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certified public accountants

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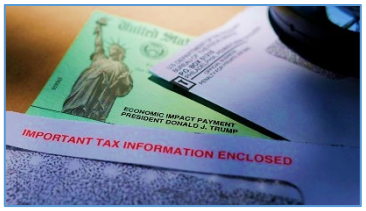
SALT EFFECT OF FEDERAL STIMULUS PACKAGE

The Consolidated Appropriations Act, 2021 (bill), a massive federal stimulus containing almost $900 billion in coronavirus aid, was signed by President Trump on December 27. The legislation earmarks an additional $284 billion for a new round of forgivable small-business loans under the Paycheck Protection Program (PPP) and makes a number of important changes to the program. On January 6, 2021, the IRS followed up by issuing Rev. Rul. 2021-2, which revokes its prior position on the disallowance of deductions for PPP-related expenses.



While the stimulus legislation may not give rise to many direct state and local tax conformity questions, it does address tax provisions related to the PPP, which could have some consequences for state and local conformity.

PPP Expense Deductions

From a state tax perspective, perhaps the most significant aspect of the changes to the PPP is confirmation that business expenses paid out of a forgiven PPP loan may be deducted for federal income tax purposes, even though the forgiven PPP loan is excluded from federal gross income. As readers are now likely keenly aware, states generally conform to the Internal Revenue Code (IRC) in one of two ways: “rolling” IRC conformity (i.e., the state conforms to the IRC automatically or “as amended”) and “fixed-date” IRC conformity (i.e., the state conforms to the IRC as of a specific date). Thus, while a rolling IRC conformity state should conform to the PPP loan expense deduction provisions in the new legislation unless the state enacts its own decoupling legislation, a fixed-date IRC conformity state may not conform without enacting its own legislation.

The issue is further complicated because one fixed-date IRC conformity state may conform to the IRC “as enacted on” a specific date, whereas another state may conform to the IRC “as in effect on” a specific date. Although the effective date of the expense deduction provision applies to taxable years ending after the date of the enactment of the CARES Act (March 2, 2020), only a handful of fixed-date IRC conformity states have updated their IRC conformity dates to on or after March 2, 2020.

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Three fixed-date IRC conformity states that enacted legislation in 2020 conforming to the CARES Act exclusion from gross income for PPP loan forgiveness illustrate the uncertainties of whether PPP expense deductions, now allowed for federal tax purposes, will be allowed for state purposes:

- California: Despite the federal enactments of the TCJA in 2017 and the CARES Act in 2020, California has not updated its January 1, 2015 IRC conformity date. However, as part of A.B. 1577 enacted in 2020, California did conform to the CARES Act exclusion from gross income for PPP loan forgiveness but A.B. 1577 also provides that related expense deductions are not deductible for California tax purposes. The federal legislation has no impact on the California treatment of PPP expense deductions and such expenses may not be deducted.

- Hawaii: When Hawaii enacted S.B. 2920 to update its IRC conformity date to the IRC "as amended as of" March 27, 2020, Hawaii also conformed with and decoupled from various provisions of the CARES Act. One such provision was conformity with the exclusion from gross income for PPP loan forgiveness. However, Hawaii's legislation was silent with respect to related PPP expense deductions. Given the bill's effective date for PPP expense deductions, taxpayers will need to address whether S.B. 2920 supports deducting PPP expenses for Hawaii income tax purposes.

- South Carolina: South Carolina updated its IRC conformity date with 2020 legislation (S.B. 545) to the IRC "as amended through" December 31, 2019. That IRC fixed-date conformity clearly did not encompass the CARES Act nor obviously the recent federal stimulus legislation. However, S.B. 545 did separately conform to the federal exclusion of PPP loan forgiveness from gross income. In addition, while South Carolina's general IRC conformity date update would not accommodate the federal stimulus legislation's PPP expense deductions, S.B. 545 also separately permitted PPP expense deductions starting in tax year 2020 for South Carolina income tax purposes if allowed for federal purposes.

Insights

- Most of the tax-related provisions of the federal stimulus legislation are specific to federal income tax. States are more fiscally constrained from enacting their own economic stimulus measures.

- Taxpayers should monitor state legislatures, as many state legislative sessions normally begin in January and February (taking into account the ongoing COVID-19 pandemic). We anticipate that a number of states will respond to CARES Act tax provisions, as well as PPP expense deductions.