



PAYCHECK PROTECTION PROGRAM (PPP) UPDATE

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The CARES Act has authorized billions in forgivable loans to small businesses for job retention and certain other expenses through the PPP. The PPP provided qualifying small businesses and other organizations loans with an interest rate of 1%. PPP loan proceeds must be used by the business on certain eligible expenses.

The PPP allows the interest and principal on the PPP loan to be entirely forgiven if the business spends the loan proceeds on these expense items within a designated period of time and uses at least 60% of the PPP loan proceeds on payroll expenses.

An eligible recipient may have a PPP loan forgiven in an amount equal to the sum of the following costs incurred and payments made during the covered period:

1. Payroll costs;
2. Interest (not principal) payments on covered mortgage obligations (for mortgages in place before February 15, 2020);
3. Payments for covered rent obligations (for leases that began before February 15, 2020); and
4. Certain utility payments.

An eligible recipient seeking forgiveness of indebtedness on a covered loan must verify that the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage, make payments on a covered lease, or make eligible utility payments during either the 8- or 24-week covered period after the loan was received. Borrowers must apply for forgiveness within 10 months after the last day of their covered period otherwise they must begin making loan payments to their PPP lender. Borrowers have until the maturity date of the loan to apply for forgiveness.

Borrowers may choose to submit their loan forgiveness application before the end of their covered period if all the loan proceeds have been used. However, borrowers should consider if they would benefit more by waiting to submit their application. This would allow additional time to incur more expenses and to allow borrowers who experienced any reduction in employees, or their salaries, the opportunity to restore those reductions by December 31, 2020.

The amount of the PPP loan that is forgivable may be reduced if the borrower has reduced its number of full-time equivalent employees or the individual employee's rate of pay during the covered period. The SBA form 3508 PPP Loan Application provides the necessary calculations for determining if there is a reduction in the forgivable amount. Borrowers must submit payroll reports and calculations; support for non-payroll costs including lease agreements and invoices; and proof of payments. If the borrower received an Economic Injury Disaster Loan (EIDL) advance amount, the SBA will deduct this amount from the forgiveness amount remitted to your lender.

Borrowers that are self-employed and did not list any employees on their original loan application or borrowers that have employees, but did not reduce employees or their salaries, may use SBA form 3508EZ in applying for forgiveness. This form does not require the full-time equivalent employee or salary reduction calculations.

Borrowers that received loans of \$50,000 or less may use SBA form 3508S. The borrowers that qualify for use of this form will not have their forgiveness reduced for reductions in employees or their salaries as long as all the other rules for forgiveness are met, including the requirement that at least 60% of the forgiveness amount is from payroll.

Regarding non-payroll costs, borrowers should consider recent SBA guidance:

- Deductible home office expense can qualify as an expense but only to the extent that they were deductible business expenses on the 2019 or 2020 tax filing, as applicable.
- Rent or lease payments paid to related parties are limited to the mortgage interest owed on the property during the covered period by the related party. The lease and mortgage must also have been entered into prior to February 15, 2020. Mortgage interest payments to a related party are not eligible for forgiveness. A related party relationship is deemed to exist where there is any common ownership between the business and the property owner.
- Amounts received from a subtenant of a borrower reduce the forgivable amounts related to the rent or lease expense.

Borrowers should maintain all records related to their PPP loan forgiveness for six years from the date the loan is forgiven or repaid in full.

There are various income tax implications to consider with loan forgiveness:

Cancellation of Debt Income

In general, the reduction or cancellation of non-PPP indebtedness results in cancellation of debt (COD) income to the debtor, which may affect a debtor's tax liability. However, the forgiveness of PPP debt is excluded from gross income. A taxpayer's tax attributes (net operating losses, credits, capital and passive activity loss carryovers, and basis) would not generally be reduced on account of this exclusion.



Expenses Paid with Loan Proceeds

The IRS has stated that expenses paid with proceeds of PPP loans cannot be deducted because the loans are forgiven without a recipient having taxable COD income. Therefore, the proceeds are, in effect, tax-exempt income. Expenses allocable to tax-exempt income are nondeductible because deducting the expenses would result in a double tax benefit.

The IRS has issued recent guidance regarding the deductibility of expenses in the event that loan forgiveness has not been secured by the end of 2020. The IRS indicates that borrowers may not deduct these expenses if loan forgiveness is reasonably estimated and anticipated.

The IRS has also provided safe harbor rules and instructions for the deduction of expenses if a taxpayer is denied PPP loan forgiveness or opts not to apply for forgiveness, in whole or in part. Such borrowers may consider extending their 2020 tax returns until the final determination is made.

Pending additional guidance from the SBA, self-employed individuals that received a PPP loan solely based on their schedule C net income may not be subject to the disallowance of deductions since there are no deductions attributable to their loan forgiveness.

The IRS's position on the non-deductibility of expenses used for PPP loan forgiveness has been criticized by accounting organizations and some Congress members who have argued that the denial of the deduction for these expenses is inconsistent with legislative intent. Congress may pass new legislation directing the IRS to allow deductions for expenses paid with PPP loan proceeds.

The leaders at the U.S. Treasury and the SBA have indicated that recipients of PPP loans of \$2 million or more should expect an audit if they apply for loan forgiveness. The SBA will also be sending form 3509 Paycheck Protection Program Loan Necessity Questionnaire to these borrowers. These forms ask questions to establish the borrower's need for PPP funds. This excludes smaller borrowers from PPP audits based on good faith certifications. However, government leaders have stated that there may be audits of smaller PPP loans if they see possible misuse of funds.

As the PPP is a new law, there may be more guidance coming out in the future. If you received PPP loans in 2020 and have any questions about the process and how the rules apply to your individual situation, please make sure to speak with your tax professional.

**Do you have questions about the PPP or any other year-end tax planning needs?
Contact us today, we will be happy to help!**



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