[Updates]

After much political gridlock, Congress passed an omnibus government-spending bill (Appropriations Act), which includes another COVID-19 relief package. The Appropriations Act contains many tax-related provisions. Some of the more notable of these provisions, and those discussed in this update, are provisions (1) clarifying the tax treatment of expenses paid with Paycheck Protection Program (PPP) loan proceeds, (2) temporarily providing for a 100% deduction of business meal expenses, (3) modifying the Employee Retention Tax Credit previously enacted under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (as described below), (4) extending the repayment period of certain deferred payroll taxes, and (5) extending the tax credits available to employers under the Families First Coronavirus Response Act (FFCRA) and Section 45S of the Internal Revenue Code of 1986, as amended (the Code) for employer-paid family and medical leave.

Clarifying the Tax Treatment of Expenses Paid with PPP Loan Proceeds

Superseding prior IRS Guidance, the Appropriations Act provides that expenses paid with PPP loan proceeds may be deductible.

- As discussed in some of our firm's prior updates (including here and here), under the CARES Act, loan forgiveness under the PPP loan program is excluded from gross income to the extent the loan proceeds are used for certain qualifying purposes.
- In Notice 2020-32, the Internal Revenue Service (IRS) limited the tax relief of the PPP loan program by clarifying that no deduction would be allowed for an expense that was otherwise deductible if the payment of the expense resulted in forgiveness under the PPP loan program. The IRS premised this clarification on the notion that deducting expenses that were paid with PPP loan proceeds which were already excluded from gross income would have constituted an impermissible "double tax benefit" under Section 265(a) of the Code. The IRS then expanded on this interpretation in Revenue Ruling 2020-27, holding that calendar year taxpayers could not deduct expenses paid for with PPP loan proceeds if, at the end of the calendar year, the taxpayer reasonably expected to receive forgiveness of the PPP loan.
- The Appropriations Act affirms that a recipient of PPP loan forgiveness need not include any amount in gross income by reason of such forgiveness. It also supersedes the IRS guidance relating to deductibility of expenses paid with PPP proceeds, providing that "no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied" by reason of the exclusion from gross income for forgiven PPP loan proceeds. Finally, the Appropriations Act clarifies that, for partnerships and S corporations, PPP loan forgiveness is to be treated as tax-exempt income, and that any increase in a partner's outside basis in a tax partnership by reason of a forgiven PPP loan being treated as tax-exempt income shall be equal to that partner's distributive share of the deductions resulting from costs giving rise to PPP loan forgiveness.
- The above Appropriations Act PPP tax treatment provisions apply to taxable years ending after the date of the enactment of the CARES Act (March 27, 2020), and thus are expected to apply to all PPP loans that are forgiven, regardless of whether the loan was received prior to, or after, passage of the Appropriations Act.
- The Appropriations Act also provides clarifications relating to the interaction between the PPP loan program and the Employee Retention Tax Credit available under the CARES Act. These clarifications are described in greater detail below.

Temporary 100% Deduction of Business Meal Expenses

Business meal expenses paid or incurred in 2021 or 2022 are 100% deductible (rather than merely 50% deductible).

- Prior to the Appropriations Act, subject to certain exceptions, taxpayers were limited in their ability to deduct expenses associated with business meals. Specifically, Section 274(n)(1) of the Code limited the deductibility of business meal expenses incurred for food and beverages to 50% of any such expenses.

- The Appropriations Act amends Section 274(n)(2) of the Code to temporarily provide for 100% deductibility with respect to expenses incurred "for food or beverages provided by a restaurant." Note that other requirements for deductibility, including that the expense be "ordinary" and "necessary" and incurred in carrying on a trade or business, remain intact.
- The increased deductibility of business meals expenses is temporary—100% deductibility applies only with respect to amounts paid or incurred after December 31, 2020, and before January 1, 2023.

Modifications to the Employee Retention Tax Credit

The Appropriations Act modifies the Employee Retention Tax Credit previously enacted under the CARES Act by, among other things, increasing the potential amount of the credit, expanding the number of employers who might qualify for the tax credit, and clarifying the availability of the tax credit to employers who also receive a PPP loan.

- Previously, under the CARES Act, certain qualified employers adversely affected by COVID-19 were eligible for a refundable Social Security tax credit for up to 50% of qualified wages paid during the COVID-19 crisis (Employee Retention Tax Credit). The Employee Retention Tax Credit was available with respect to the first $10,000 of qualified wages, including health benefits, paid to an eligible employee annually. Please see our previous update here describing the Employee Retention Tax Credit in greater detail.
- The Appropriations Act modifies the Employee Retention Tax Credit in various ways, including by (1) increasing the tax credit percentage from 50% of qualified wages to 70% of such wages, (2) increasing the $10,000 *annual* cap on eligible employee wages to a $10,000 *quarterly* cap on eligible employee wages, (3) extending the tax credit until June 30, 2021 (the credit was previously scheduled to expire on December 31, 2020), (4) providing that the credit may be available to employers who came into existence during 2019, and (5) allowing eligible employers with 500 or fewer employees to claim an advance payment of the tax credit for any quarter in an amount not to exceed 70% of the average quarterly wages paid by the employer during 2019 (subject to certain provisions for seasonal employers).
- The changes described in the above paragraph are effective for all calendar quarters beginning after December 31, 2020. In other words, the changes are not retroactive to the inception of the Employee Retention Tax Credit.
- The Appropriations Act also contains provisions clarifying the interaction between the PPP loan program and the Employee Retention Tax Credit. Previously, under the CARES Act, employers who received a PPP loan were ineligible for the Employee Retention Tax Credit. The Appropriations Act provides that that employers who receive a PPP loan may still qualify for the Employee Retention Tax Credit with respect to wages that are not paid for with PPP loan proceeds. As to the effective date of this change, unlike the effective date for the other modifications to the Employee Retention Tax Credit mentioned in this update, this modification to the Employee Retention Tax Credit is effective retroactive to the date the CARES Act was enacted.
- Accordingly, companies that received a PPP loan (and thus did not claim Employee Retention Tax Credits) should consider whether they could now be eligible to claim Employee Retention Tax Credits for 2020.

Extending the Repayment Period of Certain Deferred Payroll Taxes

The repayment period for the employee portion of certain payroll taxes previously deferred pursuant to IRS guidance has been extended through December 31, 2021.

- On August 28, 2020, the IRS issued Notice 2020-65, providing a basic framework for allowing the deferral of withholding, deposit, and payment of the employee's portion of Social Security taxes (the 6.2% tax on employee wages generally required to be withheld by employers) on certain qualifying wages, as directed by the presidential memorandum issued by President Donald Trump on August 8, 2020. Notice 2020-65 postponed the due date for the withholding, deposit, and payment of such taxes on qualifying wages paid between September 1, 2020, and December 31, 2020, with such deferred taxes to be repaid between January 1, 2021, and April 30, 2021.
- The Appropriations Act extends the repayment period through December 31, 2021. Thus, employers who deferred payroll taxes pursuant to the presidential memorandum and Notice 2020-65 must now withhold and pay the deferred tax amounts ratably between January 1, 2021, and December 31, 2021. Interest, penalties, and additions to tax will begin to accrue on January 1, 2022, with respect to any unpaid amounts.

Extending the Tax Credits Available to Employers Under the FFCRA and Section 45S of the Code for Employer-Paid Family and Medical Leave

The Appropriations Act extends through March 31, 2021, the payroll tax credits available to employers who provide FFCRA paid family and medical leave and extends through December 31, 2025, the income tax credits available under Section 45S of the Code to employers who provide paid family and medical leave.

- Described generally, under the FFCRA, eligible employees of certain employers are entitled to up to 12 weeks of job-protected leave if they are unable to work due to certain reasons related to COVID-19. To alleviate the cost to employers of providing such paid leave, the FFCRA provides employers with a tax credit against the employer's portion of Social Security taxes. The tax credit is equal to 100% of the paid leave wages required to be paid under the FFCRA. If the tax credit (wages paid out under the new benefit) exceeds the amount of the employer's portion of Social Security tax due for the applicable quarter, the employer may treat the excess as a refundable overpayment. The amount of any tax credit claimed by an employer is subject to certain limitations, including a cap tied to the type of leave taken by an employee ($511 per day in cases of leave taken to care for oneself and $200 per day where leave is taken to care for another individual). The amount of the tax credit that may be claimed by an employer is increased by an amount equal to the employer's portion of any Medicare taxes (imposed at a 1.45% rate) incident to the payment of paid leave wages under the FFCRA; however, this additional tax credit amount continues to operate as an offset to the Social Security tax, as described above. Additional discussion of the FFCRA and its provisions can be found here and here.
- The Appropriations Act extends the eligibility period for FFCRA credits to March 31, 2021, available to employers who provide FFCRA paid family and medical leave through March 31, 2021. However, the Appropriations Act does not mandate that employers provide FFCRA paid leave, and that mandate will

expire on December 31, 2020. Thus, in summary, after December 31, 2020, employers may *voluntarily* provide FFCRA paid leave to employees and will be remain eligible to receive the tax credit under the FFCRA with respect to such paid leave.

- Similar to the extension of the payroll tax credits available in conjunction with paid leave under the FFCRA, the Appropriations Act extends the employer income tax credit available under Section 45S of the Code for employer-paid family and medical leave (Section 45S Tax Credit). The Section 45S Tax Credit was originally enacted in 2017 as part of the Tax Cuts and Jobs Act, and it allows employers to claim a tax credit based on a percentage of wages paid to qualifying employees while they are on paid family and medical leave for up to 12 weeks per taxable year. The Section 45S Tax Credit was scheduled to expire on December 31, 2020 (after having received a one-year extension from its original expiration date of December 31, 2019). The Appropriations Act extends the Section 45S Tax Credit for an additional five years, with the tax credit now set to expire on December 31, 2025.

It is not currently clear when President Trump will sign the Appropriations Act into law or whether Congress will make any additional changes to the Appropriations Act. Once the Appropriations Act becomes law, we expect that the IRS may issue guidance addressing at least some of the above-described federal income tax considerations or the various other tax-related provisions in the Appropriations Act. We will continue to monitor federal tax developments related to the Appropriations Act and COVID-19, and we encourage you to reach out to any member of Perkins Coie's federal tax group with any questions you might have regarding these new provisions and initiatives.

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