

SUBCOMMITTEE NO. 4

Agenda

Senator Anna Caballero, Chair

Senator Jim Nielsen

Vacancy



Tuesday, January 26, 2021

9:00 a.m.

State Capitol - Room 3191

Informational Hearing

Governor's Proposal for Direct Workers and Small Businesses

Consultant: Nora Brackbill and Joe Stephenshaw

AGENDA

- I. Opening Remarks
 - a. Senator Caballero
 - b. Senator Nielsen

- II. Small Business Relief Grants
 - Somjita Mitra, Chief of Economic Research, Department of Finance
 - Isabel Guzman, Director of the California Office of the Small Business Advocate
 - Brian Weatherford, Senior Fiscal & Policy Analyst, Legislative Analyst's Office
 - Mark Herbert, Vice President, California, Small Business Majority
 - Lucy Salcido Carter, Public Policy Director, CA Association of Nonprofits (CalNonprofits)

- III. Golden State Stimulus
 - Jay Chamberlain, Chief of Financial Research, Department of Finance
 - Chas Alamo, Principal Fiscal & Policy Analyst, Legislative Analyst's Office
 - Sara Kimberlin, Senior Policy Analyst, California Budget & Policy Center

- IV. Public Comment

Small Business Relief Grants

Governor's Budget. The Governor's budget proposes \$575 million one-time General Fund in 2020-21 to provide support to small businesses impacted by COVID-19 and the health and safety restrictions. The Office of Small Business Advocate will provide micro grants up to \$25,000 to help support impacted small businesses-both for profit and nonprofit. \$25 million is designated for cultural institutions. This supplements \$500 million that was provided in December.

Background.

Small businesses have been disproportionately affected by the COVID-19 pandemic and the related health and safety restrictions, with hundreds of thousands of businesses permanently shuttered and many more on unstable financial footing¹. Compared to this time last year, small business revenue in California is down more than 30 percent, with the hardest hit sector, leisure and hospitality, down over 70 percent². More than 40 percent of Californian small businesses reported requiring financial assistance or additional capital in the next 6 months³.

Existing Federal Aid.

The primary source of federal small business aid is the Paycheck Protection Program (PPP), which closed in August 2020 with over \$100 billion in unused funding and reopened in January 2021 with an additional \$284 billion. PPP is administered by the Small Business Administration (SBA) and provides forgivable, low-interest loans to businesses with fewer than 500 employees. As of the initial close in August, 623,360 Californian businesses had received a total of \$69 billion in PPP loans (average loan size \$110k)⁴. The program tied loan forgiveness to maintaining payroll and specified that businesses must use at least 75 percent of the funds on payroll expenses within eight weeks (extended to 24 weeks in June 2020). Many small businesses, especially in underserved communities, were shut out of the first round of PPP loans due to structural issues within the program, including the first-come, first-served model and lack of access to lending partners. In total, 87 percent of the loans were less than \$150k, and constituted 28 percent of the funding available, while the largest 5 percent of loans received 50 percent of the funding⁵. As of December 2020, 91 percent of PPP borrowers had exhausted their PPP loan⁶.

In the new PPP that opened in January 2021, eligible companies can apply for a second loan, and some changes were made to address the issues faced by small businesses. These include early access for lenders that focus on smaller and underserved businesses and expanding the categories of expenses eligible for forgiveness (although at least 60 percent must still go towards payroll). For companies applying for a second PPP loan, the maximum number of employees was reduced to 300 and companies must demonstrate at least a 25 percent drop in gross receipts compared to 2019. At least \$25 billion was set aside for second PPP loans to the smallest businesses (maximum 10 employees or for loans of \$250,000 or less to eligible borrowers in low- or moderate-income

¹ https://www.brookings.edu/wp-content/uploads/2020/09/PP_Hamilton_Final.pdf

² <https://tracktherecovery.org/>

³ <https://portal.census.gov/pulse/data/#data>

⁴ <https://home.treasury.gov/system/files/136/SBA-Paycheck-Protection-Program-Loan-Report-Round2.pdf>

⁵ <https://www.washingtonpost.com/business/2020/12/01/ppp-sba-data/>

⁶ <https://www.nfib.com/content/press-release/coronavirus/one-in-four-small-business-owners-will-close-doors-if-economic-conditions-dont-improve-soon/>

neighborhoods). SBA also simplified the process for forgiving loans that are less than \$150k. SBA and the Treasury have stated that they expect the recent additional funding to be enough, and they do not anticipate money running out⁷.

Other sources of federal aid include Economic Injury Disaster Loans (EIDL), Shuttered Venue Operators (SVO) grants, and additional non-forgivable loan programs. The EIDL Advance program distributed \$20 billion in the form of forgivable grants of up to \$10k but ran out of funding in July 2020⁸. The December federal aid package includes another \$20 billion for a Targeted EIDL Advance program, which focuses on applicants located in low-income communities who demonstrate at least a 30 percent drop in gross receipts. The December aid package also includes \$15 billion for Shuttered Venue Operators grants to live venues, independent movie theaters, and other cultural institutions. Other non-forgivable loan programs are also available through SBA.

Proposed Federal Aid.

In addition to the December federal aid package, the Biden administration has proposed a large relief package. It includes \$15 billion to support more than one million small businesses through a grant program. The proposal also includes investing in successful state, local, tribal, and non-profit small business financing programs, leveraging \$35 billion in government funds into \$175 billion in loans. There is funding to support states' short-time compensation programs, which allow businesses to keep employees on at reduced hours while making up the difference in pay. It does not appear to include additional funding for PPP or EIDL. However, the details of the proposal have not been released and it is not clear what will end up in the final package.

California Small Business Relief Grant Program.

The California Small Business Relief Grant program was created in November 2020 with an initial investment of \$500 million to provide small grants (up to \$25,000) to businesses affected by COVID-19 and related health and safety restrictions, targeting small and underserved businesses that did not receive enough federal aid. The fund is administered by the California Office of the Small Business Advocate (CalOSBA) within the Governor's Office of Business and Economic Development (GO-Biz). Businesses with gross annual revenue of at least \$1,000 and at most \$2.5 million are eligible for grants ranging from \$5,000 to \$25,000, depending on size. There are a number of other eligibility criteria, including that businesses must be open if permitted, and they must have been operating since at least June 1, 2019. The funds are not tied to payroll and can be used on a wider range of expenses, including overhead and costs associated with complying with safety guidelines.

The grants are being distributed in two rounds, and CalOSBA reported over 300,000 applications were received in the first round alone. If the average grant size were \$10,000, this first round alone would equate to approximately \$3 billion in demand. Applications are scored and ranked based on four equally weighted factors: the severity of COVID-19 restrictions in their geographic region (such as stay at home orders, closures, etc.), the impact of COVID-19 restrictions on their industry, their revenue loss (computed using tax returns), and whether they are part of an underserved

⁷ <https://www.washingtonpost.com/business/2021/01/08/sba-ppp-loans/>

⁸ <https://www.sba.gov/article/2020/jul/11/sba-provided-20-billion-small-businesses-non-profits-through-economic-injury-disaster-loan-advance>

business group (such as rural businesses or businesses owned by veterans, women, or minorities). Additional details of the scoring and ranking process have not been released.

The Governor's proposal more than doubles the amount of funding available for Small Business Relief Grants, from \$500 million to \$1.075 billion. \$25 million of that is set aside for cultural institutions such as museums and art galleries. The existing program structure would remain the same.

Proposed Legislative Action. SB 74 (Borgeas and Caballero) was introduced as an urgency bill that would immediately designate \$2.6 billion for a similar program within CalOSBA called the Keep California Working Grant Program. Grants would be awarded to small businesses and nonprofits with fewer than 100 employees who have experienced economic hardship resulting from the COVID-19 pandemic. As introduced, the key differences from CalOSBA's current Small Business Relief Program are that grants would be available on a first-come, first-served basis and the maximum business size is determined based on number of employees rather than revenue, but the details of the proposal may change. Grant amounts were not specified in the introduced bill, but a six-tiered system with a maximum grant size of \$75k has been discussed⁹.

LAO Comment.

Program established quickly and lacks transparency. The LAO notes that the program was established quickly and without much communication with stakeholders or with the Legislature, and many details of the program are still unknown. Partner organizations and applicants have raised a number of concerns about the existing program, including an application that was only available online and in English, and was not appropriate for nonprofit organizations, among other issues. Establishing a brand new program often involves unforeseen implementation challenges. Some of the problems with this program listed above might have happened under other circumstances. However, some stakeholders felt that better communication and outreach from the administration and the third-party vendor could have addressed some potential issues before the program began. The program was also intended to target underserved businesses in locations and industries most affected by the pandemic, but the LAO is unable to assess whether it actually is much better targeted than the federal PPP program because they do not have detailed information about how the program is making grant award decisions.

The LAO suggests deferring immediate action until more information about the program is provided and its effectiveness can be determined, especially given that a new round of PPP funds is available. Specifically, the LAO suggests collecting data on the first round of grants, including information on applicants and on the amount of revenue decline, location, and industry of the entities that receive grants. More information should also be provided about how the program was designed, including details about fraud prevention and CalOSBA's selection of and contract with the third-party vendor who administered the program. The LAO suggests that the Legislature should also consider other details of the program, including potentially prioritizing businesses that did not receive a PPP loan, working out the tax implications of the grants, and considering different definitions of small business.

⁹ https://www.facebook.com/watch/live/?v=210443464116336&ref=watch_permalink

Staff Comment.

Limited detail and oversight. As noted by the LAO, the Small Business Relief Grants were established and administered by the executive branch, with limited oversight by the legislative branch. Notably, the program is not codified, and the Administration has not provided any accompanying language. Thus, the details of the program, from grant sizes to eligible businesses to ranking criteria, have all been set by GO-Biz and the Administration. There are also no details available about the new set-aside for cultural institutions, which have been severely impacted by pandemic-related closures and may have different needs than other small businesses. Thus, the Legislature may want to consider laying out more specific guidelines for the program.

Interaction with federal aid. The proposal was made prior to the December federal aid package, and it is not clear how much relief Californian businesses will get from the new funds or how quickly they will be able to access them. The Biden administration's proposal is still in the early stages, and it may be significantly different in its final form. The Small Business Relief Grant program stipulates that grant money cannot be used for expenses already covered through grants, forgivable loans or other relief through federal, state, county or city programs, but it does not take those other sources of aid into account when ranking applications. Ultimately, the need for immediate relief for small businesses must be weighed against the desire to wait for federal aid.

Estimated demand. Based on the first round of applications received by CalOSBA, it seems likely that the demand for small business grants will be overwhelming. The Legislature may want to consider increasing the amount of funding available.

Related tax issues. As noted by the LAO, the tax status of these grants needs to be clarified with the Administration. The December federal aid package legislation states that small business assistance—including PPP forgiven funds, emergency EIDL grants, Targeted EIDL Advances, certain loan repayment assistance, and grants for shuttered venues—will not be taxable as income and clarifies that deductions are allowed for otherwise deductible expenses paid with the proceeds of this small business assistance.

Golden State Stimulus

Governor's Budget. The Governor's budget proposes \$2.4 billion one-time General Fund in 2020-21 to provide a one-time \$600 refund to taxpayers who received the California Earned Income Tax Credit (CalEITC) for the 2019 tax year, as well as individual tax identification number (ITIN) filers who will receive the credit for the 2020 tax year.

Background.

The recession caused by the COVID-19 pandemic disproportionately impacted low-income jobs and exacerbated existing economic inequality in California¹⁰. As of October 2020, employment rates for high wage workers (>\$60k) had returned to pre-pandemic levels, while employment rates

¹⁰ <https://www.ppic.org/wp-content/uploads/incoming-inequality-and-economic-opportunity-in-california-december-2020.pdf>

for low wage workers (<\$27k) were down almost 30 percent¹¹. Many Californians have reported food and housing insecurities and difficulty in paying for usual household expenses¹².

Two direct stimulus payments have been provided by the federal government. The March CARES package included \$1,200 per adult and \$500 per child under 17 for individuals whose income was less than \$75,000, and a reduced benefit up to incomes of \$99,000. The December aid package included an additional \$600 per adult and up to \$600 for each qualifying child. The initial payment kept an estimated 8 million Americans out of poverty^{13,14}. However, while some Americans have spent the entire amount and need additional assistance, at least some significant portion saved the entire amount, so the overall impact of the payments is unclear^{15,16,17,18}. The Biden administration has proposed an additional stimulus payment of \$1,400, but the timing and amount of that payment is not final.

The Golden State Stimulus targets low-income Californians using a pre-defined population: taxpayers who claim the CalEITC. CalEITC was established in 2015 to provide low-income Californians, especially those with children, with an additional tax refund. For the 2019 tax year, Californians with annual incomes up to \$30,000 were eligible, and 3.8 million CalEITC tax returns were filed. CalEITC was expanded to filers that use an ITIN for the first time in the 2020 tax year, and an estimated 250,000 ITIN-filers will claim it.

Other aspects of existing and proposed federal aid may also help CalEITC filers. In addition to the direct stimulus payment, the December federal relief bill includes a special temporary rule allowing lower-income individuals to use their earned income from tax year 2019 to determine the federal EITC and the refundable portion of the Child Tax Credit (i.e., the Additional Child Tax Credit) in the 2020 tax year. The Biden administration's proposed plan also includes more than doubling the amount of the federal EITC, raising the maximum income from \$16k to \$21k, and eliminating the age cap so older workers can claim the credit. It also includes an expanded Child Tax Credit. Other federal aid programs, such as expanded unemployment benefits, may also help this population.

However, ITIN-filers are typically excluded from federal aid, even though many are essential workers or work in industries hit hard by COVID-19¹⁹. The IRS issues ITINs to individuals who owe taxes but are not eligible for social security numbers (SSNs). They are issued regardless of immigration status and are only used for tax reporting. Examples of taxpayers who use ITINs include unauthorized or undocumented workers and non-resident foreign nationals who own or invest in U.S. businesses, among others. The March CARES Act excluded families if any member filed using an ITIN, which also prevented millions of spouses and children who are U.S. citizens or permanent resident immigrants from receiving the initial stimulus payment. Some of those

¹¹ <https://www.tracktherecovery.org/>

¹² <https://www.census.gov/data-tools/demo/hhp/#/?measures=EXR&mapAreaSelector=st&barChartAreaSelector=st>

¹³ <https://www.urban.org/research/publication/using-cash-payments-reduce-poverty>

¹⁴ <https://www.nber.org/papers/w27729>

¹⁵ https://www.nber.org/system/files/working_papers/w27693/w27693.pdf

¹⁶ <https://www.bls.gov/opub/btn/volume-9/receipt-and-use-of-stimulus-payments-in-the-time-of-the-covid-19-pandemic.htm>

¹⁷ <https://insight.kellogg.northwestern.edu/article/stimulus-checks-spending-data-2020-coronavirus-covid>

¹⁸ <https://www.bankrate.com/banking/savings/stimulus-check-survey-2021/>

¹⁹ <https://calbudgetcenter.org/resources/about-2-in-3-immigrant-workers-excluded-from-the-caleitc-are-covid-19-essential-workers/>

families became eligible in the December federal aid package and could receive the initial payment retroactively. However, families where both parents use ITINs are still ineligible for both payments, which has also prevented stimulus support from reaching more than two million U.S.-citizen and legal-immigrant children nationwide²⁰. A family of four where both parents use ITINs missed out on \$5,800 in federal stimulus payments. At the state level, some undocumented adults received a one-time payment of \$500 through the Disaster Relief Assistance for Immigrants Program in May 2020. However, only 150,000 payments were available, while California is estimated to have over 2 million undocumented individuals.

The Governor's budget proposes distributing a \$600 one-time refund to taxpayers who received CalEITC for the 2019 tax year, and to the newly eligible ITIN-filers who receive CalEITC for the 2020 tax year. The payments for the 2019 filers would be distributed in February and March, and the payments for the 2020 ITIN-filers would be distributed as their returns are filed. Taxpayers who file using SSNs who claim the credit in 2020 but did not claim the credit in 2019 would not be eligible. The payment would be tax free, and could not be redirected for owed child, family, or spousal support, or for income tax liability, although it may be intercepted for other types of debt and bank liens. It also excludes individuals who are deceased or incarcerated who also file as single and do not have qualified dependents.

LAO Comment.

Targeting Governor's Proposal to Fill in Gaps Left in Federal Relief. Prior to the pandemic, many of California's low-income workers struggled to cope with the state's high cost of living. The pandemic has exacerbated this problem, as job losses have fallen disproportionately on low-wage workers. In light of this, the Governor's proposal to target relief to low-income Californians makes sense. However, the LAO suggests focusing on filling gaps in federal relief. While many 2019 EITC recipients have faced income losses during the pandemic, most have received significant federal income support. Due to enhanced unemployment insurance (UI) benefits and stimulus checks, income in 2020 for most EITC workers was similar, if not higher, than their 2019 income. In contrast, ITIN taxpayers and other undocumented workers have faced significant income losses but have not received UI benefits or stimulus checks. In addition, using the EITC to target pandemic relief may leave out some low-income Californians, including the over 20 percent of low-income workers who are eligible for the EITC but do not claim it.

The LAO proposes that the Legislature consider using a different approach to target populations in need. The LAO suggests narrowing the Governor's proposal to only include ITIN filers whose incomes fell below a certain amount in 2019 or 2020, and to increase the payment to these taxpayers above \$600. As an example, the state could provide a larger, \$1,800 refund per adult (equal to the federal stimulus payments) to ITIN filers with incomes below \$30,000. This approach likely would cost between \$700 million and \$1 billion. The Legislature could use the remaining funds to target the half or more of the state's undocumented workers who do not use an ITIN and would not be eligible for the refund, and the recipients of safety net programs, which include low-income Californians who likely have struggled with the rising costs of food and utilities and the potential inability to access government and community resources.

²⁰ <https://www.migrationpolicy.org/news/cares-act-excluded-citizens-immigrants-now-covered>

Staff Comment.

Support for ITIN taxpayers. As discussed above, ITIN taxpayers and their families have been excluded from federal aid during the pandemic, and the Legislature may want to consider increasing the amount of aid directed at this population. In 2019, 70 percent of ITIN-filers had dependents, and the average size of an ITIN tax unit was 2.3 (compared to 1.6 for SSN-filers who claimed CalEITC in 2019). The Legislature could consider disbursing per-person (rather than per-tax-unit) stimulus payments to ITIN taxpayers and their families. A family of four where both parents use ITINs would need to receive \$1,200 per adult and child to recoup 83 percent of the missed federal aid.

Tax year 2019 versus 2020. The proposal does not include SSN-filers who will claim CalEITC in 2020 but did not in 2019. It is not clear how many taxpayers fall into this group, as CalEITC eligibility has expanded most years, making it difficult to estimate the year-to-year turnover. It is also not clear how the COVID-19 pandemic will affect CalEITC claims, as economic instability may lead to more low-income workers, but enhanced unemployment benefits may actually disqualify some workers. An additional verification step would also be necessary to avoid double payments for taxpayers who received the credit both years. The Legislature may want to consider including this population anyway, or solely relying on 2020 claims for both ITIN and SSN filers. This would also help eliminate some issues with using older tax return data, where the recipients may have moved out of state or otherwise become ineligible for the refund.

Excluded populations who need support. As noted by the LAO, using the CalEITC population as a proxy for Californians who need aid may leave out other vulnerable populations. In particular, Supplemental Security Income/State Supplementary Payment recipients often do not have enough earned income to qualify for the credit.

Uptake among qualified recipients. As noted by the LAO, there are many qualified recipients who do not claim the credit, and therefore would be excluded from the Golden State Stimulus. ITINs are time-consuming and difficult to obtain, and some undocumented workers may not trust the process. In addition, some Californians are simply not aware that they qualify for the credit. SB 1409 (Caballero), Chapter 114, Statutes of 2020 was passed in response to this issue and directs the Franchise Tax Board to develop a plan to increase the number of CalEITC claims. The Legislature may want to consider how this issue affects the Golden State Stimulus. There may be a more immediate need to increase participation in CalEITC among both SSN and ITIN filers, such as making the payment retroactive for late filers or expanding tax assistance programs. Alternatively, the payment could be distributed to different populations, as suggested by the LAO.

Potential for redirection of payments for debt. The current trailer bill language prevents the payment from being redirected for owed child, family, or spousal support, or to offset tax liability. However, the payment would be subject to a bank lien if there was one on the account where the payment was deposited. The Legislature may want to consider whether there are additional protections that should be put in place to ensure the stimulus payments are not intercepted.

Lack of time to verify ITINs. The Franchise Tax Board can immediately verify SSNs, but not ITINs. Some portion of CalEITC claims filed each year are fraudulent. A large, direct payment may drive additional fraudulent claims this year, especially for unverifiable ITINs.