

PPP Tax-Exempt Income Timing Guidance Issued

Paycheck Protection Program (PPP) loans have caused a myriad of confusion for tax practitioners, with previous IRS guidance leading to even more complexity and uncertainty. The law that authorized PPP loans mandated that their forgiveness was non-taxable. Next, the IRS proposed that expenditures paid with PPP loans were non-deductible. Subsequent legislation then made it clear that those expenditures were deductible. Ambiguity resulting from these conflicting statements led to questions, including when did forgiveness occur? Was it when the taxpayer received the forgiveness letter from the bank? Was it when the taxpayer submitted its request for forgiveness, or was it when the taxpayer spent the money as directed by the PPP directives?

The timing of actual forgiveness was even more important to flow-through entities because the recognition of the tax-exempt income increased the basis of the stakeholders in their respective partner capital accounts or shareholder stock. Without this basis, increase deductions might not be deductible, or distributions might become taxable.

To add clarity, the IRS has recently issued three revenue procedures that provide guidance addressing these timing issues, partner basis adjustments and filing of amended partnership returns and information statements.

Timing of Tax-Exempt Income

Revenue Procedure 2021-48 provides that a taxpayer that received a PPP loan may treat tax-exempt income resulting from the partial or complete forgiveness of the PPP loan as received or accrued as follows:

- As the taxpayer pays or incurs eligible expenses¹;
- When the taxpayer files an application for forgiveness of the PPP loan; or
- When the PPP loan forgiveness is granted.

The timing treatment is also relevant when the partial or complete forgiveness of a PPP loan is treated as gross receipts under a federal tax provision.

Taxpayers may report tax exempt income on a timely filed original or amended tax return. If a taxpayer received PPP loan forgiveness of less than the amount that the taxpayer previously treated as tax-exempt income, the taxpayer must file an amended return, information return or administrative adjustment request as applicable.

¹ Under the safe harbor that allows certain taxpayers who relied on prior guidance and did not deduct certain PPP-related expenses on a tax return filed before the COVID Tax Relief Act was enacted, to deduct the expenses in the next tax year. A taxpayer that has elected to use the safe harbor will be treated as paying or incurring the eligible expenses during the taxpayer's immediately subsequent tax year following the taxpayer's 2020 tax year in which the expenses were actually paid or incurred, as described in Rev. Proc. 2021-20.



Partnership Basis Adjustments

If covered partnerships meet certain requirements, the IRS will treat the covered taxpayer's allocation of amounts treated as tax exempt income and allocation of deductions as determined in accordance with IRC section 704(b).

Amended Returns

Normally, under the centralized partnership audit regime, partnerships cannot amend their tax returns. Rather they must submit administrative adjustment requests, if the original due date has passed. Rev. Proc. 2021-50 allows eligible partnerships subject to the centralized partnership audit regime that filed a Form 1065 and furnished all required Schedules K-1 for tax years ending after March 27, 2020 and before Rev. Proc. 2021-50 was issued to file amended partnership returns and furnish amended Schedules K-1 on or before December 31, 2021.

Action Items

Taxpayers should evaluate whether and how they reported forgiveness income and determine if it was consistent with the above alternatives or if they would like to amend their tax returns to a more favorable alternative. Most importantly, if amending a return is warranted and you are a partnership subject to the centralized partnership audit regime, it would behoove you to file the amended return prior to December 31, 2021.

Learn More

For more information on taxation requirements for PPP loans, please contact your BT advisor by calling 770.396.2200.