open sky POLICY INSTITUTE

***EDITOR'S NOTE:** A description of each CARES Act tax change, as well as the estimate of total revenue reduction, can be found in this Department of Revenue report. The CARES Act tax changes also will be the focus of a Tuesday, July 7 webinar with Adam Thimmesch, associate professor at the University of Nebraska College of Law. The webinar starts at 10 a.m. CT and you can register for it here. Thimmesch has recently written about the CARES Act tax changes and how states can adjust to them in the tax blogs Tax Notes and The Surly Subgroup.*

The federal government recently implemented a series of tax cuts, mostly for businesses, as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Nebraska automatically conforms to these federal changes, and the provisions are set to reduce state revenues by $250 million over the next three years unless the state opts to decouple from the federal law, as several states have done.[1] This $250 million would be on top of other revenue losses caused by the pandemic, which are estimated to be between 10% to 25% of state revenues. Adding this degree of loss on top of the other anticipated losses puts funding for vital state services, and other priorities such as reducing property taxes, at risk.

According to the Nebraska Department of Revenue (DoR), $230 million of the $250 million anticipated revenue loss will come from reduced business taxes. DoR projects $125 million of the revenue loss would hit in FY 21,[2] when economists forecast large state revenue reductions because of the pandemic.[3] As highlighted in a recent brief, pandemic-related revenue losses are already materializing. In FY22 and FY23, businesses are projected to receive $132 million in tax cuts, while individual taxpayers in Nebraska will see a $7 million tax increase because of the federal law.[4]

Revenue losses are primarily due to expansion of Net Operating Loss (NOL) deductions

According to a June 16 handout from the DoR, more than $214 million of the $250 million three-year total decline in state revenue comes from changes to Net Operating Losses (NOL), the amount by which a taxpayer's business deduction exceeds its gross

[1] Nebraska Department of Revenue, "Effects of the Coronavirus Aid, Relief, and Economic Security Act on the State of Nebraska's Tax Revenue," accessed at https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/research/CARES_Act/CARES_Act_Report_5-27-2020.pdf on June 30, 2020.
[2] Nebraska Department of Revenue, "Effects of the Coronavirus Aid, Relief, and Economic Security Act on the State of Nebraska's Tax Revenue," accessed at https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/research/CARES_Act/CARES_Act_Report_5-27-2020.pdf on June 30, 2020.
[3] NCSL, "COVID-19: Fiscal and Economic Issues," accessed at https://readytalk.webcasts.com/starthere.jsp?ei=1294001&tp_key=f22e395e39 on April 8, 2020.
[4] Nebraska Department of Revenue, "Effects of the Coronavirus Aid, Relief, and Economic Security Act on the State of Nebraska's Tax Revenue," accessed at https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/research/CARES_Act/CARES_Act_Report_5-27-2020.pdf on June 30, 2020.

income in a given year.[5] The 2017 Tax Cuts and Jobs Act (TCJA) eliminated taxpayer ability to carry back NOLs and limited the use in any year to 80% of the taxpayer's total income. This measure was intended to raise revenue to offset some of the TCJAs tax cuts. However, the CARES Act allows businesses to carry back losses incurred in tax years ending after Dec. 31, 2017 and before Jan. 1, 2021 for five years and suspended the TCJAs 80% limitation for tax years beginning before 2021.[6] While undoing the intended pay-fors at the national level has no immediate consequence as the country can take on debt, federal tax cuts that are conformed to at the state level can create a huge strain on state budgets, which must be balanced either with increases in other revenues or cuts to state services.

CARES Act tax changes, largely a business tax cut for wealthy Nebraskans in the middle of a pandemic, coincide with push for new business incentive program

The suspension of the 80% limitation includes losses from tax years beginning in 2018 or 2019, meaning the changes are not explicitly targeted to businesses affected by the pandemic. Furthermore, the CARES Act allows pass-through business owners to use NOLs to offset their non-business income above the previous limit of $250,000 (single) or $500,000 (married filing jointly) for 2018, 2019, and 2020.[7] The DoR estimates this change, which would benefit only wealthy taxpayers,[8] would be the most expensive CARES Act tax provision for the state, costing more than $80 million in FY21 alone, and more than $187 million through FY23.[9] The CARES Act tax cuts also coincide with a push to pass a state business tax incentive program that would reduce revenue by about $1 billion through FY 31. The proposed incentive program and CARES Act tax cuts would be in addition to two tax incentive programs already on the books, which are estimated to reduce state revenues by $1.67 billion through FY 28.[10]

CARES Act tax cuts won't occur in a bubble, will likely force funding cuts

Because Nebraska has to balance its budget, any lost revenue due to the CARES Act changes will have to be balanced by increases in other revenues or less funding for key

---

[5] The revenue reductions from changes to treatment of NOLs are shown in lines 4, 7, and 11 of the linked DOR handout.
[6] Adam Thimmesch, "State Tax Conformity: The CARES Act and Beyond," May 21, 2020, accessed at https://www.taxnotes.com/featured-analysis/state-tax-conformity-cares-act-and-beyond/2020/05/21/2cjvb?highlight=Thimmesch on July 6, 2020.
[7] Garrett Watson, "A Review of Net Operating Loss Tax Provisions in the CARES Act and Next Steps for Phase 4 Relief," Tax Foundation, April 14, 2020, accessed at https://taxfoundation.org/phase-4-relief-legislation-net-operating-loss-cares-act/ on June 22, 2020.
[8] Jesse Drucker, "Bonanza for Rich Real Estate Investors, Tucked Into Stimulus Package," *New York Times*, March 26, 2020, accessed at https://www.nytimes.com/2020/03/26/business/coronavirus-real-estate-investors-stimulus.html on June 22, 2020.
[9] Fred Knapp (NET Nebraska," "Estimate of GF Revenues Impact of CARES Act," accessed at https://twitter.com/fredmknapp/status/1272907799530475522/photo/1 on July 8, 2020.
[10] Nebraska Department of Revenue, "Nebraska Tax Incentives 2018 Annual Report to the Nebraska Legislature," accessed at https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/incentives/annual_report/2018_Nebraska_Tax_Incentives.pdf on June 30, 2020.

services. A study examining the effect of tax changes and public spending found that tax cuts may cause an economic boost if they could be enacted without reducing spending, but in practice, tax cuts must go hand in hand with spending cuts at the state level. The study shows that the combination of a tax cut and corresponding funding cuts is likely to have a net negative effect on the state economy.[11] Furthermore, the study found that funding of public services is a better long-term investment than tax cuts, as the economic benefits of increased state investments in key services were significant for six years, while the benefits of the tax cuts lasted only two years.[12]

Some states decoupling from CARES Act tax changes

Although several states don't conform to federal tax changes, many states that do conform are in the process of decoupling from the business tax cuts included in the CARES Act. Georgia,[13] North Carolina[14] and New York have decoupled from certain provisions of the CARES Act tax cuts, while Colorado has a decoupling bill awaiting the Governor's signature.[15]

Just decoupling from NOL provisions could stop significant loss of needed revenue

Decoupling from the CARES Act NOL changes alone would prevent more than $214 million in state revenue losses over the next three years. Rather than providing tax breaks to wealthy residents for business losses that might not even be pandemic-related, the state could preserve this revenue in order to limit the budget cuts that likely will be necessitated by the pandemic.

Conclusion

In the current fiscal climate, the state will likely have to choose between providing CARES Act tax relief or minimizing cuts to key services that will be caused by the fallout from the pandemic. Decoupling from the CARES Act tax cuts could help the state meet

---

[11] Arwiphawee Srithongrung and Kenneth A. Kriz, "The Impact of Sub-national Fiscal Policies on Economic Growth: A Dynamic Analysis Approach, Journal of Policy Analysis and Management, 2014, accessed at https://www.wichita.edu/academics/fairmount_college_of_liberal_arts_and_sciences/hugowall/documents/Research-Wichita-State-University-Hugo-Wall-School-Public-Affairs-Kansas-Public-Finance-Center_Impact-Subnational-Fiscal-Policies-Economic-Growth-Approach-Kenneth-Kriz-Arwiphawee-Srithongrung.pdf on June 22, 2020.

[12] Arwiphawee Srithongrung and Kenneth A. Kriz, "The Impact of Sub-national Fiscal Policies on Economic Growth: A Dynamic Analysis Approach, Journal of Policy Analysis and Management, 2014, accessed at https://www.wichita.edu/academics/fairmount_college_of_liberal_arts_and_sciences/hugowall/documents/Research-Wichita-State-University-Hugo-Wall-School-Public-Affairs-Kansas-Public-Finance-Center_Impact-Subnational-Fiscal-Policies-Economic-Growth-Approach-Kenneth-Kriz-Arwiphawee-Srithongrung.pdf on June 22, 2020.

[13] Lauren Lorricchio, Georgia Legislature Passes Bills on CARES Act, Other Tax Changes," accessed at https://www.taxnotes.com/featured-news/georgia-legislature-passes-bills-cares-act-other-tax-changes/2020/06/30/2cnxr on June 30, 2020.

[14] Bloomberg Tax, "North Carolina Governor Signs Law Decoupling From Federal CARES Act Tax Provisions," July 1, 2020, accessed at https://news.bloombergtax.com/daily-tax-report-state/north-carolina-governor-signs-law-decoupling-from-federal-cares-act-provisions on July 8, 2020.

[15] "Colorado HB1420," accessed at https://legiscan.com/CO/bill/HB1420/2020 on July 8, 2020.

the major challenges presented by the pandemic by preserving $250 million of state revenue that can support vital state services Nebraskans will rely on more than ever. In fact, decoupling from the CARES Act NOL changes alone would preserve $214 million in revenue that Nebraska could use to meet pressing state needs. At a minimum, the situation warrants a conversation about the tradeoffs involved in conforming to the CARES Act tax changes in order to determine what policy choices would most benefit current and future Nebraskans.