NORTH CAROLINA GENERAL ASSEMBLY

Session 2021

Legislative Fiscal Note

Short Title: Putting North Carolina Back to Work Act.
Bill Number: Senate Bill 116 (Third Edition)
Sponsor(s):

SUMMARY TABLE

FISCAL IMPACT OF S.B. 116, V.3 ($ in millions)

	FY 2021-22	FY 2022-23	FY 2023-24	FY 2024-25	FY 2025-26
State Impact					
General Fund Revenue				-	-
SECTIONS 2-4: Forgiven PPP Loans	(550.0)	(50.0)			
SECTION 5: Unemployment Comp.	(250.0)				
Less Expenditures	-	-	-	-	-
General Fund Impact	**(800.0)**	**(50.0)**	**-**	**-**	**-**
NET STATE IMPACT	**($800.0)**	**($50.0)**	**-**	**-**	**-**

FISCAL IMPACT SUMMARY

Sections 2-4 change 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. The deduction would reduce State income tax revenue by approximately $600M.

Section 5 allows an income exclusion of up to $10,200 per person in unemployment compensation received during tax year 2020. The provision applies to those taxpayers whose federal adjusted gross income is less than $150,000. This change would reduce State individual income tax revenue by approximately $250M.

Background and Explanation of Tax Treatment of PPP Loans

Federal Tax Treatment
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

In S.L. 2020-58 (H.B. 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

Sections 2-4: Deduction for Expenses Paid Using Forgiven PPP Loans

According to data provided by the U.S. Small Business Administration, North Carolina businesses have received over $17 billion from the PPP thus far. However, the percentage of loans that will ultimately be forgiven is unknown. The estimate assumes, based on data available currently, that most of the loans will be forgiven, and that between $16 billion and $17 billion would be excluded from income and deducted.

To determine the fiscal impact of the 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 have received between 4% and 6% of all loans. 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 deductions
- Other business types that are primarily subject to tax at the 5.25% individual income tax rate account for about 60% of the deductions.

In total, this results in a tax value of the deductions of approximately $650M. That estimate has been adjusted down to $600M to account for pass-through entities with C corporation ownership that are subject to the lower 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 recognized in FY 2021-22 and FY 2022-23. However, the timing could fluctuate, particularly based on the timing of the bill becoming law.

Section 5: Deduction of Unemployment Compensation
This section allows a taxpayer to deduct unemployment compensation that is excluded from federal income tax in tax year 2020. The Internal Revenue Service (IRS) instructs taxpayers to use "the amount reported in box 1 of your Form 1099-G" to determine the amount of unemployment compensation that may be excluded, up to a maximum exclusion of $10,200 per person. Taxpayers with federal adjusted gross income of at least $150,000 are not eligible for the exclusion. According to the NC Division of Employment Security, approximately 950,000 claimants received 1099-G's for tax year 2020 with an average benefit of $9,600.

To determine the fiscal impact of this deduction, Fiscal Research used data from the NC Division of Employment Security showing the count of claimants aggregated into buckets by total unemployment compensation received in 2020. Based on historical data and the Fiscal Research Division Individual Income Tax Microsimulation model, we assumed a 3.6% effective tax rate and that approximately 50,000 claimants (5%) would not be eligible for the deduction because their federal adjusted gross income in 2020 was at least $150,000. This analysis assumes that the fiscal impact will be recognized in FY 2021-22. However, the timing could fluctuate, particularly based on the timing of the bill becoming law.

Technical Considerations

N/A.

Data Sources

North Carolina Department of Revenue, FRD Individual Income Tax Microsimulation Model, US Small Business Administration, Internal Revenue Service, NC Division of Employment Security

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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