



NCSL TASK FORCE ON STATE AND LOCAL TAXATION VIRTUAL MEETING SERIES

Impact of the CARES Act on State Tax Systems

MAY 1, 2020



AGENDA

- Welcome
- Federal Stimulus and Relief Measures: Coronavirus Response - Scott Roberti, Ernst & Young
- State Tax Conformity to the CARES Act Provisions – Karl Frieden, Council On State Taxation (COST)
- Impact of CARES Act on State Tax Systems – Richard Cram, Multistate Tax Commission
- Q&A



NATIONAL CONFERENCE OF STATE LEGISLATURES

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FEDERAL STIMULUS AND RELIEF MEASURES: CORONAVIRUS RESPONSE

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Presenter



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Coronavirus (COVID-19) response: what has been done

Bill #1: \$8.3b spending bill to fight the coronavirus outbreak enacted **March 6**

| | | | |
|--|--------------------|-----------------------|-----------------------------------|
| \$3.1b for vaccine development, supplies | \$2.2b for the CDC | \$826m to support R&D | \$1.2b for global health programs |
|--|--------------------|-----------------------|-----------------------------------|

Treasury/IRS Payment Relief: Notice 2020-18 released March 20: due date for filing Federal income tax returns and making Federal income tax payments due April 15 is automatically postponed to July 15.

Bill #2: \$104b Families First Coronavirus Response Act enacted **March 18**

- Paid sick leave
- Family and medical leave
- Employers would receive a 100% refundable payroll tax credit on the wages required to be paid
- Unemployment insurance — \$1 billion for emergency transfers to states
- Provides states with a 6.2% Medicaid FMAP increase
- Food and nutrition assistance
- Funding for free testing

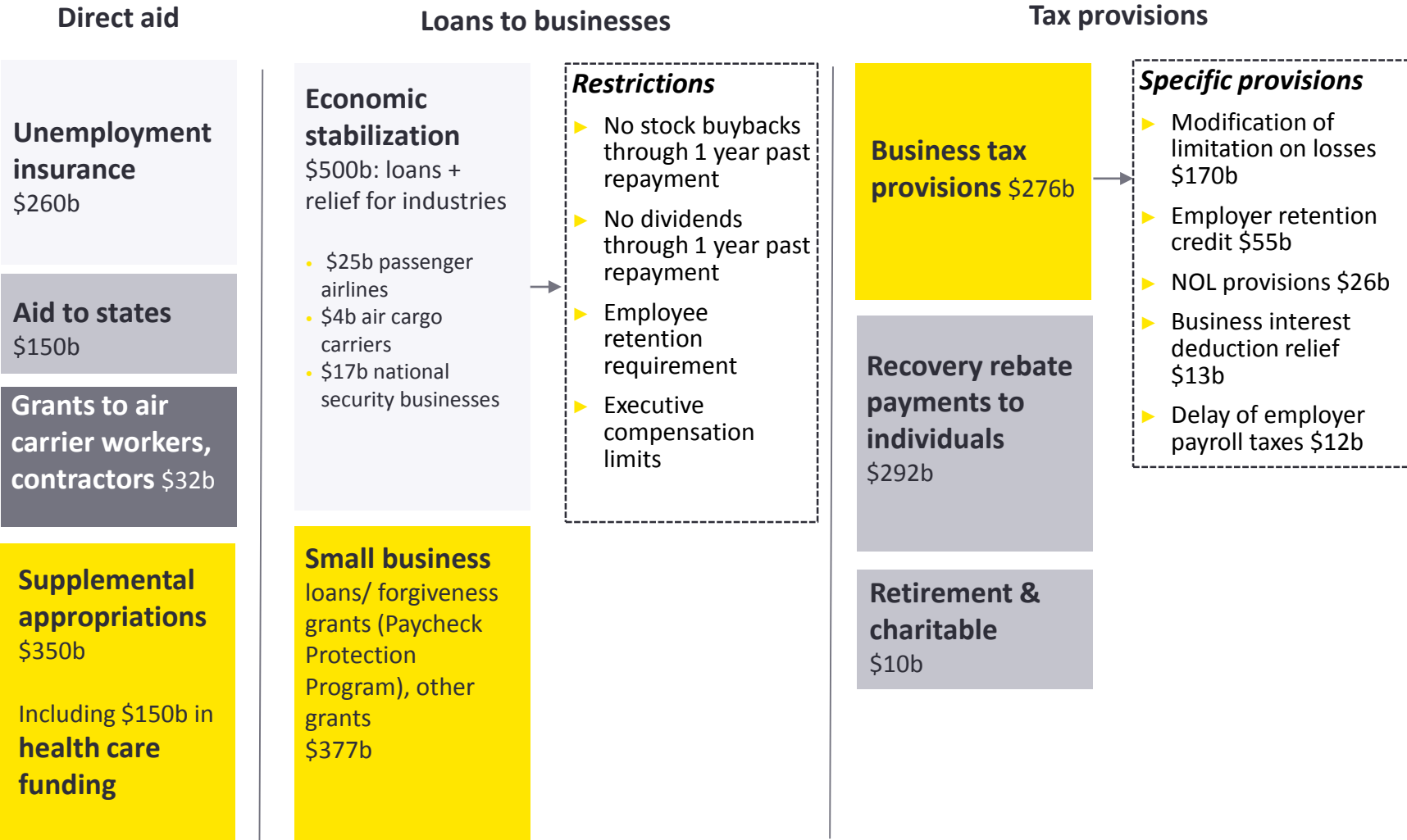
Bill #3: \$2.2t Coronavirus Aid, Relief, and Economic Security (CARES) Act enacted **March 27**

- Direct payments to individuals
- Loans and other aid to businesses small and large
- Aid to states
- Expanded unemployment benefits
- Health care funding
- Retirement and charitable provisions
- Employer retention credit, payroll tax deferrals
- Business tax provisions

Bill #3.5: \$484b Paycheck Protection & Health Care Enhancement Act enacted **April 24**

- Additional \$310b for PPP loan program
- Additional \$60b for Economic Injury Disaster Loan program
- Additional \$75b for hospitals
- Additional \$25b for testing

Highlights of \$2t-plus Coronavirus Aid, Relief, and Economic Security (CARES) Act



CARES Act: highlights of tax provisions

Individual tax relief

- \$1,200 checks to individuals, \$2,400 for couples
 - increased \$500 for every child
 - phased out beginning at \$75k/\$150k AGI
- No penalties for retirement withdrawals <\$100k
- No required minimum distributions for 2020
- \$300 above-line deduction for charitable donations
- Increased limitations on charitable deductions
- Exclusion for employer payments of student loans

Payroll tax relief

- Employers can delay 2020 6.2% Social Security tax
 - Half paid by the end of 2021
 - The rest by the end of 2022
- Employee retention credit
 - 50% on wages credit against employment taxes
 - Businesses whose operations were suspended or receipts declined >50%

TCJA rollbacks

- 30% business interest limitation under Section 163(j) set at 50% for 2019 and 2020
- Net operating loss from 2018, 2019 or 2020 can be carried back 5 years
- Temporarily remove taxable income limitation to allow an NOL to fully offset income
- Taxpayers with AMT credits able to claim a refund for the entire amount of the credit instead of recovering credit through refunds

Other business provisions

- NOLs extended to passthroughs, sole proprietors ("Modification of limitation on losses for taxpayers other than corporations")
- NOL technical correction to conform effective dates mismatched in TCJA
- "Retail glitch" qualified improvement property (QIP) TCJA drafting fix
- Temporary exception from excise tax for alcohol used to produce hand sanitizer

CARES Act: employee retention credit

Who is eligible?

Any employer
(regardless of
size) who:

Is fully or partially
suspended due to
government
COVID-19 order
(includes tax-
exempt orgs)

Or loses 50% of
gross receipts
compared to the
same quarter in
2019

Employers w/<100 employees:
applies to all wages
Employers w/>100 employees:
only wages paid to employees
when not providing services
due to COVID-19 order

How much is the credit?

50% of wages
paid to each
employee.
\$10,000 total cap
on credit per
employee for
2020

Qualified wages
include health
care costs paid by
employer to
maintain a group
health plan

Note: The credit is not available to employers receiving a small business interruption loan under the SBA's Paycheck Protection Program.

CARES Act: small business loans (Paycheck Protection Program)

Who is eligible?

Businesses with:
500 or fewer employees

- Restaurants, hotels, & other food/lodging businesses may qualify if each location has 500 or fewer employees
- 501(c)(3) nonprofits, including organizations, are eligible
- Sole proprietors, independent contractors, gig economy workers and self-employed all eligible
- Effort to exempt venture capital from SBA affiliation rules that exclude small companies with common ownership that have >500 employees combined

How much can be borrowed?

\$10 million

- 2 months average payroll costs + plus 25% for overhead, up to \$10m
- Intended to cover 8 weeks of payroll expenses + payments toward debt obligations
- Applies between February 15-June 30, which is the application deadline
- From: any lender in existing Small Business Administration lending program and additional lenders approved by Treasury

Forgiveness terms

- For businesses that retain employees, loan will be forgiven
- For those that lay off employees, forgiveness reduced by % decrease
- If payroll on employees earning <\$100k decreases by >25%, loan forgiveness reduced by same amount
- Businesses will owe if loan used for purposes other than payroll, mortgage/ rent, utilities

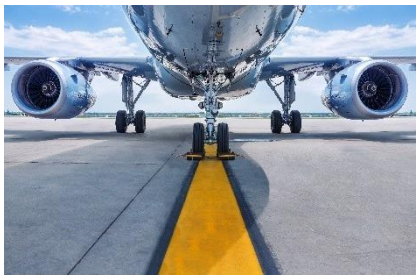
CARES Act: economic stabilization

\$454 billion for loans, loan guarantees and investments in support of Federal Reserve’s emergency lending facilities to businesses, states & municipalities.

Restrictions

| <i>Workers</i> | <i>Corporate governance</i> | <i>Conflicts and oversight</i> |
|---|---|--|
| Must use funds to retain at least 90% of workforce at full compensation and benefits through Sept. 30, 2020 | Limits on executive compensation and cannot engage in stock buybacks (unless they are contractually obligated) or pay dividends | Not for businesses owned >20% by President, members of Congress + family 5-member oversight commission + IG |

Multibillion-dollar amounts for support to specific industrial sectors:



- \$25 billion for passenger air carriers
- \$4 billion for cargo air carriers



- \$17 billion for businesses important to maintaining national security

Congressional interim measure

\$484b Paycheck Protection & Health Care Enhancement Act

- Senate approved by voice vote April 21
- House approved April 23
- Signed by President on April 24

\$320b more for CARES Act Paycheck Protection Program (PPP)

- Sets aside \$ for loans made by specific institutions
 - \$30b for loans by Insured depository institutions and credit unions assets between \$10b-\$50b
 - \$30b for loans made by community financial institutions, small insured depository institutions, and credit unions with assets less than \$10b

\$60b Economic Injury Disaster Loan program

- Appropriates an additional
 - \$50b for Disaster Loans Program Account
 - \$10b for Emergency Economic Injury Disaster Loan (EIDL) Grants

\$75b hospital funding

- Reimbursement to hospitals, health care providers for COVID-19 expenses and lost revenue
 - Language remains the same as CARES Act

\$25b coronavirus testing

- \$11b for states, as well as funding for CDC, NIH
- Testing plans from each states required in 30 days
- Health & Human Services (HHS) report on testing required in 21 days

State fiscal challenges

- Federation of Tax Administrators predict “grim” state revenue picture:
 - Short-term, states expect a cash-flow crisis, income tax payment due dates of July 15, 2020 push revenue beyond most current state fiscal years ... some states opted to extend their fiscal years
 - Long-term, a recession could cause a shrinking tax base, driving down anticipated revenue in future years
- National Governors Association & National Association of State Budget Officers (NASBO) initially requested \$150 billion direct aid (ultimately included in CARES Act) and \$500 billion on April 17
- Global oil and gas price changes and overall drop in demand causes decline in severance-tax revenue
- Will there be a greater impact on non-income tax states?

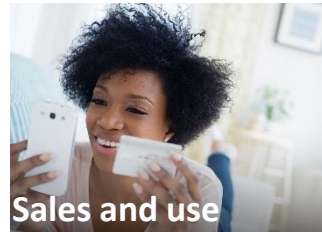
*Source: <https://www.taxadmin.org/covid19-federal-impact> (last accessed April 20, 2020).

State and local tax responses

Responses from state governors, legislatures, tax administrators and local governments:



- Filing and payment due date deferral
- Penalty and interest waivers
- Above-mentioned relief may extend to state franchise taxes
- Electronic filing and signature guidance
- Relief for nexus and apportionment impacts of remote work from home (WFH) orders



- Filing and payment due date deferral
- Penalty and interest waivers
- Targeted relief for business sectors
- Exemptions for sale and use of medicine and supplies to fight the COVID-19 pandemic
- Electronic filing guidance



- Filing and payment due date deferral, including for exemptions
- Penalty and interest waivers
- Above-mentioned relief addresses several property types, including real property, hotels, and tangible personal property, transfer taxes
- Appraisals and appeals



- Filing and payment due date deferral
- New offerings for small businesses
- New incentives for production of personal protective equipment (PPE)
- Waivers of jobs credits requirements impacted by WFH orders



- Employment tax issues in response to the COVID-19 pandemic
- Fuel tax
- Excise taxes
- Business licenses

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STATE TAX CONFORMITY TO THE CARES ACT PROVISIONS

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Key Taxpayer-Favorable Provisions in the CARES Act

Modifications to the Business Interest Deduction (Section 2306)

- Increase the cap from 30% to 50% for 2019 and 2020
- Allow 2019 adjusted taxable income to be used for calculating the 2020 business interest deduction

Net Operating Loss Modifications (Section 2303)

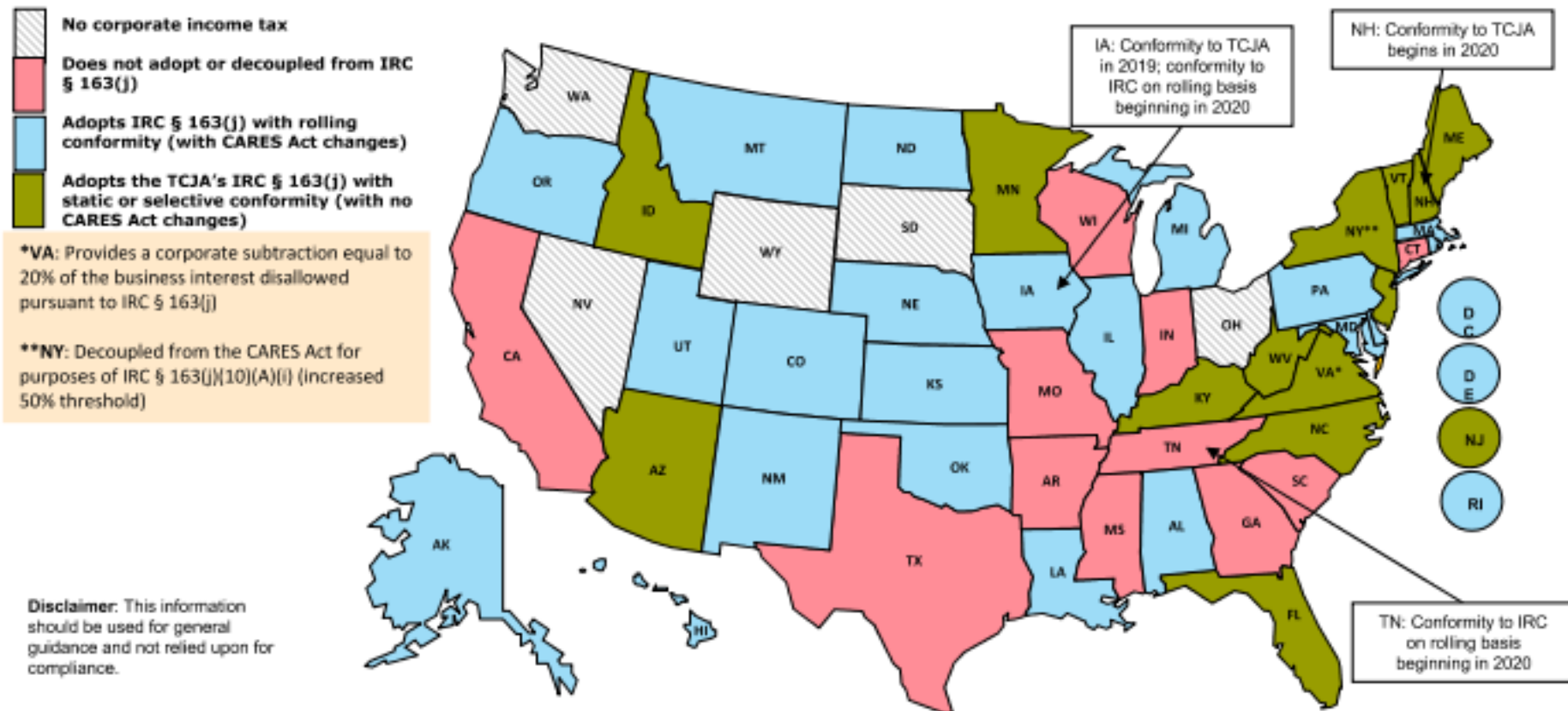
- Allow for 5-year carryback of losses
- No 80% cap for 2018, 2019 and 2020

Reclassification of Qualified Improvement Property (QIP) (Section 2307)

- Reclassify QIP from 39-year property to 15-year property
- As result, QIP is eligible for 100% bonus depreciation under IRC § 168(k)
- Takes effect as if included in TCJA

These changes involve **timing** differences solely affecting **when** a taxpayer receives a deduction, not **if** a taxpayer is entitled to the deduction.

State Corporate Tax Law Conformity with IRC § 163(j) Interest Expense Limitation

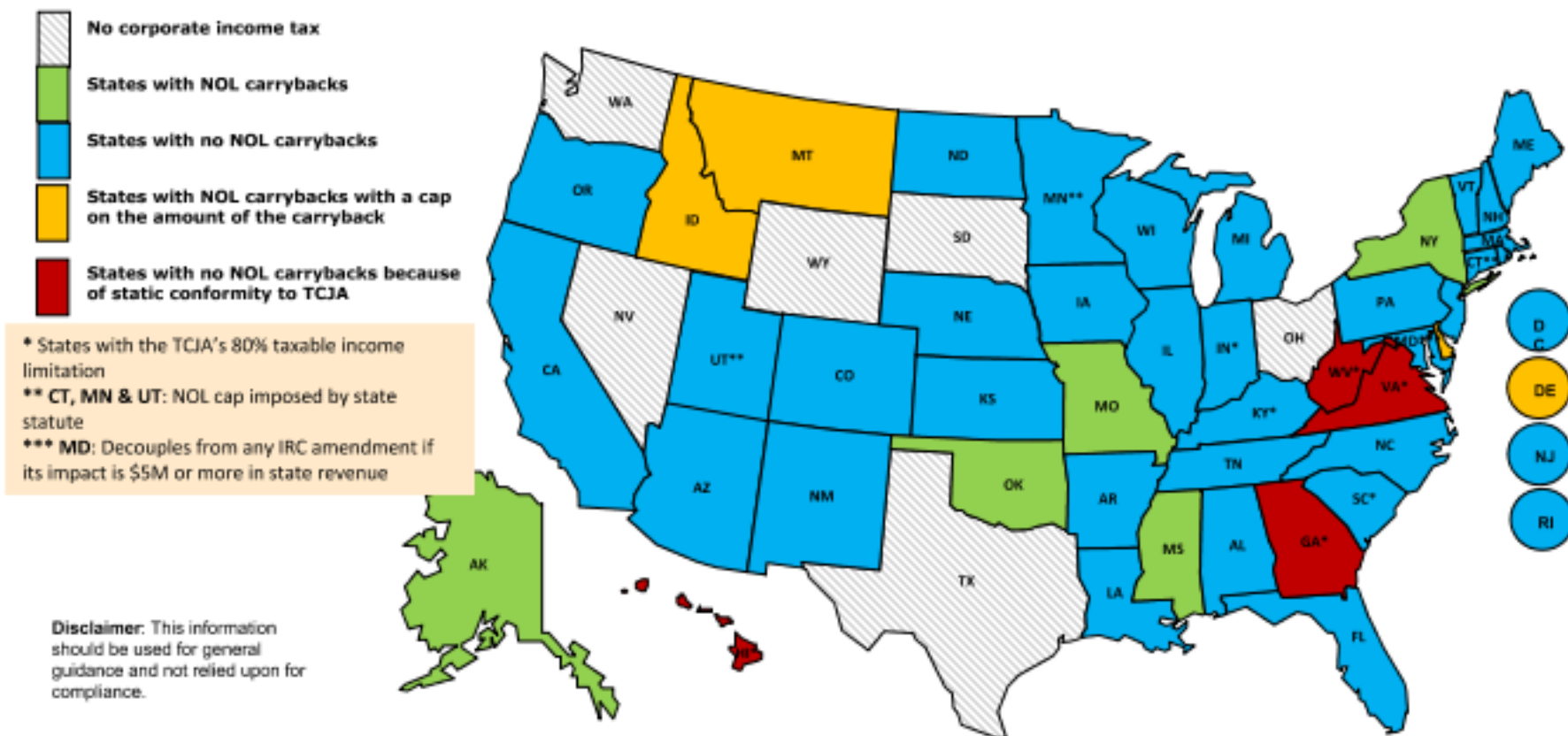


Source: Council On State Taxation

Record Levels of U.S. Corporate Debt – Even Before the COVID-19 Crisis

- Between 2000 and 2019 (non-financial) U.S. corporate debt increased from \$4.5 trillion to nearly \$10 trillion, or a record 47 percent of the overall economy.
- Much of this growth occurred since the 2008-2009 financial crisis, as companies borrowed for recovery and expansion taking advantage of historically low interest rates.
- Additional debt incurred in 2020 and 2021 to offset near-catastrophic declines in revenue in many business sectors will significantly increase corporate interest expenses, accentuating the need for a higher threshold of allowable interest expense deductions.

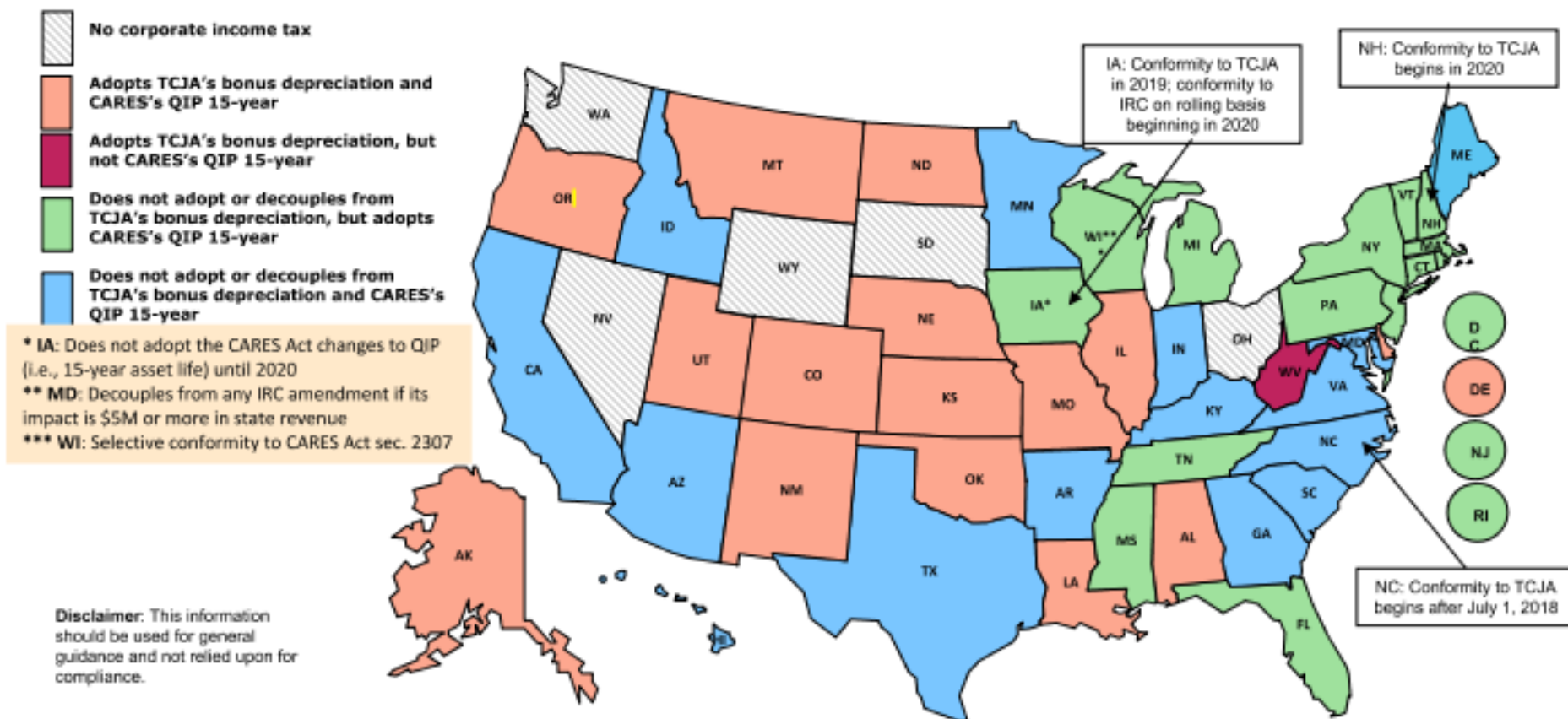
State Corporate Tax Law Conformity with NOL Carryback Provisions



The Expected Resurgence of Net Operating Losses (NOLs)

- The CARES Act NOL carryback provision targets assistance to businesses that, through no fault of their own, but because of the unforeseen and unprecedented stoppage or slowdown of the country's economic life are now suddenly experiencing large losses where in previous years they had significant net income.
- During the recent Great Recession, NOLs per year nearly tripled in the U.S. from \$225.5 billion in 2007 to \$722.4 billion in 2010.

State Corporate Tax Law Conformity with TCJA's Bonus Depreciation (IRC § 168(k)) & CARES Act's QIP MACRS Classification



Disclaimer: This information should be used for general guidance and not relied upon for compliance.

Source: Council On State Taxation

The Policy Implications of State Tax Conformity with the Federal Tax Provisions in the CARES Act

- The COVID-19 crisis upended all other state tax legislation for 2020.
- States are now in a precarious fiscal situation that may require balancing conflicting priorities:
 - Drafting balanced budgets in the face of sharply declining tax revenues; and
 - Providing businesses (and individuals) with tax and other financial relief to help them cope with the onslaught of mandatory business shutdowns or slow downs.

The Policy Implications of State Tax Conformity with the Federal Tax Provisions in the CARES Act

- It is important to recognize that **all three of the key federal tax provisions included in the CARES Act involve “timing” differences solely impacting when a taxpayer receives a deduction, not if a taxpayer is entitled to the deduction.**
 - None of these changes involve a corporate tax rate reduction or some other form of a corporate tax cut.
 - It is for precisely this reason that these changes are an important part of the federal government’s COVID-19 economic recovery program and should be considered by states, **where possible**, that have not already adopted similar provisions.
- For more information see: Karl A. Frieden and Stephanie T. Do, “State Tax Conformity to Key Taxpayer Favorable Provisions in the CARES Act,” *State Tax Notes*, April 20, 2020

IMPACT OF CARES ACT ON STATE TAX SYSTEMS

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Are forgiven loan amounts under the Paycheck Protection Program taxable by the state?

CARES Act provides that forgiven portion of a Payment Protection Program loan is excluded from “gross income” for federal income tax purposes.

Tax treatment at the state level could depend on whether state conforms to CARES Act provisions.

State tax guidance is needed.

Are business expenses covered with forgiven Paycheck Protection Program loan proceeds still deductible for federal and state income tax purposes?

The Internal Revenue Code (Sec. 265) generally provides that expenses related to exempt income are not deductible.

The IRS has not published specific guidance yet.

Tax treatment at the state level depends on whether the state conforms to the CARES Act provisions.

State tax guidance is also needed.

Are the \$1200 stimulus payments to individuals under the CARES Act taxable by the state?

IRS: such payments are considered federal income tax rebates of 2020 federal individual income tax and not taxable.

State level tax treatment depends on whether state provides deduction for federal income taxes paid. If so, deduction could take into account receipt of the federal income tax rebate. If not, such payment should generally not be taxable by the state.

These states issued guidance stating stimulus payments are not taxable: AR (FAQ, HB 1083), CA, DC, GA, IL, PA, MN, (FAQ), NJ, WI.

CARES Act \$300 “Above the line” Charitable Contribution Deduction

Under the CARES Act, taxpayers claiming the standard deduction on their federal individual income tax returns can also claim an “above the line”(pre-AGI) charitable deduction not exceeding \$300 for tax year 2020.

This one-time change will impact states that base determination of “taxable income” on the individual’s federal adjusted gross income.

Corporate
income tax
nexus issues
arising from
“stay home”
order
telework
requirement
s

DC, Indiana, Massachusetts,
Minnesota, Mississippi, New
Jersey, North Dakota,
Pennsylvania, Philadelphia: no
nexus from teleworker presence

Ohio: HB 197--teleworker presence
will not count toward 20-day
threshold for municipal income tax
nexus

Maryland: Current nexus rules
apply

Payroll
factor
numerator
issues
arising from
“stay home”
order
telework
requirements

**Massachusetts, Minnesota,
Mississippi, New Jersey,
North Dakota, Pennsylvania:**
payroll factor numerator not
changed by “stay home” order
telework

Maryland: Current rules apply

Sales/use
tax nexus
issues
arising from
“stay home”
order
telework
requirements

**Massachusetts, Minnesota,
Pennsylvania:** no sales/use tax
nexus attributable solely to
“stay home” order teleworker
presence

Employer
withholding
tax issues
arising from
“stay home”
order
telework
requirement
s

Massachusetts, Mississippi,
New Jersey: No withholding
requirement change for “stay
home” order telework

Maryland(reciprocity
agreements with DC PA VA
WV), Minnesota: current
withholding rules apply



Questions and Answers

Please type your questions into the chat box on the right side of your screen or unmute yourself to ask your questions.

UPCOMING SALT TASK FORCE VIRTUAL MEETINGS

- **State Tax Administration and Compliance in the COVID-19 Era – Friday, May 8 (1 pm ET)**
<https://ncsl.zoom.us/j/94647291278?pwd=YnFBR3llaUhUVEIxSm9ybW1vQUZlZz09>
Meeting ID: 946 4729 1278
Password: 860756
- **The Pandemic and the Damage Done: Revitalizing State Revenue Streams – Friday, May 15 (1 pm ET)**
<https://ncsl.zoom.us/j/98239802441?pwd=Vms5Vjk4OGFjYzFZS1VZcjZUZ0NBZz09>
Meeting ID: 982 3980 2441
Password: 289070



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