

**Update on Current Developments Occurring with the  
Paycheck Protection Program (PPP)  
December 12, 2020**

If we've learned anything in 2020, it's to take life one day at a time and take to heart an old planning mantra – "Plan for Today and Hope for Tomorrow". Business owners who participated in the Paycheck Protection Program (PPP) have been taken on a wild ride. The PPP was supposed to make the lives of business owners easier during the pandemic, after all the rule changes and conflicting publications in many respects the PPP has just added to their burden. And we're not done yet!

### **Executive Summary**

This document is intended to provide a robust update and overview of the Paycheck Protection Program and the related aspects of the PPP loans many of our clients, including our own firm, have been able to benefit from during this pandemic pause that continues to challenge all of us in many ways. There is a lot of information here and some may or may not apply to your particular situation but regardless, we hope it will be helpful to you and your advisors as we move forward with what we are calling the forgiveness phase of the PPP program. There are still open items and questions for Congress, the SBA and the IRS to resolve regarding the ultimate deductibility of PPP funded expenses and related issues and we will do our best to continue to monitor developments and provide future updates as warranted.

### **Some Background**

The Paycheck Protection Program (PPP) is part of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) passed by Congress and signed into law by the President on March 27. These loans were designed to provide small to mid-sized businesses with financial support to continue paying rent and wages to employees in businesses impacted by the Coronavirus/COVID 19. One of the most important components of the PPP was that compliance with the various rules and regulations would result in up to 100% of the loans being forgiven with no requirement for the business receiving the loans to repay the forgiven portion. The federal government would pick up the tab and repay the bank that provided the PPP loan. Small business owners understood this to mean that up to 100% of their loan proceeds could be forgiven with the expectation that the forgiven portion of the PPP loan would be non-taxable.

To expand a bit on the above, one of the major provisions of the loan, is that the Small Business Administration (SBA) who administrates the PPP loan program through SBA



approved lenders, will forgive the loans if certain employee retention criteria are met, and if the funds are used for eligible expenses, including payroll, benefits, salaries, interest payments, rent and utilities. The borrower must apply the funds to what is referred to as a “covered period”. The “covered period” refers to the period of time that eligible expenses may qualify for forgiveness. Basically, if the loan was funded AFTER June 5, 2020, the borrower must use a 24-week covered period. If the loan was funded BEFORE June 5, 2020, the borrower may also use an 8-week covered period. Neither of these may go beyond December 31, 2020 and the period starts on the day of the loan disbursement. Borrower’s may submit their application for forgiveness before their covered period ends if they have already maximized their forgiveness.

Borrower’s may submit a loan forgiveness application any time before the maturity date of their PPP loan, which is either two or five years from the loan’s origination, depending on the agreement with their lender.

A few of the other important details of the PPP loan include:

- PPP loans have an interest rate of 1%.
- Loans issued prior to June 5, 2020 have a maturity of two years. Loans issued after June 5, 2020 have a maturity of five years.
- Loan payments will be deferred for borrowers who apply for loan forgiveness until the SBA remits the borrower's loan forgiveness amount to the lender. If a borrower does not apply for loan forgiveness, payments are deferred 10 months after the end of the covered period for the borrower’s loan forgiveness (either 8 weeks or 24 weeks).
- Subleasing and Related Party Rents – Follow up [PPP loan forgiveness guidance](#) states that the amount of eligible rent expense cannot include any amount attributable to the business operations of a tenant or subtenant. For instance, a borrower with a \$10,000 monthly rent payment who subleases a portion of the rented space for \$2,500 can only include \$7,500 as an eligible rental expenditure.

The Paycheck Protection Program Flexibility Act of 2020 (the “Flexibility Act”) extended the deferral period for borrower payments of principal, interest, and fees on all PPP loans to the date on which the amount of forgiveness is remitted by the SBA to the lender. The new guidance, found in question No. 52 in the SBA’s [FAQs](#), clarifies that the deferral period extension automatically applies to all loans, with no requirement from the SBA of a formal modification of the promissory note.



Borrowers must file a forgiveness application with their lender. The SBA and Treasury Department have issued three different application forms: Form 3508, Form 3508EZ, and Form 3508S (see more info on Form 3508S below). Selecting the correct form will depend on the nature of the business, the loan size and whether the borrower had a reduced employee head count or salaries and wages. Lenders can provide the borrowers with either of the three forms, or a lender may use its own lender equivalent form.

In April 2020, the Internal Revenue Service “IRS” issued Notice 2020-32; In our prior alert, we explained the IRS' position that “no deduction is allowed for an eligible expense that is otherwise deductible if the payment of the eligible expense results in forgiveness of the covered loan.” That meant that a loan that was supposed to be excluded from income was now getting brought back in through the back door. In other words, you get the benefit of the money, but you can't deduct payments for covered expenses (payroll, rent, interest on covered mortgage obligations and utility payments) which effectively increases your taxable business income.

Receiving the loan proceeds tax free and being able to deduct the expenses qualifying the loan proceeds as non-taxable has been identified by the IRS as a "double-dip". Whether or not it was Congress' intention that small businesses receive this double-dip benefit to provide additional funding for the company to restart or continue operations after the lockdown will be unclear and will require further clarification *and legislation by Congress along with approval by whoever is President at the time of Congressional action.*

There is bipartisan commentary by House and Senate members that their intention was that the loan would be tax free and the expenses would be deductible; however, current law does not contain that clarification. Bipartisan legislation has been introduced but remains bottled up in Congress. The accounting industry, through the American Institute of Certified Public Accountants, is strongly advocating for Congress to address this through clarifying legislation that would allow of the deduction of PPP funded expenses, but the prospect of action on this in the near term is not good.

### **IRS Issues Guidance on the Timing of the Non-Deductibility of Expenses Giving Rise to Non-Taxable Forgiveness of PPP Loans**

On November 18, the IRS released Revenue Ruling 2020-27 and Revenue Procedure 2020-51 addresses the question of the deductibility of the expenses and sets forth different reasoning for the non-deductibility of the expenses from the earlier Notice 2020-32, but the result is the same; proceeds of the PPP loan are effectively taxable.



After the April issuance of Notice 2020-32, additional questions are raised:

1. Whether or not if forgiveness had been applied for and not received or not applied for at all, would the expenses funded by the PPP loans be deductible in 2020?
2. Would the non-deductibility of the expenses be deferred until 2021?

Revenue Ruling 2020-27 clearly addresses the IRS' position, stating that; if a taxpayer received a PPP loan which was used to pay otherwise deductible expenses, those expenses would not be deductible in 2020 if the taxpayer reasonably expects to receive forgiveness for the loan. Meaning the expenses would not be deductible in 2020 whether forgiveness has been received or even applied for by December 31, 2020.

Recognizing that not all taxpayers will apply for forgiveness and that some of those who do apply for forgiveness will not qualify entirely or in part for forgiveness, the IRS provides relief in the form of a “safe harbor” in Revenue Procedure 2020-51. The safe harbor allows a taxpayer to claim the deduction in the taxpayer's 2020 tax year return if that return is unfiled at the time that the taxpayer receives notification that all or a portion of its PPP loan will not be forgiven. The safe harbor is effective if the taxpayer either received notification that a part of its PPP loan would not be forgiven or if ultimately the taxpayer decides not to request forgiveness for the PPP loan. In either situation the Revenue Procedure's safe harbor states that the taxpayer may deduct the non-forgiven expenses on either a timely filed 2020 original tax return or an amended 2020 tax return filed in a subsequent year.

## **Problems to Come**

While the recent Revenue Ruling and Procedure clearly identifies the IRS' position it creates more questions. The IRS position may not be the final word –

1. There are court cases not cited by the IRS in Revenue Ruling 2020-27 that support other interpretations of the timing of non-deductibility of the expenses different from the IRS' position. These positions are “facts and circumstances specific” and not applicable to every situation.
2. Congress also continues to debate if additional COVID-19 aid will be provided to businesses and individuals.
3. What do business owners with no employee payroll do (e.g., Schedule C filers with no employees)? These business owners do not take deductions for owner compensation, which is the payroll expense that qualifies them for forgiveness. Are they in the clear or does this money get added to their income (which specifically contradicts the CARES Act that established the program)?



4. If Sole Proprietor filers do get the entire amount forgiven, but business owners with employees don't, is that fair? Creating a dynamic where similarly situated taxpayers are treated differently and does this create the basis for many a tax court case.
5. If Congress passes and the President signs legislation that eliminates the issue of non-deductibility of expenses giving rise to PPP forgiveness, the matter would be closed. However, as of now, the issue remains very much undecided.

## **IRS Issues PPP Loan Forgiveness Application Form 3508S**

The newest PPP Loan Forgiveness Application, **Form 3508S**, has been created for those borrowers whose PPP loans were \$50,000 or less. Consisting of a one page application consisting solely of summary information about the business, their loan & forgiveness amounts, and representations and certifications that must be signed off by the borrower.

Despite the change in the format from the original application the determination of a borrower's forgivable amount remains the same. The borrower must still spend their loan amount on forgivable payroll and non-payroll costs subject to the limitations described in both the CARES Act and Paycheck Protection Flexibility Act as well as subsequent guidance issued by the SBA including payments to related parties. Noticeably absent in the abbreviated application and accompanying instructions, however, are references to employee salary or wage reductions, or to reductions in employees or full-time equivalents. The removal of these deduction calculations will save small borrowers time, effort, and uncertainty when it comes to the determination of their forgivable amount.

## **SBA Issues PPP Loan Necessity Questionnaires to PPP Borrowers Who Received \$2 Million or More**

It was well publicized that large PPP borrowers would be subject to enhanced scrutiny from the SBA. The SBA previously announced their intention to audit all PPP loans that were issued for \$2 million or more. To assist in that effort the SBA has released two new questionnaires for borrowers who, together with their affiliates, received PPP loans with an original principal amount of \$2 million or greater. These new questionnaires are designed to collect additional information from borrowers for the SBA to use in evaluating the legitimacy of the good-faith certification made as part of the loan application process and that "economic uncertainty" made the loan request "necessary to support ongoing operations."

The questionnaire is broken into two segments the "Business Activity Assessment" and the "Liquidity Assessment":



1. The Business Activity Assessment, poses several questions including –
  - a. Did the borrower shut down either voluntarily or as a result of a government order?
  - b. Did the business significantly alter normal operations, cease or reduce operations?
  - c. Did the borrower begin any non-COVID-19 related capital improvement projects?
2. The Liquidity Assessment covers –
  - a. The borrower's cash available at the time of the loan application,
  - b. Compensation in excess of \$250,000 paid to owners or employees,
3. The net book value of shareholder's equity at the end of the quarter immediately before submission of the loan application. In most cases this will be March 31, 2020.

The extent to which the SBA will use these questionnaires as a metric for determining the necessity of the borrower's loan or simply as a screening to determine which borrowers may be subject to further scrutiny remains to be seen. It is important to note however, that these questionnaires are mandatory and that if the borrower does not return them to their lender within the 10-day period the SBA may determine that the borrower *"was ineligible for either the PPP loan, the PPP loan amount or any forgiveness amount claimed, and the SBA may seek immediate repayment of the PPP loan or pursue other available remedies."*

The good news is we are all in this together, and we'll figure it out. It just may take some patience and time before that happens. As always, all of us here at Seigneur Gustafson LLP stand ready to assist you with tax planning for 2020 before year-end. We will also be pleased to answer any questions that you may have about the PPP issues discussed in this email alert and in the forgiveness application process.

Please feel free to contact the partner or staff member representing you and your business.

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