

BIG QUESTIONS, BIG ANSWERS

PPP LOANS AND LOAN FORGIVENESS

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With nearly 30 years of accounting experience, Michael is skilled in assessing and minimizing tax ramifications in acquisitions, divestitures, and reorganizations. As an expert in multi-state manufacturing industry accounting and multi-jurisdiction tax compliance, his clients know him as someone who can translate unique and challenging tax strategy concepts into a format they can easily understand.

WHAT ARE PPP LOANS?

In spring 2020, no one could have estimated the effect COVID19 would have on our economy and our communities. It quickly became apparent that Congress would have to act fast to provide some assurances to business owners and nonprofit executives who employ millions of workers across the country every day. Congress used the CARES Act (Coronavirus Aid, Relief, and Economic Security Act) to provide relief funding for businesses and nonprofits to help them cover payroll expenses and also some rent, mortgage, and utility costs through loans. The Paycheck Protection Program (PPP) loans were set up in anticipation of many businesses experiencing significant losses and layoffs due to COVID19-related interruptions and closures. PPP loans were made available on April 3rd, and by August, 5.2 million businesses and nonprofits qualified and received their allocations.

HOW DO PPP LOANS WORK?

If the funds are spent on qualifying costs, the loan can be fully forgiven by the Small Business Administration and no repayment will be required.

According to the legislation, PPP loans have a 1% interest rate, loan payments are deferred for six months, and no collateral or personal guarantees are required. These features make the program desirable for many potential borrowers. However, it is the two additional features of PPP loans that make them particularly attractive. First, so long as the funds are spent on qualifying costs, the loan can be fully forgiven by the Small Business Administration (SBA) and no repayment will be required. Most PPP loans will likely be forgiven entirely. Second, the law also states that, for taxable income purposes, the income created from the loan forgiveness will not be included in income.



5.2M

By August 2020, 5.2 million businesses and nonprofits qualified for PPP loans.

\$101K

Overall average loan size among all PPP borrowers was \$101K.

"At first glance, PPP loans seem relatively black and white; however, there has been a significant change in the tax treatment." ➡

WHAT'S THE CATCH?

At first glance, PPP loans seem relatively black and white; however, there has been a significant change in the tax treatment. When enacting the CARES Act, Congress failed to include specific instructions on whether or not expenses paid with PPP funds are deductible or not. To remedy this omission, the IRS released a statement to clarify that expenses that are paid with PPP funds are not deductible for tax purposes (IRC Section 265). The IRS is interpreting these expenses to fall under IRC Section 265 (and the related regulations) and is likely correct in this interpretation. Many hope that Congress will act quickly to remedy this issue, but it has not happened yet. With all political eyes on election season 2020, it's unclear when we can expect a decision.

As of October 2020, it is highly probable that some businesses will obtain forgiveness in 2020, but others won't know until well into 2021. Businesses on a fiscal year ends (such as September 30th) won't have forgiveness granted just yet.

If your business received a PPP loan and you're on pins and needles wondering if you'll lock in loan forgiveness or not, keep waiting. The American Institute of Certified Public Accountants (AICPA) continues to urge legislators to pass a technical correction that will make the PPP forgiveness excludable from income and keep the related expenses as being deductible.

Does this impact the Qualified Business Income or QBI deduction? Is the taxable portion of PPP included in QBI? Are wages reduced in the calculation if treated as nondeductible?

As of right now, we believe the taxable income created by the PPP loan will be included as QBI. The W2 component of the QBI calculation is based on total W2 wages, generally from payroll tax returns. It would seem that there would be no impact to the QBI calculation, even if some of the wages end up not being deducted for income tax purposes.

When are these expenses treated as not deductible under current law? When they were incurred or when the loan is forgiven?

For Calendar Year 2020, businesses that receive forgiveness in 2020, this is not an issue. The PPP loan is essentially taxable in 2020 (loan forgiveness isn't in taxable gross income, but the expenses that triggered the income are not deductible). For those businesses, this will be the same tax year, so timing isn't an issue. For Calendar Year 2020 businesses that receive forgiveness in 2021, many believed that the expenses will be treated as not deductible in the year forgiveness is granted, 2021. However, IRC Section 265 and the regulations call for the expenses to be nondeductible in the year incurred, without regard to when the tax-exempt forgiveness income is recognized. Note, fiscal year ends will need some analysis on this timing situation, and both years might be impacted accordingly.





How do I plan for estimates for 2020?

As you're working on year-end projections, the PPP loan forgiveness needs to be considered. Consider the impact of the expenses not being deductible in fourth-quarter income tax estimate considerations. These payments are generally due January 15th. (December 15th for C corporations). There is still a significant level of uncertainty here that can be discussed with your tax advisor. We hope by year-end that we have better guidance to share with you. If your estimates are based on the 2019 safe harbor, you have less to consider for the fourth quarter, but it may be wise to calculate some preliminary 2020 tax projections to prepare for the impact on the 2020 tax deadline in 2021.

We will have more to come on this topic. Kruggel Lawton is closely monitoring guidance and interpretations from our resources as they come out. Please let us know if you have any additional questions. We are here for you.

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