

Publication

03/31/2020

Tax Savings in the Paycheck Protection Program

The Coronavirus Aid, Relief, and Economic Security Act (CARES) Act authorizes the Small Business Administration to make loans to allow “small businesses” to continue their payroll, and provides for cancellation of the loans under certain circumstances. Section 1106(i) of the CARES Act provides that the cancellation of the loan is excluded from gross income. Under general tax rules, loan cancellation income is taxable, unless an exception applies.

If one of the traditional exceptions applies, a taxpayer has to reduce its basis in assets or its loss carryforwards, to prevent a taxpayer from taking deductions for borrowed money that it did not include in income. There is no corresponding provision in the CARES Act.

So if a taxpayer borrows \$100,000 to pay wages, pays the wages and the loan is cancelled, the taxpayer has \$100,000 of tax deductions without effectively having come one dollar out of pocket.

Interesting issues will also arise in connection with the timing of the loan cancellation for a partnership or LLC. For example, can there be ordinary deductions coupled with capital gain? We at Neal Gerber Eisenberg will be looking at the application of this provision to private equity funds and other emerging issues.

If you have questions regarding the CARES Act or other tax planning issues, please do not hesitate to

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contact Scott Bakal or your Neal Gerber Eisenberg attorney.

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