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DFA INCOME TAX NOTICE – OCTOBER 11, 2022

**IMPACT OF STATE INCOME TAX LAW ON FEDERAL BENEFITS UNDER
THE AMERICAN RESCUE PLAN ACT OF 2021 (ARPA)**

INTRODUCTION

On March 10, 2021, Congress enacted its most recent round of stimulus legislation in response to the Covid-19 pandemic: the American Rescue Plan Act of 2021 (ARPA).¹ The ARPA created new federal programs and extended and expanded programs created by the Coronavirus Aid, Relief, and Economic Security (CARES) Act.² The focus of this memo is on the Arkansas income tax consequences of benefits that Arkansas taxpayers may receive under the ARPA.

DISCUSSION

A. Businesses

1. Paycheck Protection Program (PPP) Loans. Section 5001 of the ARPA modifies and expands the Paycheck Protection Program, which was a CARES Act program that provides for loans to small businesses to cover payroll costs, continuation of group health care benefits, and expenses such as rent, mortgage, and utilities. The PPP also provides for loan forgiveness up to 100% of the principal amount borrowed. The ARPA provided additional funding for the PPP program and expanded eligibility to nonprofit organizations, domestic marketing organizations with less than 300 employees, and internet news and publishing organizations with less than 500 employees.

On March 2, 2021, the 93rd General Assembly enacted Act 248, which exempted PPP loan forgiveness from gross income that would be subject to Arkansas income tax.³ Act 248 also provided that PPP loan proceeds are deductible as business expenses regardless of whether the taxpayer has received loan forgiveness.⁴ In addition, the Act adopted provisions of federal legislation that exempted “subsequent Paycheck Protection loan forgiveness” from gross income and provided that subsequent forgiven PPP loans remain deductible as business expenses.

¹ American Rescue Plan Act of 2021, HR1319, 117th Cong. (as engrossed Mar. 10, 2021).

² Pub. L. 116-136 (H.R. 748), enacted March 27, 2020.

³ See Ark. Code Ann. § 26-51-404(b)(31) (Supp. 2021).

⁴ *Id.*

Income that a business receives as a result of loan forgiveness under the PPP Program authorized by the ARPA **IS NOT** subject to Arkansas corporate and individual income tax as taxable gain that is includable in the taxpayer's gross income. *See* Ark. Code Ann. § 26-51-404(b)(31) (Supp. 2021). In addition, a PPP loan authorized by ARPA that would otherwise qualify as a business expense deduction will remain deductible for Arkansas income tax purposes even if the taxpayer receives loan forgiveness. *Id.*

2. Emergency SBA Economic Injury Disaster Loan (EIDL) Grants. Section 5002 of the ARPA provides an additional \$15 billion in funding for grants to applicants who are waiting for approval of SBA EIDL loans.

These emergency EIDL grant funds **ARE** subject to Arkansas individual or corporate income tax because they constitute net income of the business. *See* Ark. Code Ann. § 26-51-201 (Repl. 2020); Ark. Code Ann. § 26-51-205 (Repl. 2020). Arkansas law allows a deduction for eligible business expenses, including expenses that a business incurs by using EIDL grant funds, if the expense otherwise qualifies as a business expense under state income tax law. *See* Ark. Code Ann. § 26-51-423(a)(1) (Repl. 2020) (adopting 26 U.S.C. § 162, as an effect on January 1, 2019, regarding trade or business expenses).

3. Employer Tax Credits for Paid Sick and Family Leave. Section 9641 of the ARPA expands employer tax credits for paid sick and family leave first passed under the CARES Act.

This federal tax credit **IS NOT** income that is subject to Arkansas corporate and individual income tax as taxable gain that is includable in the taxpayer's gross income. *See, generally,* Ark. Code Ann. § 26-51-404 (Supp. 2021).

4. Employee Retention Credit. Section 9651 of the ARPA expanded the Employee Retention Credit under the CARES Act.

This federal tax credit **IS NOT** income that is subject to Arkansas corporate and individual income tax as taxable gain that is includable in the taxpayer's gross income. *See, generally,* Ark. Code Ann. § 26-51-404 (Supp. 2021). Arkansas law allows a deduction for eligible business expenses, including qualified wages funded through the federal employee retention credit, if the expenses otherwise qualify as a business expense under state income tax law. *See* Ark. Code Ann. § 26-51-423(a)(1) (Repl. 2020) (adopting 26 U.S.C. § 162, as an effect on January 1, 2019, regarding trade or business expenses).

5. Additional COVID-19 Relief Under ARPA for Specific Organizations. The ARPA added several new sources of COVID-19 relief to specific organizations, including: (1) \$28.6 billion in Restaurant Revitalization grants; (2) \$1.25 billion for shuttered venue operators grants; (3) \$3 billion for aviation manufacturing job protection grants; (4) \$15 billion for airline and airline contractors for the extended Payroll Support Program; and (5) \$10.4 billion for USDA grant and loan forgiveness programs.

Funds received under these programs **ARE** subject to Arkansas individual or corporate income tax because they constitute net income of the business. *See* Ark. Code Ann. § 26-51-201

(Repl. 2020); Ark. Code Ann. § 26-51-205 (Repl. 2020). Arkansas law allows a deduction for eligible business expenses, including expenses that a business incurs by using grant funds, if the expense otherwise qualifies as a business expense under state income tax law. *See* Ark. Code Ann. § 26-51-423(a)(1) (Repl. 2020) (adopting 26 U.S.C. § 162, as an effect on January 1, 2019, regarding trade or business expenses).

B. Individuals

6. Individual Tax Rebates (Stimulus Recovery Rebate Checks). Section 9601 of the ARPA provided additional recovery rebates for individuals in the maximum amount of \$1,400 per qualifying adult (\$2,800 for joint filers) and \$1,400 per qualifying child.

The federal recovery rebate checks **ARE NOT** subject to Arkansas individual income tax because the ARPA treats them as a credit against the taxpayer's federal income tax obligations and not as additional taxable wages or income. *See, generally,* Ark. Code Ann. § 26-51-404 (Supp. 2021).

7. Child Tax Credits. Section 9611 of the ARPA increased the child tax credit from \$2,000 to \$3,600 for children under age six and to \$3,000 for children aged 6 to 17. The additional credit is phased out for single taxpayers between \$40,000 and \$80,000, \$50,000 to \$100,000 for head of household, and \$60,000 to \$120,000 for joint filers.

The federal child tax credit **IS NOT** subject to Arkansas individual income tax because the ARPA treats them as a credit against the taxpayer's federal income tax obligations and not as additional taxable wages or income. *See, generally,* Ark. Code Ann. § 26-51-404 (Supp. 2021).

8. Earned Income Tax Credit (EITC). Sections 9621-9623 of the ARPA expanded the EITC for childless individuals, reduced the minimum age from 25 to 19, and eliminated the maximum age, previously 65.

The federal EITC **IS NOT** subject to Arkansas individual income tax because the ARPA treats it as a credit against the taxpayer's federal income tax obligations and not as additional taxable wages or income. *See, generally,* Ark. Code Ann. § 26-51-404 (Supp. 2021).

9. Dependent Care Assistance Credit. Sections 9631-9632 of the ARPA expanded the Dependent Care Assistance Credit by increasing the cap on qualifying expenses from \$3,000 to \$8,000 for one child and from \$6,000 to \$16,000 for two or more children. It also increased the percentage of expenses eligible for the credit from 35% to 50% for those with less than \$125,000 of income. The credit is phased down to 20% of expenses for those with income of up to \$183,000 and then from 20% to zero for those with income up to \$438,000.

The federal dependent care assistance credit **IS NOT** subject to Arkansas individual income tax because the ARPA treats it as a credit against the taxpayer's federal income tax obligations and not as additional taxable wages or income. *See, generally,* Ark. Code Ann. § 26-51-404 (Supp. 2021).

10. Insurance Premium Tax Credit. Section 9661 of the ARPA expanded the premium tax credit that allows a credit for insurance purchased through the federal or state marketplace for taxpayers making up to 400% of \$12,760 per year for individuals, \$17,240 for families of two, and \$26,200 for families of four.

The federal insurance premium tax credit **IS NOT** subject to Arkansas individual income tax because the ARPA treats it as a credit against the taxpayer's federal income tax obligations and not as additional taxable wages or income. *See, generally*, Ark. Code Ann. § 26-51-404 (Supp. 2021).

11. Emergency Rental Assistance Grants. Section 3201 of the ARPA included an additional \$21.55 billion in Emergency Rental Assistance grants for renters and landlords after the Consolidated Appropriations Act of 2020 appropriated \$25 billion in such grants.

Funds received under this program **ARE** subject to Arkansas individual or corporate income tax because they constitute net income. *See* Ark. Code Ann. § 26-51-201 (Repl. 2020); Ark. Code Ann. § 26-51-205 (Repl. 2020). Arkansas law allows a deduction for eligible business expenses, including expenses that a business incurs by using grant funds, if the expense otherwise qualifies as a business expense under state income tax law. *See* Ark. Code Ann. § 26-51-423(a)(1) (Repl. 2020) (adopting 26 U.S.C. § 162, as an effect on January 1, 2019, regarding trade or business expenses).

Summary of State Income Tax Applicability to ARPA Programs

ARPA Program	Section(s)	Is it subject to Arkansas income tax?	Are related business expenses deductible?
Businesses			
Forgiven Paycheck Protection Program (PPP) Loans	5001	No	Yes
Emergency SBA Economic Injury Disaster Loan (EIDL) Grants	5002	Yes	Yes
Employer Tax Credits for Paid Sick and Family Leave	9641	No	N/A
Employee Retention Credit	9651	No	Yes
Restaurant Revitalization Grant	9673	Yes	Yes
Shuttered Venue Operator Grant	5005	Yes	Yes
Aviation Manufacturing Job Protection Grant	7201 <i>et seq.</i>	Yes	Yes
Extended Payroll Support Program for Airlines and Airline Contractors	7301	Yes	Yes
USDA Grant and Loan Forgiveness Programs	1006	Yes	Yes
Individuals			
Individual Tax Rebates (Stimulus Recovery Rebate Checks)	9601	No	N/A
Child Tax Credit	9611	No	N/A
Earned Income Tax Credit (EITC)	9621- 9623	No	N/A
Dependent Care Assistance Credit	9631- 9632	No	N/A
Insurance Premium Tax Credit	9661	No	N/A
Emergency Rental Aid Assistance Grants	3201	Yes	Yes