

State Tax Implications of PPP Expense Deductibility and Loan Forgiveness

February 18, 2021



The Paycheck Protection Program (PPP), created as part of the Coronavirus Aid, Relief and Economic Security (CARES) Act and extended under the Consolidated Appropriations Act of 2021, provided much-needed relief for businesses struggling to stay afloat during the COVID-19 pandemic. While the CARES Act specifically excluded forgiven loans from taxable income at the federal level, the deductibility of the associated expenses remained in question until the enactment of the Consolidated Appropriations Act which clarified the allowance of such deductions.

State Process in Addressing the Federal Tax Treatment

While the taxability of PPP loan forgiveness and the related expenses are settled for federal purposes, questions persist with regard to the state tax treatment. Unfortunately, it cannot be assumed that states will conform to the federal tax treatment concerning forgiven PPP loans as states tend to differ on how they tie their tax regimes to the Internal Revenue Code (the Code). Most state income taxes are based, to a certain extent, on the Code, but conformity to it in its entirety is not automatic. In general, states are split between “rolling” conformity – continual adaptation of all changes to the federal tax laws – and “static” conformity – provision

adoption as of a certain date, while a few utilize a “selective” approach – cherry-picking specific Code clauses. The type of conformity that a state employs may provide some insight into whether a state will follow the federal PPP treatment in the absence of any formally issued guidance. It should be mentioned that the actual provisions for the deductibility of the PPP related expenses and the non-taxability of the loan forgiveness were not technically modifications to the Code, but separate provisions within the respective Acts further complicating the conformity process.

State Taxation

To date, about 20 states have provided guidance regarding the treatment of PPP loans. However, the majority of these states have only addressed the taxability of loan forgiveness. Many still have not opined on the deductibility of the expenses paid with the PPP loan proceeds. Notably, both New York and New Jersey have recently announced that they will fully conform to the federal PPP loan treatment. Other jurisdictions are less taxpayer friendly. For example, California will not treat PPP loan forgiveness as taxable income, although expenses paid with loan funds are not deductible. Note, California, as well as other states, have introduced legislation to permit the deduction of these expenses, but it is unknown if these bills will be passed into law.

State Apportionment

For those states that specifically decouple from the federal PPP loan tax treatment, a further complication arises as to how such loan proceeds should be sourced to the states. Loan recipients operating in multiple states need to account for allocation and apportionment rules with respect to the discharge of indebtedness income. For example, North Carolina allocates discharge of indebtedness income to a taxpayer’s commercial domicile, whereas both Massachusetts and Wisconsin require such income to be apportioned. Consequently, a multistate business headquartered in New York may not have to recognize PPP income in New York, but may be subject to tax on a portion of the PPP loan in another state.

Resident Credit

In addition to the above, resident taxpayers of conforming states should be aware

that if taxes are paid to another state that imposes tax on PPP loans, such state tax payments likely will not be available for a resident credit. Typically, a state will only grant a credit for taxes paid to another state if such income is also taxed in the resident state. Therefore, since a conforming state will not levy tax on the forgiven PPP loans, the state will not allow a credit for other state taxes paid on these funds.

If you have questions regarding how your PPP loan impacts your state and local tax obligations, please contact Alan Goldenberg, Leader of Anchin's State and Local (SALT) group at alan.goldenberg@anchin.com or your Anchin Relationship Partner.

Disclaimer: Please note this is based on the information that is currently available and is subject to change.