen fit to vest in those administering the tax laws very broad authority to interpret those laws," and that the power specified in § 7805(a) is "essential to efficient and fair administration of the tax laws." *Bob Jones University v. United States*, 461 U.S. 574, 596 (1983). Thus, the Court has "long recognized the primary authority of the IRS and its predecessors in construing the [IRC]." *Id.*

C. Plaintiffs' SALT Deduction Cap Workarounds

In the wake of the 2017 Tax Act, several states and localities enacted laws that seek to permit their residents to circumvent the SALT deduction cap. These laws allow taxpayers to make payments or transfers to certain funds; in return, the taxpayers receive credits against state or local income or property tax.[1]

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[1] "[A] tax 'credit' is an item that reduces the amount of tax directly; in contrast, a 'deduction' is an item that reduces the amount of taxable income." *United States v. Martinez-Rios*, 143 F.3d 662, 670 n.2 (2d Cir. 1998) (quotation marks omitted). For example, if a taxpayer earns $10,000 in income taxed at a rate of 15%, which would ordinarily incur $1,500 in tax, a $1,000 tax deduction means that the taxpayer will pay tax only on $9,000, and thus pay tax of $1,350. A

New York was the first state to enact such a law. It established a state-administered charitable trust fund to which taxpayers can contribute in exchange for a state income tax credit equal to 85% of their contributions. (JA 42); N.Y. Tax Law § 606(iii). In addition, it permitted local governments to create charitable gift reserve funds to which taxpayers may contribute in exchange for local property tax credits of up to 95% of the value of their contributions. (JA 42 (citing N.Y. Gen. Mun. Law §§ 6-t, 6-u; N.Y. Real Prop. Tax Law § 980-a)). Scarsdale established such a fund and permitted its real property owners to claim a property-tax credit equal to 95% of any donation to that fund. (JA 55 (citing Scarsdale Village Code §§ 269-35 to -38)).

New Jersey enacted a provision that authorizes localities to establish charitable funds for specific public purposes and permits 90% of a contribution to be credited toward the contributor's property tax obligation, subject to certain limitations. (JA 42 (citing N.J. Stat. Ann. §§ 54:4-66.6 to -66.9)). Connecticut enacted a program under which a municipality may grant property tax credits in exchange for contributions to specified private organizations, which then transfer those contributions, less administrative expenses, to the municipality; the tax credits are equal to the lesser of the property tax owed or 85% of the donation. (JA 42 (citing Conn. Gen. Stat. § 12-129v)). Plaintiffs acknowledge that the aim of these workaround programs is to offset the tax consequences of the SALT

$1,000 tax credit, in contrast, reduces the taxpayer's $1,500 tax liability to $500.

deduction cap. (JA 24, 42, 45, 80); *see also* Village of Scarsdale, *Charitable Gift Fund Tax Credit* (Aug. 29, 2018), https://web.archive.org/web/20190910170218/https://www.scarsdale.com/566/Charitable-Gift-Fund-Tax-Credit; Office of Legislative Research, *Connecticut's Response to Federal Tax Reform* (Nov. 20, 2018), https://www.cga.ct.gov/2018/rpt/pdf/2018-R-0283.pdf.

To illustrate how the state's program would work, New York's Director of the Division of the Budget offered the example of married taxpayers earning $200,000 a year in adjusted gross income. (JA 67-72). If that couple donated $5,000 to New York's charitable trust fund in the 2019 tax year, they would receive two tax benefits from the state. First, in the year they donate to that fund, they would deduct $5,000 from their income; at the state's applicable tax rate of 6.49%, that would yield a benefit to the taxpayers of $325 in reduced state tax. (JA 70). Second, they would receive a state tax credit the following year in the amount of 85% of their donation: $4,250. (JA 70). In addition, if this donation were fully deductible on the taxpayers' federal tax return, they would be able to deduct $5,000 from their income, which, given the applicable federal marginal tax rate of 24%, would yield a $1,200 tax savings. (JA 70).

In short, by contributing $5,000 to the state's charitable fund, the taxpayers in New York's example would reduce their state and federal tax bills by a total of $5,775—a net gain to the couple of $775. The state would receive $5,000 from the contribution, but give up $4,575 in tax revenue—a net gain of $425. Both the

state's and the taxpayers' profits result from the loss of $1,200 in tax revenue to the federal government.[2]

D. The Regulation

1. Proposed Regulation

The IRS responded to the states' enactments by publishing a Notice of Proposed Rulemaking (the "NPRM"). *See Contributions in Exchange for State or Local Tax Credits*, 83 Fed. Reg. 43,563 (Aug. 27, 2018); (JA 186-221).

The NPRM explained that proposed amendments to IRS regulations would address "the availability of charitable contribution deductions under section 170 when a taxpayer receives or expects to receive a corresponding state or local tax credit." 83 Fed. Reg. at 43,563. The proposed amendments required taxpayers to reduce charitable contribution deductions on federal income tax returns by the amount of the tax credit received or expected to be received in return. *Id.* at 43,565, 43,571. The NPRM also proposed an exception for tax credits amounting to 15% or less of the payment or transfer. *Id.*

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[2] The IRS performed similar calculations. 84 Fed. Reg. at 27,525-26 (taxpayer at 24% marginal rate contributing $1,000 and receiving $1,000 state tax credit, under "baseline" scenario—i.e., with SALT deduction cap in place and with that contribution fully deductible —"receives a $240 net benefit while the federal government has a loss of $240").

As background, the NPRM noted that in years leading up to the notice, states and localities had increasingly provided tax credits in return for contributions to certain charitable entities. *Id.* at 43,564. In light of that development and the new statutory SALT deduction cap, the IRS determined to review whether contributions in exchange for state or local tax credits are fully deductible under § 170, "based on longstanding federal tax law principles, which apply equally to taxpayers regardless of whether they are participating in a new state and local tax credit program or a preexisting one." *Id.* at 43,565.

The NPRM reviewed case law and administrative statements addressing § 170. *Id.* at 43,563-64. Before the NPRM, the IRS had not provided any "authoritative regulatory guidance on the treatment of state or local tax credits arising from charitable contributions." *Id.* at 43,566. The NPRM noted that the IRS Office of Chief Counsel had issued several Chief Counsel Advice memorandums ("CCAs") addressing whether state and local tax credit programs were *quid pro quo* benefits affecting deductible amounts, but explained that CCAs "are not official rulings or positions of the IRS, are not ordinarily reviewed by the Treasury Department, and are not precedential." *Id.* at 43,564. The NPRM acknowledged that CCA 201105010 (Oct. 27, 2010) (the "2010 CCA," JA 1504-08) had advised that taxpayers could take "the full amount of a contribution made in return for a state tax credit, without subtracting the value of the credit received in return." *Id.* at 43,564. However, the 2010 CCA observed that such a contribution made in return for a tax credit could be "characterized as either a charitable contribution

deductible under section 170 or a payment of state tax possibly deductible under section 164." *Id.* The CCA also assumed that "after the taxpayer applied the state or local tax credit to reduce the taxpayer's state or local tax liability, the taxpayer would receive a smaller deduction for state and local taxes under section 164." *Id.* Finally, the 2010 CCA cautioned that "there may be unusual circumstances in which it would be appropriate to recharacterize a payment of cash or property that was, in form, a charitable contribution as, in substance, a satisfaction of tax liability." *Id.*

The NPRM pointed out that when the 2010 CCA was issued—before the SALT deduction cap was enacted in 2017—the deduction for state and local taxes was "unlimited in amount." *Id.* For that reason, a deduction for a contribution in exchange for a state tax credit "was likely to be available under either section 164 or section 170"—meaning that the characterization of those contributions "had little practical consequence" for federal income taxation. *Id.* But after the 2017 SALT deduction cap, if a taxpayer's state-tax liability exceeds $10,000, "a charitable contribution deduction under section 170 would no longer be offset by a reduction in the taxpayer's state and local tax deduction under section 164. Thus, as a consequence, state and local tax credit programs now give taxpayers a potential means to circumvent the $10,000 limitation in section 164(b)(6) by substituting an increased charitable contribution deduction for a disallowed state and local tax deduction." *Id.*

In light of that changed circumstance, the IRS undertook a review of the issue, and concluded that

receipt of a tax credit in return for a contribution to a charitable entity "constitutes a *quid pro quo*," and therefore "the amount otherwise deductible as a charitable contribution must generally be reduced" by the amount of the tax credit, "just as it is reduced for many other benefits." *Id.* at 43,565. Disregarding that *quid pro quo* would, the NPRM observed, "precipitate significant revenue losses that would undermine and be inconsistent with" the SALT deduction cap, and "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." *Id.*

The NPRM also discussed deductions (as opposed to credits) allowed on state tax returns for charitable contributions. *Id.* It reasoned that although state tax deductions "could be considered *quid pro quo* benefits in the same manner as credits," doing so would generate significant administrative complexity and costs for both taxpayers and the IRS. *Id.* Because the benefit from a deduction is limited to the fraction of that amount represented by the taxpayer's marginal tax rate, "the risk of deductions being used to circumvent [the SALT deduction cap] is comparatively low." *Id.* Therefore, the NPRM proposed to allow taxpayers to disregard state tax deductions for purposes of assessing deductibility under § 170. *Id.* at 43,565, 43,571.

To provide consistent treatment for state tax deductions and state tax credits "that provide a benefit that is generally equivalent to a deduction," the NPRM included an exception under which taxpayers may

disregard state tax credits that do not exceed 15% of their contribution. *Id.* at 43,565. The NPRM noted that this proposed exception reflects the fact that "the combined value of a state and local tax deduction, that is the combined top marginal state and local tax rate, currently does not exceed 15 percent." *Id.*

The NPRM also analyzed the proposed Regulation's expected benefits and costs. *Id.* at 43,568-70. Among other things, it observed that the proposed Regulation will "substantially diminish th[e] incentive to engage in socially wasteful tax-avoidance behavior," and is expected "to make the federal tax system more neutral to taxpayers' decisions regarding donations" by reducing the "economic distortion" favoring "contributions to organizations which give rise to a state tax credit for taxpayers, particularly for taxpayers above the SALT cap." *Id.* at 43,568-69. The NPRM thus sought comments on "any effects on charitable contribution decisions that may occur as a result of these proposed regulations." *Id.* at 43,569.

The IRS received approximately 7,700 written comments on the proposed Regulation, and held a public hearing on November 5, 2018. (JA 330-83); https://www.regulations.gov/docket/IRS-2018-0025/comments. Plaintiffs submitted written comments opposing the proposed Regulation. (JA 29, 59, 384-528).

2. Final Regulation

On June 13, 2019, the IRS published the final Regulation. (SPA 63-81); *Contributions in Exchange for State or Local Tax Credits*, 84 Fed. Reg. 27,513 (June 13, 2019). The Regulation generally retains the

NPRM's proposal with certain clarifications and technical changes. 84 Fed. Reg. at 27,514. Principally, it retains the general rule that if a taxpayer makes a payment or transfer to or for the use of a charitable entity and receives or expects to receive a state or local tax credit in return, the credit constitutes a return benefit requiring the taxpayer to reduce its federal charitable contribution deduction. *Id.*; 26 C.F.R. § 1.170A-1(h)(3)(i).

The preamble to the Regulation explained that under the "*quid pro quo* principle" of § 170, "'[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return.'" 84 Fed. Reg. at 27,513 (quoting *United States v. American Bar Endowment*, 477 U.S. 105, 116 (1986)). Rather, § 170 provides "a deduction for taxpayers' gratuitous payments to qualifying entities, not for transfers that result in receipt of valuable economic benefits." *Id.* at 27,515. Consistent with "longstanding principles under section 170 and sound tax policy," the IRS determined it would not be "appropriate to categorically exempt state or local tax benefits from the normal rules that apply to other benefits received" by a taxpayer in exchange for a contribution. *Id.* Thus, a state tax credit received in return for a charitable contribution "constitutes a return benefit, or *quid pro quo*, to the taxpayer and reduces the taxpayer's charitable contribution deduction." *Id.* at 27,514. State tax deductions, on the other hand, "do not constitute a *quid pro quo* unless they exceed the amount of the donor's payment or transfer." *Id.*; 26 C.F.R. § 1.170A-1(h)(3)(ii). The Regulation also retains the exception under which a state tax credit is "not treated as a *quid pro quo* if

the credit does not exceed 15 percent" of the contribution. 84 Fed. Reg. at 27,514-15; 26 C.F.R. § 1.170A-1(h)(3)(vi).[3]

Finally, the preamble to the Regulation addressed commenters' concerns about various effects of the Regulation. 84 Fed. Reg. at 27,515-23.

E. The District Court's Opinion

Plaintiffs challenged the validity of the Regulation under the APA.[4] The district court upheld it.

The district court first held that New York and Scarsdale had standing to sue as they had suffered injury in fact. (SPA 23). The court concluded the Regulation made taxpayers less likely to donate to workaround funds established by New York and Scarsdale, thus decreasing their revenue. (SPA 21-23). However, the district court determined that New Jersey and

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[3] The preamble to the Regulation referred to IRS Notice 2019-12, 2019-27 I.R.B. 57 (JA 532), which announced the IRS's intent to propose a regulation providing a safe harbor for individuals who contribute to a charity in return for a tax credit, allowing them to treat the amount disallowed as a *quid pro quo* as a tax payment. 84 Fed. Reg. at 27,514. A final rule embodying that safe harbor became effective in 2020. 85 Fed. Reg. 48,467 (Aug. 11, 2020); 26 C.F.R. § 1.170A-1(h)(3)(ix).

[4] The states asserted a claim under the Regulatory Flexibility Act, 5 U.S.C. § 601 *et seq.* (JA 39), but have abandoned it on appeal.

Connecticut lacked standing. Those states' legislation allowing localities to establish workaround programs had never been implemented, and the court concluded that the states' assertion that the Regulation prevented localities from setting up programs was too speculative to support standing. (SPA 24-25). The district court also rejected the states' other arguments regarding injury. (SPA 25-27).

The district court next held that the Anti-Injunction Act ("AIA"), 26 U.S.C. § 7421(a), does not apply here because if these actions are prohibited, plaintiffs have no other avenue to contest the Regulation. (SPA 31-34). In so holding, the court declined to limit the judicially created exception to the AIA's applicability from *South Carolina v. Regan*, 465 U.S. 367 (1984), to constitutional claims.

On the merits, the district court upheld the Regulation. Using the since-overruled analytical framework of *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984), the district court noted that § 170 "does not define 'gift,' or 'contribution,'" nor does it address whether contributions made in exchange for a tax credit are deductible. (SPA 39). The district court cited Supreme Court cases interpreting § 170 to allow deductions for unrequited payments, but not for those made in return for benefits. (SPA 41). It concluded a tax credit provides donors with substantial benefits, making the donation subject to the "standard rule that the amount of a federal charitable contribution is reduced by the amount of the benefit received." (SPA 42-43). The court reasoned that "while the broad purpose of IRC § 170 is to encourage charitable contributions

to certain organizations," § 170 also included limitations on what payments are deductible. (SPA 43-44). The district court disagreed with plaintiffs' suggestion that in enacting the 2017 Tax Act, "if Congress had intended the *quid pro quo* principle to be applied to state or local tax credits, it would have amended [§ 170] to so state." (SPA 44-45).

Moving to *Chevron* step two, the district court examined whether the IRS's interpretation of "contribution or gift" to exclude payments made in exchange for state tax credits is "based on a permissible construction" of § 170. (SPA 45). The district court emphasized Congress's grant of rulemaking authority in 26 U.S.C. § 7805(a), and concluded the IRS had "provided a reasoned explanation" for its requirement. (SPA 45-49). The court also opined that the Regulation represented a "reasonable policy choice," given the "steps taken by states and municipalities to undermine the SALT deduction limitation." (SPA 49).

The district court rejected plaintiffs' contention that the Regulation represented an impermissible change in position, holding that the IRS had adequately explained its reasons for deviating from the 2010 CCA. (SPA 50-54). The district court dismissed plaintiffs' arguments that the Regulation is unreasonable because it treats different types of tax benefits—federal deductions, state deductions, and state credits—inconsistently. (SPA 54-58).

Last, the district court rejected plaintiffs' assertion that the Regulation was arbitrary and capricious. (SPA 58-61). In the wake of the enactment of the 2017 Tax Act, "the IRS was called upon to consider and

balance a number of competing interests." (SPA 60). In promulgating the Regulation, the district court held, the IRS "considered and addressed in the [Regulation] the arguments Plaintiffs raise here, and provided reasonable explanations for the decisions and determinations it made." (SPA 59).

The district court therefore entered judgments in the government's favor. (SPA 1, 2). This appeal followed.

Summary of Argument

The Court should affirm the district court's judgments. To begin with, the district court lacked jurisdiction because this lawsuit is barred by the Anti-Injunction Act. That Act broadly prohibits actions, like this one, that seek to restrain the government from assessing and collecting taxes; instead, it generally requires that to challenge a tax law, a taxpayer must pay the tax then sue for a refund. By attempting to enjoin the government from applying the Regulation, which will increase tax collection, plaintiffs are doing what the AIA forbids. While the district court held that the exception to the AIA created in *Regan* applies here, that exception should be narrowly construed and limited to constitutional cases. *See infra* Point I.

On the merits, the Regulation should be upheld, as the Regulation's interpretation is the best reading of IRC § 170. That statute defines a deductible "charitable contribution" as a "contribution or gift," and the plain meaning of that phrase requires that no compensation be received in return. Both the IRS and the Supreme Court have accordingly recognized that

payments that are part of a *quid pro quo* exchange are not deductible; thus the value of a benefit received in return for a payment must be subtracted from the deductible amount. The Regulation applies that principle to state tax credits that are received in return for a payment to a charitable entity. Its rule thus not only applies longstanding law, but furthers Congress's purpose in allowing charitable contribution deductions, namely, to encourage gratuitous, altruistic giving to charities. *See infra* Point II.A.1. And the Regulation properly treats state tax credits as return benefits in a *quid pro quo*. While some tax incentives have long been allowed with no reduction in the deductible amount, the Regulation continues to permit more limited tax benefits, primarily deductions on state tax returns, while treating the far larger and more easily calculable benefit received from a state tax credit as a *quid pro quo*. *See infra* Point II.A.2.

If there is doubt about the meaning of § 170, the Court should respect the IRS's interpretation. Although *Chevron* has been overruled, agency experience and expertise may still inform courts' reading of a statute—particularly the IRC, because, as the Supreme Court has stated, Congress has granted the IRS broad interpretive authority. And Congress has specifically granted the IRS authority, in § 170 itself, to decide when charitable contributions are allowable as deductions. The Regulation falls within the scope of the IRS's authority to address the changed circumstances resulting from the SALT deduction cap and the states' implementation of workaround funds. While the Regulation abandons the position taken in the 2010 CCA, that document was nonprecedential by statute, and

the Regulation explains why the IRS has departed from its conclusions: the 2010 CCA was never persuasive, and it rested on assumptions that are no longer true after the enactment of the SALT deduction cap. *See infra* Point II.B.

Nor is the Regulation arbitrary and capricious: the Regulation survives the APA's deferential review. The IRS properly considered all relevant factors, including that the workaround funds will cause revenue loss to the federal government by bypassing the SALT deduction cap, which was a revenue-raising enactment. And the Regulation reasonably distinguishes state tax credits from other tax benefits like state and federal tax deductions, as the latter have more limited value to the taxpayer, and thus cause more limited revenue loss for the government and are less likely to be used to circumvent the SALT deduction cap. The value of a deduction is also more variable, and harder to calculate, than the value of a tax credit. Additionally, the Regulation reasonably excepted small tax credits, those worth 15% or less of the donation, from its requirement, on the ground that a credit of that size has approximately the same value as a tax incentive in the form of a state tax deduction. *See infra* Point II.C.

The district court's judgments should be affirmed.

ARGUMENT

Standard of Review

This Court reviews *de novo* a district court's decision on a motion to dismiss a case for lack of

jurisdiction or for failure to state a claim. *Tsirelman v. Daines*, 794 F.3d 310, 313 (2d Cir. 2015). Similarly, the Court reviews *de novo* a district court's review of agency action. *NRDC v. Muszynski*, 268 F.3d 91, 96 (2d Cir. 2001). Where "an APA-based challenge to an agency's action presents a pure question of law, a district court's procedural decision to award summary judgment is generally appropriate," and this Court "review[s] *de novo* such a grant." *Aleutian Capital Partners, LLC v. Scalia*, 975 F.3d 220, 229 (2d Cir. 2020).

POINT I

The District Court Lacked Jurisdiction to Consider Plaintiffs' Claims, Which Are Prohibited by the Anti-Injunction Act

At the outset, the district court lacked jurisdiction over this action, which is barred by the Anti-Injunction Act. That statute provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." 26 U.S.C. § 7421(a). Although the district court held that the AIA is no bar in this case due to the exception in *South Carolina v. Regan*, that exception does not apply, and at a minimum should not be expanded to the non-constitutional claims at issue here.

"The manifest purpose of [the AIA] is to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund." *Enochs v. Williams Packing &*

Navigation Co., 370 U.S. 1, 7 (1962). The statute "withdraw[s] jurisdiction from . . . federal courts to entertain suits seeking injunctions prohibiting the collection of federal taxes." *Id.* at 5. "Because of the Anti-Injunction Act, taxes can ordinarily be challenged only after they are paid, by suing for a refund." *National Federation of Independent Business v. Sebelius*, 567 U.S. 519, 543 (2012).

This action falls within the scope of the AIA's prohibition. Plaintiffs seek to enjoin the application of the Regulation. (JA 49 (states' complaint), 66 (Scarsdale's complaint)).[5] Doing so would increase federal charitable contribution deductions, which would restrain assessment and collection of taxes that would otherwise be due. *See Bob Jones University v. Simon*, 416 U.S. 725, 738-39 (1974) (suit to enjoin revocation of charitable-organization status is barred by AIA because result of injunction would be decreased tax liability); *Cohen v. United States*, 650 F.3d 717, 725 (D.C. Cir. 2011) (AIA precludes judicial relief where "injunction would have impacted [a taxpayer's] future tax liability"). The Regulation can be challenged in court by a taxpayer who pays the tax, then seeks a refund on the ground that the Regulation was unlawful and improperly increased their tax liability. *Bob Jones University*, 416 U.S. at 746-47. But by its terms, the AIA prohibits this suit to prevent the government from assessing and collecting taxes prospectively.

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[5] States and governmental entities are "persons" to whom the AIA applies. *Regan*, 465 U.S. at 373-81.

The district court incorrectly concluded it had jurisdiction based on *Regan*, 465 U.S. 367. In that case, the Supreme Court created a narrow exception to the AIA, under which a suit can proceed only where there would otherwise likely be no avenue for judicial review of the government's action. *Id.* at 380-81; *see Yakama Indian Nation v. Alcohol & Tobacco Tax & Trade Bureau*, 843 F.3d 810, 815 & n.2 (9th Cir. 2016) (the "true focus [of the *Regan* exception] appears to be on whether the claims can be judicially reviewed at all"); *RYO Machine, LLC v. Department of Treasury*, 696 F.3d 467, 472 (6th Cir. 2012); *Judicial Watch, Inc. v. Rossotti*, 317 F.3d 401, 408 n.3 (4th Cir. 2003). Here, such an avenue exists: taxpayers whose tax liabilities were affected by the Regulation can sue for a tax refund.

This Court interpreted *Regan* more broadly in *SALT I*, reasoning that the exception applies when the particular plaintiff in a case would have no opportunity to challenge a tax law. 15 F.4th at 578-79. Here, plaintiffs, who themselves do not pay the taxes at issue, would not be able to institute a refund suit. (SPA 32). The government acknowledges that both the district court and a panel of the Court are bound by that ruling, but preserves the argument that it was incorrect in case of further review.

Even if *SALT I* is correct, the district court erred in extending it to this case. The *Regan* exception is narrow, and in tension with the AIA's plain language. Because "'Congress is vested with the power to prescribe the basic procedural scheme under which claims may be heard in federal courts,'" "judge-made exceptions" to those rules are to be "narrowly construed."

Hoyt v. Lane Construction Corp., 927 F.3d 287, 294 (5th Cir. 2019) (some quotation marks omitted; quoting *Patsy v. Board of Regents*, 457 U.S. 496, 501 (1982)). The *Regan* exception too must be interpreted narrowly, as remaining faithful to the purpose of the AIA—to permit the government "to assess and collect taxes . . . without judicial intervention"—"requires a strict construction of any possible exceptions." *American Bicycle Ass'n v. United States*, 895 F.2d 1277, 1281 (9th Cir. 1990) (quotation marks omitted); *see Yakama Indian Nation*, 843 F.3d at 815; *RYO Machine*, 696 F.3d at 472 ("'Because of the strong policy animating the [AIA], and the sympathetic, almost unique, facts in [*Regan*], courts have construed the [*Regan*] exception very narrowly . . . .'" (quoting *Judicial Watch*, 317 F.3d at 408 n.3)).

Regan itself involved a constitutional claim, 465 U.S. at 380, as did *SALT I*, 15 F.4th at 572, and the exception should be limited to that context. As the Supreme Court has stated, a "'serious constitutional question' . . . would arise if a federal statute were construed to deny any judicial forum for a colorable constitutional claim." *Webster v. Doe*, 486 U.S. 592, 603 (1988) (quoting *Weinberger v. Salfi*, 422 U.S. 749, 762 (1975)); *accord Demore v. Kim*, 538 U.S. 510, 517 (2003); *Bhaktibhai-Patel v. Garland*, 32 F.4th 180, 196 (2d Cir. 2022). The *Regan* exception permits such constitutional challenges to proceed. *See Cohen*, 650 F.3d at 726-27 ("[T]his court has allowed constitutional claims against the IRS to go forward in the face of the AIA."). But no constitutional issue is present in this case. Under the plain text of the AIA, the district court

lacked jurisdiction and this action should have been dismissed for that reason.

POINT II

The Regulation Is Lawful

If the Court reaches the merits, it should affirm the district court's judgments that plaintiffs' claims must be dismissed. The Regulation correctly interprets and applies the plain text of § 170, is consistent with longstanding case law and administrative practice, and is faithful to the purposes of the charitable contribution deduction.

A. The Regulation Correctly Interprets "Contribution or Gift" as Used in § 170

1. A "Contribution or Gift" Is a Payment Made Without Compensation as a *Quid Pro Quo*

The Regulation's requirement turns on the meaning of "contribution or gift" as used in § 170(c). As described above, the IRC allows deductions for "any charitable contribution." 26 U.S.C. § 170(a). A "charitable contribution" is defined as "a contribution or gift to or for the use of" an eligible entity, including to or for the use of a state or its subdivision if the contribution or gift is for public purposes. *Id.* § 170(c).

The statute does not define either "contribution" or "gift," so those words are given the ordinary meaning they had at the time the statute was enacted. *See Food Marketing Institute v. Argus Leader Media*, 588 U.S. 427, 433-34 (2019). The same words were used in the

1917 War Revenue Act, ch. 63, § 1201(2), 40 Stat. at 300, 330, when the charitable contribution deduction was originally enacted, and the words then had the same meaning as they do now. A "gift" is "anything voluntarily transferred by one person to another without compensation." *Webster's New International Dictionary of the English Language* 910 (1917); *accord American Heritage Dictionary of the English Language* (5th ed. 2022) ("[s]omething that is bestowed voluntarily and without compensation"). Similarly, to "contribute" means to "give or grant in common with others" or to "give . . . for a specified object" or "to a common purpose," and a "contribution" is "[t]hat which is contributed; the portion which an individual furnishes to . . . the whole which is formed by the gifts of individuals." *Webster's*, *supra*, at 489-90; *accord American Heritage*, *supra* ("contribute" means "[t]o give or supply in common with others; give to a common fund or for a common purpose"). "It is well settled that the term 'charitable contribution' as used in section 170 is synonymous with the word 'gift.'" *Collman v. Commissioner*, 511 F.2d 1263, 1267 (9th Cir. 1975).[6]

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[6] In addition, because the phrase "contribution or gift" is used to define the term "charitable contribution," the adjective "charitable" informs the interpretation of the defining phrase. *See Leocal v. Ashcroft*, 543 U.S. 1, 11 (2004) (court "cannot forget that [it] ultimately [is] determining the meaning of the term" being defined); *Johnson v. United States*, 559 U.S. 133, 140 (2010) ("in the context of a statutory definition of 'violent felony,' the phrase 'physical force' means

In short, to be a "gift," a payment must be made without compensation. The Supreme Court's interpretation of "contribution or gift" accords with that definition. As the Court explained, "[t]he *sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration." *American Bar Endowment*, 477 U.S. at 118. The deductible amount is therefore "the difference between a payment to a charitable organization and the market value of the benefit received in return." *Id.* at 117. That rule reflects Congress's intent "to differentiate between unrequited payments" and payments made in return for an identifiable benefit. *Hernandez v. Commissioner*, 490 U.S. 680, 690-91 (1989). In short, payments that are part of a "*quid pro quo* exchange" are not deductible as a "contribution or gift" under § 170. *Id.*

That same meaning has been applied by the IRS consistently over decades. In the 1967 revenue ruling, the IRS stated that to be a deductible "gift," a payment must be made "without adequate consideration," and the taxpayer must prove "that the portion of the payment claimed as a gift represents the excess of the total amount paid over the value of the consideration received therefor." 1967-2 C.B. 104; (JA 1509). That rule is reiterated in IRS regulations, which now provide

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violent force"). A "charitable" contribution is "given for the love of God, or the love of your neighbor . . . free from the stain or taint of every consideration that is personal, private, or selfish." *Ould v. Washington Hospital for Foundlings*, 95 U.S. 303, 311 (1877) (quotation marks omitted).

that the deductible amount cannot exceed the amount of the payment minus the value of "the goods or services received or expected to be received in return." 26 C.F.R. § 1.170A-1(h)(2).

The Regulation's treatment of state and local tax credits embodies that same *quid pro quo* principle, by requiring a taxpayer to subtract the value of a state or local tax credit "that the taxpayer receives or expects to receive in consideration for the taxpayer's payment or transfer." *Id.* § 1.170A-1(h)(3)(i). That requirement merely extends the established, Supreme Court-approved meaning of "contribution or gift" to a different type of consideration—state and local tax credits—received in return for a payment. Tax credits are no less a "substantial benefit in return" for a payment than tickets to a banquet, *see* Rev. Rul. 67-246, or an insurance policy, *see American Bar Endowment*, 477 U.S. at 117. Just like those items received in a *quid pro quo* with a charitable entity, the value of a tax credit reduces the amount of the payment that constitutes a "contribution or gift," and accordingly reduces the amount that the taxpayer can deduct.

That rule not only accords with the text of § 170 and the case law interpreting it, it is entirely consistent with § 170's purposes: to give individuals incentives to donate money to charitable organizations that "confer[ ] a public benefit" and serve a "public, charitable purpose." *Bob Jones University*, 461 U.S. at 591 & n.18. "[C]ommon sense and history tell us [that] in enacting . . . § 170 . . . , Congress sought to provide tax benefits to charitable organizations, to encourage the development of private institutions that serve a

useful public purpose or supplement or take the place of public institutions of the same kind." *Id.* at 587-88; *accord id.* at 587 n.11 ("The plain language of § 170 reveals that Congress' objective was to employ tax exemptions and deductions to promote certain charitable purposes."); Bittker & Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 35.1.1 (deduction enacted to prevent "impair[ing] the flow of funds to hospitals, colleges, and other charitable institutions"). Thus, allowing deductions for charitable contributions is "intend[ed] to favor gifts for altruistic objects . . . by encouraging [taxpayers] to make such gifts." *Young Men's Christian Ass'n v. Davis*, 264 U.S. 47, 50 (1924) (construing charitable contribution deduction in estate tax).

The Regulation furthers those objectives. By excluding taxpayers' payments to state and local funds made in exchange for tax credits, the Regulation confines § 170's application to charitable contributions and gifts that promote charitable, public purposes, rather than payments that offset a taxpayer's state or local taxes. If the amount of the deduction were not reduced by the value of state tax credits received in return, "taxpayers [could] characterize payments as fully deductible charitable contributions for federal income tax purposes, while using the same payments to satisfy their state tax liabilities." 84 Fed. Reg. at 27,516.[7] Payments that merely stand in for state taxes

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[7] Indeed, allowing taxpayers to do just that was the reason the states created these programs in the first place. (JA 24 (plaintiffs' complaint, stating that

hardly promote the "altruistic objects" Congress meant to encourage in § 170. *Davis*, 264 U.S. at 50; *see* 83 Fed. Reg. at 43,565 ("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.").[8]

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they created tax credit programs "[t]o ease the burden on their taxpayers [resulting from the SALT deduction cap]"), 42 (explaining all three states' programs are designed to be used for the amounts remaining after a taxpayer's $10,000 SALT deduction is exhausted), 45 (explaining states' interests in "lessening the tax burden for their residents" "particularly in light of the newly enacted cap on the SALT deduction"), 80 (program meant to provide federal tax deduction "that more closely approximated the one they could claim prior to the new SALT cap" and "alleviate the harmful effects" of the cap)).

[8] Plaintiffs note that individual motives are not considered in determining if taxpayers' contributions to a charity are deductible. (Scarsdale Br. 14; States Br. 29); *see Hernandez*, 490 U.S. at 690-91 (IRS examines only "external features" of a transaction, "obviating the need for the IRS to conduct imprecise inquiries into the motivations of individual taxpayers"); *Scheidelman v. Commissioner*, 682 F.3d 189, 200 (2d Cir. 2012) ("If the motivation to receive a tax benefit deprived a gift of its charitable nature under Section 170, virtually no charitable gifts would be deductible."). But that does not change Congress's purpose to

To the contrary, plaintiffs' own example of a common tax scenario illustrates that many taxpayers would actually make money from their "gifts" to state charitable funds. As described in New York's declaration, a couple with $200,000 in income that made a $5,000 donation to New York's fund would receive a $4,250 benefit from the tax credit, $325 from the charitable contribution deduction on their state taxes, and $1,200 from the federal charitable contribution deduction (if the Regulation were not in place)—a total benefit of $5,775 in exchange for their $5,000 "gift." Taxpayers who profit from making their "donation" do not fulfill the essential characteristic of a charitable contribution, the "hard choice of supporting a worthwhile charitable endeavor" rather than putting the funds to their own benefit. *American Bar Endowment*, 477 U.S. at 116. Economically rational taxpayers would not only make that easy choice every time, but would scale it up as much as possible to multiply the profit from their "gifts." Congress never intended such a perverse result.

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benefit charities by encouraging charitably minded donations, and that purpose remains relevant to whether the Regulation's interpretation of "contribution or gift" is correct.

2. The Regulation Properly Treats State Tax Credits as Return Benefits That Reduce the Value of a Charitable Contribution Deduction

The essence of plaintiffs' position is that state tax credits should not be treated the same as other valuable benefits received in return for a payment to a charity. That view makes little sense. If a state responded to a taxpayer's payment to a charitable fund by giving the taxpayer municipal bonds, preloaded subway fare cards, or simply cash, there would be no doubt that a *quid pro quo* exchange had occurred, and the deductible value of the taxpayer's payment must be reduced by the amount of the return benefit. But in plaintiffs' view, a return benefit is not a return benefit if it is called a tax credit—even though the effect (more money in the taxpayer's pocket) is precisely the same. To be sure, states have long offered tax incentives to encourage charitable giving, as does the federal government, and to accommodate that policy goal the value of those incentives does not always reduce the deductible amount of a charitable contribution. But the Regulation properly applies the *quid pro quo* principle in this context: it maintains the preexisting practice that the § 170 deduction need not be reduced by the value of state and local tax deductions, while limiting the § 170 deduction when the state or locality returns substantial benefits—as much as 95% of the contribution—to the taxpayer. That falls well within the bounds of § 170's requirements, as dictated by its text and the case law construing it.

Plaintiffs' arguments to the contrary misread this Court's and the Supreme Court's precedents. First, they contend that the *quid pro quo* principle only applies when payments are made in exchange for "'goods or services.'" (Scarsdale Br. 17-20; States Br. 28-29 (both quoting *Hernandez*, 490 U.S. at 690)). But the Supreme Court's decisions are not so narrow. In *Hernandez*, the Court stated that only "unrequited payments . . . were deemed deductible"; it noted that "gifts" were "payments made with no expectation of a financial return," and that the essential character of a charitable contribution is that it is made "without adequate consideration"; and it held that the payments at issue in that case were not "contributions or gifts" because the taxpayers "received an identifiable benefit" in exchange for their payments. 490 U.S. at 690-92 (quotation marks and emphasis omitted). The Court's single use of the phrase "goods or services" does not change the clear and broad meaning of those other formulations. And in *American Bar Endowment*, the Court did not use that phrase at all[9]—it said a "substantial benefit in return" for a payment renders it ineligible for the charitable contribution deduction, which applies only to a payment "in excess of the value of any benefit [the taxpayer] received in return." 477 U.S. at 116-18. Plaintiffs' contention that the *quid pro*

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[9] The Court used the words "goods" and "services" when quoting a statute in a part of the decision not relevant here, but did not use those terms in the discussion of the *quid pro quo* principle. 477 U.S. at 116-19.

quo rule only applies to "'goods or services' such as medical treatment" or "insurance policies" (Scarsdale Br. 18-19)—and not to credits against tax liability, which are essentially money in the taxpayer's pocket—is not only illogical, but disregards plain language in the Supreme Court's decisions to the contrary.[10]

Plaintiffs next argue that all tax incentives—including the federal tax deduction, state tax deductions, and state tax credits—must be treated the same as each other, and differently from nontax benefits received in return for a payment. (States Br. 29-31;

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[10] Scarsdale relies on the requirement that charities, in some circumstances, must give donors receipts substantiating whether they provided goods or services in consideration for the donation. (Scarsdale Br. 19-20, citing § 170(f)(8)(B)). The argument, first, ignores the definition of "goods or services" for this purpose as "cash, property, services, benefits, and privileges." 26 C.F.R. § 1.170A-13(f)(5). Second, the substantiation requirement is a wholly different context. As Scarsdale's own quotation from legislative history demonstrates, Congress thought it appropriate that charities inform donors that their deduction is limited by the consideration they received, and provide donors with a good faith estimate of the value of that consideration. Section 170(f)(8) was enacted to "require substantiation and disclosure relating to certain charitable contributions," H.R. Conf. Rep. 103-213, at 565, *reprinted in* 1993 U.S.C.C.A.N. 1088, 1254 (1993); it has no bearing on whether tax credits are a benefit to a taxpayer.

Scarsdale Br. 13-17, 20-22). But not all tax incentives are the same. "[A] dollar-for-dollar state or local tax deduction does not raise the same concerns as a state or local tax credit, and it would produce unique complications if it were to be subject to the *quid pro quo* principle." 84 Fed. Reg. at 27,520. First, the "economic benefit of a dollar-for-dollar deduction is limited because it is based on a taxpayer's state and local marginal rate," and accordingly "the potential revenue loss" to the federal government is comparatively low. *Id*. Moreover, the IRS initiated the process leading to the Regulation in response to the states' creation of tax credits as a means to circumvent the SALT deduction cap, *see* 83 Fed. Reg. at 43,564-65—but because of the limited effect of a deduction, "the risk of a taxpayer using such deductions to circumvent" the SALT deduction cap is low, 84 Fed. Reg. at 27,520.

In addition, substantial administrative complications would result from treating deductions as benefits received in return for payments to charitable entities —complications that are not present when treating tax credits as such. While a tax credit is always worth the specified percentage of the payment to the charitable entity, the value of a tax deduction varies with the taxpayer's marginal tax rate, making calculations more difficult and burdensome for both the taxpayer and the IRS. *Id*. In addition, if the value of a state tax deduction were used to reduce the § 170 deduction, the deductible amounts would differ on the state and federal tax returns, contrary to typical practice and leading to more administrative problems. *Id*.

Plaintiffs also suggest that treating state tax credits as a return benefit in a *quid pro quo* is inconsistent with not doing so for the federal charitable contribution deduction itself. (States Br. 29). The deduction authorized by § 170 is expressly approved by Congress as an incentive for charitable giving. Reducing the deductible value of a gift or contribution by the value of the § 170 deduction would reduce that incentive, contrary to congressional intent. But the same cannot be said of treating the cash-back value of a state tax credit as a benefit a donor receives in consideration for a payment. Regardless, as explained above regarding a state deduction, the value of a federal deduction is limited by the marginal tax rate, which also makes the calculation administratively difficult. In fact, reducing the § 170 deduction by its own value is an inherently circular process that would lead to a recursive loop of calculations that would make determining the deductible amount nearly impossible.[11]

In light of those distinctions, the Regulation reasonably treats both federal and state tax deductions differently from the "workarounds stemming from taxpayer's use of state and local tax credit programs"—

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[11] If a taxpayer makes a $100 contribution to a charity and pays a 24% marginal tax rate, the value of the deduction is $24. If the deductible amount must be reduced by that value, then only $76 is deductible. But if that is the case, then the value of the deduction should be $18 (24% of $76)—so the properly deductible amount would be $82, contradicting the last calculation, *ad infinitum*.

distinguishing limited incentives for taxpayers to make gratuitous donations to charity from "workarounds" that allow taxpayers to circumvent the limit Congress imposed on the SALT deduction by recharacterizing their payments to states and localities.[12]

Nor is that analysis undermined by the fact that "tax benefits [are not] 'income'" within the meaning of the IRC. *Randall v. Loftsgaarden*, 478 U.S. 647, 656-57 (1986); (States Br. 30-34; Scarsdale Br. 21-22). From that undisputed principle, plaintiffs illogically conclude that tax benefits "do not count as return goods for the purpose of Section 170 either." (States Br. 30). But that does not follow. "Income" is defined in § 61 of the Code. *See Randall*, 478 U.S. at 657 (citing 26 U.S.C. § 61). The analysis of whether something is income under § 61 is "separate and distinct from the analysis for determining whether a payment or transfer is a deductible contribution under section 170." 84 Fed. Reg. at 27,516. As the Supreme Court reasoned, tax benefits do not meet the statutory definition of income, in part because they lack value "in themselves": tax credits only have value to offset preexisting tax liability, and tax deductions only have value to reduce

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[12] The Regulation also applies to tax credit programs that preexisted the 2017 SALT deduction cap, and will continue to apply if that cap expires after 2025. (States Br. 35). But to ensure "fair and consistent treatment," the Regulation applies the *quid pro quo* principle equally, as that principle does not turn on the intent or origination date of a recipient organization. 84 Fed. Reg. at 27,522.

otherwise existing taxable income. *Randall*, 478 U.S. at 656-57. But in the context of a tax credit offered in return for a payment to a charitable fund, the tax credit has a fixed and easily determined value equal to a set percentage of the payment. (JA 70).[13] It is therefore a benefit the taxpayer receives in return for a payment as part of a *quid pro quo*.[14]

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[13] Although New York itself offers a straightforward computation of the value of the tax credit (JA 70), as does the IRS, 84 Fed. Reg. at 27,525-27, 27,529 Table 1 (calculating value and effects of tax credit in various scenarios), Scarsdale insists that such a tax credit has "no set value." (Scarsdale Br. 30). But in this context, the tax credit is worth a fixed dollar amount. Cash in one's pocket may not be usually referred to as having a "fair market value," but it has value all the same.

[14] Plaintiffs rely on *Maines v. Commissioner*, 144 T.C. 123 (2015), and *Tempel v. Commissioner*, 136 T.C. 341 (2011). (States Br. 33,44; Scarsdale Br. 20-21). But those cases essentially mirror *Randall* in concluding that tax credits are not gross income for federal tax purposes. *Tempel*, 136 T.C. at 350-51. In a footnote, *Tempel* referred to an argument "neither party has advocated" that would treat charitable donations in return for state tax credits as "in part a sale." *Id.* at 351 n.17. It declined to adopt that view, but did so in reliance on the 2010 CCA, which, as discussed below, was never precedential and has now been repudiated by the IRS. *See* 84 Fed. Reg. at 27,516-17 (concluding

In short, the explicit purpose and design of plaintiffs' SALT workaround programs is that payments to the state funds are made with "the expectation of [a] quid pro quo," namely, the receipt or expected receipt of valuable state and local tax credits. *Hernandez*, 490 at 690 (quotation marks omitted). The Regulation correctly applies the Supreme Court's holdings and the text of § 170 in determining that those credits must reduce the deductible amount of contributions to the states' programs.

B. The IRS's Interpretation of § 170 Deserves Judicial Respect

If there is any doubt about the meaning of § 170, the Court should give meaningful weight to the IRS's interpretation in the Regulation.

The district court decided this case based on the deferential framework of *Chevron*, which was later overruled by *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244 (2024). Under *Loper Bright*, "courts must exercise independent judgment in determining the meaning of statutory provisions" and in "deciding whether an agency has acted within its statutory authority," rather than deferring to an agency's permissible readings of ambiguous statutes. *Id.* at 2262, 2273. As explained above, the Regulation's interpretation of § 170 is the "best reading" of that statute, and should be upheld for that reason alone. *Id.* at 2266.

Maines and *Tempel* are "are not relevant for purposes of interpreting section 170").

Moreover, in determining the statute's best reading, courts still "may—as they have from the start—seek aid from the interpretations of those responsible for implementing particular statutes." *Id.* at 2262. And in some cases, "the best reading of a statute is that it delegates discretionary authority to an agency," in which case the courts' role is to "effectuate" that delegation. *Id.* at 2263 ("the statute's meaning may well be that the agency is authorized to exercise a degree of discretion"); *accord id.* at 2273 ("when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it"). More broadly, the Supreme Court has long recognized that the "'interpretations and opinions' of the relevant agency, 'made in pursuance of official duty' and 'based upon specialized experience,' 'constitute[ ] a body of experience and informed judgment to which courts and litigants [can] properly resort for guidance,' even on legal questions." *Id.* at 2259 (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 139-40 (1944); alteration omitted). The weight of the agency's judgment depends "'upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.'" *Id.* (quoting *Skidmore*, 323 U.S. at 140).

Respect for Executive interpretation is particularly warranted in interpretation of the IRC. Before *Chevron* was decided, the Supreme Court observed that "ever since the inception of the tax code, Congress has seen fit to vest in those administering the tax laws very broad authority to interpret those laws. In an

area as complex as the tax system, the agency Congress vests with administrative responsibility must be able to exercise its authority to meet changing conditions and new problems." *Bob Jones University*, 461 U.S. at 596. For that reason, the Supreme Court "has long recognized the primary authority of the IRS and its predecessors in construing the Internal Revenue Code." *Id.*

That authority carries even more weight where, as here, Congress has given the agency specific authority regarding the statute to be interpreted. *Loper Bright*, 144 S. Ct. at 2263 ("In a case involving an agency, of course, the statute's meaning may well be that the agency is authorized to exercise a degree of discretion . . . [or] to prescribe rules to 'fill up the details' of a statutory scheme."). As set forth above, § 170 itself grants the IRS express authority: "A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary." 26 U.S.C. § 170(a)(1). Congress thus clearly stated its intent that the IRS, through its regulations, is to determine what charitable contributions are allowable as deductions.

Plaintiffs maintain that the authority delegated by § 170(a) is limited to whether a contribution is "verified" according to rules promulgated by the agency. (States Br. 39). But an agency cannot "verify" a contribution unless it decides what a "charitable contribution" is in the first place.[15] *See Loper Bright*, 144 S. Ct.

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[15] None of the cases plaintiffs cite say otherwise, as they all concerned the actual verification or sub-

at 2259 (discussing pre-*Chevron* cases in which the Court deferred to agency's legal interpretation where "a particular statute empowered an agency to decide how a broad statutory term applied to specific facts found by the agency"); *see also Bob Jones University*, 461 U.S. at 597-98 ("the IRS has the responsibility, in the first instance, to determine whether a particular entity is 'charitable' for purposes of § 170."). And that determination falls well within the IRS's experience and informed judgment in implementing the charitable contribution deduction—a responsibility it and its predecessors have exercised for over a century. While the issue of state tax credits implemented to circumvent the limits on a separate deduction is a "new problem[]," *Bob Jones University*, 461 U.S. at 596, the IRS applied its knowledge and expertise in "longstanding principles under section 170" to address it, 84 Fed. Reg. at 27,515, and the resolution it fashioned was reasonable, within its statutory authority, and entitled to the Court's "most respectful consideration," *Loper Bright*, 144 S. Ct. at 2258 (quotation marks omitted).

Nor do prior IRS interpretations undermine the Regulation's validity. Plaintiffs rely primarily on the 2010 CCA, where the Chief Counsel advised taxpayers they could "take a § 170 deduction for the full amount" of a contribution made in return for a state tax credit, without subtracting the value of the credit received in return. (JA 1506-07); *see* 84 Fed. Reg. at 27,514. But CCAs are specifically prohibited by statute from being

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stantiation of donations that were not contested as being charitable contributions.

"used or cited as precedent," 26 U.S.C. § 6110(b)(1)(A), (k)(3), as the 2010 CCA itself expressly stated (JA 1504). Nor are they "official rulings or positions of the IRS," or "ordinarily reviewed by the Treasury Department." 83 Fed. Reg. at 43,564; *accord* 84 Fed. Reg. at 27,516.

And even if the 2010 CCA's analysis were official or precedential, the IRS plainly explained why the Regulation departs from its conclusions. "Agencies are free to change their existing policies as long as they provide a reasoned explanation for the change"; an agency "must at least 'display awareness that it is changing position' and 'show that there are good reasons for the new policy.'" *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016) (quoting *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009)). The Regulation does just that. It explicitly "acknowledge[s] that the proposed and final regulations depart from the conclusion of the 2010 CCA in important respects." 84 Fed. Reg. at 27,516. It explains that the agency's review of authorities in the wake of the 2017 SALT deduction cap led it to "question[] the reasoning of the 2010 CCA." *Id.* at 27,514. It then sets out its reasons for disagreeing with, and abandoning, that reasoning. To begin with, the 2010 CCA was not "persuasive[]" because it relied on cases that addressed tangential issues but "did not specifically address whether the value of state or local tax credits should be treated as a *quid pro quo* that reduces the amount of the deduction" or "address the application of the *quid pro quo* principle under section 170." *Id.* at 27,516.

Moreover, the legal landscape had changed since 2010: "the analysis in the 2010 CCA assumed that after the taxpayer applied the state or local tax credit to reduce the taxpayer's state or local tax liability, the taxpayer would receive a smaller deduction for state and local taxes under section 164." *Id.*; *accord* 83 Fed. Reg. at 43,564 (prior to SALT deduction cap, issue "had little practical consequence from a federal income tax perspective" because a deduction was likely available "under either section 164 or section 170"). But that assumption "no longer holds true for the vast majority of taxpayers" after the enactment of the SALT deduction cap in 2017: "for taxpayers who itemize and have state and local tax liabilities above the new limitation, the use of the tax credit would not reduce the deduction for state and local taxes." 84 Fed. Reg. at 27,516. That explanation is more than adequate—in particular, given that Congress has expressly given the agency authority to promulgate "all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." 26 U.S.C. § 7805(a). The IRS therefore has broad authority here, where it is responding to both the 2017 Tax Act's SALT deduction cap and the states' efforts to circumvent the effect of that federal change in law. (JA 24, 42, 45, 80); *see* 83 Fed. Reg. at 43,564 ("state and local tax credit programs now give taxpayers a potential means to circumvent the $10,000 limitation in section 164(b)(6)").[16]

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[16] Plaintiffs maintain that the § 7805(a) rulemaking authority is displaced by narrower authority in

Plaintiffs insist that Congress should be presumed to have been aware of the 2010 CCA, and more generally to have been aware that other states, even before the 2017 Tax Act, offered state tax credits as incentives for charitable giving; its decision not to amend § 170 to overrule the 2010 CCA therefore means, according to plaintiffs, that it accepted the Chief Counsel's position. (States Br. 35-37; Scarsdale Br. 16). But while the Supreme Court has "recognized congressional acquiescence to administrative interpretations of a statute in some situations, [it has] done so with extreme care." *Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers*, 531 U.S. 159, 169 (2001). A typical example of a court's reliance on congressional acquiescence is a case where "there is evidence that Congress considered and rejected the 'precise issue' presented before the Court." *Rapanos v. United States*, 547 U.S. 715, 750 (2006) (quoting *Bob Jones University*, 461 U.S. at 600). Absent "overwhelming evidence of acquiescence," the Court is "skeptic[al] [of] reading the tea leaves of congressional inaction," and has stated that supposed acquiescence

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§ 170(a). (States Br. 39-40). The § 170(a) authority is not narrower, as explained above. But if plaintiffs were correct that the regulatory authority in § 170(a) is limited to "verification" of contributions and thus does not reach the meaning of "contribution or gift," then it does not displace the broader § 7805(a) authority. In any event, the two can coexist without conflict. *Alli v. Commissioner*, 107 T.C.M. (CCH) 1082 n.12 (2014).

is "more appropriately . . . called Congress's failure to express any opinion." *Id*. at 749-50.

There is no actual evidence—and plaintiffs cite none—through reports or floor debates or proposed legislation, that Congress was actually aware of the 2010 CCA. And even if it had been, its decision not to respond legislatively to an unofficial, nonprecedential opinion of the IRS Chief Counsel cannot support an inference that it agreed with that opinion. *See Rapanos*, 547 U.S. at 750 ("We have no idea whether the [Congress] Members' failure to act in 1977 was attributable to their belief that the [agency's] regulations were correct . . . ."). Nor was there evidence that Congress concerned itself with state tax credit programs that existed before the 2017 Act. As the district court pointed out, it was not until "after the 2017 Tax Act" that states created such programs with the aim of circumventing the SALT deduction cap; it was those "efforts by states and taxpayers to devise alternate means for deducting the disallowed portion of their state and local taxes [that] has generated increased interest in the question of whether a state or local tax credit should be treated as a return benefit." 84 Fed. Reg. at 27,514. Congress's lack of action before those efforts occurred does not even remotely suggest it approved of the states' workaround programs.[17]

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[17] Plaintiffs cite scattered comments from legislators around the time of the 2017 Tax Act regarding the § 170 deduction. (States Br. 36-37). But those comments all concerned the general principle of allowing deductions for charitable contributions; they had

For all these reasons, the Regulation is consistent with the text, context, and history of § 170, is the product of "reasoned decisionmaking within [the] boundaries" of the discretion that Congress has delegated to the IRS, *Loper Bright*, 144 S. Ct. at 2263 (quotation marks omitted), and is valid in all respects.

C. The Regulation Is Not Arbitrary and Capricious

Furthermore, the IRS's promulgation of the Regulation was not arbitrary and capricious. The APA's "arbitrary and capricious" standard is "narrow and particularly deferential" to agencies. *Environmental Defense v. EPA*, 369 F.3d 193, 201 (2d Cir. 2004). Under this standard, the Court "may not substitute its own policy judgment for that of the agency," but "simply ensures that the agency has acted within a zone of reasonableness and, in particular, has reasonably considered the relevant issues and reasonably explained the decision." *FCC v. Prometheus Radio Project*, 592 U.S. 414, 423 (2021).

Plaintiffs argue that the Regulation is arbitrary and capricious in two respects. First, they contend that

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nothing to do with state tax credits. In any event, "excerpts from committee hearings and scattered floor statements by individual lawmakers . . . [are] among the least illuminating forms of legislative history." *Advocate Health Care Network v. Stapleton*, 581 U.S. 468, 481 (2017) (quotation marks omitted). Tweets do not even make the list.

the Regulation did not adequately explain the different treatment of tax credits and deductions. (States Br. 43-48). As described above, the IRS explained that "a dollar-for-dollar state or local tax deduction does not raise the same concerns as a state or local tax credit, and it would produce unique complications if it were to be subject to the *quid pro quo* principle." 84 Fed. Reg. at 27,520; *supra* pp.36-39. It was reasonable for the IRS to conclude that the two are not the same, and plaintiffs' arguments to the contrary depend on the rejected 2010 CCA and cases that, as explained above, do not undercut the IRS's reasoning, *supra* pp.39-40, 44-46.

Plaintiffs suggest that in considering the "potential revenue loss" from not reducing § 170 deductions by the amount of the state tax credits received in return, the IRS has relied on "factors which Congress has not intended it to consider." *Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 43 (1983); (States Br. 45; Scarsdale Br. 23-24). But the SALT deduction cap was enacted to raise revenue, and that congressional goal is entirely proper for the IRS to consider in responding to states' legislation enacted to bypass that cap.[18] The IRS is not prohibited from considering whether taxpayers may misuse IRC provisions or existing regulations to avoid paying income taxes, nor from choosing to amend its

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[18] Scarsdale faults the IRS for not including a formal "revenue estimate" (Scarsdale Br. 24-25), but there is no denying that programs that circumvent a revenue-raising measure will reduce revenue.

regulations to address such concerns. *See Carpenter, Chartered v. VA*, 343 F.3d 1347, 1352 (Fed. Cir. 2003) ("[A] regulation is reasonably related to the purposes of the legislation to which it relates if the regulation serves to prevent circumvention of the statute and is not inconsistent with the statutory provisions.").

Plaintiffs next accuse the IRS of "ignor[ing] the value of federal deductions" in reaching its conclusion that not treating deductions as return benefits will have a limited effect. (States Br. 45). But the IRS addressed federal deductions, concluding that they should be treated the same as state deductions, but differently from state tax credits. 84 Fed. Reg. at 27,521; *supra* p.38. It is true that federal marginal tax rates are higher than states' rates, and the effect of a federal deduction for charitable contributions is therefore larger. But it is beyond dispute that the value of a federal deduction (which under current law is no higher than 37% of the donation to a charity) is "comparatively low" as opposed to the state tax credits at issue in this case, which go up to 95% of the donation. Even applying plaintiffs' methodology of adding all tax benefits together, the sum remains well below the value of the state tax credits. Nor do plaintiffs explain why that additive approach is valid. To the contrary, one of the reasons the IRS promulgated the Regulation was to prevent states' creation of tax credits to circumvent federal limits on tax deductions. But that logic does not apply to federal deductions. Congress cannot be said to be circumventing its own enactment by allowing a charitable contribution's value to be deducted on federal tax returns without subtracting that same deduction's value. Rather, its enactments must be read

"as a harmonious whole rather than at war with one another." *Epic Systems Corp. v. Lewis*, 584 U.S. 497, 502 (2018). In short, federal tax deductions are in no way "an important aspect of the problem" of circumventing the SALT deduction cap, *State Farm*, 463 U.S. at 43; they are not a part of the problem at all.

Plaintiffs also attack the IRS's reasoning based on the administrative complexity of reducing a deductible amount by the value of a deduction, essentially contending that reducing the deductible amount by the value of a tax credit may pose its own administrative difficulties. (States Br. 46-47). They point to no specifics; they merely identify a number of possible rules on which the value of a tax credit "may hinge," none of which appear to be present (nor do plaintiffs contend they are present) in the state laws at issue. N.Y. Tax Law § 606(iii) (providing for a credit worth 85% of the sum of certain contributions, without further qualification); N.J. Stat. Ann. § 54:4-66.9 (same, up to 90% of donations); Conn. Gen. Stat. § 12-129v (same, up to either 85% of donations or amount of property tax owed).[19] And even divorced from the actual tax laws at issue here, the concerns plaintiffs identify are hardly

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[19] As authority, the states cite only their own comment letter submitted to the IRS during the rulemaking process. (States Br. 46-47). In turn, a single paragraph of that letter cites only one Tax Notes article, which itself identifies no specific state laws. (JA 396 (citing Bankman et al., *Caveat IRS: Problems with Abandoning the Full Deduction Rule*, 88 State Tax Notes 547, 552-53 (2018))).

insurmountable: for instance, limits on the amount or percentage a taxpayer may claim, or rules turning on a taxpayer's filing status, are generally easily computable ex ante. Regardless, it is no answer to the Regulation's identification of administrative difficulties to point out that a different requirement would also pose administrative difficulties: all tax laws create at least some potential for complicated calculations. The IRS's determination that a reduction in the deductible amount for tax credits is manageable, more so than a reduction for the value of deductions, was explained in the Regulation's preamble and is based on its expertise and authority in administering the nation's tax laws, and is not undermined by plaintiffs' conclusory insistence that other complications may result from the Regulation's requirements.

The second ground on which plaintiffs maintain the Regulation is arbitrary and capricious is its adoption of an exception for tax credits worth 15% or less of the contribution. (States Br. 48-50). That exception was adopted to reconcile two established but competing principles: that the deductible amount of a charitable contribution should be reduced by the benefit received in return, and that tax incentives for such contributions have historically been allowable. The IRS thus chose to limit the permissible tax incentive to the typical value of a state tax deduction, the narrower and more common form of tax incentive: the exception was "designed to provide consistent treatment for state or local tax deductions and state or local tax credits that provide a benefit that is generally equivalent to a deduction." 84 Fed. Reg. at 27,520. Because the "combined benefit of state and local tax deductions, that is,

the combined top marginal state and local tax rates, . . . do not exceed 15 percent" as the IRS has determined, allowing a full deduction if state tax credits do not exceed 15% of the donation amount approximates the benefit accorded by state deductions, and thus ensures the two types of tax incentives are treated on par with each other: "The exception ensures that taxpayers in states offering state tax deductions and taxpayers in states offering economically equivalent credits are treated similarly." *Id.*[20]

As for plaintiffs' objection to the "cliff effect" that results from excluding 15% tax credits, but not 16% (or higher) credits, the agency is entitled to exercise its judgment—based in its expertise and experience—in determining when a tax credit (worth a set percentage of a payment) becomes "economically equivalent" to a tax deduction (which varies in value depending on marginal tax rates). *See Mayo Foundation v. United States*, 562 U.S. 44, 59 (2011) ("Regulation . . . often requires drawing lines."). That a "cliff effect" may result does not invalidate the needed line-drawing judgment: "when lines have to be drawn they are bound to appear arbitrary when judged solely by bordering cases." *10 East 40th St. Bldg., Inc. v. Callus*, 325 U.S. 578, 584

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[20] Scarsdale's objection that the risk of "fluctuation" in state tax rates means the premise of the 15% exception "may evaporate at any moment" (Scarsdale Br. 27) is unfounded; it offers no reason to think any significant change in those rates is imminent, or why the IRS cannot address that change if and when it happens.

(1945); *accord Louisville Gas & Electric Co. v. Coleman*, 277 U.S. 32, 41 (1928) (Holmes, J., dissenting) ("When a legal distinction is determined . . . a point has to be fixed or a line has to be drawn . . . . Looked at by itself without regard to the necessity behind it the line or point seems arbitrary."). That is particularly true "[w]here any classification is based on a percentage or an amount," in which case "it is necessarily somewhat arbitrary." *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 553 (1949) (upholding requirement that 4.999% shareholder, but not 5.000% shareholder, is subject to security and liability requirements).

But here, the IRS's decision was well explained and reasonable. Determining that the combined marginal state and local tax rates throughout the country do not currently exceed 15%, the IRS used that number as a reasonable approximation of the benefit typically afforded a taxpayer through a state-tax deduction for a charitable contribution. *See Massachusetts, Dep't of Public Welfare v. Secretary of Agriculture*, 984 F.2d 514, 522 (1st Cir. 1993) (when "agency exercises [line-drawing] authority in a reasonable way, neither the fact that there are other possible places at which the line could be drawn nor the fact that the administrative scheme might occasionally operate unfairly from a particular participant's perspective is sufficient, standing alone, to undermine the scheme's legality"; citing *Knebel v. Hein*, 429 U.S. 288, 294 (1977)). Nor, in any event, is the "cliff" as foreboding as plaintiffs would make out: a taxpayer at a 24% marginal rate who makes a $1,000 donation and receives a 15% state tax credit receives a § 170 deduction worth $240; if the state tax credit is 16%, the federal deduction's value is

$202 (24% of $840). The IRS's inclusion of the 15% exception was not arbitrary and capricious.

Finally, Scarsdale asserts that the Regulation will disincentivize charitable giving generally. (Scarsdale Br. 24, 31-32). But as the IRS explained, gratuitous donations still qualify for the federal tax deduction; state-level tax benefits remain unchanged; and donations to the state programs at issue here can still be deducted under § 164 as state or local taxes. 84 Fed. Reg. at 27,521-22. And overall, incentives for charitable giving remain "entirely unchanged for the vast majority of taxpayers," since, according to the IRS's analysis of return data, 90% of taxpayers will not itemize deductions and therefore are "entirely unaffected" by the Regulation. *Id*. at 27,528.

In sum, the IRS's regulatory decisions were reasonable, well explained, and based on a thorough consideration of the relevant factors. *See State Farm*, 463 U.S. at 43. As the district court explained, Congress granted the IRS broad regulatory authority, understanding that the goal of "promoting charitable giving must be balanced against the nation's need for revenue," and that regulatory adjustments would be needed as the law and circumstances change. (SPA 60). The IRS appropriately responded to the SALT deduction cap and the states' efforts to circumvent it, and in doing so was required to "consider and balance a number of competing interests, including, *inter alia*, the nation's need to raise revenue; Congress's clear intent to limit SALT deductions; the desire to encourage charitable giving, as reflected in IRC § 170; the *quid pro quo* principle; and the

administrative burdens and practicalities associated with a variety of regulatory approaches." (SPA 60). Nothing in the Regulation's accommodation of those concerns, or the requirements it adopted, was unlawful or arbitrary and capricious, and plaintiffs' challenge to its validity must fail.

CONCLUSION

The judgments of the district court should be affirmed.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(g), the undersigned counsel hereby certifies that this brief complies with the type-volume limitation of the Federal Rules of Appellate Procedure and this Court's Local Rules. As measured by the word processing system used to prepare this brief, there are 13,967 words in this brief.

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