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Texas Franchise Tax Update: Texas Taxpayers Spared from Tax Increase Arising from PPP Loan Forgiveness

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Texas taxpayers can breathe a collective sigh of relief since House Bill 1195 was signed into law on May 8, 2021. The bill provides that forgiveness on Paycheck Protection Program (PPP) loans will not be considered revenue for Texas franchise tax purposes. Additionally, HB 1195 clarifies that taxpayers may include qualifying expenses paid with PPP loans into their Texas franchise tax compensation or cost of goods sold calculations (if they otherwise qualify).

Prior to the passage of this bill, the Comptroller's position was that taxpayers must include the proceeds from the forgiven PPP loans in total revenue on their franchise tax reports for the year in which the loan was forgiven. For a significant number of taxpayers, this would have resulted in the taxpayers being hit with an increased tax bill stemming from PPP loan forgiveness.

The 2020 CARES Act stipulated that PPP loan forgiveness would not be classified as taxable income for federal tax purposes even though loan forgiveness is usually taxed under federal income tax law as cancellation-of-debt (COD) income. This was the U.S. Legislature's nod to the hardship the pandemic posed to taxpayers and the economy. The IRS, however, attempted to tax the PPP loan forgiveness in another manner, announcing that it would deny deductions, otherwise deductible, for expenses giving rise to the forgiven loan. These expenses include, for example, payroll costs and rent. The U.S. Congress quickly passed federal legislation after the IRS announcement to bar it from denying deductions financed with forgiven PPP loan proceeds.

These issues of COD income inclusion and the deductibility of expenses paid by PPP loans percolated into the Texas state tax sphere.

While the federal tax implication of PPP loan forgiveness was abundantly clear given the explicit language in the 2020 CARES Act, it was uncertain whether that same loan forgiveness would also benefit from revenue exclusion for Texas franchise tax purposes.

In a moment of déjà vu, taxpayers were thrown into apprehension again after an official at the Comptroller's office stated that the Comptroller planned to require

taxpayers to add forgiven portions of PPP loans into their total revenue for the Texas franchise tax margin calculation.

This uncertainty has been laid to rest now thanks to the Texas Legislature. PPP loan forgiveness is excluded from revenue and the corresponding costs can be included in compensation or cost of goods sold subtraction for Texas franchise tax purposes.

The bill passed with ease in both the Texas House and Senate and was signed by the Governor on May 8, 2021. The law is effective immediately. After an incredibly tumultuous year, taxpayers will welcome this sliver of certainty provided by Texas lawmakers.