Help Your Borrowers With Tax Breaks On Forgiven PPP Loans

lending business customers pandemic

Summary: The IRS recently provided guidance on certain tax breaks for forgiven PPP loans. With a large number of community financial institutions providing these loans, it is important to pass this information on to borrowers. We give you a short summary of the allowed deductions and how the reporting rules were modified for financial institutions providing these loans.

Believe it or not, the fax machine was invented back in the 1840s. While it took a little longer to hit the mainstream, bankers used the fax machine in the normal course of lending and other business for decades.

Still, with its shiny, easily smudged paper, it is a good thing that fax machines are not the only way to conduct business anymore. As of February 7, 2021, community financial institutions (CFIs) under $10B had granted 653,684 loans totaling $53,430,722,294 under the new 2021 Paycheck Provider Program (PPP), showing how fervently CFIs continue to serve their small business borrowers. For those borrowers who received PPP loan forgiveness, CFIs will want to spread the good news that these borrowers can get newly approved tax breaks.

The Internal Revenue Service issued guidance stating that funds from forgivable PPP loans can be excluded from the borrower's gross income (i.e., reduces taxable revenue), and business expenses allowed under the program (that were paid with forgiven PPP loans) can be deducted on the borrower's tax return (i.e., reduces taxable income). The IRS initially had not allowed PPP borrowers to deduct those expenses, stating that Congress must explicitly permit the tax breaks. In response, in December 2020, Congress included the tax breaks in the last COVID-relief legislation. With this new provision, we lay out what is deductible for your borrowers along with the associated revised reporting rules for CFIs.

1. What's deductible – and what's not. Deductible expenses under the PPP program include payroll, mortgage interest, rent, and utility expenses – as well as additional expenses approved in the December 2020 legislation: software, cloud services, accounting, human resources, property damage due to civil unrest, personal protective equipment, and supplier costs ordered or contracted for prior to loan approval. What's not allowed to be paid using PPP funds and later deducted: business taxes.

While borrowers with forgiven PPP loans also can't claim wages paid on their tax return, they can now claim the Employee Retention Tax Credit on wages paid above and beyond the amount forgiven, per the December legislation. To be eligible, borrowers must have paid their employees even if they had to shut down or had posted a 20% decline in gross receipts compared with the same quarter in the prior year. The credit is retroactive to March 12, 2020, and is good on qualified wages paid up to July 1, 2021.

2. Modified reporting rules for CFIs. Aside from the changes to tax deductions for PPP borrowers, last December, the IRS announced that lenders should disregard the normal rules for reporting forgiveness on debt when it comes to borrowers who've had their PPP loans forgiven. In these cases, lenders should not file a Form 1099-C to the IRS, nor give a copy of the form to the borrower. This will not only avoid confusion, but also the potential for class action claims.

A number of CFIs are now letting their PPP borrowers know about these new rules, via both personal phone calls as well as posting information and links on their websites. This is just one more way that you are supporting your communities. Your borrowers will be grateful to hear this good news as they continue to find ways to survive and keep their businesses running.

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