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PPP Loan Forgiveness and Tax Planning



Like most PPP loan recipients, you are likely now outside the covered period for your loan and are shifting your focus toward loan forgiveness. Recent guidance from the IRS concerning PPP loan expense deductions may have a significant effect on when you apply for forgiveness and how to maximize your loan forgiveness amount.

In late November, the IRS issued Revenue Ruling 2020-27 which says that you cannot deduct expenses paid with funds from a PPP loan if your loan is forgiven or if you expect it to be forgiven. The ruling applies regardless of when you apply for forgiveness or expect forgiveness to be granted. For example, if you apply for forgiveness in 2020 and expect your application to be granted in 2021, the expenses are not deductible in 2020. Likewise, if you wait to apply until 2021 and expect your PPP loan to be forgiven, the PPP loan expenses are not deductible according to this Ruling.

What if your loan forgiveness application is denied?

What happens if you apply for loan forgiveness with a reasonable expectation for forgiveness and later learn that your application is denied? The IRS also issued Revenue Procedure 2020-51 which provides a Safe Harbor for PPP loan recipients in two scenarios. First, the Safe Harbor allows you to recover the expense deductions if you apply for loan forgiveness in good faith and later learn that your application is denied, in whole or in part. In this case, the deductions would be recovered either in an amended return or applied to an extended return. In the second scenario, the Procedure allows for the expense deductions if you choose not to seek PPP loan forgiveness.

What about tax planning?

What does this mean for your end of year tax planning? It is important to note that some members of Congress disagree with both the initial guidance on PPP deductibility as well as with the recent guidance. There is proposed legislation that seeks to make PPP expenses fully deductible, but it's unknown whether or not such legislation will ever be passed.



Year-end approaches to consider

In light of this uncertainty, there are several approaches that you may want to consider if you are a calendar year end.

First, you can follow the current guidance, pay estimated taxes based on not deducting expenses paid with your PPP loan, and file your tax return by the due date. Depending on the outcome of current or new legislation, you may need to file an amended return to recover any deductions.

Second, you can extend your tax return, pay estimated taxes based on not deducting expenses paid with your PPP loan, and wait for legislation to play out in Congress. With this approach you may be able to avoid having to file an amended return if new legislation is passed.

Third, you can extend your tax return, pay estimated taxes based on being able to deduct expenses paid with your PPP loan, and hope that Congress enacts legislation to deduct expenses paid with PPP loan funds prior to your having to file your extended return. Of course with this approach, you risk having to pay underpayment penalties if Congress fails to pass legislation that deems expenses paid with your PPP loan to be tax deductible.

Finally, you can decide to forego loan forgiveness and take the deductions on expenses paid with PPP loan funds. If your PPP loan was made on or after June 5, 2020, you might choose to pay off the 1% loan over the 5-year loan period. Note that you would have to make this decision prior to taking the deductions. Also note that if you make that choice in a year that is different from the year you applied for the loan, you have to include a statement with your tax return that includes the specific date on which you decided not to seek loan forgiveness.



Applying for PPP Loan Forgiveness

PPP Loan recipients have until the loan maturity date to apply for forgiveness. However, loan recipients must begin making payments 10 months after the end of the PPP loan forgiveness covered period, so it may be beneficial to apply prior to that date. Also, if you expect a significant drop in full time equivalent employees prior to year-end, then it may be beneficial to file for forgiveness sooner than later. We suggest discussing your particular situation with our office to help determine when to apply for forgiveness.

If you have decided to seek loan forgiveness and are ready to apply, you will want to use the appropriate application form. There are three forms to consider: Simplified Application, EZ Application, and the Standard Application.

The Simplified Application, Form 3508S should only be used for PPP loans of \$50,000 or less.

The EZ Application, Form 3508EZ can be used if you meet one of the following three criteria:

- You are self-employed, an independent contractor or a sole proprietor with no employees.
- You did not reduce salary or wages for any employee by more than 25%, AND you also did not reduce the number of hours for your employees, you should use the EZ Application. It is important to know that you don't have to count reduced hours if your employees were laid-off and refused an offer to return to work.
- You did not reduce salary or wages for any employee by more than 25% during the covered period and experienced reductions in business activity because of health directives related to COVID-19.

The Standard Application, Form 3508 should be used by all other borrowers.



Final Thoughts

Given the current guidance and the uncertainty surrounding new legislation, you will want to consult with one of our financial services professionals as to the best path and timing for your PPP loan forgiveness. As always, we are here to help you as you navigate the PPP loan forgiveness process.



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