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TO: All Senators and Staff

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RE: Fiscal Recovery Funds

On Monday, May 10, 2021, the U.S. Treasury adopted Interim Final Rule RIN 1505-AC77 regarding the use of Coronavirus State and Local Fiscal Recovery Funds. Below is a list of answers to frequently asked questions about the funding, including some questions and answers about the guidance contained in the Interim Final Rule. The answers contained in this document are preliminary. Senate Counsel, Research and Fiscal Analysis staff continue to review the contents of the Interim Final Rule (IFR) and will make updates to this document as necessary.

What is Minnesota's allocation of State Fiscal Recovery Funds (SFRF) provided by the American Rescue Plan Act (ARPA)?
Minnesota was allocated $2.833 billion of Fiscal Recovery Funds.

How was this allocation determined?
ARPA provided $195.3 billion for the Coronavirus State Fiscal Recovery Fund (CSFRF) to be distributed to the 50 states and the District of Columbia—$25.5 billion was allocated equally, $754.9 million was allocated specifically to the District of Columbia, and the remaining $169 billion was allocated based on each entity's share of national unemployment spanning the three-month period ending with December 2020.

When will Fiscal Recovery Funds be made available?
Minnesota may now request its allocation of Coronavirus State and Local Fiscal Recovery Funds. Upon application, Minnesota, like the majority of state recipients, will receive these funds in two payments. The federal government will deliver the first 50 percent in May 2021. The federal government will deliver the remaining 50 percent 12 months later, in May 2022.

What is the timeline for the use of Fiscal Recovery Funds?
Minnesota may use the funds for costs incurred beginning on March 3, 2021, through December 31, 2024. With regard to these funds, "incurred" means "obligated." Unlike the Coronavirus Relief Funds, it does not mean "expended" (i.e. the service has been performed or the goods acquired). Within that meaning, the funding must be expended by December 31, 2026.

In other words, Minnesota must return any funds not obligated by December 31, 2024, and any funds not expended to cover such obligations by December 31, 2026.

What are the eligible uses for the funds?
The ARPA identified several eligible uses for the funds. The fact sheet published by Treasury in conjunction with the IFR provides a detailed description of these uses:

1. *Support public health expenditures, by, for example, funding COVID-19 mitigation efforts, medical expenses, behavioral healthcare, and certain public health and safety staff;*
2. *Address negative economic impacts caused by the public health emergency, including economic harms to workers, households, small businesses, impacted industries, and the public sector;*
3. *Replace lost public sector revenue, using this funding to provide government services to the extent of the reduction in revenue experienced due to the pandemic;*
4. *Provide premium pay for essential workers, offering additional support to those who have and will bear the greatest health risks because of their service in critical infrastructure sectors; or*
5. *Invest in water, sewer, and broadband infrastructure, making necessary investments to improve access to clean drinking water, support vital wastewater and stormwater infrastructure, and to expand access to broadband Internet.*

Fiscal Recovery Funds can be used to replace lost revenue. How is the replacement amount determined?
The amount of SFRF that may be used to replace lost revenue is calculated using the difference between actual revenue during the covered period and a counterfactual trend of what revenue might have been, if not for the pandemic. The counterfactual trend for Minnesota will be calculated using FY19 own-source revenue adjusted using the higher of the average annual growth rate for FY17-FY19 or 4.1 percent.

The difference between the state's actual revenue in the reporting year and the counterfactual amount estimated is the amount that may be used in the provision of government services to replace lost revenue. It should be noted that SFRF allowable for use in replacing lost revenue provides a broader set of eligible uses.

The amount of lost revenue that Minnesota may replace under this calculation is a subset of the state's total SFRF allocation ($2.833 billion). The lost revenue calculation does not add additional resources to the allocation. Fiscal staff are working through the data and calculations to provide an estimate of Minnesota's revenue loss based on the guidance. This estimate will be provided when it is available.

What is "General Revenue from Own-sources," as defined by the Census methodology?
The IFR requires a specific revenue definition to be used for the purpose of calculating a state's revenue loss. The definition of own-source revenue for the purposes of SFRF closely mirrors the definition of own-source revenue used in the state's submission to the Census Bureau's Annual Survey of State and Local Government Finances.

As defined by the Census Bureau for that purpose, own-source revenue is composed of three categories: 1) taxes (individual, corporate, sales, etc.); 2) charges and fees; and 3) miscellaneous other revenues (interest earnings, special assessments, sale of property, etc.).

Consequently, this definition will combine revenue sources from several different Minnesota funds and accounts into a single revenue definition for this purpose. The definition will be different than most common approaches to Minnesota revenue that is used in the legislative context. Additional information will be presented when it is available.

Is the replacement of lost revenue calculated separately by fund or by revenue category, or is it calculated in aggregate?
According to the IFR, "In calculating revenue loss, recipients will look at general revenue in the aggregate, rather than a source-by-source basis. Given that recipients may have experienced offsetting changes in revenue across sources, Treasury's approach provides a more accurate representation of the effect of the pandemic on overall revenues."

What are impermissible uses for the funds?
Funds may only be put towards eligible uses. However, Congress explicitly identified two ineligible use of funds:

1. The funds may not be used "to either directly or indirectly offset a reduction in … net tax revenue … resulting from a change in law, regulation or administrative interpretation during the covered period that reduces any tax … or delays the imposition of any tax or tax increase."
2. The funds may not be used for deposit into any pension fund. For purposes of this context, the IFR defines a "deposit" as an "extraordinary payment" that reduces an accrued, unfunded liability incurred before the start of the COVID-19 public health emergency and occurs outside the recipient's regular timing for making such payments. Contributions to a pension fund are an eligible use of funds if they are routine contributions for employees whose wages and salaries are an eligible use of funds.

Additionally, the IFR identifies several categories of generally ineligible uses of funds including debt service, legal settlements or judgments, deposits in budget reserves, and general infrastructure spending, not including water, sewer, or broadband. Spending on these items is generally prohibited unless there is a connection to the eligible uses identified above.

What are the consequences of putting funds toward an impermissible use?
Funding that is put towards impermissible uses could be subject to recoupment by the Treasury Department. Recoupment is limited to the amount of funds put towards an impermissible use and will not include the entire amount, unless the entire amount was put towards an impermissible use.

Is tax conformity an eligible use of the funds?
Tax conformity is not identified in ARPA or the IFR as an eligible use of these funds. However, the IFR further expands on an earlier statement by Treasury on April 7, 2021, that net tax reductions resulting from conformity would not be subject to the offset (recoupment) provisions that apply to any net tax reductions. Admittedly, this is complex because the penalty for an impermissible use of funds is recoupment of funds. The distinction here appears to be that state resources allocated to conform state tax code to the federal tax base will not factor into the

calculation of net tax reductions for the purposes of recoupment. However, as a general matter, SFRF funding could be recouped if the resources are directly spent on an ineligible use.

According to the guidance, can Minnesota reduce taxes and not be subject to the offset provisions relating to a net tax reduction?
Yes, under certain circumstances. The guidance outlines how Treasury will determine if a net tax reduction has occurred and whether a state would be subject to recoupment. The determination is multipart, with two key exceptions.

1. For each reporting year within the covered period, Minnesota will need to determine the total value of revenue reducing changes. This amount would be determined using the same methodology for revenue estimates used in budgeting.
    a. Exception 1 – De Minimis: If the total value of revenue reducing changes for the reporting year is below a de minimis amount, the state is not subject to the offset provisions. The de minimis amount is one percent of baseline tax revenue. Based on the most recent available census data, the estimated de minimis amount for Minnesota is an amount less than ≈$275 million.
    b. Exception 2 – Safe Harbor: If the actual tax revenue for the year is greater than FY19 tax revenue collections, adjusted for inflation, the state is not subject to the offset provisions. *Note that this is a separate determination from the state's budget surplus amount, which is the difference between revenue and expenditures. This safe harbor exception is only calculated based on the difference between actual revenues and baseline revenues.*
2. If actual tax revenue for the year is less than FY19 tax revenue collections, adjusted for inflation, the state will calculate the value of revenue reduction that has not been offset by tax changes that would increase any source of general fund revenue and spending cuts in areas not being replaced by fiscal recovery funds. The amount not offset by tax increases or spending reductions will be subject to recoupment by Treasury.

Where can I find more information about Fiscal Recovery Funds?
Additional information can be found on the Treasury's webpage for this program.