STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Burke Bill Number: AB 1577

SUBJECT

Coronavirus Aid, Relief, and Economic Security (CARES) Act and subsequent amendments in the Paycheck Protection Program and Health Care Enhancement Act and the Paycheck Protection Program Flexibility Act of 2020, related to loan forgiveness

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), exclude from gross income covered loan amounts forgiven pursuant to the federal CARES Act (Public Law 116-136), Paycheck Protection Program and Health Care Enhancement Act (Public LAW 116-139), or the Paycheck Program Flexibility Act of 2020 (Public Law 116-142) for taxable years beginning on and after January 1, 2020.

REASON FOR THE BILL

The reason for this bill is to provide relief to individuals and businesses currently suffering from unexpected economic difficulties caused by the COVID-19 pandemic.

ANALYSIS

Under the PITL and CTL, this bill would, for taxable years beginning on and after January 1, 2020, exclude from gross income covered loan amounts that are forgiven under the Paycheck Protection Program (PPP) established by section 1106 of the CARES Act (Public Law 116-136), and modified by the Paycheck Protection Program and Health Care Enhancement Act (Public Law 116-139) and Paycheck Program Flexibility Act of 2020 (Public Law 116-142). This bill defines a covered loan as a loan guaranteed under paragraph (36) of section 7(a) of the Small Business Act, as added by the CARES Act. The covered loans are generally low interest loans made from February 15, 2020, through June 30, 2020, that are provided to certain small businesses and self-employed individuals for an eight-week period, beginning on the date of origination of the covered loan, for the purpose of covering payroll and other eligible expenses.

The Paycheck Protection Program and Health Care Enhancement Act (Public Law 116-139), increased appropriations for the PPP. The Paycheck Protection Program Flexibility Act of 2020 (Public Law 116-142), among other things, modified the definition of “covered period” to replace the eight-week period with a date that begins on the date of origination of a covered loan and ends the earlier of 24-weeks after the origination date or December 31, 2020.

This bill also provides that any deduction or credit otherwise allowable under this section be reduced by the amount of the exclusion allowed.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2020.

Federal/State Law

Federal Law

Under section 1106 of the CARES Act, a recipient of a covered loan under the PPP is eligible for forgiveness of indebtedness on the loan in an amount generally equal to the sum of certain costs incurred and payments made during the eight-week period beginning on the date of the origination of the covered loan, including payroll costs, certain mortgage interest payments, certain rent payments and certain utility payments.

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness. (Internal Revenue Code (IRC) sections 61(a) (11)).

The CARES Act specifically excluded the income resulting from the discharge of PPP loans from gross income for federal purposes under section 1106 of the Act (pursuant to the authority of Title 15 USCA 636(a) (7)).

The Paycheck Protection Program and Health Care Enhancement Act (Public Law 116-139), increased appropriations for the PPP.

The Paycheck Protection Program Flexibility Act of 2020 (Public Law 116-142), amended the CARES Act and Small Business Act to modify certain provisions related to loan forgiveness under the PPP, among other provisions.

State Law

California generally conforms to IRC section 61 pursuant to Revenue and Taxation Code sections 17071 and 24271 as of January 1, 2015, except as otherwise provided.

California does not conform to the CARES Act's exclusion from gross income for the cancellation of indebtedness income related to PPP loans. Therefore, the cancellation of indebtedness income resulting from covered loan forgiveness under the PPP is included in gross income for California purposes, unless another exclusion applies.

Also, California does not conform to the changes to the PPP under the Paycheck Protection Program and Health Care Enhancement Act (Public Law 116-139), or to the Paycheck Protection Program Flexibility Act of 2020 (Public Law 116-142),

Implementation Considerations

None noted.

Technical Considerations

None noted.

LEGISLATIVE HISTORY

AB 3208 (Kiley and Obernolte, 2019/2020) would, under the PITL and the CTL, exclude from gross income covered loan amounts forgiven pursuant to the PPP under the CARES Act for taxable years beginning on or after January 1, 2020. As of May 6, 2020, this bill is in the Assembly Revenue and Taxation committee.

PROGRAM BACKGROUND

The PPP provides forgivable loans to businesses to fund payroll costs including benefits for the covered period that begins on the date of origination and ends 24-weeks after the date of origination of a covered loan or December 31, 2020, whichever is earlier. Funds can also be used to pay interest on mortgages, rent, and utilities. These loans are implemented by the Small Business Administration (SBA) to help businesses keep their workforce employed during the Coronavirus (COVID-19) crisis.

As relevant to the PPP, according to the Small Business Administration's website, loan forgiveness is based on the employer rehiring and maintaining employees and their salary levels. Forgiveness will be reduced if full-time headcount declines, or if salaries and wages decrease.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill as amended July 9, 2020, would have a revenue impact, however, the amount of revenue impact to the General Fund is unknown. The revenue impact of this bill depends on the portion of these loans that are forgiven, as well as the timing and amount of the related business expense deductions claimed, which is difficult to predict until the forgiveness of covered loans begins.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

This bill would exempt from taxation the forgiveness of qualified amounts of loans from the PPP. Data from the U.S. Small Business Administration's PPP Report indicates that California taxpayers received approximately $67 billion in loans from the PPP as of July 10, 2020. It is expected that additional loans will be issued under this program. The revenue impact will increase in proportion to the amount of money ultimately received from the PPP. The revenue impact of this bill depends on the portion of these loans that are forgiven, which is difficult to predict. The average tax rate on the forgiven income is estimated to be about 6 percent. Thus, if about one third of PPP loans would be forgiven, the revenue loss from the exemption of tax would be about $400 million for each $20 billion of PPP loans to California taxpayers; and if 80 percent of the PPP loans are ultimately forgiven, the revenue loss would be approximately $1 billion for each $20 billion of loans. The timing of the revenue impact will depend on when the loans are forgiven, but will likely fall mostly in FY 2020/2021 or FY 2021/2022.

In addition, under IRS notice 2020-2032, otherwise deductible business expenses may not be deducted if they are paid with funds from forgiven PPP loans. In concept, the denied deductions would offset the cancellation of indebtedness income and there would be no revenue impact. In practice, however, there may be complications.

For example, if a taxpayer incurs expenses in 2020 but does not have their loan forgiven until 2021, the increase in income from the disallowed deduction will occur in an earlier year than the decrease in cancellation income. If the taxpayer is in a different tax bracket in the two years, there would be a change in tax even though the total amount of income taxed over the two years is the same. It seems likely in this case that some taxpayers will be in a higher tax bracket in 2021 than in 2020, in which case there would be a net revenue loss from this bill.

Also, taxpayers may claim their deductions for 2020 before they know their loan will be forgiven. If so they may need to file an amended return to reverse those deductions. Some may delay filing those amended returns in which case the forgiveness of cancellation income will result in delayed receipt of revenue. It is also possible that some taxpayers will fail to file amended returns which could result in additional revenue losses.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

VOTES

Location	Date	Yes Votes	No Votes
Concurrence	August 30, 2020	74	0
Senate Floor	August 28, 2020	39	0
Assembly Floor	May 2, 2019	76	0

LEGISLATIVE STAFF CONTACT

Yolanda Richardson
Agency Secretary, GovOps
Work (916) 651-9011

Christina Spagnoli
Legislative Deputy, GovOps
Work (916) 651-9373

Selvi Stanislaus
Executive Officer, FTB
Work (916) 845-4543

Annette Kunze
Legislative Director, FTB
Work (916) 845-6333