



STATE OF VERMONT
OFFICE OF THE STATE AUDITOR

TO: Michael Sirotkin, Chair, Senate Committee on Economic Development
Michael Marcotte, Chair, House Committee on Commerce

Cc: Jane Kitchel, Chair, Senate Committee on Appropriations
Mary Hooper, Chair, House Committee on Appropriations
Ann Cummings, Chair, Senate Committee on Finance
Janet Ancel, Chair, House Committee on Ways and Means

DATE: April 20, 2021

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

I'm aware that the Economic Recovery Bridge Grant program in [H.315](#) uses 2020 federal tax loss to establish eligibility for grants. Focusing on tax loss may help target limited resources to businesses that need assistance to remain viable. However, federal tax loss could include some deductions that increase 2020 losses but overstate the businesses' need for financial assistance. Also, H.315 did not establish a threshold for loss to qualify, so it's possible that businesses with slight losses will receive substantial grants.

Federal tax losses may include deductions for depreciation, amortization, and carryforward of prior year(s) losses, none of which represent the impact of COVID-19 on business operations. Depreciation and amortization are non-cash expenses and losses from prior years don't relate to the COVID-19 pandemic.¹ To better understand aspects of federal tax loss that may exaggerate businesses' need for financial assistance, the Legislature could request that the Department of Taxes advise them about whether there are items that should be excluded from the consideration of tax loss.

The lack of a threshold for losses could mean that resources aren't directed to those businesses with the greatest need for assistance. Also, a 2020 federal tax loss may not demonstrate that businesses need assistance, particularly businesses that routinely report tax losses, and may not provide adequate evidence that losses are due to COVID-19.

¹ Depreciation and amortization are accounting methods of allocating the cost of an asset over its useful life or life expectancy. These are non-cash charges that reduce earnings but not cash flows.

To address these issues, the Legislature could require measurement of the change in net operating income (loss) from 2019 to 2020 and set a threshold for the extent of the change required to qualify for a grant. For example, to qualify for a grant a business' net operating income must have decreased by greater than [X] percent from 2019 to 2020.

I understand that no later than 10 days after the effective date of the legislation, the Agency of Commerce and Community Development (ACCD) is required to establish guidelines governing the implementation of the program. To address some of the observations in this memo, the Legislature could ask ACCD how the guidelines will address the following questions:

- How will federal tax loss be defined?
- Since the application period is likely to occur prior to when business tax filings are due, what documentary evidence will ACCD require to substantiate a federal tax loss?
- Will depreciation, amortization, and net operating loss carryforwards be added back to federal tax loss?
- How will ACCD ensure that federal tax loss is the result of impacts of the COVID-19 pandemic on business operations?
- Has ACCD considered measuring the loss by comparing the 2019 federal taxable income or tax loss to 2020's federal taxable income or tax loss?
- Does ACCD plan to establish a minimum threshold for losses? If so, what will be the threshold?

