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In this installment of The Endres Assessment, Endres and Doyle discuss the New York State Department of Taxation and Finance's guidance on the state's partial decoupling from recent federal changes to the Internal Revenue Code.

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The New York State Department of Taxation and Finance recently posted to its website instructions for new Form IT-558, "New York State Adjustments Due to Decoupling From the IRC."¹ As its name indicates, the new form was created to mechanically effectuate the state's partial decoupling from recent federal changes to the Internal Revenue Code. New York's fiscal 2021 budget decoupled the state's personal income tax from any amendments made to the IRC after

March 1, 2020² — including changes under the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-36) and any other federal amendments to the IRC. Thus, any amendments made to the IRC after March 1, 2020, will not apply to New York state or New York City personal income tax.

The form purports to explain the personal income tax addition and subtraction modifications used to recompute federal amounts using the rules in place before any changes made to the IRC after March 1, 2020.³ For example, the form will contain the following addition/subtraction modifications requiring taxpayers to adjust income figures reported on New York returns:

- an addback for deductions for charitable contributions allowed under IRC section 62(a)(22) (not to exceed \$300);
- an addback for employer payments of student loans (principal or interest);
- both an addition and a subtraction modification to adjust net operating losses;
- an addback for additional excess business losses deducted under IRC section 461(l)(3);
- both an addition and a subtraction modification for depreciation of qualified improvement property (QIP) if the calculation is different from that provided for under the pre-March 1, 2020, IRC;
- both an addition and a subtraction modification for business interest deductions;
- both an addition and a subtraction modification for a partner's and New York S

² See Part WWW of Chapter 58 of the Laws of 2020.

³ The form notes that its addition and subtraction adjustments are separate from the addition and subtraction modifications reported on Form IT-225, "New York State Modifications." Thus, taxpayers may need to file both Form IT-558 and Form IT-225.

¹ Instructions available at: https://www.tax.ny.gov/pdf/current_forms/it/it558i.pdf.

corporation's distributive share of adjustments to ordinary business income of a partnership; and

- both an addition and a subtraction modification for a beneficiary's distributive share of adjustments to federal taxable income of an estate or trust.

While most tax practitioners were expecting the tax department to issue a form to make those adjustments, the big news is actually what the form did *not* contain. Specifically, the form did not include an addition modification for forgiven loan proceeds under the Paycheck Protection Program. This was a change from the draft instructions that had been circulating for the past month or so in practitioner circles and causing much consternation. Thus, as of this writing, New York state apparently does not plan to tax forgiven PPP loan amounts.

Background is necessary to understand the full picture. And we apologize for how technical this article will get, but there's just no way around it.

The CARES Act

The CARES Act is not a tax bill. While it amends the IRC, it has many other provisions — including non-IRC tax provisions and language amending the Small Business Act and other nontax laws. One non-IRC tax provision is in CARES Act section 1106(i). And regarding PPP loan forgiveness, it provides that “canceled indebtedness under this section shall be excluded from gross income for purposes of the Internal Revenue Code of 1986.” This provision does *not* amend the IRC; rather, it simply says how the IRC should be construed under a particular set of circumstances. Certainly an amendment to IRC section 61 could have achieved the same result, but Congress went in a different direction. The absence of an amendment to the IRC is critical to our analysis.

Computing Adjusted Gross Income

New York's starting point for computing income subject to tax is federal adjusted gross income. New York applies addition and subtraction modifications to federal AGI to determine New York AGI. If an item of income,

gain, loss, or deduction is in the computation of federal AGI, and there is no modification to remove it, it is then in the computation of New York AGI. Likewise, if such an item is not in federal AGI and there is no modification to add it in, then it is not in New York AGI. Simple, right? So, if Congress adopts a change in the IRC to remove an item from federal AGI and the New York State Legislature does not respond, the item is also removed from New York AGI.

How Did New York Decouple From the CARES Act?

Facing increased COVID-19-response spending needs and decreased revenues from a COVID-19-depleted economy in March 2020, the Legislature determined that the additional hits to the state fisc resulting from specific CARES Act IRC changes reducing federal AGI were undesirable. Accordingly, in the fiscal 2021 budget, as noted, lawmakers approved a provision to decouple from specific CARES Act provisions. However, at least as it pertains to personal income taxpayers, only CARES Act provisions amending the IRC were negated by the Legislature. Here is the specific decoupling language from 2020 Laws of New York, Ch. 58, Part WWW, section 2:

“[Tax Law section 607(a) is amended to read as follows:] General. Any term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required but such meaning shall be subject to the exceptions or modifications prescribed in this article or by statute. Any reference in this article to the laws of the United States shall mean the provisions of the internal revenue code of [1986] (unless a reference to the internal revenue code of [1954] is clearly intended), and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time for the taxable year. **Provided however, for taxable years beginning before January [1, 2022], any amendments made to the internal**

revenue code of [1986] after March [1, 2020,] shall not apply to this article.”

(Amendment is the highlighted language.) [Emphasis added.]

Under the budget signed by Gov. Andrew Cuomo (D) on April 3, 2020, federal AGI — the starting point for calculating state AGI — is to be calculated through 2021 as if none of the amendments to the IRC adopted after March 1, 2020, including those in the CARES Act, had occurred. These include amendments to IRC section 461(l) relating to excess business losses and IRC section 163(j) relating to business interest deduction limitations. However, since the CARES Act exclusion from federal AGI for forgiven PPP loans is not an amendment to the IRC, the Legislature’s decoupling law should not result in the New York composition of federal AGI being increased by the federally excluded PPP forgiveness income. Thus, the exclusion should likewise be reflected in the computation of New York AGI.

We were initially surprised to see that that the draft instructions to Form IT-558 required that, in computing New York AGI, personal income tax payers were required to modify federal AGI by adding back to it any CARES-Act-excluded debt discharge income from a forgiven PPP loan. The draft instruction said:

A-007 Paycheck protection program loan forgiveness

If you had indebtedness that was forgiven on a loan covered under the federal Paycheck Protection Program, Public Law 116-136, [section] 1106, and you excluded from federal gross income an amount per Public Law 116-136, [section] 1106(i), then enter such amount.

Inasmuch as the exclusion from federal AGI for forgiven PPP loans is not an “amendment made to the [IRC]” after March 1, 2020, we assume that the tax department edited the draft to, among other things, reconsider the forgiven PPP loan modification to income. Therefore, we were pleased that the current version on the department’s website now says: “A-007 Intentionally omitted.”

Moreover, shortly after posting the final instructions to its website, the tax department posted a set of Frequently Asked Questions regarding the tax implications of the federal CARES Act.⁴ The FAQs ask, “are Payroll Protection Program (PPP) loans that are forgiven subject to New York State personal income taxes?” The tax department answers, “New York State follows the federal treatment. If the forgiven loan is excluded from federal adjusted gross income it is also excluded from New York adjusted gross income.” This is consistent with our analysis above.

The FAQs go on to address other issue, as well:

- confirming that federal economic impact payments (i.e., individual stimulus relief) are not included in federal AGI or New York AGI;
- confirming that New York will follow the federal treatment by waiving required minimum distributions for retirement plans for both 2020 and the extended rollover period;
- confirming that New York will follow the federal treatment of allowing coronavirus-related distributions from an eligible retirement plan to be included in income over a three-year period;
- asserting that New York will not follow the federal CARES Act changes to NOLs, instead directing taxpayers to recompute their federal NOL deduction using the rules in place prior to any CARES Act or subsequent federal changes (hence the adjustments in Form IT-558 discussed above); and
- asserting that New York’s personal income tax does not conform to the federal changes to qualified improvement property (again, hence the adjustments in Form IT-558 discussed above).

Thus, it appears that the tax department does not intend to try to include forgiven PPP loans within New York AGI. We commend the department for circulating the draft and

⁴ See New York State Department of Taxation and Finance, “New York State Tax Implications of the Federal CARES Act” (updated Jan.).

correcting it before issuing the final version and then posting the FAQs to its website. This is how government should work. Of course, this may not be the final chapter in this story. Future legislation could seek to decouple New York from the federal treatment of PPP loan forgiveness (or cause expenses paid by those proceeds to be nondeductible — more on this shortly). But for now, it appears that the law and the department’s form instructions are in sync.

PPP Expense Deduction

The Consolidated Appropriations Act, 2021, (P.L. 116-260) signed into law by then-President Trump on December 27, 2020, confirmed that deductions are allowed for otherwise deductible expenses paid with the proceeds of a forgiven PPP loan.⁵ Similar to our earlier analysis, there is no adjustment or modification that would change this result for New York tax purposes. So we expected that these expenses would also be deductible for New York tax purposes, and, indeed, the FAQs published by the tax department confirm this result. The FAQs confirm that New York follows the federal treatment and goes on to state, “If the expenses related to the forgiven loan are deducted in computing federal adjusted gross income, these deductions are automatically excluded from New York adjusted gross income.”

Conclusion

Despite initial trepidation, for now it appears that New York and the federal government are in unison regarding their tax treatment of PPP loan forgiveness and the deductibility of otherwise deductible expenses paid using loan proceeds. It will be interesting to see if this consistent treatment survives New York’s budgetary pressures in the future. ■

⁵ Bill available at: <https://rules.house.gov/sites/democrats.rules.house.gov/files/BILLS-116HR133SA-RCP-116-68.pdf>.

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