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TAX EFFECTS ON PAYCHECK PROTECTION PROGRAM BORROWERS

Apr 06, 2020

With regard to the interplay of various tax provisions of the CARES Act and the Paycheck Protection Program (PPP), we note the following:

- If a borrower takes a PPP loan, they are restricted from claiming the employee retention credit, even if the PPP loan is not forgiven.
- If any portion of a borrower's PPP loan is forgiven, the borrower is restricted from taking advantage of the deferred payment of the employer portion of Social Security tax obligations.
- If all or a portion of borrower's PPP loan is forgiven, the statute provides that such forgiven amount shall be excluded from gross income.

Employee retention credit. The CARES Act provides certain eligible employers a refundable credit with respect to the employer’s share of Social Security tax for due in an amount equal to 50% of qualified wages paid after March 12, 2020 and before January 1, 2021 (up to $10,000 per employee for all calendar quarters). Eligible employers generally include those required to fully or partially suspend operations due to a COVID-19 related government order or that have a 50% decrease in gross receipts for a calendar quarter when compared to the same quarter in 2019. Generally, all employee wages paid by employers with up to 100 full-time employees in 2019 are eligible for the credit. However, if an employer had more than 100 full-time employees in 2019, only wages paid to employees who are not providing services due to the suspension of operations or significant decrease in gross receipts are credit-eligible. If an employer takes a PPP loan, they are not eligible to take advantage of the employee retention credit.

Deferral of employer portion of payroll tax. The CARES Act defers payment of the employer's share of Social Security tax due on wages paid from March 27, 2020 through the end of 2020. The deferred tax liability must be paid in two equal installments, by December 31, 2021 and December 31, 2022, respectively. If an employer takes a PPP loan and any portion of the loan is forgiven, they may not also take advantage of this deferral. **(Update #1:** While a taxpayer that has had a PPP loan forgiven cannot defer social security tax payments, the IRS guidance indicates that they can defer such taxes up until the time the loan is forgiven. In addition, the previously deferred payments are not required to be paid at the time of forgiveness – they continue to be deferred until 2021 and 2022. It is only social security taxes due after the time of forgiveness that are not eligible for deferral.) (**Update #2:** Under the PPP Flexibility Act, taxpayers that have a PPP loan forgiven may take full advantage of the CARES Act deferral of employer portion of payroll taxes.)

Treatment of forgiven PPP loans. The CARES Act explicitly provides that any amount that otherwise would be includable in gross income of the borrower by reason of forgiveness of PPP loan indebtedness shall be excluded from gross income. Accordingly, borrowers should not have taxable income as a result of PPP loan forgiveness. (**Update:** The IRS has indicated that while the cancellation of debt will not be included as taxable income, any amounts used to support such forgiveness will not be treated as tax deductible expenses, thereby resulting in additional income tax. Some members of Congress have expressed disappointment (or stronger feelings) regarding this result, although no further modifications in this IRS position have yet been made.)

Bryan Cave Leighton Paisner has also provided an overview of the tax provisions of the CARES Act and a client alert with additional details on the employee retention credit.

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