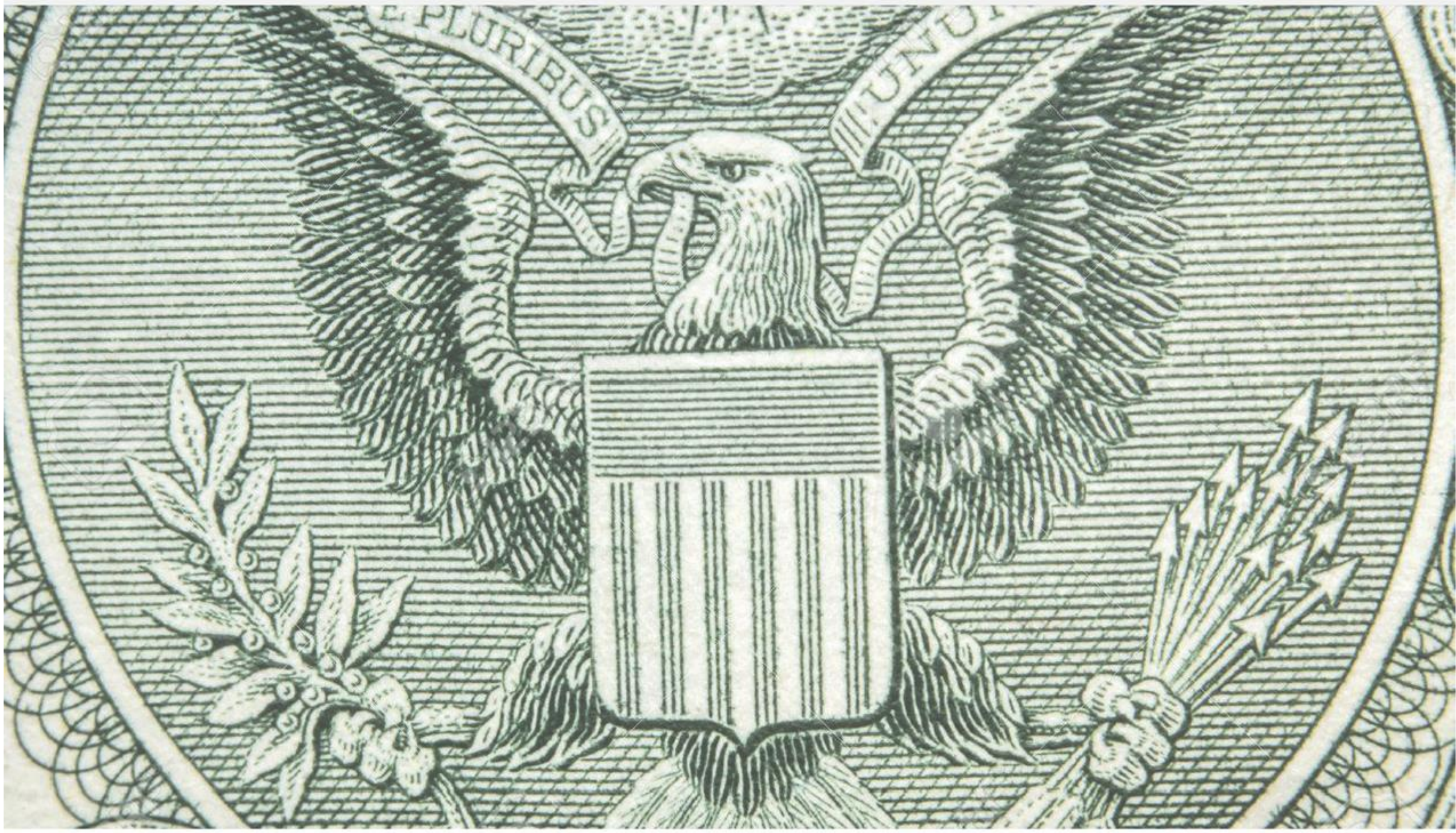
FISCAL BRIEF

States Mind Their Own Businesses



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Over the last year, the pandemic has left small businesses struggling to survive. Government restrictions and public health fears led to sharp declines in revenue and cash balances. Many businesses had to close doors or lay off employees. Grave uncertainty left businesses, and the economies they support, vulnerable. Lawmakers at all levels of government prioritized business assistance to keep main street and state economies from irrevocable damage. Evidence suggests business relief is working. Yet, additional support is still needed. Without a continued focus on small businesses, recovery could be halted too soon.

Early in the pandemic, states took immediate action to assist small businesses by funding capital programs that offered direct financial assistance or by providing tax relief. The enactment of the Coronavirus Aid, Relief, and Economic Security (CARES) Act strengthened state efforts. Under the CARES Act, support for small businesses took several forms including:

- State and local aid through the Coronavirus Relief Funds (CRF).
- Direct loans like the Paycheck Protection Program (PPP).
- Tax relief.

Layered measures provided multiple avenues to address business needs.

Targeted Loans and Grants

States designed small business relief programs in a variety of ways, often prioritizing the sectors of the economy that had endured the most financial hardship. Most relief efforts came in the form of targeted loans and grants based on size, revenue losses, industry or ownership. Some programs prioritized businesses that were ineligible for direct federal loans.

Loan Programs

While direct grant programs were common, some states leveraged relationships with financial institutions to provide aid. At least two states, Montana and Pennsylvania, used CRF to partner with banks, credit unions and lending institutions on new loan deferment programs.

Other loan programs built on existing development networks. Kansas enacted Senate Bill 15 in its 2021 legislative session, which created an Economic Recovery Loan Deposit Program. The program provides incentives to financial institutions to offer low-interest loans for businesses. The program links to two deposit programs related to agriculture and housing.

A different approach was taken by Illinois, which established a Small Business Emergency Loan Fund that allows eligible businesses to covert low-interest loans into grants as part of a larger Business Interruption Grant program.

Industry Specific

The pandemic brought major disruption to certain industries. According to McKinsey & Company, small businesses in several sectors were especially threatened by COVID-19 implications, whether by public health mandates or financial volatility. States utilized state and federal dollars to provide direct grant relief throughout the pandemic's reign.

New Hampshire, for example, dedicated $10 million to dairy and non-dairy farms; Missouri designed a personal protective equipment retooling grant for manufacturers retooling production; and Alabama included nonprofits and faith-based organizations in its Revive Plus grant program. States like New Mexico and Pennsylvania concentrated efforts on restaurant, bars, and hotel recovery programs.

Minority- and Women-Owned Businesses

Minority- and women-owned business have been disproportionately impacted by the pandemic's economic crisis. Minority-owned businesses are more likely to have trouble securing loans, which left many ineligible for federal relief. Compared to non-minority and male-owned businesses, fewer minority and women business owners reported that they expect higher revenues in 2021.

Small business CRF grant programs were targeted to minority- and/or women-owned businesses in at least nine states: Colorado, Louisiana, Massachusetts, New York, Ohio, Oregon, Rhode Island, Tennessee, and Vermont.

State Stimulus

In tandem with federal stimulus packages, a handful of states have designed their own stimulus plans to accelerate economic recovery. Packages from California, Colorado, and Maryland included direct immediate relief to small businesses through low-interest loans, direct grant aid, and tax credits.

Tax Relief

In addition to grants and loans, states have provided businesses more financial breathing room through various forms of tax relief.

Paycheck Protection Loan Taxability

Over $600 billion dollars have been granted to small businesses through the Federal Paycheck Protection Program (PPP). The federal government exempted these loans from taxable income and also clarified that business expenditures funded by PPP loans are deductible. Most state tax codes conform to the federal tax code in terms of how they define income. That means if something is taxable at the federal level it is taxable at the state level. Some states automatically conform to the latest version of the federal revenue code (rolling conformity), while others must vote to adopt them as they occur (static conformity). A significant issue facing states is the extent to which they will conform to the federal treatment of PPP loans, which would amount to tens or hundreds of millions in tax relief in most states.

As it currently stands, the majority of states will conform to the double-benefit at the federal level, although many of these states have not issued guidance confirming their treatment of PPP-funded expenses or currently have legislation pending that could change their status. At least 20 states have considered PPP tax-related legislation in 2021, and it has passed in at least eight states: Arkansas, Georgia, Iowa, Kentucky, Maine, Virginia, West Virginia and Wisconsin.

Filing Extensions

In 2020, the federal government extended the filing and payment deadlines for income taxes, which provided a moment of financial relief to a minority of taxpayers by allowing those who owed on their returns and had not yet scheduled an April 15 payment with their banks to hold onto their cash for an additional three months. It also gave businesses and tax preparation services time to adapt to the logistical challenges stemming from the closing of physical workspaces across the country, as certain aspects of tax filing cannot be done remotely. All 45 states that levy an income tax delayed their filing dates well. Forty-one mirrored the federal government exactly and chose July 15 as their new "Tax Day."

With the recent IRS announcement that Tax Day in 2021 has postponed to May 15, it is likely that most if not all states will again follow suit and many have already done so.

Workarounds for State and Local Tax Deduction Cap

States are continuing to adopt new entity-level taxes that will allow pass-through businesses to take advantage of federal deductions for state and local taxes. As part of the 2017 Tax Cuts and Jobs Act, Congress implemented a $10,000 cap on deductions for state and local income, sales and property taxes. The pandemic has led growing number of states to implement or consider adopting new entity-level taxes (most of which are voluntary), which are fully deductible at the federal level, and creating off-setting credits to avoid double taxation.

Nine states have created pass-through entity taxes, including Arkansas and Alabama in 2021. Other states currently considering legislation to do include: Arizona (HB 2838), California (SB 104), Maryland (H 1087), Minnesota (HF 1958), New York (SB 3186), and South Carolina (H 3978)

Non-resident Safe Harbor

One of the major tax-related impacts of the coronavirus stems from large numbers of workers shifting to remote situations. Workers who may have lived in one state and commuted into another for work (as is common in populous border regions like the tri-state area of New York, New Jersey and Connecticut) were suddenly working from home. This has important implications when it comes to determining personal and corporate income tax liability and could result in states fighting over the right to tax certain businesses and individuals, creating great uncertainty for taxpayers.

According to the American Institute of Certified Public Accountants, 18 states have offered some assurance to businesses by providing that the presence of an employee working in a state due to shelter -in -place restrictions will not create nexus for tax purposes in that state and 15 states are providing a temporary safe harbor or waiver for state withholdings and tax liability for remote work in different state during pandemic.

Other Notable Business Relief Efforts

- New Mexico passed Senate Bill 1, which allows many restaurants, bars, breweries and similar businesses a Gross Receipts Tax deduction for sales of prepared food and drinks made after March 1, 2021 and prior to July 1, 2021.
- Guam temporarily reduced the business privilege tax rate on the first $250,000 for small businesses.
- Delaware, Kentucky, and Maryland have passed measures to ensure that employers' unemployment insurance taxes do not increase.
- Maine created an Economic Recovery Grant Program which was inclusive of early-stage businesses, or businesses that were established at the very beginning of the pandemic. Businesses revenue losses were evaluated on a "forward looking basis."
- States like, Massachusetts, Nevada, Rhode Island, Washington supported small businesses through technical assistance.

Looking Ahead

More recently, federal and state tax relief efforts coupled with state economic stimulus packages and the anticipated federal American Rescue Plan Act of 2021 are seeking to sustain business financial support through the pandemic's end.

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