March 19, 2021

The Honorable Janet Yellen
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Yellen:

We look forward to working with you and your U.S. Treasury colleagues to help our state gain back lost jobs, reopen shuttered businesses, and support the more than 3.8 million Californians still receiving unemployment benefits. California has already taken a number of steps on its own to promote the recovery, all of which are aligned with the underlying objectives of the American Rescue Plan Act of 2021.

The Coronavirus State Fiscal Recovery Fund will further promote that recovery and will be a critical component of our continued efforts to help regain what COVID has taken from our individuals, families, small businesses, and overall economy. To maximize the economic benefits of this additional funding, California recommends that Treasury consider the following issues as it develops and releases flexible guidance governing the permissible uses of these funds:

Incurred Costs. In implementing the CARES Act, Treasury limited the definition of what is viewed as an incurred cost. We urge your office to consider a legal obligation to pay for a good or service or a subvention to another government entity (such as a county or city) to be considered an incurred cost. Restarting the state's economic engine, implementing an equitable and broad-based recovery, and addressing disproportionate impacts of the pandemic will require time and thus a combination of short- and long-term investments.

Use of Funds to Maintain Government Services. State and local governments rely upon a mix of revenue sources to support a variety of programs and provide critical services. Many are supported by dedicated revenues from areas of the economy that were devastated in efforts to contain the public health pandemic including tourism, travel, and hospitality. Therefore, to maintain or restore governmental services to pre-pandemic levels, flexibility is needed to demonstrate a revenue loss is due to the COVID-19 public health emergency relative to the revenues collected prior to the pandemic, including their long-term growth trends.

Tax Conformity. California also recommends that Treasury consider taking steps to prevent inadvertent inequities between states that have automatic conformity with federal tax laws and those that do not. Penalizing the non-automatic implementation of conformity—by treating conformity legislation as a tax cut—could limit a state's ability to adopt policies that support federal goals and could thus constrain the economic benefits that were intended by the authorization of these funds. For example, automatic conformity states will exempt the first $10,200 in unemployment insurance and student debt forgiveness from income, and they have already implemented state conformity with prior federal legislation exempting forgiven Paycheck Protection Program loans from taxable income. Assuming that automatic conformity states will not be penalized for those tax cuts, we believe California should also not be penalized for the exact same policy.

In addition, California has in the past set up automatic budget stabilizers, such as appropriations for the California Earned Income Tax Credit or housing credits that are subject to annual appropriation. We are seeking clarification as to whether these would also be viewed by Treasury as a tax cut. If so, requiring that the state not renew these credits in its budget legislation in order to avoid reduction of its State Fiscal Recovery Fund disbursement would actually constitute a revenue increase versus the previous year, thereby undercutting the effects of the federal stimulus.

Infrastructure. As you know, the American Rescue Plan Act permits the state to use the State Fiscal Recovery Fund "to make necessary investments in water, sewer, or broadband infrastructure." Treasury should interpret this provision, and subsection (c)(1)(A) for other infrastructure projects that put Californians back to work, as broadly as possible so as not to restrict states from meeting a broad range of critical infrastructure needs and addressing the economic impacts of COVID-19 as extensively as possible.

Disbursement Timing. In addition to these guidance-related suggestions, I also wanted to convey a request pertaining to the timing and size of the State Fiscal Recovery Fund's disbursement. We would like to coordinate closely with your office to disburse the first payment in smaller increments. This approach would allow California's Department of Finance to coordinate with our State Treasurer's Office on the timing and size of the disbursements, thus reducing the impacts on the treasury market in which the state invests as well as on our state's custodian bank. We recognize that this may slightly delay the timeline envisioned—of full initial payment within the 60-day window authorized by the Act.

Federal, state, and local budgets should work in concert during times of economic need, and the implementation of the Coronavirus State and Local Recovery Funds will support and complement the state's ongoing and planned efforts. California is poised to support President Biden's commitment to the people of this state, and we are grateful for your partnership and support as we all work to bring about an inclusive economic recovery for the American people.

KEELY MARTIN BOSLER
Director

cc: Brian Deese, Director of the National Economic Council
Jeff Zients, COVID-19 Response Coordinator and Counselor to the President
Gene Sperling, White House American Rescue Plan Coordinator
Julie Chavez Rodriguez, Director of the White House Office of Intergovernmental Affairs