Certified Public Accountants

Gatto McFerson

February 3, 2021

Dear Friends and Colleagues,

The Consolidated Appropriations Act of 2021 (CAA) was signed into law on December 27, 2020. Among other things, the law provided additional funds for the Paycheck Protection Program (PPP), and provided clarification and simplification for the loan forgiveness process. Below are some items we feel you should know about.

PPP Loans - First Draw

If you didn't receive a PPP loan in 2020 – either by choice or by accident (the application deadline was August 15, 2020) – then here is another chance. CAA has reopened the original PPP loan program - labeled First Draw - until March 15, 2021.

For the most part, guidelines, limits, and application rules are the same as before. You are eligible for First Draw if:

- You did not already receive a PPP loan last year;
- Your business was in operation on February 15, 2020;
- You have 500 employees or less.

As before, the maximum loan amount is based on 2.5 times your average monthly payroll costs. Forgiveness requirements – 60/40 spending on payroll/non-payroll, employee headcounts, stability in compensation – remain the same.

PPP Loans - Second Draw

For businesses that took advantage of the First Draw PPP Loans but remain in need of additional assistance, CAA introduced Second Draw PPP Loans.

To be eligible for Second Draw, your business must have:

- Been in operation on February 15, 2020;
- Received a First Draw PPP Loan;
- 300 or fewer employees;
- Used the full amount of the First Draw;
- Experienced a drop in revenue of 25% or more in 2020 compared to 2019.

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The 25% drop in revenue requirement is the new wrinkle for the Second Draw loans, as they are meant for businesses truly in need. One way to calculate this revenue drop is to compare your annual revenue for 2020 to 2019; if revenue was down 25%, then you qualify. If, on an annual basis, you don't qualify, you can also analyze quarter by quarter. Compare a quarter in 2020 to the corresponding quarter in 2019; if revenue dropped by more than 25% in that particular quarter, then you qualify.

As with the First Draw loans, the maximum amount of the loan is two-and-a-half times your average monthly payroll costs. You can use calendar year 2020 or calendar year 2019 - whichever is more favorable - in calculating the amount.

There is also the convenience factor of the Second Draw. If, for instance, you're using the same 2019 payroll figures that you did for the First Draw, and you're using the same lender, then you won't need to submit nearly as much of the documentation that you did the first time around.

If your loan request is under $150,000, you also won't need to provide documentation of the 25% reduction with the application…but you will when applying for forgiveness.

If your loan request is greater than $150,000, you must submit documentation proving the reduction in revenue. This can be in the form of tax returns, financial statements, or bank statements.

The loan forgiveness process for Second Draw loans is similar to First Draw.

<u>Forgiveness Applications</u>

Most veterinarians will be eligible for the simpler forgiveness applications (there are three) that are being offered by the SBA, depending on the amount of the loan.

Form 3508S is the most basic form, but is only for borrowers with loan amounts of $150,000 or less. The form requires no calculations or documentation, but the borrower must certify that:

- they used the funds appropriately;
- they didn't reduce the number of employees;
- they did not reduce employee pay.

Again, no documentation is required to be submitted, but the SBA has the right to request this paperwork in the future.

Form 3508EZ is for borrowers who received loans larger than $150,000.

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).

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 10 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.

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.

California, for instance, recently introduced legislation (AB 281) to conform California law to the federal law allowing the deduction of expenses paid with forgiven PPP debt.

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

Sincerely,

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