What the ARP and AJP mean for states

Presentation for the Governor's Council on Tax Reform

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What major federal legislation means for states

- American Rescue Plan (ARP) – *enacted*
  - $350 billion in state and local aide
  - The federal rules on how these federal dollars can be spent
  - What we know about ARP's state tax cut restriction
- American Jobs Plan (AJP) – *proposed*
  - Major infrastructure plan introduced by the Biden administration on Wednesday
  - Also includes significant federal corporate tax changes
  - Biden administration also plans to make another announcement in April on its plans for health insurance coverage, child-care subsidies, community colleges and other proposals

American Rescue Plan

$350 billion in direct aid to state and local governments

- $195.3 billion for states
  - Small share divided equally; larger share divided by 3-month Dec 2020 unemployment rates
  - **Kansas: $1.586 billion**
- $130.2 billion for local governments
  - County aid is based on population, municipal aid is distributed based on the federal Community Block Grant formula (based on population, poverty levels, and housing overcrowding)
  - **Kansas: $989 million**
- $10 billion for capital projects
  - **Kansas: $143 million**
- **Kansas total federal ARP funds: $2.718 billion**

What ARP funds can (and cannot) be spent on

- Responding to the public health emergency
- Offsetting the pandemic's negative economic effects
- Providing premium pay for front-line public sector workers
- Replacing lost tax revenue
- Investing in infrastructure improvements
- **ARP funds <u>cannot</u> be spent on (state) tax cuts or pension contributions**
  - "A state or territory shall not use the funds … to either directly or indirectly offset a reduction in the net tax revenue … (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase."
  - Treasury can clawback every dollar in violation of this rule
  - Treasury working on rules in how this is defined

Does ARP really end states' abilities to cut taxes? (Hint: Of course not)

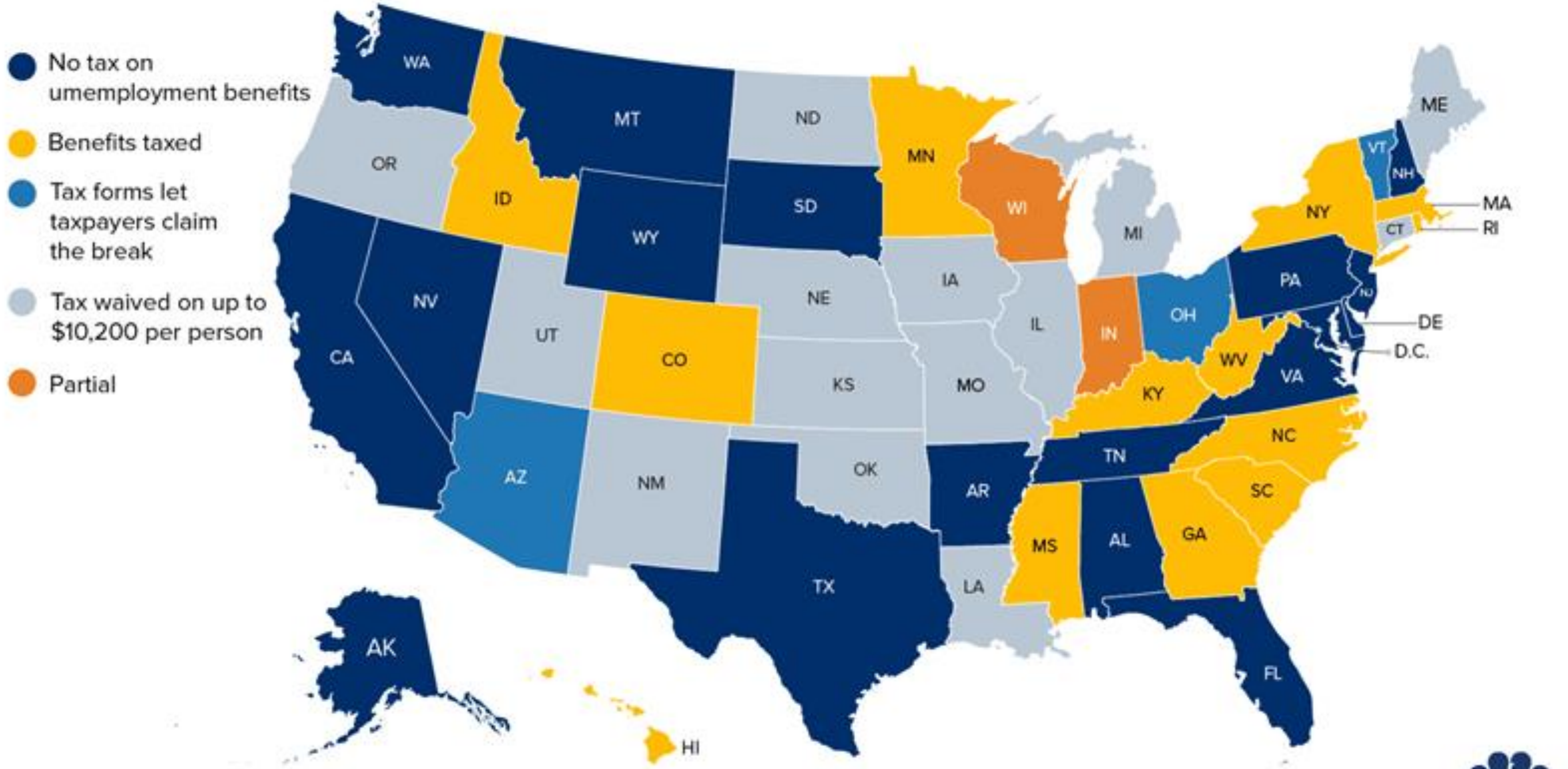
- The AG of Ohio immediately sued the Biden administration over the state tax cut restriction; 21 other Republican AGs wrote a letter to Treasury threating legal action
- In a response, Secretary Janet Yellen wrote the ARP provision is conventional congressional guidance and only applies to these specific federal funds
  - "Nothing in the Act prevents States from enacting a broad variety of tax cuts. That is, the Act does not 'deny States the ability to cut taxes in any manner whatsoever.' It simply provides that funding received under the Act may not be used to offset a reduction in net tax revenue resulting from certain changes in state law. If States lower certain taxes but do not use funds under the Act to offset those cuts-for example, by replacing the lost revenue through other means-the limitation in the Act is not implicated."
- Still, all states need official Treasury guidance as they move forward this year

Prominent examples of possible state tax cuts and ARP implications

- Fully exempting unemployment benefits (AR, DE, MD did before the ARP; others considering) or conforming with the ARP's $10,200 exemption
  - Hard to imagine these changes triggering the restriction because it's part of the ARP
- Using ARP funds to restore unemployment insurance trust funds (and prevent tax hikes)
  - Many states used CARES funds for this; Maryland just announced it will use ARP funds for this. Also hard to imagine this use of federal funds triggering the restriction
- Enacting or expanding an earned income tax credit or child tax credit
  - Very much in line with the stated goals for the ARP funds
  - But might depend on how done – checks to beneficiaries okay, permanent change??
- Small changes such as increasing the standard deduction or retirement income credits
  - Will probably depend on the specific proposal and the specific state's fiscal standing
- Eliminating the state income tax without offsets (Mississippi and West Virginia)
  - This could certainly trigger the restriction – reason for inclusion

States where taxpayers get a break on unemployment benefits

The American Rescue Plan waived federal tax on up to $10,200 of benefits per person. Thirteen states don't offer a break on state tax.



Source: H&R Block. Data as of March 29, 2021. States that don't tax 2020 unemployment benefits either don't levy a personal income tax or exclude benefits from tax under state law. Indiana and Wisconsin allow partial unemployment compensation exclusions. Arizona, Ohio and Vermont are administratively allowing the tax break because their state tax forms let taxpayers file as if they comply with the federal rule.

Source: These states aren't allowing the $10,200 unemployment tax break (Greg Iacurci, March 30, 2021, CNBC)

Other notable recent state tax trends

- New York approved legal and taxable marijuana sales
  - New Mexico is also close to approving legislation
  - North Dakota rejected legislation
- Florida and Missouri are trying to approve *Wayfair* legislation that will allow these states to collect tax from online transactions (FL and MO are the last holdouts)
  - These states currently collect no tax from online transactions, but they are also the only other states (in addition to Kansas) without marketplace-facilitator legislation

American Jobs Plan

$2 trillion infrastructure (over 8 years)

- $115 billion for highways and roads
- $85 billion to modernize existing transit systems
- $174 billion in grant and incentive programs for state and local governments and the private sector to build a national network of 500,000 electric-vehicle chargers by 2030
- $25 billion for airports
- $100 billion to deliver universal broadband (particularly for rural Americans)
- $213 billion for affordable and sustainable housing

- This is all an outline. We're still waiting on more details.

$1.8 trillion tax plan (over 15 years)
Made in America Tax Plan

- Raises the corporate tax rate from 21% to 28%
  - Note: Federal rate changes do not affect state taxes
- Increases the global minimum tax (GILTI) paid from about 13% to 21%
- Impose a 15% minimum tax on the income large US corporations report to their shareholders
- Repeal the base erosion and anti-abuse tax (BEAT) and replace it with an unspecified provision to bar foreign corporations based in countries that do not adopt their own “strong” minimum tax from deducting intra-company payments
  - These changes could affect state taxes (because they are changes to the tax base) but the change will most likely be small and not on the level of the changes in the TCJA, CARES, or ARP