NORTH CAROLINA GENERAL ASSEMBLY

Session 2021

Legislative Fiscal Note

Short Title: Temp Align PPP Treatment to Federal Treatment.
Bill Number: House Bill 334 (First Edition)
Sponsor(s): Representatives Pickett and Saine

SUMMARY TABLE

FISCAL IMPACT OF H.B. 334, V.1 ($ in millions)

	FY 2021-22	FY 2022-23	FY 2023-24	FY 2024-25	FY 2025-26
State Impact					
General Fund Revenue	(367.0)	(33.0)	-	-	-
Less Expenditures	-	-	-	-	-
General Fund Impact	**(367.0)**	**(33.0)**	**-**	**-**	**-**
NET STATE IMPACT	**($367.0)**	**($33.0)**	**-**	**-**	**-**

FISCAL IMPACT SUMMARY

House Bill 334 temporarily repeals a provision in current law that does not allow businesses to deduct expenses funded with Payroll Protection Program (PPP) dollars if the proceeds received from forgiven PPP loans are excluded from income for tax purposes. Allowing businesses to take the deduction would reduce State revenue by approximately $600M. However, House Bill 334 allows the deduction for the 2020 tax year only. Since many PPP recipients could benefit from this provision in the 2021 tax year but not in 2020, the estimated fiscal impact is lowered to $400M.

Background and Explanation

Federal Tax Treatment of PPP Loans
The federal Payroll Protection Program (PPP) provided loans to some businesses during the COVID pandemic. These loans are cancelled (i.e., forgiven) if basic conditions are met. Although cancelled debt is taxable income, the federal government created an income exclusion for cancelled PPP loans, meaning that the forgiven debt is excluded from income for tax purposes. The federal government also allowed businesses to take a deduction for spending the PPP proceeds.

North Carolina Tax Treatment of PPP Loans
In S.L. 2020-58 (HB 1080), the General Assembly conformed to the federal income exclusion but did not allow businesses to also take a deduction in calculating State income. House Bill 334 would repeal the provision in S.L. 2020-58 that prohibited businesses from taking a deduction

related to the PPP if they have received an income exclusion. This would give some businesses that received PPP money the combined benefit of an income exclusion and a deduction.

The following chart illustrates how the combination of an income exclusion and a deduction shields additional income from tax and impacts tax collections.

Business Receives $50,000 from PPP

	Current NC Law (Income exclusion only)	**Proposed** (Income exclusion + deduction)
Amount of $50,000 in PPP Receipts Included in Income	$0	$0
Operating Income	$50,000	$50,000
PPP Deduction	($0)	($50,000)
Business Taxable Income	$50,000	($0)
Tax at 5.25% Tax Rate	$2,625	($0)

If instead the business had no operating income and was a sole proprietor or pass-through entity, non-business income can be shielded from tax by the combination of the income exclusion and the deduction. For example, if the business owner's spouse had $50,000 in wages, the $50,000 PPP deduction would offset the wages, resulting in no income reported for tax purposes on the NC Individual Income Tax Return.

FISCAL ANALYSIS

According to data provided by the U.S. Small Business Administration, North Carolina businesses received about $12.5 Billion from the PPP through June 30, 2020, equal to about 2.4% of the total amount issued. Subsequently, about $290 Billion in additional PPP loans have been authorized. If North Carolina businesses receive the same share of the additional loans, the total amount is increased to approximately $19.2 Billion. However, since the additional loans were not issued and forgiven during 2020, they are excluded from the analysis.

About 85% of loans have been forgiven. This results in cancelled debt of approximately $10.6 Billion that is excluded from income for North Carolina tax purposes for 2020. House Bill 334 would repeal the current law that does not allow a tax deduction for spending the $10.6 Billion when the $10.6 Billion has been excluded from income.

To determine the fiscal impact of the $10.6 Billion in deductions, Fiscal Research reviewed SBA Data to distinguish between non-profit organizations, C corporations, and all other business entity types that received PPP loans to determine the tax value of the deductions. The total tax value of the deductions is equal to the sum of the deductions available by business type multiplied by the applicable tax rate for the specific business entity classification.

- Non-Profits received about 4% of all loans, accounting for an estimated $425M of the $10.6 Billion. Since non-profit organizations are exempt from tax except for income characterized as unrelated business income, their portion has been excluded from the estimated fiscal impact of the deduction.

- C corporations, subject to a 2.5% tax rate, account for about 40% of the remaining $10.175 Billion in deductions.
- Other business types that are primarily subject to tax at the 5.25% individual income tax rate account for about 60% of the $10.175 Billion in deductions.

In total, this results in a tax value of the deductions of approximately $425M. That estimate has been adjusted down to $400M to account for a minority of pass-through entities with C corporation ownership that are subject to the 2.5% corporate tax rate.

Businesses that operate in North Carolina and in other states are subject to North Carolina tax even if they are domiciled in another state. Allowing businesses to take the deduction proposed in House Bill 334 would reduce North Carolina revenue collections from these businesses. However, sufficient data is not available to determine the extent of the fiscal impact.

The estimated timing of the fiscal impact is primarily in FY 21-22. This could fluctuate based on various factors, particularly based on when the bill becomes law.

TECHNICAL CONSIDERATIONS

N/A.

DATA SOURCES

US SMALL BUSINESS ADMINISTRATION, NC DEPARTMENT OF REVENUE, INTERNAL REVENUE SERVICE

LEGISLATIVE FISCAL NOTE – PURPOSE AND LIMITATIONS

This document is an official fiscal analysis prepared pursuant to Chapter 120 of the General Statutes and rules adopted by the Senate and House of Representatives. The estimates in this analysis are based on the data, assumptions, and methodology described in the Fiscal Analysis section of this document. This document only addresses sections of the bill that have projected direct fiscal impacts on State or local governments and does not address sections that have no projected fiscal impacts.

CONTACT INFORMATION

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