# Current Federal Tax Developments

Week of December 14, 2020

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ACCOUNTING
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CURRENT FEDERAL TAX DEVELOPMENTS
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# SECTION: 401
# IRS RELEASES GUIDANCE IN FORM OF Q&AS ON SECTIONS 102 AND 103 OF SECURE ACT

## Citation: Notice 2020-86, 12/9/20

The IRS has issued Notice 2020-86[1] which gives a set of questions and answers related to the following two provisions of the SECURE Act:

- §102 of the SECURE Act increases the 10 percent cap for automatic enrollment safe harbor plans.
- §103 of the Secure Act eliminates certain safe harbor notice requirements for plans that provide for safe harbor nonelective contributions and adds new provisions for the retroactive adoption of safe harbor status for those plans.[2]

### *Guidance Related to Secure Act §102: Increase in 10 Percent Cap for Auto-Enrollment Safe Harbor*

The notice begins by noting that the SECURE Act changes do not require that a qualified automatic contribution arrangement (QACA) safe harbor §401(k) plan increase the automatic deferral:

> **Q-1. In order to maintain its status as a QACA safe harbor § 401(k) plan, is a QACA safe harbor § 401(k) plan required, pursuant to § 102(a) of the SECURE Act, to increase the maximum qualified percentage of compensation used to determine automatic elective contributions?**
>
> A-1. No. The qualified percentage under a QACA safe harbor § 401(k) plan may be any percentage of compensation determined under the plan, as long as the percentage is applied uniformly, does not exceed the maximum percentage specified in § 401(k)(13)(C)(iii) (15 percent, or 10 percent during the initial period of automatic elective contributions described in § 401(k)(13)(C)(iii)(I)), and satisfies certain minimum percentage requirements specified in § 401(k)(13)(C)(iii)(I) – (IV).

The notice next discusses what needs to be done with a plan that incorporates the maximum percentage of §401(k)(13)(C)(iii) by reference—a rate that has now been changed. The question and answer for this are:

> **Q-2. If a plan incorporates the maximum qualified percentage of § 401(k)(13)(C)(iii) by reference, will the plan fail to operate in**

[1] Notice 2020-86, December 9, 2020, https://www.irs.gov/pub/irs-drop/n-20-86.pdf (retrieved December 9, 2020)

[2] Notice 2020-86, Section I, December 9, 2020

**accordance with its terms merely because the plan continues to apply the maximum qualified percentage of 10 percent that applied under § 401(k)(13)(C)(iii) of the Code before that section was amended by § 102(a) of the SECURE Act?**

A-2. No. However, the plan would need to be amended on or before the plan amendment deadline determined under § 601(b) of the SECURE Act,3 as described in Q&A G-1 of Notice 2020-68, to provide explicitly that the plan's maximum qualified percentage is 10 percent, retroactive to the first day of the first plan year beginning after December 31, 2019. If a plan incorporates the maximum qualified percentage of § 401(k)(13)(C)(iii) of the Code by reference and the plan is not amended on or before the plan amendment deadline determined under § 601(b) of the SECURE Act to provide a specific maximum qualified percentage, then the plan will be treated as providing for the maximum qualified percentage specified in § 401(k)(13)(C)(iii) of the Code, as amended by § 102(a) of the SECURE Act, effective as of the first day of the first plan year beginning after December 31, 2019. In this case, the plan will have failed to operate in accordance with its terms by applying the maximum qualified percentage of 10 percent that applied under § 401(k)(13)(C)(iii) of the Code before that section was amended by § 102(a) of the SECURE Act.

Finally, the notice discusses the timing of plan amendments related to this provision:

**Q-3. What plan amendment timing rules apply to a plan amendment that increases the maximum qualified percentage of compensation used to determine automatic elective contributions to a percentage greater than 10 percent (but no greater than 15 percent) after the initial period of automatic elective contributions described in § 401(k)(13)(C)(iii)(I)?**

A-3. In general, the plan amendment timing provisions of § 601 of the SECURE Act, as described in Q&A G-1 of Notice 2020-68, apply to a plan amendment adopted under § 102 of the SECURE Act. In addition, a plan may be amended to reflect § 102 of the SECURE Act after the applicable plan amendment deadline under § 601 of the SECURE Act, in accordance with the general discretionary amendment deadlines set forth in Rev. Proc. 2016-37, 2016-29 IRB 136, as most recently modified by Rev. Proc. 2020-40, 2020-38 IRB 575.

## *Guidance Related to Secure Act §103: Safe Harbor Notice Requirements and Retroactive Safe Harbor Status For Plans That Provide Safe Harbor Nonelective Contributions*

While only three questions addressed the issues with the auto-enrollment cap, there are ten questions dealing with the changes to the notice requirements for changes in safe harbor plans found in Secure Act §103.

The first question deals with how §103(a) of the SECURE Act affects the safe harbor notice requirement for a traditional safe harbor §401(k) plan or a traditional safe harbor §401(m) plan.

> **Q-4. How does § 103(a) of the SECURE Act affect the safe harbor notice requirements for a traditional safe harbor § 401(k) plan or a traditional safe harbor § 401(m) plan?**
>
> A-4. Section 103(a) of the SECURE Act amended the requirements for a traditional safe harbor § 401(k) plan that satisfies the safe harbor nonelective contribution requirements of § 401(k)(12)(C) of the Code by eliminating the safe harbor notice requirements of § 401(k)(12)(D) (including the requirement under § 1.401(k)-3(d)(3)(i) to provide a safe harbor notice within a reasonable period before an employee becomes eligible). However, § 103(a) of the SECURE Act did not eliminate the safe harbor notice requirements of § 401(m)(11)(A) of the Code for a traditional safe harbor § 401(m) plan that satisfies the safe harbor nonelective contribution requirements of § 401(k)(12)(C).
>
> Thus, for example, if a traditional safe harbor § 401(k) plan satisfies the safe harbor nonelective contribution requirements of § 401(k)(12)(C), but also provides non-safe harbor matching contributions that are structured to satisfy the requirements of § 1.401(m)-3(d) (and, therefore, are not required to satisfy the ACP test), then the plan still must satisfy the safe harbor notice requirements of § 401(m)(11)(A). On the other hand, if a traditional safe harbor § 401(k) plan that satisfies the safe harbor nonelective contribution requirements of § 401(k)(12)(C) also provides non-safe harbor matching contributions that are not intended to satisfy the requirements of § 1.401(m)-3(d) (and, therefore, are required to satisfy the ACP test), then the plan need not satisfy the safe harbor notice requirements of either § 401(k)(12)(D) or 401(m)(11)(A).

The notice goes on to give information on the impact on a QACA safe harbor § 401(k) plan or a QACA safe harbor § 401(m) plan.

> **Q-5. How does § 103(a) of the SECURE Act affect the safe harbor notice requirements for a QACA safe harbor § 401(k) plan or QACA safe harbor § 401(m) plan?**
>
> A-5. Section 103(a) of the SECURE Act amended the requirements for a QACA safe harbor § 401(k) plan that satisfies the safe harbor nonelective contribution requirements of § 401(k)(13)(D)(i)(II) of the Code by eliminating the safe harbor notice requirements of § 401(k)(13)(E) (including the requirement under § 1.401(k)-3(d)(3)(i) to provide a notice within a reasonable period before an employee becomes eligible). The amendments made by § 103(a) of the SECURE Act also result in the elimination of any safe harbor notice requirement under § 401(m)(12) of the Code for a QACA safe harbor § 401(m) plan that satisfies the safe harbor nonelective contribution requirements of § 401(k)(13)(D)(i)(II). The result is different for a traditional safe harbor § 401(m) plan, as described in Q&A-4 of this

notice, than for a QACA safe harbor § 401(m) plan because § 401(m)(11) specifically requires a traditional safe harbor § 401(m) plan to satisfy the safe harbor notice requirements of § 401(k)(12)(D), but § 401(m)(12)(A) merely requires a QACA safe harbor § 401(m) plan to satisfy the requirements for a QACA safe harbor § 401(k) plan.

Question 6 deals with the impact on other requirements of SECURE Act §103(a).

**Q-6. Does § 103(a) of the SECURE Act change any other requirements?**

A-6. No. Section 103(a) of the SECURE Act does not change any other requirements that may apply to a plan that satisfies the safe harbor nonelective contribution requirements applicable to a traditional or QACA safe harbor § 401(k) plan under § 401(k)(12)(C) or 401(k)(13)(D)(i)(II) of the Code. For example, § 103(a) of the SECURE Act did not change the notice requirements under § 414(w)(4) of the Code for a plan that permits, pursuant to the eligible automatic contribution arrangement rules of § 414(w), an employee to elect to withdraw automatic elective contributions (and earnings) no later than 90 days after the date of the first elective contribution with respect to the employee under the eligible automatic contribution arrangement. Accordingly, the § 414(w)(4) notice requirements continue to apply even if the plan satisfies the safe harbor nonelective contribution requirements of § 401(k)(12)(C) or 401(k)(13)(D)(i)(II).

As another example, § 103(a) of the SECURE Act did not change the requirement under § 1.401(k)-1(e)(2)(ii) that a cash or deferred arrangement (including an arrangement in a plan that satisfies the safe harbor nonelective contribution requirements of § 401(k)(12)(C) or 401(k)(13)(D)(i)(II) of the Code) provide an employee with an effective opportunity, determined based on all the relevant facts and circumstances, including the adequacy of notice of the availability of a cash or deferred election, to make (or change) a cash or deferred election at least once during each plan year.

Question 7 looks at issues when a plan does not provide a safe harbor notice, but provides a notice that includes a statement that the plan may be amended mid-year to reduce or suspend safe-harbor contributions:

**Q-7. If a plan does not provide a safe harbor notice for a plan year beginning after December 31, 2019 (because, pursuant to § 103(a) of the SECURE Act and Q&A-4 or Q&A-5 of this notice, safe harbor notice requirements no longer apply to the plan), but the employer nevertheless provides a notice that includes a statement that the plan may be amended mid-year to reduce or suspend safe harbor nonelective contributions, as described in §§ 1.401(k)-3(g)(1)(ii)(A)(2) and 1.401(m)-3(h)(1)(ii)(A)(2), and that otherwise satisfies the requirements for a safe harbor notice, will the plan fail to satisfy the condition in § 1.401(k)-3(g)(1)(ii)(A)(2) or 1.401(m)-3(h)(1)(ii)(A)(2) that the statement regarding the possible mid-year reduction or suspension of safe**

**harbor nonelective contributions be included in a safe harbor notice?**

A-7. No. The plan will not fail to satisfy § 1.401(k)-3(g)(1)(ii)(A)(2) or 1.401(m)-3(h)(1)(ii)(A)(2) merely because the employer included the statement described in §§ 1.401(k)-3(g)(1)(ii)(A)(2) and 1.401(m)-3(h)(1)(ii)(A)(2) in a notice that otherwise satisfies the requirements for a safe harbor notice (rather than in an actual safe harbor notice).4 Further, solely with respect to the first plan year beginning after December 31, 2020, a notice will be treated as satisfying the requirement under §§ 1.401(k)-3(d)(3) and 1.401(m)-3(e) that the notice be provided within a reasonable period before the beginning of the plan year if the notice is given to each eligible employee by the later of (1) 30 days before the beginning of the plan year, or (2) January 31, 2021. However, except as provided in Q&A-8 of this notice, the plan must satisfy all other requirements set forth in § 1.401(k)-3(g)(1)(ii) or 1.401(m)-3(h)(1)(ii), as applicable, in order to reduce or suspend safe harbor nonelective contributions during the plan year.

Question 8 deals with a traditional or QACA safe harbor §401(k) plan that is first amended to reduce or suspend the plan's safe harbor nonelective contributions during the plan year, but then later amends the plan to readopt the safe harbor nonelective contributions for the remainder of the plan year.

**Q-8. If an employer amends a traditional or QACA safe harbor § 401(k) plan (or a traditional or QACA safe harbor § 401(m) plan) to reduce or suspend the plan's safe harbor nonelective contributions during a plan year, but later amends the plan to readopt the safe harbor nonelective contributions in accordance with § 401(k)(12)(F) or 401(k)(13)(F) for the entirety of the plan year, will the plan be required to satisfy the ADP or ACP test (as applicable) for the plan year or be subject to the top-heavy rules under § 416 for the plan year?**

A-8. No. The retroactive plan amendment provisions of §§ 401(k)(12)(F) and 401(k)(13)(F) of the Code, as amended by § 103 of the SECURE Act, are not conditioned on whether a prior plan amendment reduced or suspended safe harbor nonelective contributions during the plan year. Accordingly, the plan will not be required to satisfy either § 1.401(k)-3(g)(1)(ii)(E) (ADP testing) or 1.401(m)-3(h)(1)(ii)(E) (ACP testing) for the plan year and, pursuant to § 416(g)(4)(H) of the Code, the plan will not be subject to the top-heavy rules under § 416 for the plan year.

Question 9 deals with a situation when safe harbor payments under an amendment are paid after the due date for filing the sponsor's tax return, but before the last day for distributing excess contributions.

**Q-9. If a plan is amended pursuant to § 401(k)(12)(F)(i)(II) (traditional) or 401(k)(13)(F)(i)(II) (QACA) to adopt safe harbor nonelective contributions of at least four percent of**

**compensation for a plan year, and the safe harbor nonelective contributions are contributed to the plan after the tax filing deadline for the prior taxable year (including extensions) but before the last day under § 401(k)(8)(A) for distributing excess contributions for the plan year, are the safe harbor nonelective contributions deductible for the prior taxable year?**

A-9. No. Section 404(a)(6) provides that a taxpayer will be deemed to have made a payment on the last day of the prior taxable year if the payment is on account of that taxable year and is made not later than the time prescribed by law for filing the return for that taxable year (including extensions). Therefore, the safe harbor nonelective contributions are not deductible for the prior taxable year because they are contributed to the plan after the latest date permitted under § 404(a)(6) for a contribution to be deductible for the prior taxable year. However, the safe harbor nonelective contributions are deductible for the taxable year in which they are contributed to the plan, to the extent otherwise deductible under § 404.

Questions 10-13 discuss retroactive plan amendment rules.

**Q-10. For plan years beginning after December 31, 2019, do the retroactive plan amendment requirements of § 401(k)(12)(F) or 401(k)(13)(F) of the Code, as amended by § 103 of the SECURE Act, apply to an amendment adopted during a plan year that adds the traditional or QACA safe harbor design set forth in § 401(k)(12) or 401(k)(13) of the Code for the plan year using safe harbor nonelective contributions (rather than the retroactive plan amendment rules in § 1.401(k)-3(f))?**

A-10. Yes. Effective for plan years beginning after December 31, 2019, in order for a plan to be amended during a plan year to adopt the safe harbor design set forth in § 401(k)(12) or 401(k)(13) for the plan year using safe harbor nonelective contributions, the plan must satisfy the retroactive plan amendment requirements of § 401(k)(12)(F) or 401(k)(13)(F) of the Code, as amended by § 103 of the SECURE Act. Accordingly, the retroactive plan amendment rules of § 1.401(k)-3(f) no longer apply for those plan years.

**Q-11. For plan years beginning after December 31, 2019, do the retroactive plan amendment requirements of § 401(k)(13)(F) of the Code, as amended by § 103 of the SECURE Act, apply to an amendment adopted during a plan year that adds the safe harbor design set forth in § 401(m)(12) of the Code (QACA) for the plan year using safe harbor nonelective contributions (rather than the retroactive plan amendment rules in § 1.401(m)-3(g))?**

A-11. Yes. Effective for plan years beginning after December 31, 2019, in order for a plan to be amended during a plan year to adopt the safe harbor design set forth in § 401(m)(12) for the plan year using safe harbor nonelective contributions, the plan must satisfy the retroactive plan amendment requirements of § 401(k)(13)(F) of the Code, as

amended by § 103 of the SECURE Act. Accordingly, the retroactive plan amendment rules of § 1.401(m)-3(g) no longer apply for those plan years.

**Q-12. For plan years beginning after December 31, 2019, do the retroactive plan amendment requirements of § 401(k)(12)(F) of the Code, as amended by § 103 of the SECURE Act, apply to an amendment adopted during a plan year that adds the safe harbor design set forth in § 401(m)(11) of the Code (traditional) for the plan year using safe harbor nonelective contributions (rather than the retroactive plan amendment rules in § 1.401(m)-3(g))?**

A-12. No. As described in Q&A-4 of this notice, § 103(a) of the SECURE Act did not eliminate the safe harbor notice requirements of § 401(m)(11)(A) of the Code for a traditional safe harbor § 401(m) plan that satisfies the safe harbor nonelective contribution requirements of § 401(k)(12)(C). Accordingly, a plan sponsor must comply with the retroactive plan amendment rules of § 1.401(m)-3(g) (including both the contingent and follow-up notice requirements under § 1.401(k)-3(f)) in order for the plan to qualify as a safe harbor design set forth in § 401(m)(11) after the beginning of the plan year using safe harbor nonelective contributions.

**Q-13. What plan amendment timing rules apply to a plan amendment that is adopted after the beginning of a plan year to provide that the safe harbor nonelective contribution requirements of § 401(k)(12)(C) (traditional) or 401(k)(13)(D)(i)(II) (QACA) will apply for the plan year, in accordance with § 103(b) or (c) of the SECURE Act?**

A-13. In general, the plan amendment timing provisions of § 601 of the SECURE Act, as described in Q&A G-1 of Notice 2020-68, apply to a plan amendment adopted under § 103(b) or (c) of the SECURE Act (even if the applicable plan amendment deadline under § 601 of the SECURE Act is later than the deadline under § 103(b) or (c) of the SECURE Act). In addition, a plan may be amended after the applicable plan amendment deadline under § 601 of the SECURE Act, in accordance with the plan amendment provisions of § 103(b) or (c) of the SECURE Act (which provide an exception to the general discretionary amendment deadlines set forth in Rev. Proc. 2016-37, as most recently modified by Rev. Proc. 2020-40).

# SECTION: 6651
# AICPA AND SIX OTHER TAX RELATED ORGANIZATION SEND ADDITIONAL LETTER TO IRS OUTLINING NEED FOR AGENCY TO SET UP SPECIAL COVID RELATED PENALTY RELIEF

## Citation: December 7, 2020 Letter from the alliantgroup, LP, AICPA, NAEA, NATP, NCCPAP, NSTP and Padgett Business Services, 12/7/20

On November 18, 2020 we noted reports of the IRS Commissioner's statement that more COVID-related penalty relief was "not going to happen" when speaking to the AICPA National Conference on Federal Taxes, as well as the reaction from the AICPA's Chief Tax Officer Ed Karl, stating rather pointed disagreement with this decision.[3]

Now the AICPA, along with six other tax groups, has issued a new letter again requesting relief, this time addressed to both Commissioner Rettig and Treasury Assistant Secretary (Tax Policy) (and former interim Commissioner) David Kautter.[4] In addition to the AICPA, which had previously written a letter to which Commissioner Rettig was responding to at the conference, the following groups signed onto this letter:

- alliantgroup, LP
- National Association of Enrolled Agents (NAEA)
- National Association of Tax Professionals (NATP)
- National Conference of CPA Practitioners (NCCPAP)
- National Society of Tax Professionals (NSTP) and
- Padgett Business Services.

The letter begins by describing the problems, and pointedly notes that the IRS, through botched notices, has contributed to the problems facing taxpayers and tax professionals:

> The Coronavirus Disease 2019 pandemic (commonly known as "Coronavirus") has created unique challenges for the Internal Revenue

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[3] Ed Zollars, "IRS Commissioner Rejects AICPA Call For COVID-19 Relief on Late-Payment and Late-Filing Penalties," *Current Federal Tax Developments* website, November 18, 2020 (https://www.currentfederaltaxdevelopments.com/blog/2020/11/18/irs-commissioner-rejects-aicpa-call-for-covid-19-relief-on-late-payment-and-late-filing-penalties retrieved December 8, 2020)

[4] December 7, 2020 Letter from the alliantgroup, LP, AICPA, NAEA, NATP, NCCPAP, NSTP and Padgett Business Services, December 7, 2020

> Service (IRS), taxpayers and tax professionals alike. The organizations signed onto this letter are in a distinctive position to understand those challenges. The reality is that for many Americans, the global pandemic has created obstacles preventing many taxpayers and their advisors from timely filing returns or making timely payments despite their best efforts. Additionally, the IRS sent mistargeted notices resulting from their inability to process some timely filed returns and timely paid taxes. Indeed, the current state of the IRS, including a reduced workforce, mail backlog, and premature compliance actions call attention to the situation.[5]

The short, two-page letter, then continues to request the following relief:

> A concerted effort to address these problems is needed as we are all, unfortunately, facing illness, death, economic hardships or other Coronavirus related tests. We, therefore, ask the IRS and the Department of the Treasury to:
>
> - Provide targeted penalty relief through the creation of an expedited and streamlined reasonable cause penalty abatement process to taxpayers affected by the Coronavirus pandemic that eliminates the need for written requests;
>
> - Develop specific Coronavirus examples, for impacts on both taxpayers and tax professionals, where the taxpayer can self-certify that they qualify for reasonable cause abatement and share these examples with all telephone assistors through interim guidance; and
>
> - Develop a dedicated telephone number, or dedicated prompt, for taxpayers or their advisors to call to request Coronavirus-related penalty relief.[6]

In a footnote, the authors of the letter suggest that a self-certification program of the type requested in the second bullet could be modeled on the late IRA rollover relief self-certification program the IRS established in Revenue Procedure 2016-47.[7]

Given the Commissioner's previous rejection out of hand of such relief, it's not clear that this letter will change his mind. But it does put the issue on the record, as well as moving pressure up the line into Treasury itself.

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[5] December 7, 2020 Letter from the alliantgroup, LP, AICPA, NAEA, NATP, NCCPAP, NSTP and Padgett Business Services, December 7, 2020

[6] December 7, 2020 Letter from the alliantgroup, LP, AICPA, NAEA, NATP, NCCPAP, NSTP and Padgett Business Services, December 7, 2020

[7] December 7, 2020 Letter from the alliantgroup, LP, AICPA, NAEA, NATP, NCCPAP, NSTP and Padgett Business Services, December 7, 2020. See our article on Revenue Procedure 2016-47 at "IRS Provides for Automatic Qualified Plan/IRA Late Rollover Relief," *Current Federal Tax Developments* website, August 24, 2016 (https://www.currentfederaltaxdevelopments.com/blog/2016/8/24/irs-provides-for-automatic-qualified-planira-late-rollover-relief retrieved December 8, 2020)

# SECTION: CARES
# GUIDANCE ON INFORMATION REPORTING RESPONSIBILITIES FOR PAYMENTS UNDER CARES ACT §1112 MADE BY SBA

## Citation: SBA Information Notice, Control No. 5000-20067, Tax Issues Relating to the Payments Made on Behalf of Borrowers under Section 1112 of the CARES Act,

The Small Business Administration has issued information on tax reporting for payments made under §1112 of the CARES Act.[8] That provision provided that the government, via the SBA, would pay principal and interest for loans covered by §7(a) of the Small Business Act for a period of six months.[9]

Although the Act did not provide any explicit guidance governing whether such payments were to be treated as income by the recipient, Congress did not specifically provide that the amounts were not to be treated as taxable income, unlike the explicit provision treating forgiveness of PPP debt as not being subject to tax.[10]

IRC §61 broadly defines gross income as "all income from whatever source derived, including (but not limited to)" a long list of items, including "[i]ncome from the discharge of indebtedness…"[11] Thus, from the very beginning, it appeared that these payments would represent taxable income to the businesses who had a portion of their debts paid.

### *SBA Notice*

The notice effectively confirms the amounts represent a form of income, outlining Form 1099 and Form 1098 reporting responsibilities. The notice begins:

> In April 2020, SBA began making payments under Section 1112 of the CARES Act to cover, for a 6-month period, the principal, interest, and any associated fees that small businesses owe on 7(a), 504, and Microloans ("Section 1112 payments"). These Section 1112 payments relieve the small businesses of the obligation to pay that amount. SBA is providing the following information to 7(a) Lenders, Microloan Intermediaries, and Certified Development Companies with respect to

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[8] SBA Information Notice, Control No. 5000-20067, Tax Issues Relating to the Payments Made on Behalf of Borrowers under Section 1112 of the CARES Act, December 8, 2020 (https://www.sba.gov/sites/default/files/articles/5000-20067.pdf?utm_medium=email&utm_source=govdelivery retrieved December 12, 2020)

[9] CARES Act, §1112

[10] CARES Act, §1106(i)

[11] IRC §61(a)(11)

> information reporting issues arising from the Section 1112 payments…[12]

The notice provides the following guidance to the lenders regarding the involved parties' responsibilities for filing a Form 1099MISC reporting this income to the borrower:

> In accordance with section 6041 of the Internal Revenue Code ("Code") and the regulations thereunder, the following are responsible for issuing the Form 1099- MISC with respect to the Section 1112 payments:
>
> - 7(a) Lenders are responsible for issuing the Form 1099-MISC for: (1) loans that have not been purchased by SBA, and (2) loans that have been purchased by SBA and are serviced by the 7(a) Lender. SBA is responsible for issuing the Form 1099-MISC for 7(a) loans that have been purchased, and are serviced, by SBA.
>
> - Microloan Intermediaries are responsible for issuing the Form 1099-MISC for the Microloans serviced by the Intermediaries. SBA is responsible for issuing the Form 1099-MISC for the Microloans that are serviced by SBA.
>
> - SBA is responsible for issuing the Form 1099-MISC for all 504 loans. Lenders and Microloan Intermediaries should refer to the Instructions for Form 1099- MISC and the General Instructions for Certain Information Returns for more information about filing and furnishing the forms, including requirements to file electronically. Microloan Intermediaries and 7(a) Lenders should contact IRS's Stakeholder Liaison Local Contacts at https://www.irs.gov/businesses/smallbusinesses-self-Employed/stakeholder-liaison-local-contacts (link provided to SBA by the U.S. Department of the Treasury) with any questions concerning the information reporting of the Section 1112 payments.[13]

The notice provides that the following amounts are to be reported as income on the Form 1099MISC:

> *The total amount of the Section 1112 payments must be reported as income to the Borrower, including the principal, interest and any fees that were included in the*

[12] SBA Information Notice, Control No. 5000-20067, Tax Issues Relating to the Payments Made on Behalf of Borrowers under Section 1112 of the CARES Act, p. 1

[13] SBA Information Notice, Control No. 5000-20067, Tax Issues Relating to the Payments Made on Behalf of Borrowers under Section 1112 of the CARES Act, pp. 1-2

> *Section 1112 payments. (emphasis added)* This total amount should be included in Box 3 of Form 1099-MISC.[14]

The notice continues, outlining who is to be shown as the payor and recipient on the Form 1099MISC related to CARES Act §1112 payments:

> The 7(a) Lender and Microloan Intermediary should be identified as the PAYER in the "Payer" box in Form 1099-MISC, with its name, street address, city or town, state or province, country, ZIP code, and telephone number. The Borrower of the 7(a) loan or the Microloan should be listed as the "RECIPIENT" in Form 1099-MISC.[15]

The notice concludes by noting that even though interest may have been paid with CARES Act §1112 payments, if a Form 1098 is required to be issued on the obligation that interest should be reported on the Form 1098:

> In accordance with section 6050H of the Code and the regulations thereunder, the amount of interest paid on the loan by the Section 1112 payments should be reported to the IRS, and furnished to small businesses, on Form 1098, Mortgage Interest Statement.[16]

## *Tax Treatment on the Recipient's Return*

Note that the SBA is not indicating that the payments should be treated as cancellation of debt, with a Form 1099C being issued. Rather this is being viewed as some other form of income.

While it might seem that there's little difference—the amounts represent ordinary income—if a borrower is insolvent while some or all of the payments are paid, it becomes important whether this is a cancellation of indebtedness or some other form of income. The issue is that IRC §108 provides relief in certain cases from having to report some or all cancellation of debt income if certain requirements are met. A key one that could apply to some borrowers is the exclusion under §108(a)(1)(B) if the taxpayer is insolvent at the time the debt is cancelled.

In this case it does seem the most supportable view is that the payments do not represent cancellation of indebtedness. The debt in this case is not payable to the SBA in most cases, but rather the federal government has stepped in to make such payments on behalf of the businesses. Thus the lender did not cancel the debt in question.

Note that there are cases, as the notice points out, where the SBA will have purchased the loan and may even be servicing the loan. The notice does not treat such loans differently from those held by another lender, most likely to provide a consistent result.

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[14] SBA Information Notice, Control No. 5000-20067, Tax Issues Relating to the Payments Made on Behalf of Borrowers under Section 1112 of the CARES Act, p. 2

[15] SBA Information Notice, Control No. 5000-20067, Tax Issues Relating to the Payments Made on Behalf of Borrowers under Section 1112 of the CARES Act, p. 2

[16] SBA Information Notice, Control No. 5000-20067, Tax Issues Relating to the Payments Made on Behalf of Borrowers under Section 1112 of the CARES Act, p. 2

But there may be some room to argue that in this case, the lender is truly forgiving a portion of the debt.

The borrower should be able to claim a deduction for the interest paid on the business's behalf, as the business is reporting such a payment as income. Thus, for most practical purposes, the payment of the principal and any otherwise nondeductible amounts would be the net amount taxable under this program.

# SECTION: PPP LOAN
# SBA ADDS QUESTION AND ANSWER TO PPP FAQ REGARDING FORMS 3509 AND 3510

## Citation: Paycheck Protection Program Frequently Asked Questions, As of December 9, 2020, Small Business Administration

The SBA has released an updated version of its Paycheck Protection Program Frequently Asked Questions,[17] adding new question 53 that addresses the Forms 3509 and 3510 being sent to certain borrowers.

The new form, initially reported about on October 30, 2020, is being sent to borrowers who face scrutiny regarding whether their certification that their loan request was necessary given the current economic uncertainty was made in good faith. For those who had a loan of less than $2 million, the SBA had previously stated that their certifications will be deemed to have been made in good faith,[18] so those with loans of $2 million or more are the ones facing scrutiny of their certification.

The new question and answer provide limited details on why the form is being sent out and how the data requested will be used:

> **53. Question:** Why are some PPP borrowers receiving a Loan Necessity Questionnaire (SBA Form 3509 or 3510)?
>
> **Answer**: As previously announced, SBA is reviewing all loans of $2 million or more, and other loans as appropriate, for eligibility, fraud or abuse, and compliance with loan forgiveness requirements. As part of this process, SBA is providing a Loan Necessity Questionnaire to lenders for them to provide to PPP borrowers that, together with their affiliates, received loans of $2 million or more. Upon request from their lender, borrowers should return the completed questionnaire to their lender within 10 business days of receipt.

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[17] Paycheck Protection Program Frequently Asked Questions, As of December 9, 2020, Small Business Administration, https://www.sba.gov/sites/default/files/2020-12/Final%20PPP%20FAQs%20%28December%209%202020%29.pdf (retrieved November 9, 2020)

[18] Paycheck Protection Program Frequently Asked Questions, As of December 9, 2020, Small Business Administration, Question 46

The information that borrowers provide on the questionnaire will help SBA assess those borrowers' certification in their loan application that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant," as required by the CARES Act

A request to complete the Loan Necessity Questionnaire does not mean that SBA is challenging a borrower's certification that is required by the CARES Act. SBA's assessment of a borrower's certification will be based on the totality of the borrower's circumstances through a multi-factor analysis. As described in FAQ #46, SBA will assess whether the borrower had adequate basis for making the required good-faith certification, based on its individual circumstances in light of the language of the certification and SBA guidance. This certification is required to have been made in good faith at the time of the loan application, even if subsequent developments resulted in the loan no longer being necessary. In its review, SBA may take into account the borrower's circumstances and actions both before and after the borrower's certification to the extent that doing so will assist SBA in determining whether the borrower made the statutorily required certification in good faith at the time of its loan application.

After a borrower submits its completed questionnaire, SBA may request additional information, if necessary, to complete its review. When additional information is requested, borrowers will have an opportunity to provide a narrative response to SBA explaining the circumstances that provided the basis for their good-faith loan necessity certification. SBA will make a final determination that a borrower lacked an adequate basis for its loan necessity certification after reviewing any additional information that a borrower chooses to submit. This targeted, multi-step approach will ensure the integrity of the evaluation process and expeditious processing, as well as properly allocate SBA's finite resources to those loans that require additional review.[19]

[19] Paycheck Protection Program Frequently Asked Questions, As of December 9, 2020, Small Business Administration, Question 53