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To All Valued Clients:

As a follow-up to our last email regarding impact of PPP loan if you operate your business utilizing a pass-through entity such as an S-Corporation or LLC, we ran a test case with the following results:

Assumptions:

1. We operate our business utilizing an S-Corporation. We are the landlord for our business location and operate utilizing an LLC. Not being the landlord or using LLC does little to change the results.
2. We record a 20% decline in annual operating revenue for the S-Corp. business operation.
3. We pay only expenses eligible for loan forgiveness from our PPP loan bank account and when the calculations are made after 2 months from our loan deposit date, all of our expenses qualify for loan forgiveness.
4. We elect to have our entire loan forgiven.
5. Since we have paid identified expenses from our forgiven loan account and this forgiven loan amount is not considered income, none of these expenses are eligible to be deducted on our business profit and loss statement.
6. Since our LLC is the landlord, all rent received is considered income to the LLC even though the expense is not deducted at the S-Corporation business operation.
7. Since both the S-Corporation and the LLC are pass-through entities, the results are passed through to the personal tax return of the S-Corp shareholders and LLC members.

The results are as follows:

a. In spite of the lost business operating revenue, the non-deductibility of loan forgiveness expenses and the minimal change in LLC rental income, the personal tax returns of the S-Corp. shareholders and LLC members reflect a 16.32% increase in their personal Adjusted Gross Income. All other income and expense items on the personal tax returns remain unchanged from prior year.
b. There is a 180% increase in our Qualified Business Income (QBI) deduction on our personal income tax return.
c. The result is a 20.67% increase in total personal income tax due. This percentage change could be more or less, dependent upon our tax rate from other sources.
d. The PPP loan has an annual interest rate of 1% and we decide to take full advantage of the PPP loan first payment due date of 12/31/2021 and second payment on 12/31/2022.
e. When we add the 1% interest calculated on the PPP loan and the additional personal income tax due, our effective annual interest rate is 5.976%. Not bad, but a far distance from the 1% rate quoted from your lender.

We think the lesson here is that the purpose of the PPP loan was to allow business owners to continue to pay their employees even though revenue is reduced. It probably was successful. Our politicians described it as potentially free money but as illustrated here, that was perhaps an overly aggressive description. What appears important is to encourage us all to not only make our estimated tax payments but perhaps add what we can afford to our calculated amount. We also have to keep in mind that we don't know what our Fall season will look like. Some predict a resurgence of COVID-19 infections resulting in another wave of "social distancing", temporary business closures, and customer reluctance to venture out on their normal routine. Some suggest another round of loans to protect our economy is inevitable, but as illustrated above, loans will probably be repaid somehow and little is actually "Free".

Please call if you have any comments or questions!

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