STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Kiley and Obernolte	Sponsor:	Bill Number: AB 3208
Analyst: Margo Cave	Phone: (916) 845-7475	Introduced: February 21, 2020
Attorney: Shane Hofeling	Related Bills: See Legislative History	Amended: May 4. 2020 and May 5, 2020.

SUBJECT

Payroll Protection Program 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 Paycheck Protection Program (PPP) under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Public Law 116-136) for taxable years beginning on or after January 1, 2020.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

This bill as introduced February 21, 2020, made nonsubstantive changes to the definition of a non-resident under Revenue and Taxation Code (R&TC) section 17015.

On May 4, 2020, the bill was amended to allow a credit against tax in an amount equal to 50 percent of the amount donated to a qualified charitable organization for taxable years beginning on or after January 1, 2021, and before January 1. 2026.

The May 5, 2020, amendments removed the provisions of the bill related to a credit for donations to qualified charitable organizations and replaced them with the provisions discussed in this analysis.

This is the department's first analysis of the bill.

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 or after January 1, 2020, exclude from gross income covered loan amounts that are forgiven under the PPP established by the CARES Act. 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. For the purpose of this bill, 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 for the purpose of covering payroll and other eligible expenses.

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)).

State Law

California generally conforms to IRC section 61 pursuant to R&TC Code sections 17071 and 24271, 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.

Implementation Considerations

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The Paycheck Protection Program Flexibility Act of 2020 (HR 7010; PL 116-142) was signed by the President on June 5, 2020 and it amendments CARES Act section 1106. The author may want to amend the bill to include the amendments included in PL 116-142.

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

Research of California legislative history found no legislation similar to the provisions of this bill.

By conforming the state's rules to the federal law that allows cancellation of indebtedness income from PPP loans to be excluded from gross income, this bill would help simplify the preparation of California tax returns for those years to which the provisions apply.

PROGRAM BACKGROUND

The PPP provides forgivable loans to businesses to fund up to eight weeks of payroll costs including benefits. 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

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

ECONOMIC IMPACT

Revenue Estimate

This bill as amended May 5, 2020 would have a revenue loss, 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, 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.

Because the impact of current economic circumstances is unknown, this estimate is subject to change.

Revenue Discussion

This bill would exempt from taxation the forgiveness of qualified amounts of loans from the new federal PPP. Data from the U.S. Small Business Administration's PPP Report indicates that California taxpayers received approximately $66 billion in loans from the PPP as of May 30, 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 will be forgiven, the revenue loss from this bill 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 almost $900 million for each $20 billion of loans. The timing of the revenue loss will depend on when the loans are forgiven, but will likely fall mostly in FY 2020/2021 or
FY 2021/2022.

LEGAL IMPACT

None Noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

None noted.

LEGISLATIVE STAFF CONTACT

Margo Cave
Legislative Analyst, FTB
(916) 845-7475
margo.cave@ftb.ca.gov

Tiffany Christiansen
Revenue Manager, FTB
(916) 845-5346
tiffany.christiansen@ftb.ca.gov

Annette Kunze
Legislative Director, FTB
(916) 845-6333
annette.kunze@ftb.ca.gov