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TO: Lindsey Kurrle, Secretary, Agency of Commerce and Community Development
Joan Goldstein, Commissioner, Department of Economic Development

DATE: April 30, 2021

RE: Use of federal tax loss for purposes of businesses' eligibility for COVID-19 financial assistance

I'm aware that the program guidance issued by ACCD on April 27, 2021 for the Economic Recovery Bridge Grant program uses 2020 federal tax loss to establish eligibility for grants consistent with the requirements of H.315 (Act 9). Focusing on tax loss may help target limited resources to businesses that need assistance to remain viable.

However, clarification is needed in the program guidance to avoid reliance on a tax-based measure that is not representative of losses associated with the COVID-19 public health emergency and to prevent grant awards that exceed business need. Also, there are some inconsistencies in terminology in the guidance that should be addressed.

<u>Certain deductions in federal tax loss overstate businesses' need for financial assistance and should be excluded</u>

- Depreciation, amortization, and carryforward of prior year(s) losses do not reflect the impact of the COVID-19 public health emergency on business operations but are included in the calculation of tax loss. Depreciation and amortization are non-cash expenses that reduce earnings but not cash flows.[1] Tax losses from prior years existed before the COVID-19 pandemic.
- To better understand aspects of federal tax loss that could exaggerate businesses' need for financial assistance, ACCD should consult the Department of Taxes and request advice about whether there are items that should be excluded from tax loss because they are not a result of the pandemic.

<u>Lack of a threshold for qualifying losses and no consideration of the extent of the tax loss in the grant award calculation means that businesses with slight losses could receive awards up to $150,000</u>

- Per Act 9 and ACCD's program guidance, it appears the following scenario could occur:

[1] Depreciation and amortization are accounting methods of allocating the cost of an asset over its useful life or life expectancy.

    - Example: Business A’s 2020 tax loss is $50,000 greater than in 2019. Business B’s 2020 tax loss is $175,000 greater than in 2019. Both businesses’ monthly fixed expenses are $50,000. Each will receive a $150,000 award (3 times fixed monthly expenses) even though Business A’s increase in tax loss is significantly less.
- ACCD’s guidance specifies that businesses must demonstrate a greater net loss in 2020 than reported in 2019 (substantiated by federal tax returns) but does not require a minimum percentage increase to be eligible. Additionally, the award amount is the lessor of three times fixed monthly expenses or $150,000 but does not establish a cap based on the extent of the increase in losses.
- To prevent awards that are much greater than a business’ tax loss, ACCD should consider whether to establish a minimum percentage increase in tax loss and/or whether the award amount could be limited to the increase in tax loss or a multiple of the tax loss.

The program guidance uses multiple different terms for loss (tax loss, net loss, net tax loss). One consistent term should be used, and it would be helpful if the term were clearly defined. In addition, the guidance mentions calculating net income based on submitted monthly P&Ls and adjusted net operating income in footnote 2, but it’s not clear how these calculations relate to the requirement for businesses to demonstrate a federal tax loss greater in 2020 than in 2019.