Department of Finance and Administration

Legislative Impact Statement

Bill: HB1361 Amendment Number: H1
Bill Subtitle: TO PROVIDE FOR THE TAX TREATMENT OF CERTAIN LOANS, PAYMENTS, AND EXPENSES RELATED TO CORONAVIRUS 2019 (COVID-19) RELIEF PROGRAMS; AND TO DECLARE AN EMERGENCY.

Basic Change :

Sponsors: Reps. Eaves, Beaty Jr., L. Fite, Fortner, D. Garner, Hawks, M. Hodges, Jean, Jett, Lundstrum, Lynch, J. Mayberry, McClure, McCollum, M. McElroy, McGrew, McNair, Milligan, Vaught, Warren, and Wooten
Sen. J. Dismang

House Amendment No. 1 --- HB1361-H1 amends the language of the original bill to clarify that the exclusion from gross income of forgiven PPP loans and other CARES Act funds does not affect the inclusion of such income for purposes of calculating net operating loss carryovers under § 26-51-427(2).

Original Bill --- HB1361 amends the Income Tax Act of 1929 to track certain provisions of federal COVID-19 relief legislation. The bill excludes income that a taxpayer received through certain federal COVID-19 relief programs, including loan forgiveness under the Paycheck Protection Program (PPP), Small Business Administration (SBA) grants under the Economic Injury Disaster Loan (EIDL) program, and payments received under the Coronavirus Food Assistance Program (CFAP), from the definition of gross income. The bill also permits the taxpayer to deduct otherwise allowable expenses incurred using forgiven PPP loans, EIDL grant funds, and CFAP funds.

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.

HB1361 would be effective retroactively to tax years beginning on and after January 1, 2019.

Revenue Impact :

FY2021 - $33 million reduction to State General Revenue.
FY2022 - $179 million reduction to State General Revenue.

$212 million - Total reduction to State General Revenue for FY2021 through FY2032 for Round 1 and Round 2 of PPP loans forgiven and EIDL Grants exempted under HB1361.

[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 the rate will ultimately be 94% because the majority of those rejected were due to lack of documentation. It is

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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 for Round 1 of the PPP loan program 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 general revenue resulting from forgiveness of Round 1 of PPP attributable to $3.3 billion in Arkansas loans is $134 million.

Round 2 of PPP loans are authorized for up to $284 billion by PL 116-260. The revenue impact for Round 2 of PPP loans is estimated at half the revenue impact of Round 1 and will affect FY2022 only.

EIDL loan advance payments and grants totaling $20 billion were authorized and funded in Round 1. $125.2 million in EIDL grants were made to 35,531 Arkansas businesses. Round 2 of the EIDL grant program is for another $20 billion total, and it is anticipated the same amount of grants would be given to Arkansas businesses.

The Revenue Impact above uses an effective tax rate of 4.5%. This rate is slightly lower than the effective tax rate customarily used in a DFA Fiscal Impact Statement for individual income tax and 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, 6.6% 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.]

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. A taxpayer that received a grant or loan advancement under the EIDL program would be allowed to exempt the grants from gross income. Students receiving emergency financial aid under various provisions of the CARES Act would be able to exempt the aid from gross income on their income tax returns.

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.

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Other Comments :

The U.S. Small Business Administration reported that Arkansas Paycheck Protection Program loans totaled $3.3 billion deriving from 43,669 loans and reported that Arkansas EIDL grants and loan advances totaled $125.2 million.

EIDL grants if given were to be an offset against PPP loans if awarded but were mostly intended as an advance on EIDL loans. There is no information available concerning how many recipients of EIDL grants received PPP loans, EIDL loans or neither. Exempting EIDL grants only makes up $11.2 million of the total revenue impact of HB1361. If we assumed that the ratio of $3.3 billion of PPP loans and $1 billion in EIDL loans in Arkansas is the same for EIDL grants, then the revenue impact would be reduced by $4 million each year for a total of $8 million from the $212 million total.

Legal Analysis :

House Amendment No. 1 --- HB1361-H1 deletes the term "tax attribute," which is a term of art in federal law that does not appear in the Income Tax Act of 1929. The bill also clarifies that the exclusion from gross income of forgiven PPP loans and other CARES Act funds does not affect the inclusion of such income for purposes of calculating net operating loss carryovers under § 26-51-427(2).

Original Bill --- HB1361 adopts certain provisions of the federal COVID-19 relief bill enacted December 27, 2020 for the purpose of computing Arkansas income tax liability. The bill tracks federal law by excluding from the definition of gross income small business loans forgiven under the federal Paycheck Protection Program (PPP). The bill specifically incorporates provisions in federal law that exempt forgiven PPP loans under the original CARES Act and provisions that exempt subsequent forgiven PPP loans. The bill also allows the taxpayer to deduct expenses incurred using forgiven PPP loan funds. The bill also excludes from the definition of gross income emergency student financial aid grants awarded under the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The bill also excludes from the definition of gross income CARES Act emergency SBA Economic Injury Disaster Loan (EIDL) grants, CARES Act subsidies for certain SBA loans, and CARES Act grants for shuttered venue operators and would allow deductions for expenses incurred using those CARES Act funds.

The bill excludes from the definition of gross income payments received under the Coronavirus Food Assistance Program (CFAP) as it existed on January 19, 2021 and would allow deductions for expenses incurred using such CFAP funds.

The bill gives the DFA discretion to waive any requirement to file an information return with respect to income attributable to any of the above exclusions.

HB1361 does not define the term "tax attributes" as it appears on page 2, lines 18, 22, and 36, and it is unclear what this term encompasses. The term "tax attributes" does not currently appear in the Income Tax Act of 1929. Under federal income tax law, tax attributes include items such as net operating loss carryovers, general business credits, minimum tax credits, capital loss carryovers, basis reductions, passive activity loss and credit carryovers, and foreign tax credit carryovers. The bill would benefit from

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a definition of "tax attributes" in order to achieve greater clarity.

If a net operating loss carryover is a tax attribute as that term appears in the bill, this would constitute a change in state income tax law. Under current law, a taxpayer must add to gross income all nontaxable income not required by law to be reported as gross income less any expenses properly and reasonably incurred in earning nontaxable income, which expenses would otherwise be nondeductible. § 26-51-427(2). If "tax attributes" include net operating loss carryovers, this bill would provide different treatment for federal COVID-19 funds that the bill excludes from gross income by allowing the taxpayer to disregard them for the purpose of calculating NOL. This is an additional tax benefit that does not exist in the federal COVID-19 legislation.

This bill contains an emergency clause. The emergency clause provides that it will become effective on the earliest of the following: the date of its approval by the Governor; 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, if the Governor vetoes the bill, the date the last house overrides the veto. The bill states that its provisions affecting the tax treatment of federal COVID-19 relief funds are effective for tax years beginning on or after January 1, 2019.