New IRS rule will push many US small businesses to the brink

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The U.S Treasury Department and Internal Revenue Service (IRS) released a new ruling November 18 which will affect millions of small businesses that received a portion of the total $717 billion in relief funds from the US Small Business Administration (SBA) through the federal Paycheck Protection Program (PPP) beginning in April 2020.

Revenue Ruling 2020-27 and Revenue Procedure 2020-51 clarify "the tax treatment of expenses where a Paycheck Protection Program (PPP) loan has not been forgiven by the end of the year the loan was received," according to the US Treasury Department website.

The latest ruling outlines a number of restrictions that small businesses owners will face if they attempt to deduct business expenses from their annual tax returns if those expenses were paid for with money from a PPP loan. It states that a small business which "applies for loan forgiveness in 2020 and reasonably expects that its loan will be forgiven... may not deduct otherwise deductible expenses paid for with PPP funds." The same rule applies to small business owners that have not applied for a PPP loan in 2020 but plan to do so in 2021 and who expect that the loan will be forgiven.

This affects a great majority of small businesses, who due to their ability to maintain full-time employees with the loans are expected to be eligible for some level of forgiveness. The rate of forgiveness is reduced if a small business spends the loan on anything other than rent, mortgage, utilities and payroll costs, and if wages were reduced by over 25 percent for employees earning less than $100,000 per year.

Faced with a mounting economic crisis which was exploding the social tensions in the US caused by mounting inequality, the federal government enacted the PPP as part of the over $3 trillion CARES Act. The PPP officially authorized up to $349 billion in forgivable loans to small businesses to pay employees during the crisis, up to $100,000 on a yearly basis per employee and $10 million per business or non-profit organization.

Small businesses in the US are allowed to deduct business expenses before ordinary income rates are applied each year. For many small business owners, the ability to write off significant amounts of operating costs and expenses spells the difference between staying afloat or going under financially.

After the PPP application process had begun, the IRS released Notice 2020-32 in May, which outlined that a small business that received a loan would not be able to deduct otherwise deductible expenses if paid with funds from a PPP loan that was later forgiven.

These types of expenses include rent, mortgages and utilities, but also a number of others which small, independent retail shops, restaurants, service centers, studios, and others have had to take on to operate as safely as possible under conditions which no substantial form relief from the federal government was provided to working class people and small business owners. These could include personal protective equipment, plexiglass barriers, sanitizers, cleaning services, webconferencing tools, packaging and shipping costs, air filtration devices, outdoor dining permits and furnishings and more.

For many small businesses, the costs of operating during the pandemic have come at great expense. Out of an estimated 31 million small businesses in the US, at least 97,966 have closed permanently as of September, according to data from the online review site Yelp. Taking into account the number of unreported closures and accelerating rate of closures since COVID-19 spiked again in July, the real number of permanent small business closures in the US is likely far higher.

The latest IRS ruling will further devastate many small businesses in the US that have been staring down destitution. Varying lockdown measures across the US and the shift to remote work and schooling upended certain sections of the small business economy. The World Economic Forum noted October 6 that “in the US as a whole, data suggests that nearly a quarter of all small businesses remain closed” either temporarily or permanently during the ongoing health crisis and that “many of these temporary closures are looking to be permanent.”

The World Economic Forum suggested that 37 percent of small businesses in the leisure and hospitality sector have recorded no transactions since mid-March when statewide lockdown orders first went into effect. It also reported that over half of small business closures in the retail and nightlife categories have become permanent.

To add insult to injury, Gallup reported that the average holiday spending budget for individual Americans is expected to drop by over 14 percent this year compared to 2019, to the lowest level since 2016. The drop in spending will disproportionately affect small businesses, which lack the capital and resources to offset the projected sales dip.

Ostensibly enacted to preserve workers’ jobs, in many instances the PPP took on the form of an added corporate bailout. Far from glorifying the small business owner and entrepreneur as it likes to proclaim, the US federal government gave nearly three quarters of all larger loans under the program to large organizations including big corporations, religious institutions, charter schools, and Democratic and Republican think tanks.

There is ample reason to believe these large-scale recipients make up the bulk of those using the loans for their own financial interests, instead of using them to preserve employment. As the WSWS noted in its perspective, “What the rich are thankful for” on November 25, “An MIT team concluded that the PPP [Paycheck Protection Program] handed out $500 billion in loans yet saved only 2.3 million jobs over roughly six months… the annualized cost of the program comes out to roughly $500,000 per job.”

Although large corporations dominate the total share of wealth, small businesses make up a significant section of the US economy. According to the World Economic Forum, small businesses employ nearly half of all workers in the US private sector. The closure of more small businesses and layoffs that will follow when business owners cannot make ends meet because of the IRS rule will fan the flames of the ongoing social crisis well into 2021.