Effects of the Consolidated Appropriations Act, 2021, on the State of Nebraska's Tax Revenue

Prepared by the
Nebraska Department of Revenue

February 25, 2021

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DEPARTMENT OF REVENUE

Pete Ricketts, Governor

February 25, 2021

Honorable Pete Ricketts
Governor of Nebraska

Senator Mike Hilgers
Speaker of the Legislature

Senator Dan Hughes
Chairperson of the Executive Board of the Legislative Council

Senator Lou Ann Linehan
Chairperson of the Revenue Committee

Senator John Stinner
Chairperson of the Appropriations Committee

Tom Bergquist
Legislative Fiscal Analyst

Dear Governor, Speaker, Senators, et al.:

I am pleased to present you the report *Effects of the Consolidated Appropriations Act, 2021, on the State of Nebraska's Tax Revenue*.

This report is made pursuant to Neb. Rev. Stat. § 77-27,222, which requires the Department of Revenue to issue a report to the Governor, the Legislative Fiscal Analyst, and select members of the Legislature within 60 days after a change to the Internal Revenue Code of 1986, as amended, detailing the changes to the IRC and the impact of the changes on state income tax revenues and various classes and types of taxpayers. On December 27, 2020, President Trump signed into law the Consolidated Appropriations Act, 2021. This report addresses its impact on state revenues.

Sincerely,

Tony Fulton
Tax Commissioner

Tony Fulton, Tax Commissioner
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**The Impact of the Federal Consolidated Appropriations Act, 2021,
on Nebraska Tax Receipts**

On December 27, 2020, President Trump signed into law the Consolidated Appropriations Act, 2021, P.L. 116-260 (CAA 2021) which amended several provisions of the federal tax code. Nebraska is a state of rolling conformity to the federal tax code. Hence, any changes in the federal tax code can affect the Nebraska Revenue Act of 1967, thereby influencing Nebraska tax receipts. This report summarizes the major provisions of the CAA 2021 and the impact on Nebraska tax receipts. This report first discusses the federal changes affecting Nebraska individual income tax receipts, and then discusses the changes affecting Nebraska business income tax receipts.

This report was prepared pursuant to Neb. Rev. Stat. § 77-27,222, which requires the Nebraska Department of Revenue (DOR) to issue a report to the Governor and the Legislature within 60 days after a change to the Internal Revenue Code of 1986, as amended (IRC), detailing the changes to the IRC and the impact of the changes on Nebraska income tax revenues of more than $5 million, and on various classes and types of taxpayers.

I. Individual Income Tax

In this section, DOR discusses the following major items related to the CAA 2021 changes to the federal taxation of individuals and how such changes will impact Nebraska individual income tax receipts:

- Temporary Charitable Contribution Deduction for Taxpayers Who Do Not Itemize
- Repeals the Tuition and Related Expenses Above-the-Line Deduction, and Increases the Phase-out Threshold of Modified AGI for the Lifetime Learning Educational Tax Credit
- Allows Taxpayers with Farming Losses to Retroactively Elect-Out of CARES Act Treatment of Net Operating Losses Arising in Tax Years Beginning in 2018, 2019, and 2020
- Temporary Rule for Determining Earned Income for First Taxable Year Beginning in 2020
- Extends by One Year the Temporary Increase on the Limitation on Itemized Deductions for Qualified Charitable Contributions
- Decreases the Percentage AGI Threshold to 7.5% from 10% for the Medical and Dental Expense Deduction for Taxable Years Beginning after December 31, 2020
- Exclusion from Gross Income for Students Who Received Qualified Emergency Financial Aid Grants after March 26, 2020
- Temporarily Extends for Five Years the Exclusion from Gross Income of Certain Employer Payments on Student Loans of Employees Made after March 1, 2020
- Modifies and Temporarily Extends for Five Years the Exclusion from Gross Income for Discharged Qualified Principal Residence Indebtedness

Nebraska individual income taxation begins with federal adjusted gross income (AGI) and federal itemized deductions. As such, any changes to the federal tax code that change the component and/or computation of federal AGI and federal itemized deductions will flow through to the Nebraska income tax, possibly impacting the Nebraska individual income tax receipts. The following sections examine each of the federal changes listed above and reports whether each change increases, decreases, or has no impact on Nebraska individual income tax receipts.

Temporary Charitable Contribution Deduction for Taxpayers Who Do Not Itemize

For tax year 2020 only, the CARES Act allows single individuals, heads of household, and married, filing jointly taxpayers who do not itemize deductions to take an above-the-line deduction not to exceed $300 for cash contributions made to qualifying charitable organizations, as defined in IRC § 170(b)(1)(A), other than contributions to supporting organizations as defined in § 509(a)(3) and donor advised funds as defined in § 4966(d)(2). Contributions of noncash property, such as securities, are not qualified contributions. Generally, an above-the-line deduction lowers both federal AGI and the federal taxable income of the taxpayer.

For any taxable year beginning in 2021, the CAA 2021 allows single individuals, heads of household, and married, filing separately taxpayers who do not itemize to deduct up to $300 and married, filing jointly taxpayers to deduct up to $600 for cash contributions made to qualifying charitable organizations, as defined in IRC § 170(b)(1)(A), other than contributions to supporting organizations as defined in § 509(a)(3) and donor advised funds as defined in § 4966(d)(2) made during the tax year. The deduction does not apply to cash contributions carried over from prior tax years, or contributions of noncash property, such as securities. The CAA 2021 provides for an increased penalty for taxpayers who overstate this deduction.

Unlike the CARES Act provision, the CAA 2021 charitable deduction for taxpayers who do not itemize is not an above-the-line deduction. The deduction is claimed after federal AGI is calculated and is in addition to standard and itemized deductions. The deduction affects federal taxable income only. This change will not impact Nebraska individual income tax receipts.

Repeals the Tuition and Related Expenses Above-the-Line Deduction, and Increases the Phase-out Threshold of Modified AGI for the Lifetime Learning Educational Tax Credit

The IRC contains educational tax benefits related to the payment of qualified tuition and related expenses which are required for enrollment or attendance of the taxpayer, taxpayer's spouse, or taxpayer's dependent at an institution of higher education. Eligible expenses generally include expenses for required course materials, and do not include room and board; insurance; transportation costs; and other sports or hobby expenses unrelated to the student's degree program.

Under the IRC, taxpayers may take an above-the-line deduction for qualified tuition and related expenses of up to $4,000, with the amount of the deduction decreasing as the federal AGI of the taxpayer increases. Taxpayers with federal AGI over $80,000 ($160,000 for married filing jointly) cannot claim this deduction. The Lifetime Learning Credit allows a maximum refundable credit up to $2,000 for tuition and related expenses. The credit amount is reduced ratably as the modified AGI of the taxpayer increases. For tax year 2020, the credit amount starts to reduce for taxpayers with modified AGI of $59,000 ($118,000 for married, filing jointly) and is reduced to zero for taxpayers with modified AGI of $69,000 ($138,000 for married, filing jointly). Taxpayers can only claim one educational tax benefit for the eligible expenses of the same student.

The CAA 2021 repealed the above-the-line deduction for qualified tuition and related expenses for tax years beginning after December 31, 2020. In addition, the CAA 2021 increased the modified AGI thresholds for phasing out or reducing the Lifetime Learning Credit. For tax years beginning after December 31, 2020, the Lifetime Learning Credit starts to decrease for taxpayers with modified AGI of $80,000 ($160,000 for married, filing jointly) and decreases to zero for taxpayers with modified AGI of $90,000 ($180,0000 for married, filing jointly). The phase-out threshold is not adjusted for inflation.

The repeal of the above-the-line deduction for qualified tuition and related expenses may increase Nebraska individual income tax receipts. The increased thresholds of the federal Lifetime Learning Credit will not impact Nebraska individual income tax receipts.

Allows Taxpayers with Farming Losses to Retroactively Elect-Out of CARES Act Treatment of Net Operating Losses Arising in Tax Years Beginning in 2018, 2019, and 2020

A net operating loss (NOL) generally means the amount by which a taxpayer's current-year business deductions exceeded its current-year gross income. Under prior law, NOLs could not be deducted in the year generated, but could be carried back two years and carried forward 20 years to offset taxable income in those years. The Tax Cuts and Jobs Act of 2017 (TCJA) amended the federal NOL provisions to provide that taxpayers may deduct an NOL carryover or carryback only to the extent of 80% of the taxpayer's taxable income (determined without regard to the NOL deduction). In addition, the TCJA generally repealed all carrybacks but provided a special one-year carryback for small businesses and farms in the case of certain casualty and disaster losses. A special rule also provided a two-year carryback period for farming losses. But taxpayers could carryforward unused NOLs indefinitely.

The CARES Act enacted several amendments for NOLs arising in tax years beginning in 2018, 2019, and 2020 (tax years beginning after December 31, 2017 and before January 1, 2021). In relevant part, taxpayers must carry back these NOLs to the five taxable years preceding the taxable year of loss unless the taxpayer elects to waive the carryback. The CARES Act also suspended the 80% taxable income limitation on NOLs arising in 2018, 2019, and 2020.

Under the CAA 2021, taxpayers with farming losses arising in tax years beginning in 2018, 2019, and 2020 may make an irrevocable election to apply the two-year carryback period and 80% taxable income limitation under the TCJA. Taxpayers who filed a tax return for a tax year beginning in 2018, 2019, and 2020 before December 27, 2020 applying the TCJA rules are deemed to have made the election. Taxpayers may revoke the deemed election, by filing an amended return applying the CARES Act rules by the due date of the return for the first tax year ending after December 27, 2020.

Under Nebraska law, individuals have the same NOL carryback and carryforward periods as permitted for federal NOLs. In addition, an individual income taxpayer must apply the Nebraska NOL in the same manner as the federal NOL. In general, the allowance of a two-year carryback period for taxpayers with farming losses may decrease Nebraska income tax receipts. The 80% income limitation on the NOL deduction for tax years beginning in 2018, 2019, and 2020 for taxpayers with farming losses may cause a small increase of Nebraska income tax receipts.

Temporary Rule for Determining Earned Income for First Taxable Year Beginning in 2020

For the first tax year beginning in 2020, the CAA 2021 allows taxpayers who have a higher earned income in 2019 than in 2020 to elect to use his or her 2019 earned income amount when calculating the earned income tax credit and the child tax credit. Likewise, taxpayers may use the 2020 earned income if it produces a higher amount.

Except for nonresidents and taxpayers who file married, filing separately returns, Neb. Rev. Stat. § 77-2715.07(2)(e) generally allows a refundable credit equal to 10% of the federal earned income tax credit. Nebraska has no related State child tax credit to the federal child tax credit.

By allowing taxpayers to use higher earned income amounts in 2020 under the CAA 2021, the amount of the federal earned income tax credits will increase causing the related Nebraska earned income tax credit amounts to increase, which will decrease Nebraska individual income tax receipts. The use of increased earned income amounts for the federal child tax credit in 2020 will not impact Nebraska individual income tax receipts.

Extends by One Year the Temporary Increase on the Limitation on Itemized Deductions for Qualified Charitable Contributions

Instead of taking the federal standard deduction, an individual may elect to take his or her federal itemized deductions. Taxpayers who itemize for federal income tax purposes may, for Nebraska income tax purposes, take the greater of the Nebraska standard deduction or the Nebraska modified federal itemized deductions.

For individual taxpayers, the federal itemized deduction for charitable contributions is generally subject to percentage limitations based on the contribution base of the taxpayer. The percentage limitation may vary depending on the type of recipient organization and the property contributed. The contribution base is defined under the IRC as the AGI of the taxpayer computed without regard to any NOL carryback.

For calendar year 2020 only, the CARES Act increased the percentage limitation and allowed a deduction for qualified charitable contributions by an individual of up to 100% of the contribution base for cash contributions made during calendar year 2020 to qualifying charitable organizations, as defined in IRC § 170(b)(1)(A), other than contributions to organizations described in § 509(a)(3) and donor advised funds as defined in § 4966(d)(2). Contributions of noncash property, such as securities, are not qualified contributions. Taxpayers must elect to apply the increased deduction.

The CAA 2021 amends the definition of qualified charitable contribution under the CARES Act, and extends the increased limitation for qualified cash charitable contributions to include calendar year 2021. An individual may carry forward five years any qualified cash contribution exceeding the contribution base. All other requirements under the CARES Act apply. This change increases this itemized deduction, resulting in lower federal AGI and a decrease in Nebraska individual income tax receipts.

Decreases the Percentage AGI Threshold to 7.5% from 10% for the Medical and Dental Expense Deduction for Taxable Years Beginning after December 31, 2020

Generally, taxpayers may only take an itemized deduction for medical and dental expenses that exceed a certain percentage of the taxpayer's federal AGI. Previous federal legislation lowered the federal AGI percentage temporarily from 10% to 7.5% for tax years 2019 and 2020.

For taxable years beginning after December 31, 2020, the CAA 2021 permanently decreases the percentage of federal AGI to 7.5%, which allows taxpayers to take the itemized deduction for all medical and dental expenses incurred during the tax year that exceed 7.5% of his or her federal AGI. The lower federal AGI percentage will increase the itemized deduction, resulting in lower federal AGI and a decrease in Nebraska individual income tax receipts.

Exclusion from Gross Income for Students Who Received Qualified Emergency Financial Aid Grants after March 26, 2020

The CAA 2021 enacts an exclusion from gross income for students who receive qualified emergency financial aid grants made after March 26, 2020. Under this provision, qualified emergency financial aid grants do not reduce the amount of qualified tuition and related expenses for determining the amounts of the federal educational tax credits (American Opportunity Credit and Lifetime Learning Credit). Qualified emergency grants that represent payment for teaching, research, or other services required to receive the grant are not excludable under this provision.

Qualified emergency financial aid grants include grants awarded by an institution of higher education under the CARES Act, and any other emergency financial aid grant made to a student from a federal agency, a State, an Indian tribe, an institution of higher education, or a scholarship-granting organization (including tribal organizations as defined by federal law) for the purposes of providing financial relief to students enrolled at institutions of higher education in response to a qualifying emergency under the CARES Act. The CARES Act defines a qualifying emergency as a federally declared COVID-19 related public health emergency, major disaster, or national emergency.

This exclusion from gross income reduces the federal AGI of individual income taxpayers, which will cause a small decrease in Nebraska individual income tax receipts.

Temporarily Extends for Five Years the Exclusion from Gross Income of Certain Employer Payments on Student Loans of Employees Made after March 1, 2020

Under the IRC, individual taxpayers may claim an exclusion of up to $5,250 from gross income for certain employer-provided assistance. In general, the exclusion does not apply to employer payments to or on behalf of employees for student loans of employees incurred by the employee. The amount of these employer payments are included in the taxable wages of the employees. The CARES Act expanded the definition of "educational assistance," and provided an exclusion from gross income of up to $5,250 of an employee for employer payments to a lender or to the employee on a qualified student loan of the employee made after March 27, 2020 and before January 1, 2021. The employee cannot claim a deduction for the interest paid by the employer under this provision.

The CAA 2021 extends this exclusion five years, meaning employees may claim this exclusion from gross income for qualifying payments made by his or her employer on a student loan of the employee if made after March 27, 2020 and before January 1, 2026. An exclusion from gross income reduces the federal AGI of the individual income taxpayer, which will cause a decrease in Nebraska individual income tax receipts.

Modifies and Temporarily Extends for Five Years the Exclusion from Gross Income for Discharged Qualified Principal Residence Indebtedness

Under the IRC, individuals can exclude from gross income up to $2,000,000 ($1,000,000 for married, filing separately returns) of qualified principal residence indebtedness discharged or forgiven during a taxable year before December 31, 2020. The term qualified principal residence indebtedness includes any debt secured by a principal residence that is incurred in acquiring, constructing, or substantially improving a principal residence, as well as, debts resulting from refinancing such debts. A taxpayer can only have one principal residence, and it is generally the home where the taxpayer lives the majority of the time.

The CAA 2021 extends the exclusion from gross income of discharged qualified principal residence indebtedness five years, but lowers the amount subject to exclusion. Specifically, the CAA 2021 provides taxpayers may exclude from gross income up to $750,000 ($350,000 for married, filing separately returns) of the indebtedness of a qualified principal residence discharged after December 31, 2020 and before January 1, 2026. The temporary federal extension will allow taxpayers to take the exclusion from gross income for discharged principal residence indebtedness which will lower federal AGI generally, but the lower exclusion amount may cause less of a decrease in federal AGI for these individual income taxpayers. This exclusion will decrease taxable income, and decrease Nebraska individual income tax receipts.

II. Business Income Tax

In this section, DOR discusses the following major items related to the changes in the taxation of corporations and businesses other than corporations under the CAA 2021 and how it impacts Nebraska's corporation and business income tax receipts.

- Amendments to the Refundable Employee Retention Credits Enacted under the CARES Act
- Extends Deferral of Delayed Payments of Employee Portion of Employment Taxes
- Amendments to the Tax Treatment of Forgiven Paycheck Protection Program Loans and Other Federal Financial Assistance
- Allows Taxpayers with Farming Losses to Retroactively Elect-Out of CARES Act Treatment of Net Operating Losses Arising in Tax Years Beginning in 2018, 2019, and 2020
- Temporary Increase in Business Meal Deduction Limitation for Food and Drinks from Restaurants Paid or Incurred on or after January 1, 2021 and on or before December 31, 2022
- Extends Percentage Limitation Increase in CARES Act to Qualified Charitable Contributions Made by Corporations in Calendar Year 2021

- Extends Percentage Limitation Increase under CARES Act for Food Inventory Charitable Contribution Deduction to Contributions Made by Non-Corporate and Corporate Taxpayers in 2021
- Temporary Increase in Percentage Limitation for Qualified Disaster Relief Contributions made by Corporations on or after January 1, 2020 and on or before February 25, 2021
- Allows for Depreciation of Residential Rental Property over 30-Year Period Held by Certain Electing Real Property Trades or Businesses

Amendments to the Refundable Employee Retention Credits Enacted under the CARES Act

The CAA 2021 extended and made changes to the refundable employee retention credit enacted under the CARES Act. The following description first details provisions in the CARES Act, and then explains the changes due to the CAA 2021, some apply as if enacted with the CARES Act and some apply in 2021.

1. The CARES Act

Under the CARES Act, eligible employers are allowed a refundable credit against the employer's portion of Old-Age, Survivors, and Disability Insurance tax under IRC § 3111(a) or the Railroad Retirement Tax Act under IRC § 3221(a) (employment taxes) for each calendar quarter of up to 50% of the qualified wages paid to each employee in a calendar quarter. The credit is limited to $10,000 of the qualified wages paid to each employee for all calendar quarters between March 13, 2020 and December 31, 2020. The maximum credit is $5,000 of qualified wages paid to any employee for all calendar quarters.

Employers carrying on a trade or business in calendar year 2020 must meet one of two tests to claim the credit: (1) the governmental order test, which requires that a governmental order fully or partially suspended operations due to COVID-19; or (2) the reduced gross receipts test, which requires that the employer experienced a significant decline or a 50% decline in gross receipts for any calendar quarter in 2020 as compared to the same calendar quarter in 2019. The significant decline in gross receipts ends either with the first calendar quarter of 2021, or the first calendar quarter in 2020 after the quarter where the employer's quarterly gross receipts are greater than 80% for the same calendar quarter in 2019.

Qualified wages have a different meaning for small and large employers. For employers with 100 or less full-time employees on average in 2019 (small employers), qualified wages means the wages paid when the employer met the governmental order or reduced receipts test. For employers with over 100 full-time employees on average in 2019 (large employers), qualified wages means wages paid to employees for the time the employees do not provide services because the employer met the governmental order or reduced receipts test. In addition, the wages paid by large employers cannot exceed the amount the employees would have been paid for working an equivalent duration during the 30 days immediately before the period that the employer met either test.

Employers may choose not to apply the credit in a calendar quarter. The allowed credit amount cannot exceed the employment taxes imposed on the employer, reduced by certain credits under the IRC and the Families First Coronavirus Response Act. If the credit amount exceeds the employer's portion of employment taxes for the calendar quarter, the difference is treated as an overpayment and is refunded to the employer.

An IRC § 501(c) organization may qualify as an eligible employer. Employers that receive a small business interruption loan under the Paycheck Protection Program (PPP) are ineligible. The credit generally does not apply to government employers, such as the U.S. government; state or political subdivisions; or any government agency or instrumentality.

2. The CAA 2021

The CAA 2021 extends the refundable credit for qualified wages paid through June 30, 2021. Effective March 27, 2020 (the CARES Act enactment), health plan expenses are treated as wages to the extent the amounts are properly allocable to the employee, rather than to qualified wages. Effective January 1, 2021, the CAA 2021 increases the amount of the credit to 70% of qualified wages paid per employee in a calendar quarter. The CAA 2021 also changes the limit to $10,000 per employee per calendar quarter. In 2021, the maximum credit per employee per calendar quarter is $7,000, for a total of $14,000.

The CAA 2021 amends the reduced gross receipts test. Effective January 1, 2021, the CAA 2021 no longer uses the term "significant decline," and lowers the percentage from 50% to a 20% decline. Employers meet the test in 2021, if the gross receipts for the calendar quarter are less than 80% of the gross receipts for the same calendar quarter in 2019. Employers not in existence in 2019 may calculate gross receipts by comparison to the same calendar quarter in 2020. Employers also may compare the decline in gross receipts for the immediately preceding calendar quarter (i.e., the fourth calendar quarter in 2020 or the first calendar quarter in 2021) to the same calendar quarter in 2019.

The CAA 2021 increases the threshold number of employees to be considered a large employer to more than 500 employees on average in 2019. The CAA 2021 also modifies the term qualified wages for large employers to means wages paid during the time the employee does not provide services because the employer meets either the governmental order or reduced gross receipts test. The CAA 2021 eliminates the limitation for large employers based on the amount the employee would have been paid 30 days immediately preceding the period when the employer met either test.

The CAA 2021 prohibits advance payments of the credit to large employers. Large employers must claim the credit before filing employment tax returns by reducing employment tax deposits. Small employers, employers with less than 500 employees on average in 2019, may request advance payments. Advance payments are limited to 70% of the average quarterly wages paid by the employer in calendar year 2019 or, if not in existence in 2019, in calendar year 2020. The refundable credit must be reduced, but not below zero, by the aggregate amount of any advance payments.

Effective March 27, 2020 (the CARES Act enactment), the CAA 2021 retroactively allows employers who received small business interruption loans under the PPP to claim the credit for qualified wages not treated as payroll costs in obtaining forgiveness of the PPP loan. Effective

January 1, 2021, the CAA 2021 allows certain governmental employers to claim the credit, including governmental employers that are IRC § 501(c)(3) tax-exempt organizations; colleges or universities; and entities whose principal function is providing medical or hospital care.

The amendments to the employee retention credit in the CAA 2021 will generally increase taxable income, and increase Nebraska tax receipts.

Extends Deferral of Delayed Payments of Employee Portion of Employment Taxes

On August 8, 2020, President Trump issued a memorandum directing the Treasury Secretary to allow employers to defer the employee portion of federal employment taxes on wages paid during the period of September 1, 2020 to December 31, 2020. The deferral applies to employees whose biweekly, pre-tax wages are less than $4,000, or a similar amount in a different pay period. The Treasury Secretary determined this relief applies to those employers required to withhold and pay the employee portion of employment taxes that are affected by the COVID-19 emergency. The employers must begin withholding and paying the deferred taxes in the period beginning on January 1, 2021 and ending on April 30, 2021, with interest penalties, and additions to tax on unpaid taxes beginning to accrue on May 1, 2021.

The CAA 2021 changes the withholding and payment period for the above deferred employee-share of employment taxes to the period beginning January 1, 2021 and ending December 31, 2021. Employers must withhold and pay the deferred taxes ratably from wages and compensation paid during 2021. In addition, penalties, interest, or other additions to tax on the unpaid deferred taxes begin to accrue on January 1, 2022. The postponement of the employee portion of employment taxes will not impact Nebraska tax receipts.

Amendments to the Tax Treatment of Forgiven Paycheck Protection Program Loans and Other Federal Financial Assistance

The CARES Act established the Paycheck Protection Program (PPP) that provides loans to small businesses impacted by the COVID-19 pandemic. Loan amounts used to cover payroll and employee health insurance costs, mortgage or rent obligations, and certain utility payments between February 15, 2020 and June 30, 2020 may be forgiven. The federal government subsequently extended the PPP loan dates to August 8, 2020. The forgiven amounts are considered canceled indebtedness. Any forgiven loan amount that would otherwise be included in gross income of the loan recipient, is excluded from gross income. A § 501(c) organization may qualify.

The CARES Act established other forms of financial assistance for small businesses impacted by the COVID-19 pandemic as well, including allowing banks and other lenders to make PPP loans under the U.S. Treasury Program Management Authority (CARES Act § 1109); providing Economic Disaster Injury Loan advances and grants (§ 1110); and financial payments by the Small Business Administration of principal, interest, and fees of certain loans to small businesses (§ 1112(c)).

Generally, IRC § 162 allows a deduction for all ordinary and necessary expenses paid or incurred in a trade or business during the taxable year. Under the CARES Act, however, no deduction was allowed if the payment of expenses resulted in the forgiveness of a PPP loan.

The CAA 2021 extended the period for making PPP loans to March 31, 2021, and made several clarifying amendments. The CAA 2021 provides that all forgiven PPP loans and other financial assistance received from the above CARES Act programs are excluded from gross income. In addition, the forgiven loans are not considered canceled indebtedness. The CAA 2021 provides that the exclusion from gross income of these amounts does not result in a denied deduction, a reduced tax attribute, or a denied basis increase. In relevant part, the CAA 2021 permits recipients of forgiven loans or other financial assistance from the federal CARES Act programs to take the ordinary and necessary business expense deduction for eligible expenses paid with these amounts.

The exclusion from gross income of federal PPP loans and other federal financial assistance for businesses impacted by the COVID-19 pandemic will not impact Nebraska tax receipts. The allowance of deductions for payments made with amounts received from these CARES Act programs will increase deductions, decrease taxable income, and decrease Nebraska income tax receipts.

Allows Taxpayers with Farming Losses to Retroactively Elect-Out of CARES Act Treatment of Net Operating Losses Arising in Tax Years Beginning in 2018, 2019, and 2020

The federal NOL provisions and the CAA 2021 changes were discussed in depth within the Nebraska individual income tax section. The CARES Act will impact Nebraska corporation income tax receipts because, depending on the year of loss, Nebraska law permits corporations to carryforward NOLs for a specified number of tax years succeeding the year of loss. That said, Nebraska law does not allow corporations to carryback NOLs. See Neb. Rev. Stat. § 77-2734.07.

In general, the CAA 2021 change that allows taxpayers with farming losses to elect-out of the CARES Act treatment of NOLs, and apply the 80% income limitation on the NOL deduction for tax years beginning in 2018, 2019, and 2020 may cause a small increase in Nebraska corporate income tax receipts.

Temporary Increase in Business Meal Deduction Limitation for Food and Drinks from Restaurants Paid or Incurred on or after January 1, 2021 and on or before December 31, 2022

Under the IRC, businesses may generally take a deduction for business meals, which is generally limited to 50% of the cost. The deduction is subject to additional requirements, such as the expense must be ordinary and necessary; not lavish or extravagant; and the taxpayer or employee of the taxpayer and a current or potential business associate must be present for the business meal.

The CAA 2021 increased the limitation on the business meal expense deduction to 100% for amounts paid or incurred for food or beverages provided by a restaurant after December 31, 2020 and before January 1, 2023. All other limitations required under the IRC still apply. The increased percentage limitation on the business meal deduction for meals at restaurants will result in increased deductions, a decrease in taxable income for businesses, and will result in a decrease in Nebraska corporate and other business income tax receipts.

Extends Percentage Limitation Increase in CARES Act to Qualified Charitable Contributions Made by Corporations in Calendar Year 2021

Before the CARES Act, corporations were allowed a deduction for charitable contributions up to 10% of the corporation's taxable income, subject to certain modifications. During calendar year 2020, the CARES Act allowed a deduction by corporations up to 25% of the taxpayer's taxable income for qualified cash charitable contributions made to qualifying charitable organizations. Contributions of noncash property, such as securities, are not qualified contributions. Taxpayers must elect to have contributions treated as qualified contributions. If a corporation's contributions exceed the 25% limitation, the excess contributions may be carried over to the next five tax years.

The CAA 2021 amended the definition of qualified charitable contribution under the CARES Act to extend the increased limitation on the deduction to qualified cash charitable contributions made by corporations in calendar year 2021. All other requirements under the CARES Act apply. The increased percentage limitation for corporate qualified charitable contributions results in more deductions, a decrease in the taxable income of corporations, and will cause a decrease in Nebraska corporate income tax receipts.

Extends Percentage Limitation Increase under CARES Act for Food Inventory Charitable Contribution Deduction to Contributions Made by Non-Corporate and Corporate Taxpayers in 2021

Any taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to claim a deduction for donations of food inventory under IRC § 170(e)(3)(C). For taxpayers other than C corporations, the total deduction for donations of food inventory generally may not exceed 15% of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships from which contributions of food are made. For C corporations, food inventory contributions are subject to a 15% of taxable income (as modified) limitation.

The CARES Act increased the limitation to 25% for food inventory contributions made during 2020. The CAA 2021 extends the CARES Act provision to apply to food inventory contributions made in 2021. The increased limitation on the deduction for charitable contributions of food inventory will generally result in more deductions and decrease taxable income, causing a decrease in Nebraska income tax receipts.

Temporary Increase in Percentage Limitation for Qualified Disaster Relief Contributions made by Corporations on or after January 1, 2020 and on or before February 25, 2021

As discussed above, before the CARES Act, corporations were allowed a deduction for charitable contributions up to 10% of the corporation's taxable income, subject to certain modifications. The CARE Act increased the limitation to 25% for qualified cash charitable contributions.

The CAA 2021 increases the percentage limitation to 100% for qualified disaster relief contributions made between January 1, 2020 and February 25, 2021. Qualified disaster relief contributions are any qualified charitable contribution made in cash to qualifying organizations, as defined in the CARES Act, for use in relief efforts in one or more qualified disaster area. All other limitations on qualified charitable contributions under the CARES Act apply.

Qualified disaster areas include any area in which a major disaster was declared by the President, between January 1, 2020 and February 25, 2021, under § 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act if the incident period of the declared disaster begins on or after December 18, 2019 and on or before December 27, 2020. Qualified disaster areas do not include areas where disasters were declared solely due to COVID-19. The incident period is the period that the Federal Emergency Management Agency has specified as the period when the disaster occurred.

In determining the deduction, qualified contributions other than qualified disaster relief contributions must be treated as allowed contributions under IRC § 170(b)(2). The increased 25% limitation on the charitable contribution deduction under the CARES Act must be applied first without regard to any qualified disaster relief contribution, and then separately to such qualified disaster relief contribution. Corporate taxpayers must elect to apply the qualified disaster relief contribution rules, and must receive a contemporaneous written acknowledgement from the organization that the contribution was, or will be, used for relief efforts in the qualified disaster area.

The increased limitation for qualified disaster relief charitable contributions will increase the deduction, decrease taxable income, and cause a decrease in Nebraska corporate tax receipts.

Allows for Depreciation of Residential Rental Property over 30-Year Period Held by Certain Electing Real Property Trades or Businesses

For residential rental property placed in service after December 31, 2017, the TCJA reduced the ADS recovery period from 40 years to 30 years. But the ADS recovery period remained 40 years for residential rental property placed in service before January 1, 2018. In addition, the TCJA generally limited the business interest expense deduction for businesses with average annual gross receipts of $25 million or less for tax years beginning after 2017. A real property trade or business could elect out of the business interest expense limitation. However, beginning in the year of election, the electing real property trade or business must depreciate any nonresidential, residential rental, and qualified improvement property using the ADS recovery period.

The CAA 2021 amends the TCJA to provide that the ADS 30-year recovery period applies to residential rental property placed in service before January 1, 2018 that is held by a real property trade or business that elects out of the business interest limitation. To apply, the real property trade or business must elect out of the business interest limitation in a tax year beginning after 2017, and the property must not have been depreciated using ADS before January 1, 2018. The shortened recovery period will increase the depreciation deduction, which will decrease taxable income for these taxpayers. This change will decrease Nebraska income tax receipts.

III. Estimates for Nebraska's Business and Individual Income Tax Receipts Due to the CAA 2021.

The above discussion highlights the areas of the CAA 2021 that contribute most significantly to Nebraska's tax receipts; however, this report does not include all changes made by the CAA 2021. For a complete list of changes, please refer to the federal legislation. Furthermore, this report does not include any analysis of federal tax liability.

DOR employed various data sources to analyze the impact of the CAA 2021 on Nebraska individual and business income tax receipts. The data DOR utilized included DOR's internal individual income tax data where in-house data were available. Where DOR does not have in-house data to analyze the fiscal impact of the changes, DOR derived its estimates by utilizing the estimates provided by the Joint Committee on Taxation (JCT). DOR analyzed which provisions would impact the State the most and used the estimated fiscal impact at the federal level provided by the JCT. DOR then analyzed the tax base at the federal level relative to the Nebraska tax base to derive its estimates.

The estimated fiscal impact to Nebraska's individual and business income tax receipts for tax fiscal year FY2020-21 through FY 2024-25 due to the CAA 2021 are as follows:

Fiscal Year	Individual Income Tax	Corporation Income Tax	Total
FY2020-21	$ (44,640,000)	$ (3,770,000)	$ (48,410,000)
FY2021-22	$ (36,460,000)	$ (9,970,000)	$ (46,430,000)
FY2022-23	$ (15,770,000)	$ (9,580,000)	$ (25,350,000)
FY2023-24	$ (15,130,000)	$ (5,510,000)	$ (20,640,000)
FY2024-25	$ (11,520,000)	$ (4,070,000)	$ (15,590,000)

The provision contributing to the largest change in income tax receipts under the CAA 2021 is the deductibility of forgivable Paycheck Protection Program (PPP) loans. For the fiscal impact, DOR utilized data from the Small Business Administration (SBA) on the first round of PPP loans that were issued in Nebraska, and assumes the same distribution ratio will occur on the second round of PPP. Of the approximately $156 million in total reduction in revenue over the next five fiscal years, the provision on the deductibility of PPP accounts for approximately $131 million.

Appendix – Estimated Revenue Impact on Nebraska of the Consolidated Appropriations Act, 2021

	Provisions	FY20-21	FY21-22	FY22-23	FY23-24	FY24-25
1	Temporary Charitable Contribution Deduction for Taxpayers Who Do Not Itemize ($300/$600 MFJ)	No Revenue Impact				
2	Repeal of the Tuition and Related Expenses Above-the-Line Deduction	$ -	$ 960,000	$ 990,000	$ 1,020,000	$ 1,060,000
3	Temporary Rule for Determining Earned Income for First Taxable Year Beginning in 2020	$ (2,270,000)	$ -	$ -	$ -	$ -
4	Extension of Temporary Increase on Limitations on Itemized Deductions for Qualified Charitable Contributions	$ (560,000)	$ (2,480,000)	$ 680,000	$ 580,000	$ 330,000
5	Decreases the Percentage AGI Threshold to 7.5% from 10% for the Medical and Dental Expense Deduction for Taxable Years Beginning after December 31, 2020	$ (290,000)	$ (1,420,000)	$ (1,700,000)	$ (1,760,000)	$ (1,840,000)
6	Exclusion from Gross Income for Students Who Received Qualified Emergency Financial Aid Grants after March 26, 2020	$ (100,000)	$ (80,000)	$ (10,000)	$ -	$ -
7	Temporarily Extends for Five Years the Exclusion from Gross Income of Certain Employer Payments on Student Loans of Employees Made after March 1, 2020.	$ (380,000)	$ (840,000)	$ (890,000)	$ (940,000)	$ (990,000)
8	Modifies and Temporarily Extends Five Years the Exclusion from Gross Income for Discharged Qualified Residence Indebtedness	$ (70,000)	$ (580,000)	$ (740,000)	$ (760,000)	$ (780,000)
9	Amendments to the Refundable Employee Retention Credits Enacted under the CARES Act	$ 480,000	$ 20,000	$ -	$ -	$ -
10	Amendments to the Tax Treatment of Forgiven Paycheck Protection Program Loans and Other Federal Financial Assistance	$ (42,810,000)	$ (36,920,000)	$ (20,310,000)	$ (17,860,000)	$ (13,060,000)
11	Temporary Increase on Business Meal Deduction Limitation for Food and Drinks from Restaurants Paid or Incurred on or after January 1, 2021 and on or before December 31, 2022	$ (1,130,000)	$ (3,790,000)	$ (2,920,000)	$ (610,000)	$ -
12	Temporary Increase in Percentage Limitation for Qualified Disaster Relief Contributions made by Corporations on or after January 1, 2020 and on or before February 25, 2021	$ (140,000)	$ (20,000)	$ 50,000	$ 30,000	$ 20,000
13	Allows for Depreciation of Residential Rental Property over 30-Year Period Held by Certain Electing Real Property Trades or Businesses	$ (1,090,000)	$ (1,140,000)	$ (380,000)	$ (240,000)	$ (240,000)
14	Other Remaining Provisions	$ (50,000)	$ (140,000)	$ (120,000)	$ (100,000)	$ (90,000)
	Total	**$ (48,410,000)**	**$ (46,430,000)**	**$ (25,350,000)**	**$ (20,640,000)**	**$ (15,590,000)**