

August 2020

Spending the PPP Money on You and Your Employees

If you report your business income and expenses on Schedule C of your Form 1040, your Payroll Protection Program (PPP) loan forgiveness is straightforward, as you see in the four answers below.

1. Paying Myself

Question. I know that I can achieve full forgiveness based solely on my 2019 Schedule C income in 10.8 weeks under the 24-week program. Do I have to pay myself every week for 10.8 weeks?

Answer. No. Let's say your PPP loan is for \$20,000. You could, for example, take \$20,000 out of your business account in one lump sum and put that in your personal savings anytime during the 10.8-week period and then apply for forgiveness in week 11.

Because both your loan and forgiveness are based on your 2019 Schedule C net profit (yes, last year), you simply need to use the loan money for personal purposes. This is how you pay yourself and obtain loan forgiveness the easy way.

Sure, you need to use only 60 percent of the proceeds for yourself and could use 40 percent for interest, rent, and utilities. But think about it:

- Pay yourself only: simple paperwork.
- Pay interest, rent, and utilities: more rules and paperwork.

Keep it simple. Don't make yourself suffer.

2. Waiting to Spend

Question. Can I wait a number of weeks before I spend my loan proceeds?

Let's say I receive the PPP proceeds on August 1, 2020. Can I use the 24-week period and start on August 17, for 11 weeks? Would that be okay? And would it be eligible for forgiveness?

Answer. Yes, no problem. But let's be clear:

- For PPP loans made on June 5 or later, the 24-week covered period is the rule (there's no "can" here—no eight-week possibility).
- There's no requirement that a Schedule C taxpayer spread out the payments.
- There's no payroll or other impediment here.

3. Spending in Chunks

I am a Schedule C taxpayer with no employees. My PPP loan amount was deposited into my business checking account on May 19, 2020. I am not electing the eight-week covered period. Instead, I am choosing the 24-week covered period, which ends on November 2, 2020.

I have two questions.

Question 1. Can I write one check for every four weeks of payroll and deposit it in my personal checking account?

Answer 1. Yes—but this is not a payroll check. As a Schedule C taxpayer with no employees, you have no payroll. Your PPP loan was based on your 2019 net profit. And your forgiveness will be based on the same amount. You don't need to spread out your payments.

Question 2. Does this check have to be cashed within that four-week period, or if it is written within that period, is that sufficient to apply for forgiveness?

Answer 2. In general, your check is a payment on the date it is written. Because you are dealing with yourself, you should ensure that the check is cashed soon after it is written.

Also, we don't see any wisdom (in fact, just the opposite) in writing the check within the 24 weeks and then cashing it outside the 24 weeks.

4. Got the PPP Money but Had a Loss in 2019

Question. I am a Schedule C filer, ran at a loss in 2019, but withdrew \$120,000 from the business as the business increased its debt position.

I used my draw amount to obtain a \$120,000 PPP loan before the guidance was issued on how sole proprietors should calculate their pay. If the business now has two employees, can both of those employees be used for the forgiveness application?

Answer. Yes, you can use the two employees on the forgiveness application, and you can use 24 weeks of pay. In addition to payroll, 40 percent of the forgiveness can come from interest, rent, and utilities.

Example. Say the two-employee payroll for the 24 weeks totals \$60,000 and the interest, rent, and utilities total \$30,000. You would achieve \$90,000 of forgiveness.

Q&A: PPP Forgiveness Answers for S Corporation Owner-Employees

Tax law definitions do not apply to much of the PPP, making it new ground for owners of S corporations. Here are answers to four questions of concern to many S corporation owners.

1. Spouse Owns S Corporation

Question. My wife owns 100 percent of the S corporation. She has a full-time job and does no work for the S corporation. I am the sole worker in the S corporation. Am I treated as:

- a “non-owner employee” of the S corporation; or
- an “owner-employee” subject to the limits?

Answer. The PPP guidance does not address the situation you describe. From what we know, you are a non-owner employee, which means you are **not stuck** with the owner-employee limits.

In tax law, you would have to consider “attribution rules” that would make you own what your wife owns because of your marital relationship. (Yes, in tax law you both would own 100 percent.) But the PPP guidance to date contains no such rules.

According to the latest from the Small Business Administration (SBA), you may rely on the laws, rules, and guidance available at the time of your PPP loan application. As we write, the latest guidance is from over a month ago, on June 25, 2020.

2. S Corporation Owner-Employee with No W-2

Question. I submitted my PPP loan application before the guidance disallowing independent contractor payments was published. And at the time of submission, I had not yet started paying myself a salary.

Now I have the PPP money from the bank but cannot get it forgiven through contractor payments. If I pay myself on a W-2, I lack the look-back period of 2019 payroll. Am I out of luck? Should I go on payroll and hope for the best?

Answer. Under the rules, you are out of luck. Your loan forgiveness is based on the lower of your 2019 W-2 (zero) or your 2020 W-2.

3. S Corporation Loan Based on K-1

Question. I operate my business as an S corporation with two W-2 employees other than me (I don't receive a W-2). I applied for the PPP loan and obtained it based on my K-1.

A few weeks later the lender told me that the money I received was not available to be forgiven. This doesn't seem fair. My profit is my income. Is there any workaround for this?

Answer. No—no workaround. But in your case, likely no PPP loan forgiveness problem either.

But first, let's think about taxes. You operate as an S corporation, and you take no salary. (That's incorrect and likely a tax problem if the IRS audits your tax return.)

Now, let's get to the PPP. Your lender granted you the PPP loan based on the K-1 and ignored your employees. That shows how confusing the PPP has been. But let's ignore the right and wrong of that and get to the heart of the issue. Can you obtain forgiveness?

Yes, your S corporation's forgiveness begins with what you pay your W-2 employees during the 24-week covered period, including what you pay in health insurance and retirement on their behalf. In addition, you may include some or all of your payments for business interest, rent, and utilities during the 24 weeks beginning with receipt of the loan.

Example. Let's say you received a \$100,000 loan. If your payroll during the 24 weeks is \$63,000 and the rent and utilities total \$37,000, you would qualify for 100 percent forgiveness. If you achieve this in 20 weeks, you could apply for forgiveness then.

Observation. The fact that the lender based your loan on your profits is simply a mistake by the lender. It does not affect forgiveness, which is based on your using the money for the intended PPP purposes such as payroll.

4. S Corporation with Home Office

Question. You recommend that the S corporation owner use an expense report to submit home-office expenses to the business for reimbursement and then classify the reimbursement in the tax return as an office expense.

How would we classify this as mortgage interest and utilities under the PPP loan forgiveness guidelines? We have the same question for partnerships where an item is claimed as an unreimbursed partner expense.

Answer. The reimbursed expense won't work for the PPP, but here's the solution: choose the 24-week program, and you will achieve full forgiveness with only the payroll in as little as 10.8 weeks.

Insights into the PPP Loan and Its Forgiveness

We receive many questions about the PPP. Here are two of them with our answers.

1. Good Faith at the Time

Question. What are your thoughts on the repercussions for business owners who acted in good faith based on the information available at the time and are now left to do things that may be more questionable to earn PPP loan forgiveness?

Answer. First, with good faith, there's no fraud issue as there is no fraud intent. Second, lenders and individuals had to scramble for a good two months or more before guidance was clarified, so many of the PPP loan application forms were murky (and some still are).

Obtaining the loan based on the guidance that existed at the time of your loan application and approval is a non-issue. Further, lenders used their own formulas during the early process (and in some cases, still use them) to determine the loan amounts.

As to taking "questionable" actions to earn forgiveness, if you follow the forgiveness applications, you are doing nothing questionable. And that's what you should do: follow the instructions in the loan forgiveness applications.

2. EIDL, EIDL Advance, and PPP

Question. I've heard of the Economic Injury Disaster Loan (EIDL), EIDL advance, and the PPP. What are the differences?

Answer. We'll deal with the big picture here. It will prove helpful.

PPP. The PPP is the cash infusion program of choice. The cash infusion part comes from a bank or other SBA lender and is based on your prior payroll (2019 in most cases). It comes into your business as a forgivable loan if you spend the money on defined payroll, interest, rent, and utilities during a period of up to 24 weeks.

Example. You receive a \$50,000 PPP loan and spend it within the 24 weeks on defined payroll with no reduction in your employee head count. You qualify for 100 percent forgiveness.

EIDL. Unlike the PPP loan, which comes from a bank or other approved SBA lender, the EIDL is a loan directly from the SBA; it carries a 3.75 percent interest rate, may require collateral, and must be repaid.

EIDL advance. The EIDL advance, when available, comes into play with the EIDL application. It's an advance on the EIDL of up to \$10,000. If you reject or don't receive an EIDL and don't have a PPP loan, the EIDL becomes a non-taxable grant and does not have to be repaid.

If you have a forgivable PPP loan, you reduce the amount of forgiveness by the amount of your EIDL advance.

Example. You have a forgivable PPP loan of \$30,000 and an EIDL advance of \$7,000. The lender will forgive \$23,000 of your \$30,000. Let's say you pay off the remaining \$7,000. In this case, you have received a net of \$30,000 ($\$7,000 + \$30,000 - \$7,000$).

All About Limited Liability Companies

Limited liability companies (LLCs) are a popular choice of entity for small businesses and investment activities. LLC owners are called members.

Single-member LLCs have one owner, although spouses who jointly own an LLC in a community property state can elect treatment as a single-member

LLC for federal income tax purposes. We will call LLCs with two or more members multimember LLCs.

Key point. LLCs are not corporations. But LLCs can offer similar legal protection to their members (owners).

Here are the most important things to know about LLCs.

LLCs Offer Legal Protection

Using an LLC to conduct a business or investment activity *generally* protects your personal assets from LLC-related liabilities—similar to the legal protection offered by a corporation.

As you know, liabilities can arise from simple things—like a delivery guy slipping on something you left on your front steps—or in seemingly endless and complicated ways if you have employees.

Key point. As a general rule, no type of entity (including an LLC) will protect your personal assets from exposure to liabilities related to your own professional malpractice or your own tortious acts.

Tortious acts are wrongful deeds other than by breach of contract—such as negligent operation of a motor vehicle resulting in property damage or injuries. The issue of liability protection offered by an LLC is a matter of state law. Seek advice from a competent business attorney for details.

Single-Member LLC Tax Basics

Single-member LLC businesses owned by individuals are treated as sole proprietorships for federal income tax purposes *unless* the member elects to treat the single-member LLC as a corporation.

In other words, the *default* federal income tax treatment for a single-member LLC business is sole proprietorship status. Under the default treatment, you

simply report all the single-member LLC's income and expenses on Schedule C of your Form 1040.

If the single-member LLC business activity generates net self-employment income, you will report that on Schedule SE of your Form 1040.

Rental. If the single-member LLC activity is a rental activity, you report the rental income and expenses on Schedule E of your Form 1040.

Farm or ranch. You report the numbers for a farming or ranching activity on Schedule F.

Simple. You don't need to file a separate federal income tax return for the single-member LLC. And other things being equal, simple is good.

Three key points

1. The big federal income tax advantage of operating as a single-member LLC is simplicity.
2. The big non-tax advantage is liability protection, under applicable state law.
3. As mentioned, you can elect to treat a single-member LLC as a corporation for federal income tax purposes, but we don't recommend that, for reasons we explain later.

Multimember LLC Tax Basics

Multimember LLCs are treated as partnerships for federal income tax purposes *unless* you elect to treat the LLC as a corporation.

In other words, the *default* federal income tax treatment for a multimember LLC is partnership status. Under the default treatment, you must file an annual partnership federal income tax return on Form 1065. From the Form 1065 partnership return, the LLC issues an annual Schedule K-1 to each member to

report that member's share of the LLC's income and expenses. The member then takes those taxable and deductible amounts into account on the member's own return (Form 1040 for a member who is an individual).

The LLC itself does not pay federal income tax. This arrangement is called *pass-through taxation*, because the income and expenses from the LLC's operations are passed through to the members, who then take them into account on their own returns. (The same pass-through taxation concept applies to entities set up as "regular" partnerships under applicable state law.)

Electing to Treat the LLC as a Corporation for Tax Purposes

You have the option of electing to treat a single-member LLC or multimember LLC as a corporation for federal income tax purposes. You do that by filing IRS Form 8832, *Entity Classification Election*, to change the default classification of the single-member LLC or multimember LLC to the new classification as a corporation.

If your desire is to have your LLC treated as an S corporation, it can elect S corporation status directly using IRS Form 2553, or it can elect C corporation treatment on Form 8832 and then S corporation treatment on IRS Form 2553. While there may be valid non-tax reasons for electing to treat an LLC as a corporation, we think tax reasons generally dictate against taking that step.

If you conclude that there are tax advantages to electing corporate status, why not just *actually* incorporate your operation in the first place? That's simpler. Keeping your tax matters simple is generally good policy.

Electing corporate status from the LLC could have unintended tax consequences. For example, you can potentially collect federal-income-tax-free gains from selling stock in a qualified small business corporation (QSBC). But you must own shares and hold them for over five years to cash in on this super-favorable deal.

Can an LLC membership (ownership) interest count as QSBC stock for this purpose? Apparently not. It's not stock.

If you are looking for the QSBC stock break, just set up as a corporation in the first place.

Here's another example: a special federal income tax break allows you to annually deduct up to \$50,000 of losses from selling eligible small business stock, or \$100,000 if you're a married joint filer, and treat the loss as a tax-favored ordinary loss instead of a tax-disfavored capital loss.

Can an LLC membership interest count as eligible stock for this purpose? Apparently not. It's not stock. Avoid the problem—set up as a corporation in the first place.