What's Your Year End Strategy for CARES Act Funding?

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Published November 23, 2020 - As we approach the end of 2020, millions of American businesses will soon need to make decisions on how to account for the impacts of COVID-19 and programs that they participated in through the Coronavirus Aid, Relief and Economic Security (CARES) Act – most notably the Small Business Administration's Paycheck Protection Program (PPP).

For businesses and organizations that received PPP loans, there are a few choices to make:

- Whether and when to seek forgiveness of a PPP loan?
- If seeking forgiveness, whether to recognize loan forgiveness in their 2020 financial statements?
- If seeking forgiveness, which expenses to submit for the application?
- How to treat actual or prospective forgiveness for tax purposes?

One may think "this is simple, right? – Of course, I want to seek forgiveness, why give up free money?" … … "Why wouldn't I recognize it in the financial statements if I can? – a better looking bottom line in 2020 can't hurt" … "As for what to seek forgiveness on, isn't the path of least resistance best? – I have 24 weeks of payroll expenses, that more than covers it, I'll just send the report from my payroll provider" … "Tax 'is what it is' – the IRS already said the expenses I paid with the proceeds aren't deductible."

Those may be the right thoughts for your business, but it may be more complicated than that – and with tens or hundreds of thousands, or even millions, at stake, it's worth taking the time to talk with a trusted advisor about your options.

Before continuing, a caveat is in order. As all who have followed these programs know, the government has been consistently inconsistent – changing standards and rules along the way. And, there was an election last week that could change who is making decisions on rules and forgiveness come January. That said, based on what is known as of November 20, there are some things you should consider.

Whether to seek forgiveness of PPP

We expect that for most businesses, the right choice will be to seek PPP forgiveness, but, what are the reasons you may think twice? If you are in a business that did well through the pandemic, or maybe even benefited from it (for example, you were a manufacturer of protective equipment, or an installer of plexiglass), you may ask yourself if you remain confident in your original eligibility for the loan. While in March none of us could see the future and many asserted a need for assistance in good faith, maybe, with perfect 20-20 hindsight, you are not as sure – or you worry about the optics in the community or from your customers. If your loan was over $2 million, the SBA has come out with a questionnaire to aid in their determination of if you were initially qualified. Looking over that questionnaire may guide your thinking. More strategically, do you have contracts or arrangements where having more expenses or less revenue in 2020 could be to your advantage? For example, is 2020 an index year that will set rates for a long-term contract?

Financial statement recognition

For those seeking PPP forgiveness, accounting standard setters have offered alternative treatments for GAAP financial statements. Generally, a for profit business may choose to either treat a PPP loan as debt, and recognize the forgiveness of debt as a gain when the formal forgiveness is approved by their bank and the Small Business Administration, or they may analogize to International Accounting Standards that allow for immediate recognition of certain government economic incentive loan programs where the requirements for forgiveness are such that their achievement is reasonably assured (i.e. probable). If recognizing immediately, there is further support for a choice between recognizing as revenue or as a decrease to expenses. Not-for-Profit organizations have an additional choice – looking to contributions and grants guidance, accounting for the forgiveness over time as a grant – as qualifying expenses are incurred.

Simplifying the above few sentences, most businesses will be able to choose “Now” or “Later” for financial statement purposes. Why might you choose “Later?” - From a pure optics perspective, some business leaders may view 2020 as a year that will forever have an asterisk on the results anyway – so there may be some strategy to taking a “good guy” in 2021. You may be still deciding whether it is appropriate to seek forgiveness or want to wait for further clarification on tax treatment. Lastly, if you participated in other CARES Act programs, have “cost plus” contracts or arrangements or participate in government programs with rate setting, the rules and regulations specific to those programs and arrangements may be as of yet unsettled – particularly as it relates to expenses that would qualify for multiple programs. There may be value to not committing yourself to an accounting treatment before knowing how that treatment will be viewed in other programs.

If you do believe it is appropriate to recognize “Now” – a conversation with your independent accountants is warranted on your meeting the requirements being “reasonably assured” – especially if it was a larger loan and there is any doubt on your original qualifications to apply.

As a result of the several accounting alternatives, any entity that obtains a PPP loan should provide clear and complete disclosure about the loan, including its terms, how the entity determined it was qualified to receive the loan, and how the entity is accounting for the loan and presenting it in its financial statements.

Which expenses to seek forgiveness for

As originally launched, the PPP advanced businesses two and a half months (approximately 10-11 weeks) of payroll to cover employee and occupancy costs for an eight-week forgiveness period. Seven months ago, the strategy discussion focused on moving qualifying expenses into the eight-week period, with prevailing wisdom that most businesses could get maybe 90% of the loan forgiven.

Luckily, the rules were loosened, and businesses were granted 24 weeks to use the funds – putting many in the position that 24 weeks of payroll alone might be double the amount they need to support a forgiveness application. Its tempting to “keep it simple” and ignore the tracking of non-payroll costs to allow a quick and easy submission to your bank. Simple may be the best approach, but, before you submit, consider if you have any strategic reason to maximize the 40% of forgivable expenses that can be non-payroll.

To the extent that forgiven expenses aren't tax deductible, are there any differences in your facts and circumstances to the tax treatment of payroll vs. non-payroll expenses – especially if you participate in any economic incentive tax credit programs where wages (or certain wages) are an input. If you are not-for-profit where certain expenses are reimbursed by grants, it is common for such programs to cover direct payroll but not overhead costs (like occupancy) - would you want to save grant-reimbursable expenses for the grants and bias your PPP application towards non-grant covered expenses? Similar to the grant example, if you participated in other CARES Act programs in combination with PPP, most won't let you "double-dip" on expenses and planning which are covered by which program is important.

Tax considerations

The CARES Act specified that PPP forgiveness was not taxable revenue, but the IRS later clarified that forgiven expenses are not incurred, and thus are not deductible (i.e. PPP forgiveness is generally increasing taxable income). On November 18, the IRS released a Revenue Ruling further clarifying that, for most taxpayers, deductions would be disallowed if the forgiveness of the loan was likely, even if forgiveness had not yet been applied for. (See our related blog **here**). If you are rethinking your original qualification for the loan based on the SBA Questionnaire, or whether to seek forgiveness, your tax considerations may be more complicated. To the extent you have more qualifying expenses than your loan size, there is limited if any guidance as of now on which expenses to not deduct. With the (extended) due date for a tax return often many months after the issuance of annual financial statements, and a general rule that book and tax treatment should reconcile, there may be value to keeping options open by not choosing to allocate expenses in financial statements.

Other COVID programs

As alluded above, while PPP was arguably the most popular government relief program, it was not the only one. Entities in healthcare often received significant dollars under the Provider Relief Program. Aviation and Hospitality, Tourism and Leisure entities also had targeted aid. Early in the process, some entities applied for SBA Loan Programs (such as Economic Injury Disaster Loans), and there are other programs sponsored by state and local governments. Many of these other programs have reporting requirements and rules on eligible expenses – with some of the rules and instructions still being written. Most will not allow "double dipping," so, as part of the total picture, a holistic view of how expenses allocate to the different sources of aid is needed.

The bottom line – unfortunately it is not that simple…

While an easy answer is, well, easy, your choices on seeking forgiveness can be complex.

All of us were impacted by the Coronavirus pandemic – many of us significantly. As 2020 heads for a close, it will be a task to account for the impact, and to take the time to make sure your business maximizes the assistance to which it is entitled.

We are here to help. Dopkins & Company has experts well versed on the PPP program and certain industry-specific programs. And, of course, your tax advisors are in the best position to advise on how this could impact your 2020 returns. If you would like to talk about your strategy, please contact us.

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