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Financing Payroll with Covid-19 Loans, Grants, and Tax Credits

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INTRODUCTION

Employers affected by Covid-19 seek to maximize the economic and tax benefits of refundable tax credits, grants, or loan forgiveness, which may be used to subsidize payroll costs. This article analyzes and compares the requirements and tax consequences of paid leave credits, employee retention credits, loan advances, and loan forgiveness, which may assist employers, including tax-exempt organizations, in mitigating payroll and other operating costs. Applicability of each federal program discussed in this article will depend on the particular financial, tax, and operational considerations of an employer.

This article focuses on the tax consequences to an employer of each program individually and in combination with other federal payroll assistance. Based on the requirements and tax consequences of the payroll relief, financial modeling may assist in more complex situations in determining the tax benefits based on the specific circumstances of an employer. For this purpose, employers would take into account other tax considerations, including certain tax and employee

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benefits relief available under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).¹

PPP

Section 1102 of the CARES Act sets forth requirements for loans issued to small business employers,² including nonprofit organizations, under the Paycheck Protection Program (PPP) administered by the United States Small Business Administration (SBA).³ CARES Act, §1102 added paragraph (36) to §7(a) of the Small Business Act, as amended (the “Act”).⁴ An eligible recipient, subject to entity affiliation rules,

¹ Pub. L. No. 116-136, §2202, §2203 (allowing certain penalty-free distributions from eligible retirement plans, and a temporary waiver of required minimum distributions); *see also* CARES Act, §2204, §2205 (limited charitable contribution deduction for taxpayers who do not itemize deductions, and a temporary suspension of limitation on deductible cash contributions), §2206 (exclusion from employee gross income of certain employer payments of student loans), §2303 (carryback of net operating losses for five years, 100% offset of income with losses in open tax years beginning before 2021 at the previously higher federal corporate income tax rate), §2304 (repeal for 2018 and 2019 of the \$250,000 net business loss limitation for non corporate taxpayers), §2305 (immediate refundability of tax credit for prior year minimum tax liability of corporations), §2306 (raising limitation on deduction of business interest for tax years beginning in 2019 and 2020), §2307 (classifying qualified improvement property as 15-year depreciation property).

² Self-employed individuals also may be eligible for PPP loans. *See* SBA §7(a)(36)(D)(ii). SBA as used in this article refers to the Act cited in Note 4, below or to the Small Business Administration, as context requires. The citations of SBA §7(a) and SBA §7(b) throughout this article refer to sections of the Small Business Act codified under 15 U.S.C. §636.

³ *See* I.R.C. §501(a), §501(c)(3); SBA §7(a)(36)(A)(vii). For detailed treatment of qualified paid sick leave and paid family leave refundable credits, *see* Vishnepolskaya, *Paid Leave Credit for Private Sector and Nonprofit Employers Within the Families First Coronavirus Response Act*, 48 Comp. Plan. J. No. 4 (Apr. 3, 2020). *See* SBA and Dep’t of Treasury, *Paycheck Protection Program Loans FAQs*, Q&A 42 (May 3, 2020) (nonprofit organizations eligible for PPP under CARES Act, §1102 include nonprofit hospitals exempt from federal income taxation under §115); 85 Fed. Reg. 23,450, 23,451 (Apr. 28, 2020).

⁴ CARES Act, §1102(a); Small Business Act, Pub. L. No. 85-

may apply for and be approved for a covered loan (PPP loan) in the amount up to \$10,000,000, determined generally by multiplying average monthly payroll for the one year period before the loan is made by 2.5 and adding an SBA Economic Injury Disaster Loan program (EIDL) loan amount.⁵

Generally, an eligible recipient may use the PPP loan for payroll costs, paid leave, continuation of group health care benefits during paid leave, insurance premiums, compensation, mortgage, and other interest, rent, and utilities.⁶ Payroll costs include generally wages, paid leave, allowance for separation or dismissal, group health care plan contributions, employee benefits, and payment of state and local taxes on employee compensation, including state unemployment insurance, and independent contractor or self-employment compensation.⁷ Compensation of employees without a primary residence in the United States, individual compensation exceeding \$100,000 on a prorated basis, federal employment taxes, and the Families First Coronavirus Response Act (FFCRA)⁸ qualified sick leave or family leave wages are expressly excluded from PPP payroll costs.⁹

The borrower must make certain good faith certifications, which include generally status of operations and payroll at beginning of covered period, the necessity of the loan request due to economic uncertainty to support ongoing operations, use of funds for allowable purposes, absence of duplicative funds, support-

ing documentation including tax returns and PPP loan forgiveness.¹⁰

PPP LOAN FORGIVENESS

Under CARES Act, §1106, a PPP loan amount for costs and payments incurred during the covered period beginning on the origination date, may be forgiven, subject to certain limitations.¹¹ An eligible recipient excludes the amount of PPP loan forgiveness, including proceeds used to fund payroll, from gross income under §1106(i) of the CARES Act. But the exclusion applies only to amounts of forgiveness that otherwise would be taxable under the I.R.C. as cancellation of indebtedness income to the employer.¹² Originally, the last day, on which a lender could have obtained a PPP loan number¹³ in connection with submitting an application for a PPP loan,¹⁴ fully guaranteed by the SBA,¹⁵ was June 30, 2020.¹⁶ On June 30, 2020, the U.S. Senate approved an extension of the

¹⁰ See SBA §7(a)(36)(G) (borrower certification requirements for a PPP loan). See 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020); 85 Fed. Reg. 36,308, 36,311 (June 16, 2020) (original borrower certification requirements in SBA and Treasury first interim final rule and revised borrower certification requirements in light of enactment of Paycheck Protection Program Flexibility Act of 2020 (Flexibility Act), Pub. L. No. 116-142, §3(b)(2), respectively).

¹¹ CARES Act, §1102(a)(2) (adding PPP to the SBA), §1106(a)(1) (defining “covered loan” subject to forgiveness as a PPP loan), §1106(a)(3) (defining “covered period”), §1106(b) (scope of PPP loan forgiveness), §1106(d) (limitations on forgiveness, including based on a reduction in number of full-time equivalent employees (FTEs) or total salary or wages of any employee during the covered period, but providing an exemption for rehired employees or restoration of salary or wages); SBA §7(a)(36)(A)(ii) (defining “covered loan” as an SBA loan to an eligible recipient during the covered period subject to the requirement of SBA §7(a)(36)); RIN 1505-AC69 at 1, n.1, 15 (May 22, 2020) (interim final rule on loan forgiveness providing a *de minimis* exemption from FTE reduction penalty when borrower eliminates reductions by June 30, 2020).

¹² See CARES Act, §1106(b) (forgiveness), §1106(i) (taxability); I.R.C. §61(a)(12).

¹³ See SBA and Dep’t of Treasury, *Paycheck Protection Program Loans FAQs*, Q&A 21 (May 13, 2020).

¹⁴ See SBA Form 2483, *Paycheck Protection Program Borrower Application Form Revised June 24, 2020* (expiring Oct. 31, 2020); SBA Form 2484, *Lender’s Application – Paycheck Protection Program Loan Guaranty Revised June 12, 2020* (expiring Oct. 31, 2020).

¹⁵ See CARES Act, §1102(a)(1)(B) (adding paragraph (F) to SBA §7(a)(2) specifying that SBA participation in PPP loans shall be 100%); SBA §7(a)(36)(B) (providing SBA may guarantee covered loans under the same terms, conditions, and processes as an SBA §7(a) loan); 85 Fed. Reg. 21,747, 21,748 (Apr. 20, 2020) (loans under the PPP 100% guaranteed by the SBA); SBA and Dep’t of Treasury, *Paycheck Protection Program Loans FAQs*, Q&A 30 (Apr. 17, 2020) (PPP loan sold on a secondary market would be 100% SBA guaranteed).

¹⁶ See CARES Act, §1102(a)(2); SBA §7(a)(36)(A)(iii) (defin-

536 (1953).

⁵ See SBA §7(a)(36)(A)(iv) (defining an eligible recipient as individual or entity eligible to receive a covered loan), §7(a)(36)(A)(i) (defining a covered loan as a loan made under the PPP during the covered period), §7(a)(36)(A)(iii) (defining a covered period as the period beginning February 15, 2020, and ending on December 31, 2020), §7(a)(36)(D) (eligibility for covered loans of certain borrowers generally with 500 or fewer employees), §7(a)(36)(E) (maximum loan amount requirements, generally capped at \$10,000,000 per eligible recipient, subject to affiliation rules or a waiver of such rules generally referenced in SBA §7(a)(36)(D)(iv)); 13 C.F.R. 121.301(f) (as amended in 2020) (SBA affiliation rules applicable to PPP), 85 Fed. Reg. 20,817, 20,821 (Apr. 15, 2020) (interim final rule amending 13 C.F.R. §121.103(b) to set forth affiliation rules and related eligibility requirements under PPP for faith-based organizations).

⁶ See SBA §7(a)(36)(F) (allowable uses of covered loans generally including payroll costs, employee benefits, compensation, mortgage interest payments, rent, utilities, and interest on other debt obligations incurred before February 15, 2020); 85 Fed. Reg. 36,308, 36,311 (June 16, 2020) (allowable uses of PPP loan proceeds).

⁷ SBA §7(a)(36)(A)(viii)(I); 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020).

⁸ Pub. L. No. 116-127.

⁹ SBA §7(a)(36)(A)(viii)(II); 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020).

PPP loan program to August 8, 2020.¹⁷ As of June 29, 2020, \$134 billion remained in available PPP funding.¹⁸ Legislation was introduced in Congress to allow eligible recipients with 100 or fewer employees to receive second PPP loans if they experienced revenue loss of 50% or more due to the pandemic and spent or expected to spend the initial PPP funds.¹⁹ In addition, a bi-partisan congressional task force reportedly is considering further small business aid.²⁰ Moreover, on June 30, 2020, legislation was introduced requiring forgiveness of all PPP loans under \$150,000.²¹

HCE Act

The \$349 billion initial funding for the PPP was depleted as of April 16, 2020.²² On April 24, 2020, the Paycheck Protection Program and Health Care Enhancement Act (HCE Act) was signed into law.²³ Section 101 of the HCE Act provided for appropriation of additional \$310 billion to the PPP²⁴ and additional \$10 billion for emergency grants under the EIDL.²⁵

Flexibility Act

On June 5, 2020, the president signed into law the Paycheck Program Flexibility Act of 2020 (Flexibility

Act) extending covered period as extending from February 15, 2020, to June 30, 2020); 85 Fed. Reg. 36,308, 36,309, 36,311 (June 16, 2020).

¹⁷ S. 4116, A bill to extend the authority for commitments for the paycheck protection program and separate amounts authorized for other loans under section 7(a) of the Small Business Act, and for other purposes, 116th Cong., 2d Sess. (June 30, 2020).

¹⁸ See Yuka Hayashi, *PPP Loan Window Is Closing, With \$134 Billion Still on Offer*, Wall St. J. (June 30, 2020), <https://www.wsj.com/articles/ppp-loan-window-is-closing-with-134-billion-still-on-offer-11593509402>.

¹⁹ See S. 4014, A bill to provide for supplemental loans under the Paycheck Protection Program, 116th Cong., 2d Sess. (Introduced June 18, 2020); H.R. 7241, To provide for supplemental loans under the Paycheck Protection Program, 116th Cong., 2d Sess. (Introduced June 18, 2020).

²⁰ See Yuka Hayashi, *PPP Loan Window Is Closing, With \$134 Billion Still on Offer*, Wall St. J. (June 30, 2020).

²¹ S. 4117, A bill to provide automatic forgiveness for paycheck protection program loans under \$150,000, and for other purposes, 116th Cong., 2d Sess. (June 30, 2020).

²² See CARES Act, §1102(b)(1) (amount authorized for commitments for covered loans); CNBC, *Small business rescue loan program hits \$349 billion limit and is now out of money* (Apr. 16, 2020), <https://www.cnbc.com/2020/04/16/small-business-rescue-loan-program-hits-349-billion-limit-and-is-now-out-of-money.html>.

²³ Pub. L. No. 116-139.

²⁴ HCE Act, §101(a) (amending CARES Act, §1102(b)(1)).

²⁵ HCE Act, §101(b) (amending CARES Act, §1107(e)(7)), §1110(e) (authorizing advances of up to \$10,000 under the EIDL program, which do not have to be repaid); SBA §7(b)(2) (EIDL requirements).

Act).²⁶ Initially, pursuant to SBA guidance published on April 15, 2020, non-payroll costs could not exceed 25% of the forgiven loan amount.²⁷ Section 3 of the Flexibility Act increased the maximum percentage of PPP loan that may be used for non-payroll costs from 25% to 40% of the covered loan amount in order to qualify for forgiveness.²⁸

Section 3 of the Flexibility Act also extended the covered period, within which an employer must spend the PPP loan funds to qualify for forgiveness, from eight weeks beginning on the date of PPP loan origination to the earlier of 24 weeks after such date or December 31, 2020.²⁹ Additionally, this §3 exempted generally employers who reduced workforce and were unable to hire employees due to Covid-19 requirements on or before December 31, 2020, from a proportional reduction of a PPP loan forgiveness amount.³⁰ Furthermore, §2 of the Flexibility Act set the minimum repayment term of covered loans for which an eligible recipient submitted an application for forgiveness³¹ as five years, leaving intact the maximum maturity date of 10 years from the date of submission of the application.³²

Additionally, §3 of the Flexibility Act extended the initial deferral period under SBA §7(a)(36)(M)³³ for repayment of a PPP loan until the date the amount of

²⁶ Pub. L. No. 116-142.

²⁷ 85 Fed. Reg. 20,811, 20,813–20,814 (Apr. 15, 2020).

²⁸ Flexibility Act, §3(b)(2) (amending CARES Act, §1106(d) by adding new paragraph §1106(d)(8)), §1106(b) (costs and payments for which an eligible recipient would be eligible for forgiveness).

²⁹ Flexibility Act, §3(b)(1) (amending CARES Act, §1106(a)(3)).

³⁰ Flexibility Act, §3(a) (extending the covered period for a PPP loan), §3(b)(2) (amending CARES Act §1106(d) by adding new paragraph §1106(d)(7)); see CARES Act, §1102(b); SBA and Dep't of Treasury, *Paycheck Protection Program Loans FAQs*, Q&A 40 (May 13, 2020) (laid off employees who were offered to be rehired by eligible recipient but declined the offer not counted for purposes of reduction of PPP loan forgiveness amount pursuant to CARES Act, §1106).

³¹ See CARES Act, §1106(e); SBA Form 3508, *Paycheck Protection Program Loan Forgiveness Application Rev. June 16, 2020* (June 2020) (expiring Oct. 31, 2020); SBA Form 3508EZ, *Paycheck Protection Program Forgiveness Application* (expiring Oct. 31, 2020) (permitted to be filed by borrower who is a self-employed individual, sole proprietor or independent contractor, without employees, and who did not include any employee salaries in computation of average monthly payroll on borrower application, or by borrowers, which satisfy generally certain conditions regarding payroll maintenance or level of business activity during the covered period).

³² Flexibility Act, §2(a); SBA §7(a)(36)(K)(ii).

³³ SBA §7(a)(36)(M)(i) (defining an impacted borrower as an eligible recipient that was in operating on February 15, 2020, and submitted a PPP loan application which was pending or approved on or after March 27, 2020). SBA §7(a)(36)(M)(i) directed SBA to require lenders to grant deferment on repayment of PPP loans

forgiveness is remitted to the lender.³⁴ If a borrower failed to submit an application for forgiveness within 10 months of the disbursement, the borrower may delay repayment for 10 months after December 31, 2020.³⁵ SBA §7(a)(36)(L) provided that the interest rate on a covered loan during the covered period may not exceed four percent.

SBA guidance limited the rate of interest on a PPP loan to one percent.³⁶ The SBA stated that if the full amount of a PPP loan was eligible for forgiveness, the borrower would not be required to pay any interest accrued on the PPP loan during the deferment period.³⁷ The SBA also clarified that the maximum amount subject to forgiveness is the full principal amount of the PPP loan and any accrued interest.³⁸

S. 4014 and H.R. 7241

Congress may pass legislation allowing certain small businesses with significant reduction of receipts to receive second PPP loans. Eligible recipients with 100 or fewer employees in certain parts of the United States may continue to be affected by delayed reopening of business activity due to higher incidence of Covid-19. These eligible recipients would be able to structure business operations to use second PPP loan proceeds or FFCRA payroll credits as financial assistance. However, the first PPP loan of an employer would preclude applicability of an employee retention credit. Likewise, an initial PPP loan would deny eligibility for an EIDL Advance. Thus, limited planning opportunities would remain for recipients of second PPP loans, primarily with respect to use of PPP loan proceeds or FFCRA credits to offset liabilities in-

by impacted borrowers for a minimum of six months and not exceeding one year; 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020) (specifying an initial deferment period of six months for repayment of principal and interest on a PPP loan). See also RIN 3245-AH47, 15-16 (May 22, 2020) (interim final rule setting forth claw-back requirements with respect to lender PPP loan processing fees paid by SBA).

³⁴ Flexibility Act, §3(c)(1), §3(c)(2); SBA §7(a)(36)(M)(ii)(II), SBA §7(a)(36)(M)(iii).

³⁵ Flexibility Act, §3(c)(3); SBA §7(a)(36)(M)(v).

³⁶ 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020) (imposing applicable interest rate of 100 basis points).

³⁷ 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020) (imposing applicable interest rate of 100 basis points).

³⁸ See 85 Fed. Reg. 36,308, 36,311 (June 16, 2020).

curred due to Covid-19. But with the PPP Loan Program extension to August 8, 2020, more planning opportunities will be open to small businesses that had not applied yet for PPP loans.

TAX CONSEQUENCES OF PPP LOAN FORGIVENESS

Notice 2020-32

On April 30, 2020, the IRS issued Notice 2020-32 (the “Notice”), which provides generally that an employer may not deduct business expenses paid using forgiven PPP loan proceeds. The expenses may not be deducted to the extent that any forgiven portion of the PPP loan is excluded from gross income of the employer under §1106(i) of the CARES Act.³⁹ The purpose of the guidance is to prevent a double tax benefit to the employer.⁴⁰

On May 5, 2020, three members of the U.S. Senate who are leaders of their respective congressional tax-writing committees, asked Treasury in a letter⁴¹ to reverse Notice 2020-32 denying deductions for certain small business expenses that are subject to loan forgiveness.⁴² The letter accompanied introduction on the same day by five senators of the Small Business Expense Protection Act of 2020 to clarify availability of the deduction by amending §1106(i) of the CARES Act.⁴³ The House introduced a companion PPP loan deduction bill on May 12, 2020.⁴⁴ The proposed legislation was not enacted as part of the Flexibility Act.

³⁹ Notice 2020-32.

⁴⁰ Notice 2020-32.

⁴¹ Grassley, Neal, Wyden, *Ltr. to the Hon. Steven T. Mnuchin, Secretary of the Treasury Regarding Deductibility of PPP Loan Forgiveness Amounts* (May 5, 2020), <https://www.grassley.senate.gov/sites/default/files/2020-05-05%20CEG%2C%20RW%2C%20RN%20to%20Treasury%20%28PPP%20Business%20Deductions%29.pdf>.

⁴² See Notice 2020-32; Richard Rubin, *Tax Deductions Tied to Forgiven Small Business Loans Draw Support*, Wall St. J. (May 5, 2020), https://www.wsj.com/articles/tax-deductions-tied-to-forgiven-small-business-loans-draw-support-11588718734?mod=business_major_pos4.

⁴³ S. 3612, Small Business Expense Protection Act of 2020, 116th Cong., 2d Sess. (May 5, 2020).

⁴⁴ H.R. 6821, Small Business Expense Protection Act of 2020, 116th Cong., 2d Sess. (May 12, 2020).

Effect of Deferral of Employment Tax Deposits

Section 4 of the Flexibility Act allows delay of payment of payroll taxes⁴⁵ by an employer⁴⁶ that received forgiveness of PPP loan amounts under CARES Act, §1106⁴⁷ or of coronavirus loans issued by additional authorized lenders under CARES Act, §1109.⁴⁸ Section 4 of Flexibility Act, which eliminated the deferral exception for eligible recipients in CARES Act §2302(a), is effective retroactively for any PPP loan.⁴⁹

Thus, eligible recipients may defer payment of the employer portion of FICA social security tax or equivalent RRTA taxes due for the payroll tax deferral period, beginning March 27, 2020, and ending December 31, 2020.⁵⁰ Employers may defer deposit of 50% of the amount of the excise tax due for the deferral period until December 31, 2021.⁵¹ Likewise, employers may pay over to the IRS the remaining 50% by December 31, 2022.⁵²

Employers may retain certain amounts of withheld employment taxes in anticipation of receiving employment tax credits under FFCRA or the CARES

Act.⁵³ Eligible recipients may not seek PPP financing for wages subject to FFCRA credits, and would not be eligible for CARES Act employee retention credits.⁵⁴ Thus, allowing deferral of payroll tax payments by employers, which received PPP loan forgiveness, was a legislative step toward achieving parity of tax benefits of financing payroll through PPP or employment tax credits.

Interaction with Employer Credits

Payroll costs that may be funded by a PPP loan exclude qualified sick leave wages (qualified sick leave) or qualified family leave wages (qualified family leave), for which a refundable credit is allowed.⁵⁵ PPP payroll costs may not exclude the allocable qualified health plan expenses or employer Medicare tax on qualified sick leave or family leave wages.⁵⁶ Together, this article refers to these benefits alternatively as “qualified paid leave.” Small business employers must provide qualified paid leave to employees as re-

⁴⁵ See Flexibility Act, §4(a) (amending CARES Act, §2302(a)); CARES Act, §2302(d)(1) (defining applicable employment taxes for deferral purposes). CARES Act, §2302 permits similar deferral of 50% SECA tax liability of self-employed individuals equivalent to employer portion of FICA social security tax. See CARES Act, §2302(b); I.R.C. §1401(a) (self-employment income tax equivalent to both employer and employee portion of FICA social security tax), §3111(a) (employer portion of social security tax), §3201(a) (employee portion of social security tax).

⁴⁶ Flexibility Act, §4(a).

⁴⁷ See CARES Act, §1106(i), §2302(a)(3) (previously disallowing deferral of employer portion of payroll taxes by employers that received PPP loan or similar loan forgiveness under CARES Act, §1106 or §1109, respectively); Flexibility Act, §4 (striking CARES Act, §2302(a)(3)), thus allowing deferral of payroll tax payments by employers that received such forgiveness).

⁴⁸ See CARES Act, §1109(b), §1109(d)(2)(D) (requirements for loans issued by non-SBA lenders similar to PPP loan requirements).

⁴⁹ Flexibility Act, §4(a) (striking CARES Act, §2302(a)(3)); CARES Act §2302(b) (effective date).

⁵⁰ Flexibility Act, §4; CARES Act, §2302(a)(1) (deferral of applicable employment taxes for the payroll tax deferral period until the applicable date), §2302(d)(1) (defining applicable employment taxes), §2302(d)(2) (defining payroll tax deferral period), §2302(d)(2) (defining the term “applicable date”); I.R.C. §3102(a) (withholding of employee portion of FICA taxes), §3111(a) (employer portion of FICA social security tax), §3211(a) (employee portion of RRTA tax), 3221(a) (employer portion of RRTA tax). See also I.R.C. §3301 (imposing FUTA excise tax on limited wages paid by certain employers, generally credited with state unemployment tax liability).

⁵¹ CARES Act, §2302(a), §2302(d)(3)(A); I.R.C. §3102(a), §3111(a).

⁵² CARES Act, §2302(a), §2302(d)(3)(B); I.R.C. §3102(a), §3111(a).

⁵³ FFCRA §7001(f)(3), §7003(f)(3) (authorizing Treasury to issue regulations concerning waiver of penalties for failure to deposit payroll taxes in anticipation of the qualified sick leave or family leave credits, respectively); CARES Act, §2301(k) (requiring waiver of any failure to deposit penalty under I.R.C. §6656 with respect to applicable employment taxes if such failure as determined by the IRS was due to reasonable anticipation of the employee retention credit). To create liquidity for employers, which anticipate a refund of the excess payroll credit, the IRS has allowed employers to retain both the employer and employee portion of withheld employment taxes. See Notice 2020-22; IRS FAQ, *COVID-19-Related Tax Credits: How to Claim the Credits FAQs*, Q&A 38, 39 (Apr. 28, 2020). By contrast, CARES Act, §2302 does not address situation where a refund would be issued, and thus, allows deferral of only the employer portion of FICA social security taxes or equivalent taxes. Compare FFCRA §7001(f)(3), §7003(f)(3) (directing Treasury to issue regulations or other guidance for avoiding failure to deposit penalties with respect to amounts in anticipation of payroll credits), CARES Act, §2301(k) (waiver of failure to deposit penalties with respect to employer portion of FICA social security or equivalent taxes in anticipation of employee retention credit) with CARES Act, §2302(d)(1) (defining applicable employment taxes subject to deferral until the applicable date as employer portion of FICA social security or equivalent taxes).

⁵⁴ See CARES Act, §1106(b) (allowing forgiveness of indebtedness on a covered loan in an amount equal to certain costs incurred during the covered period, including payroll costs), §2301(j) (employer that received forgiveness of a PPP loan not eligible for employee retention credit); SBA §7(a)(36)(A)(viii)(II)(dd), §7(a)(36)(A)(viii)(II)(ee) (excluding qualified sick leave or family leave wages from the definition of payroll costs for purposes of determining amount of PPP loan).

⁵⁵ FFCRA §7001, §7003; SBA §7(a)(36)(A)(viii)(II)(dd), §7(a)(36)(A)(viii)(II)(ee).

⁵⁶ See SBA §7(a)(36)(A)(viii)(II); 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020) (outlining items that qualify and that expressly are excluded as payroll costs under PPP).

quired under the FFCRA.⁵⁷ Payroll costs do not exclude qualified wages, for which an employer claims a payroll credit under CARES Act, §2301.⁵⁸ However, an employer that received a PPP loan would not be eligible for an employee retention credit.⁵⁹

By contrast, payroll costs may include paid family and medical leave, for which an employer may claim a business tax credit under I.R.C. §45S (the “FMLA credit”), a work opportunity tax credit under I.R.C. §51 (WOTC) or another employment credit.⁶⁰ The FMLA credit may not apply to the same wages, for which a payroll credit under the FFCRA or the CARES Act was claimed.⁶¹ In addition, an employee the wages paid to whom are subject to a WOTC may not count for purposes of an employee retention credit.⁶² Thus, the employment credits may be mutually exclusive with the payroll credits but not with PPP loan forgiveness.

For wages subject to either of these employment credits, which are paid in a taxable year that I.R.C. §280(C) disallows a deduction. An employee retention credit is subject to the same tax treatment as an employment credit.⁶³ Generally, the employer excludes the amount of the credit from gross income and may not claim a deduction for qualified wages subject to the credit.⁶⁴ There is lack of guidance whether the FMLA credit, a WOTC or another employment credit

may apply to wages included in payroll costs funded with forgiven PPP loan proceeds.

Therefore, absent further guidance, the FMLA credit may apply to a portion of the wages, which an employer funded with PPP loan proceeds subject to forgiveness. The employer would not be eligible to deduct the portion of the wages, for which the FMLA credit was claimed. If the proceeds used to finance the credited portion of payroll are forgiven, under CARES Act §1106(i), an employer does not include the amount of forgiveness in income. Simultaneously, the employer would not be eligible to deduct the amount of the wages, for which the PPP loan proceeds were subject to forgiveness.

Thus, on the one hand, the employer receives tax-free cancellation of indebtedness income in the amount of wages subject to forgiveness. The employer also receives the FMLA credit. But the deduction for the amount of wages subject to both the FMLA credit and PPP loan forgiveness is disallowed only once, under I.R.C. §280C(a). Therefore, the Notice requiring disallowance of deduction for payroll costs subject to PPP loan forgiveness would apply to the same amount.

On the other hand, to the extent that the FMLA credit is not offset by inclusion in income, the employer may be deemed to receive a double tax benefit. On the other hand, the benefit of a tax credit is not the same as the benefit of exclusion of an item from gross income addressed by the Notice. Therefore, the policy in the Notice of denying a double tax benefit does not support clearly allowing forgiveness for payroll costs for which an employer claimed the FMLA credit. Accordingly, absent further IRS guidance, employers may evaluate whether to claim an employment credit for wages funded with PPP loan proceeds, with respect to which employers anticipate submitting an application for forgiveness.

EMERGENCY EIDL GRANTS

CARES Act §1110 authorizes under SBA §7(b)(2) emergency EIDL “advances,” or grants, in an amount up to \$10,000 to eligible entities, which include small businesses and not-for-profit organizations.⁶⁵ The advances are referenced in this article alternatively as

credit allowed for purposes of I.R.C. §38), §280C(a) (disallowance of a deduction); see IRS FAQ, *COVID-19-Related Employee Retention Credits: Special Issues for Employers FAQs*, Q&A 86 (May 5, 2020), <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-special-issues-for-employers-faqs#income-and-deduction>.

⁶⁵ CARES Act, §1110(b) (definition of eligible entity), §1110(e) (requirements for emergency EIDL grants); SBA §7(b)(2); SBA and Dep’t of Treasury, *Paycheck Protection Program Loans FAQs*, Q&A 42 (May 19, 2020) (nonprofit organization).

⁵⁷ FFCRA §3102, §5102, §7001–§7004 (qualified paid leave requirements, related refundable payroll credits, or similar credits for self-employed individuals).

⁵⁸ SBA §7(a)(36)(A)(viii)(I)(AA)–§7(a)(36)(A)(viii)(I)(EE) (payments of wages and group health care benefits included within payroll costs under PPP); CARES Act, §2301(a) (refundable credit for an eligible employer against employment taxes in an amount equal to 50% of qualified wages for a calendar quarter), §2301(c)(3) (defining qualified wages generally as wages, as defined for purposes of FICA in I.R.C. §3121(a) or compensation for RRTA purposes in I.R.C. §3231(e), paid by an eligible employer to an employee during the covered period, with respect to which the employee is not providing services during a calendar quarter due to Covid-19 conditions described in CARES Act, §2301(c)(2)(A)(ii), and including group health plan contributions under I.R.C. §5000(b)(1), by an employer that are excluded from gross income of employees under I.R.C. §106(a)).

⁵⁹ CARES Act, §2301(j).

⁶⁰ See SBA §7(a)(36)(A)(viii)(I)(CC) (including within payroll costs, for which covered loan proceeds may be expended, payment for vacation, parental, family, medical, or sick leave); I.R.C. §45S(a) (employer credit for paid family and medical leave); FMLA §102; I.R.C. §38 (business tax credit), §45S (paid family and medical leave credit), §51(a) (work opportunity tax credit), §280C(a) (generally disallowing a deduction for wages for which certain employment credits are allowable); *PPP Loans FAQs*, Q&A 8 (May 19, 2020).

⁶¹ FFCRA §7001(e)(1), §7003(e)(1); CARES Act, §2301(h)(2).

⁶² CARES Act, §2301(h)(1).

⁶³ See CARES Act, §2301(e); I.R.C. §51(i)(1), §280C(a).

⁶⁴ I.R.C. §38(a) (allowing certain business credits as credits against income tax), §45S(a)(1) (paid family and medical leave

emergency EIDL grants or EIDL Advances. Eligible entities may apply for emergency EIDL grants during the covered period beginning January 31, 2020, and ending December 31, 2020.⁶⁶ Eligible entities must self-certify that they are not able to obtain financing on reasonable terms elsewhere in applying for an emergency EIDL grant.⁶⁷ If approved by the SBA, the grant must be disbursed within three days of receipt of the application.⁶⁸

An eligible entity may use an emergency EIDL grant for any allowable purpose for a loan under SBA §7(b)(2).⁶⁹ Allowable uses of funds include providing paid sick leave to employees unable to work due to coronavirus, payroll to retain employees during business disruptions or slowdowns, increased costs to obtain materials due to supply chain disruptions, rent or mortgage payments, and repaying obligations that cannot be met due to revenue losses.⁷⁰ An applicant generally does not have to repay an emergency EIDL grant.⁷¹

HCE Act, §101(c) added an agricultural enterprise as defined in SBA §18(b) with 500 or fewer employees to the list of eligible entities.⁷² The SBA stopped accepting EIDL applications on April 15, 2020.⁷³ Following passage of the HCE Act, on May 4, 2020, the SBA reopened the EIDL portal to accept applications only from agricultural businesses.⁷⁴ As of June 15, 2020, the SBA resumed processing applications received before April 15, 2020, and began accepting new EIDL and emergency EIDL grant (EIDL Advance) applications from all eligible entities.⁷⁵

Some of those eligible entities may have applied for PPP loans to finance payroll after receiving emer-

gency EIDL grants. In addition, eligible entities may consider applying payroll credits under FFCRA and CARES Act discussed below to the wages the payment of which was funded through an emergency EIDL grant. In each of these cases, the interaction of the emergency EIDL grant program with operation of PPP and payroll credit requirements are relevant.

Interaction with PPP, FFCRA, and CARES Act Payroll Credits

An applicant may have received an emergency EIDL grant and subsequently, was approved for PPP. The applicant may use PPP loan proceeds to finance payroll. In addition, the employer may apply for forgiveness of the PPP loan. In that case, the amount of the emergency EIDL grant will be deducted from PPP loan forgiveness amount for a PPP loan applied toward payroll costs.⁷⁶

Neither FFCRA nor CARES Act refer expressly to allowance of a payroll credit if the employer received an emergency EIDL grant.⁷⁷ CARES Act §2301(j) provides that an employer that received a PPP loan would not be eligible for an employee retention credit.⁷⁸ The provision is silent on allowance of an employee retention credit if the employer received an emergency EIDL grant but did not apply for a PPP loan.⁷⁹

IRS guidance is silent on the interaction of emergency EIDL grants with employer payroll credits under FFCRA or CARES Act.⁸⁰ IRS guidance provides that an employer that received a PPP loan may not claim an employee retention credit.⁸¹ But if an otherwise eligible employer repaid the PPP loan by May

⁶⁶ CARES Act, §1110(a)(1), §1110(e)(1).

⁶⁷ CARES Act, §1110(e)(2).

⁶⁸ CARES Act, §1110(e)(1).

⁶⁹ CARES Act, §1110(e)(4); SBA §7(b)(2).

⁷⁰ CARES Act, §1110(e)(4)(A), §1110(e)(4)(E).

⁷¹ CARES Act, §1110(e)(5).

⁷² HCE Act, §101(c)(3); CARES Act, §1110(a)(2)(F); SBA §18(b).

⁷³ HCE Act, §101(a), §101(b) (increasing appropriations for PPP and EIDL, respectively); SBA §7(a)(36), §7(b)(2); CARES Act, §1102 (PPP), §1110 (EIDL advances); SBA Rel. No. 20-32, *Statement by Secretary Mnuchin and Administrator Carranza on the Paycheck Protection Program and Economic Injury Disaster Loan Program* (Apr. 15, 2020) (PPP and EIDL loan approvals to cease to be issued due to lapse in appropriations).

⁷⁴ SBA §18(b) (defining agricultural businesses); SBA Rel. No. 20-38, *SBA to Make Economic Injury Disaster Loans Available to U.S. Agricultural Businesses Impacted by COVID-19 Pandemic* (May 4, 2020), <https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/sba-make-economic-injury-disaster-loans-available-us-agricultural-businesses-impacted-covid-19>.

⁷⁵ CARES Act, §1110(a)(2) (defining, for purposes of emergency EIDL grant requirements, an eligible entity as including generally a business, cooperative, ESOP, or tribal small business

concern with 500 or fewer employees, a sole proprietorship, a private nonprofit organization, and a small agricultural cooperative, each as defined under the SBA); SBA §7(b)(2) (setting forth EIDL requirements); SBA Notice, *Now Accepting New Applications for COVID-19 Economic Injury Disaster Loans and Advance* (June 15, 2020), <https://www.sba.gov/page/disaster-loan-applications>.

⁷⁶ CARES Act, §1106(a) (allowing PPP loan forgiveness), §1110(e)(6) (requiring deduction of emergency EIDL grant amount from PPP loan forgiveness amount used for payroll costs); SBA §7(a)(36)(A)(viii)(I) (defining payroll costs for PPP purposes).

⁷⁷ See FFCRA §7001, §7003, §7005; CARES Act, §2301(j).

⁷⁸ CARES Act, §2301(j).

⁷⁹ CARES Act, §2301(j).

⁸⁰ See generally IRS FAQ, *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs*, Q&A 78 (May 8, 2020); IRS FAQ, *COVID-19-Related Tax Credits: Special Issues for Employers FAQs*, Q&A 52 (guidance on interaction with other tax credits, no mention of interaction with emergency EIDL grants) (Apr. 28, 2020).

⁸¹ IRS FAQ, *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs*, Q&A 78 (May 8, 2020); 85 Fed. Reg. 23,450, 23,451 (Apr. 28, 2020)

18, 2020, the employer may claim the payroll credit.⁸² Absent further IRS guidance, there is lack of clarity regarding whether an employer receiving an emergency EIDL grant may claim an employee retention credit for qualified wages paid using grant funds.

Likewise, SBA guidance does not refer to interaction of emergency EIDL grants with employer payroll credits under FFCRA.⁸³ CARES Act, §1110(e)(4)(A) includes paid sick leave to employees unable to work due to the direct effect of the Covid-19 as an allowable use of emergency EIDL grant funds.⁸⁴ There is no statutory language or agency guidance clarifying whether an employer may fund paid sick leave with an emergency EIDL grant and claim a credit for the qualified sick leave wages under FFCRA §7001.⁸⁵

TAX CONSEQUENCES OF EMERGENCY EIDL GRANTS

The IRS has not provided guidance on whether an emergency EIDL grant is subject to tax, or on tax treatment of employer expenses paid with emergency EIDL grant funds.⁸⁶ An emergency EIDL grant effectively is an advance on an SBA loan, specifically authorized under CARES Act, §1110(e)(1).⁸⁷ Under CARES Act, §1110(e)(5), the emergency EIDL grant is not required to be repaid.

Thus, failure to repay an emergency EIDL grant would appear to result in cancellation of debt income

(original repayment due date of May 7, 2020, under the certification safe harbor allowing borrower that failed to meet the certification standard to repay the PPP loan funds to comply with the PPP certification standard); 85 Fed. Reg. 31,357, 31,357 (May 26, 2020) (reference to further extension of PPP loan repayment deadline under nonbinding guidance to comply with certification standards from May 14, 2020, to May 18, 2020); SBA, *Paycheck Protection Program Loans FAQs*, Q&A 47 (May 13, 2020).

⁸² IRS FAQ, *COVID-19-Related Employee Retention Credits: Interaction with Other Credit and Relief Provisions FAQs*, Q&A 79 (May 26, 2020).

⁸³ See 85 Fed. Reg. 21,747, 21,749 (Apr. 20, 2020) (guidance on calculating PPP loan amounts taking into account emergency EIDL grants, no reference to interaction with payroll credits).

⁸⁴ CARES Act, §1110(e)(4)(A).

⁸⁵ See FFCRA §5102(a) (general paid sick leave requirements under the Emergency Paid Sick Leave Act, FFCRA §5101 *et seq.*), §7001(a) (refundable employer credit for qualified sick leave wages and certain related expenses).

⁸⁶ See 85 Fed. Reg. 36,308, 36,311 (June 16, 2020) (confirming that an EIDL loan may be refinanced into a PPP loan, that an EIDL loan used for payroll costs must be refinanced by a PPP loan, if any, and that proceeds from any advance up to \$10,000 on the EIDL loan will be deducted from the loan forgiveness amount on the PPP loan; not setting forth specific tax consequences for the EIDL advance).

⁸⁷ CARES Act, §1110(e)(1); SBA §7(b)(2) (EIDL requirements).

under I.R.C. §61(a)(12).⁸⁸ Absent further IRS guidance, general income tax principles would appear to apply to emergency EIDL grant funds that an employer did not repay.⁸⁹ Thus, an employer generally would be subject to cancellation of debt income on the emergency EIDL grant amount.⁹⁰ Likewise, an employer generally would deduct payroll expenses financed with emergency EIDL grant amounts as ordinary and necessary business expenses.⁹¹

Interaction with Payroll Credits

An employer may have to include emergency EIDL grant funds that were not repaid in income, but generally may be able to claim deductions for wages and benefits, as well as other related costs, which were paid using grant proceeds.⁹² The employer also may have claimed FFCRA payroll credit with respect to the same wages, qualified allocable health plan expenses, and employer portion of Medicare tax on the qualified sick leave wages. In that case, the FFCRA credit would be includible in gross income of the employer, and the paid sick leave for which the credit was claimed generally would be deductible.⁹³

Thus, there would not be an additional tax benefit from a deduction for EIDL Advance proceeds applied toward paid sick leave credited under FFCRA. Therefore, an employer seeking federal assistance for more than \$10,000 in expenses may consider claiming a FFCRA credit for paid sick leave and applying emergency EIDL grant funds for other purposes.⁹⁴

Subsequent PPP Loan

An employer subsequently may have a PPP loan. By contrast to an EIDL loan, an employer does not have to refinance an EIDL Advance not subject to re-

⁸⁸ See CARES Act, §1110(e)(5); SBA §7(b)(2); I.R.C. §61(a)(12).

⁸⁹ See, e.g., I.R.C. §61 (gross income), §162 (deductions for ordinary and necessary business expenses paid or incurred during the tax year in carrying on any trade or business).

⁹⁰ I.R.C. §61(a)(12) (gross income including income from discharge of indebtedness).

⁹¹ I.R.C. §162(a)(1) (deductibility of salaries or other compensation for personal services actually rendered).

⁹² See generally I.R.C. §61(a)(12), §162(a), §404(a).

⁹³ See FFCRA §7001(e)(1); I.R.C. §162(a); IRS FAQ, *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs*, Q&A 50 (Apr. 28, 2020).

⁹⁴ See FFCRA §7001(c), §7001(d) (credit allowable for qualified sick leave wages and certain allocable health plan expenses), §7005(b) (allowance, *inter alia*, of credit for employer portion of Medicare tax, I.R.C. §3111(b), on qualified sick leave wages for which paid sick leave credit is allowed); CARES Act, §1110(e)(4) (allowable uses of emergency EIDL grant funds).

payment into a PPP loan.⁹⁵ However, any amount of an emergency EIDL grant would be deducted from the amount of PPP loan forgiveness for a PPP loan for payroll costs.⁹⁶

Thus, whether or not the grant proceeds were used for payroll, the grant up to \$10,000 would retain the tax treatment applicable to an EIDL grant.⁹⁷ Therefore, the EIDL Advance funds spent for payroll will not be rolled into PPP payroll costs. Accordingly, instead of exclusion from gross income and disallowance of deduction under PPP loan forgiveness, the funds would be includible in gross income and deductible. Also, the employer would not be eligible for an employee retention credit for prior calendar quarters, regardless of whether or not the grant proceeds were applied toward payroll costs.⁹⁸

Comparison with PPP

By contrast to the definition of payroll costs under PPP, the payroll expenses for which an emergency EIDL grant may be used are broader.⁹⁹ SBA §7(b)(2) provides an EIDL may be made to an entity that suffered a substantial economic injury as a result of a disaster, including Covid-19.¹⁰⁰ Substantial economic injury is an inability to meet obligations as they matured, pay ordinary and necessary operating expenses or market, produce, or provide a product or service ordinarily marketed, produced, or provided by the business concern.¹⁰¹

Under the CARES Act, allowable purposes of an emergency EIDL grant include providing paid sick leave to employees unable to work due to the direct effect of the Covid-19 and maintaining payroll to retain employees during business disruptions or substantial slowdowns.¹⁰² The list of allowable purposes does not elaborate any further on whether employee benefits, certain federal, state, or local taxes on employee compensation, certain other, compensation or

other employer costs would be included.¹⁰³ However, the definition of substantial economic injury under SBA suggests an emergency EIDL grant may be used for any ordinary or necessary operating expenses.¹⁰⁴

Thus, the scope of payroll or associated expenses funded with an emergency EIDL grant may be broader than the payroll costs financed with a PPP loan.¹⁰⁵ Conversely, the amount of PPP loan may be substantially greater than an emergency EIDL grant subject to a \$10,000 limit.¹⁰⁶

An employer, which used an emergency EIDL grant to meet payroll or other obligations and subsequently was approved for a PPP loan must deduct the emergency EIDL grant amount from PPP loan forgiveness amount used for payroll costs.¹⁰⁷ Therefore, these payroll costs will not be subject to income tax treatment applicable to payroll costs financed with

¹⁰³ See CARES Act, §1110(e)(4); cf. SBA §7(a)(36)(A)(viii).

¹⁰⁴ SBA §7(b)(3)(A)(iii).

¹⁰⁵ See SBA §7(a)(36)(F) (allowable uses of covered loans including payroll costs, group health care benefits, salaries and commission, interest on mortgage payments, rent, utilities, and interest payments on other debt obligations incurred before the covered period).

¹⁰⁶ See SBA §7(a)(36)(A)(viii)(II)(aa) (compensation of individual employee limited to a prorated portion of an annual salary of up to \$100,000); RIN 3245-AH51 (June 17, 2020) (SBA interim final rule revising third and sixth interim final rules, clarifying that amount of PPP loan forgiveness will depend, in part, on the total amount spent over the 24-week period beginning on the PPP loan disbursement date, and including, among other costs, payroll costs including salary, wages, and tips, up to \$100,000 of annualized pay per employee (for 24 weeks, a maximum of \$46,154 per individual, and if employer elected to use the prior, eight-week covered period, a maximum of \$15,385 per individual), as well as covered benefits for employees, excluding owners, including health care expenses, retirement contributions, and employer state taxes on payroll, such as unemployment insurance). See Flexibility Act, §3(b) (extending covered period to 24 weeks or ending on December 31, 2020, if earlier; amending CARES Act to permit election of an eight-week covered period); CARES Act, §1106(b)(1) (election of an eight-week covered period), §1106(b)(3).

¹⁰⁷ CARES Act, §1106(b) (forgiveness of indebtedness on a PPP loan), §1106(d)(1) (amount of forgiveness limited to principal amount of the PPP loan), §1110(e)(6) (reduction of PPP loan forgiveness amount used for payroll costs by emergency EIDL grant amount), Flexibility Act, §3(b) (amending certain PPP loan forgiveness requirements); CARES Act, §1106(d)(8) (increased percentage of PPP loan as non-payroll costs allowable for PPP loan forgiveness); 85 Fed. Reg. 36,308, 36,311 (June 16, 2020) (clarifying that principal and accrued interest on a PPP loan may be subject to forgiveness if less than the full amount of the PPP loan is forgiven, and further, that if payroll costs constitute less than 60% of the PPP loan, the amount of loan forgiveness will be reduced proportionally, in this way enabling forgiveness of accrued interest); 85 Fed. Reg. 20,811, 20,813 (Apr. 15, 2020) (determining a one percent interest rate for PPP loans).

⁹⁵ SBA Procedural Notice, *Refinance of EIDL Loans with PPP Loan Proceeds and Lender Remittance of EIDL Refinance Proceeds to SBA*, Control No. 5000-20032 (June 22, 2020) (effective June 19, 2020, and expiring June 1, 2021).

⁹⁶ CARES Act, §1110(e)(6).

⁹⁷ See CARES Act, §1110(e)(6).

⁹⁸ CARES Act, §2301(j); IRS FAQ, *Employee Retention Credit under the CARES Act*, Q&A 78 (May 8, 2020).

⁹⁹ Compare SBA §7(a)(36)(A)(viii) (defining payroll costs as including specific expenses) with CARES Act, §1110(e)(4) (specifying general uses of funds for emergency EIDL grants without narrowly defining the purposes).

¹⁰⁰ SBA §7(b)(2)(D).

¹⁰¹ SBA §7(b)(3)(A)(iii).

¹⁰² CARES Act, §1110(e)(4)(A), §1110(e)(4)(B).

PPP loan proceeds subject to forgiveness.¹⁰⁸ Instead of the amount of PPP loan forgiveness being excluded from income and a corresponding disallowance of deductions, the payroll amounts would be includible in income and deductible by the employer. Distinctly, EIDL amounts do not reduce the percentage of PPP loan used for payroll costs, and therefore, do not affect the amount of PPP loan forgiveness.¹⁰⁹

Therefore, to the extent of this dollar limitation, emergency EIDL grant amounts that were not used for payroll costs under the PPP definition may have to be deducted from PPP loan forgiveness amounts used for payroll costs.¹¹⁰ The deductibility of payroll expenses funded with an emergency EIDL grant remains unclear if the eligible recipient subsequently received a PPP loan. Accordingly, a corresponding deduction may be allowable for some costs financed with PPP loan proceeds subject to forgiveness, contrary to Notice 2020-32 rules.

FFCRA PAYROLL CREDITS

Generally, the FFCRA requires employers with fewer than 500 employees, other than certain small business employers, to provide paid sick leave and paid family or medical leave if requested by employee in connection with absence, including inability to telework, due to the coronavirus.¹¹¹ A covered employer may claim the tax credits in the aggregate up to \$10,000 per employee for payment of qualified sick leave or family leave wages, allocable qualified health plan expenses, and the employer portion of Medicare tax on those wages for the period between April 1, 2020, and December 31, 2020.¹¹² The credits offset social security tax on the employer with respect to

wages paid to any employees for the calendar quarter, not just to those who receive the FFCRA paid leave.¹¹³ To the extent the credits exceed employer social security tax liability for the calendar quarter, the credits are refundable to the employer.¹¹⁴

TAX CONSEQUENCES OF FFCRA PAYROLL CREDITS

Qualified sick leave or family leave wages generally are deductible by an employer as a payroll expense.¹¹⁵ Deductible employer portion of FICA social security taxes are creditable for qualified sick leave or family leave wages.¹¹⁶ Employer portion of Medicare tax on qualified sick leave or family leave wages was included in the amount of payroll credits, but the payroll credits apply only against employer FICA social security tax.¹¹⁷ Moreover, there is no employer social security tax on qualified sick leave or family leave wages.¹¹⁸ Conversely, the credit applies to any social security tax on the employer for a calendar quarter for wages paid to any of its employees.¹¹⁹

The deduction for qualified sick leave or family leave wages and employment taxes is an above the line item.¹²⁰ The tax benefit to an employer of a deduction for qualified leave wages generally is tax savings in the amount of federal income tax that would have been paid on income equal to the amount of the

for FFCRA credits); Notice 2020-21; IRS FAQ, *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs*, Q&A 47, 48 (Apr. 28, 2020) (period the wages may be subject to FFCRA credits).

¹¹³ See FFCRA §7001(a), §7003(a).

¹¹⁴ See FFCRA §7001(b), §7003(b).

¹¹⁵ IRS FAQ, *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs*, Q&A 50.

¹¹⁶ FFCRA §3102(a) (general paid leave requirement under the Emergency Family and Medical Leave Expansion Act, FFCRA §3102 *et seq.*), §5102(a) (general paid sick time requirement under the Emergency Paid Sick Leave Act, FFCRA §5102 *et seq.*), §7001(a), §7001(c), §7001(d), §7003(a), §7003(c), §7003(d).

¹¹⁷ See FFCRA §7001(a), §7003(a); I.R.C. §3111(a); *cf.* FFCRA §7001(c), §7003(c), §7005(b) (allowance only for Medicare tax, thereby excluding social security tax from being creditable). *But see* I.R.C. §3221(a) (credit applicable to RRTA tax analogous to employer portion of FICA tax, which includes the employer portion of both social security and Medicare tax); FFCRA §7001(c), §7003(c), §7005(b) (allowance only for Medicare tax, thereby excluding social security tax from being creditable).

¹¹⁸ See FFCRA §7005(a).

¹¹⁹ FFCRA §7001(b)(3), §7003(b)(2).

¹²⁰ See I.R.C. §62(a)(1) (adjusted gross income definition, taking into account generally trade or business expenses among other deductions), I.R.C. §162(a)(1) (deduction for employee wages), 404(a) (including deduction for employer contributions to qualified plans); *see generally* I.R.C. §401(a), §501(a) (rules for qualified employee trusts).

¹⁰⁸ See CARES Act, §1106(i) (exclusion of PPP loan forgiveness amounts from gross income); Notice 2020-32 (denial of deduction for expenses financed with PPP loan forgiveness amounts).

¹⁰⁹ 85 Fed. Reg. 36,308, 36,311 (June 16, 2020).

¹¹⁰ See CARES Act, §1106(b), §1110(e)(6).

¹¹¹ See FFCRA §3102(a), §5102(a); Dep't of Labor, *Families First Coronavirus Response Act: Questions and Answers*, Q&A 59 (generally exempting employers, including nonprofits, with fewer than 50 employees from FFCRA paid leave requirements, subject to certain conditions).

¹¹² See generally FFCRA §7001–§7004 (availability of credits to employers as well as self-employed individuals). See FFCRA §7001(b), §7003(b) (providing limitations on wages taken into account for purposes of the payroll credits; \$10,000 aggregate limit per employee for all calendar quarters includes FFCRA sick leave and family leave; credit for each employee generally may not exceed \$200 for any day employee is paid qualified leave wages or \$511 for any day the employee receives paid sick leave to quarantine or seek medical diagnosis for Covid-19 symptoms; credits are reduced by certain veteran and small business research credits under I.R.C. §3111(e) and §3111(f), wages for which family leave credit under I.R.C. §45S was claimed are not taken into account

qualified sick leave or family leave wages.¹²¹ Generally, for corporate taxpayers, under the Tax Cuts and Jobs Act of 2017 (TCJA) the applicable federal income tax rate for tax years beginning after December 31, 2017, is 21%.¹²²

The rate, at which the FICA tax is deductible by an employer is distinct from the employment tax rate, at which the FICA tax is imposed on applicable wages of the employee,¹²³ which is 6.2% for the employer social security portion, and 1.45% for the Medicare portion.¹²⁴ However, an employer deducts the payment of Medicare tax at the income tax rate, or 21% for a corporate taxpayer.¹²⁵

The mechanism for receiving the tax benefits under the FFCRA with respect to qualified paid leave effectively includes two matching tax offsets. First, the amount of out-of-pocket costs for qualified paid leave is offset by the amount of below-the-line allowed FFCRA credits. Second, the above-the-line deduction for qualified paid leave is offset by inclusion in gross income of the employer of the amount of the FFCRA credits. Thus, the rate, at which the Medicare tax is imposed on qualified sick leave or family leave wages is a factor in determining the amount of the payroll credit. But, the tax rate for ordinary income and for deductions of ordinary and necessary business expenses are the same for an employer, resulting in net offsets. Therefore, the income tax rate, at which an employer deducts the Medicare tax does not affect the tax benefit from FFCRA credits received by the employer for qualified paid leave.

In addition, if there is sufficient payroll tax liability, the employer receives the credit against the employer

social security portion of FICA taxes, deductible at the 21% federal income tax rate for corporate taxpayers.¹²⁶ The payroll credit offsets the employer social security tax imposed for the calendar quarter, for which an employer claims the credit, on wages paid to any employees of the employer.¹²⁷ The IRS may refund in advance the FFCRA credits to an employer, or waive the failure to deposit penalty for employment taxes withheld but not deposited in anticipation of the FFCRA credits. The retained amounts of withheld employment taxes may not exceed the credits actually allowed in order to avoid the penalty.¹²⁸

The FFCRA payroll credits inevitably must offset social security tax on any other wages paid to the employee who was granted paid sick or family leave under FFCRA.¹²⁹ Once the latter amount is depleted, any remaining payroll credits would apply against social security tax on any wages paid to any other employees for the calendar quarter, for which the credit was claimed.¹³⁰ If there is insufficient employment tax liability to apply the credit, any unused portion of the credit for qualified paid leave is refundable to the employer.¹³¹ The payroll tax credit, as well as any refund are includible in gross income of the employer to offset the deduction.¹³² The taxpayer includes both portions of the credit in gross income at the applicable income tax rate.¹³³

¹²¹ See I.R.C. §1 (individual income tax rates), §11(b) (corporate income tax rate), §162(a)(1) (deduction for employee wages), §404(a) (including deduction for employer qualified plan contributions).

¹²² See Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97 §13001(a), §13001(c), 131 Stat. 2096 (2017) (TCJA); I.R.C. §11(b).

¹²³ Compare I.R.C. §1, §11(b), §62(a), §162(a) (deduction for employment tax liability), §404(a) (providing a deduction for employer contributions to qualified plans and certain deferred compensation) with §3111(a) (FICA tax rate for employer social security portion on wages paid to employees).

¹²⁴ §3111(a), §3111(b).

¹²⁵ I.R.C. §11(b), §162(a), §3111(b).

¹²⁶ FFCRA §7001(a), §7003(a), §7005(b); I.R.C. §1, §11(b), §162(a), §404(a), §3111(a).

¹²⁷ See FFCRA §7001(b)(3), §7003(b)(2).

¹²⁸ See CARES Act §3606 (amending FFCRA §7001, §7003, allowing advance refunding of FFCRA payroll credits and requiring IRS to waive failure to deposit penalty under I.R.C. §6656 with respect to employer social security tax if the failure to deposit was due to anticipation of FFCRA payroll credits, unless employer sought advance refunds by filing IRS Form 7200).

¹²⁹ See FFCRA §7001(b)(3), §7003(b)(2). See also Dep't of Labor, *Families First Coronavirus Response Act: Questions and Answers*, Q&A 15 (Mar. 24, 2020) (providing generally the documentation requirements for employer with respect to employee requesting emergency paid sick leave or expanded family or medical leave under FFCRA).

¹³⁰ See FFCRA §7001(b)(3), §7003(b)(2).

¹³¹ FFCRA §7001(b)(4)(A), §7003(b)(3).

¹³² FFCRA §7001(e)(1), §7003(e)(1).

¹³³ FFCRA §7001(e)(1), §7003(e)(1); I.R.C. §11(b) (applicable income tax rate for a corporation).

Comparison with PPP Tax Consequences

The IRS treats the forgiven portion of a PPP loan for payroll costs¹³⁴ more stringently than certain costs included in qualified paid leave, for which a refundable credit is allowed under the FFCRA.¹³⁵ In contrast to an employer receiving FFCRA credits, a taxpayer receiving PPP loan forgiveness for covered payroll costs remains out of pocket for employer FICA taxes, less the allowed deductions. Compared to qualified paid leave, payroll costs include additional employee benefit plan contributions and state and local employment taxes paid by employer, but exclude Medicare tax. Thus, effectively, with respect to an amount of wages and related costs, an employer would have net offsets for federal income tax purposes on a different set of liabilities under FFCRA and PPP loan forgiveness, respectively.

In contrast, with respect to a hypothetical \$10,000 of wages and FICA taxes on the wages, FFCRA provides a credit for Medicare tax, whereas PPP loan forgiveness excludes any FICA tax from payroll costs. Thus, an employer would receive a slightly higher tax benefit under FFCRA than under loan forgiveness with respect to this hypothetical amount. But, an employer may be required to provide qualified paid leave per employee, which would exceed the allowable FFCRA credits.¹³⁶

PPP loan forgiveness and FFCRA credits are mutually exclusive. An employer may elect out of FFCRA credits for a calendar quarter, but would not be able to roll qualified paid leave into PPP payroll costs even on election out if the FFCRA otherwise were allowed. An employer may structure operations to apply employee retention credit or fund payroll with PPP loan forgiveness amounts in event of business suspension,

or apply FFCRA for requested paid leave due to Covid-19. Moreover, additional related costs, such as employer qualified plan contributions and state and local employment taxes may vary. Successful financial modeling based on the requirements and tax consequences of each program will ensure that the taxpayer receives an accurate snapshot of payroll liabilities and enable planning with respect to application of Covid-19 relief.

CARES ACT PAYROLL CREDIT

An eligible employer, including a tax-exempt organization¹³⁷ may qualify for an employee retention credit of 50% of qualified wages up to \$10,000 paid to an employee under §2301 of the CARES Act.¹³⁸ Qualified wages generally include wages paid to an employee who is not providing services due to certain Covid-19 conditions, or for employers with 100 or fewer full-time employees, wages paid during suspension of operations due to Covid-19 or during a certain period of significant decline in gross receipts.¹³⁹ Qualified wages may not exceed an amount the employee would have been paid by an employer with more than 100 full-time employees for the same duration of work during the immediately preceding 30-day period.¹⁴⁰

Generally, an eligible employer may claim the credit for a calendar quarter for which the operation of the trade or business was fully or partially suspended due to Covid-19 orders from a governmental authority.¹⁴¹ Alternatively, an employer experiencing a significant decline in gross receipts generally may claim the employee retention credit for calendar quarters ending with the first quarter after a quarter for which the receipts exceeded 80% of the receipts for the period in the preceding year.¹⁴² An eligible employer that is a tax-exempt organization is exempt

¹³⁴ See RIN 1505-AC69, 8–9 (May 22, 2020) (SBA and Treasury interim final rule on loan forgiveness, clarifying the timing for incurring or payment during the covered period of payroll costs eligible for forgiveness; deeming payroll costs to be paid on the day paychecks are distributed or an ACH credit transaction by the borrower is originated); RIN 3245-AH51 (June 17, 2020) (modifying sixth interim final rule provisions regarding covered period following enactment of Flexibility Act, §3(b)).

¹³⁵ Compare CARES Act, §1102(a)(2) (amending SBA §7(a) to codify the PPP), §1106(i) (exclusion from gross income of forgiven PPP loan amount); SBA §7(a)(36)(A)(vii) (definition of payroll costs) with FFCRA §7001(e)(1), §7003(e)(1) (inclusion in income of refundable payroll credits for qualified paid sick or family leave available to employers), §7001(c), §7003(c) (definition of qualified paid leave wages under FFCRA); I.R.C. §162(a)(1) (deductibility of qualified paid leave wages subject to FFCRA §7001 and §7003), I.R.C. §404(a) (deductibility of employer contributions to qualified plans and certain deferred compensation).

¹³⁶ See Dep't of Labor, *Families First Coronavirus Response Act: Questions and Answers*, Q&A 7 (Mar. 24, 2020).

¹³⁷ See CARES Act, §2301(c)(2)(C); I.R.C. §501(a), §501(c).

¹³⁸ CARES Act, §2301(a) (allowance of employee retention credit), §2301(c)(2) (eligible employer definition).

¹³⁹ CARES Act, §2301(c)(2), §2301(c)(3); see I.R.C. §4980H (definition of full-time employee).

¹⁴⁰ CARES Act, §2301(c)(3)(A)(i), §2301(c)(3)(B).

¹⁴¹ CARES Act, §2301(c)(2) (defining eligible employer other than a tax-exempt organization, which is not subject to the following requirements, generally as carrying on a trade or business during 2020, and with respect to any calendar quarter, either the operation of which was either fully or partially suspended due to government orders due to coronavirus, or gross receipts from which, I.R.C. §448(c), were less than 50% year-to-year, unless the quarter is the calendar quarter immediately following the first calendar quarter after such period, during which the gross receipts recovered to an excess of 80% year-to-year).

¹⁴² CARES Act, §2301(c)(2)(B).

from business suspension or gross receipts requirements.¹⁴³

Comparison with FFCRA Payroll Credits

FFCRA generally limits the size of employers, other than government employers or certain other persons,¹⁴⁴ eligible for credit for qualified sick leave to employers with 50 to under 500 employees.¹⁴⁵ FFCRA does not provide employee limit exclusions for purposes of credit for qualified family leave.¹⁴⁶ In contrast to FFCRA, CARES Act, §2301 does not limit size of workforce of employers for employee retention credit eligibility.¹⁴⁷ The CARES Act applies only to employers carrying on a trade or business during calendar year 2020, including tax-exempt organizations.¹⁴⁸ Nevertheless, an employee retention credit incentivizes keeping employees on payroll during a shutdown due to Covid-19. By contrast, under the FFCRA, if an employee is furloughed, an employer is not eligible for qualified paid leave credits.¹⁴⁹

An eligible employer may take into account up to \$10,000 of qualified wages for all calendar quarters

¹⁴³ CARES Act, §2301(c)(2)(C).

¹⁴⁴ See FFCRA §5110(2)(B)(i)(I)(bb) (at least one employee, without a cap on the number of employees, would have to be employed by a public agency, which generally is a government employer, see Family and Medical Leave Act of 1993, 29 U.S.C. §2611 *et seq.* (FMLA) §3(x), or any other entity, which is not a private entity or individual to qualify as a covered employer for purposes of the Sick Leave Act, and qualified paid sick leave credits under FFCRA §7001(credit for employers) or §7002 (credit for certain self-employed individuals); Dep't of Labor, *Families First Coronavirus Response Act: Questions and Answers*, Q&A 3, n.1 (clarifying that federal employees subject to Title II of FMLA are not covered by the requirements of the Emergency Family Leave Act).

¹⁴⁵ FFCRA §3102(b) (adding, *inter alia*, §110(a)(1)(B) of FMLA to substitute a maximum threshold of 500 employees for a minimum threshold of 50 or more employees in FMLA §101(4)(A)(i) for purposes of applicability of the Emergency Family and Medical Leave Expansion Act, FFCRA §3101 *et seq.* (Emergency Family Leave Act), codified in new FMLA §102(a)(1)(F), and the qualified paid family leave credit), FFCRA §5110(2)(B)(i)(I)(aa) (defining a covered employer generally as any person engaged in commerce or in any industry or activity affecting commerce that, in the case of a private entity or individual, employs fewer than 500 employees for purposes of the Emergency Paid Sick Leave Act, FFCRA §5101 *et seq.* (Sick Leave Act)), §7001(a), §7003(a).

¹⁴⁶ See FFCRA §3102(b); FMLA §110(a)(1)(B) (not including an exception to the employer threshold for covered government employers for purposes of the Emergency Family Leave Act).

¹⁴⁷ CARES Act, §2301(c)(2).

¹⁴⁸ CARES Act, §2301(c)(2).

¹⁴⁹ Dep't of Labor, *Families First Coronavirus Response Act: Questions and Answers*, Q&A 26 (employee may not request FFCRA paid sick leave or family leave, and employer would not claim corresponding tax credits under FFCRA if employee had been furloughed).

for a maximum employee retention credit of \$5,000 per employee.¹⁵⁰ The wages taken into account must be paid after March 12, 2020, and before January 1, 2021.¹⁵¹ An employee retention credit may not be claimed with respect to the same wages, for which FFCRA payroll credits were claimed.¹⁵² Similarly to an FFCRA payroll credit, an employee retention credit is applied against employer social security tax liability¹⁵³ and is refundable.¹⁵⁴

As with respect to an FFCRA payroll credit, an employee may seek an advance payment of the portion of employee retention credit not offset by employment tax deposits by filing IRS Form 7200.¹⁵⁵ If an employer did not file Form 7200, as under FFCRA, an employer generally may avoid a I.R.C. §6656 penalty for reducing the amount of deposit of withheld employment taxes for a calendar quarter in anticipation of the employee retention credit.¹⁵⁶ The reduced amount may not exceed the amount of the credit allowed for the quarter.¹⁵⁷

Interaction with Section 45S Paid Leave Credit

An employer may claim paid leave credit under I.R.C. §45S, enacted as part of TCJA and extended in 2019 to apply to wages paid in tax years beginning not later than December 31, 2020.¹⁵⁸ Under both FFCRA and CARES Act, an employer may not claim an I.R.C. §45S credit with respect to wages for which a payroll credit was claimed.¹⁵⁹ But, an employer may

¹⁵⁰ CARES Act, §2301(b)(1).

¹⁵¹ CARES Act, §2301(m).

¹⁵² CARES Act, §2301(b)(2) (providing that certain credits under I.R.C. §3111(e) and §3111(f) further would reduce the employee retention credit for a calendar quarter); IRS Fact Sheet, *New Employee Retention Credit helps employers keep employees on payroll*, FS-2020-05 (May 2020).

¹⁵³ CARES Act, §2301(c)(1) (defining applicable employment taxes as FICA social security tax under I.R.C. §3111(a) or the equivalent of FICA taxes under the Railroad Retirement Tax Act, I.R.C. §3201 *et seq.* (RRTA)). See I.R.C. §3221(a).

¹⁵⁴ CARES Act, §2301(b)(2) (applicability of credit against employment tax liability), §2301(b)(3) (refundability of excess, nonapplied credit).

¹⁵⁵ IRS News Release IR 2020-62 (Mar. 31, 2020); IRS Form 7200, *Advance Payment of Employer Credits Due to COVID-19* (Mar. 2020).

¹⁵⁶ See I.R.C. §6656; Notice 2020-22.

¹⁵⁷ Notice 2020-22.

¹⁵⁸ TCJA §13403(a)(1); see Further Consolidated Appropriations Act of 2020, Pub. L. No. 116-94, §142(b), 133 Stat. 3234 (Dec. 20, 2019); I.R.C. §45S(i).

¹⁵⁹ FFCRA §7001(e), §7003(e); CARES Act, §2301(h)(2).

elect out of applying a CARES Act payroll credit, similarly to FFCRA payroll credits.¹⁶⁰

TAX CONSEQUENCES OF EMPLOYEE RETENTION CREDIT

Comparison With FFCRA Payroll Credits

In contrast to the FFCRA credit, an employee retention credit is not includible in gross income of the employer.¹⁶¹ Thus, even the refundable portion of an employee retention credit would not constitute taxable income for the employer.¹⁶² Instead, a CARES Act disallowance rule similar to I.R.C. §280C(a) reduces the aggregate amount of deductions claimed by an employer by the amount of the credit.¹⁶³ In addition, unlike with respect to qualified paid leave and qualified wages under the CARES Act, an employer incurs a deductible payroll tax liability for both the social security and Medicare portions of FICA tax.¹⁶⁴

Therefore, to summarize, unlike a FFCRA payroll credit includible in gross income of employer, an em-

ployee retention credit is generally tax-free to an employer. Consistently, unlike a FFCRA credit for deductible qualified paid leave, an employee retention credit results in disallowance of an above the line deduction for 50% of qualified wages of up to \$10,000 or \$5,000 per employee. Also, an employer has no FICA social security tax liability and Medicare tax liability under FFCRA, which is includible in income but deductible. By contrast, an employer must pay deductible FICA tax on CARES Act qualified wages, which on their own are not deductible to the extent of the amount of the tax-free employee retention credit.

TAX-EXEMPT EMPLOYERS AND PAYROLL RELIEF

Tax Indifference; UBTI

A tax-exempt organization generally is indifferent to income tax consequences of PPP loan forgiveness, EIDL Advances, or payroll credits, unless the organization incurred unrelated business taxable income (UBTI).¹⁶⁵ A tax-exempt organization, however, may receive the benefit of a Medicare tax credit under FFCRA and reimbursement of FICA tax from an EIDL Advance. UBTI is taxed at ordinary income tax rates applicable to a corporate taxpayer.¹⁶⁶ Thus, deductions of payroll amounts or related expenses may offset UBTI.¹⁶⁷ However, under TCJA, I.R.C. §512(a)(6) provided generally that, for any organization with more than one unrelated trade or business,¹⁶⁸ UBTI, including for purposes of determining any net operating loss deduction, would be computed separately with respect to each trade or business.¹⁶⁹

sick leave wages), §7003(a), §7003(c) (defining qualified family leave wages), §7005(a) (providing qualified sick or family leave wages are not subject to FICA social security tax on employers or to RRTA tax under I.R.C. §3221(a)), §7005(b) (extending payroll credit to Medicare portion of FICA tax paid by employer on credited qualified sick or family leave wages) with CARES Act, §2301(a), §2301(c)(3) (defining qualified wages for which an employee retention credit is allowable), §2301(c)(5) (defining wages as wages for FICA purposes defined in I.R.C. §3121(a) and compensation for RRTA purposes as defined under I.R.C. §3231(a), thus not exempting credited qualified wages from FICA or RRTA tax).

¹⁶⁵ See generally I.R.C. §501(a), §501(c)(3), §512(a).

¹⁶⁶ I.R.C. §11, §511(a).

¹⁶⁷ See I.R.C. §513(a) (defining a trade or business).

¹⁶⁸ See I.R.C. §513(a) (defining a trade or business).

¹⁶⁹ TCJA §13702(a); I.R.C. §512(a)(6).

¹⁶⁰ CARES Act, §2301(g) (permitting an election not to apply employee retention credit for any calendar quarter); FFCRA §7001(e)(2) (similar election for qualified paid sick leave credit), §7003(e)(2) (similar election with respect to qualified paid family leave credit).

¹⁶¹ See CARES Act, §2301(e) (rules similar to employment credit calculation rules under I.R.C. §51(i)(1) and §280C(a) apply); IRS FAQ, *COVID-19-Related Employee Retention Credits: Special Issues for Employers*, Q&A 87 (May 5, 2020), <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-special-issues-for-employers-faqs#income-and-deduction>. See also I.R.C. §51(i)(1) (related party rules for taking wages into account for purposes of determining the amount of WOTC as a credit claimed by a business under I.R.C. §38), I.R.C. §280C(a) (not allowing a deduction for wages taken into account for determining certain employment credits, including a WOTC, for a taxable year); CARES Act, §2301(h)(1) (employee whose wages are taken into account for purposes of WOTC, under I.R.C. §51 for any period may not be included with respect to any employer to claim an employee retention credit for such period). *But see* I.R.C. §111(b) (tax benefit rule for credits requiring generally inclusion in income of the amount of credit allowable in a prior tax year to the extent credit is attributable to an adjustment).

¹⁶² IRS FAQ, *COVID-19-Related Employee Retention Credits: Special Issues for Employers FAQs*, Q&A 86 (May 5, 2020), <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-special-issues-for-employers-faqs#income-and-deduction>.

¹⁶³ I.R.C. §280C(a) (disallowing deduction for wages taken into account for purposes of certain employment credits); IRS FAQ, *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs*, Q&A 85 (May 5, 2020).

¹⁶⁴ Compare FFCRA §7001(a), §7001(c) (defining qualified

Application of the Siloing Rule to Payroll Relief

Thus, the siloing rule effectively requires analysis of the tax consequences of payroll relief for each separate unrelated trade or business of a tax-exempt organization. A nonprofit may house certain projects in subsidiaries disregarded as separate from the owner for federal income tax purposes due to liability protection, operational, charitable giving, or other concerns.¹⁷⁰ The disregarded subsidiary, commonly organized as a single-member limited liability company (SMLLC), may be treated as a separate unrelated trade or business and incur UBTI.¹⁷¹

In this situation, only the payroll expenses of the SMLLC attributable to the unrelated business activities of the SMLLC may be deducted from gross income of the SMLLC.¹⁷² A not-for-profit with a more complex organizational structure must take the silo rule into account when planning to apply PPP loan forgiveness, EIDL Advances, or payroll credits to payroll expenses attributable to any unrelated trades or businesses, whether or not housed in separate entities and subject to aggregation rules. In the event a nonprofit or any of its subsidiaries incur UBTI, the general discussion in this article of the requirements and tax consequences of each form of payroll relief would be relevant. Specific rules applicable to a tax-exempt organization is discussed below.

Interaction of PPP Loan Forgiveness and Employee Retention Credit for a Nonprofit

A 24-week limitation¹⁷³ generally applies for forgiveness beginning on the PPP loan origination date

¹⁷⁰ See Reg. §301.7701-2(a) (as amended in 2019), Reg. §301.7701-3(b)(1) (as amended in 2020).

¹⁷¹ See Prop. Reg. §1.512(a)-6(b), REG-106864-18, 85 Fed. Reg. 23,172, 23,196 (Apr. 24, 2020) (general rule for identifying a separate unrelated trade or business).

¹⁷² See I.R.C. §512(a)(6)(A); Reg. §1.512(a)-1(b) (as amended in 2002); Prop. Reg. §1.512(a)-6.

¹⁷³ CARES Act, §1106(a)(3) (covered period), §1106(b)(1) (forgiveness of payroll costs over a covered period).

for paying or incurring¹⁷⁴ expenses of a tax-exempt organization, as well as interest on a PPP loan.¹⁷⁵ By contrast, there is no time limit on operations, with respect to which the nonprofit may claim an employee retention credit for qualified wages in 2020.¹⁷⁶ Rather, a nonprofit generally¹⁷⁷ may claim an employee retention credit for qualified wages paid to an employee over a course of employment longer than 24 weeks within the applicable period.¹⁷⁸

However, the employee retention credit would cover only 50% of \$10,000 of qualified wages, or up to \$5,000. Also, neither PPP loan forgiveness nor an employee retention credit would reimburse a nonprofit employer for FICA social security tax on the qualified wages. A tax-exempt employer may require relief for payroll over a course of time that extends beyond 24 weeks. Absent the timing concern, taking into account other factors, the organization may receive greater economic benefit in financing payroll costs under PPP than applying an employee retention credit.

COMPARISON OF TAX BENEFITS UNDER PPP LOAN FORGIVENESS, EIDL ADVANCES AND PAYROLL CREDITS

The following table summarizes the general requirements and tax consequences, subject to limitations as applicable under FFCRA and the CARES Act, for PPP loan forgiveness, emergency EIDL grants, FFCRA paid leave credits and employee retention credit applied to payroll amounts.¹⁷⁹

¹⁷⁴ The amount of forgiveness is the sum of costs incurred and amounts actually paid during the covered period. CARES Act, §1106(b)(1).

¹⁷⁵ See CARES Act, §1106(a)(3), §1106(b)(1) (forgiveness of debt on a covered loan in the amount of certain expenses, including payroll costs paid and incurred over a covered period).

¹⁷⁶ CARES Act, §2301(c)(2)(C).

¹⁷⁷ See CARES Act, §2301(c)(3)(B) (qualified wages may not be higher than the employee would have earned during 30 days immediately preceding the period for which employer is claiming the retention credit).

¹⁷⁸ See CARES Act, §2301(c)(2)(A)(ii)(I), §2301(c)(2)(C).

¹⁷⁹ For deferral purposes with respect to PPP loan forgiveness and EIDL Advances, FICA tax includes the employer social security portion. See IRS FAQ, *Deferral of employment tax deposits and payments through December 31, 2020*, Q&A 4.

TABLE 1: Comparison of PPP Loan Forgiveness, EIDL Advances and Payroll Credits

	Scope of Payroll Funding	Aggregate Amount of Wages Covered	Aggregate Amount of Benefits Covered	FICA employer Social security tax included or not	FICA employer Medicare tax included or not	Covered Period for Payroll	FICA employer taxes apply or not	FICA employer tax deferral applies or not	Deductibility of Payroll Costs or Qualified Wages	Deductibility of FICA employer taxes on the wages	Income Tax Liability of Employer	Percentage Interest Accrued
PPP Loan Forgiveness	Payroll costs subject to forgiveness, including wages, group health care and employee benefits, paid leave, state and local employment taxes	No specific limitation, loan up to \$10,000,000 determined by formula	No specific limitation, loan up to \$10,000,000 determined by formula	Social security tax not included in payroll costs	Medicare tax not included in payroll costs	February 15, 2020, to December 31, 2020	FICA taxes applicable to wages	FICA tax may be deferred	Deduction for PPP loan forgiveness amount disallowed	Deductible	Forgiveness amount excluded from gross income	One percent but none due if loan forgiven
Emergency EIDL Grant	Paid sick leave to employees unable to work due to the direct effect of the Covid-19; costs or expenses in maintaining payroll to retain employees during business disruptions or substantial slowdowns; other compensation, federal, state and local employment taxes may be included as ordinary and necessary operating expenses	\$10,000	Any group health plan costs or employee benefits may be included as ordinary and necessary operating expenses	Social security taxes may be included as part of maintaining payroll during disruption or slowdown or generally as part of ordinary and necessary operating expenses	Medicare taxes may be included as part of maintaining payroll during disruption or slowdown or generally as part of ordinary and necessary operating expenses	January 31, 2020, to December 31, 2020	FICA taxes applicable to wages	FICA tax may be deferred	Deduction appears to be allowed	Deduction appears to be allowed	Amount of grant which is not repaid appears to be included in gross income	No interest rate on the grant is specified or appears to apply
FFCRA Payroll Credits	Qualified sick leave or family leave wages; allocable qualified health plan expenses; Medicare tax on qualified sick leave or family leave wages	\$10,000 per employee for qualified sick leave or family leave wages, in addition to state and local employment taxes on employer	Allocable qualified health plan expenses	Social security tax not included in creditable amount	Medicare tax on qualified sick leave or family leave wages included in creditable amount	April 1, 2020, to December 31, 2020	Social security tax does not apply to qualified sick leave or family leave wages; Medicare tax applies to qualified sick leave or family leave wages	Advance refund of payroll credits for a calendar quarter; waiver of failure to deposit penalty for withheld FICA taxes equal to or less than the actual amount of the payroll credits for the calendar quarter; or, deferral of social security employer tax	Qualified sick leave or family leave wages and allocable health plan expenses are deductible	Deductible	Payroll credits are includible in gross income	Generally not applicable
CARES Act Payroll Credit	Qualified wages, including allocable health plan expenses	50% of up to \$10,000 of qualified wages, or \$5,000 per employee, reduced by any FFCRA credits allowed with respect to the wages for the calendar quarter	Allocable health plan expenses are included in the \$10,000 qualified wage limit.	Social security tax not included in qualified wages	Medicare tax not included in qualified wages	March 13, 2020, to December 31, 2020	FICA employer taxes applicable to qualified wages	Advance refund of payroll credits for a calendar quarter; waiver of failure to deposit penalty for withheld FICA taxes equal to or less than the actual amount of the payroll credits for the calendar quarter; or, deferral of social security employer tax	Deduction for qualified wages disallowed	Deductible	Employee retention credit not includible in gross income	Generally not applicable

CONCLUSION

The federal government has made available several forms of relief under recent legislation and a bevy of

multi-agency guidance, which assist employers with financing payroll and related costs in the current Covid-19 economic environment. Smaller businesses

and tax-exempt organizations may plan to maximize economic benefits of each program, including PPP loan forgiveness, EIDL advances not subject to repayment, FFCRA refundable paid leave credits, and the CARES Act refundable employee retention credit. The interaction of each respective form of assistance with other payroll relief may necessitate financial modeling in more complex situations to assess the tax consequences of each program are met to the employer based on applicable requirements.

Whereas the tax benefits may be compared, each form of payroll relief serves a distinct purpose in providing financial assistance to employers impacted by Covid-19. Thus, the primary legislative objective of PPP loan forgiveness was to assist employers impacted by Covid-19 with keeping employees on payroll, particularly in light of percentage limitation on allowed non-payroll costs. The CARES Act employee retention credit fulfilled a similar objective. Both programs provide assistance regardless of whether business operations are ongoing or suspended due to Covid-19.

By contrast, the FFCRA payroll credit effectively compensated employers, but not necessarily to full extent, for providing required paid leave to employees in Covid-19 medical and family care situations, but did not apply to furloughed employees. Emergency EIDL grants are the benefit in the federal Covid-19 rescue package with broader applicability employer expenses, but the grants are limited to \$10,000 per eligible entity. Except for the employee retention credit, which may assist large employers, the legislation generally limited relief to smaller businesses and tax-exempt organizations.

Amounts of FFCRA credits and, subject to further IRS guidance, EIDL Advances each are includible in

gross income but deductible by an employer. By contrast, both PPP loan forgiveness and employee retention credit are excludible from gross income, but a deduction for the amounts is disallowed. Each tax benefit is conferred by means of one or more net offsets, except that different benefits may offset a different set of payroll expenses.

Unlike for an employee retention credit, an employer is not required to have suffered significant reduction in gross receipts to qualify for a PPP loan. Rather, among the borrower requirements is a certification by a small business employer that the uncertainty of current economic conditions makes necessary the loan request to support ongoing operations. Thus, the more severe economic impact on an employer eligible for a CARES Act payroll credit justifies from a policy perspective the payroll availability of the employee retention credit to larger employers.

The availability of each form of payroll assistance to an employer is interdependent. Thus, an employee retention credit may not be claimed with respect to wages credited under FFCRA. An EIDL Advance is subtracted from PPP loan forgiveness amount for payroll costs. FFCRA qualified paid leave is excluded from payroll costs subject to PPP loan forgiveness. And an eligible recipient of a PPP loan may not claim an employee retention credit for any calendar quarter unless the PPP loan was repaid by May 18, 2020. Therefore, to maximize the economic and tax benefits of payroll assistance, employers must plan in advance and make corresponding staffing decisions. Accordingly, an employer must take into account financial, tax, and operational considerations in financing payroll liabilities with the federal Covid-19 relief programs through current year end.