

Effects of the American Rescue Plan Act of 2021 on the State of Nebraska's Tax Revenue

**Prepared by the
Nebraska Department of Revenue**

May 11, 2021

NEBRASKA

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DEPARTMENT OF REVENUE



Pete Ricketts, Governor

May 11, 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 American Rescue Plan Act of 2021 on the State of Nebraska's Tax Revenue*.

The 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, (IRC) 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 March 11, 2021, President Biden signed into law the American Rescue Plan Act of 2021. This report addresses its impact on the State of Nebraska.

Sincerely,

Tony Fulton
Tax Commissioner

The Impact of the Federal American Rescue Plan Act of 2021 on Nebraska Tax Receipts

On March 11, 2021, President Biden signed into law the [American Rescue Plan Act of 2021, P.L. 117-2](#) (ARPA) which amended several provisions of the federal tax code, i.e., the Internal Revenue Code of 1986, as amended (IRC). 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 ARPA and the impact on Nebraska tax receipts. It 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 any changes to the IRC, detailing the changes and the impact of the changes on Nebraska income tax revenues of more than \$5 million, and the impact on various classes and types of taxpayers.

I. Individual Income Tax

In this section, DOR discusses the following major items related to the ARPA changes to the federal taxation of individuals and how these changes will impact Nebraska individual income tax receipts. The report includes the ARPA changes to the:

- Earned Income Tax Credit;
- Child Tax Credit;
- Child and Dependent Care Tax Credit;
- Exclusion of Employer-Provided Dependent Care Assistance;
- Exclusion for Unemployment Compensation Received in 2020; and
- Tax Treatment of Discharged or Cancelled Qualified Student Loans in 2021 to 2025.

Nebraska individual income taxation begins with federal adjusted gross income (AGI) and federal itemized deductions. Therefore, 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.

Earned Income Tax Credit

The ARPA made many changes to the federal earned income tax credit (EITC): some apply only to any taxable year beginning in 2021, and some apply to all taxable years beginning after 2020. This section will (1) provide a brief description of the federal EITC; (2) describe the temporary changes; (3) describe the permanent changes; and (4) describe the impact that the ARPA changes to the federal EITC will have on Nebraska individual income tax receipts.

Brief Description of the Federal EITC

The federal EITC provides a refundable tax credit to taxpayers who have earned income with AGI below a threshold amount during the taxable year. The amount of the EITC and applicable threshold amount depends on the marital status, the number of qualifying children claimed by the taxpayer, and the earned income amount of the taxpayer. In addition, there are several factors that may disqualify taxpayers from claiming the federal EITC.

Temporary Changes

For the first taxable year beginning in 2021, the ARPA allows taxpayers who have a higher earned income in 2019 than in 2021 to elect to use the 2019 earned income amount when calculating the 2021 EITC. In general, this change should allow taxpayers to claim higher EITC amounts.

The ARPA also enacted several changes to the EITC for taxpayers who have no qualifying children for any taxable year beginning in 2021 (the taxable year beginning after December 31, 2020 and before January 1, 2022). Generally, taxpayers who have no qualifying children may claim the federal EITC if the taxpayer (1) does not qualify as a dependent of another taxpayer for the tax year; (2) has a principal place of abode in the United States for more than one-half of the tax year; and (3) is at least age 25 and under age 65 at the end of the tax year.

To determine the EITC amount, a credit percentage applies to the earned income amount of the taxpayer up to a statutory limit. For taxpayers with no qualifying children in 2021, the credit percentage is 7.65% and the statutory limit is \$4,220 (not adjusted for inflation). The EITC also phases out for taxpayers when the phaseout percentage of the taxpayer's AGI or earned income, whichever is greater, exceeds the phaseout amount. For taxpayers with no qualifying children in 2021, the phaseout percentage is 7.65% and the phaseout amount is \$5,280 for single and head of household taxpayers, and \$10,280 for married, filing jointly taxpayers (not adjusted for inflation).

For any taxable year beginning in 2021, the ARPA expands the age range for taxpayers with no qualifying children. The ARPA eliminates the maximum age, allowing taxpayers with no qualifying children who are above age 65 at the end of the year to claim the EITC. In addition, the ARPA decreases the minimum age for claiming the credit to: (1) age 19, generally; (2) age 18, if the taxpayer is a qualified foster youth or qualified homeless youth; and (3) age 25, if the taxpayer is a specified student who is not a qualified foster youth or qualified homeless youth.

The ARPA increases both the credit percentage and phaseout percentage for taxpayers with no qualifying children from 7.65% to 15.3%. The statutory limit on the earned income amount is increased from \$4,220 to \$9,820, and the phaseout amount for single and head of household taxpayers is increased from \$5,280 to \$11,610. The ARPA temporary changes to the EITC for taxpayers with no qualifying children generally increases the number of taxpayers qualifying for the EITC and may allow higher EITC amounts.

Permanent Changes to the Federal EITC

The ARPA enacted several changes to the federal EITC for taxable years beginning after December 31, 2020. Married, filing separately taxpayers generally cannot claim the federal EITC. To claim the EITC, married taxpayers must file joint returns. Married taxpayers may be treated as unmarried if the following IRC § 7703 requirements are met: (1) the taxpayer files a separate return and maintains as a home a household that, for at least half of the tax year, is also the principal place of abode of a dependent child; (2) the taxpayer furnishes over half of the costs of maintaining the household during the tax year; and (3) the spouse of the taxpayer is not a member of the household during the last six months of the tax year.

Taxpayers with qualifying children do not qualify for the federal EITC if the children's identification numbers are not included on the taxpayer's income tax return. In addition, taxpayers with investment income during the tax year above a certain limit do not qualify. Adjusted for inflation, the investment income limit was \$3,650 for taxable years beginning in 2021.

For taxable years beginning after December 31, 2020, the ARPA changes how separated spouses who do not file joint returns may be treated as unmarried. Under the ARPA, a taxpayer may be treated as unmarried if: (1) the taxpayer is married but does not file a joint return; (2) the taxpayer resides with a qualifying child of the taxpayer for more than one half of the tax year; and (3) either (a) the taxpayer does not have the same principal place of abode as his or her spouse for the last six months of the tax year; or (b) the taxpayer has a separation decree, instrument, or agreement (other than a divorce decree) as defined in IRC § 121(d)(3)(C) and is not a member of the spouse's household at the end of the tax year.

Further, the ARPA eliminates the requirement that taxpayers with qualifying children must provide the children's identification numbers for tax years beginning after 2020. In addition, the ARPA increases the investment income limitation on claiming the federal EITC to \$10,000, and provides the amount will be adjusted for inflation each year after 2021.

Except for nonresidents and taxpayers who file married, filing separately Nebraska returns, [Neb. Rev. Stat. § 77-2715.07\(2\)\(e\)](#) generally allows a refundable credit equal to 10% of the federal EITC. The above temporary changes for tax year 2021 and the permanent changes to the federal EITC allow more taxpayers to qualify for the federal EITC and more taxpayers to claim higher federal EITC amounts. The federal changes will generally increase the related Nebraska earned income tax credit amounts, which will decrease Nebraska individual income tax receipts.

Child Tax Credit

Under IRC § 24, taxpayers may claim a \$2,000 federal child tax credit for each qualifying dependent child who has not reached the age of 17 during the taxable year. If the child tax credit exceeds the tax liability of the taxpayer, the taxpayer may qualify for the additional child tax credit. The additional child tax credit allows certain taxpayers to claim up to \$1,400 of the \$2,000 child tax credit as a refund. The additional child tax credit is subject to further limitations, including that the taxpayers must have at least \$2,500 of earned income as determined in IRC § 32. The child tax

credit and additional child tax credit are reduced (but not below zero) by \$50 for each \$1,000 (or fraction thereof) by which the modified AGI exceeds \$400,000 for taxpayers filing married, filing jointly returns and \$200,000 for taxpayers filing any other return.

For any taxable year beginning in 2021 (after December 31, 2020 and before January 1, 2022), the ARPA makes the child tax credit fully refundable for taxpayers (for joint returns, if one spouse) that have a principal place of abode in the United States for at least one-half of the tax year. In addition, the ARPA increases the age of qualifying children to children who have not reached the age of 18 during the tax year.

The ARPA increases the child tax credit to \$3,000 for each qualifying child or \$3,600 for qualifying children who have not reached age six at the end of the calendar year for which the tax year begins. In addition, the credit is reduced by \$50 for each \$1,000 (or fraction thereof) of AGI over: (1) \$150,000 for married, filing jointly taxpayers; (2) \$112,500 for head of household taxpayers; or (3) \$75,000 for all other taxpayers. This reduction in the credit amount is further limited to the lesser of: (1) the increased credit amount in tax year 2021 (\$1,000 for qualifying children or \$1,600 for qualifying children under age six); or (2) 5% of the applicable phaseout range. The applicable phaseout range is the pre-2021 phaseout threshold of the taxpayer (AGI over \$400,000 for married, filing jointly taxpayers, and \$200,000 for all other taxpayers) minus the applicable phaseout threshold for the increased credit.

Because Nebraska law has no related child tax credit, the ARPA changes to the federal child tax credit will not impact Nebraska individual income tax receipts.

Child and Dependent Care Tax Credit

Generally, the child and dependent care tax credit in IRC § 21 allows eligible taxpayers a nonrefundable tax credit to cover up to 35% of the employment-related child and dependent care expenses incurred by the taxpayer for the care of one or more qualifying individuals. Married taxpayers must file married, filing jointly returns to claim this credit. The maximum amount of expenses taken into account for the credit during the tax year is \$3,000 for taxpayers caring for one qualifying individual and \$6,000 for taxpayers caring for two or more qualifying individuals. This amount is reduced by amounts excluded from gross income under an employer-dependent care assistance program in IRC § 129. The 35% maximum credit percentage of the employment-related dependent care expenses is reduced, but not below 20%, for each \$2,000 of AGI exceeding \$15,000. Because the federal credit is nonrefundable, the taxpayer loses any credit exceeding the taxpayer's federal income tax liability.

Employment-related expenses generally mean expenses paid for the care of one or more qualifying individuals and any household services expenses that are incurred by the taxpayer to remain gainfully employed. Qualifying individual means: (1) a dependent of the taxpayer under age 13; or (2) a spouse or dependent of the taxpayer who shares the same principal place of abode with the taxpayer for more than one-half of the tax year, and who is physically or mentally incapable of self-care.

For any taxable year beginning in 2021 (after December 31, 2020 and before January 1, 2022), the ARPA made several changes to the federal child and dependent care tax credit. The ARPA makes the credit refundable for taxpayers who have a principal place of abode in the United States for at least one-half of the tax year. The ARPA increases the amount of the credit from \$3,000 to \$8,000 for taxpayers caring for one qualifying individual, and from \$6,000 to \$16,000 for taxpayers caring for two or more qualifying individuals. In addition, the ARPA increases the credit percentage from 35% to 50%, and changes the AGI amount when the credit begins to phaseout from \$15,000 to \$125,000. For any taxable year beginning in 2021, the ARPA also defines the term phaseout percentage to mean 20% reduced (but not below zero) by 1 percentage point for each \$2,000 (or fraction thereof) by which the AGI of the taxpayer for the taxable year exceeds \$400,000.

Under [Neb. Rev. Stat. § 77-2715.07\(2\)\(b\)](#), Nebraska generally allows resident and partial-year resident taxpayers with AGI of \$29,000 or less a refundable credit equal to a percentage of the federal child and dependent care tax credit in IRC § 21, whether or not the federal credit was limited by federal income tax liability. The percentage of the federal credit is 100% for taxpayers with AGI less than \$22,000, and is reduced by 10% for each \$1,000, or fraction thereof, that federal AGI exceeds \$22,000. In addition, Nebraska allows resident and partial-year resident taxpayers a nonrefundable tax credit equal to 25% of the federal child and dependent care tax credit who have AGI greater than \$29,000. Generally, married taxpayers must file married, filing jointly Nebraska returns to claim the Nebraska dependent and child care tax credit.

The temporary changes to the federal child and dependent care tax credit for tax year 2021 will generally increase the amount of the credit, which will cause an increase in the related Nebraska child and dependent care tax credit amounts. As a result, this ARPA change will generally decrease Nebraska individual income tax receipts.

Exclusion of Employer-Provided Dependent Care Assistance

Under IRC § 129, taxpayers may exclude up to \$5,000 (\$2,500 for married, filing separately taxpayers) from gross income for amounts paid or incurred by an employer for a nondiscriminatory dependent care assistance program. To qualify for the exclusion, the program must be a separate written plan of the employer provided for the exclusive benefit of its employees and the benefits provided under the program must not discriminate in favor of highly compensated employees. No deduction or credit is allowed for amounts excluded from gross income by an employee for dependent care assistance.

For the tax year beginning in 2021 (after December 31, 2020 and before January 1, 2022), the ARPA increases the dependent care assistance exclusion to \$10,500 for single, heads of household, and married, filing jointly taxpayers and to \$5,250 for married, filing separately taxpayers. The increased exclusion will decrease the federal AGI of taxpayers, and will cause a decrease in Nebraska individual income tax receipts.

Exclusion for Unemployment Compensation Received in 2020

Generally, gross income includes unemployment compensation. For any tax year beginning in 2020 only, the ARPA allows taxpayers with a modified AGI of less than \$150,000 to exclude up to \$10,200 in unemployment compensation received in 2020. For married, filing jointly taxpayers, each spouse may exclude up to \$10,200 in unemployment compensation received by the spouse in 2020, making the maximum exclusion \$20,400 for these returns.

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

Tax Treatment of Discharged or Cancelled Qualified Student Loans in 2021 to 2025

Generally, gross income includes any income realized by the taxpayer from the cancellation or discharge of debt. For student loans, IRC § 108(f) provides some exceptions to the general rule for certain discharged or cancelled student loans. One exception allows for an exclusion between tax years 2017 and before 2026 for amounts of discharged or cancelled student loans because of the student's death, or total or permanent disability. The student loan must have been made from a qualified lender to assist the taxpayer in attending an eligible educational institution, as defined by federal law.

The ARPA provides that an individual may exclude from gross income the amount of certain student loans, as defined by the ARPA, which are cancelled or discharged between calendar years 2021 and 2025 (after December 31, 2020 and before January 1, 2026). The exclusion only applies to the student loans as defined in IRC § 108(f)(5) by the ARPA. The exclusion does not apply to private education loans or loans made by an educational organization, as defined by IRC § 170(b)(1)(A)(ii), if the discharge is on account of services provided to the private lender or organization. In effect, the ARPA replaces the exclusion from gross income for student loans discharged or cancelled on account of the death or total or permanent disability of the student.

The broader exclusion from gross income for student loans cancelled or discharged between 2021 and 2025 will allow more taxpayers to take the federal exclusion. The increase in the exclusion will cause federal AGI of individual income taxpayers to decrease, and will generally decrease Nebraska individual income tax receipts.

II. Business Income Tax

In this section, DOR discusses the major item related to the changes in the taxation of corporations and businesses other than corporations under the ARPA and how it impacts Nebraska corporation and business income tax receipts. The following section addresses the refundable employee retention credit as enacted under the ARPA.

The Refundable Employee Retention Credit Enacted under the ARPA

This report will only discuss the employee retention credit as enacted by the ARPA. Under the ARPA, eligible employers are allowed a refundable employee retention credit against the employer's portion of the Medicare tax under IRC § 3111(b) or the Railroad Retirement Tax Act (RRTA) Tier 1 tax under IRC § 3221(a) as attributable to the rate in effect under IRC § 3111(b) (employment taxes) for each calendar quarter of up to 70% of the qualified wages paid by the eligible employer for that calendar quarter.

In general, the ARPA employee retention credit is limited to \$10,000 of qualified wages paid to each employee employed by an eligible employer between July 1, 2021 and December 31, 2021 (after June 30, 2021 and before January 1, 2022). For recovery startup businesses (as defined below), the total credit amount allowed after applying the \$10,000 qualified wage limit to each employee cannot exceed \$50,000 for any calendar quarter.

An eligible employer means: (1) an employer that was carrying on a trade or business during the calendar quarter for which the credit is determined; and (2) either (a) a governmental order due to COVID-19 fully or partially suspended its business operations; or (b) the employer's gross receipts for the calendar quarter are less than 80% of the gross receipts for the same calendar quarter in 2019; or (c) the employer is a recovery startup business. A recovery startup business is an employer that: (1) started carrying on a trade or business after February 15, 2020; (2) had average annual gross receipts for the three-taxable-year period ending with the tax year that precedes the calendar quarter for which the credit is determined did not exceed \$1,000,000; and (3) for such calendar quarter, (a) a governmental order due to COVID-19 did not fully or partially suspend its business operations, and (b) whose gross receipts for the calendar quarter were not less than 80% of the gross receipts for the same calendar quarter in 2019.

Employers may elect to compare the gross receipts for the immediately preceding calendar quarter to the corresponding calendar quarter in calendar year 2019. If the employer did not exist during the corresponding quarter in 2019, the election will compare the gross receipts for the immediately preceding calendar quarter to the corresponding calendar quarter in calendar year 2020.

Generally, the ARPA employee retention credit does not apply to the U.S. government, the government of any state or political subdivision, or any agency or instrumentality thereof. However, the following tax exempt entities may claim the credit: (1) IRC § 501(c)(1) organizations; (2) public colleges and universities; and (3) public entities whose principal purpose is providing medical or hospital care.

The meaning of the term qualified wages depends on the average number of full-time employees employed by the eligible employer during 2019. For employers with an average of more than 500 full-time employees during 2019 (large employers), qualified wages means the wages paid to employees when the employees are not working because: (1) a governmental order due to COVID-19 partially or fully suspended business operations; or (2) the gross receipts for the calendar quarter are less than 80% of the gross receipts for the same calendar quarter in 2019. For eligible employers with an average of 500 or fewer full-time employees in 2019 (small employers), qualified wages

means any wages paid to an employee when: (1) a governmental order due to COVID-19 partially or fully suspended business operations; or (2) the gross receipts for the calendar quarter are less than 80% of the gross receipts for the same calendar quarter in 2019. If the eligible employer did not exist in 2019, it may determine the qualified wages using the average number of full-time employees during 2020. Qualified wages includes amounts paid to provide and maintain a group health plan to the extent the amounts are excluded from the employees' income and are properly allocable to the employee in the manner as provided by the IRS.

The ARPA employee retention credit does not include wages paid to related individuals, as provided in IRC § 51(i)(1). The ARPA employee retention credit also does not apply to wages taken into account as payroll costs with the following: (1) Paycheck Protection Program (PPP) loans received under §§ 7(a)(37) or 7A of the Small Business Act (SBA); (2) grants received under § 324 of the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act; or (3) restaurant revitalization grants received under § 5003 of the ARPA. The ARPA directs the Treasury Secretary to issue guidance providing that payroll costs paid will not fail to be treated as qualified wages, if the taxpayer's loan received under §§ 7(a)(37) or 7A of the SBA is not forgiven.

The ARPA generally does not allow advance payments of the employee retention credit. But small employers may elect to receive an advance payment. The advance payment is limited to 70% of the average quarterly wages paid by the small 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 payment.

The allowed credit amount also cannot exceed the employment taxes imposed on the employer, reduced by allowed credits under the IRC §§ 3131 and 3132. 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. In addition, eligible employers must reduce its deductions for wages and salaries by the amount of the ARPA employee retention credit.

The ARPA employee retention credit will generally increase taxable income, and increase Nebraska tax receipts.

III. Estimates for Nebraska Tax Receipts Due to the Major Components of the ARPA

The above discussion highlights the areas of the ARPA that contribute most significantly to Nebraska tax receipts; however, this report does not include all changes made by the ARPA to the IRC. 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 ARPA on Nebraska income tax receipts. The data DOR utilized included internal income tax data, where available. If DOR did not have internal data to analyze, DOR derived its estimates by utilizing the estimates provided by the Joint Committee on Taxation (JCT). DOR analyzed which provisions of the ARPA would impact State revenue 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 income tax receipts for fiscal years FY2020-21 through FY2023-24 from the major items enacted by the ARPA are as follows:

Amounts are in Thousand Dollars				
Provision / Fiscal Year	FY20-21	FY21-22	FY22-23	FY23-24
Earned Income Tax Credit	\$ -	\$ (5,951)	\$ (442)	\$ (452)
Child Tax Credit	<i>No Impact on Tax Receipts</i>			
Child and Dependent Care Tax Credit	\$ -	\$ (14,954)	\$ (787)	\$ -
Exclusion of Employer-Provided Dependent Care Assistance	<i>Included in Child and Dependent Care Tax Credit Estimate</i>			
Exclusion for Unemployment Compensation Received in 2020	\$ (29,253)	\$ (12,537)	\$ -	\$ -
Tax Treatment of Discharged or Cancelled Qualified Student Loans in 2021-2025	<i>Minimal</i>			
Refundable Employee Retention Credit	\$ (827)	\$ (175)	\$ -	\$ -
Total	\$ (30,080)	\$ (33,617)	\$ (1,229)	\$ (452)