

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1060

Bill Subtitle: CONCERNING THE TAX TREATMENT OF FORGIVABLE SMALL BUSINESS LOANS AND EXPENSES RELATED TO THE CORONAVIRUS 2019 (COVID-19) CRISIS; AND TO DECLARE AN EMERGENCY.

Basic Change :

Sponsors: Rep. J. Mayberry and Sen. A. Clark

HB1060 would create a state income tax exemption for any portion of a small business loan forgiven under the Paycheck Protection Program (PPP), which is a part of the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act. The bill also would permit a state income tax deduction for eligible expenses that a business incurs in relation to a small business loan forgiven under PPP.

Under current Arkansas law, income that a business receives as a result of PPP loan forgiveness is subject to Arkansas corporate and individual income tax as a taxable gain that is includable in the taxpayer's gross income. See § 26-51-404(a) and (b)(10). The receipt of a PPP loan does not create taxable income in Arkansas unless the debt is forgiven, in whole or in part. Arkansas law also allows a deduction for eligible business expenses, including expenses that a business incurs by using forgiven PPP loan funds, if the expense otherwise qualifies as a business expense under state income tax law. See § 26-51-423(a)(1). Under current law, a taxpayer's payment of eligible business expenses with PPP loan funds, either forgiven or not, does not affect the taxpayer's ability to deduct eligible business expenses on the taxpayer's return.

HB1060 would be effective retroactively to tax years beginning on and after January 1, 2019.

Revenue Impact :

FY2021 - \$27 million reduction to State General Revenue.

FY2022 - \$107 million reduction to State General Revenue.

\$134 million – Total reduction to State General Revenue for both FY2021 and FY2022 for Round 1 of PPP loans forgiven (\$3.3 billion) under HB1060.

[PPP loans have totaled \$525 billion nationwide with \$3.3 billion going to Arkansas businesses and nonprofit organizations. The loan forgiveness process began in October 2020, and as of January, 14, 2021, approximately \$100 billion of the loans have been forgiven or approximately 19% of the \$525 billion funded. 88% of all loan requests have been approved so far and it is expected that rate to end up being 94%, because the majority of those rejected were due to lack of documentation. It is estimated that approximately 5% of PPP loans were made to non-profit organizations not subject to tax.

If 19% of the loan forgiveness attributable to Arkansas was approved in 2020, it is estimated a General Revenue loss of \$27 million would result in FY2021. The estimated General Revenue loss of adopting the exemption of PPP loan forgiveness in FY2022 for Round 1 of the PPP loan program is estimated to be \$107 million. The total reduction to State General Revenue resulting from forgiveness of Round 1 of PPP attributable to \$3.3 billion in Arkansas loans is \$134 million.

The Revenue Impact above utilizes an effective tax rate of 4.5%, which is slightly lower than the effective tax rate customarily used in a DFA Fiscal Impact Statement for individual income tax due and

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corporation income tax purposes due to the disparate economic impact resulting across different business sectors during the COVID-19 pandemic. The top tax rate for individual income tax in Arkansas was 6.9% in 2019, 6.5% in 2020, and is 5.9% in 2021. The top corporation income tax rate in Arkansas was 6.5% in 2020, 6.2% in 2021, and will be 5.9% in 2022.

The above Revenue Impact estimates are for Round 1 of the PPP loan program. The U.S. Congress authorized Round 2 of PPP loans in the amount of \$284 billion. It is unknown the amount of additional PPP loans that may be attributable to Arkansas borrowers and taxpayers. This Revenue Impact may be subject to adjustment in the future as additional data is made available.]

Taxpayer Impact :

A taxpayer that received loan forgiveness of a PPP loan would be allowed to exempt the part of the loan that is forgiven. A taxpayer would also be able to deduct related eligible expenses.

Resources Required :

Computer programs, tax forms, and instructions will need to be updated.

Time Required :

Adequate time is needed for implementation.

Procedural Changes :

Computer programs, tax forms and instructions and training manuals will need to be updated. Department employees will need to be educated as well as the tax community.

Other Comments :

The U.S. Small Business Administration reported that Arkansas Paycheck Protection Program loans totaled \$3.3 billion deriving from 43,669 loans.

Legal Analysis :

HB1060 creates a state income tax exemption for any portion of a small business loan that is forgiven through the Paycheck Protection Program, which is a part of the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act. The bill also permits a deduction for eligible expenses that a business incurs in relation to a small business loan forgiven under the Paycheck Protection Program. Under current law, the forgiven loan funds would be subject to Arkansas individual or corporate income tax because they constitute net income of the business. However, a taxpayer may deduct the cost of an eligible expense that otherwise qualifies as a business expense under state income tax law.

On Page 2, lines 2-5, Section 1(a)(4) includes a legislative finding that the United States Department of the Treasury and the Internal Revenue Service have stated that a business cannot take a deduction for

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an eligible expense that is otherwise deductible if the payment of that eligible expense results in forgiveness of a loan under the Paycheck Protection Program. On December 27, 2020, President Trump signed a new COVID-19 relief bill. Among other things, the new statute overrides prior federal guidance by providing that no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of a forgiven small business loan under the Paycheck Protection Program. For clarity, it may be beneficial to add a statement to Section 1(a)(4) that reads: "Subsequent amendments to federal law have overridden this federal guidance."

On Page 2, line 24, Section 2, the caption that reads "Forgiven small business loans and related expenses" likely should read "Forgiven small business loans." The statutory amendment created by Section 2 of this bill does not address the expenses related to forgiven small business loans. Section 3 of the bill addresses the related expenses by permitting a deduction for eligible expenses related to a small business loan that is forgiven or is anticipated to be forgiven under the Paycheck Protection Program.

On Page 2, lines 35-36, Section 3, the phrase "in addition to all other deductions allowed by law" may benefit from deletion in order to achieve greater clarity. Current law already allows a deduction for eligible business expenses, including expenses that a business incurs by using forgivable loan funds, if the expense otherwise qualifies as a business expense under state income tax law. Deleting the phrase "in addition to all other deductions allowed by law" could help avoid the misperception that a taxpayer could claim two deductions for the same expense: (1) once as an eligible business expense; and (2) again as an eligible expense related to a small business loan that is forgiven or is anticipated to be forgiven under the Paycheck Protection Program.

This bill contains an emergency clause. The emergency clause provides that it will become effective on the earliest of the following: (1) the date of its approval by the Governor; (2) if the Governor neither approves nor vetoes the bill, the expiration of the period of time during which the Governor may veto the bill; or, (3) if the Governor vetoes the bill, the date the last house overrides the veto. The bill states that its provisions creating an exemption from income tax and permitting a business expense deduction are effective for tax years beginning on or after January 1, 2019.