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# TREATMENT OF PPP LOAN FORGIVENESS

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In November 2021, the Internal Revenue Service (IRS) released a series of revenue procedures to provide guidance on how to take into account loan forgiveness under the Paycheck Protection Program (PPP) loan program for federal income tax purposes. This guidance was greatly anticipated, as it addresses many of the practical questions about the timing for recognizing tax-exempt income, how particular entities should treat exclusions from income and deductions, and how BBA partnerships can take the guidance into account.

## Background

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act)<sup>1</sup> established the PPP to disburse federal funds to help get businesses through the pandemic and retain employees. The PPP uses the Small Businesses Administration (SBA) "7(a) Loan Program"<sup>2</sup> as a structure for enabling businesses to obtain funds. Though structured as loans, these loans were not meant to be repaid if taxpayers qualified for the loans and used them properly over a set covered period. The CARES Act allowed the SBA to guarantee covered PPP loans<sup>3</sup> and instructed taxpayers to exclude forgiven PPP amounts from gross income.<sup>4</sup>

Section 61(a)(11) ordinarily requires most taxpayers to include discharged debt in gross income. While PPP funds create income, the law instructs taxpayers to exclude that income from taxable income. To better effectuate the PPP's purpose, the Consolidated Appropriations Act of 2021 followed up to fill in gaps and ensured that taxpayers may deduct expenses related to loans forgiven or expected to be forgiven.<sup>5</sup>

With a patchwork of law and guidance covering two draws of PPP loans, and particularly with a novel form of debt and excludable debt forgiveness income, taxpayers had significant questions of interpretation.

<sup>1</sup> Public Law 116-136, 134 Stat. 281 (2020).

<sup>2</sup> 15 U.S.C. 636(a).

<sup>3</sup> CARES Act at § 1102(a)(2) (defining "covered loans" as loans made under the PPP between Feb. 15, 2020 and Dec. 31, 2020); see also Paycheck Protection Program Flexibility Act of 2020, Public Law 116-142, 134 Stat. 641 (June 5, 2020) (clarifying deductibility provisions).

<sup>4</sup> CARES Act at 1106(b) ("any amount which [but for PPP provisions] would be includable in gross income of the eligible recipient by reason of forgiveness [through the PPP] ... shall be excluded from gross income").

<sup>5</sup> COVID-related Tax Relief Act of 2020 (COVID Tax Relief Act), enacted as Subtitle B of Title II of Division N of the Consolidated Appropriations Act, 2021 (Appropriations Act), Public Law 116-260, 134 Stat. 1182 (Dec. 27, 2020).

## Rev. Proc. 2021-48

Rev. Proc. 2021-48 addresses one of the primary mechanisms of the PPP. It instructs a taxpayer on how to treat amounts excluded from gross income (tax-exempt income) in connection with the forgiveness of Paycheck Protection Program (PPP) Loans. Under the revenue procedure, taxpayers may treat the tax-exempt income as received or accrued following one of three different approaches: (1) as the taxpayer pays or incurs the eligible expenses; (2) when the taxpayer files an application for PPP Loan forgiveness; or (3) when PPP Loan forgiveness is granted.<sup>6</sup>

Though the income is not taxed, there are still important timing considerations for many taxpayers. The revenue procedure highlights the need for a taxpayer to determine when such tax-exempt income is included in gross receipts under sections 448(c) or 6033 of the Code. Importantly, the IRS has provided a safe harbor that permits taxpayers to exclude PPP-related tax-exempt income from gross receipts when determining eligibility for the employee retention tax credit (ERTC).<sup>7</sup> However, Rev. Proc. 2021-48 allows that taxpayers may also choose to include that income in gross receipts or may need to incorporate that information for other purposes in different code sections.

Taxpayers may report such tax-exempt income under one of these three methods on a timely filed original or amended Federal income tax return, information return or administrative adjustment request (AAR) (or for BBA partnerships, an amended return rather than an AAR as permitted pursuant to Rev. Proc. 2021-50 below).

## Rev. Proc. 2021-49

Rev. Proc. 2021-49 provides guidance for partnerships and consolidated groups regarding amounts excluded from gross income and deductions relating to the PPP and a variety of other COVID-19 relief programs. Rev. Proc. 2021-49 covers taxpayers in the following situations:

1. a taxpayer that received a PPP Loan that was fully or partially forgiven;
2. a partnership for which the SBA made payments with respect to a covered loan under § 1112(c) of the CARES Act (i.e. 7(a) loans or 504 loans, or SBA microloans);

<sup>6</sup> See section 3 of Rev. Proc. 2021-48.

<sup>7</sup> Revenue Procedure 2021-33, 2021-34 I.R.B. 327.

3. a partnership that received an Emergency EIDL Grant, a Targeted EIDL Advance, or a Shuttered Venue Operator Grant;
4. a partnership that received a Supplemental Targeted EIDL Advance;
5. a partnership that received a Restaurant Revitalization Fund Grant.

To reflect the effects of the various COVID-related exclusions from income and deductions, Rev. Proc. 2021-49 provides guidance on how to allocate certain partnership items, adjust partnership interest basis, or adjust stock basis in consolidated groups. The rules vary by the different programs, so taxpayers should review these provisions to identify their specific circumstances. If a PPP loan is not fully forgiven, a taxpayer must make adjustments on an amended return, information return or AAR, as applicable, for the tax year(s) in which the taxpayer treated tax-exempt income from the forgiveness of such PPP loan as received or accrued.

### Rev. Proc. 2021-50

Rev. Proc. 2021-50 allows BBA partnerships to implement the procedures of Rev. Proc. 2021-48 or Rev. Proc. 2021-49 without filing an administrative adjustment request (AAR). Eligible BBA partnerships may file an amended return instead of an AAR. The revenue procedure clarifies, however, that amendment is optional and a partnership may still file an AAR for the same purpose. A BBA partnership that files an amended return pursuant to this revenue procedure is still subject to the centralized partnership audit procedures enacted by the BBA.

To take advantage of the option to file an amended return, a BBA partnership must file a Form 1065 (with the "Amended Return" box checked) and furnish amended Schedules K-1 to its partners. The amended return

should state "FILED PURSUANT TO REV PROC 2021-50" at the top, and any amended K-1 should include the same language in a statement. The Rev. Proc. includes additional rules for taxpayers under exam, taxpayers that have already filed AARs, and taxpayers with a BBA partnership as a partner.

### Conclusion

After multiple large legislative packages, the IRS continues to issue guidance to help taxpayers interpret and implement the new provisions. With these new revenue procedures, taxpayers have more certainty about the timing and impact of tax-exempt income from PPP loans and similar programs.

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