

Conformity to Federal Tax Treatment of Paycheck Protection Program Loans

Issue: Recent federal legislation clarified federal tax rules related to PPP loans. This change rendered California's tax rules for PPP loans out of conformity. If California does not take action to conform, small businesses across the state will face significant tax implications simply because they participated in a federal relief program designed to help them weather economic uncertainty.

Ask: Support legislative action to conform California's tax rules for PPP loans to the current federal rules.

Emergency Assistance to Small Businesses

Created under the CARES Act, the PPP provided a lifeline to countless California businesses facing unprecedented financial challenges. Many PPP loan recipients used the funds on payroll and other qualifying expenses to stay operational. By keeping business running and people employed, PPP loans likely helped many Californians weather the uncertainty of the current economic situation.

PPP Loans are Tax-Exempt Under Current Federal Rules

When Congress created the PPP, they did not want the acceptance and forgiveness of a PPP loan to adversely affect the recipient's tax liability. Specifically, Congress excluded forgiven PPP loan dollars from taxable gross income, and most recently, superseded IRS guidance to clarify that the forgiveness of a PPP loan does not affect the deductibility of business expenses paid with PPP dollars.

California is Out of Conformity with Current Federal Rules

AB 1577 (Burke, Chapter 39, Statutes of 2020) conformed to the federal tax rules for PPP loans as of Aug. 2020. However, subsequent Congressional action in December 2020 clarified that business expenses paid with proceeds from forgiven PPP loans remain tax-deductible. This rendered California out of conformity with Federal tax rules for PPP expenses. CalCPA's support letter for AB 1577 noted this possibility and need for subsequent action:

While AB 1577 reflects current federal laws and guidance by the IRS, we recognize that forthcoming Congressional action could lead to additional changes. Specifically, Congressional action is expected to alter current guidance and clarify that a forgiven PPP loan does not affect the deductibility of ordinary business expenses. Should federal legislation make substantive changes to the tax treatment of PPP loans, we encourage the Legislature to consider subsequent legislative actions to maintain consistency with federal rules.

Urgent Action is Necessary to Avoid Significant Tax Complications

If California does not conform to the current federal tax rules for PPP loans, small businesses across the state will face significant tax implications simply because they participated in a federal relief program designed to help them weather economic uncertainty. Additionally, urgent action is necessary since businesses and tax practitioners are already beginning the process of tax compliance for the 2020 calendar tax year. Timely clarity is necessary to prepare accurate returns, make correct payments, and appropriately account for subsequent fiscal years.