KANSAS FARM MANAGEMENT ASSOCIATION

Building Strong Relationships...Producing Excellence

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The Consolidated Appropriations Act (CAA), signed by the President on December 27, 2020 made several significant changes to the Small Business Administration (SBA) Paycheck Protection Program (PPP) and the Employee Retention Credit (ERC) which may be beneficial to Kansas agricultural producers.

First Draw PPP Loan Updates

Deductible Expenses – In 2020, the CARES Act established that if proceeds from PPP loans were used for qualified expenses, the loan may be forgiven, and that the amount of loan forgiveness received was not to be included in taxable income. However, the Internal Revenue Service (IRS) specified that expenses used to calculate loan forgiveness were not deductible. In passing CAA, Congress reversed the IRS position and clarified that expenses used to determine PPP loan forgiveness *are deductible*.

First Draw PPP Reauthorized – The original PPP loan program was reauthorized through March 31, 2021. This allowed business owners that were not originally eligible, or chose not to apply for a loan, to apply for a First Draw PPP loan.

"Farmer" PPP – The original PPP loan amount was based on average monthly payroll costs. The term "payroll costs" included both the cost of wages paid to employees and owner compensation based on net earnings from Form 1040 Schedule F. This meant that a sole proprietor with a negative Schedule F was not allowed to include owner compensation in payroll costs and if they had no employees, they were not eligible to apply at all.

With CAA, agricultural producers are now allowed to use gross income from Schedule F, Line 9 (limited to $100,000) to determine the owner's payroll cost. This rule applies to sole proprietors and eligible self-employed farmers who were in business as of February 15, 2020. Based on guidance from SBA, it appears that this rule is not available to partnerships or corporations. When combined with the reauthorization of the First Draw PPP program, certain producers may be eligible to apply for a loan or modify an existing loan depending on the circumstances:

- ***No employees***
  - ***Negative Schedule F*** – Can now apply for a first draw PPP loan using gross income (Schedule F, line 9 limited to $100,000) as owner's payroll cost with a maximum loan amount of $20,833
  - ***Positive Schedule F*** – Can request a modification to first draw PPP loan using gross income (Schedule F, line 9 limited to $100,000) ***less*** net Schedule F amount included in original application as owner's payroll cost
- ***With employees***
  - ***Negative Schedule F*** – Can request a modification to first draw PPP loan using gross income (Schedule F, line 9 minus lines 15, 22, and 23 limited to $100,000) as owner's payroll cost
  - ***Positive Schedule F*** – Can request a modification to first draw PPP loan using gross income (Schedule F, line 9 minus lines 15, 22, and 23 limited to $100,000) ***less*** net Schedule F amount included in original application as owner's payroll cost

A request for modification can only be made if SBA had not remitted a forgiveness payment to the lender (the loan is forgiven). Contact the original PPP loan lender to request a loan modification.

Other Rule Changes

- For new first draw PPP loans, or modifications to an existing loan, a producer may use either 2019 or 2020 payroll costs to determine the loan amount
- Borrowers may now choose a covered period to pay or incur eligible expenses stretching from 8 weeks up to 24 weeks from the date loan proceeds are disbursed
- The list of eligible expenses for PPP loan forgiveness has been expanded to include certain payments for labor, rent, mortgage interest, utilities, certain business software and services, and goods that are essential to the operation. The requirement to spend at least 60 percent of the proceeds on payroll costs to receive full forgiveness has not changed

- A simplified loan forgiveness application is available for PPP loans under $150,000

Second Draw PPP Loan Created for 2021

Eligible agricultural producers, who received a first draw PPP loan during 2020, may be eligible for a second draw PPP loan, even if the first loan has been forgiven. A qualifying borrower is one who:

- Has 300 or fewer employees
- Has used, or will have used, all the original loan funds for authorized purposes before the new loan payments are disbursed
- Experienced a reduction in gross receipts of at least 25% in any calendar quarter of 2020 compared to the same quarter in 2019 **or** experienced an *annual* reduction in gross receipts of at least 25% in 2020 compared to 2019.
  - When comparing 2020 to 2019 on a *quarterly* basis, a producer will need to carefully review their accounting records, looking at receipts that make up farm income.
  - Alternatively, a producer can calculate change in gross receipts on an *annual* basis by comparing their 2020 tax return to their 2019 tax return.
  - While more guidance is needed, it appears that partnerships and corporations may see different results when calculating change in gross receipts quarterly (using accounting records) versus annually (using tax returns)

First draw PPP forgiveness received in 2020 is not included in gross income.

Borrowers may use payroll costs from either 2019 or 2020 to calculate their second draw PPP loan amount

2020 Employee Retention Credit

The CARES Act established the Employee Retention Credit (ERC) for 2020. At the time, an employer could choose between the ERC or a PPP loan and for many agricultural producers, the PPP was more advantageous. However, the CAA made it possible for an employer to utilize both an ERC and PPP loan, creating a last-minute scramble to determine ERC eligibility.

Eligible employers can claim a 2020 ERC against payroll withholding deposits of up to 50% of wages paid to certain employees during the employer's eligible period. The eligible period:

- Begins the first day of a 2020 calendar quarter where gross receipts fall below 50% of the same quarter in 2019
- Ends at the end of the first quarter (following the beginning quarter) where gross receipts exceed 80% of the same quarter in 2019

Wages paid prior to March 12, 2020 are not included in the credit calculation. The credit is limited to $5,000 per employee per year and is claimed on the employer's 2020 Form 943 (due January 31, 2021). Wages paid to most family members are not eligible for the credit. Keep in mind that wages used for the 2020 ERC cannot be included as payroll costs when calculating PPP loan forgiveness, limiting PPP forgiveness in certain situations.

Because of the required reduction in gross receipts, it may seem that few agricultural producers are eligible for the 2020 ERC as government payments and year-end grain prices were at levels not seen for some time. While that may be true when looking at the entire year, the credit is based on gross receipts in a calendar quarter. A difference in timing of grain sales, livestock sales, or equipment trades in 2019 compared to 2020 may result in a reduction in gross receipts that makes a producer eligible for the ERC even if there is no change in gross receipts when looking at the entire year.

Employers who receive an ERC based on 2020 wages must reduce payroll expenses reported on their 2020 tax return by the amount of the credit received.

2021 Employee Retention Credit

The Employee Retention Credit (ERC) continues into the first two quarters of 2021, with some modifications. Eligible employers can claim a 2021 ERC against payroll withholding deposits of up to 70% of wages paid to certain employees in Q1 or Q2 of 2021 if gross receipts for that quarter fall below 80% of the same quarter in *2019*. The 2021 credit is limited to $7,000 per employee *per calendar quarter* and is claimed when filing 2021 Form 943 or by filing Form 7200. As with the 2020 ERC, wages paid to employees cannot be used for both the ERC and PPP loan forgiveness.

Because agricultural producers have significant flexibility when it comes to timing of grain or livestock sales, there may be planning opportunities for the 2021 ERC. While grain or livestock sales deferred from 2020 to 2021 may limit flexibility in Q1 of 2021, but careful planning in Q2 may result in credit eligibility.

Please note that this summary is based on available guidance from the department of Treasury and the Small Business Administration as of January 19, 2021. It is not intended as tax advice and does not cover these provisions in detail. Please contact your KFMA Economist or tax advisor to learn more about how these provisions apply to your farm or ranch business.