

# NAVIGATING THE PPP LOAN FORGIVENESS PROCESS

Presentation: October 20, 2020

**withum**<sup>+</sup>

# Disclaimer

- This content is for general informational purposes only and should not be used as a substitute for individualized tax advice with a qualified tax advisor. This content represents the views of the authors only and does not necessarily represent the views or professional advice of WithumSmith + Brown, PC.

# Presenters



**Daniel Mayo** , JD, LLM  
Principal, National Lead, Federal  
Tax Policy



**Matthew Walsh, CPA, MS**  
Attest Senior Manager  
Lead, SBA Financial Assistance  
Services

# How did we get here? Quick history...

- Enacted March 27, 2020 – CARES Act appropriated ~ \$350B for Paycheck Protection Program (“PPP”)
- Application process opened April 3, 2020
- ~ April 16, 2020 – PPP ran out of funding – ~ 1.6M loans issued
- April 24, 2020 – PPP and Health Care Enhancement Act added ~ \$310B of additional funding
- June 5, 2020 – PPP Flexibility Act brought in 24-week covered period, 60/40 rule, new FTE safe harbors, and other borrower-favorable rules
- July 4, 2020 – PPP Extension Act extended loan application deadline to August 8, 2020
- Application process now closed
- About 5.2 million PPP loans were issued ([SBA report](#) through 8/8/2020)
- ~ 87% of PPP loans are under \$150,000
- ~ 95% of PPP loans are under \$350,000
- August 10, 2020 – SBA started accepting loan forgiveness applications from lenders; many lenders are now accepting them from borrowers, but not all

# Loan Forgiveness – where are we as of today?

Covered period status

Lender portal / process status

Lender review requirements / responsibilities

SBA review process

# Covered Period

- CP defaults to 24 weeks beginning on the day of the first loan disbursement
  - Paid or incurred rule still applies to payroll and nonpayroll costs
  - Borrowers who received loan before June 5<sup>th</sup> can use an 8-week CP
- Thus, there are only 2 options for the CP: 8 weeks or 24 weeks
  - Borrower can submit loan forgiveness application at any time before maturity of the loan, even before the end of its CP if the entire loan amount has been spent
  - If apply early, borrower can only include spending up to the date of the application, and must account for any wage reductions in excess of 25% through the end of its CP
  - No requirement to account for any subsequent FTE reductions

# Payroll Costs

## Payroll costs

- Non-owner employees – (for C and S corps, this means owner-EEs that own < 5%)
  - Cash compensation (including wages, tips, commissions, bonuses and hazard pay) –
    - 8-week CP – subject to cap of \$15,385 ( $\$100K \times 8/52$ )
    - 24-week CP – subject to cap of \$46,154 ( $\$100K \times 24/52$ )
  - Non-cash compensation includes employer-paid group health care benefits (which includes vision and dental), retirement benefits, and state/local employment taxes.
    - These are in addition to cash compensation
    - Employee group health care costs are includible to the extent paid by the employer during the CP for coverage during the CP, but not for coverage outside the CP (different from cash compensation “paid” rule)
    - Cannot accelerate retirement benefits from outside the CP – this too represents a narrowing of the “paid” rule
- Owner-employees/self-employed/general partners – (for C and S corps, owner-EEs that own  $\geq 5\%$ )
  - 8-week CP – cash compensation limited to lesser of 8 weeks of 2019 compensation or \$15,385 ( $\$100K \times 8/52$ ), in total across all businesses
  - 24-week CP – cash compensation limited to lesser of 2.5 months of 2019 compensation or \$20,833 ( $\$100K \times 2.5/12$ ), in total across all businesses

# Payroll Cost – Owner-Employee Considerations

## Payroll costs

- C corporation owner-employees that own  $\geq 5\%$  – capped at 2019 cash compensation, plus employer state/local employment taxes, health care contributions, and employer retirement contributions capped at 2.5 months of the 2019 retirement contribution amount
- S corporation owner-employees that own  $\geq 5\%$  – capped at 2019 cash compensation, plus employer state/local employment taxes and employer retirement contributions capped at 2.5 months of the 2019 retirement contribution amount, and health care contributions for  $< 2\%$  owners and family members of such owners
  - Cannot include health insurance contributions of  $2\%+$  owners or family members of  $2\%+$  owners
- Schedule C filers – capped at owner compensation replacement amount, calculated based on 2019 net profit on Schedule C, line 31
  - Cannot include state/local employment taxes, retirement or health care contributions
- General partners – capped at 2019 net earnings from self-employment on Sch. K-1, box 14a (reduced by box 12 §179 expense deduction, unreimbursed partnership expenses on Form 1040, Sch. SE, and depletion from oil and gas properties), multiplied by 0.9235
  - Amount must be paid during the covered period to be eligible for forgiveness
  - Cannot include state/local employment taxes, retirement or health care contributions



# Loan Forgiveness – Nonpayroll Costs

## ■ Nonpayroll (*i.e.*, overhead) costs

- Interest on mortgage obligations on real or personal property incurred before 2/15/2020
  - Property must be secured by a mortgage or security interest (*e.g.*, UCC-1)
  - Interest payment must relate to borrower's use of the underlying property
    - For example, if a borrower pays interest on a covered mortgage on a building and it uses only 75% of the property, leasing out the remaining 25%, then it can include only 75% of the interest on its loan forgiveness application
  - Interest paid to a related party is not eligible for forgiveness (related party includes any common ownership)
- Rent under a lease on real or personal property in force before 2/15/2020, or a renewal of such lease
  - Does not include amounts paid that are attributable to a sub-tenant
    - For example, borrower pays rent of \$10K, but receives \$3K from a sub-tenant. Only \$7K can be included on its loan forgiveness application
  - Does not include household expenses in the case of a home-based business; includes only those expenses that are deductible on borrower's tax return
  - Rent paid to a related party is eligible for forgiveness if (i) the amount of rent does not exceed the amount of mortgage interest owed on the property during the covered period that is attributable to the space being rented and (ii) the lease and mortgage were both in effect prior to February 15, 2020
    - What if there is no mortgage on the property? SBA did not address this
    - Related party includes any common ownership
- Utilities for which service began before 2/15/2020 (*e.g.*, electric, gas, water, transportation (*e.g.*, gas and transportation utility fees assessed by state/local governments), telephone, and internet)

# Loan Forgiveness Amount – Paid or Incurred

- Includes costs paid or incurred during the CP
  - This includes costs –
    - incurred BEFORE the CP and paid DURING the CP and
    - incurred DURING the CP and paid AFTER the CP but ON OR BEFORE the next regular pay date
      - Employee group health care costs are includible to the extent paid by the employer during the CP for coverage during the CP, but not for coverage outside the CP (different from cash compensation “paid” rule)
      - Cannot accelerate retirement benefits from outside the CP
  - Can include more than 8 or 24 weeks of costs –
    - for non-owner employees
    - for owner-employees/self-employed/general partners, subject to the appropriate cap (*i.e.*, 2019 comp or specific dollar amount)
    - For overhead costs, subject to the 40% limit on loan forgiveness amount
- Overall loan forgiveness cannot exceed the principal amount of the loan plus accrued interest

# Loan Forgiveness Applications

- **Loan Forgiveness Application Form 3508 (Long Form)**
  - Required for all borrowers who do not meet qualifications to utilize another form
  - Requires completion of Schedule A, which includes FTE calculations for borrowers' CP and reference period
- **Loan Forgiveness Application Form 3508EZ (EZ Form)**
  - Borrowers must certify they meet one of three options in order to qualify
  - No requirement for submission of FTE calculations/documentation
- **Loan Forgiveness Application Form 3508S (Simplified Form)**
  - Released 10/8/2020 - only for borrowers whose loan is  $\leq$  \$50,000 (and  $<$  \$2M when combined with affiliates)
  - Headcount and salary reductions do not apply – SBA granted *de minimis* exemptions
  - Affects 3.57M loans, totaling about \$62B of the \$525B in PPP loans
- All forms require submission of loan forgiveness calculation and supporting documentation, even the simplified form for loans  $\leq$  \$50,000

# Form EZ Certifications

- ☐ The Borrower is a self-employed individual, independent contractor, or sole proprietor who had no employees at the time of the PPP loan application and did not include any employee salaries in the computation of average monthly payroll in the Borrower Application Form (SBA Form 2483).

- ☐ The Borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period (as defined below) compared to the period between January 1, 2020 and March 31, 2020 (for purposes of this statement, “employees” means only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000);

**AND**

The Borrower did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the Covered Period. (Ignore reductions that arose from an inability to rehire individuals who were employees on February 15, 2020 if the Borrower was unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020. Also ignore reductions in an employee’s hours that the Borrower offered to restore and the employee refused. See [85 FR 33004](#), 33007 (June 1, 2020) for more details.

- ☐ The Borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period (as defined below) compared to the period between January 1, 2020 and March 31, 2020 (for purposes of this statement, “employees” means only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000);

**AND**

The Borrower was unable to operate during the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020 by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration, related to the maintenance of standards of sanitation, social distancing, or any other work or customer safety requirement related to COVID-19.

# Loan Repayment – if applicable

- Lender/SBA requirements for decision –
  - Lenders have 60 days from receipt of completed application to issue a decision to SBA
    - Only need to confirm borrower costs up to the requested loan forgiveness amount
    - Excess costs need not be reviewed
  - SBA then has 90 days to render a decision to the lender
- Decision can be either –
  - Approval in whole or in part
  - Denial
  - Denial without prejudice pending SBA review of the loan, but borrower can appeal
- No payments of principal, interest and fees are due until the date the SBA issues decision to lender and remits the loan forgiveness amount
  - If borrower does not apply for loan forgiveness, then the deferral period ends 10 months after the end of its CP
  - If forgiveness is denied by the SBA, then the deferral period ends to the extent repayment is due

# Are Changes Coming?

- Current Democratic proposal – the second version of bill that would be the HEROES Act
  - Loan forgiveness would be tax-free – this would reverse legislatively the IRS position of expense disallowance
  - Second round of PPP –
    - Eligibility – limited to borrowers with 200 or fewer EEs (vs. 500 in first PPP)
    - Eligibility – borrowers must have suffered 25% reduction in gross revenue in Q1, Q2 or Q3 of 2020 vs. same quarter of 2019
    - Loan size – 250% of average monthly payroll costs up to \$2M (vs. \$10M in first PPP)
    - At least \$25B earmarked for businesses with 10 or fewer employees
    - Potential for expanded list of eligible nonpayroll costs (subject to 40% cap)
      - Would include nonpayroll costs such as PPE, expenses related to adapting work environments for social distancing guidelines, software/cloud computing services that facilitate important business functions, costs related to vandalism, looting or damage due to 2020 protests (to extent not covered by insurance)



# TAXATION OF PPP LOAN

---

**withum**<sup>+</sup>

# Taxation of Receipt of PPP Loan

- Generally, no tax consequences on issuance of a note and receipt of loan proceeds
- There is no accession to wealth because of the obligation to repay the loan
- This general rule applies to the receipt of a PPP loan – no tax consequences until repayment or forgiveness



# Taxation of Loan Forgiveness

- Generally, cancellation of debt (COD) income gives rise to taxable income for borrowers
- This is because the elimination of the repayment obligation creates an accession to wealth
- Section 1106(i) of the CARES Act provides that any amount that would be includible on the forgiveness of a PPP loan “shall be excluded from gross income”
  - Applies regardless of whether the income is characterized as COD income includible under §61(a)(11) or as income otherwise includible under §61
- The CARES Act did not address the expense side of the equation
- The IRS addressed expenses in [Notice 2020-32](#)

# Taxation of Loan Forgiveness (cont'd)

## Notice 2020-32

- Payroll costs, rent and utilities are deductible under §162, and interest on covered mortgages is deductible under §163(a)
- The allowance of these deductions is subject to exceptions, including §265
- Under §265 and Reg. §1.265-1, no deduction is allowed for any amount otherwise deductible if it is allocable to one or more classes of income (other than interest) that is wholly exempt from tax (whether or not any amount of income of that class or classes is received or accrued)
- The purpose of §265 is to prevent a double tax benefit
- §265 also applies tax-exempt income that is earmarked for a specific purpose and the deductions are incurred in carrying out that purpose
- Because the loan forgiveness amount is a “class of exempt income,” borrower should eliminate the deductions relating to that class of income
- In addition, the expenses are subject to disallowance under case law and published rulings that deny deductions for otherwise deductible payments for which the taxpayer receives reimbursement

Many legislators have stated that expense disallowance was not intended, and legislation has been proposed to restore the deductions (*S. 3612, the Small Business Expense Protection Act of 2020*)

# Taxation of Loan Forgiveness (cont'd)

- Example: B has gross income of \$500 and expenses of \$300. B received a PPP loan for \$100, and expects 100% loan forgiveness

	Base Case	With COD Income	With COD Income & COD Exclusion (Congressional Intent)	With COD Income, COD Exclusion & Expense Disallowance (Notice 2020-32)
Income	\$ 500	\$ 500	\$ 500	\$ 500
COD Income		\$ 100	\$ -	\$ -
Total Income	\$ 500	\$ 600	\$ 500	\$ 500
Expenses	\$ (300)	\$ (300)	\$ (300)	\$ (300)
Expense Disallowance	\$ -	\$ -	\$ -	\$ 100
Total Expenses	\$ (300)	\$ (300)	\$ (300)	\$ (200)
Net Income	\$ 200	\$ 300	\$ 200	\$ 300



QUESTIONS?