




STATE OF ARKANSAS  
**Department of Finance  
and Administration**

**OFFICE OF STATE BUDGET**  
1509 West Seventh Street, Suite 402  
Post Office Box 3278  
Little Rock, Arkansas 72203-3278  
Phone: (501) 682-5372  
[www.arkansas.gov/dfa](http://www.arkansas.gov/dfa)

Memorandum

TO: Governor Asa Hutchinson  
Secretary Larry Walther, Department of Finance and Administration

From: Robert Brech, State Budget Officer 

DATE: July 26, 2022

Subject: Safe Harbor Provisions of the American Rescue Plan Act

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Arkansas has recently contemplated the acceleration of individual and corporate tax cuts passed in a special session December 2021 and has considered temporary low-income tax relief. These actions have been considered as an effort to provide tax relief during the current inflationary period, along with continued revenue collections that have surpassed funds needed to provide for essential governmental services. These tax issues would be brought up in a special session called by Governor Hutchinson scheduled for early next month.

As part of the process leading up to the special session, there have been grave concerns regarding the potential for recoupment under the American Rescue Plan Act ("ARPA"). ARPA does contain provisions relating to the recoupment of funds should they be used improperly. The Act has specific provisions outlining the proper use of the ARPA funds. The Act states at 42 U.S.C. § 802(c)(2)(A):

A State or territory shall not use the funds provided under this section or transferred pursuant to section 603(c)(4) to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase.

It is clear that funds are not to be used to offset a reduction in the net tax revenue of a state following tax cuts implemented by the Arkansas General Assembly. However, it is not required nor planned for this to occur. Arkansas's budget grew during the recent fiscal session at a normal percentage, while revenues continue to surpass budgetary needs. It is the reduction of excess revenue that will be used to pay for the tax decreases. Absolutely no ARPA funds will be used to directly offset the potential tax cuts. Any indirect offset would be difficult to compute, if it exists.

Should funds be used in violation of ARPA, there is a recoupment provision that could be applicable. Section 802(e) states:

Any State, territory, or Tribal government that has failed to comply with subsection (c) shall be required to repay to the Secretary an amount equal to the amount of funds used in violation of such subsection, provided that, in the case of a violation of subsection (c)(2)(A), the amount the State or territory shall be required to repay shall be lesser of (1) the amount of the applicable reduction to net tax revenue attributable to such violation; and (2) the amount of funds received by such State or territory pursuant to a payment made under this section or a transfer made under section 603(c)(4).

Even if there was a finding that Arkansas indirectly utilized ARPA funding to offset tax reductions, the potential liability would be severely limited. The Department of Finance and Administration has been making the calculations necessary to determine if the safe harbor provisions would be applicable. Those calculations are based on 2019 state tax collections adjusted for inflation. It is a real possibility that Arkansas will fail the initial test after tax cuts have been implemented; however, it will not fail the test of using funds in violation of ARPA. In the event it should, the potential liability will be diminished greatly and not what was previously estimated.

The Department has reached out to the attorneys in the Attorney General's Office that have been involved in a case regarding ARPA. In a case filed March 31, 2021 in the Northern District of Alabama, Western Division, Arkansas joined twelve other states seeking to invalidate and enjoin the "Tax Mandate" of the American Rescue Plan Act. The Court ruled the States' motion for a final judgment and a permanent injunction was granted and the Treasury Department's motion to dismiss was denied. The Court permanently enjoined the Secretary of the Department of Treasury from seeking enforcement of the Tax Mandate against Arkansas and the twelve other states. The Court's decision is being appealed to the Eleventh Circuit Court of Appeals. The Court made reference to a response provided by then Secretary Janet Yellen of Department of Treasury to twenty-one states that made inquiries regarding the Tax Mandate. In that response, the Secretary wrote:

Nothing in the Act prevents States from enacting a broad variety of tax cuts. That is, the Act does not "deny States the ability to cut taxes in any manner whatsoever." It simply provides that funding received under the Act may not be used to offset a reduction in net tax revenue. If states lower certain taxes but do not use funds under the Act to offset those cuts—for example, by replacing the lost revenue through other means—the [Tax Mandate] is not implicated.

The Attorney General's Office has indicated the potential for any recoupment is extremely low. Given Arkansas's current economic condition, record surpluses the previous two fiscal years, and forecasted surpluses next year with or without further tax reductions, the Tax Mandate should not be a factor in moving forward with the proposed tax changes.