

December 28, 2020

Dear Friends and Colleagues,

After some fits and starts, the Consolidated Appropriations Act of 2021 (CAA) was signed into law on December 27, 2020. Along with stimulus checks, increased unemployment benefits, and a variety of other items meant to help those in need, the law also provided some clarity on key issues relating to the Paycheck Protection Program (PPP).

#### Deductibility of PPP Expenses

CAA provides that payroll and other allowable expenses paid for with PPP loan proceeds will be deductible for federal income tax purposes. This provision, which was the original intent of Congress when PPP was first introduced, effectively nullifies the IRS ruling from earlier this year which would have disallowed deductible business expenses paid for with PPP loan proceeds.

This piece of the legislation has massive tax implications for PPP borrowers, all positive. As an example, a \$300,000 PPP loan could have resulted in additional taxes of \$90,000 for the borrower, assuming a 30% tax rate.

Now, not only will the borrower likely have the PPP loan forgiven, but they also will be able to deduct the related expenses. Without question, this is a win-win.

#### California/New York/Other States to Follow?

CAA applies to federal taxes only. However, it is expected, but not guaranteed, that most state taxing authorities will follow suit and allow the same deductions.

#### PPP - Second Draw

The new law also provides loan funds for smaller and harder-hit businesses that had previously received PPP funding. This time around, however, the requirements are much stricter. To be eligible, businesses must employ less than 300 employees, and demonstrate a drop in revenues of at least 25% during the first, second, or third quarter of 2020, compared to the same quarter of 2019.

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### Other PPP Changes

As you may know, the covered period is the time period allowed for borrowers to spend their PPP loan proceeds on qualified expenses. The new law allows borrowers to choose a “covered period” of 8 or 24 months, depending on which is more appropriate.

The law also expands what expenses can be included in the forgiveness calculation. Before, only payroll costs and certain mortgage, rent, and utility expenses were allowed. Now, Coronavirus supply costs (like cleaning supplies), related facility modifications, and personal protective equipment required for safety can now be included.

### Easier Forgiveness Process for Smaller Loans

CAA creates a simplified forgiveness process for loans of \$150,000 or less. An application must still be submitted, but it will essentially be a one-page certification. On this simplified form, you will only be required to submit the number of employees retained, the amount spent on payroll costs, and the amount of the original loan. No supporting documentation will need to be submitted, but you must retain these records for up to four years. The SBA has been ordered to create the simplified form within 24 days of the bill’s signing, which would be middle of January.

### Deadline to Apply for Forgiveness

There has been some confusion as to when the deadline is to submit the PPP Forgiveness Application. As long as the borrower submits its loan forgiveness application within ten months of the completion of the Covered Period, the borrower will not be required to make any principal or interest payments to the SBA. So, as an example, if your Covered Period ended August 31, 2020, then your deadline is June 30, 2021. If the loan is fully forgiven, the borrower will not be responsible for any payments. If only a portion of the loan is forgiven, or if the forgiveness application is denied, any remaining balance due on the loan must be repaid by the borrower on or before the maturity date of the loan.

### Applying for Forgiveness – Loans Above \$150,000

Make sure you are using the SBA Form 3508EZ. To qualify, only **one** of the following three statements need apply:

- a. 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 original PPP loan application;
- b. The borrower did not reduce the annual salary or hourly wages of any employee by more than 25 percent during the Covered Period; 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. (Reductions can be ignored if employees refused to come to work, were terminated for good cause, left voluntarily, or cut hours voluntarily;
- c. The borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period; 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 safety or governmental requirements (such as the closing of a non-essential business, or reduction in services because social distancing requirements).

### PPP Loans and the Sale of a Business

On October 2, the SBA issued guidelines regarding PPP loans and the sale of a business. These guidelines address both the sale of business stock (20% or more) and the sale of business assets (50% or more).

If, prior to closing on a business sale, the PPP loan has been repaid or forgiven, then there isn't an issue. However, if a sale is pending and the PPP loan hasn't been forgiven, then the PPP lender must be notified in writing ahead of time and provided copies of the sales documents. Under this scenario, the lender may then approve the sale without the SBA's consent, if:

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1. The borrower has used all of its PPP loan funds appropriately;
2. The borrower has submitted to the lender a complete loan forgiveness application, and;
3. The borrower has established an interest-bearing escrow account controlled by the PPP lender with an amount of funds equal to the amount of the PPP loan outstanding. This escrow account must state that these funds go to repay any remaining PPP loan balance, *plus* interest, if any amounts under the PPP loan are not forgiven.

If the above conditions aren't met, then the sale will require the approval of the SBA. This would be, as you can imagine, an involved and lengthy process

#### Liability Protection for Employers?

There had been a lot of back and forth about adding to CAA some liability protections for companies concerning the risks involved with the pandemic. The idea was to provide at least a partial shield for employers as it related to employees and the coronavirus. This provision did not end up in the final bill.

Should you have any questions about the above, please feel free to contact our office at any time.

Sincerely,



Tom A. McFerson, CPA, ABV  
Gatto McFerson, CPAs