

California Law Excludes PPP Loans Forgiven under the CARES Act from Gross Income

Overview

On September 9, 2020, California's Governor Newsom signed Assembly Bill 1577 ("A.B. 1577") into law.¹ A.B. 1557 generally conforms California to federal law allowing an exclusion from gross income for covered Paycheck Protection Program ("PPP") loans that are forgiven as a part of the federal Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act").² A.B. 1557 also disallows otherwise allowable credits and deductions for amounts paid or incurred using forgiven loan funds.³ Because California generally conforms to the version of the Internal Revenue Code ("IRC") that existed as of January 1, 2015, California did not automatically conform to the CARES Act and subsequent, related federal legislation.⁴ Absent conformity, the California Legislature anticipated that California businesses could have to pay more than \$3 billion in additional taxes attributable to forgiven PPP loans.⁵ As a result, the California Legislature enacted A.B. 1557 to provide some relief.⁶

This Tax Alert provides a brief overview of the federal legislation relating to the PPP, summarizes the notable changes to California law made by A.B. 1577, and provides some taxpayer considerations.

Background on Federal Legislation Relating to the PPP

On March 27, 2020, the federal government enacted the CARES Act in response to the COVID-19 pandemic.⁷ Sections 1102 and 1106 of the CARES Act amend section 7(a) of the Small Business Act to create the PPP, through which up to \$349 billion in funding was provided to businesses through federally guaranteed loans. An additional \$310 billion of PPP loan funding was subsequently provided by the federal Paycheck Protection Program and Health Care Enhancement Act (P.L. 116-139, the "Enhancement Act").⁸ The federal government also enacted the Paycheck Protection Program Flexibility Act (P.L. 116-142, the "Flexibility Act") to, among other things, modify certain restrictions imposed in regulations issued by the Small Business Administration ("SBA") relating to qualifications for forgiveness of PPP loans.⁹ Administered by the SBA and overseen by the U.S. Treasury Department, the PPP is designed to provide short-term relief to millions of America's businesses to ensure they can sustain operations and keep their workers employed as the economy recovers.¹⁰

The PPP allows qualifying businesses to apply for a loan to maintain their payroll and some overhead expenses through the period of emergency.¹¹ If a business takes a loan under the PPP, it may apply to have some or all of the loan forgiven (the "Forgiven Loan Amount")—specifically that portion of the PPP loan used to cover payroll costs, interest on mortgage obligations, rent obligations, and utility payments, subject to specific conditions and during the 24 week period after the loan is distributed (the "Loan Forgiveness Eligible Expenses").¹² Generally, federal and California law treat the cancellation of debt as gross income.¹³ However, the CARES Act excludes the Forgiven Loan Amount from gross income for federal tax

¹ A.B. 1577, 2019-2020 REG. SESS. (CAL. 2020) (available [here](#)).

² A.B. 1577, §§ 1, 2; CALIFORNIA ASSEMBLY FLOOR ANALYSIS, AUG. 29, 2020 (available [here](#)); see also Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136.

³ A.B. 1577, §§ 1, 2.

⁴ CAL. REV. & TAX CODE §§ 17024.5(a); 23051.5(a).

⁵ INCOME TAXES: FEDERAL CARES ACT: GROSS INCOME: LOAN FORGIVENESS, JULY 8, 2020 (available [here](#)).

⁶ See CALIFORNIA SENATE COMMITTEE ON GOVERNANCE AND FINANCE ANALYSIS, JULY 24, 2020 (available [here](#)); CALIFORNIA ASSEMBLY FLOOR ANALYSIS, AUG. 29, 2020.

⁷ For additional details relating to the federal CARES Act and subsequent legislations relating to the PPP, please refer to the Deloitte Heads Up, Volume 27, Issue 8, Highlights of the CARES Act, updated September 18, 2020 (available [here](#)).

⁸ *Id.*

⁹ For additional details relating to the federal Flexibility Act, please refer to the Deloitte Tax News & Views Capitol Hill Briefing, dated June 12, 2020 (available [here](#)).

¹⁰ See *supra* n. 6.

¹¹ Pub. L. No. 116-136, § 1106(b).

¹² *Id.*

¹³ See I.R.C. § 61; CAL. REV. & TAX CODE § 24271.

purposes.¹⁴ Additionally, for federal and California tax purposes, certain business expenses may be deducted such as those under IRC sections 162 or 163.¹⁵ The Internal Revenue Service, however, issued Notice 2020-32 clarifying that deductions otherwise allowable under any provision of the IRC, including sections 162 and 163, are not allowed to the extent of the Forgiven Loan Amount.¹⁶

Overview of Notable Changes under A.B. 1577

A.B. 1577 adds two identical California tax provisions – California Revenue & Taxation Code (“CRTC”) section 17131.8 under the Personal Income Tax Law (“PITL”) and CRTC section 24308.6 under the Corporation Tax Law (“CTL”). These new provisions provide “[f]or taxable years beginning on and after January 1, 2020, gross income does not include any covered loan amount forgiven pursuant to section 1106 of the [CARES Act], pursuant to the [Enhancement Act], or pursuant to the [Flexibility Act].”¹⁷ For this purpose “covered loan” is defined as having “the same meaning as in section 1106 of the [CARES Act].”¹⁸ Thus, the Forgiven Loan Amount is not included in gross income for PITL or CTL purposes.

Additionally, A.B. 1577 disallows a credit or deduction for Loan Forgiveness Eligible Expenses to the extent of the Forgiven Loan Amount. Specifically, the new law states that “[a]ny credit or deduction otherwise allowed under this part [(Part 10 for the PITL and Part 11 for the CTL)] for any amount paid or incurred by the taxpayer upon which this exclusion is based shall be reduced by the amount of the exclusion allowed under this section.”¹⁹

Considerations

A.B. 1577 is effective immediately and applies to taxable years beginning on and after January 1, 2020.²⁰ Taxpayers that have received a PPP loan should be aware that the Forgiven Loan Amount is excluded from gross income for California PITL and CTL purposes. However, California disallows a credit or deduction for Loan Forgiveness Eligible Expenses to the extent of the Forgiven Loan Amount. Taxpayers that have received PPP loans should consult with their California tax advisors regarding the changes made by A.B. 1577 and how these changes impact their California tax liabilities.

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¹⁴ See Pub. L. No. 116-136, § 1106(i).

¹⁵ See e.g., I.R.C. §§ 162, 163; CAL. REV. & TAX CODE §§ 24344; 24344.5; 24344.7.

¹⁶ See I.R.S. Notice 2020-32 (available [here](#)).

¹⁷ A.B. 1577, 2019-2020 REG. SESS., §§ 1 (see new CRTC § 17131.8(a)), 2 (see new CRTC § 24308.6(a)).

¹⁸ A.B. 1577, 2019-2020 REG. SESS., §§ 1 (see new CRTC § 17131.8(c)), 2 (see new CRTC § 24308.6(c)).

¹⁹ A.B. 1577, 2019-2020 REG. SESS., §§ 1 (see new CRTC § 17131.8(b)), 2 (see new CRTC § 24308.6(b)).

²⁰ See A.B. 1577, §§ 1-3 (stating that “[t]his act provides for a tax levy within the meaning of Article IV of the California Constitution and shall go into immediate effect”).

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