Taxes, PPP, EIDL and ERTC
Contractors and PPP

September 22, 2020

Taxes, PPP, EIDL and ERTC

Here is what we know today:

The CARES Act spells out that the forgiven loan amount won't be included in taxable income. That means you don't pay taxes on the money that you receive. The aim of this loan is to provide businesses with the money to keep running and continue paying employees, not to create a tax burden for businesses receiving the funds.

But, there's a catch. The IRS later released a notice clarifying how the forgiven loan amount would be treated when it comes to 2020 taxes

https://www.irs.gov/pub/irs-drop/n-20-32.pdf

Here is what we know today:

“This notice clarifies that no deduction is allowed under the Internal Revenue Code (Code) for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan pursuant to section 1106(b) of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Public Law 116-136, 134 Stat. 281, 286-93 (March 27, 2020) and the income associated with the forgiveness is excluded from gross income for purposes of the Code pursuant to section 1106(i) of the CARES Act.”

Put simply: if the forgiven loan isn’t included in a business’s taxable income, the expenses paid for with the forgiven loan aren’t able to be included as a tax deduction. That may sound like a small detail, but it can potentially have a big impact on your final tax bill at the end of the year.

Here is what we know today:

What does this look like on your tax return?

Normally if a business has payroll, rent, mortgage interest, or utility expenses, these are deductible from taxable income. That deduction lowers your taxable income. Without that deduction, you'd owe the government more in taxes.

And that's what is going to happen in this situation: you lose out on some tax deductions, so you may have to pay more when it comes time to file your taxes.

Here is what we know today:

For example, let's say your business is a C corporation that received $100,000 in a PPP loan. You used that money entirely on payroll expenses and qualified for loan forgiveness. The $100,000 that you receive won't be included in taxable income at the end of the year.

But you won't get a $100,000 tax deduction for the expenses you incurred. That means you could have an extra $21,000 tax liability at the end of the year ($100,000 * 21% corporate tax rate) that you wouldn't have if you were allowed to take the deductions as normal.

While the PPP did provide you with an extra $100,000, you're losing $21,000 in tax deductions that you'd normally get. In this example, you're still going to have a net benefit of $79,000 from the program—money that you probably wouldn't have otherwise. But for some business owners, this could be a big tax surprise that could be waiting for you at the end of the year from a program that is supposed to help your business stay afloat.

Here is what we know today:

While this is a frustrating (and expensive) update to the loan program, it may not be the final decision. Rules are still being written and plenty of people are unhappy that the IRS has taken a position that would negatively impact businesses that are struggling.

The American Institute of Certified Public Accountants (AICPA) is challenging the IRS decision that these expenses aren't deductible, saying that this goes against Congress's intent when they created the PPP.

There is also a potential update to the law that could be passed. The recent stimulus proposal reverses the decision that these expenses can't be deductible. While this is still just a proposal and hasn't been signed into law, it's clear that some lawmakers want to change the tax treatment of forgiven PPP loans.

There is a chance things could change in the future, but for now, it's a good idea to assume that you won't be able to deduct these expenses and you may have a higher tax bill as a result.

Here is what we know today:
How the EIDL advance affects taxes

The Economic Injury Disaster Loan (EIDL) is a loan option available through the SBA to help businesses struggling with financial hardship due to COVID-19. While it is a loan and doesn't have any special treatment when it comes to taxes, there is one thing that may affect your taxes: the EIDL advance.

The EIDL advance is technically a grant for small businesses of up to $10,000. Because it's a grant, it's not part of the loan that needs to be repaid. That means it's going to be treated differently than a loan on your financial statements and your tax return at the end of the year.

Unlike the PPP loan forgiveness, this grant will probably need to be included in taxable income. This isn't definitive because the IRS hasn't specifically said that this advance should be included in taxable income, but previously they've been pretty clear that any forgiven SBA loan amounts need to be included in income.

If you received an EIDL advance for the maximum amount of $10,000, that money will need to be added to your taxable income at the end of the year. But if it's added to your taxable income, you'll be able to deduct any expenses that you use to pay for this grant.

Here is what we know today:

How the EIDL advance affects taxes

For example, say you received an EIDL advance of $10,000. You'll increase your taxable income for the year by that amount. But you also used all of that money to pay for some of your business expenses, like inventory and rent. You'll get to take that $10,000 that you spent as a deduction against your taxable income, which means you won't pay taxes on the money you received.

Here is what we know today:

How the Employee Retention Credit affects taxes

You might find that the total amount of tax you owe has been reduced thanks to the Employee Retention Credit. This credit is eligible for business with fewer than 500 employees who either suspended or partially suspended their business due to COVID-19 because of a government order or they experienced a 50% decline in gross receipts when compared with the same quarter in the previous year. The catch is that you can't have a PPP Loan and receive the Employee Retention Credit

Tax credits are incredibly valuable because unlike a deduction, which reduces your taxable income, tax credits reduce your tax liability on a dollar for dollar basis. So if you have a $10,000 tax liability and a $3,000 tax credit, the amount of tax you owe is now $7,000.

The credit is calculated per employee and is 50% of up to $10,000 in qualified wages paid per quarter. If you qualify for the credit and paid three employees $8,000 in qualified wages during a quarter, you'd be eligible for a credit of $12,000.

Because the government knows you need this money now, you won't need to wait until the end of the year to claim the credit. It can be claimed on your quarterly form 941.

Government Contractors:

PPP Loans & Section 3610

CARES Act & Government Contractors

- CARES Act established the PPP loan program (which we are all hopefully fairly familiar with at this point.)

- Section 3610 - Authorizes (but doesn't not require) an adjustment for government contractors of up to 40 hours per week of leave for certain employees unable to work because of COVID-19 related restrictions.

- Government contractors that qualify for both PPP loans and Sect. 3610 adjustments can access both programs as long as the funds are not applied to cover the same costs.

Section 3610

- Permits federal agencies to reimburse contractors and subcontractors for the cost of providing paid leave to employees who cannot perform work on a government approved site (or otherwise perform remotely) due to the effects of the pandemic.

- Purpose - to maintain a ready workforce for the federal government and preserving critical pieces of our industrial base.

Section 3610

- Documentation for Reimbursement
  - At a minimum, the federal government will require:
    - A narrative describing why you are an affected contractor
    - Names, labor categories, and skill levels of all impacted employees
    - Detailed information justifying the rates and hours for which reimbursement is being requested.

Section 3610

- Reimbursement claims may include appropriate overhead costs, but NOT profit or fees lost due to an inability to operate.

- Additionally, contractors are required to disclose the amount of any loan that is forgiven under PPP or tax credits received under FFCRA.

The Future of Section 3610

- May be included in a federal budget that has yet to be voted upon.
- For now, Section 3610 only covers paid leave from March 27 - September 30, 2020.
- Reimbursement is discretionary and remains subject to available appropriations.

We are answering your questions live on the air right now.

Please submit questions through the Q&A function, *not* the chat option at the bottom of your screen.

Questions?

For legislative and regulatory questions, please email:

questions@dominionpayroll.com

Don’t forget to wash your hands!