STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Burke, et al.	Sponsor:	Bill Number: AB 80
	Related Bills: See Legislative History	Amended: February 17 and April 15, 2021

SUBJECT

Forgiven Loan Exclusion Expansion & Modified Conformity to Paycheck Protection Program Business Expense Deductions

SUMMARY

For taxable years beginning on or after January 1, 2019, this bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), expand the exclusion from gross income for covered loan amounts forgiven pursuant to California conformity to certain federal provisions. This bill would also conform to the exclusion from gross income for advance grant amounts forgiven pursuant to certain federal provisions, and conform to the allowance of deductions and treatment of tax basis and other tax attributes relating to business expenses paid with forgiven covered loan amounts under the Paycheck Protection Program (PPP), except for ineligible entities, as specified.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The February 17, 2021, amendments removed provisions of the bill related to the moratorium on evictions for non-payment of rent due to a COVID-19 financial hardship and replaced them with provisions that would have expanded the California conformity to the exclusion from gross income for covered loan amounts forgiven pursuant to certain federal provisions to taxable years beginning on or after January 1, 2019, and would have allowed business deductions, for taxable years beginning on or after January 1, 2019, not to exceed $150,000, for certain business expenses paid with these loan amounts.

The April 15, 2021, amendments modified the California conformity provisions related to the exclusion from gross income for covered loan amounts forgiven pursuant to certain federal provisions and the limited allowance of certain business expenses, 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 small businesses currently suffering from unexpected economic difficulties caused by the COVID-19 pandemic.

ANALYSIS

This bill, under the PITL and CTL, would extend the exclusion from gross income of PPP covered loan amounts that are forgiven under California's current conformity to certain federal provisions, which includes the PPP established by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Public Law (PL) 116-136), modified by the Paycheck Protection Program and Health Care Enhancement Act (PL 116-139), and the Paycheck Program Flexibility Act of 2020 (PL 116-142), from taxable years beginning on or after January 1, 2020, to taxable years beginning on or after January 1, 2019.

This bill would also conform to the exclusion from gross income of PPP covered loan amounts and Economic Injury Disaster Loan (EIDL) advance grant amounts that are forgiven under the Consolidated Appropriations Act, 2021 (CAA) (PL 116-260) for taxable years beginning on or after January 1, 2019. This bill would also provide the same treatment for PPP Second Draw loans, provided under the CAA, which have the same general loan terms as the PPP First Draw loans.

In addition, this bill would adopt the provisions of the CAA that prohibit any denial of tax deductions, denials of basis increases, and prevent required reductions in tax attributes based on the exclusion from gross income provided for any covered loan or advanced grant amount forgiven, except for an ineligible entity, as defined.

With respect to the income exclusion for covered loan amounts forgiven pursuant to California's current conformity to certain federal provisions, this bill would remove the requirement that any credit or deduction for amounts paid or incurred by the taxpayer be reduced by the amount of the exclusion allowed under this section.

For purposes of this bill:

1) "Covered loan" means a PPP loan amount provided pursuant to the CARES Act or the CAA.
2) "Advance grant amount" means an EIDL grant amount provided pursuant to the CARES Act or the CAA.
3) "Ineligible entity" means a taxpayer that either:
    A. Is a publicly-traded company.
    B. Does not meet a twenty-five percent (25%) or more reduction in gross receipts in 2020 as compared to the same period in 2019 requirement for issuance of covered loans under the PPP, as added by the CAA. There

are additional rules provided for new businesses. (This bill incorporates the federal twenty-five percent (25%) or more reduction in gross receipts test as described in the Small Business Act (15 United States Code (USC) 636(a)(37)(A)(iv)(bb)) added by the CAA.)

For purposes of complying with Section 41, this bill states that the Legislature finds and declares that the specific goal, purpose, and objective that the deductions, tax basis, and other attributes is to provide relief to California small businesses that have been harmed economically by the COVID-19 pandemic shall include whether these goals are met and the extent to which the businesses that received the PPP loans and subsequently used the deductions, tax basis, and other attributes reflect the industries, regions, and businesses, by type of ownership, that were most substantially harmed by the COVID-19 pandemic, and whether any particular industries, regions, or businesses, by type of ownership, in the business community were not able to participate in the PPP loans and the deductions, tax basis, and other attributes.

The Legislative Analyst's Office (LAO) would be required to collaborate with the Franchise Tax Board (FTB), as well as reviewing other publicly available data, to analyze whether the PPP loans and the tax benefits of the deductions, tax basis, and other attributes were distributed evenly over industries, regions, and businesses by type of ownership harmed by the COVID-19 pandemic and would be required to report by January 1, 2024, to the Legislature.

The LAO may request information from the FTB for purposes of this data collection requirement. The FTB would be required to provide any available data requested by the LAO pursuant to this subdivision and the disclosure provisions of this bill would be an exception to Revenue and Taxation Code (RTC) section 19542.

The rulemaking procedures under the Administrative Procedure Act would not apply to any standard, criterion, procedure, determination, rule, notice, guideline, or any other guidance established or issued by the FTB pursuant to the provisions of this bill.

This bill contains a provision that the benefits authorized by this bill would not constitute a gift of public funds.

Effective/Operative Date

As an urgency measure, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2019.

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 either the eight-week or the 24-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) section 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 CARES Act (pursuant to the authority of Title 15 USC 636(a)(7)).

The PPP and Health Care Enhancement Act, increased appropriations for the PPP. The Paycheck Protection Program Flexibility Act of 2020, 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.

Section 276 of the CAA, among other things, provided a "second draw" for certain businesses under the PPP and, in addition to the loan forgiveness itself being excluded from income, any expenses paid with loan proceeds are deductible.

Additionally, no basis or tax attribute adjustment is required with respect to the underlying forgiveness of debt and/or the exclusion from income of the forgiven debt. The CAA, also provided the EIDL, which are low-interest loans with a 30-year repayment, no loan payments due during the first year, for up to ten thousand dollars ($10,000). EIDL advance grants were targeted to businesses located in low-income communities to ensure small business continuity, adaptation, and resiliency.

The American Rescue Plan Act of 2021 (ARPA) (PL 117-2), enacted in March 2021, among other things, extended additional CAA funding from December 31, 2021, to September 30, 2022, expanded the PPP to include additional nonprofits and certain internet publishing companies, provided restaurant revitalization grants, and excludes from gross income other targeted EIDL advance grant amounts forgiven pursuant to certain federal provisions.

State Law

California generally conforms to IRC section 61 pursuant to RTC sections 17071 and 24271 as of January 1, 2015, except as otherwise provided. For taxable years beginning on or after January 1, 2020, California conforms to the exclusion from gross income for covered loan amounts that are forgiven under the PPP established by Section 1106 of the CARES Act, and modified by the Paycheck Protection Program and Health Care Enhancement Act, and Paycheck Program Flexibility Act of 2020. California law specifically provides that any deduction or credit otherwise allowable, and upon which the exclusion is based, be reduced by the amount of the exclusion allowed.

California has not conformed to the changes to the PPP program made by the CAA or the ARPA.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 281 (Burke, 2021/2022), is a "spot" bill that states the intent of the Legislature is to enact legislation that would bring California's tax treatment of covered PPP into conformity with federal tax laws. AB 281 was held in the Assembly pending referral.

AB 708 (Garcia, 2021/2022), AB 936 (Chen, 2021/2022), and AB 1380 (Fong, 2021/2022), which are also related to PPP conformity, would, under the PITL and CTL, expand the exclusion from gross income for covered loan amounts forgiven pursuant to California conformity to certain federal acts and conform to the allowance of deductions and treatment of tax basis, and other tax attributes relating to business expenses paid with forgiven covered loan amounts under the PPP. These bills were held in the Assembly Revenue and Taxation Committee without further action.

SB 265 (Borgeas, 2021/2022), for taxable years beginning on or after January 1, 2019, this bill would, under the PITL and the CTL, expand the exclusion from gross income for covered loan amounts and advance grant amounts forgiven pursuant to California conformity to certain federal acts and conform to the allowance of deductions and treatment of tax basis and other tax attributes relating to business expenses paid with forgiven covered loan and advanced grant amounts. SB 265 was held in the Senate Governance and Finance Committee without further action.

AB 1577 (Burke, Chapter 39, Statutes of 2020), under the PITL and the CTL, provided an exclusion from gross income covered loan amounts forgiven pursuant to the federal CARES Act, Paycheck Protection Program and Health Care Enhancement Act, or the Paycheck Program Flexibility Act of 2020 for taxable years beginning on and after January 1, 2020. It also prohibited the deduction of expenses paid with excluded income.

AB 3208 (Kiley and Obernolte, 2019/2020) would have, under the PITL and the CTL, excluded 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. AB 3208 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

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 United States Small Business Administration (SBA) to help businesses keep their workforce employed during the COVID-19 pandemic.

As relevant to the PPP, according to the SBA'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.

EIDLs are low-interest loans for up to ten thousand dollars ($10,000) with a 30-year repayment with no loan repayment for first year. EIDL advance grants were targeted to businesses located in low-income communities to ensure small business continuity, adaptation, and resiliency.

Eligible applicants include:

- Businesses with 500 or fewer employees or defined as small per the SBA Standards.
- Cooperatives with 500 or fewer employees.
- Agricultural enterprises with 500 or fewer employees.
- Most private nonprofits.
- Faith-based organizations.
- Sole proprietorships and independent contractors.

FISCAL IMPACT

This bill would not significantly impact the department's costs; however, the changes proposed in this bill could result in additional amended returns being filed by impacted taxpayers that have already filed a tax return prior to enactment.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 80 as Amended April 15, 2021
Assumed Enactment after June 30, 2021

($ in Millions)

Fiscal Year	Revenue
2020-2021	-$140
2021-2022	-$2,900
2022-2023	-$1,500
2023-2024	-$950

This estimate represents a point in time and is therefore subject to change as new information becomes available. 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

Based on data from the SBA's PPP, as of April 11, 2021, California taxpayers received approximately $100 billion in loans from all PPP approved lending.

Under the current PPP, taxpayers are able to receive loans, up to specified amounts, to assist in paying certain business expenses during the COVID 19 restrictions. If requirements are met, taxpayers can apply for forgiveness of the loan. The amount of loans forgiven are excluded from taxable income, but the expenses related to the loan amount are not deductible. The provisions of this bill allow eligible taxpayers to deduct expenses previously disallowed under the existing program, up to the amount of the loan forgiven.

It is estimated that approximately 75 percent (75%), or $75 billion, of participants would apply for and receive loan forgiveness. It is expected that roughly 50 percent (50%) of that amount would be approved by the end of calendar year 2021.

Research indicates that approximately 90 percent (90%) of forgiven loans, or approximately $70 billion, would be to taxpayers that meet the eligibility requirements as specified in the bill. This translates into approximately $70 billion of business expense deductions that were previously disallowed.

Applying an average tax rate of 10 percent (10%), the estimated revenue loss from allowing these expenses would be approximately $7 billion.

It is expected that taxpayers would only be able to use about 60 percent (60%), or $2.3 billion, in qualified expenses in the 2020 and 2021 taxable years. The remaining expenses would be carried forward to be used in future years as business losses.

Based on data from the SBA's EIDL program, California taxpayers received approximately $5 billion in EIDL advance grants. Applying an average tax rate of 7 percent (7%) would result in an estimated total revenue loss of approximately $350 million. It is estimated the revenue impact would take place over a period of 5 years and that approximately 30 percent (30%), or $100 million, would occur during the 2020 and 2021 taxable years.

The tax year estimates are converted to fiscal year estimates, accrued back to account for amended returns, and then rounded to arrive at the amounts reflected in the above table.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

Arguments in Support

The Assembly Floor Analysis dated April 26, 2021, includes the following argument in support of AB 80: "Supporters state that 'PPP loans became a necessary lifeline to many retailers that have endured significant financial hardship during the pandemic. PPP loans are instruments of relief, not a means to increase the tax liability of struggling community businesses. We applaud the author for recognizing the need for greater tax conformity with federal law, preventing further economic hardship for retailers across the state."

Arguments in Opposition

The Assembly Floor Analysis dated April 26, 2021, stated that there is no opposition on file.

LEGISLATIVE CONTACT

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