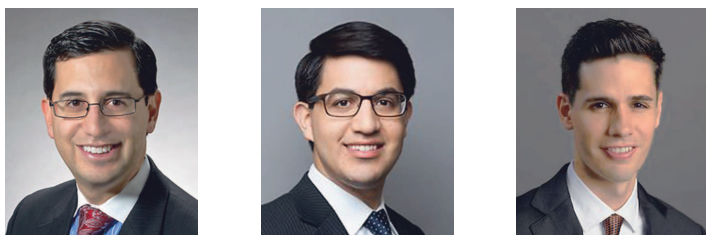


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INSIGHT: Tax Issues Associated With Paycheck Protection Program Loan Forgiveness Process



BY JUAN F. VASQUEZ, JR., JAIME VASQUEZ, AND
VICTOR J. VISER

For the well deserving small businesses receiving Paycheck Protection Program (PPP) loans from the SBA that agonized through the myriad of rule changes and conflicting information, the most important issues first and foremost were to provide necessary jobs and serve as lifelines to their employees and the greater community so that they could weather the Covid-19 pandemic and see a better tomorrow. After making it through those initial challenges, small businesses need to consider the tax issues that come with the loan forgiveness process.

The recently released PPP loan forgiveness application provides much needed flexibility for small businesses hoping to take advantage of excludable loan forgiveness available for certain eligible expenses (defined with respect to each applicable PPP loan amount as applying at least 75% towards payroll costs and up to 25% towards rent, mortgage interest, and utilities that were in existence as of February 15, 2020) made during their eight-week covered period.

Significantly, the application provides an optional Alternative Payroll Covered Period for small businesses with a biweekly (every other week) or more frequent payroll schedule. If elected, the small business's eight-week covered period, for purposes of calculating eligible payroll costs, begins on the first day of their first pay period after the loan was disbursed. On the other hand, if no election is made, the small business will continue to use the normal covered period which starts on the first day the loan was disbursed. Small businesses using the Alternative Payroll Covered Period should keep in mind that, in general, this alternative period only applies for payroll costs, and other non-payroll ex-

penses continue to use the normal eight-week covered period.

Regarding eligible payroll and non-payroll expenses, the application broadly interprets the CARES Act to allow loan forgiveness for both (i) expenses paid, but not incurred, during the covered period and (ii) expenses incurred, but not paid, during the covered period. In particular, payroll costs that were incurred before the covered period are eligible for loan forgiveness if they are paid during the eight-week covered period. Payroll costs that are incurred during the last pay period of the covered period are eligible for loan forgiveness if they are paid on or before the next regular payroll date following the end of the covered period.

Finally, the application provides a potentially more generous full-time equivalent (FTE) calculation than what many small businesses have been using. Before the application was released, many small businesses have been conservatively using the FTE calculation found under the Affordable Care Act, which considers an employee working an average of 30 or more hours per week to be 1 FTE. The application increases the threshold to be considered 1 FTE to employees working an average of 40 or more hours per week, which should result in fewer FTEs overall. In addition, the application allows less sophisticated small businesses to use a simpler FTE calculation where employees working 40 hours or more per week on average count as 1 FTE and employees working less than 40 hours per week on average count as 0.5 FTE.

A borrower may apply for loan forgiveness only after the eight-week covered period expires and the borrower gathers the required loan documentation. Comprehensive documentation is required to substantiate all eligible expenses. With regard to payroll expenses, the borrower must provide:

(1) bank account statements or third-party payroll service provider reports documenting the amount of cash compensation paid to employees;

(2) tax forms (or equivalent third-party payroll service provider reports) for the periods that overlap with the covered period, such as payroll tax filings reported, or that will be reported, to the Internal Revenue Service; and state quarterly business and individual employee wage reporting and unemployment insurance tax filings reported or that will be reported to the State;

(3) payment receipts, canceled checks, or account statements documenting the amount of any employer contributions to employee health insurance and retirement plans that the borrower included in the forgiveness amount.

With regard to non-payroll expenses, the borrower must provide documentation verifying the existence of the obligations and/or services prior to Feb. 15, 2020, and eligible payments made during the covered period.

To apply for loan forgiveness, the borrower submits to the lender servicing its PPP loan, the application, which consists of (i) the PPP Loan Forgiveness Calculation Form; (ii) PPP Schedule A; (iii) the PPP Schedule A Worksheet; and (iv) the optional PPP Borrower Demographic Information Form. The borrower should apply for loan forgiveness only after the eight week covered period expires and the borrower gathers the required loan documentation. Please note that the 75%-25% allocation of expenses issue as well as the eight-week covered period may change if regulatory and legislative fixes occur, as there is a significant push to further improve the flexibility of the PPP program.

Following the lender's receipt of the application, the lender has up to 60 days to issue a decision on loan forgiveness. Each small business and their tax and legal

advisors will want to work closely with the applicable lender to ensure that the appropriate amount of loan forgiveness is secured and that the tax treatment and reporting on a Form 1099-C, *Cancellation of Debt*, attributable to the PPP loan is correct.

Finally, from a potential tax deduction standpoint, as of the date of this writing, PPP funds amounts are excludable from gross income under Section 1106(i) of the CARES Act, but the IRS has issued subsequent guidance taking the position that ordinary business expenses that are forgiven as part of a PPP loan are in fact not deductible. The IRS position appears contrary to Congressional intent in enacting the CARES Act and could be subject to court challenges down the road. Further, such IRS position may well change or be superseded going forward, especially in light of recent filed legislation that would ensure deductibility of certain PPP loan amounts received and paid for covered expenses.

While the Paycheck Protection Program has been subject to much controversy and criticism regarding its rollout, changing or missing guidance, and tax treatment, the Loan Forgiveness application provides small businesses some much needed and appreciated flexibility going forward.

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Author Information

Juan F. Vasquez Jr. is a shareholder and co-chair of the tax controversy section at Chamberlain Hrdlicka, White, Williams & Aughtry. Jaime Vasquez is a shareholder and Victor J. Viser is an associate at Chamberlain, Hrdlicka.