Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: http://legis.wisconsin.gov/lfb

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Internal Revenue Code Update -- ARPA and TCJA
(General Fund Taxes -- Income and Franchise Taxes)

[LFB 2021-23 Budget Summary: Page 202, #1]

CURRENT LAW

State individual income tax and corporate income/franchise tax provisions regarding the amount of income subject to taxation are generally referenced to definitions under federal law. With limited exceptions, changes to federal law take effect for state tax purposes only after action by the Legislature. The Legislature typically reviews the previous year's federal law changes each year to update state references to the federal Internal Revenue Code (IRC). Under current law, state tax references generally refer to the code in effect on December 31, 2020.

BACKGROUND

On March 11, 2021, President Biden signed into law P.L. 117-2, the American Rescue Plan Act of 2021 (ARPA). ARPA follows three other federal acts in response to the coronavirus pandemic: (a) the Families First Coronavirus Response Act (FFCRA); (b) the Coronavirus Aid, Relief, and Economic Security Act (CARES); and (c) the Consolidated Appropriations Act of 2021 (CAA). Two of these federal acts modified IRC references relevant for state tax purposes. The Legislature adopted 2019 Act 185 in response to the federal tax law changes included under CARES. Federal tax law changes modified under the CAA, as well as tax law changes modified under several prior federal acts, were adopted under 2021 Act 1. Certain provisions of ARPA were automatically adopted for state tax purposes, while others would require legislative approval. This paper describes provisions of ARPA that modify IRC references relevant for state tax purposes that would require legislative approval to adopt.

State references to federal law provide greater simplicity for taxpayers in preparing returns and reduce the administrative burden and cost for both taxpayers and the Department of Revenue

(DOR) in assuring compliance with tax laws. The IRC references are used to determine which items of income are subject to taxation prior to specific state modifications. The state uses separate tax rates and brackets and separate provisions regarding standard deductions, personal exemptions, itemized deductions, net operating loss, tax credits, excise taxes, and subtractions after the computation of federal adjusted gross income (AGI). Therefore, changes to these federal provisions typically have no effect for state tax purposes. For example, the expansion of the federal child and dependent care expenses credit under ARPA for tax year 2021 does not affect the state deduction for child and dependent care expenses. Although Wisconsin is tied to the federal credit's definition of employment-related expenses for purposes of the corresponding state deduction, the federal credit modifications included in ARPA do not impact the definition of these expenses, and so do not impact expenses allowed under the state deduction. Changes to federal tax laws under ARPA that the Legislature previously elected not to adopt, such as changes to the federal earned income tax credit (EITC) for individuals without children, are not described in this paper.

The Legislature previously considered and adopted provisions of the Tax Cuts and Jobs Act of 2017 (TCJA) as part of 2017 Act 231. This paper discusses provisions of the TCJA that were not adopted under Act 231 or other legislation, but which were recommended for state adoption under Assembly Bill 68/Senate Bill 111 (AB 68/SB 111).

DISCUSSION POINTS

1. The tax law changes presented in this paper describe the ARPA provisions and TCJA provisions Wisconsin could adopt to conform state definitions of income to the modified federal definitions of income. The paper separately describes ARPA changes the Committee could consider for state adoption that: (a) make permanent changes to the IRC (Alternative A1); (b) make temporary changes to the IRC beginning in tax year 2021 (Alternative A2); and (c) make a temporary change to the IRC for tax year 2020 (Alternative A3). It should also be noted that the Committee could choose to adopt any combination of Alternatives A1, A2, and A3. Alternatively, the Committee could choose not to adopt certain federal tax law changes presented as part of Alternatives A1 and A2. It should be noted that Alternatives A1 and A2 include provisions related to the state EITC, which are also considered for state adoption in LFB Paper #307. If Alternatives A1 and A2 were adopted as presented in this paper, the EITC-related provisions of LFB Paper #307 would not have an additional fiscal impact.

2. State adoption of temporary tax law changes provides simplicity for taxpayers and for DOR tax administration. However, adopting temporary federal tax law changes can present challenges for state governments. Because the federal government does not have a balanced budget requirement, it can issue general obligation debt to implement temporary tax reduction provisions to stimulate economic activity in response to a recession. Conversely, Wisconsin is required to enact a balanced budget each biennium and cannot issue general obligation debt to provide temporary tax relief. Historically, Congress has enacted extensions and/or expansions of temporary tax reduction provisions that would require the Legislature to choose whether to continue maintaining conformity with the IRC provision or to allow that provision to sunset under current law. Extensions of temporary tax provisions can occur after DOR has printed guidance and made its forms available to practitioners for that tax year. In general, adoption of a federal tax provision

that applies retroactively to previous tax years requires a taxpayer to file an amended return to receive the benefit, which can create administrative complexities for taxpayers and DOR.

3. As introduced, AB 68/SB 111 would update references to the IRC under the individual and corporate income/franchise tax to several IRC provisions of the TCJA, as amended by subsequent federal legislation, for tax years beginning after December 31, 2020. This includes: (a) loss limitation for taxpayers other than corporations; (b) amortization of research and experimental expenditures; (c) accounting rules for accrual method taxpayers; (d) limitation on the deduction for business interest; (e) limitation on the deduction for entertainment, amusement, and recreation expenses; (f) limitation on the deduction of Federal Deposit Insurance Corporation (FDIC) premiums; and (g) modification of the limitation on the deduction for highly paid individuals. State adoption of these provisions under AB 68/SB 111 would increase state income and franchise tax revenues by $264.2 million in 2021-22 and $275.9 million in 2022-23. Each of the TCJA provisions are described individually in this paper and can be adopted separately or jointly under Alternatives B1 through B7.

Permanent Tax Provisions of ARPA

4. The federal EITC is a refundable credit based on income and family size and is calculated based on a percentage of earned income up to certain thresholds. The state EITC is calculated as a percentage of the federal credit that varies based on the claimant's number of qualifying children. The state credit is not available to claimants without qualifying children.

Under federal law, the EITC is denied to individuals having disqualified income in excess of a certain limit. The disqualified income limit for tax year 2020 is $3,650, and is adjusted each year for inflation. Disqualified income is defined as taxable and nontaxable interest income, dividends, net income from nonbusiness rents and royalties, capital gain net income, and net passive income (if greater than zero) that is not self-employment income. ARPA increases this disqualified income limit to $10,000 beginning in tax year 2021, and specifies that the increased limit is to be indexed for inflation annually thereafter. The state EITC is funded through a sum certain PR appropriation from the temporary assistance for needy families (TANF) program and a sum sufficient GPR appropriation. Therefore, adopting this provision is estimated to increase GPR expenditures by $1.8 million in 2021-22, $1.5 million in 2022-23, $1.3 million in 2023-24, and $1.4 million in 2024-25.

5. Under federal law, married taxpayers must file using the married-joint filing status in order to claim the EITC. However, a provision in ARPA allows an exception to this filing requirement, beginning in tax year 2021, for an individual who: (a) files married-separate; (b) lives with their qualifying child (for purposes of the EITC) for more than half the year; and (c) during the last six months of the relevant tax year, did not live in the same principal dwelling as their spouse (or possesses a divorce or separation instrument relating to their spouse and is not a member of the same household as their spouse at the end of the relevant tax year). State adoption of this provision is estimated to increase GPR expenditures by $0.1 million on an annual basis, beginning in 2021-22.

6. For taxable years beginning after December 31, 2020, multinational taxpayers were permitted to allocate interest expenses of a domestic group member on a worldwide basis. This

altered the computation of the limitation on the foreign tax credit such that the interest expenses of foreign members of a worldwide affiliated group would have been considered in determining whether interest expenses of domestic members of the group must be allocated to foreign-sourced income. Initially enacted in 2004, federal law had delayed the effective date numerous times. ARPA permanently repeals the election. It is estimated that state adoption of this provision would increase income and franchise tax collections by $7.8 million in 2021-22, $11.1 million in 2022-23, $13.4 million in 2023-24, and $14.2 million in 2024-25 and annually thereafter.

7. The Committee may decide to adopt only those federal provisions of ARPA which are permanent (Alternative A1). Table 1 displays the net fiscal effect of state adoption of the permanent provisions of ARPA, which are estimated to increase the general fund balance by $5.9 million in 2021-22, $9.5 million in 2022-23, $12.0 million in 2023-24, and $12.7 million in 2024-25.

TABLE 1

Fiscal Effect of State Adoption of Permanent ARPA Tax Provisions (Millions)

Provision	2021-22	2022-23	2023-24	2024-25	Source
Increase EITC Disqualified Income Limit	$1.8	$1.5	$1.3	$1.4	GPR
EITC for Certain Separated Individuals	0.1	0.1	0.1	0.1	GPR
Repeal Worldwide Interest Allocation Election	7.8	11.1	13.4	14.2	GPR-Tax
Subtotal GPR-Tax	$7.8	$11.1	$13.4	$14.2	GPR-Tax
Subtotal GPR	$1.9	$1.6	$1.4	$1.5	GPR
Net Increase to State General Fund	$5.9	$9.5	$12.0	$12.7	

Temporary Tax Provisions of ARPA

8. With certain exceptions, forgiven student loans are generally considered taxable income under federal law. ARPA stipulates that any forgiven student loan that was expressly provided for postsecondary educational expenses and meets certain other requirements is excluded from taxable income for tax years 2021 through 2025. If the state were to adopt this provision, it is estimated that individual income tax revenues would decrease by a minimal amount annually through 2025-26.

9. Under current law, health insurance premium assistance is generally included in gross income. Under separate provisions of ARPA, eligible individuals receiving continuation health care coverage pursuant to the Consolidated Omnibus Budget Reconciliation Act (COBRA) are entitled to premium assistance between April 1, 2021, and September 30, 2021. Under ARPA, the federal government will pay the premiums in full for such individuals during this period. ARPA specifies that any such COBRA premium assistance received is not included in the gross income of the individual. If the state were to conform to this federal exclusion, individual income tax revenues would decrease by an estimated $9.8 million in 2021-22.

10. Under federal law, an employer may participate in a dependent care assistance program, whereby the employer pays (directly or indirectly) for services to care for its employees' dependents (such as through a dependent care flexible spending arrangement). To be eligible for preferential tax treatment, such services must be provided to enable the employees to remain employed. Generally, an individual can exclude from gross income up to $5,000 ($2,500 if filing married-separate) per year of such dependent care assistance benefits. For tax year 2021 only, this limit is increased to $10,500 ($5,250 for married-separate filers). State adoption of this provision is estimated to reduce individual income tax collections by $0.9 million in 2021-22.

11. For EITC claims filed for tax year 2021, ARPA generally allows a taxpayer to use their earned income from tax year 2019 when determining their credit amount, provided their earned income in 2021 is lower than in 2019. A similar provision applicable to tax year 2020 was included in the CAA, and was adopted in state law under 2021 Act 1. Adopting this provision is estimated to increase GPR expenditures by $6.0 million in 2021-22. Because this provision only applies to EITC claims filed for tax year 2021, a minimal increase in GPR expenditures is estimated in 2022-23 and thereafter.

12. ARPA provides $28.6 billion in federal fiscal year 2021 for a new restaurant revitalization grant program, including $5 billion for eligible entities with gross receipts during 2019 of no more than $500,000. Grants are equal to the pandemic-related revenue loss of an eligible entity, up to $10 million per eligible entity, with no more than $5 million for each physical location. Any grant amounts that exceed the actual gross receipts of an eligible entity in 2020 must be returned.

Grants are generally awarded to eligible entities in the order in which applications are received. Eligible entities include most businesses in which the public or patrons assemble for the primary purpose of being served food or drink. Such entities located within an airport terminal are considered eligible. State and municipal owned businesses are not eligible. Entities that own or operate more than 20 locations, regardless of whether they do business under the same name, are not eligible.

Grant proceeds may be used for the following expenses incurred as a direct result of, or during, the COVID–19 pandemic during the period beginning February 15, 2020, and ending December 31, 2021: (a) payroll costs; (b) payments of principal or interest on any mortgage obligation (not including prepayments of principal); (c) rent payments (not including prepayment of rent); (d) utilities; (e) maintenance expenses, including construction to accommodate outdoor seating and walls, floors, deck surfaces, furniture, fixtures, and equipment; (f) supplies, including protective equipment and cleaning materials; (g) food and beverage expenses that are within the scope of the normal business practice of the eligible entity before the covered period; (h) covered supplier costs; (i) operational expenses; (j) paid sick leave; and (k) any other expenses determined to be essential to maintaining the eligible entity.

Eligible recipients must certify in their application for a grant that: (a) the uncertainty of current economic conditions makes the grant request necessary to support the ongoing operations; and (b) they have not applied for or received a shuttered venue grant under the CAA.

ARPA also provides that restaurant revitalization grant proceeds are excluded from gross income for income tax purposes and that otherwise deductible expenses paid directly or indirectly with such grants would be deductible. Further, ARPA provides that distributions to owners of partnerships and S corporations of such excluded amounts are treated as tax exempt income. ARPA directs the Secretary of the Treasury to prescribe rules for determining a partner's distributive share for purposes of determining a partner's or shareholder's basis in the ownership interest of a partnership or S corporation. It is estimated that state adoption of this provision would decrease state tax revenues by an estimated $15.6 million in 2021-22, $7.5 million in 2022-23, $4.1 million in 2023-24, and a minimal amount thereafter.

13. CARES provided for economic injury disaster loan (EIDL) advances to applicants of up to $10,000, which did not have to be repaid. However, program funding ran out in July, 2020. The CAA later extended the program, now referred to as targeted EIDL advances, and provided that such advances are not taxable. ARPA clarifies for income tax purposes that: (a) targeted EIDL advances are not included in gross income; (b) otherwise deductible expenses cannot be denied because they were paid with EIDL advance proceeds; and (c) distributions to owners of pass-through entities, such as partnerships and S corporations, are tax neutral, in that the forgiveness of indebtedness and other financial assistance is treated as an increase in a partner's or shareholder's basis in the ownership interest of a partnership or S corporation. These provisions are not anticipated to have a fiscal effect because provisions of 2021 Act 1 already conformed state law to federal law in making EIDL advances nontaxable.

14. The Committee could choose to adopt the temporary tax provisions of ARPA (Alternative A2). Table 2 depicts the fiscal effects of state adoption of the temporary tax provisions of ARPA which first apply in tax year 2021. These provisions are estimated to reduce the general fund balance by $32.3 million in 2021-22, $7.5 million in 2022-23, and $4.1 million in 2023-24, and are estimated to have a minimal impact on general fund revenues thereafter.

TABLE 2

Fiscal Effect of State Adoption of Temporary ARPA Tax Provisions Beginning Tax Year 2021 (Millions)

Provision	2021-22	2022-23	2023-24	2024-25	Source
Student Loan Forgiveness Exclusion	Minimal	Minimal	Minimal	Minimal	GPR-Tax
Health Insurance Premium Assistance Exclusion	-$9.8	Minimal	Minimal	Minimal	GPR-Tax
Increased Exclusion for Dependent Care Benefits	-0.9	Minimal	Minimal	Minimal	GPR-Tax
Using 2019 Earned Income for 2021 EITC	6.0	Minimal	Minimal	Minimal	GPR
Restaurant Revitalization Grants Exclusion	-15.6	-$7.5	-$4.1	Minimal	GPR-Tax
Clarify Targeted EIDL Advances	Minimal	Minimal	Minimal	Minimal	GPR-Tax
Subtotal GPR-Tax	-$26.3	-$7.5	-$4.1	Minimal	GPR-Tax
Subtotal GPR	$6.0	Minimal	Minimal	Minimal	GPR
Total Impact on State General Fund	-$32.3	-$7.5	-$4.1	Minimal	

Unemployment Compensation Exclusion for Tax Year 2020, ARPA

15. Unemployment compensation payments are generally taxable under federal law. However, for tax year 2020, ARPA provides that the first $10,200 of unemployment payments received in calendar year 2020 are excluded from taxable income, provided the taxpayer's federal AGI (with certain modifications) is less than $150,000. Eligible married-joint filers are able to exclude up to $10,200 of unemployment compensation received by each spouse (up to $20,400 total).

16. It should be noted that this exclusion for unemployment compensation applies only to tax year 2020. If this provision were adopted for state tax purposes retroactively for tax year 2020, most individuals would have to file an amended return to receive the tax benefit. According to DOR, it does not have the ability to systematically identify individual returns it has received and recompute each individual's tax liability for tax year 2020 on the individual's behalf.

17. State adoption of this provision is estimated to reduce individual income tax revenues by $121.0 million in 2021-22 and by a minimal amount thereafter (Alternative A3).

TCJA Provisions

18. Under state law, a net loss is generally defined as the excess of business expenses allowed as deductions in computing net income over the amount of income attributable to the operation of a trade or business in the state. Under both the individual income tax and the corporate income/franchise tax, net losses can be carried forward and used to offset income for the following 20 years. Under the individual income tax, a net operating loss (NOL) can also be carried back to offset net income in the two prior taxable years. However, state law does not allow for carrybacks of net business losses for purposes of the corporate income/franchise tax.

Under the TCJA, as modified by CARES, noncorporate taxpayers' excess losses are limited in tax years 2021 through 2025. ARPA extends the loss limitation for excess losses through December 31, 2026. Excess losses are defined as the aggregate deductions for business purposes that exceed the sum of the noncorporate taxpayer's gross income or gain plus either the inflation-adjusted amount of $500,000 for married-joint filers or $250,000 for other types of filers. Any losses exceeding this amount may only be carried forward for subsequent tax years. The limitation does not apply to excess farm losses. Under CARES, starting in 2021, excess business losses are determined without regard to deductions, gross income, or gains attributable to any trade or business or performing services as an employee, including any federal deduction allowable for NOLs or qualified business income and deductions for losses and certain gains from the sales or exchanges of capital assets. State law has not adopted these provisions of the TCJA.

Adopting the limitation on excess losses for noncorporate taxpayers beginning in tax year 2021 would increase state individual income tax collections by an estimated $72.9 million in 2021-22, $58.2 million in 2022-23, $56.5 million in 2023-24, and $54.6 million in 2024-25 (Alternative B1).

19. Most business expenses associated with the development or creation of an asset that

has a useful life beyond the current year must be capitalized and depreciated over the useful life of the asset. Amortization provisions allow a taxpayer to annually deduct a portion of certain capital expenses that are not ordinarily deductible. Generally, these expenses are not otherwise deductible because: (a) they relate to assets that are not depreciable because the assets have unlimited or indefinite life; or (b) they pertain to organizational or investigative expenses that were incurred before the taxpayer went into business. Generally, the capital expenses which are amortized are deducted in equal monthly amounts over the amortization period, which depends upon the type of asset that is acquired.

Under state law, researchers can elect to immediately deduct reasonable research or experimentation expenditures associated with the development or creation of a business asset. Researchers also may elect to amortize such expenditures over a five-year or 10-year period, rather than capitalize such expenditures under uniform capitalization rules.

Under the TCJA, for taxable years beginning after December 31, 2021, research and experimental expenditures must be capitalized and amortized ratably over a five-year period, rather than immediately expensed in the year the expenses were incurred. Expenditures attributable to research conducted outside of the United States must be capitalized and amortized ratably over a period of 15 years. The TCJA also expanded the definition of research or experimental expenditures to include expenditures for software development, as well as depreciation and depletion allowances for property other than land that is depreciated or depleted in connection with research or experimentation. State law has not adopted these provisions of the TCJA.

State adoption of this provision would increase state tax revenues by an estimated $63.2 million in 2021-22 and $101.5 million in 2022-23, $98.6 million in 2023-24, and $95.3 million in 2024-25 (Alternative B2).

20. Generally, under cash accounting, income is included in taxable income when actually or constructively received and deductions are allowed when expenses are paid. By contrast, under accrual accounting, revenue and expenses are recognized as of the time a transaction occurs instead of when the payment is made.

The TCJA requires an accrual method taxpayer to recognize income no later than the taxable year in which such income is taken into account as revenue in an applicable financial statement, with an exception for taxpayers without an applicable or other specified financial statement. The TCJA codifies the current deferral method of accounting for advance payments for goods, services, and other specified items to allow accrual method taxpayers to elect to defer the inclusion of income associated with advance receipt if such income is also deferred for financial statement purposes. The TCJA also repeals special rules that apply to the accrual of interest for original issue discount debt instruments (other than mortgage servicing contracts) that have an applicable financial statement, and the change in accounting for such debt instruments must be taken into account ratably over six taxable years.

State adoption of this provision, beginning in tax year 2021, would increase state tax revenues by an estimated $7.9 million in 2021-22, $3.5 million in 2022-23, $3.3 million in 2023-24, and $3.2 million in 2024-25 (Alternative B3).

21. Wisconsin law allows a deduction for interest on indebtedness incurred in the operation of a trade or business. Interest is defined as compensation for the use or forbearance of money. Only interest on actual indebtedness is deductible. Certain types of interest, such as interest incurred for an obligation that is wholly exempt from tax or interest paid that is attributable to the underpayment of tax, cannot be deducted.

Under the TCJA, beginning in tax year 2018, the federal deduction for business interest differs substantially from state law. The federal deduction was limited to the sum of: (a) business interest income; (b) 30% of the taxpayer's adjusted taxable income; and (c) floor plan financing interest of the taxpayer for the taxable year. For tax years 2018 through 2021, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion. Any deduction disallowed as a result of the limit for business interest may be carried forward indefinitely for use in future years. The following entities are exempt from the deduction limit: (1) taxpayers with average gross receipts of less than $25 million over the prior three taxable years; (2) certain regulated public utilities; (3) most businesses engaged in real property development, construction, rental, leasing, or brokerage activities; and (4) farming businesses, as well as certain agricultural or horticultural cooperatives.

State adoption of this provision, beginning in tax year 2021, would increase state tax revenues by an estimated $99.3 million in 2021-22, $95.3 million in 2022-23, $92.6 million in 2023-24, and $89.4 million in 2024-25 (Alternative B4).

22. Ordinary and necessary business expenses related to the operation of a trade or business that are not deducted elsewhere can be deducted under a general miscellaneous category. Prior to tax year 2018, miscellaneous business expenses under state and federal law generally included: (a) 50% of food and beverages provided to employees and 100% if excluded from the gross income of the employee as a de minimis fringe benefit; and (b) 50% of entertainment expenses that are directly related to a taxpayer's active trade or business.

The TCJA repealed the deduction for entertainment expenses beginning in tax year 2018. Further, the TCJA extended the 50% limit to expenses for food and beverages provided for the convenience of the employer through certain eating facilities for amounts incurred and paid after December 31, 2017, and eliminated the deduction for such expenses paid or incurred after December 31, 2025. However, the CAA temporarily allows the full deduction of food or beverages provided by a restaurant between January 1, 2021, and December 31, 2022.

State adoption of this provision, beginning in tax year 2021, would increase state tax revenues by an estimated $10.0 million in 2021-22, $7.8 million in 2022-23, $7.6 million in 2023-24, and $7.3 million in 2024-25 (Alternative B5).

23. State law conforms to previous federal law, which provided a deduction for FDIC premiums paid without limit. Beginning in tax year 2018, taxpayers under federal law may deduct 100% of FDIC premiums only if such assets are less than $10 billion. Taxpayers with total consolidated assets of $50 billion or more may not deduct FDIC premiums. The applicable percentage of the federal deduction is prorated for taxpayers with assets of between $10 billion and $50 billion (for example, if the taxpayer has $20 billion of such assets, 25% of FDIC premiums are

taxable).

It is estimated that state adoption of this provision would increase state tax revenues by $6.5 million in 2021-22, $6.3 million in 2022-23, $6.1 million in 2023-24, and $5.9 million in 2024-25 (Alternative B6).

24. Under state law, salaries, wages, and other forms of remuneration to officers of the business are deductible expenses. However, a publicly-held corporation cannot deduct compensation in excess of $1.0 million per tax year that is paid or accrued to certain executives. The deduction limitation applies to: (a) compensation to the principal executive officer (or an individual acting in that capacity); and (b) any other employee having total compensation required to be reported to shareholders under SEC rules because the employee is among the four highest compensated officers in the tax year. Compensation subject to the limitation includes cash and noncash benefits paid for services except for certain specified types of remuneration, such as commission-based or performance-based compensation. The $1.0 million limit on deductible compensation is reduced by the amount of excess golden parachute payments that are not deductible under the IRC. The deduction is further limited to $500,000 for compensation paid to certain executives of certain health insurance providers.

Under the TCJA, federal law provides that the limit on excess compensation includes remuneration paid on a commission basis and performance-based compensation. The TCJA also expanded the definition of a publicly held corporation to include all domestic publicly traded corporations, including large private C corporations or S corporations that are not publicly traded. Further, an individual who is a covered employee remains a covered employee subject to the $1.0 million deduction limit with respect to compensation otherwise deductible in subsequent years, including years in which the individual is no longer employed by the corporation and in years after the employee has died (for purposes of compensation paid to beneficiaries).

The TCJA also expanded the definition of a covered employee to include the principal financial officer in addition to the principal executive officer and the three most highly compensated officers (five covered employees). This includes any individual that holds the position of principal executive officer or principal financial officer at any time during the taxable year. Effective for taxable years beginning after December 31, 2026, ARPA further expands "covered employees" to include the next five highest paid employees in each taxable year (such persons are not included in future years unless they remain in the top five highest paid).

It is estimated that state adoption of this provision would increase state tax revenues by $4.4 million in 2021-22, $3.3 million in 2022-23, $3.2 million in 2023-24, and $3.1 million in 2024-25 (Alternative B7).

25. The Committee could choose to adopt the TCJA provisions, as described above, beginning in tax year 2021. Table 3 depicts the fiscal effects for state adoption of these provisions, which are estimated to increase state income and franchise tax revenues by $264.2 million in 2021-22, $275.9 million in 2022-23, $267.9 million in 2023-24, and $258.8 million in 2024-25.

TABLE 3

Fiscal Effect of State Adoption of TCJA Tax Provisions (Millions)

Provision	2021-22	2022-23	2023-24	2024-25	Source
Loss limitation for noncorporate taxpayers other than corporations	$72.9	$58.2	$56.5	$54.6	GPR-Tax
Amortization of research and experimental expenditures	63.2	101.5	98.6	95.3	GPR-Tax
Accounting rules for accrual method taxpayers	7.9	3.5	3.3	3.2	GPR-Tax
Limitation on deduction for business interest	99.3	95.3	92.6	89.4	GPR-Tax
Limitation on the deduction for entertainment and meal expenses	10.0	7.8	7.6	7.3	GPR-Tax
Limitation on deduction for FDIC premiums	6.5	6.3	6.1	5.9	GPR-Tax
Modification of the limitation for highly paid individuals	4.4	3.3	3.2	3.1	GPR-Tax
Total	$264.2	$275.9	$267.9	$258.8	GPR-Tax

ALTERNATIVES

A. Tax Law Changes Under ARPA

1. Adopt the following federal tax provisions of ARPA which are permanent: (a) increase EITC disqualified income limit; (b) EITC for certain separated individuals; and (c) repeal worldwide interest allocation election. Estimate increased income and franchise tax collections of $7,800,000 in 2021-22 and $11,100,000 in 2022-23. Also, estimate increased GPR expenditures of $1,900,000 in 2021-22 and $1,600,000 in 2022-23. [This alternative could be adopted in conjunction with any other alternative.]

ALT A1	Change to Base
GPR-Tax	$18,900,000
GPR	3,500,000

2. Adopt the following temporary federal tax provisions of ARPA that apply beginning in tax year 2021: (a) student loan forgiveness exclusion; (b) health insurance premium assistance exclusion; (c) increased exclusion for dependent care benefits; (d) using 2019 earned income for 2021 EITC; (e) restaurant revitalization grants exclusion; and (f) clarify targeted EIDL advances. Estimate reduced individual income tax collections of $26,300,000 in 2021-22 and $7,500,000 in 2022-23. Estimate increased GPR expenditures of $6,000,000 in 2021-22 and a minimal amount thereafter. [This alternative could be adopted in conjunction with any other alternative.]

ALT A2	Change to Base
GPR-Tax	- $33,800,000
GPR	6,000,000

3. Adopt the federal exclusion from gross income included in ARPA for up to $10,200 of unemployment compensation received in tax year 2020. Estimate reduced individual income tax collections of $121.0 million on a one-time basis in 2021-22. [This alternative could be adopted in conjunction with any other alternative.]

ALT A3	Change to Base
GPR-Tax	- $121,000,000

4. Take no action.

B. Tax Law Changes Under TCJA

1. Adopt the federal tax provision of the TCJA regarding the loss limitation for taxpayers other than corporations, as modified by subsequent federal acts to date. Estimate increased income and franchise tax collections of $72,900,000 in 2021-22 and $58,200,000 in 2022-23. [This alternative could be adopted in conjunction with any other alternative.]

ALT B1	Change to Base
GPR-Tax	$131,100,000

2. Adopt the federal tax provision of the TCJA regarding the amortization of research and experimental expenditures, as modified by subsequent federal acts to date. Estimate increased income and franchise tax collections of $63,200,000 in 2021-22 and $101,500,000 in 2022-23. [This alternative could be adopted in conjunction with any other alternative.]

ALT B2	Change to Base
GPR-Tax	$164,700,000

3. Adopt the federal tax provision of the TCJA regarding the accounting rules for accrual method taxpayers, as modified by subsequent federal acts to date. Estimate increased income and franchise tax collections of $7,900,000 in 2021-22 and $3,500,000 in 2022-23. [This alternative could be adopted in conjunction with any other alternative.]

ALT B3	Change to Base
GPR-Tax	$11,400,000

4. Adopt the federal tax provision of the TCJA regarding the limitation on the deduction for business interest, as modified by subsequent federal acts to date. Estimate increased income and franchise tax collections of $99,300,000 in 2021-22 and $95,300,000 in 2022-23. [This alternative

could be adopted in conjunction with any other alternative.]

ALT B4	Change to Base
GPR-Tax	$194,600,000

5. Adopt the federal tax provision of the TCJA regarding the limitation on the deduction for entertainment, amusement, and recreation expenses, as modified by subsequent federal acts to date. Estimate increased income and franchise tax collections of $10,000,000 in 2021-22 and $7,800,000 in 2022-23. [This alternative could be adopted in conjunction with any other alternative.]

ALT B5	Change to Base
GPR-Tax	$17,800,000

6. Adopt the federal tax provision of the TCJA regarding the limitation on the deduction of FDIC premiums. Estimate increased income and franchise tax collections by an estimated $6,500,000 in 2021-22 and $6,300,000 in 2022-23. [This alternative could be adopted in conjunction with any other alternative.]

ALT B6	Change to Base
GPR-Tax	$12,800,000

7. Adopt the federal tax provision of the TCJA regarding the modification of the limitation on the deduction for highly paid individuals, as modified by subsequent federal acts to date. Estimate increased income and franchise tax collections of $4,400,000 in 2021-22 and $3,300,000 in 2022-23. [This alternative could be adopted in conjunction with any other alternative.]

ALT B7	Change to Base
GPR-Tax	$7,700,000

8. Take no action.

Prepared by: Dan Spika, John Gentry, and Sean Moran
Attachment

ATTACHMENT

State Adoption of Select Federal ARPA and TCJA Provisions
Net Fiscal Effect to General Fund
(Millions)

	2021-22	2022-23	2023-24	2024-25	Source
IRC Provisions -- ARPA Provisions					
Increase EITC Disqualified Income Limit	$1.8	$1.5	$1.3	$1.4	GPR
EITC for Certain Separated Individuals	0.1	0.1	0.1	0.1	GPR
Repeal Worldwide Interest Allocation Election	7.8	11.1	13.4	14.2	GPR-Tax
Student Loan Forgiveness Exclusion	Minimal	Minimal	Minimal	Minimal	GPR-Tax
Health Insurance Premium Assistance Exclusion	-9.8	Minimal	Minimal	Minimal	GPR-Tax
Increased Exclusion for Dependent Care Benefits	-0.9	Minimal	Minimal	Minimal	GPR-Tax
Using 2019 Earned Income for 2021 EITC	6.0	Minimal	Minimal	Minimal	GPR
Restaurant Revitalization Grants Exclusion	-15.6	-7.5	-4.1	Minimal	GPR-Tax
Clarify Targeted EIDL Advances	Minimal	Minimal	Minimal	Minimal	GPR-Tax
Unemployment Compensation Exclusion for 2020	-121.0	Minimal	Minimal	Minimal	GPR-Tax
Subtotal GPR-Tax	-$139.5	$3.6	$9.3	$14.2	
Subtotal GPR	$7.9	$1.6	$1.4	$1.5	
IRC Provisions -- TCJA Provisions					
Loss Limitation for Taxpayers other than Corporations	$72.9	$58.2	$56.5	$54.6	GPR-Tax
Amortization of Research and Experimental Expenditures	63.2	101.5	98.6	95.3	GPR-Tax
Accounting Rules for Accrual Method Taxpayers	7.9	3.5	3.3	3.2	GPR-Tax
Limitation on Deduction for Business Interest	99.3	95.3	92.6	89.4	GPR-Tax
Limitation on the Deduction for Entertainment and Meal Expenses	10.0	7.8	7.6	7.3	GPR-Tax
Limitation on Deduction for FDIC Premiums	6.5	6.3	6.1	5.9	GPR-Tax
Modification of the Limitation for Highly Paid Individuals	4.4	3.3	3.2	3.1	GPR-Tax
Subtotal GPR-Tax	$264.2	$275.9	$267.9	$258.8	
Totals					
GPR-Tax	$124.7	$279.5	$277.2	$273.0	
GPR	7.9	1.6	1.4	1.5	
Net Effect on General Fund Balance	$116.8	$277.9	$275.8	$271.5	