Article 2: Relating to the Paycheck Protection Program

Article 2 partially decouples Rhode Island law from federal tax statutes governing how federal Paycheck Protection Program (PPP) loans are treated for purposes of personal and business income taxes. The purpose of the initiative is to preserve pandemic relief for those smaller businesses that received PPP loans of $150,000 or less, while mitigating the significant State revenue loss that would result by remaining completely in alignment with federal law. The article also increase the State's hospital license fee. Article 2 specifically:

- Provides the Tax Administrator with authority to exclude the amount of any PPP loan forgiven for federal income tax purposes from State tax in the event that the federal government provides funds to the State for revenue replacement.
- Exempts the first $150,000 of a PPP loan from Rhode Island business and personal income taxation.
- Includes the amount of any forgiven PPP loan over $150,000 as part of net patient-services revenue for purposes of calculating the State's nursing facility provider assessment (for Tax Years beginning January 1, 2020, and after).
- Increases the hospital license fee from 5.0 percent to 6.0 percent in FY2021 and includes the amount of any forgiven PPP loan over $150,000 as part of net patient services revenue for purposes of calculating the fee beginning in FY2022.

FISCAL IMPACT

The increase in the hospital license fee results in $32.3 million more general revenue in FY2021 than estimated by the November 2020 Revenue Estimating Conference. The fiscal impact of the policy changes related to forgiven PPP loans and the calculation of the hospital license fee and the nursing facility provider assessment are not clear. To date, no hospitals have received PPP loans; however, a number of nursing homes received PPP loans and a significant amount of such loans are likely to have gone towards caring for patients, and thus impact revenue. The Office of Management and Budget has not provided a fiscal impact estimate for these sections of the article. The fiscal impact of the remaining sections of the article are summarized in the following table:

	FY2021		FY2022		
PPP Tax Policy Revenue Changes	**Personal Income Tax**	**Business Taxes**	**Personal Income Tax**	**Business Taxes**	**Total 2 Year Impact**
Federal PPP Loan Forgiveness	($28,788,938)	($57,489,763)	($15,678,451)	($31,308,915)	($133,266,067)
Decoupling from Federal PPP Loan Forgiveness ≥ $150,000	969,731	2,630,262	19,480,908	44,597,887	67,678,788
Total	**($27,819,207)**	**($54,859,501)**	**$3,802,457**	**$13,288,972**	**($65,587,279)**

ANALYSIS AND BACKGROUND

In response to devastating impacts that the COVID-19 pandemic had on businesses, Congress enacted a series of supports and relief measures in 2020. The Coronavirus Aid, Relief, and Economic Security (CARES), enacted in March 2020, established the federal Paycheck Protection Program, which provides loans to help businesses keep their workforce employed during the pandemic. In December 2020, Congress enacted the Consolidated Appropriations Act (CAA), with the purpose of providing further pandemic relief, including for businesses. The CAA allowed businesses to deduct expenses paid for with PPP loans. These federal interventions combined to produce a significant loss in State revenue for FY2021 and FY2022.

Paycheck Protection Program

The Paycheck Protection Program (PPP) is a small business loan program created by Congress in the CARES Act in March 2020. Congress originally appropriated $350.0 billion for the PPP program in order to provide small businesses with cash-flow assistance through 100.0 percent federally guaranteed loans, backed by the United States Small Business Administration (SBA). In April 2020, Congress provided the program an additional $310.0 billion in funding, allowed more time to spend the funds, and made it easier to get loans forgiven. In December 2020, Congress enacted a second stimulus package, the CAA, which provided an additional $285.0 billion in funding and updated the eligible expenses. Congress also authorized businesses to receive a second PPP loan if they had used up their first PPP loan and experienced a 25.0 percent or greater decrease in revenue.

- **Loan Terms:** Under the PPP program, businesses with 500 employees or less (definition of "small business") are eligible. Loans have a maturity rate of two years and an interest rate of 1.0 percent. Loans made after June 5, 2020, have a length of five years and cover expenses for 24 weeks starting from the loan disbursement date. Businesses are not required to make payments until either 10 months after the 24-week covered period ends or if the loan is forgiven. Collateral is not required and there are no fees.
- **Eligible Expenses:** At least 60.0 percent of a PPP loan must be used to fund payroll and employee benefits costs. The maximum amount a business can receive is equal to the monthly average payroll cost in 2019, 2020, or the one-year period before the application, multiplied by 2.5, up to a maximum of $2.0 million. Businesses in the food and accommodation industries are eligible for 3.5 times the average payroll costs, also with a maximum of $2.0 million. The remaining 40.0 percent can be spent on mortgage interest payments, rent and lease payments, utilities, operations expenditures, property damage, costs due to public disturbances not covered by insurance, supplier costs such as cost of goods sold, and worker protection expenditures to be COVID compliant.
- **Loan Forgiveness:** If a business uses its PPP loan for eligible expenses, it may apply to have its loan forgiven. The amount of loan forgiveness may be reduced in proportion to the reduction of retained employees and if any wages are reduced by more than 25.0 percent. If a laid off employee rejects a re-employment offer at the same wage and number of hours, the business may be allowed to exclude this employee when calculating forgiveness.
- **Rhode Island:** According to the SBA, there have been 22,090 total PPP loans made to Rhode Island businesses, totaling $2.3 billion as of March 28, 2021. The average loan in the State is $102,964 and the average company size is 11 employees.

PPP - Income and Deductions

Under normal circumstances, when a business' debt is cancelled, the amount forgiven and not paid is considered income for federal tax purposes. The CARES Act explicitly excludes the amount of the forgiveness of PPP loans from federal gross income. The Act, however, does not address how expenses used to achieve forgiveness are to be treated. In August 2020, the Internal Revenue Service (IRS) clarified that, under existing law, expenses paid with PPP loan proceeds could not be deducted from any other taxable income. This clarification was consistent with previous IRS determinations regarding how tax-exempt income is treated. However, in December 2020, Congress enacted the CAA, which nullified the IRS position, and explicitly allowed for the deductibility of expenses paid for with forgiven PPP loan proceeds.

Analyst Note: The CAA was enacted a month after the 2020 November Revenue Estimating Conference, and therefore the fiscal impact of the new exemption was not considered in the estimates.

- **Example:** The following tables demonstrate a simplified example of the impact of the federal changes on small businesses (example provided by the Office of Revenue Analysis).
  - Without a PPP loan, a business reduces variable expenses, such as labor costs, by laying off workers and increasing unemployment:

No PPP Loan	Normal TY2020	Pandemic TY2020	Explanation
Gross Sales	$100	$50	COVID-19 pandemic impact reduces sales by 50.0%
Total Expenses	90	45	Business reduces expenses proportional to revenue decline
Net Income	**$10**	**$5**	**Businesss net income decreases**

- Under the CARES Act and IRS guidance, a PPP loan is made available to the business. Under the August 2020 IRS guidance, a business realizes an increase in net income above what would have been realized without the PPP loan:

With PPP Loan & IRS Guidance	Scenario 1 Pandemic TY2020	Scenario 2 Pandemic TY2020	Explanation
Gross Sales	$50	$50	COVID-19 pandemic impact reduces sales by 50.0%
Total Expenses	45	[90]	Business pays $90 in expenses with PPP loan that is forgiven so cannot deduct expenses
Net Income	**$5**	**$50**	**Business net income increases**

- CAA passes and negates the IRS regulations regarding deductibility of expenses paid with tax-exempt and forgiven PPP loans. Under the CAA nullification, a business that took out a PPP loan that is forgiven has reduced net income (a loss in this example) that may be less than the net income realized without the PPP loan:

With PPP Loan and CAA Deductiblity & IRS Guidance	Scenario 1 Pandemic TY2020	Scenario 2 Pandemic TY2020	Explanation
Gross Sales	$50	$50	COVID-19 pandemic impact reduces sales by 50.0%
Total Expenses	[90]	90	Businesses can deduct expenses paid with PPP loan againset other taxable income
Net Income	**$50**	**($40)**	**Business net income decreases**

- **Implications for Rhode Island:** Rhode Island business and personal income tax statutes mirror federal tax statutes and regulations, particularly as it relates to what constitutes income, adjusted for deductions and other modifications. Any significant change in these modifications affects how income is determined for purposes of Rhode Island taxes. This includes the PPP expense deductions. The timing of the changes described above is such that it was not included in the 2020 November Revenue Estimating Conference estimates. In TY2020, $1.9 billion of PPP loans were made to 17,875 businesses in the State, of which $1.7 billion was made to for-profit, non-tax-exempt entities. If this entire amount of loans is forgiven and the $1.7 billion of expenses paid with these loans are deducted against other taxable income, the impact on state revenues for FY2021 would be in a loss of $86.3 million in revenue ($57,5 million in business corporation tax revenues and $28.8 million in personal income tax revenues).

Article 2 Changes Relative to PPP

In an effort to preserve a portion of the federal pandemic tax relief at the State level while ameliorating related revenue losses, Article 2 of the FY2021 Revised Budget makes several changes to State tax law. Changes include exempting the first $150,000 of expenses paid with forgiven PPP loans from personal income and business corporations taxation and the calculation of the hospital license fee and nursing facility assessment. Specifically, the article:

- Exempts the first $150,000 of a PPP loan from State business and personal income taxation. According to the Office of Management and Budget, 13.0 percent of businesses in the State have loans greater than $150,000.
- Includes the amount of any forgiven PPP loan up to $150,000 as part of net patient-services revenue for purposes of calculating the State's hospital license fee (for Tax Years beginning January 1, 2020 and after).
- Includes the amount of any forgiven PPP loan up to $150,000 as part of net patient-services revenue for purposes of calculating the State's nursing facility provider assessment (for Tax Years beginning January 1, 2020 and after).

The ORA estimates that the decoupling from the federal pandemic relief statutes reduces the State revenue impact by $66.0 million.

	FY2021		FY2022		
PPP Tax Policy Revenue Changes	**Personal Income Tax**	**Business Taxes**	**Personal Income Tax**	**Business Taxes**	**Total 2 Year Impact**
Federal PPP Loan Forgiveness	($28,788,938)	($57,489,763)	($15,678,451)	($31,308,915)	($133,266,067)
Decoupling from Federal PPP Loan Forgiveness ≥ $150,000	969,731	2,630,262	19,480,908	44,597,887	67,678,788
Total	**($27,819,207)**	**($54,859,501)**	**$3,802,457**	**$13,288,972**	**($65,587,279)**

The fiscal impact of the policy changes related to forgiven PPP loans and the calculation of the hospital license fee and the nursing facility provider assessment are not clear. To date, no hospitals have received PPP loans; however, a number of nursing homes received PPP loans and a significant amount of such loans is likely to have gone towards caring for patients, and thus affect revenue. The Office of Management and Budget has not provided a fiscal impact estimate for this section of the article.

Article 2 Changes Relative to Tax Administrator Discretion

Article 2 also provides the Tax Administrator with authority to exclude the amount of any PPP loan forgiven for federal income tax purposes from State tax in the event that the federal government provides funds to the State for revenue replacement. The American Rescue Plan (ARP), enacted on March 11, 2021, appears to do this. The amount of revenue replacement made available under the ARP is not clear.

Hospital License Fee

The hospital license fee is a provider tax which the State levies on hospitals. This fee is federally capped at 6.0 percent and requires annual legislative action in order to continue. It is calculated as a percent of gross patient services revenue, which includes revenues from patient care activity but excludes other activities such as research, academic activity, or investment earnings. It is assessed against all community hospitals in Rhode Island, including the State-run Eleanor Slater Hospital. Bradley and Butler Hospitals and the Rehabilitation Hospital of Rhode Island are exempt from paying the fee because their primary services and patient beds are psychiatric in nature. Hospitals pay the fee each July but the revenues are booked as a receivable to the prior fiscal year.

In past fiscal years, the hospital license fee has been used as a mechanism to generate State funds, approximately one-third of which are then matched with federal Medicaid funds and returned to hospitals to offset uncompensated care costs through the Disproportionate Share Hospital (DSH) program. The hospital license fee was assessed at the statutory maximum of 6.0 percent in FY2019 and FY2020. However, due to planned federal cuts to the DSH program, the FY2020 Enacted Budget lowered the fee to 5.0 percent for FY2021 to recognize a corresponding reduction in revenues needed to make the DSH payment. The federal DSH cuts were ultimately delayed by the Coronavirus Response and Relief Supplemental Appropriations Act of 2021 (CRRSAA) in December 2020. Article 2 restores the fee to 6.0

percent, accordingly, to provide the additional DSH funds. The rate is discounted by 37.0 percent for hospitals located in Washington County (South County and Westerly Hospitals).

The 6.0 percent hospital license fee is expected to generate $193.8 million in FY2021. The November 2020 revenue estimate included $161.5 million from the 5.0 percent fee based on current law, which was included in the FY2021 Budget as Enacted in December 2020. The Governor's Revised Budget assumes an additional $32.3 million in collections from the 1.0 percentage point increase.

FY2021 Hospital License Fee Revenue

Hospital	2018 Revenues	Enacted (5.0%)	Article 2 (6.0%)	*Change*
Eleanor Slater Hospital	$113,808,358	$5,690,418	$6,828,501	*$1,138,084*
Kent Hospital	333,131,126	16,656,556	19,987,868	*3,331,311*
Landmark Medical Center	122,851,913	6,142,596	7,371,115	*1,228,519*
Miriam Hospital	432,069,972	21,603,499	25,924,198	*4,320,700*
Newport Hospital	107,157,575	5,357,879	6,429,455	*1,071,576*
Rhode Island Hospital	1,261,059,365	63,052,968	75,663,562	*12,610,594*
Roger Williams	162,804,976	8,140,249	9,768,299	*1,628,050*
St. Joseph's	134,622,907	6,731,145	8,077,374	*1,346,229*
South County Hospital	160,376,076	5,051,846	6,062,216	*1,010,369*
Westerly Hospital	65,349,407	2,058,506	2,470,208	*411,701*
Women & Infants	421,116,177	21,055,809	25,266,971	*4,211,162*
Total	**$3,314,347,852**	**$161,541,471**	**$193,849,765**	***$32,308,294***

Analyst Note: Article 2 assesses the FY2021 fee against a hospital fiscal year 2018 revenue base. Typically, the fee is assessed against revenues from each hospital's most recently-completed fiscal year (two years behind the budget year), which would normally be 2019 revenues for FY2021. When the FY2021 fee was initially authorized, 2018 was the most recently-completed fiscal year that could be included in the enabling statute. Typically, the revenue base would have been updated in the FY2021 Enacted Budget once the 2019 data became available. Because the General Assembly enacted a "skinny" budget for FY2021, it did not include language to amend the base year. The Governor's Budget does not update the base year to 2019. Of note, a 6.0 percent fee assessed against 2019 revenues would generate an additional $1.1 million.

Article 2 also adds a provision to include the amount of Paycheck Protection Program (PPP) loans in excess of $150,000 in the patient revenue base, meaning the loans are subject to the hospital license fee. This provision only applies to the portion of a PPP loan in excess of $150,000 that otherwise would be considered patient service revenues. Effectively, the fee would only be assessed against the amount of PPP funds that were allocated for patient care activities. This provision is applicable to any taxable year beginning on or after January 1, 2020, which would impact the patient revenue base used to calculate the hospital license fee beginning in FY2022.

Analyst Note: As of March 24, 2021, according to data released by the federal Small Business Administration, no hospitals have received a PPP loan in any amount since the program began. Accordingly, FY2022 hospital license fee revenues should not be affected, but the provision leaves open the possibility that future PPP loans to hospitals could be taxed at the State level.