

Current Federal Tax Developments

Week of January 25, 2021

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ACCOUNTING
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS
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SECTION: 6698

LIMITED PENALTY RELIEF OFFERED TO PARTNERSHIPS FOR REPORTING BEGINNING TAX BASIS PARTNERS' CAPITAL ON 2020 RETURNS

Citation: Notice 2021-13, 1/20/21

In Notice 2021-13¹ the IRS has provided for relief from penalties for certain incorrect reporting related to partners' tax basis capital accounts on Schedules K-1s.

The Notice describes the changes to K-1 capital account reporting that are effective for 2020 filings:

Prior to the 2020 taxable year, partnerships could report their partners' capital accounts for the taxable year on Schedules K-1, Partner's Share of Income, Deductions, Credits, etc., using one of a variety of methods that are based on different principles (for example, tax basis, generally accepted accounting principles (GAAP), section 704(b) book, or any other method). Starting in the 2018 taxable year, however, the instructions for Form 1065 required partnerships that did not report tax basis capital accounts to their partners to report separately the beginning and ending tax basis capital account balance of any partner that would have a negative beginning or ending tax basis capital account balance.

Beginning in the 2020 taxable year, the 2020 Form 1065 Instructions require partnerships to calculate and report their partners' capital accounts using the transactional approach for the tax basis method, irrespective of whether the beginning or ending balance is negative for a partner. The instructions for Form 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships, refer to the Form 1065 Instructions for reporting partners' capital accounts. Under the transactional approach outlined in the 2020 Form 1065 Instructions, partnerships report partner contributions, each partner's share of partnership net income or loss, withdrawals and distributions, and other increases or decreases using tax basis principles, instead of methods based on other principles such as GAAP. The 2020 Form 1065 Instructions explain that if a partnership did not report its partners' capital accounts using the tax basis method in the 2019 taxable year and did not maintain its partners' capital accounts under the tax basis method in its books and records, the partnership may determine its partners' beginning capital accounts for the 2020 taxable year using any one of the following methods: the tax basis method, modified outside basis method, modified previously taxed capital

¹ Notice 2021-13, January 20, 2021, <https://www.taxnotes.com/tax-notes-today-federal/information-reporting/partnerships-given-penalty-relief-some-incorrect-reporting/2021/01/21/2l6n5> (retrieved January 22, 2021)

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method, or section 704(b) method (each as described in the 2020 Form 1065 Instructions).²

Penalties that Potentially Could Apply

The Notice also details the various penalties that can apply when these forms are properly completed by the partnership. The notice points out that a failure to properly complete the K-1 can trigger penalty for failure to timely file the partnership return (Form 1065) under IRC §6698:

‘Section 6698 imposes a penalty for failing to file a return or report at the time prescribed therefor, or for filing a return or a report that fails to show the information required under section 6031. A return required under section 6031 includes Form 1065 and each Schedule K-1. A failure to file a partnership return that shows information required under section 6031 would generally subject a partnership to the section 6698 penalty. A section 6698 penalty will not be imposed if it is shown that the failure is due to reasonable cause.’³

A separate penalty applies to the failure to timely file the information return—and the Schedule K-1 is such an information return. Thus, a penalty under §6721 would also potentially apply if the form is not properly completed:

Section 6721 imposes a penalty for any failure to file an information return on or before the required filing date, and for any failure to include all of the information required to be shown on the return or the inclusion of incorrect information. When regulations under section 6011 require a partnership to file a partnership return electronically, each Schedule K-1 required to be included with the return with respect to each partner is treated as a separate information return subject to the section 6721 penalty. See section 6724(e) of the Code. Failure to electronically file a correct Schedule K-1 when required would generally subject a partnership to a section 6721 penalty.⁴

A similar penalty will apply for failing to provide the partner with a properly completed statement in a timely fashion under IRC §6722:

Section 6722 imposes a penalty for any failure to furnish a payee statement on or before the date prescribed therefor to the person to whom such statement is required to be furnished, and for any failure to include all of the information required to be shown on a payee statement or the inclusion of incorrect information. Section 6724(d)(2) provides a definition for “payee statement” that applies to section 6722. Under section 6724(d)(2)(A), a Schedule K-1 furnished to each partner is considered a payee statement. A failure to furnish a correct

² Notice 2021-13, Section 2

³ Notice 2021-13, Section 2

⁴ Notice 2021-13, Section 2

Schedule K-1 as required under section 6031 would generally subject a partnership to the section 6722 penalty.⁵

The Notice points out that the penalties for failing to file and provide the information returns can be escaped if the partnership shows reasonable cause for the failure and that it was not due to willful neglect:

Section 6724 provides an exception to a penalty for any failure under sections 6721 and 6722 if it is shown that the failure is due to reasonable cause and not to willful neglect. Under § 301.6724-1 of the Procedure and Administration Regulations, a penalty is waived for reasonable cause only if the filer establishes that either there are significant mitigating factors with respect to the failure or the failure arose from events beyond the filer's control. In addition, the filer must establish that the filer acted in a responsible manner both before and after the failure occurred.⁶

Finally, the Notice points out that the improper reporting could lead to an assessment of tax against the partnership under the BBA 2015 partnership audit rules, and that examination assessment could lead to an accuracy related penalty under §6662.

Section 6662 imposes an accuracy-related penalty on portions of an underpayment attributable to one or more types of misconduct, such as negligence or substantial understatement of income tax. Under section 6221, the applicability of any penalties, additions to tax, or additional amounts that relate to an adjustment to a partnership-related item must be determined at the partnership level for partnerships subject to the centralized partnership audit regime enacted by the Bipartisan Budget Act of 2015, Pub. L. 114-74, 129 Stat. 584. Section 6233 makes partnerships subject to the centralized audit regime liable for the section 6662 penalties calculated on the imputed underpayment.⁷

As should be clear, at least in theory a failure to properly determine and report partners' tax basis capital accounts could expose a partnership to a rather significant amount of penalties.

Late Filing Penalty Relief (§§6698, 6721 and 6722)

Relief for the various late filing penalties is provided in Section 3 of the Notice.

The notice deals with relief when issues arise with the proper reporting and computation of the partners' beginning capital account balance on the tax basis, providing:

A partnership will not be subject to a penalty under sections 6698, 6721, or 6722 due to the inclusion of incorrect information in

⁵ Notice 2021-13, Section 2

⁶ Notice 2021-13, Section 2

⁷ Notice 2021-13, Section 2

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reporting its partners' beginning capital account balances on the 2020 Schedules K-1 if the partnership can show that it took ordinary and prudent business care in following the 2020 Form 1065 Instructions to report its partners' beginning capital account balances using any one of the following methods, as outlined in the instructions: the tax basis method, modified outside basis method, modified previously taxed capital method, or section 704(b) method.⁸

The Notice goes on to describe *ordinary and prudent business care* for these purposes:

For purposes of this notice, “ordinary and prudent business care” means the standard of care that a reasonably prudent person would use under the circumstances in the course of its business in handling account information. In demonstrating ordinary and prudent business care, taxpayers are reminded that capital account balances are part of a partnership's books and records and must be maintained accordingly.⁹

The notice also provides relief from issues with ending capital account balances, but only to the extent the error arises due to errors in the beginning capital account:

In addition, a partnership will not be subject to a penalty under sections 6698, 6721, or 6722 due to the inclusion of incorrect information in reporting its partners' ending capital account balances on Schedules K-1 in taxable year 2020 or its partners' beginning or ending capital account balances on Schedules K-1 in taxable years after 2020 to the extent the incorrect information is attributable solely to the incorrect information reported as the beginning capital account balance on the 2020 Schedule K-1 for which relief under this notice is available.¹⁰

Although this relief is limited in a way that may trouble advisers, the Notice reminds taxpayers that reasonable cause exceptions to these penalties are still available if this Notice doesn't deal with the issue:

The penalty relief provided in this notice is in addition to the reasonable cause exception to penalties for failing to properly report the partners' beginning capital account balances, as described in section 2 of this notice.¹¹

The late filing relief for errors in capital accounts concludes by providing that this relief will not apply to returns that are simply not filed, even with these errors, in a timely fashion:

A partnership that fails to timely file a 2020 Form 1065, Form 8865, and Schedules K-1 is not eligible for the relief provided by this notice.

⁸ Notice 2021-13, Section 3

⁹ Notice 2021-13, Section 3

¹⁰ Notice 2021-13, Section 3

¹¹ Notice 2021-13, Section 3

A partnership that fails to include a partner's beginning capital account balance on the Schedule K-1 is also not eligible for relief.¹²

As well, this relief does not impact the requirement that a *partner* needs to have maintained accurate records for his/her basis in the partnership interest.

This notice does not relieve a partner of its obligation to determine the adjusted basis of its interest in the partnership for purposes of determining its tax liability or that of any other person as prescribed in section 705 of the Code and § 1.705-1(a)(1) of the Income Tax Regulations.¹³

Relief for Accuracy Related Penalty Under §6662 in BBA Exams

If a partnership has an error that is eligible for relief under the "late filing" relief provisions of this ruling, the IRS Notice provides that the accuracy related penalty under IRC §6662 will not be asserted by the Service on that part of the understatement:

The IRS will waive any accuracy-related penalty under section 6662 for any taxable year with respect to any portion of an imputed underpayment that is attributable to an adjustment to a partner's beginning capital account balance reported by the partnership for the 2020 taxable year to the extent the adjustment arises from the inclusion of incorrect information for which the partnership qualifies for relief under section 3 of this notice.¹⁴

However, the Notice provides that relief is strictly limited to those partnerships that meet the conditions for relief under the late filing section of the Notice:

This notice does not prevent the IRS from imposing an accuracy-related penalty under section 6662 for any portion of an imputed underpayment related to capital account reporting by the partnership that is not described in the previous sentence.¹⁵

¹² Notice 2021-13, Section 3

¹³ Notice 2021-13, Section 3

¹⁴ Notice 2021-13, Section 4

¹⁵ Notice 2021-13, Section 4

SECTION: ERC

IRS GUIDANCE ON EMPLOYERS WITH PPP LOANS CLAIMING ERC UNDER SPECIAL FOURTH QUARTER 941 RULE LIMITED TO THOSE DENIED FORGIVENESS

Citation: “Didn’t Get Requested PPP Loan Forgiveness? You Can Claim the Employee Retention Credit for 2020 on the 4th Quarter Form 941,” IRS website, 1/22/21

In a web page posted on January 22, 2021, the IRS has determined that the special fourth quarter Form 941 procedure to claim the Employee Retention Credit will apparently only apply to borrowers who have had their PPP application for forgiveness denied.¹⁶

IRS Guidance

The page begins by roughly describing the revisions found in the Taxpayer Certainty and Disaster Tax Relief Act of 2020 §206:

Under section 206(c) of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, an employer that is eligible for the employee retention credit (ERC) can claim the ERC even if the employer has received a Small Business Interruption Loan under the Paycheck Protection Program (PPP). The eligible employer can claim the ERC on any qualified wages that are not counted as payroll costs in obtaining PPP loan forgiveness. Any wages that could count toward eligibility for the ERC or PPP loan forgiveness can be applied to either of these two programs, but not both.

The agency then turns to the special provision in the law that allows certain taxpayers to claim the credit on the fourth quarter Form 941:

If you received a PPP loan and included wages paid in the 2nd and/or 3rd quarter of 2020 as payroll costs in support of an application to obtain forgiveness of the loan (rather than claiming ERC for those wages), and your request for forgiveness was denied, you can claim the ERC related to those qualified wages on your 4th quarter 2020 Form 941, Employer's Quarterly Federal Tax Return.

¹⁶ “Didn’t Get Requested PPP Loan Forgiveness? You Can Claim the Employee Retention Credit for 2020 on the 4th Quarter Form 941,” IRS website, <https://www.irs.gov/forms-pubs/didnt-get-requested-ppp-loan-forgiveness-you-can-claim-the-employee-retention-credit-for-2020-on-the-4th-quarter-form-941>, January 22, 2021 (retrieved January 24, 2021)

You can also report on your 4th quarter Form 941 any ERC attributable to health expenses that are qualified wages that you didn't include on your 2nd and/or 3rd quarter Form 941.¹⁷

The guidance appears to be implementing the revisions to CARES Act §2301(g)(2) for purposes of this special rule (where forgiveness was denied after the wages were used for PPP purposes). As no guidance has yet been released under revised CARES Act §2301(g)(1) (the election to bypass the employee retention credit for otherwise allowable wages, allowing them to be used for PPP purposes), the IRS does not address any such wages in this guidance.

The IRS provides the following procedure to be used by (the likely very limited number of) employers who meet these requirements:

If you choose to use this limited 4th quarter procedure, you should add the ERC attributable to these 2nd and/or 3rd quarter qualified wages and health expenses on line 11c or line 13d (as relevant) of your original 4th quarter Form 941 (along with any other ERC for qualified wages paid in the 4th quarter). You should also:

- Include the amount of these qualified wages paid during the 2nd and/or 3rd quarter (excluding health plan expenses) on line 21 of your original 4th quarter Form 941 (along with any qualified wages paid in the 4th quarter)
- Enter the same amount on Worksheet 1, Step 3, line 3a.
- Include the amount of these health plan expenses from the 2nd and/or 3rd quarter on line 22 of the 4th quarter Form 941 (along with any health expenses for the 4th quarter)
- Enter the same amount on Worksheet 1, Step 3, line 3b.¹⁸

The IRS also addresses the practical problem of attempting to comply with these instructions that were published less than 10 days before the report is due:

We understand this might be difficult to implement so late in the timeframe to file your 4th quarter return. You do not have to use this limited 4th quarter procedure. You can instead choose the regular process of filing an adjusted return or claim for refund for the

¹⁷ “Didn’t Get Requested PPP Loan Forgiveness? You Can Claim the Employee Retention Credit for 2020 on the 4th Quarter Form 941,” IRS website, <https://www.irs.gov/forms-pubs/didnt-get-requested-ppp-loan-forgiveness-you-can-claim-the-employee-retention-credit-for-2020-on-the-4th-quarter-form-941>, January 22, 2021

¹⁸ “Didn’t Get Requested PPP Loan Forgiveness? You Can Claim the Employee Retention Credit for 2020 on the 4th Quarter Form 941,” IRS website, <https://www.irs.gov/forms-pubs/didnt-get-requested-ppp-loan-forgiveness-you-can-claim-the-employee-retention-credit-for-2020-on-the-4th-quarter-form-941>, January 22, 2021

appropriate quarter to which the additional ERC relates using Form 941-X.¹⁹

Is This All PPP Employers Get for 2020?

Some may worry that this guidance means that employers will have to receive denial of their applications for forgiveness to get an employee retention credit—but that ignores a few key issues.

First, CARES Act §2301(g)(1), as added by the Taxpayer Certainty and Disaster Tax Relief Act of 2020, contains the following language:

(1) IN GENERAL.—This section shall not apply to so much of the qualified wages paid by an eligible employer as such employer elects (at such time and in such manner as the Secretary may prescribe) to not take into account for purposes of this section.²⁰

That section clearly indicates that *all wages paid in 2020 are first used for the employee retention credit* unless this election is made that would free up designated wages to be used for PPP loan forgiveness.

As of the date this is written, the IRS has not released guidance on how to “opt-out” of the employee retention credit for these otherwise qualified wages the employer wishes to “free up” for use towards forgiveness under the Paycheck Protection Program.

Second, a careful reading of the IRS guidance on the fourth quarter 941 program notes it does not provide there is no other way to obtain the credit in 2020 aside from waiting for denial of PPP loan forgiveness. In fact, it does not actually indicate that the IRS would not provide for other circumstances where the special fourth quarter rule might be used, though time is quickly running out for the IRS to provide such additional guidance.

Fourth Quarter Wages

There is an interesting issue for fourth quarter 941 wages that is also not addressed by this guidance. Under the law, all wages paid in the fourth quarter that would meet the test of being *qualified wages* under the credit would have to be used for that absent an election to not treat them as wages for that purpose. So far, we don’t have any information on how that election would be made for these fourth quarter 941 wages.

As well, since the changes made in §206 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 apply as if they were included in the original CARES Act,²¹ it would appear that no 2020 wages paid by an employer that would meet the requirements to be employee retention credit qualified wages would now be eligible to be used for PPP

¹⁹ “Didn’t Get Requested PPP Loan Forgiveness? You Can Claim the Employee Retention Credit for 2020 on the 4th Quarter Form 941,” IRS website, <https://www.irs.gov/forms-pubs/didnt-get-requested-ppp-loan-forgiveness-you-can-claim-the-employee-retention-credit-for-2020-on-the-4th-quarter-form-941>, January 22, 2021

²⁰ CARES Act §2301(g)(1), as amended by the Taxpayer Certainty and Disaster Tax Relief Act of 2020

²¹ Taxpayer Certainty and Disaster Tax Relief Act of 2020 §206(e)

loan relief if the law is to be applied literally—at least not until the IRS releases the method to be used to make the §2301(g)(1) election.

Since that result would seem very clearly contrary to Congressional intent, it appears that we are waiting on the IRS guidance on the election under CARES Act §2301(g)(1). Presumably, the guidance will explain how this election is to be made retroactively at which point taxpayers could then appropriately claim the employee retention credit on certain wages paid in 2020 and apply other wages to PPP forgiveness.

But getting that credit will apparently require filing Forms 941-X for the affected quarter(s).

SECTION: PPP LOAN REVISED MAXIMUM FIRST DRAW PPP LOAN BORROWING CALCULATION FAQ ISSUED BY SBA FOR ECONOMIC AID ACT CHANGES

Citation: “Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type,” SBA FAQ, 1/17/2021

The SBA has updated its FAQ computing the maximum first draw PPP loan amounts²² following the passage of the Economic Aid Act in December of 2020.

The revised guidance begins with a note that while the SBA’s calculations often refer to 2019 information to compute the maximum borrowing, in the IFRs issued on January 6, 2021 describing the revisions found in the Economic Aid Act, the SBA allows the use of calendar year 2020 as well:

The guidance describes payroll costs using calendar year 2019 as the reference period for payroll costs used to calculate loan amounts. However, borrowers are permitted to use payroll costs from either calendar year 2019 or calendar year 2020 for their First Draw PPP Loan amount calculation. Documentation, including IRS forms, must be supplied for the selected reference period.²³

²² “Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type,” SBA FAQ, January 17, 2021, <https://home.treasury.gov/system/files/136/PPP--How-to-Calculate-Maximum-Loan-Amounts-for-First-Draw-PPP-Loans-and-What-Documentation-to-Provide-By-Business-Type.pdf> (retrieved January 18, 2021)

²³ “Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type,” SBA FAQ, January 17, 2021, p. 1

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In a footnote the document indicates that the year chosen must be used for all calculations:

All components of payroll costs must be from the same calendar year. Payroll costs, including for covered benefits, can only be included for employees whose principal place of residence is in the United States.²⁴

Revision to the Calculation for Farmers and Ranchers

The document is updated in question 3 to reflect the revised calculations available for sole proprietor self-employed farmers and ranchers. The Question provides:

3. Question: I am a self-employed farmer or rancher who reports my income on IRS Form 1040 Schedule F. What documentation must I provide in place of Schedule C and how should my maximum loan amount be determined (up to \$10 million)?

Answer: Self-employed farmers and ranchers (i.e., those who report their net farm profit on IRS Form 1040 Schedule 1 and Schedule F) should use IRS Form 1040 Schedule F in lieu of Schedule C.

The calculation for self-employed farmers and ranchers without employees is the same as for Schedule C filers that have no employees, except that Schedule F line 9 (gross income) should be used to determine the loan amount rather than Schedule C line 31 (net profit).

The calculation for self-employed farmers and ranchers with employees is the same as for Schedule C filers that have employees with several exceptions. First, in place of Schedule C line 31 (net profit), the difference between Schedule F line 9 (gross income) and the sum of Schedule F lines 15, 22, and 23 (for employee payroll) should be used. Second, employer contributions for employee group health, life, disability, vision and dental insurance (portion of Schedule F line 15 attributable to those contributions) and employer contributions for employee retirement contributions (Schedule F line 23) should be used in place of those respective lines on Schedule C.

The documentation requirements are the same as for Schedule C filers except the 2019 IRS Form 1040 Schedule 1 and Schedule F must be included with the loan application in place of IRS Form 1040 Schedule C. Additionally, for farmers and ranchers with employees, IRS Form 943 should be provided in addition to, or in place of, IRS Form 941, as applicable.²⁵

²⁴ “Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type,” SBA FAQ, January 17, 2021, p. 1

²⁵ “Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type,” SBA FAQ, January 17, 2021, pp. 3-4

Partnerships Using 2020 Payroll Numbers

The FAQ notes in footnote 6 that if a partnership wishes to use the 2020 payroll numbers, it will need to complete the Form 1065 for 2020 for the partnership before applying for the loan:

If the partnership is using 2020 payroll costs and the Form 1065 for 2020 has not yet been completed, fill out the form.²⁶

S Corporation More Than 2% Shareholders

A footnote also points out that for more than 2% shareholders of an S corporation, amounts for various fringe benefits are part of cash compensation, and thus the cost cannot be added to cash compensation amounts:

Note that employer contributions for group health, life, disability, vision, and dental insurance for S-Corporation employees who own more than a 2 percent stake in the business (or employees who are family members of such owners) are not included in this figure as such contributions are already included in gross wages.²⁷

Corporations or Not for Profit Organization Not in Operation Between February 15, 2019 and June 30, 2019

Question 10 covers how to deal with corporations and not for profit organizations that were not in operation between February 15, 2019 and June 30, 2019:

10. Question: I am a corporation or nonprofit and was in operation on February 15, 2020, but was not in operation between February 15, 2019, and June 30, 2019. What reference period should I be using to compute my First Draw PPP Loan amount?

Answer: In this case, you may choose one of two ways to calculate your First Draw PPP Loan amount. The first option is for borrowers to follow the applicable instructions in Questions 5, 6, 7 and use payroll information for all of 2020 instead of 2019. The second option is for borrowers to calculate their loan amount using their average monthly payroll costs incurred in January and February 2020. For borrowers choosing the second option, the following methodology

²⁶ “Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type,” SBA FAQ, January 17, 2021, p. 4, Footnote 6

²⁷ “Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type,” SBA FAQ, January 17, 2021, p. 6, Footnote 7

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should be used to calculate the maximum amount that you can borrow:

- Step 1: Compute January and February 2020 payroll costs by adding the following:
 - Gross pay to employees for those two months whose principal place of residence is in the United States, up to \$16,667 per employee;
 - Employer group health, life, disability, vision, and dental insurance contributions for those two months;
 - Employer retirement contributions for those two months; and
 - Employer state and local taxes assessed on employee compensation for those two months, primarily state unemployment insurance tax.
- Step 2: Calculate the average monthly payroll costs (divide the amount from Step 1 by 2)
- Step 3: Multiply the average monthly payroll costs from Step 2 by 2.5.
- Step 4: Add any outstanding amount of any EIDL made between January 31, 2020 and April 3, 2020 that you seek to refinance. Do not include the amount of any advance under an EIDL COVID-19 loan (because it does not have to be repaid).

If you choose the second option, you must provide payroll records from January and February 2020, your IRS Form 941 for the first quarter of 2020, and documentation of any employer retirement and group health, life, disability, vision, and dental insurance contributions from that period.²⁸

Self-Employed Individuals and Partnerships Not in Operation Between February 15, 2019 and June 30, 2019

Similar guidance is offered for self-employed individuals and partnerships that weren't in operation between February 15, 2019 and June 30, 2019:

11. Question: I am self-employed (or a partnership) and was in operation on February 15, 2020, but was not in operation between February 15, 2019, and June 30, 2019. I have filed or will file a Form

²⁸ "Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type," SBA FAQ, January 17, 2021, pp. 9-10

1040 Schedule C or Schedule F (or Form 1065) for 2020. What reference period should I be using to compute my First Draw PPP Loan amount?

Answer: In this case, you may choose one of two ways to calculate your First Draw PPP Loan amount. The first option is for borrowers to follow the applicable instructions in Question 1 through 4 and use payroll information for all of 2020 instead of 2019. The second option is for borrowers to calculate their loan amount using their average monthly payroll costs incurred in January and February 2020. For borrowers choosing the second option, the following methodology should be used by Schedule C filers to calculate the maximum amount that you can borrow:

- Step 1: Fill out an IRS Form 1040 Schedule C for January and February 2020. The entries on the schedule must reflect all business income and expenses from those two months, with the exception that on Schedule C line 13:
 - you must include only 1/6 of the amount of any annual depreciation and section 179 expense deduction attributable to investment made in those months, and
 - you must include 1/6 of the amount of the 2020 depreciation deduction attributable to investment made in prior years.
- Step 2: Take the net profit amount for January and February on Schedule C line 31.
 - If this amount is more than \$16,667 for the two months combined, set it to \$16,667.
 - If this amount is less than 0 for the two months combined, set it to 0.
- Step 3: If you have employees, add your employee payroll costs for January and February 2020 to the result in Step 2. Only include payroll costs for those employees whose principal place of residence is in the United States and up to \$16,667 of gross pay per employee.
- Step 4: Divide the total by 2, and then multiply it by 2.5.
- Step 5: Add the outstanding amount of any EIDL made between January 31, 2020 and April 3, 2020 that you seek to refinance, less the amount of any advance under an EIDL COVID-19 loan (because it does not have to be repaid).

Your IRS Form 1040 Schedule C as completed must be provided to your lender when you apply for a PPP loan. This information should

<http://www.currentfederaltaxdevelopments.com>

be consistent with what you will submit to the IRS and must be true and accurate in all material respects. You must also supply bank statements from your business account(s) for the months of January and February 2020 to substantiate your net profit amount from Schedule C. If you have employees, you also must provide payroll records from those two months, your IRS Form 941 for the first quarter of 2020, and documentation of any employer retirement and group health, life, disability, vision, and dental insurance contributions made on behalf of employees.

Schedule F filers should use the same methodology as above but complete a Schedule F in Step 1 and replace net profit from Step 2 with the gross income amount on Schedule F line 9 (if no employees) or the difference between the gross profit amount on Schedule F line 9 and employee payroll costs from the sum of Schedule F lines 15, 22, and 23 (if you have employees). Documentation requirements are the same as above except Schedule F as completed must be provided in place of Schedule C.

Partnerships should use the same methodology as above but complete a Form 1065 in Step 1 and replace net profit from Step 2 with the net earnings from self-employment for each individual U.S.-based general partners (the difference between box 14a of IRS Form 1065 K-1 and the sum of (i) any section 179 expense deduction claimed in box 12; (ii) any unreimbursed partnership expenses claimed; and (iii) any depletion claimed on oil and gas properties) multiplied 0.9235. Documentation requirements are the same as above except Form 1065 as completed must be provided in place of Schedule C.²⁹

Fringe Benefits to Add to Medicare Wages in Computing Payroll Costs

Question 12 outlines pre-tax employee contributions related to fringe benefits that are excluded from Medicare wages that are added back to compute cash compensation:

12. Question: In addition to pre-tax employee contributions for health insurance, what are the other pre-tax employee contributions for fringe benefits that may have been excluded from IRS Form 941 Taxable Medicare wages & tips that is part of employee gross pay?

Answer: Employee contributions and deductions from pay for flexible spending arrangements (FSA) or other nontaxable benefits under a section 125 cafeteria plan, qualified transit or parking benefits (up to \$270 a month), and group life insurance (for up to \$50,000 of coverage) may have been excluded from IRS Form 941 Taxable Medicare wages & tips. However, pre-tax employee contributions to

²⁹ “Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type,” SBA FAQ, January 17, 2021, pp. 10-11

retirement plans are included in Taxable Medicare wages & tips and should not be added to that figure to arrive at gross pay.³⁰

Federal Taxes and Payroll Costs

Question 13 outlines how federal taxes impact payroll costs:

13. Question: How should a borrower account for federal taxes when determining its payroll costs for purposes of the maximum loan amount, allowable uses of a PPP loan, and the amount of a loan that may be forgiven?

Answer: Payroll costs are calculated on a gross basis without regard to federal taxes imposed or withheld, such as the employee's and employer's share of Federal Insurance Contributions Act (FICA) and income taxes required to be withheld from employees. As a result, payroll costs are not reduced by taxes imposed on an employee and required to be withheld by the employer. However, payroll costs do not include the employer's share of payroll tax. For example, the wages of an employee who earned \$4,000 per month in gross wages, from which \$500 in federal taxes was withheld, count as \$4,000 in payroll costs. However, the employer-side federal payroll taxes imposed on the \$4,000 in wages are excluded from payroll costs under the statute.³¹

Limit on PPP First Draw Loans a Corporate Group Can Receive

Finally, question 14 provides for the limit on the overall amount of loans a corporate group can receive:

14. Question: Is there a limit on the dollar amount of First Draw PPP Loans a corporate group can receive?

Answer: Yes, businesses that are part of the same corporate group cannot receive First Draw PPP Loans in a total amount of more than \$20 million. For purposes of this limit, businesses are part of a single corporate group if they are majority owned, directly or indirectly, by a common parent.³²

³⁰ "Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type," SBA FAQ, January 17, 2021, p. 11

³¹ "Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type," SBA FAQ, January 17, 2021, pp. 11-12

³² "Paycheck Protection Program How to Calculate Maximum Loan Amounts for First Draw PPP Loans and What Documentation to Provide – By Business Type," SBA FAQ, January 17, 2021, p. 12

SECTION: PPP LOAN BORROWERS WILL BE REQUIRED TO REPAY AMOUNTS OF PPP LOANS MADE IN EXCESS OF AMOUNTS ACTUALLY ALLOWED UNDER THE PROGRAM, EVEN IF DUE TO LENDER ERROR

Citation: "Paycheck Protection Program Excess Loan Amount Errors," SBA Procedural Notice, January 15, 2021

The SBA has issued a procedural notice³³ that clarified that borrowers who received loans in excess of the amounts that were allowed under PPP are going to be held responsible for repaying the excess amount of the loan.

A number of borrowers have reported being approved for PPP loans in excess of the amounts that were allowed under SBA guidance in the original program. The problem was especially prevalent for loans early in the PPP program due to both:

- Lender confusion regarding how the program provided for under the law worked, resulting in different lenders taking conflicting positions on the maximum loans for which borrowers could qualify and
- Borrowers, also having trouble interpreting the provisions, came to differing conclusions about what made up “payroll costs” for purposes of applying for the loans.

The situation was made worse as various third parties attempted to provide guidance on how to compute these amounts. Even when such guidance made clear that this was an interpretation only and the SBA might come out with a differing interpretation, users often paid little heed to such warnings and used the worksheets and other tentative guidance.

On top of all of that confusion, early in the program it became clear the demand for loans would be far in excess of the amount that Congress had appropriated—thus, it appeared that borrowers who waited for clearer and consistent guidance likely would find no loans available for them once that guidance appeared.

Not surprisingly, many borrowers in that environment were approved for a maximum loan that was not the actual maximum loan for which the borrower qualified. In some cases borrowers were approved for amounts that were less than what was actually the maximum the borrower should have qualified for, while in other cases the borrower ended up with approval for a loan in excess of what the law allowed.

It is that second category that the SBA procedural notice addresses. Note that the guidance covers only errors that were made in *good faith*. This implies that borrowers

³³ "Paycheck Protection Program Excess Loan Amount Errors," SBA Procedural Notice, January 15, 2021, https://www.sba.gov/sites/default/files/2021-01/5000-20078_0.pdf (retrieved January 17, 2021)

and lenders are not going to be able to get special treatment just because they did the best they could—rather, the excess loan is not going to be subject to forgiveness.

An excess loan amount error is a borrower or lender error made in good faith that caused a borrower to receive a PPP loan amount that exceeds the borrower's correct maximum loan amount under the CARES Act and the Economic Aid Act.³⁴

The notice provides that such excess loan amounts are not subject to forgiveness:

A borrower may not receive loan forgiveness for any amount that exceeds the correct maximum loan amount permitted by statute for that borrower. This is true whether the excess loan amount was caused by borrower error or lender error.³⁵

If such an error is identified by the lender or borrower, the lender is directed to deny forgiveness on such excess loan amount:

When preparing or reviewing a loan forgiveness application, if a borrower or lender identifies an error that resulted in a borrower receiving a larger PPP loan than the borrower was eligible to receive, the lender must issue a decision to SBA denying forgiveness for the amount that exceeded the borrower's correct maximum loan amount.³⁶

The notice also makes clear that if the error is discovered after the lender has sent the forgiveness decision on to the SBA, even if the SBA has already approved that decision and paid off the loan, the SBA must be immediately informed. If the borrower had already been notified that the entire loan was forgiven, the lender will also need to inform the borrower of the change in the situation.³⁷

The notice concludes by noting the borrower will have to immediately begin repaying the excess loan once the situation comes to light:

If the lender or SBA, as applicable, determines a borrower was ineligible for any portion of its loan amount, forgiveness will be denied for the ineligible portion and the borrower must begin making payments on the remaining loan amount. Any unforgiven loan amounts remain obligations of the borrower, even if the borrower was ineligible to receive some or all of the loan.³⁸

³⁴ "Paycheck Protection Program Excess Loan Amount Errors," SBA Procedural Notice, January 15, 2021, p. 1

³⁵ "Paycheck Protection Program Excess Loan Amount Errors," SBA Procedural Notice, January 15, 2021, p. 2

³⁶ "Paycheck Protection Program Excess Loan Amount Errors," SBA Procedural Notice, January 15, 2021, p. 2

³⁷ "Paycheck Protection Program Excess Loan Amount Errors," SBA Procedural Notice, January 15, 2021, p. 2

³⁸ "Paycheck Protection Program Excess Loan Amount Errors," SBA Procedural Notice, January 15, 2021, p. 4

SECTION: PPP LOAN SBA NOTICE PROVIDES PROCEDURES FOR SITUATIONS WHERE A SECOND DISBURSEMENT IS ALLOWED ON A FIRST DRAW PPP LOAN

Citation: SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” 1/13/21

In a procedural notice³⁹ the SBA provided lenders with guidance to deal with the additional disbursements on First Draw PPP loan provisions found in Section 312 of the Economic Aid Act. This guidance implements provisions found in the law and the January 6, 2021 Interim Final Rule released by the SBA.

The SBA describes this guidance as follows:

The Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Economic Aid Act or Act) (Pub. L. 116-260) changed the existing Paycheck Protection Program (PPP) rules regarding increases to PPP loans. Under previous PPP rules, a First Draw PPP Loan could not be increased unless the loan was made to a partnership or seasonal employer and the Lender approved the increase before the Lender submitted the initial SBA Form 1502 (1502) report for the loan. Section 312 of the Economic Aid Act provides for additional narrow circumstances under which certain eligible borrowers that received a First Draw PPP Loan may reapply for a First Draw PPP Loan or request an increase in a First Draw PPP Loan that was approved on or before August 8, 2020. The purpose of this Notice is to guide SBA employees and Lenders on the procedures for such reapplications or requests for increases for a First Draw PPP Loan that was approved on or before August 8, 2020. This Notice also discusses how Lenders can obtain the additional processing fee that is due on the increased loan amount (if not previously paid by SBA), and how Lenders can obtain a processing fee on a reapplication.⁴⁰

³⁹ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, <https://www.sba.gov/sites/default/files/2021-01/5000-20076-508.pdf> (retrieved January 23, 2021)

⁴⁰ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, p. 1

Exclusive List of Situations Qualifying for Additional Disbursement

The Notice provides that the situations described in the Notice are the only situations that qualify for an additional disbursement on previously approved First Draw PPP loans:

The interim final rule titled “Business Loan Program Temporary Changes; Paycheck Protection Program as Amended by Economic Aid Act” (the “Consolidated IFR”) posted on SBA’s website on January 6, 2021, describes the additional narrow circumstances under which certain eligible borrowers may reapply for a new First Draw PPP Loan or request an increase to a First Draw PPP Loan approved on or before August 8, 2020. First Draw PPP Loan increases can be made only by the Lender of Record, and only under the circumstances outlined in this Notice. No other First Draw PPP Loan increases are allowed.⁴¹

As well, the loan cannot be one that has already been forgiven to qualify:

If SBA has remitted a forgiveness payment to the Lender on a First Draw PPP Loan, no loan increases or reapplications are allowed.⁴²

Partnerships

The guidance first describes cases where a partnership is able to obtain additional funds. The key requirement is that the initial loan did not include any amounts for compensation of partners:

If a partnership received a First Draw PPP Loan that only included amounts necessary for payroll costs of the partnership’s employees and other eligible operating expenses, but did not include any amount for partner compensation, and SBA has not remitted a forgiveness payment to the Lender on that loan, the Lender of Record may electronically submit a request through SBA’s E-Tran Servicing site (E-Tran) to increase the First Draw PPP Loan amount to include appropriate partner compensation, even if the loan has been fully disbursed and even if the Lender’s first 1502 report to SBA on the First Draw PPP Loan has already been submitted. The amount of the increase may not exceed the maximum loan amount to which the borrower is entitled under PPP rules, and in no event can the increased loan amount exceed the maximum PPP loan amount (\$10

⁴¹ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, pp. 1-2

⁴² ⁴² SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, p. 2

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million for an individual borrower or \$20 million for a corporate group).⁴³

The partnership will be required to provide the necessary information to support this request for additional funds.

Additionally, the borrower must provide the Lender of Record with all required documentation to support the calculation of the increase to include partner compensation, and the Lender must comply with the loan amount underwriting requirements in paragraph C.3. of the Consolidated IFR.⁴⁴

Finally, the additional payment must be received from the original lender and submitted by March 31, 2021:

Any request for an increase must be submitted electronically in E-Tran by the Lender of Record on or before March 31, 2021, and is subject to the availability of funds. SBA will pay an additional processing fee to the Originating Lender on the amount of the increase.⁴⁵

Seasonal Employers

Another group that may qualify for an additional disbursement of the First Draw PPP loan consists of employers who qualify as seasonal employers under the law. The time period over which a seasonal borrower can look to find the 12-week period with the highest wages was expanded to a full year under the Consolidated Appropriations Act, 2021. That expanded period may allow the borrower to now qualify for a larger loan.

The guidance explains the situation as follows:

Section 336 of the Economic Aid Act revised the method by which a seasonal employer may determine its maximum loan amount for purposes of the PPP to allow the seasonal employer to use the average total monthly payments for payroll for any 12-week period selected by the seasonal employer beginning February 15, 2019, and ending February 15, 2020. If a seasonal employer received a First Draw PPP Loan and SBA has not remitted a forgiveness payment to the Lender on that loan, the seasonal employer would be eligible for an increase if application of the methodology in Section 336 of the Economic Aid Act results in the calculation of a higher loan amount.⁴⁶

⁴³ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, p. 2

⁴⁴ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, p.2

⁴⁵ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, p. 2

⁴⁶ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, p. 2

In this situation the lender would submit the request to the SBA:

In that case, the Lender of Record may electronically submit a request through E-Tran to increase the seasonal employer's First Draw PPP Loan amount, even if the loan has been fully disbursed and even if the Lender's first 1502 report to SBA on the PPP loan has already been submitted. The amount of the increase may not exceed the maximum loan amount to which the borrower is entitled under PPP rules, and in no event can the increased loan amount exceed the maximum PPP loan amount (\$10 million for an individual borrower or \$20 million for a corporate group).⁴⁷

The borrower will need to provide the additional information to support its qualification for a larger loan amount:

Additionally, the borrower must provide the Lender of Record with all required documentation to support the calculation of the increase due to the newly-selected 12 week period, and the Lender must comply with the loan amount underwriting requirements in paragraph C.3. of the Consolidated IFR.⁴⁸

Again, the original lender must be the one to send in the request:

Any request for an increase must be submitted electronically in E-Tran by the Lender of Record on or before March 31, 2021, and is subject to the availability of funds. SBA will pay an additional processing fee to the Originating Lender on the amount of the increase.⁴⁹

Farmers and Ranchers

The Economic Aid Act allowed certain self-employed farmers and ranchers to use their gross receipts rather than net income to compute their income replacement amount for the PPP loan. The Notice explains the situation as follows:

Section 313 of the Economic Aid Act changed the calculation of the maximum loan amount for certain farmers and ranchers. This calculation is described in subsection B.4.d. of the Consolidated IFR. If an eligible farmer or rancher received a First Draw PPP Loan and SBA has not remitted a forgiveness payment to the Lender on that loan, and such farmer or rancher would be eligible for a higher maximum loan amount based on the formula described in subsection B.4.d. of the Consolidated IFR, the Lender of Record may electronically submit a request through E-Tran to increase the First Draw PPP Loan amount, even if the loan has been fully disbursed and

⁴⁷ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 2

⁴⁸ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 2

⁴⁹ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, pp. 2-3

even if the Lender's first 1502 report to SBA on the PPP loan has already been submitted. The amount of the increase may not exceed the maximum loan amount to which the borrower is entitled under PPP rules, and in no event can the increased loan amount exceed the maximum PPP loan amount (\$10 million for an individual borrower).

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As was described for the previous situations, the borrower will have to submit documentation to show the qualification for the larger loan amount.

Additionally, the borrower must provide the Lender of Record with all required documentation to support the calculation of the increase under the new methodology, and the Lender must comply with the loan amount underwriting requirements in paragraph C.3. of the Consolidated IFR.⁵¹

Similarly, the request must be filed through the original lender:

Any request for an increase must be submitted electronically in E-Tran by the Lender of Record on or before March 31, 2021, and is subject to the availability of funds. SBA will pay an additional processing fee to the Originating Lender on the amount of the increase.⁵²

Borrowers Who Fully Repaid a PPP Loan

If a borrower fully repaid a PPP loan before December 27, 2020, the borrower may qualify to obtain another disbursement up to the maximum the borrower is allowed to receive under the First Draw program. The Notice describes the situation as follows:

If an eligible borrower received a First Draw PPP Loan, the Lender reported to SBA before December 27, 2020 that the borrower fully repaid the loan, and SBA has not remitted a forgiveness payment to the Lender on that loan, the borrower may reapply for a new First Draw PPP Loan in an amount for which the borrower is eligible under current PPP rules. All reapplications are subject to the availability of funds. Lenders may approve such a reapplication if the borrower is eligible for a First Draw Loan under current PPP rules.⁵³

⁵⁰ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 3

⁵¹ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 3

⁵² SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 3

⁵³ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 3

The Notice provides different steps a lender must take to obtain approval of the additional disbursement depending on whether the loan was reported as “cancelled” or “paid in full” originally.⁵⁴

Borrowers Who Returned a Portion of Their First Draw PPP Loan

If a borrower returned some, but not all, of the original First Draw PPP loan, they may also qualify for an additional disbursement. The Notice provides the guidance on when this option would be available:

If a borrower returned (or repaid) part of a First Draw PPP Loan, the Lender reported to SBA before December 27, 2020 that the borrower repaid the loan in part, and SBA has not remitted a forgiveness payment to the Lender on that loan, the Lender of Record may approve a borrower’s request for a loan increase and re-disburse funds equal to the difference between the amount retained by the borrower and the amount previously approved. After re-disbursing the loan increase amount, the Lender must ensure that the loan amount and status are correctly reported on the next 1502 report submitted by the Lender.⁵⁵

The practical problem in this case is that the borrower cannot have requested forgiveness for the remainder of the loan.

The Notice gives the following example of an additional disbursement:

EXAMPLE

For example, if a First Draw PPP Loan was originally approved in SBA’s loan processing system for \$100,000, the Lender disbursed \$100,000 to the borrower, the Lender reported the fully disbursed amount to SBA on the 1502 report, and the Lender reported before December 27, 2020 that the borrower repaid \$25,000 to the Lender because the borrower could not spend the funds during the covered period (retaining \$75,000), the lender can make an additional disbursement of \$25,000 on the loan to increase the outstanding balance of the loan back to the approved amount of \$100,000, provided SBA has not remitted a forgiveness payment to the Lender on that loan. Because the Lender previously reported the \$25,000 borrower repayment on the loan to SBA on the 1502 report and E-Tran currently reflects an outstanding balance of \$75,000 on the loan, the Lender must report a corrected balance of \$100,000 on the loan on the first 1502 report submitted by the Lender after the \$25,000 re-disbursement. If SBA previously paid the Originating Lender a processing fee based on the

⁵⁴ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, p.3

⁵⁵ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, pp. 4-5

\$100,000 fully disbursed amount, SBA will not pay the Originating Lender any additional processing fee as a result of the re-disbursement.⁵⁶

Borrowers Who Did Not Accept the Full Amount of a First Draw PPP Loan

The final qualifying group consists of borrowers who did not accept the full amount of the original First Draw PPP loan they qualified for. The Notice describes these qualified borrowers as follows:

If a borrower did not accept before December 27, 2020 the full amount of a First Draw PPP Loan for which it was approved in SBA's E-Tran Origination site and SBA has not remitted a forgiveness payment to the Lender on that loan, the borrower may request an increase and the Lender of Record may approve and disburse a loan increase in the amount of the First Draw PPP Loan up to the amount previously approved.⁵⁷

The notice contains instructions to the lender on how to process the request depending on how the lender had previously reported the transaction.⁵⁸

Unresolved Borrowers

As the SBA announced in procedures for processing Second Draw PPP loans, if a borrower applies for an additional disbursement on a First Draw PPP loan while the SBA either has the loan under review or otherwise believes the borrower may have been ineligible for the First Draw loan, the request will not be immediately approved:

If a First Draw PPP Loan is under review pursuant to PPP rules and/or information in SBA's possession indicates that the borrower may have been ineligible for the First Draw PPP Loan it received or for the loan amount received by the borrower, the Lender of Record will receive notification from SBA when the Lender submits a request for increase of the First Draw PPP Loan or submits a reapplication for a First Draw PPP Loan ("unresolved borrower"). If the Lender receives notification of an unresolved borrower, the Lender will not be able to process an increase on the First Draw PPP Loan, nor will the Lender be able to obtain an SBA loan number on a First Draw PPP Loan reapplication.⁵⁹

⁵⁶ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 5

⁵⁷ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 5

⁵⁸ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, p. 5

⁵⁹ SBA Procedural Notice 5000-20076 "First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act," January 13, 2021, pp. 8-9

The SBA will attempt to quickly resolve the issue to make an ultimate decision on the additional disbursement:

SBA will resolve expeditiously the issue related to the unresolved borrower and will notify the Lender of the process to obtain an increase on the First Draw PPP Loan or obtain a loan number on a First Draw PPP Loan reapplication, if appropriate.⁶⁰

SECTION: PPP LOAN

SBA GIVES DETAILS ON COMPUTING REVENUE REDUCTION AND MAXIMUM LOANS FOR PPP SECOND DRAW LOANS

Citation: “Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide,” Small Business Administration, 1/19/2021

The SBA has issued guidance on the Second Draw Payroll Protection Program dealing with:

- Calculation of the required revenue reduction and
- Maximum loan amounts for Second Draw Loans including what documentation to supply.⁶¹

The SBA describes the guidance as follows:

The Small Business Administration (SBA), in consultation with the Department of the Treasury, is providing this guidance to assist businesses in calculating their revenue reduction and payroll costs (and the relevant documentation that is required to support each set of calculations) for purposes of determining their eligibility for and amount of a Second Draw PPP Loan.

Borrowers and lenders may rely on the guidance provided in this document as SBA’s interpretation of the CARES Act, the Economic Aid Act, and the Paycheck Protection Program Interim Final Rules. The U.S. government will not challenge lender PPP actions that

⁶⁰ SBA Procedural Notice 5000-20076 “First Draw Paycheck Protection Program Loan Increases After Enactment of the Economic Aid Act,” January 13, 2021, p. 8

⁶¹ “Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide,” Small Business Administration, January 19, 2021, <https://www.sba.gov/sites/default/files/2021-01/Second%20Draw%20PPP%20Loans%20--%20How%20to%20Calculate%20Revenue%20Reduction%20and%20Maximum%20Loan%20Amounts%20Including%20What%20Documentation%20to%20Provide%20%281.19.2021%29.pdf> (retrieved January 19, 2021)

conform to this guidance and to the PPP Interim Final Rules and any subsequent rulemaking in effect at the time the action is taken.⁶²

Gross Receipts of a For-Profit Entity

The document provides the following guidance for the calculation of gross receipts in the case of a for-profit entity:

For a for-profit business, gross receipts generally are all revenue in whatever form received or accrued (in accordance with the entity's accounting method, i.e., accrual or cash) from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances but excluding net capital gains and losses. These terms carry the definitions used and reported on IRS tax return forms.

Gross receipts do not include the following:

- taxes collected for and remitted to a taxing authority if included in gross or total income, such as sales or other taxes collected from customers (this does not include taxes levied on the concern or its employees);
- proceeds from transactions between a concern and its domestic or foreign affiliates; and
- amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker.

All other items, such as subcontractor costs, reimbursements for purchases a contractor makes at a customer's request, investment income, and employee-based costs such as payroll taxes, may not be excluded from gross receipts.⁶³

The guidance is generally consistent with that released in the January 6, 2021 IFR on the Second Draw PPP loan program.

Gross Receipts for Not-for-Profit and Related Organizations

The guidance gives additional details beyond that discussed in the IFR for the gross receipts of not-for-profit and related organizations beyond simply referencing IRC §6033. The gross receipts for a nonprofit 501(c)(3) organization, a 501(c)(19) veterans organization, an eligible nonprofit news organization, an eligible 501(c)(6) organization,

⁶² "Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide," Small Business Administration, January 19, 2021, p. 1

⁶³ "Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide," Small Business Administration, January 19, 2021, p. 1

or an eligible destination marketing organization are discussed in the document, noting that:

...gross receipts means gross receipts within the meaning of section 6033 of the Internal Revenue Code of 1986, which is the gross amount received by the organization during its annual accounting period from all sources without reduction for any costs or expenses including, for example, cost of goods or assets sold, cost of operations, or expenses of earning, raising, or collecting such amounts. Thus “gross receipts” includes, but is not limited to:

- (i) the gross amount received as contributions, gifts, grants, and similar amounts without reduction for the expenses of raising and collecting such amounts,
- (ii) the gross amount received as dues or assessments from members or affiliated organizations without reduction for expenses attributable to the receipt of such amounts,
- (iii) gross sales or receipts from business activities (including business activities unrelated to the purpose for which the organization qualifies for exemption, the net income or loss from which may be required to be reported on Form 990-T),
- (iv) the gross amount received from the sale of assets without reduction for cost or other basis and expenses of sale, and
- (v) the gross amount received as investment income, such as interest, dividends, rents, and royalties.⁶⁴

Reference Periods Used by Applicants to Demonstrate a 25% Reduction in Gross Receipts

The following reference periods are to be used by Applicants to demonstrate a 25% reduction in gross receipts. The appropriate period depends on how long the Applicant has been in business.

- For all Applicants, except those satisfying the conditions set forth below, the Applicant must demonstrate that gross receipts in any calendar quarter of 2020 were at least 25 percent lower than the same quarter of 2019. Alternatively, Applicants may compare annual gross receipts in 2020 with annual gross receipts in 2019 if they were in business in 2019.
- For entities not in business during the first and second quarters of 2019 but in operation during the third and fourth quarters of 2019, Applicants must demonstrate that gross receipts in any quarter of 2020 were at least 25 percent lower than during either the third or fourth quarters of 2019.

⁶⁴ “Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide,” Small Business Administration, January 19, 2021, pp. 1-2

- For entities not in business during the first, second, and third quarters of 2019 but in operation during the fourth quarter of 2019, Applicants must demonstrate that gross receipts in any quarter of 2020 were at least 25 percent lower than the fourth quarter of 2019.
- For entities not in business during 2019 but in operation on February 15, 2020, Applicants must demonstrate that gross receipts in the second, third, or fourth quarter of 2020 were at least 25 percent lower than the first quarter of 2020.⁶⁵

Documentation Needed to Show Reduction in Gross Receipts

The SBA document provides that the following documentation can be provided to document the reduction in gross receipts:

- Quarterly financial statements for the entity. If the financial statements are not audited, the Applicant must sign and date the first page of the financial statement and initial all other pages, attesting to their accuracy. If the financial statements do not specifically identify the line item(s) that constitute gross receipts, the Applicant must annotate which line item(s) constitute gross receipts.
- Quarterly or monthly bank statements for the entity showing deposits from the relevant quarters. The Applicant must annotate, if it is not clear, which deposits listed on the bank statement constitute gross receipts (e.g., payments for purchases of goods and services) and which do not (e.g., capital infusions).
- Annual IRS income tax filings of the entity (required if using an annual reference period). If the entity has not yet filed a tax return for 2020, the Applicant must fill out the return forms, compute the relevant gross receipts value (see Question 5), and sign and date the return, attesting that the values that enter into the gross receipts computation are the same values that will be filed on the entity's tax return.⁶⁶

For taxpayers using annual income tax returns to document a reduction in gross receipts, the document provides the following instructions by entity type:

- For self-employed individuals other than farmers and ranchers (IRS Form 1040 Schedule C): sum of line 4 and line 75
- For self-employed farmers and ranchers (IRS Form 1040 Schedule F): sum of lines 1b and 9
- For partnerships (IRS Form 1065): sum of lines 2 and 8, minus line 6
- For S-Corporations (IRS Form 1120-S): sum of lines 2 and 6, minus line 4

⁶⁵ "Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide," Small Business Administration, January 19, 2021, p. 3

⁶⁶ "Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide," Small Business Administration, January 19, 2021, p. 3

- For C-Corporations (IRS Form 1120): sum of lines 2 and 11, minus the sum of lines 8 and 9
- For nonprofit organizations (IRS Form 990): the sum of lines 6b(i), 6b(ii), 7b(i), 7b(ii), 8b, 9b, 10b, and 12 (column (A)) of Part VIII
- For nonprofit organizations (IRS Form 990-EZ): sum of lines 5b, 6c, 7b, and 9 of Part I.
- LLCs should follow the instructions that apply to their tax filing status in the reference periods.⁶⁷

The document also notes a key limitation on the use of a tax return to document gross receipts for a taxpayer that files on a fiscal year:

Entities that use a fiscal year to file taxes may document a reduction in gross receipts with income tax returns only if their fiscal year contains all of the second, third, and fourth quarters of the calendar year (i.e., have a fiscal year start date of February 1, March 1, or April 1).⁶⁸

Maximum Second Draw PPP Loan Calculation by Entity Type

The SBA document provides detailed information on the calculation of the maximum PPP Second Draw loan amount and supporting documentation required by entity type in Maximum Second Draw PPP Loan Amounts questions 1 to 7 for entities in business in 2019, and questions 10 to 11 for those not in operation for the full one-year period preceding February 15, 2020.⁶⁹

Questions 10 and 11 do clarify that rule applies to those not in existence for the *full* one-year period preceding February 15, 2020—thus, a business that began on March 1, 2019 would qualify to use the calculation for such a business.⁷⁰

The documentation to be provided to substantiate payroll costs used to calculate the applied-for Second Draw PPP loan amount are detailed in question 9:

An applicant may provide IRS Form W-2s and IRS Form W-3 or payroll processor reports, including quarterly and annual tax reports, in lieu of IRS Form 941. Additionally, very small businesses that file an

⁶⁷ “Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide,” Small Business Administration, January 19, 2021, p. 4

⁶⁸ “Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide,” Small Business Administration, January 19, 2021, p. 5

⁶⁹ “Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide,” Small Business Administration, January 19, 2021

⁷⁰ “Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide,” Small Business Administration, January 19, 2021, pp. 14-15

annual IRS Form 944 or agricultural employers that file an annual IRS Form 943 should rely on and provide IRS Form 944 or IRS Form 943 in lieu of IRS Form 941.

An applicant may provide records from a retirement administrator to document employer retirement contributions. An applicant may also provide records from a health insurance company or third-party administrator for a self-insured plan to document employer health insurance contributions.⁷¹

Prior 12 Months Payroll Costs on Original PPP Loan

The document notes that while calendar year 2019 information submitted to a lender to support a First Draw PPP loan can be used to also justify a Second Draw PPP loan, this will not be true if the First Draw loan was based on the prior 12 months when the loan was issued:

...[P]ayroll costs from the precise 12-month period prior to the First Draw PPP Loan cannot be used to compute the Second Draw PPP Loan amount. Any borrower that used payroll costs from the prior 12 months when computing its First Draw PPP Loan amount can calculate the amount for its Second Draw PPP Loan amount using calendar year 2019 or calendar year 2020 payroll costs. A borrower that used calendar year 2019 for its First Draw PPP Loan amount may continue to do so.⁷²

NAICS Code Left Blank on Tax Return

The January 6, 2021 IFR indicated that a business looking to use the special maximum PPP loan calculation for NAICS Code 72 businesses could not make use of that provision unless their last filed income tax return had a business code that began with 72. However, the statement makes an exception if the return did not contain any code in that block:

If an entry for this line is missing from your tax return, you should report the industry code that is most applicable to your business' primary business activity. If your business is in the Accommodation and Food Services sector (e.g., a hotel, restaurant, bar), you can only report a NAICS Code beginning with 72 if you can substantiate this

⁷¹ "Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide," Small Business Administration, January 19, 2021, pp. 13-14

⁷² "Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide," Small Business Administration, January 19, 2021, p. 16

with alternative documentation, such as permits or licenses issued by local governments that are unique to this sector.⁷³

SECTION: PPP LOAN REVISED SBA FORMS RELEASED FOR FORGIVENESS OF PPP LOANS

Citation: Revised Forms 3508, 3508-EZ and 3508-S, 1/20/21

The Small Business Administration met the requirement to issue the one page form for PPP loan forgiveness by 24 days after the date of enactment of the Consolidated Appropriations Act, 2021. The agency also published additional updated forms.

You can find the revised forms by clicking on the links below:

- [Form 3508S](#) - One page forgiveness form for PPP loans of up to \$150,000 along with instructions.
- [Form 3508-EZ](#) - Simpler application for forgiveness for borrowers that meet certain safe harbors
- [Form 3508](#) - Full application for forgiveness of PPP loan for those that don't qualify for using either of the other two forms

⁷³ "Second Draw Paycheck Protection Program (PPP) Loans: How to Calculate Revenue Reduction and Maximum Loan Amounts Including What Documentation to Provide," Small Business Administration, January 19, 2021, p. 17