PPP Loans to PA Businesses

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On March 27, 2020, the Paycheck Protection Program (PPP) was enacted as part of the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act.[1] The program made forgivable loans available to small businesses and other entities that met certain criteria such as firms that (1) have 500 or fewer employees worldwide, (2) have tangible net worth less than $15 million and average net income less than $5 million for the prior two fiscal years and (3) conform to Small Business Administration (SBA) size standards for their industry.[2] The primary goal of the PPP was to provide economic relief to small businesses and non-profits that had been adversely impacted by COVID-19 and related mitigation efforts. Due to those efforts, many firms suspended operations temporarily. The loans would be used to replace lost revenues and allow firms to retain employees who might otherwise be released. To qualify for loan forgiveness, loans must have been used to offset payroll costs (at least 60 percent of the loan must be used for wages and benefits), mortgage interest, other interest, rent and utilities.[3] Approved loans could not exceed $10 million and were disbursed by private lenders from April through August 2020.

This research brief examines the impact of the PPP on Pennsylvania businesses by considering the number and type of firms affected, the potential employment impact and possible tax implications.

PPP Detail: Loans by Size, Type of Firm and Sector

The SBA publishes state-specific data on its website for two groups of firms: (1) firms that received loans under $150,000 and (2) firms that received loans that range from $150,000 up to $10 million.[4] The table on the next page provides detail for the $20.7 billion of loans made to Pennsylvania firms based on size of loan, type of firm and sector. Highlights include:

- Firms that received a loan under $150,000 comprised 85 percent of all firms and nearly one-quarter ($5.1 billion) of total loans.
- There were 205 firms (0.1 percent) that received a loan between $5 and $10 million, and those loans comprised 6.9 percent of total loans.
- For non-profits, 9,183 firms or entities received loans of $1.9 billion. Non-profits include schools, social assistance organizations and houses of worship.
- Pass through firms (S corporations, partnerships, sole proprietors and LLCs) received $11.3 billion of loans, while C corporations received $7.6 billion.
- Construction, manufacturing, retail-wholesale and healthcare firms received more than one-half (52.9 percent) of total dollar loans. Manufacturers received the largest average loan ($285,470).
- The All Other category includes agriculture, other services, transportation and energy firms, as well as firms that did not report an industry or sector.

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[1] The original $349 billion of loans under the CARES Act was later expanded by $320 billion by the Paycheck Protection Program and Health Care Enhancement Act of 2020.
[2] Applicants also had to self-certify that "current economic uncertainty makes this loan request necessary to support the ongoing operations."
[3] The maximum amount of funds that can be borrowed through the PPP is equal to 2.5 times the firm's average monthly payroll costs or $10 million, whichever is lower.
[4] See https://home.treasury.gov/policy-issues/cares-act/assistance-for-small-businesses/sba-paycheck-protection-program-loan-level-data.

Paycheck Protection Program Loans to PA Businesses

	Number of Firms	Share of Firms	Amount $ millions	Share of Amount	Average Amount
Loan Amount					
Under $150k	147,469	85.0%	$5,113	24.7%	$34,672
$150k to $350k	14,422	8.3%	$3,241	15.6%	$224,711
$350k to $1 million	8,066	4.6%	$4,596	22.2%	$569,792
$1 to $2 million	2,271	1.3%	$3,124	15.1%	$1,375,813
$2 to $5 million	1,083	0.6%	$3,218	15.5%	$2,971,087
$5 to $10 million	205	0.1%	$1,422	6.9%	$6,938,174
Total	**173,516**	**100.0%**	**$20,714**	**100.0%**	**$119,379**
Type of Firm					
Not for Profit	9,183	5.3%	$1,872	9.0%	$203,900
Pass Through	119,970	69.1%	$11,263	54.4%	$93,878
C Corporation	44,363	25.6%	$7,579	36.6%	$170,847
Total	**173,516**	**100.0%**	**$20,714**	**100.0%**	**$119,379**
Industry					
Construction	18,491	10.7%	$2,660	12.8%	$143,832
Manufacturing	9,373	5.4%	$2,676	12.9%	$285,470
Retailer-Wholesaler	21,791	12.6%	$2,673	12.9%	$122,650
Education	2,836	1.6%	$544	2.6%	$191,668
Healthcare-Social Assistance	17,380	10.0%	$2,946	14.2%	$169,490
Professional Services	21,727	12.5%	$2,619	12.6%	$120,550
Restaurant-Accommodation	13,343	7.7%	$1,151	5.6%	$86,257
Financial-Real Estate	14,175	8.2%	$1,023	4.9%	$72,154
Admin. Support & Waste Man.	11,672	6.7%	$1,263	6.1%	$108,175
All Other	42,728	24.6%	$3,161	15.3%	$73,989
Total	**173,516**	**100.0%**	**$20,714**	**100.0%**	**$119,379**

Note: Pass Throughs include S corporations, partnerships, sole proprietors and LLCs.

Source: Small Business Administration.

PPP Employment Impact: Jobs Saved or Retained

Although the program was enacted quickly in order to minimize job loss, new research finds that the program had a modest employment impact. The research also finds that the average cost per job saved or retained was many times higher than average annual earnings of employees at eligible firms. For example, three recent academic studies found that (results apply to the U.S., and employment gains are relative to employment that would have occurred without the program):

- The program increased employment at small businesses by 1.3 million jobs (2.0 percent) at an average cost of $377,700 per job for the April to August time period.[5] By comparison, the average annual earnings for employees at PPP-eligible firms was $45,000.[6]
- The program resulted in employment gains of 3.2 to 4.8 million jobs (4.5 to 6.8 percent) in its first three months, at an average cost of $109,000 to $164,000 per job.[7]
- The program boosted employment at PPP-eligible firms by 1.4 to 3.2 million jobs (2.0 to 4.5 percent) through the first week of June 2020 at an average cost of $162,000 to $380,000 per job.[8]

Various factors could motivate the findings of modest (and costly) employment impacts. The paper by Chetty et al. surmises that the small employment effect may be due to firms receiving loans that did not intend to lay off employees. Other firms that received loans might not have incurred a revenue reduction, or incurred only a brief, temporary reduction that was recouped in subsequent months. The SBA Inspector General has also noted that there were strong indicators of "widespread potential abuse and fraud in the PPP" which would reduce the effectiveness of the program and not contribute to its general purpose.[9]

Assuming that the results from these studies hold generally for Pennsylvania, and the average cost per job retained or saved ranges from $150,000 to $300,000, then the aggregate amount of loans disbursed to Pennsylvania firms suggests that the PPP might have temporarily preserved roughly 63,000 to 126,000 jobs at small businesses (excludes non-profits).

PPP Potential Tax Implications

On May 2, 2020 the IRS issued Notice 2020-32, which prohibits firms from deducting expenses that were covered by forgiven PPP loans in their determination of taxable income.[10] The disallowance of those deductions implies that forgiven loans would be effectively treated as taxable income. Some members of Congress have noted that the ruling contradicts lawmakers' intent and have stated their intent to enact

[5] In April 2020, U.S. payroll employment declined by 20.1 million (-13.4 percent, not seasonally adjusted) part- and full-time jobs relative to the prior year. By June, the figure improved to 13.2 million (-8.7 percent). The latest figure for October shows further improvement to 9.1 million (-6.0 percent).
[6] The analysis excludes firms in NAICS 72, Accommodation and Food Service. Raj Chetty, John N. Friedman, Nathaniel Hendren, and Michael Stepner, "The Economic Impacts of COVID-19: Evidence From a New Public Database Built Using Private Sector Data," NBER Working Paper No. 27431 (Nov. 2020).
[7] João Granja, Christos Makridis, Constantine, Yannelis, and Eric Zwick, "Did the Paycheck Protection Program Hit the Target?" (Nov. 2020).
[8] David Autor, David Cho, Leland D. Crane, Mita Goldar, Byron Lutz, Joshua Montes, William B. Peterman, David Ratner, Daniel Villar, and Ahu Yildirmaz, "An Evaluation of the Paycheck Protection Program Using Administrative Payroll Microdata," MIT Working Paper (July 2020).
[9] Hearing on Preventing Fraud and Abuse of Paycheck Protection Program, House Small Business Subcommittee, October 1, 2020.
[10] See https://www.irs.gov/pub/irs-drop/n-20-32.pdf.

legislation to provide for non-taxable treatment.[11] For Pennsylvania personal income tax, the tax base does not conform to the federal tax base, but forgiven loans would be treated as taxable income under current law.

To qualify for loan forgiveness, the funds must have been used for approved expenses (payroll, interest, rent, utilities) and firms must make a good faith attempt to maintain employment and pay levels at pre-pandemic levels. The deadline to submit an application for loan forgiveness is 10 months after the "covered period" of the loan, which can be 8 or 24 weeks from when the loan was received. The private lender has 60 days from the borrower's date of application to review, approve and submit the application to the SBA, which then has 90 days to review and make a final determination. Currently, the SBA has not published data related to the number of applications received or approved. In Revenue Ruling 2020-27, the IRS stated that if firms know the amount of expenses that qualify but either (1) have not yet heard back from the lender regarding the status of the application or (2) have not applied by the end of the year, the firm still has a reasonable expectation of forgiveness and should not deduct the relevant expenses in the determination of taxable income. [12] [13]

The tax status of forgiven loans will have material implications for Pennsylvania firms and personal income tax (PIT) and corporate net income tax (CNIT) revenues. The SBA data show that pass through firms liable for PIT received $11.3 billion in loans while C corporations liable for CNIT received $7.6 billion. For the purpose of computing potential revenue implications, there are many unknown parameters that must be assumed. The following examples provide some context regarding the potential revenue implications for tax year 2020 if all firms that received loans were granted forgiveness or assumed that forgiveness would be granted for loans received in tax year 2020 (per the IRS ruling):

- If all $11.3 billion of pass through loans were forgiven and effectively taxed, then the maximum PIT liability would be $11.3 billion * 3.07% = $346 million. However, many firms that received loans would not be taxable and the treatment of forgiven loans (i.e., the inability to deduct expenses that loans were used to pay) would merely reduce the tax losses firms would have claimed, and would not increase taxable profits. If one-third of the total loan amount flowed to taxable firms, then PIT liability could increase by $346 million * 33.3% = $115 million.

- If all $7.6 billion of C corporation loans were forgiven and effectively taxed, the maximum CNIT liability would be $7.6 billion * 9.99% = $757 million. However, many firms that received loans would not be taxable and the treatment of the loans would merely reduce the tax losses, and would not increase taxable profits. Moreover, it is unknown if (1) those firms operate only in Pennsylvania and (2) if firms based in other states that received loans must apportion taxable profits to Pennsylvania. If those issues are disregarded and one-third of the total loan amount flowed to taxable firms, then CNIT liability could increase by $757 million * 33.3% = $252 million.

It is noted that the share of loans received by profitable firms is not known and the one-third assumption is for illustrative purposes only. It is not known how loan recipients ultimately fared for tax year 2020. However, the relatively modest employment impact of the PPP suggests that many loans were likely received by firms that would not have laid off employees even without the loan. The latest economic data

[11] See https://www.grassley.senate.gov/news/news-releases/grassley-wyden-treasury-misses-mark-ppp-loan-expense-deductibility-guidance.
[12] See https://home.treasury.gov/news/press-releases/sm1187.
[13] See https://www.journalofaccountancy.com/news/2020/nov/ppp-loan-forgiveness-irs-safe-harbor.html.

also suggest that actual outcomes were not as dire as had been assumed when the program was implemented. Therefore, it is not unreasonable to assume that a material portion of disbursed loans will be subject to state income tax. A one-third taxable assumption yields total tax liability of $368 million, while a one-half assumption yields $551 million.

For the purpose of its June Official Revenue Estimate and October Update, the IFO had assumed that all loans would be forgiven and would be non-taxable. If that assumption is incorrect, then it will have material implications for General Fund revenues. The IFO will revisit that assumption with the release of its Mid-Year Update in January. At that time, it will be more clear whether Congress and state lawmakers have enacted or intend to enact legislation that changes the tax status of forgiven PPP loans.