

Taxability of CARES Act Relief Provisions to Montana Taxpayers

Background

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, passed March 30, 2020, designated \$150 billion in federal aid to be split across state and local governments across the country. These funds are to be used for necessary expenditures with respect to the COVID-19 outbreak. Montana received \$1.25 billion in funding and set aside a portion of it to provide assistance to Montana businesses, nonprofits, and individuals. These programs, discussed below, include a loan deferment program administered by Montana Board of Investments (BOI) and several grant programs administered by various state agencies.

Montana Loan Deferment Program

The purpose of the program is to allow businesses to defer payments on their commercial loans to free up the borrower's otherwise-dedicated capital. In order to do so, BOI will provide Montana banks, credit unions, and lending institutions payments to convert existing commercial loans to interest-only status for a period of 6 to 12 months. The lender will modify the borrower's loan in order to defer the payments. BOI will pay up to \$150,000 of the additional interest per loan resulting from the deferment.

The BOI created the Montana Hospitality Assistance Program (MHAP) to specifically help hotels with commercial loans that exceed the limitations of the Loan Deferment Program. CARES Act funding will be used to pay 80% of the interest on eligible businesses' deferred loan payments for up to a year.

Small Business Grants

The Montana Meat Processing Infrastructure Grant (MMPIG) aids small and medium-sized meat processors responding to COVID-19 supply chain disruptions by supporting local meat processing infrastructure and capacity in Montana. Examples of eligible expenses include, but are not limited to, equipment and infrastructure that increases processing and/or storage capacity, costs associated with becoming State or Federally inspected, and other business adaptation and diversification activities.

The Montana Business Adaptation Program (MBAP) provides reimbursement for COVID-19 expenses related to keeping staff and customers safe – from the purchase of personal protective equipment to resources needed for staff to work remotely. Eligible expenses include costs related to communication, remote work equipment, cleaning supplies, tools

to enhance social distancing and sanitation, and travel and hotel costs related to quarantining workers.

The Montana Business Stabilization Program (MBSP) provides working capital for small businesses to support payroll, rent, accounts payable, debt service and expenses related to shifts in operations in order to retain existing businesses, retain current employees or retain business viability for future re-employment.

The Montana Innovation Grant Program (MIGP) helps companies scale up, improve capabilities, or drive expanded distribution of products or services developed in response to COVID-19. Projects should demonstrate significant impact in improving public health, safety, and economic impact.

The Montana Food and Agriculture Adaptability Program (MFAAP) is for food and agriculture businesses to help increase community resilience amid the COVID 19 pandemic and other economic disruptions. Grants are intended to create additional economic activity and bolster food security. Examples of eligible projects include, but are not limited to, those focused on accessing new markets, projects which strengthen and expand local food systems, and other business adaptations that decrease food and agricultural waste. The need for such innovations must be driven by the COVID 19 pandemic.

Grants to Local Governments, Non-profits, and Individuals

The Local Government Reimbursement Program (LGRP) is available to local governments for direct costs associated with COVID-19.

Public Health Grants (PHG) are available to local and tribal health departments and urban Indian health centers to help in the response to COVID-19 and to meet the needs of their communities.

Stay Connected Grants (SCG) are available to area agencies on aging, assisted living facilities, nursing homes, tribal elder services, and Critical Access Hospitals. Grant funds can be used to fund technologies and other efforts to encourage physically distant forms of social interaction for elderly Montanans during the COVID-19 public health emergency.

Food Bank and Food Pantry Assistance Grants (FBFPAG) are available to community organizations providing food assistance to Montanans with limited resources, food banks, food pantries, community cupboards, and entities with infrastructures already in place to begin new food distribution programs. The program is designed to increase food security for Montanans hardest hit by the COVID-19 pandemic.

Social Services Nonprofit Grants (SSNG) are available to Montana-based social service nonprofits impacted by the COVID-19 public health emergency to retain existing

programs and services, employees, or organizational viability for provision of future services and operations.

Telework Assistance Grants (TAG) are available to go towards purchasing equipment to assist Montanans with disabilities access telework equipment. DPHHS will partner with a local non-profit organization to assess and support assistive technology needs of individuals with disabilities during COVID-19. This assistance will help ensure people with disabilities have the equipment needed to adapt to the change in working environment due to COVID-19.

Questions

- *Are the payments received from BOI taxable?*

These payments are gross income under IRC § 61(a)(1), and, therefore, taxable to banks and financial institutions that are not explicitly exempt in the Internal Revenue Code or Montana Code Annotated.

Credit unions are tax-exempt under IRC § 501(c)(14) and § 32-3-901, MCA.

Loan deferments or modifications for individual or business borrowers are not taxable as they do not constitute income under IRC § 61.

The borrower may not deduct any interest paid by BOI.

- *Should the BOI issue Forms 1099 to lenders that participate in the loan deferment program?*

The state should issue Form 1099-MISC to entities other than corporations or limited liability companies electing to be taxed as corporations receiving BOI payments.

- *Are grant payments made from funds delegated to Montana by the CARES Act required to be included in a grant recipient's gross income?*

Grant funds from MMPIG, MBAP, MBSP, MIGP, MFAAP, and SCG programs are required to be included in a grant recipient's gross income if the recipient is a business.

Under IRC § 61, all gains or undeniable accessions to wealth, clearly realized, over which taxpayers have complete dominion or control over are considered taxable income unless specifically exempt. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), 1955-1 C.B. 207. Recipients of all five grant programs have discretion on how to spend those funds (within the parameters of the program). Therefore, payments made under the five grant programs are included within the broad definition of "gross income" under IRC § 61.

Prior to the Tax Cuts and Jobs Act (TCJA) of 2017, corporations could omit contributions to capital from their gross income. However, TCJA removed the exemption for contributions of capital from government entities. Because the grants are from a government entity, corporations must also include the grants received as taxable income. See IRC § 118(b)(2).

It should be noted that while a grant recipient is required to include the grant in its gross income, it can deduct and/or capitalize the business expenses it paid for with grant funds.

Organizations formed under IRC § 501 are exempt from taxation unless they receive income unrelated to their charitable mission under IRC § 511. If organizations are formed under IRC § 501 and the grant funds are related to the organization's mission, they will be exempt from taxation under IRC § 501. Therefore, grant funds from the LGRP, PHG, SCG (to non-profit organizations), FBFPAG, SSNG, and TAG are not taxable.

The target recipients for the LGRP and PHG are local and tribal governments along with organizations they control. Governments and governmental units are not subject to income tax.

Finally, TAG funds recipients are individuals with disabilities. These grants are created to keep disabled individuals working. It is unclear if local non-profit organizations or the individuals will receive the funds directly. However, if the funds were to go directly to individual recipients, the funds would fit within the broad definition of IRC § 139(b)(4), which states that "qualified disaster relief payments" are an amount paid to or for the benefit of an individual by a Federal, State, or local government, or agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare. The department believes that keeping individuals employed constitutes "general welfare." If the funds were to go directly to the local non-profit organization to disburse to disabled individuals, the same logic would apply to those organizations as described above. If the organization is organized under IRC § 501 and the grant funds are related to the organization's mission, they would be exempt from taxation under IRC § 501.

- *Should the state issue Forms 1099 to grant recipients?*

Per the federal Form 1099-G instructions, the state of Montana should report amounts of taxable grants of \$600 or more to recipients that are businesses. Therefore, the state should issue Forms 1099-G to businesses that are recipients of the MMPIG, MBAP, MBSP, MIGP, MFAAP, and SCG programs.

Paycheck Protection Program

As a part of the CARES Act, the federal government created the Paycheck Protection Program (PPP). The PPP is a loan program that provides cash-flow assistance to small businesses as an incentive for businesses to retain their employees during the COVID-

19 pandemic. If the recipient fully spends the funds on payroll costs, interest on mortgages, rent, and utilities, the loan can be fully forgiven. The CARES Act has specifically excluded the cancellation of debt income from the PPP loans from gross income. See Pub. L. No. 116-136, § 1106(i). As a result, this income is also excluded from gross income in Montana, per § 15-30-2101(10), MCA.

The five state of Montana grant programs should not be confused with the PPP.

On July 6, 2020, the IRS released “frequently asked questions” regarding grants made to small businesses as a result of the CARES Act Relief Funds delegated to state and local governments. The IRS has affirmed that these grants shall not be excluded from a business’s gross income. Visit <https://www.irs.gov/newsroom/cares-act-coronavirus-relief-fund-frequently-asked-questions> for more information.

Coronavirus Food Assistance Program

The CARES Act allocated \$450,000,000 to the United States Department of Agriculture to prevent, prepare for, and respond to the coronavirus, domestically or internationally, for the emergency food assistance program. A part of this allocation was used to create the Coronavirus Food Assistance Program. This program, administered by the USDA, provides direct support to farmers who suffered a five percent or greater price decline or who had losses due to market chain disruptions due to Coronavirus. Recipients of these funds must include them in their gross taxable income as there is not a specific exemption for them in IRC or MCA.