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PAYROLL PROTECTION PROGRAM UPDATE – EXPENSES NONDEDUCTIBILITY

BIDEN'S POTENTIAL TAX POLICY PROPOSALS

[*The following information is provided by our MSADA accounting partner, O'Connor & Drew.*]

PAYROLL PROTECTION PROGRAM UPDATE – NONDEDUCTIBILITY OF PPP EXPENSES

Timing of Nondeductible PPP Expenses

Earlier this year in April the Internal Revenue Service (IRS) determined that expenses paid with Payroll Protection Program (PPP) loan proceeds were nondeductible; see Notice 2020-32. However, borrowers were left to question how expenses would be handled if the loan proceeds were spent during one year and loan forgiveness was not granted until a later year.

This week, the IRS released Rev. Rul. 2020-27, which provides that a borrower may not deduct PPP expenses in the taxable year in which the expenses were paid or incurred if, at the end of such taxable year, the taxpayer reasonably expects to receive forgiveness of the PPP loan on the basis of the expenses it paid or accrued during the covered period, even if the taxpayer has not submitted an application for forgiveness of the covered loan by the end of such taxable year.

Put simply, the new guidance clarifies that PPP expenses are nondeductible in the year paid/incurred, regardless of whether loan forgiveness occurs in the year paid/incurred, or in a later year, if the borrower expects to receive loan forgiveness. For example, for a borrower that reasonably expects to have their PPP loan forgiven, PPP expenses incurred/paid during 2020 are nondeductible in 2020 regardless of whether the borrower (1) receives loan forgiveness during 2020, (2) applies for forgiveness during 2020 but does not receive forgiveness until 2021, or (3) waits until 2021 to apply for loan forgiveness.

The American Institute of CPAs, a national CPA professional organization, continues to express confidence that there is enough bipartisan support for an eventual legislative "fix" that will allow borrowers to deduct PPP expenses. **Unfortunately, unless and until such legislation passes, PPP expenses remain nondeductible under IRS guidance.** Borrowers should continue to monitor the lame duck session for opportunities for Congress to pass PPP expense deductibility, or during Q1 of 2021 after the expected change to a Biden Administration.

The IRS also released Rev. Proc. 2020-51, which provides a safe harbor for deducting PPP expenses if a borrower's loan forgiveness is rejected, or if the borrower makes an irrevocable decision to not apply for forgiveness.

Necessity Questionnaire for Loans Exceeding $2 Million

At the end of October, the U.S. Small Business Administration (SBA) posted a Notice to the Federal Register signaling the upcoming release of PPP loan necessity questionnaires. The questionnaires, Form 3509 (for-profit borrowers) and Form 3510 (non-profit), have been circulated recently by lenders. These questionnaires require borrowers who (together with their affiliates) have PPP loans of $2 million or more to provide various information to the lender/SBA to justify necessity of PPP loans upon applying for forgiveness. However, these questionnaires have yet to be officially posted to either the Treasury or SBA websites. The comment period on the SBA Notice remains open until next week.

Subject to further guidance, it appears that "franchised businesses" are not required to combine loan amounts when determining whether a business and its affiliates have loans of $2 million or more. Under the PPP, a franchised business will not be aggregated if the franchise program has been assigned a franchise identifier code by the SBA (i.e., the franchise system is listed on the SBA Franchise Directory).

A group of over 80 national organizations wrote a letter to members of Congress earlier this week requesting a temporary suspension of the questionnaire requirement due to the burden the current version of questionnaire puts on borrowers and lenders. Organizations on the letter include the U.S. Chamber of Commerce, the American Bankers Association, and the AICPA, to name a few. OCD will continue to monitor changes to these questionnaire forms.

BIDEN'S POTENTIAL TAX POLICY PROPOSALS

The below summary highlights some of the standout tax proposals from the Biden campaign. No formal legislation has been introduced at this time to make all of these changes, and the ability of a Biden Administration to pass some of the more significant changes likely hinges on the results of the Georgia runoff Senate races occurring in early January 2021 which will determine which party will control the U.S. Senate.

Individual Tax

Tax Rate

- Restore the top marginal tax rate to the pre-TCJA rate of 39.6% for income over $400,000.
- Remove the tax rate preference for capital gains and qualified dividends for income over $1 million by taxing them at ordinary rates, top 39.6%. This rate is currently capped at 20% for top income earners.
- Keep the net investment income tax (NIIT). NIIT is a surcharge of 3.8% for interest, dividends, capital gains, rental and royalty income, and income from

passive investment activities that exceed MAGI thresholds.

Deductions

- Eliminate the $10,000 cap on the itemized deduction for state and local taxes.
- Limit total itemized deductions so the reduction in tax liability per dollar of deduction does not exceed 28%. Biden has promised that the 28% benefit limitation would not kick in until income exceeds $400,000.
- Bring back Pease limitation for itemized deductions.
- Phase out the 20% Section 199A/pass-through QBI deduction for income over $400,000.

Income Exclusion and Tax Credits

- Exclude forgiven student loan debt from taxable income.
- Raise the child tax credit to $3,600 per child under the age of 6 and $3,000 per child between the ages of 6 and 17 while making the credit fully refundable and allow taxpayers to receive the credit in monthly installments.
- Expand the earned income tax credit to workers older than 65 who do not have a qualifying child.
- Raise the child & dependent care credit up to $16,000 for low-income and middle-class families.
- Enact a refundable, advanceable tax credit of up to $15,000 for first-time homebuyers.
- Enact a renter's tax credit, designed to reduce rent and utilities to 30% of income for low-income taxpayers.
- Enact $5,000 credit for family caregivers.
- Make the electric motor vehicle tax credit permanent
- Expand tax deductions for green energy and provide variety of tax credit focused on promoting energy efficiency. This includes reinstating the solar energy credit and tax credit for residential energy efficiency.

Business Tax

_*Tax Rate*

- Increase the C corporate tax rate from 21% to 28%.

Minimum Tax on Book Income

- Require C corporations with over $100 million in book income to pay the greater of normal corporate tax liability or 15% of book income.

Deductions, Deferrals, and Amortization

- Eliminate all deductions for expenses to advertise prescription drugs.
- Increase the depreciable life of rental real estate.
- Eliminate the deferral of capital gains from like-kind exchanges for real estate.
- Establish tax incentives for opportunity zones.

Tax Credits

- Establish tax credits and incentives to incentivize domestic manufacturing.
- Expand the new markets tax credit and make it permanent.

- Expand the low-income housing tax credit.
- Establish a workplace childcare facility tax credit of up to 50% of an employer's first $1 million in costs for qualified on-site childcare.

Estate and Gift Tax

- Raise the estate tax to 2009 levels (possibly a 45% rate).
- Eliminate stepped-up basis on transfers of appreciated property at death.
- Reduce the gift and estate tax exemption to the pre-TCJA levels.

Employment and Retirement

- Impose the OASDI portion of Social Security Tax (12.4% split evenly between employees and employers) for wages in excess of $400,000. Currently, there is a wage cap of $137,700 for this tax. Under Biden's proposal, wages between the current cap and $400,000 would be free from tax (doughnut hole).
- Replace 401(k) contributions exclusion from income with a 26% credit.
- Replace deduction for worker contributions to traditional IRAs and defined contribution plans with refundable credit.
- Offer tax credits to small businesses to offset the costs of workplace retirement plans.

There is no guarantee that the campaign proposals will eventually become law. OCD will follow the legislative process to see how the proposals evolve and will provide you with updates.

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If you have any questions regarding this bulletin, please contact Robert O'Koniewski, Esq., MSADA Executive Vice President, by e-mail at rokoniewski@msada.org, or Peter Brennan, Esq., MSADA staff attorney, by e-mail at pbrennan@msada.org, or either by phone at (617) 451-1051.