

## CONCURRENCE IN SENATE AMENDMENTS

AB 1577 (Burke)

As Amended July 9, 2020

Majority vote. Tax Levy

**SUMMARY:**

Conforms state law to federal law to allow taxpayers to exclude the amount of Paycheck Protection Program (PPP) loans provided to California small businesses under the Coronavirus Aid, Relief, and Economic Security (CARES) Act for state tax purposes, and denies the business expense deduction for those expenses that were paid for using forgiven loan funds.

**The Senate Amendments:**

Delete the previous contents of this bill related to microenterprise provisions in the Business and Professions Code, and instead conforms state law to changes made to federal law by the CARES Act for PPP loans.

**COMMENTS:**

*Background:* The COVID-19 pandemic, also known as the coronavirus pandemic, is an ongoing, widespread outbreak of the disease caused by a strain of the coronavirus. The first cases in the United States occurred in early 2020 and the first California case was confirmed in late January. To control the spread of the disease, California, and other states, issued mandatory "stay-at-home" orders. These orders devastated the economy and left thousands out of work and struggling to pay for necessities. California's unemployment rate rose to a record high 16.3% in May as the state's employers lost 2,415,000 nonfarm payroll jobs, according to the Employment Development Department. In Response to the pandemic and the financial impact of the "stay-at-home" orders, CARES Act was passed by Congress and signed into law by President Trump on March 27th, 2020. The CARES Act was an over \$2 trillion economic relief package which includes many provisions to help Americans with the economic impacts of the COVID-19 pandemic. One of the items included in the Act is the "Paycheck Protection Program" (PPP), which provides to small businesses loans that can be forgiven under specified circumstances.

The PPP allows small businesses to apply for a loan to maintain their payroll and some overhead expenses through the period of emergency. Generally, the PPP is available to any business, nonprofit organization, veteran's organization, or tribal business that employs fewer than 500 employees. To receive financial assistance, the eligible small businesses must show that it has been negatively impacted by the pandemic. If a small business chooses to take a loan under the PPP, the small business may apply to have some or all of the loan forgiven. The amount that may be forgiven is the amount equal to the total cost of payroll, mortgage interest payments, rent and utility payments paid during the 24-week period after the loan is distributed. The CARES Act explicitly exempted the amount of loan that is forgiven from income for federal purposes, and an IRS notice stated that expenses paid from PPP loans could not be claimed as ordinary and necessary business expense deductions.

*Cancellation of debt and deducting expenses:* When a lender cancels a borrower's debt, federal and state law generally treat the amount of debt cancelled as income. The CARES Act explicitly exempts the amount of PPP loan that is forgiven from income for federal purposes. California does not conform to this provision. Additionally, current federal and state laws generally allow taxpayers to deduct ordinary and necessary business expenses. However, because forgiven PPP

loans are not taxable, the Internal Revenue Services has issued a notice preventing the deduction of expenses that are paid for by forgiven PPP loans.

*What does this bill do?* State law does not automatically conform to changes in federal tax law, except for specific retirement provisions. Instead, the Legislature must affirmatively conform to federal changes. This bill conforms state law to federal law to allow the amount of PPP loan provided to California small businesses under the CARES act to be excluded from gross income for state tax purposes. This bill also denies the business expense deduction for those expenses that were paid for using forgiven loan funds.

*Revenue?* Due to the unpredictability of when, to whom, and how much of the PPP loans will be forgiven, a revenue estimate cannot be provided. However, because this bill disallows a deduction for businesses expenses that were paid for using forgiven PPP funds, it is anticipated that the revenue impact should be minimal because a business expense is disallowed for the amounts that are forgiven.

**Accordinging to the Author:**

AB 1577 conforms California to the federal Paycheck Protection Program's (PPP) Loan Forgiveness provisions. The Coronavirus Aid, Relief, and Economic Security (CARES) ACT, and subsequent legislation, established and expanded the PPP, which provides small businesses with loans to help pay up to eight weeks of payroll costs, mortgages, rent, and utilities during the COVID-19 crisis. If certain requirements are met, recipients may have their loans forgiven, and those forgiven loans are specifically excluded from gross income. Unfortunately, California does not conform to the federal exclusion, which means business owners may potentially have to pay taxes on forgiven loans. Without conformity, taxpayers would have to include forgiven PPP debt as income for state purposes while excluding it for federal purposes, and disallowing expenses for federal purposes while allowing expenses for state purposes. The mismatch in treatment of income and expensing can be extremely confusing and may result in errors. Conformity would provide clarity with respect to how taxable income is treated. It also seems unfair that a program that is designed to help keep businesses afloat during this very difficult time may ultimately add additionally financial stress

**Arguments in Support:**

Supporters state that "The PPP provided countless California small businesses and nonprofit organizations with a much-needed influx of funds during an unprecedented economic recession. An integral component of the PPP is the ability for much of the loan amount to become forgivable when spent on qualifying expenses such as payroll costs, mortgage interest, rent, and utilities. This unique feature helped small businesses get the immediate financial support they needed to stay afloat without having to incur long-term debt." Supporters further state that "California does not automatically conform to this narrow exemption, which means that the forgiveness of a PPP loan remains taxable gross income for California purposes. This creates a scenario where a taxpayer's cancelled debt income from a forgiven PPP loan is not taxable for federal purposes, but is taxable for California purposes – leading to an unexpected, and potentially significant, tax liability. AB 1577 would address this issue by bringing California's tax laws into alignment with current federal tax rules related to the tax treatment of forgiven PPP loans."

**Arguments in Opposition:**

None on file

**FISCAL COMMENTS:**

According to the Franchise Tax Board, this bill "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." FTB further states that "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."

**VOTES:****ASM JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY: 7-0-0****YES:** Cervantes, Cunningham, Chau, Chen, Ramos, Luz Rivas, Smith**ASSEMBLY FLOOR: 76-0-4**

**YES:** Aguiar-Curry, Bauer-Kahan, Berman, Bigelow, Bloom, Boerner Horvath, Bonta, Brough, Burke, Calderon, Carrillo, Cervantes, Chau, Chen, Chiu, Choi, Chu, Cooley, Cooper, Cunningham, Dahle, Daly, Diep, Eggman, Flora, Fong, Frazier, Friedman, Gabriel, Gallagher, Cristina Garcia, Eduardo Garcia, Gipson, Gloria, Gonzalez, Gray, Holden, Irwin, Jones-Sawyer, Kalra, Kamlager-Dove, Kiley, Lackey, Levine, Limón, Low, Maienschein, Mathis, Mayes, McCarty, Medina, Melendez, Muratsuchi, Nazarian, O'Donnell, Obernolte, Patterson, Petrie-Norris, Quirk-Silva, Ramos, Reyes, Luz Rivas, Robert Rivas, Rodriguez, Blanca Rubio, Salas, Santiago, Smith, Mark Stone, Ting, Voepel, Waldron, Weber, Wicks, Wood, Rendon

**ABS, ABST OR NV:** Arambula, Grayson, Mullin, Quirk

**SENATE FLOOR: 39-0-1**

**YES:** Allen, Archuleta, Atkins, Bates, Beall, Borgeas, Bradford, Caballero, Chang, Dahle, Dodd, Durazo, Galgiani, Glazer, Lena Gonzalez, Grove, Hertzberg, Hill, Hueso, Hurtado, Jackson, Leyva, McGuire, Melendez, Mitchell, Monning, Moorlach, Morrell, Nielsen, Pan, Portantino, Roth, Rubio, Skinner, Stern, Umberg, Wieckowski, Wiener, Wilk

**ABS, ABST OR NV:** Jones

**UPDATED:**

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