

DEPARTMENT OF TAXATION

2020 Fiscal Impact Statement

1. **Patron** Joseph P. McNamara

2. **Bill Number** HB 5002

3. **Committee** House Finance

House of Origin:

X **Introduced**

Substitute

Engrossed

4. **Title** Individual Income Tax; Subtraction for
Paycheck Protection Program Loan
Forgiveness

Second House:

In Committee

Substitute

Enrolled

5. **Summary/Purpose:**

This bill would allow an individual income tax subtraction for any income attributable to the forgiveness of Paycheck Protection Program (“PPP”) loans provided under the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act.

This bill would be effective for taxable years beginning on and after January 1, 2020.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact is:** Preliminary (See Line 8.)

8. **Fiscal implications:**

Administrative Costs

As introduced, the Department of Taxation (“the Department”) estimates that this bill would result in administrative costs of \$83,596 in Fiscal Year 2022, \$82,994 in Fiscal Year 2023, \$85,094 in Fiscal Year 2024, \$87,196 in Fiscal Year 2025, and \$89,300 in Fiscal Year 2026. Such costs include one new audit position to ensure taxpayers correctly compute the subtraction on their Virginia returns.

With the suggested amendments (see Line 10), the Department would consider implementation of this bill as routine, and would not require additional funding.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2021. The CARES Act contains a provision that exempts from federal income taxation any PPP loan forgiveness. If Virginia conforms to this provision when it advances its date of conformity during the 2021 Session, this forgiveness of debt income will be exempt for Virginia income tax purposes.

If Virginia does not advance its date of conformity during the 2021 Session, Virginia would not conform to the CARES Act provision exempting PPP loan forgiveness. Because this CARES Act provision interacts with other sections of federal tax law, the revenue impact of this bill

might be greater by an unknown amount if Virginia does not also enact legislation to conform to this provision.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes. If Virginia does not advance the date of conformity to adopt the PPP loan forgiveness provision of the CARES Act, this bill could result in complicated computations on the individual income tax return that could have unintended consequences for certain taxpayers, including an impact on the calculation of net operating losses and itemized deduction limitations. For this reason, it is recommended that this bill be drafted as an exclusion under *Va. Code* § 58.1-321, rather than a subtraction under *Va. Code* § 58.1-322.02. Such exclusion could be drafted as follows:

D. For taxable years beginning on and after January 1, 2020, any amount which (but for this subsection) would be includible in federal adjusted gross income of an eligible recipient by reason of forgiveness described in 1106(b) of P.L. 116-136 (the Coronavirus Aid, Relief, and Economic Security Act) shall be excluded from Virginia adjusted gross income. For the purposes of this subsection, "eligible recipient" means an "eligible recipient" under 1106(a) of P.L. 116-136.

11. Other comments:

Federal Paycheck Protection Program Loans and Forgiveness

On March 27, 2020, the CARES Act was signed into law. This federal legislation provides emergency economic assistance to businesses and individuals affected by the novel coronavirus ("COVID-19"). Such relief includes the provision of PPP loans for certain small businesses with 500 or fewer employees.

A PPP loan may be forgiven if certain employee retention criteria are met, and the funds are used for eligible expenses. Eligible expenses include payroll, mortgage interest, and rent, lease, and utility costs. At least 60 percent of the forgiven amount must be used for payroll costs to qualify for forgiveness.

On June 5, 2020 and July 4, 2020, the PPP loan provisions were modified and enhanced by Congress. Such changes included extending the loan program and making forgiveness easier to achieve.

Federal Taxation of PPP Loans

For federal income tax purposes, taxpayers are generally subject to taxation when debt is forgiven. The amount of the forgiven debt is treated as income for federal tax purposes. However, the CARES Act provides that any PPP loan amount that is forgiven will not be taxed as income for federal income tax purposes. Following enactment of the CARES Act, the IRS published Notice 2020-32, which recognized that the PPP loan forgiveness provision modifies the definition of income within the Internal Revenue Code ("IRC") and, therefore, IRC code sections prohibiting deductions against tax-free income apply.

Virginia Taxation of PPP Loans

Virginia's date of conformity to the IRC is currently fixed to the IRC as it existed on December 31, 2019. Because the CARES Act was enacted after this date, Virginia does not currently conform to the CARES Act, including the provision exempting PPP loan forgiveness from taxation. The General Assembly has historically enacted legislation each year to advance Virginia's date of conformity in order to conform to federal tax law changes made by Congress during the prior year. If the General Assembly enacts updated conformity legislation during its 2021 Regular Session to conform to the 2020 federal tax law changes related to PPP loans, such legislation would exempt PPP loan forgiveness from Virginia income taxation.

Proposed Legislation

This bill would allow an individual income tax subtraction for any income attributable to the forgiveness of PPP loans provided under the CARES Act.

This bill would be effective for taxable years beginning on and after January 1, 2020.

cc : Secretary of Finance

Date: 8/20/2020 JJS
HB5002F161