

Locke Lord QuickStudy: Relief for State and Local Governments Impacted by COVID-19?

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On March 11, 2021, President Biden signed into law the \$1.9 trillion COVID-19 relief package, the American Rescue Plan Act of 2021, Pub. L. No. 117-2 (the “ARPA”). For additional information on ARPA see [here](#). ARPA includes \$350 billion in aid for state and local governments through the Coronavirus State and Local Fiscal Recovery Funds.

On May 10, 2021, the U. S. Treasury Department (the “Treasury Department”) published a [Fact Sheet](#) and [Interim Rule](#) that further clarified how the \$350 billion would be distributed to state, local, territorial and tribal governments (the “May 10 Interim Rule”). The May 10 Interim Rule from the Treasury Department clarified how the funds would be distributed to eligible recipients, as well as the permitted and prohibited uses for the funds.

A. Funding Amounts and Distribution

When ARPA was enacted, it was not clear how much each county, city, village and township could expect to receive. The May 10 Interim Rule states that Congress has allocated the \$350 billion to tens of thousands of jurisdictions as follows:

Type	Amount (\$ billions)
States and District of Columbia	\$195.3
Counties	\$65.1
Metropolitan Cities	\$45.6
Tribal Governments	\$20.0
Territories	\$4.5
Non-Entitlement Units of Local Government ¹	\$19.5

The Treasury Department has also clarified how funds will be distributed. States, territories, metropolitan cities, counties and tribal governments can expect to receive funds directly from the Treasury Department, whereas, local governments that are classified as non-entitlement units will receive funds through their applicable state

governments. Local governments should expect to see their funds distributed in two tranches, with the first being distributed starting in May and the second tranche distributed one year thereafter. States that have experienced a net increase to their unemployment rate of more than two percentage points since February 2020 will receive funds in a single payment, whereas other states will receive their funds in two payments.

B. Permitted Uses of Funding Proceeds

The May 10 Interim Rule also provided much needed clarification as to the permitted and prohibited uses of the funds. While noting that recipients have broad flexibility to decide how to best use the funds to meet the needs of their communities, the Treasury Department establishes five broad areas of permitted uses. The funds may be used to (1) support public health expenditures; (2) address negative economic impacts caused by the public health emergency; (3) replace lost public sector revenue; (4) provide premium pay for essential worker and (5) invest in water, sewer and broadband infrastructure.

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Treasury's May 10 Interim Rule provides additional guidance to assist recipients when determining the type of programs that the funds may be used to support as well as examples of allowable uses for recipients to consider. However, in general, the categories of permitted uses are designed to provide resources to those who were disproportionately impacted by Covid-19.

?(1) Support Public Health Expenditures?

The first category is aimed at assisting state and local governments in mitigating the expenses associated with fighting the pandemic. The funds may be used to address a broad range of Covid-19 mitigation programs, medical expenses, behavioral health programs, and public health resources. Some examples of permitted uses in this category include vaccination programs, testing expenses, contact tracing programs, capital improvements in public facilities to meet pandemic operational needs and personal protective equipment (PPE) purchases.

?(2) Addressing Negative Economic Impacts Caused by Covid-19?

The second category allows state and local governments to provide assistance to households, small businesses, and other industries impacted by the hardships caused by the pandemic. Funds may be used to support programs such as job training, aid to households facing food insecurities, providing technical assistance to small businesses, and by rehiring public sector staff and replenishing unemployment insurance trust funds to a pre-pandemic level. State and local governments are also permitted to use the funds to address the disproportionate public health and economic impacts of the pandemic.

?(3) Replacing Lost Public Sector Revenues?

The COVID-19 public health crisis has placed significant strain on the budgets of many state and local governments. Eligible recipients may use funds to shore up any budgetary shortfalls in order to ensure they are still able to provide public services. Recipients of funds are permitted to use such funds to replace lost revenues. When determining if and how much of the funds can be used to replace lost revenues, recipients should follow the guidance and methodology established in the May 10 Interim Rule. The methodology prescribes that recipients should calculate the extent of the reductions in their revenues by comparing their actual revenue to an

alternative representation of what their revenues could have expected to have been had there not been a pandemic. When trying to calculate their presumed revenue growth had the pandemic not occurred, recipients can use either (a) the recipient's average annual revenue growth over the three full fiscal years prior to the pandemic or (b) 4.1%, which represents the national average state and local revenue growth rate from 2015-2018. The Treasury Department has stated that once a recipient has determined a revenue shortfall has occurred, the recipient will be given broad latitude in applying funds for the provision of government services, but not for any impermissible uses, as described below.

(4) Providing premium pay for essential workers

Eligible recipients may provide funding to those essential front-line workers, with a priority on providing services for lower income workers.

(5) Investing in water, sewer, and broadband infrastructure?

State and local governments may use funds to invest in necessary improvements to their water and sewer infrastructure and their broadband internet infrastructure. It should be noted that general infrastructure spending is not considered a permitted use. Funds may only be used for projects focused on water, sewer and broadband investments.

C. Prohibited Uses

In general, the broad guidance on the permitted uses of the funds is intended to give recipients wide latitude to determine which programs and services to support. However, the Treasury Department has also established explicit impermissible uses of the funds.

ARPA broadly—without specifying details—prohibits states and territories from using amounts received from the Fund to directly or indirectly offset a reduction in net tax revenue due to a change in law from March 3, 2021 through the last day of the fiscal year in which the funds provided have been spent (the “Offset Provision”). If a state or territory violates the Offset Provision, ARPA funds used for state tax reductions must be returned to the federal government. The Offset Provision, added late in the legislative process, caused great consternation and uncertainty among the states. Multiple states have challenged the Offset Provision on various grounds in multiple courts. The Treasury on May 7, 2021, issued limited guidance recognizing that tax law changes solely to conform to recent changes in federal income tax law do not violate the Offset Provision, even if such changes reduce tax revenues. The May 10 Interim Rule provides a much-needed global framework for applying the Offset Provision. On a period-by-period basis, a state or territory must first identify the “covered changes” in law that reduce revenues and that could trigger recapture. Then, the rule specifies a four-step process for quantifying any resulting reduction in net tax revenue for a period and determining the extent to which such reduction will not be treated as violating the Offset Provision because funded from sources other than ARPA funds, such as tax revenue growth, increases in other taxes, or spending cuts. Although the framework is fact-intensive and uncertainties remain, in general the Treasury approach provides states several avenues to avoid Offset Provision violations.

Second, no recipient may use the funding to make a deposit to a pension funds. The Treasury Department defines a “deposit” as an extraordinary contribution fund for the purpose of reducing an accrued, unfunded liability. Although deposits to pension funds are prohibited, eligible recipients may use the Funds for payroll contributions for employees whose wages and salaries are an eligible use of funds.

Additionally, the Funds may not be used to fund debt service, to pay legal settlements or judgments, or to make deposits into rainy day funds or other financial reserves. The funds were intended to be used prospectively, and as such the Interim Final Rule, precludes the use of funds to pay debts incurred prior to March 3, 2021. The Treasury Department has indicated that these restrictions will help ensure that the Funds are used to support existing pressing needs. There has been some initial pushback on this limitation, as some states and local governments have expressed an interest in using the funds to repay various debts incurred in the past year to pay for pandemic-related expenses.

The Interim Final Rule was issued without advance notice and public comment to allow for immediate implementation, however, comments are being solicited from interested members of the public and from recipients of the funds for all aspects of the program. In particular, the Interim Final Rule also explicitly asks for comment on specific questions included in the Interim Final Rule. Comments must be submitted within 60 days of the date of publication of the Interim Final Rule in the Federal Register, or within 60 days of May 17, 2021.

In conclusion, the Treasury Department’s May 10 Interim Rule has provided additional information for recipients of ARPA’s Coronavirus State and Local Recovery Funds as to when they should expect to receive funds and how they may apply their funds. Your regular Locke Lord contact and the authors of this article would be happy to help you navigate the American Rescue Plan and associated guidance as they relate to or otherwise affect state and local governments.

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¹ A non-entitlement unit of local government can generally be defined as an area of local government, which is not otherwise classified as a “metropolitan city” or part of an “urban county”, which terms are further described [here](#).

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