

February 1, 2021

## Philadelphia's treatment of certain business tax provisions as a result of the Coronavirus Aid, Relief, and Economic Security (CARES) Act and The Consolidated Appropriations Act, 2021

### **Paycheck Protection Program (PPP): Business Income and Receipts Tax (BIRT) - Tax on Net Income (Method I and Method II Filers)**

- **Forgiveness of indebtedness on a loan**

Under the CARES Act, a recipient is eligible for forgiveness of indebtedness on a covered PPP loan in an amount equal to the sum of costs incurred and payments made during the covered period for payroll costs, interest payments on a covered mortgage obligation, any covered rent obligation, and covered utility payments (Act Sec. 1106(b)). Under the CARES Act, the portion of the PPP loan that is forgiven is excluded from gross income (Act Sec. 1106(i)).

**Philadelphia will conform to Act Sec. 1106(i) for the purpose of the Net Income portion of BIRT and exclude from gross income any amount forgiven under the PPP.** Note that this policy does not change the Department's general rule that loan forgiveness creates Receipts for BIRT purposes.

- **Deductions for covered expenses associated with PPP loans**

The Consolidated Appropriations Act, 2021 ("COVID-19 relief bill") clarifies 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 provided" by Sec. 1106 of the CARES Act. This provision applies to loans under both the original PPP and subsequent PPP loans. The bill supersedes IRS guidance that eligible expenses associated with PPP loans could not be deducted for federal income tax purposes (Notice 2020-32).

**Philadelphia will conform to the COVID-19 relief bill for the purpose of the Net Income portion of BIRT and allow deductions for eligible Section 1106 expenses to the extent the expenses were reimbursed by forgiven PPP loans.**

- **Tax on Gross Receipts**

The amount of a PPP loan and any amount of the loan that is forgiven under the CARES Act is excluded from a taxpayer's Receipts for purposes of the BIRT Gross Receipts Tax. Note that this policy does not change the Department's general rule that loan forgiveness creates Receipts for BIRT purposes.

- **Paycheck Protection Program (PPP): Net Profits Tax (NPT)**



For NPT purposes, consistent with our treatment of the PPP provisions for BIRT Method I taxpayers, Philadelphia will:

- Exclude from gross income any amount forgiven under the PPP;
  - Allow business deductions for eligible Section 1106 expenses to the extent the expenses were reimbursed by forgiven PPP loans.
- **Federal Employee Retention Credit (ERC)**

The ERC is a fully refundable payroll tax credit available to employers, including not-for-profits that had their operations fully or partially suspended as a result of a government order limiting commerce, travel or group meetings (the “suspension test”) due to COVID-19. The credit is also provided to employers who have experienced a greater than 50% reduction in quarterly receipts, measured on a year-over-year basis (the “gross receipts test”).

The ERC is intended to encourage eligible employers financially impacted by COVID-19 to keep employees on their payroll during the economic downturn. The employee retention credit is equal to 50% of up to \$10,000 of “qualified wages”<sup>1</sup> paid by eligible employers paid to both hourly and salaried employees from March 13, 2020, through December 31, 2020. The maximum amount of the fully refundable credit is \$5,000 per employee. Eligible employers report their total qualified wages for purposes of the ERC on their quarterly federal employment tax returns, usually Form 941.

Eligible employers that continue to provide their employees with healthcare coverage can now claim the ERC for these costs regardless of whether the employees continue to receive a salary.

*Update:* The Consolidated Appropriations Act, 2021 (“COVID-19 relief bill”) extends and expands the ERC through July 1, 2021. The bill increases the refundable payroll tax credit from a maximum of \$5,000 to \$14,000 per employee by changing the calculation from 50% of wages paid up to \$10,000 to 70% of wages paid up to \$10,000 for any quarter. The bill also clarifies that businesses will now be able to take the ERC and participate in the PPP.

**Philadelphia will include qualified wages as taxable compensation to the employee for City Wage Tax purposes.** BIRT Method II taxpayers will follow the federal treatment of qualified wages: 1) an employer’s tax deduction for qualified wages, including health plan expenses, will be reduced by the employee retention credit and 2) the employee retention credit will not be treated as gross income to the employer.

## **Modification of Limitation on Business Interest Expense**

The CARES Act amends IRC Section 163(j) for tax years beginning in 2019 and 2020. With the exception of partnerships, taxpayers may deduct business interest expense up to 50% of their adjusted taxable income (ATI), an increase from 30% of ATI under the TCJA, unless an election is made to use the lower limitation for any taxable year. In addition, for any tax year beginning in 2020, a taxpayer may elect to use its 2019 ATI for purposes of computing the 2020 Section



163(j) limitation. This will benefit taxpayers who may have reduced 2020 earnings as a result of the COVID-19 crisis.

The CARES Act includes special rules for partnerships. The increased 50% ATI threshold only applies to taxable years beginning in 2020. For any taxable year beginning in 2019, excess business interest expense (i.e., business interest expense exceeding 30% percent of the partnership's adjusted taxable income) allocated by a partnership to a partner from a taxable year beginning in 2019 would be bifurcated. 50% of that excess business interest expense would be treated as paid or accrued in 2020 and is fully deductible by the partner without regard to the section 163(j) limitation. The remaining 50% of excess business interest expense would be subject to the existing rules, which generally treat excess business interest expense as paid or accrued only if the partner receives an allocation of excess taxable income or excess business interest income in a later year from the same partnership.

**Philadelphia will conform to the CARES Act amendment to IRC Section 163(j) for tax years beginning in 2019 and 2020 and the special rules for partnerships.** As indicated in our Tax Cuts and Jobs Act (TCJA) Advisory Notice (May 29, 2019), absent authorizing Pennsylvania legislation decoupling a taxpayer's federal interest expense deduction for Philadelphia BIRT purposes, taxpayers are obligated to use the federal interest expense deduction calculated on a separate entity basis.

### **Technical Amendments Regarding Qualified Improvement Property (QIP) under IRC Section 168 (CARES Act Section 2307)**

The CARES Act includes a technical correction that corrects the 2017 Tax Act to permit 100% bonus depreciation for eligible QIP placed in service by the taxpayer after December 31, 2017 and before January 1, 2023. This technical correction is made to IRC Section 168 and provides an opportunity for taxpayers that placed eligible QIP in service during 2018 and 2019 to claim 100% bonus depreciation. The CARES Act also amends the IRC to include a 15-year regular MACRS recovery period for QIP. The Act also updates the ADS depreciation recovery period for QIP to 20 years.

**Philadelphia is required by law to follow the Commonwealth of Pennsylvania rules on federal bonus depreciation.** Pennsylvania (and therefore Philadelphia) are decoupled from the federal 100% bonus depreciation deduction allowed for qualified properties acquired and placed into service after September 27, 2017 and before January 1, 2023. The change to 100% bonus depreciation for federal taxes was part of the federal Tax Cuts and Jobs Act (TCJA).

See our Advisory Notice - Bonus Depreciation Policy Update (July 31, 2018)

Email [revenuetaxadvisors@phila.gov](mailto:revenuetaxadvisors@phila.gov) with additional questions.