LAO

The 2022-23 Budget:

Federal Tax Conformity for Federal Business Assistance

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Summary. This post provides background on federal COVID-19 business assistance programs and describes the Governor's proposal to modify state tax laws as they relate to some of these grant programs. This post also provides some comments to the Legislature on the Governor's proposal.

Background

Federal Assistance for Businesses Affected by COVID-19. The federal government created several financial assistance programs to mitigate some of the economic impacts of the COVID-19 pandemic on small businesses. We describe the four most significant of these below. The programs are closed to new applications as of January 2022.

- ***Paycheck Protection Program (PPP).*** The PPP is a forgivable loan program created in March 2020. This program allowed eligible businesses to borrow funds from private lenders. If the businesses met certain conditions, such as maintaining specified employment and compensation levels, they could then apply to the federal Small Business Administration (SBA) through their lender to have the loans forgiven. The federal government fully covers the amount of these forgiven loans. In California, nearly 700,000 businesses received $35.9 billion in PPP loans. As of January 9, 2022, about 85 percent of the PPP loans nationwide have been forgiven.
- ***Restaurant Revitalization Fund (RRF).*** The RRF program was created in March 2021 to make grants to eligible restaurants, caterers, and bars that experienced a decline in revenue during the pandemic. The RRF grants replace up to $10 million in lost revenues. As of January 2022, California restaurants have received $5.7 billion from the RRF program.
- ***Shuttered Venue Operators Grant (SVOG).*** The SVOG program was created in December 2020 to make grants to eligible theatres, performing arts organizations, and many other cultural institutions such as museums, zoos, and aquariums. COVID-19 public health restrictions required many theatres and cultural institutions to close for extended periods during the pandemic. California venues received $2.1 billion in SVOG grants.
- ***Economic Injury Disaster Loan (EIDL) Advance Grants.*** The SBA directly makes disaster loans to small businesses through its pre-existing EIDL program. Congress created a new program in March 2020 to advance $10,000 to qualified small business that applied for an EIDL related to the COVID-19 pandemic. The advances are grants that do not have to be repaid, regardless of whether the businesses were eventually approved for a loan. California businesses received just over $1 billion in pandemic-related EIDL advance grants.

Federal Tax Laws Exempt Pandemic-Related Financial Assistance. Federal personal income tax and corporation tax laws generally consider grants and forgiven loans as taxable business income. However, the federal tax laws were changed to specifically exclude these pandemic-related financial assistance programs from taxable income.

State Conformed to Federal Treatment of Forgiven PPP Loans. Chapter 39 of 2020 (AB 1577, Burke) and Chapter 17 of 2021 (AB 80, Burke) partially conformed state tax laws to the federal treatment of forgiven PPP loans and EIDL advance grants. Taxpayers that are publicly traded companies or did not have at least a 25 percent reduction in gross receipts are excluded from this provision.

Current State Law Taxes RRF and SVOG Grants. As described above, the federal government created the RRF and SVOG grant programs after it created the PPP and EIDL advance programs. Current state tax laws include grants from these programs as taxable income.

Governor's Proposal

Conform to Federal Tax Treatment of Federal Economic Relief. The Governor's budget proposes to exempt the RRF and SVOG grants from state taxation by conforming the state tax laws to federal law. The administration estimates that this change would reduce state tax revenues by about $500 million over several years.

LAO Comments

Proposal Consistent With Previous Legislative Action. Assembly Bill 80 partially conformed state law with federal tax treatment of other federal pandemic-related economic relief programs. Conforming to the federal tax treatment of the SVOG and RRF grants would be consistent with that previous action.

Restaurants and Venues Among Most Impacted Industries. The taxpayers that would benefit from the Governor's proposal operate in parts of the economy that were among the most severely impacted by the pandemic. For example, while total consumer spending in California declined by 4 percent in 2020, spending at restaurants declined by 18 percent and spending at theatres and museums declined by 60 percent.

Fiscal Effects of Conformity Have Significant Uncertainty. While we find the administration's estimate of the cost of this proposal to be reasonable, there are a number of important uncertainties. In general, data limitations prevent a precise estimate of the revenue losses from conformity. In addition, estimating in which years the revenue losses would occur is difficult. This is because most of the businesses that would benefit from conforming to the federal tax treatment of these grants have operating losses and will not owe taxes this year, or perhaps for several years.

LAO PUBLICATIONS

This post was prepared by Brian Weatherford, and reviewed by Brian Uhler and Carolyn Chu. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.