

Hey folks, Bill Fritton again with Equity Search, we solve tax problems. Doing a quick video today with an update on the PPP program. And the IRS has issued some clarification on taxable income for loan forgiveness and the deductibility of business expenses. First, a really quick review for all those who are not familiar with the PPP program during this pandemic. You would apply through your bank, you can apply for up to 2 1/2 times your average monthly salaries of your workers, with certain limitations, for the tax year 2019. Once it is funded you have eight weeks to spend that money. You could spend it on anything, but in order for it to be forgivable you have to spend it on payroll, rent, utilities, mortgage interest, other items like that.

Under the CARES Act a loan can be forgivable, as I've mentioned already, but only if it is spent on covered expenses. Also, other than payroll expenses can not exceed 25% of all expenses. So at least 75% of the proceeds need to be spent on payroll related expenses. Also, your head count cannot be reduced by a certain amount. Now, that's a little more complex, and salaries and wages of certain people can not be reduced by 25%. Those are all kind of asterisks, but for the most part it would be forgivable provided you spend the money on qualified expenses.

So the tax consequences of the PPP program. Until last week there was a widespread belief that not only was the loan forgivable, but that it would not count towards your gross income, and that also you could still deduct your related business expenses. We thought in the accounting community that seemed a little like double-dipping and somebody would eventually catch on. And sure enough, the IRS has come out with clarification, and I'm going to read from the IRS memo last week, Notice 2020-32.

So forgive me while I read. Specifically, this note clarifies that no deduction allowed under the IRC, internal revenue 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 of the CARES Act and the income associated with the forgiveness is excluded from gross income for purposes of the code pursuant to the CARES Act. So what does all that mean? Typically in any year, if you are forgiven a debt, if you owe a creditor and the debt is forgiveness, under certain circumstances, in most cases if you're a business that is going to be counted as gross income. Under the original CARES guidance this is the way it was laid out. Until this clarification came out, there was no mention as to whether ordinarily deductible expenses would still be deductible if the loan was subsequently forgiven.

In general, the code ordinarily allows for the deduction for all ordinary and necessary expenses used for the production of income. So rent, utilities, payroll, etc. As always, certain caveats exist. But for the most part, all general business expenses would be deductible. These new clarifications state that you specifically cannot deduct those ordinary business expenses to the extent that the income resulting from the loan forgiveness is excluded. I.e., so if you, let's say for the sake of argument, use 100% of the PPP proceeds for payroll, eight weeks after you received the PPP you go to your bank and you apply for it to be forgiven. Assume you get approved. That whole loan, let's say it's \$50,000, is forgiven. Ordinarily that would be included in gross income. Under the current rules with the PPP and the CARES Act, that income is not included in your gross income, but the corresponding \$50,000 that you spent on payroll is not deductible.

So it's basically net neutral. It makes perfect sense because you void the double tax benefit of not only having the forgiveness of debt but also the deduction of expenses. Essentially it's a revenue neutral plane and you can't double-dip. I hope this clarified some of it. Obviously, if you have any questions feel free to ask your CPA or accountant. And as always, you can contact us at 703-847-6686 and we can help you walk through it. You can also visit this video on [www.taxdocs.com](http://www.taxdocs.com). And again, my name is Bill Fritton. Stay safe, stay healthy, and have a good day. Thanks.