

CARES Act and CAA Tax Conformity

*Coronavirus Aid, Relief, and Economic Security (CARES) Act
Consolidated Appropriations Act (CAA) 2021*

CARES Act and CAA Tax Conformity

- Items currently in the Governor’s introduced budget and additional items to be proposed.

| CARES AND CAA CONFORMITY PROVISIONS | | | | |
|--|-----------------|-----------------|-----------------|----------------|
| Provision | FY 2021 | FY 2022 | FY 2023 | FY 2024 |
| COVID-19 Related Retirement Distributions | - | (\$8.5) | (\$1.4) | (\$0.2) |
| Above-the-Line Charitable Contributions Deduction | (\$11.1) | (\$2.8) | - | - |
| Deduction Limitations for Certain Charitable Contributions | (\$19.5) | \$4.3 | \$5.8 | \$2.3 |
| Exclusion of Educational Payments | (\$3.6) | (\$0.5) | - | - |
| Total CARES Act Provisions | (\$34.2) | (\$7.5) | \$4.5 | \$2.1 |
| Extension of the \$300 deduction for non-itemizers to Taxable Year 2021 | - | (\$21.5) | (\$5.4) | - |
| Enhancing the charitable deduction for individuals for certain contributions | (\$4.5) | (\$19.8) | \$5.4 | \$7.2 |
| Temporary full business meals deduction | - | (\$17.8) | (\$10.5) | (\$2.2) |
| Extension of exclusion for certain employer payments of student loans | - | (\$8.5) | (\$6.2) | (\$6.6) |
| Depreciation of certain residential rental property over a 30-Year Period | - | (\$8.1) | (\$1.4) | (\$0.9) |
| Temporary enhancement of the earned income tax credit for certain taxpayers | (\$3.2) | - | - | - |
| Repeal of the deduction for qualified tuition | - | \$7.7 | \$7.9 | \$7.4 |
| All other provisions | (\$1.3) | (\$1.8) | (\$0.7) | (\$0.7) |
| Total CAA Provisions | (\$9.0) | (\$69.7) | (\$10.9) | \$4.3 |

CARES Act and CAA Tax Conformity

- Items not conformed to in the Governor’s introduced budget and additional provision to be excluded.

| CARES AND CAA DECONFORMITY PROVISIONS | | | | |
|--|----------------|----------------|----------------|----------------|
| Provision | FY 2021 | FY 2022 | FY 2023 | FY 2024 |
| Enhanced Deduction for NOLs | - | -\$312.6 | \$13.1 | \$26.8 |
| Excess Business Losses for Noncorporate Taxpayers | - | -\$305.9 | - | - |
| Business Interest Deduction Limitation | - | -\$47.3 | (\$1.7) | (\$1.3) |
| Total CARES Act Provisions | - | -\$665.7 | \$11.4 | \$25.5 |
| Extension of 7.5% Floor for the Medical Expense Deduction | - | (\$14.5) | (\$29.6) | (\$30.2) |
| Deductibility of Business Expenses Funded by PPP Loan and EIDL Fund Proceeds | (\$150-\$190) | (\$190-\$310) | Unknown | Unknown |
| Total CAA Provisions | (\$150-\$190) | (\$205-\$325) | Unknown | Unknown |

Federal Tax Treatment of PPP Loans

- Under the CAA, recipients of Paycheck Protection Program (PPP) loans are entitled to a double tax benefit.
- This results in disparate tax treatment and a significant General Fund revenue loss if Virginia conforms to this change.
 - PPP recipients are treated more favorably than companies that did not receive such loans, including those that received *Rebuild VA* Grants.
 - According to Small Business Administration (SBA) data, more than half of PPP loans went to 5 percent of PPP recipients, many of them larger-sized businesses. As a result, a double tax benefit might disproportionately help larger-sized businesses.
 - The revenue impact of conforming to this treatment would be significant.
- Limited data is available on firms qualifying for PPP loans, forgiveness of the loans, firm size, operating income, and qualifying expenses.
 - Based on available SBA data, the impact would be significant.
 - The timing of the impact would depend on each PPP recipient's tax liability; any amounts not utilized could be carried over as losses.

Federal Tax Treatment of PPP Loans

- Simplified example demonstrating impact of allowing a double tax benefit:
 - Exclusion from income and the deduction of expenses is authorized under the CAA.

| | Inclusion and Deduction | Exclusion and No Deduction | Exclusion and Deduction | NO PPP Loan |
|-----------------|-------------------------|----------------------------|-------------------------|--------------|
| PPP Loan Amount | \$150,000 | \$150,000 | \$150,000 | \$ 0 |
| Expense Funded | \$150,000 | \$150,000 | \$150,000 | \$ 150,000 |
| Net Cash Result | \$0 | \$0 | \$0 | \$ (150,000) |
| Income Reported | \$150,000 | \$0 | \$0 | \$ 0 |
| Deduction Taken | \$150,000 | \$0 | \$150,000 | \$ 150,000 |
| Net Tax Result | \$0 | \$0 | (\$150,000) | \$ (150,000) |

Source: Thimmesch, Adam, "States and the PPP: The Tax Policy Case for State Nondeductibility," *State Tax Notes* 99: 129-135, 11 Jan. 2021.

Virginia Deduction for PPP Loan Recipients

- If Virginia wants to provide an additional state tax benefit to PPP loan recipients, a state tax deduction could be allowed.
- To target the benefit to smaller businesses and limit the fiscal impact, the deduction could be limited to amounts that do not exceed a threshold.
 - Options include thresholds of \$10,000; \$25,000; \$50,000; and \$100,000.
 - According to the SBA, the average PPP loan was \$107,000.
- A deduction limited to Taxable Year 2020 would provide an additional tax benefit to certain companies that received loans during 2020.
- A deduction for Taxable Years 2020 and 2021 would also allow a benefit for those who receive loans authorized under the CAA.
 - This would increase the estimated revenue loss in FY 2022.
 - Although data is not available for such loans, the impact was estimated using the amount authorized under the CAA and Virginia's share of loans issued during 2020.

Loan Size by Entity Type: Corporate vs. Non-Corporate

- The table below shows the number and percentage of companies with loans at or below each threshold amount.
- Since a deduction can only be used to offset income, the tax benefit would depend on each company's taxable income.

| | Corporate | | Non-Corporate | | Total | |
|--|---------------|-------------|---------------|-------------|----------------|-------------|
| \$10,000 or less | 4,286 | 13% | 19,274 | 26% | 23,560 | 22% |
| \$25,000 or less | 11,798 | 35% | 41,631 | 56% | 53,429 | 49% |
| \$50,000 or less | 18,568 | 55% | 53,305 | 72% | 71,873 | 66% |
| \$100,000 or less | 24,703 | 73% | 62,307 | 84% | 87,010 | 80% |
| More than \$100,000 | 9,266 | 27% | 12,238 | 16% | 21,504 | 20% |
| Total Loans (Excluding Non-Profits) | 33,969 | 100% | 74,545 | 100% | 108,514 | 100% |

Options for a Virginia Deduction

- **Deduction Amount** – *up to a threshold of:*
 - \$10,000
 - \$25,000
 - \$50,000
 - \$100,000
- **Timing of Qualified Loans**
 - Could be authorized for loans issued to date (Taxable Year 2020), or
 - Expanded to include additional loans that will be issued under the CAA (Taxable Years 2020 and 2021).
- **Qualifying Taxpayers**
 - Could be limited to the individual income tax, or
 - Expanded to corporate entities.

Virginia Deduction for PPP Loan Recipients: Taxable Year 2020 Only

| Threshold | FY 2021 | FY 2022 |
|------------------------------------|-----------------|-----------------|
| \$100,000 (Corporate & Individual) | (\$56) - (\$74) | (\$42) - (\$78) |
| \$100,000 (Individual Only) | (\$56) - (\$74) | (\$24) - (\$32) |
| \$50,000 (Corporate & Individual) | (\$39) - (\$51) | (\$29) - (\$54) |
| \$50,000 (Individual Only) | (\$39) - (\$51) | (\$17) - (\$22) |
| \$25,000 (Corporate & Individual) | (\$25) - (\$33) | (\$18) - (\$35) |
| \$25,000 (Individual Only) | (\$25) - (\$33) | (\$11) - (\$14) |
| \$10,000 (Corporate & Individual) | (\$12) - (\$16) | (\$9) - (\$17) |
| \$10,000 (Individual Only) | (\$12) - (\$16) | (\$5) - (\$7) |

** Estimated General Fund revenue impact; amounts in millions*

Virginia Deduction for PPP Loan Recipients: Taxable Year 2020 & Taxable Year 2021

| Threshold | FY 2021 | FY 2022 |
|------------------------------------|-----------------|------------------|
| \$100,000 (Corporate & Individual) | (\$56) - (\$74) | (\$72) - (\$118) |
| \$100,000 (Individual Only) | (\$56) - (\$74) | (\$55) - (\$71) |
| \$50,000 (Corporate & Individual) | (\$39) - (\$51) | (\$50) - (\$81) |
| \$50,000 (Individual Only) | (\$39) - (\$51) | (\$38) - (\$49) |
| \$25,000 (Corporate & Individual) | (\$25) - (\$33) | (\$32) - (\$52) |
| \$25,000 (Individual Only) | (\$25) - (\$33) | (\$24) - (\$32) |
| \$10,000 (Corporate & Individual) | (\$12) - (\$16) | (\$15) - (\$25) |
| \$10,000 (Individual Only) | (\$12) - (\$16) | (\$12) - (\$15) |

** Estimated General Fund revenue impact; amounts in millions*

Virginia Subtraction for *Rebuild VA* Grants

- Since *Rebuild VA* grants are taxable at the federal level, if Virginia allows a deduction for PPP loan recipients, then Virginia should allow a similar tax treatment for *Rebuild VA* grants by allowing taxpayers to subtract such grants from income on their state returns.
 - Threshold, timing, and definition of qualifying taxpayers should be consistent with the deduction for PPP loan recipients, if such tax benefits are adopted.
- Impact of a subtraction for *Rebuild VA* grants would be much smaller due to the scope of the program as compared to the PPP loan program.
 - \$12.6 billion in PPP loans granted to Virginia businesses, compared with \$120 million authorized in *Rebuild VA* grants.
 - A similar tax treatment for *Rebuild VA* grant recipients would likely have an impact ranging from less than \$1 million (\$10,000 limitation) to a maximum of \$4.5 million (\$100,000 limitation).
 - The actual impact would likely be much less depending on each company's profitability, tax liability, and entity type (non-profit vs. for-profit).

Other Business Grants for 2020-2022 Biennium

Summary of the estimated impact over the biennium if we were to allow a subtraction for *Rebuild VA* grants and local grants funded by the CARES Act, as well as a deduction related to EIDL funds.

| PROGRAMS | THRESHOLD | | | |
|---|----------------|----------------|----------------|----------------|
| | \$10K | \$25K | \$50K | \$100K |
| <i>Rebuild VA</i> | \$ 0.6 | \$ 1.6 | \$ 2.2 | \$ 2.6 |
| CARES to Localities <i>(small business grants)</i> | \$ 3.9 | \$ 4.7 | \$ 4.9 | \$ 4.9 |
| Economic Injury Disaster Loan (EIDL) Funds | \$ 16.9 | \$ 16.9 | \$ 16.9 | \$ 16.9 |
| Total | \$ 21.4 | \$ 23.2 | \$ 24.0 | \$ 24.4 |

Total \$ in millions