This week the Appropriations Committee is debating, among other things, whether or not to conform Maine's law to federal tax law with respect to PPP loans. The discussion has become political and is generating considerable heat. We'll try to shed a little light.

PPP loans are monies paid to businesses exclusively for the purpose of paying salaries and business expenses during the pandemic when operations might have otherwise contracted, employees laid off, and futures jeopardized. By definition, they can only be used for business expenses that are routinely deductible (If not, the loan must be repaid), so for every PPP dollar that is forgiven there is a dollar that would otherwise be deductible. The "loans" are being forgiven in most cases so are actually grants.

To give an over-simplified example, if a business has $10 of gross taxable income and $9 of deductible expenses, then it has $1 of net taxable income. If it receives another $10 of tax-exempt income, all of which it uses for business purposes that it can then deduct, it still has only $10 of gross taxable income but $19 of expenses.

The PPP program was established with the promise that the funds would not be included in taxable income (it wouldn't be taxed), and therein lies the tale. The debate is over whether or not the business expenses paid by the PPP funds are deductible even though the funds used to pay them are tax exempt. The IRS issued a ruling pointing out that deducting expenses when there was no taxable revenue from which to deduct them (You can't pay deductible expenses with tax-exempt income.) has never been allowed. Congress, however, overruled the IRS in December and so for federal tax purposes, the expenses paid with the tax-exempt PPP funds are deductible.

Going back to our example, if the company with $10 of initial gross taxable revenue and $9 of deductions receives $10 of PPP loans and uses all of the money for employee wages, it now still has only $10 of income but $19 of deductions for federal tax purposes. This not only wipes out the tax on the $1 of actual profits but also creates a $9 NOL (net operating loss) to carry forward. The ultimate result of this accounting is that the employer gets the PPP loan (grant) to pay business operating expenses, but then also gets a tax reduction equal to his or her marginal rate times the amount of the PPP loan/grant. This amounts to a straightforward tax reduction for the business taxpayer on top of the grant.

Since the federal government is already tens of trillions (yes, trillions with a T) in debt, the decision to exclude PPP money from taxable income was a small part of a much bigger picture. The State of Maine, however, has a constitutional requirement to have a balanced budget and doesn't have the luxury of unlimited debt. The most recent projections suggest that due to the impact of COVID-19, state revenues may be down by $.6 billion or more and the Governor's proposed budget calls for increased spending of approximately $.4 billion. The Administration also estimates that conforming to the federal tax treatment, which allows deducting the expenses paid with tax-exempt PPP monies, would cost the Maine treasury around $100 million.

Leaving aside the political considerations (and there are many), this situation raises a number of important questions. Given the potential $1 billion budget gap on the one hand and the need to combat the effects of the pandemic on the other, what's the right level of state spending? What are the right priorities? Are we getting optimal value for our tax dollars? Is the government operating at a high level of efficiency? If there is a $.6 billion revenue shortfall and we do need to increase spending by $.4

billion, how do we cover the $1 billion gap? If there ultimately is a gap of any magnitude, how do we cover it? If we want to lower taxes, is giving $100 million to the recipients of PPP loans the best way to go about it? If it is, how do we pay for it? Will it result in tax increases for other taxpayers? Will it result in a reduction of essential services?

In an ideal world, these and other questions would be examined and analyzed objectively and dispassionately with decisions made that optimize the benefits short and long term for all Mainers. We may not live in an ideal world. Given that the federal government clearly supports deducting PPP enabled expenses, one solution is for federal funds to cover the loss of state revenue. Governor Mills recently announced her intention to explore that possibility.

Since the Maine Jobs Council's (MJC) focus is foundational jobs, it generally favors anything that makes Maine employers more competitive and enables them to grow and provide more high-quality jobs. Overall, that means lower costs for energy, transportation, health care, and taxes that make Maine's currently very high cost structure competitive with other states. MJC supports efficient, cost-effective government that provides essential services, cares for those truly in need, and executes on a long-range strategy that promotes job growth and prosperity. In that role, MJC is fully prepared to participate in a thorough and thoughtful discussion of Maine's path forward for both taxes and spending.