

CARES Act: Accounting for the stimulus

No. US2020-03

April 2, 2020

(updated January 14, 2021)

What's inside

CECL optional deferral (updated January 2021)	2
Loan modifications (updated January 2021)	3
Below-market rate loans.....	6
Income taxes.....	6
Grants and employee retention credits (updated January 2021).....	16
Paycheck Protection Program.....	19
Disclosures.....	21

At a glance

The Coronavirus Aid, Relief, and Economic Security (CARES) Act became law on March 27, 2020. It was a response to the market volatility and instability resulting from the coronavirus pandemic, and includes provisions to support individuals and businesses in the form of loans, grants, and tax changes, among other types of relief.

On December 27, 2020, an additional \$900 billion in stimulus was approved, extending or modifying some of the existing provisions and creating a few new ones. The new funding was part of the Consolidated Appropriations Act.

We have provided answers to questions regarding the accounting and disclosure implications of certain of the provisions in the original and updated stimulus packages. Provisions addressed include: relief from certain accounting guidance; tax code changes; below-market loans; and other programs that essentially provide government assistance to businesses.

Originally issued in April 2020, this *In depth* was previously updated through July 10, 2020. Questions with substantive changes since July have been marked as updated. Question numbers have also been updated to be sequential by section.

This *In depth* should be read in conjunction with the *In depth*, [FAQ on accounting for COVID-19 and market volatility](#), and our other [COVID-19 resources](#), including a [podcast](#) on the original CARES Act.

CECL optional deferral

Section 4014 of the CARES Act includes an optional deferral of the effective date of ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326)*, for certain companies. ASU 2016-13 includes the current expected credit loss (CECL) methodology for estimating allowances for credit losses. Section 4014 of the CARES Act was amended on December 27, 2020.

QUESTION 1.1

Who can apply the deferral and is it GAAP?

PwC response

The optional, temporary deferral of ASU 2016-13 applies to insured depository institutions, bank holding companies, and their affiliates. A registrant would only be eligible to apply this provision if it meets the criteria specified in the CARES Act, which is a legal determination.

With regard to making the law GAAP, the SEC's Office of the Chief Accountant (OCA) released a [statement](#) noting that the SEC staff would not object to a conclusion that delaying the effective date of the CECL standard is in accordance with GAAP for those in scope and for the periods for which the relief is available.

OCA has received inquiries from preparers and auditors where the preparer has concluded that election of these narrow and limited options in Sections 4013 and 4014 of the CARES Act would be deemed to be in accordance with GAAP. For those entities that are eligible for, and elect to apply, either of Sections 4013 or 4014 of the CARES Act, the staff would not object to the conclusion that this is in accordance with GAAP for the periods for which such elections are available.

Sagar Teotia, SEC Chief Accountant

Statement on the Importance of High-Quality Financial Reporting in Light of the Significant Impacts of COVID-19, April 3, 2020

If a registrant elects the deferral, it should disclose the expected impact of the standard as required by SAB 74 and consider the impact to MD&A disclosures, such as in the liquidity and capital resources section.

QUESTION 1.2 (updated January 2021)

When is the optional, temporary relief of ASU 2016-13 effective and when does it end?

PwC response

Per the CARES Act, as amended by the Consolidated Appropriations Act, the relief period begins on March 27, 2020 and ends on the earlier of (1) the first day of the fiscal year of the insured depository institution, bank holding

company, or any affiliate thereof that begins after the date the national emergency related to COVID-19 ends or (2) January 1, 2022.

QUESTION 1.3

Is the optional deferral of ASU 2016-13 available to companies other than those listed in the CARES Act?

PwC response

The deferral of ASU 2016-13 applies only for the types of companies specified in the Act. We understand that the SEC staff would object to a registrant that is not eligible, as defined in Section 4014, applying the deferral.

Additional resources:

- For more on the effective date of and transition to CECL, see PwC's [Loans and Investments](#) guide, Chapter 13
- For more on the impact of COVID-19 on CECL, see PwC's podcast, [COVID-19: CECL consideration questions, answered](#)

Loan modifications

Section 4013 of the CARES Act provides optional relief from accounting for certain short-term modifications due to COVID-19 as troubled debt restructurings (TDR). Section 4013 of the CARES Act was amended on December 27, 2020.

QUESTION 2.1 (updated January 2021)

What is the nature of the TDR relief and is it GAAP?

PwC response

The CARES Act provides financial institutions with the option to suspend the accounting requirements within ASC 310-40 for loan modifications related to COVID-19 that would otherwise be TDRs. The Consolidated Appropriations Act clarifies that financial institutions include “insurance companies.” For a loan to be eligible, requirements include that the loan modification must be:

1. related to COVID-19,
2. modified between March 1, 2020 and the earlier of
 - a. 60 days after the national emergency related to COVID-19 ends, or
 - b. January 1, 2022, and
3. executed on a loan that was not more than 30 days past due as of December 31, 2019.

With regard to making the law GAAP, OCA released a [statement](#) noting that the SEC staff would not object to a conclusion for SEC registrants that the TDR relief is in accordance with GAAP for the periods for which the relief is available.

OCA has received inquiries from preparers and auditors where the preparer has concluded that election of these narrow and limited options in Sections 4013 and 4014 of the CARES Act would be deemed to be in accordance with GAAP. For those entities that are eligible for, and elect to apply, either of Sections 4013 or 4014 of the CARES Act, the staff would not object to the conclusion that this is in accordance with GAAP for the periods for which such elections are available.

Sagar Teotia, SEC Chief Accountant

Statement on the Importance of High-Quality Financial Reporting in Light of the Significant Impacts of COVID-19, April 3, 2020

Additionally, the US banking agencies released interagency statements in consultation with the FASB on [March 22](#) and on [April 7](#) that interpret GAAP's TDR guidance and may be applied if an entity (1) elects not to apply or (2) does not qualify for the relief under the CARES Act. The statements interpret whether a borrower is experiencing financial difficulty, which is one of the criteria for a TDR. It notes that the lender may presume that the borrower was not experiencing financial difficulty if:

1. the modification is in response to the COVID-19 National Emergency,
2. the borrower was current on payments at the time a modification program is implemented, and
3. the modification is short-term (for example, less than 6 months).

At the AICPA National Conference on Banks and Savings and Institutions on December 1, 2020, the US banking agencies noted that given the continuing impacts of the pandemic, loan modifications continue to occur. As a result, they expressed their view it would become more appropriate to consider the borrower's payment status as of the time of the modification as opposed to when a broader modification program was implemented in assessing whether a borrower was experiencing financial difficulty.

The interagency statements also provide an interpretation that government-mandated modification or deferral programs related to COVID-19 are not within the scope of ASC 310-40.

QUESTION 2.2 (updated January 2021)

Which entities are eligible to apply Section 4013 and what types of modifications would qualify for the temporary optional relief?

PwC response

The optional, temporary suspension of the TDR guidance only applies to financial institutions, which as clarified in December 2020, includes insurance

companies. A registrant would only be eligible to apply this provision if it concluded that it was a financial institution, which is a legal determination.

The following provision of the CARES Act defines its applicability to loan modifications:

- (a) shall be applicable for the term of the loan modification, but solely with respect to any modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019; and
- (b) shall not apply to any adverse impact on the credit of a borrower that is not related to the coronavirus disease 2019 (COVID-19) pandemic.

Section 4013 also states that to apply its provisions, loan modifications must occur during the applicable period beginning on March 1, 2020 and ending on the earlier of January 1, 2022, or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak declared by the President on March 13, 2020 terminates.

We believe a company should seek the advice of legal counsel if questions arise in determining if a loan modification would meet the criteria in the CARES Act.

QUESTION 2.3

Should a financial institution's election to apply (or not apply) the optional temporary relief provided under Section 4013 of the CARES Act be made on a company-wide basis?

PwC response

During an April 2020 webcast, staff from the US banking agencies noted that companies may apply Section 4013 of the CARES Act on a company-wide, product or portfolio, or a loan-by-loan basis. Companies should disclose the basis on which Section 4013 of the CARES Act is applied in sufficient detail that a user can understand to which loans the temporary relief was applied, to which ones it was not, and the accounting ramifications of the elections.

QUESTION 2.4

Which companies are eligible to apply the US banking agencies' interpretation of the TDR guidance outlined in the interagency statements?

PwC response

The interagency statements were developed in consultation with the FASB and outline an interpretation of GAAP for assessing whether the modification of a loan results in a TDR. We believe any company, even if not subject to the supervision of the banking agencies, may apply the interpretation in the interagency statement. However, we do not believe that non-banking entities

are required to apply the guidance issued by the banking agencies as it is an interpretation of GAAP; other acceptable interpretations may be applied.

Additional resources:

- For more on loan refinancing, including TDRs, see PwC's [Loans and Investments](#) guide, Chapter 10

Below-market rate loans

The CARES Act includes various loan packages, including a provision that caps the interest rate on certain loans to eligible businesses. For certain borrowers, the loan may be below-market.

QUESTION 3.1

Does interest need to be imputed on a below-market rate loan from the government?

PwC response

ASC 835-30, *Imputation of interest*, provides guidance for imputing interest when financing is provided or obtained at other-than-market terms. However, ASC 835-30-15-3(e) excludes from the scope of this guidance “transactions where interest rates are affected by the tax attributed or legal restrictions prescribed by a governmental agency (for example, industrial revenue bonds, tax exempt obligations, government guaranteed obligations, income tax settlements).” Thus, a company would not need to impute interest on a loan from the government with a below-market interest rate.

Income taxes

Under US GAAP, the effect of a change in tax law is recorded discretely as a component of the income tax provision related to continuing operations in the period of enactment (March 27, 2020 for the CARES Act). A number of items included in the CARES Act have tax accounting implications, including changes to deferred taxes, valuation allowances, and balance sheet classification. These items should not be evaluated in isolation as there could be interplay between the various changes resulting from the CARES Act and other knock-on effects that impact the tax provision in totality.

Net operating losses

The Tax Cuts & Jobs Act of 2017 (2017 tax reform act) changed the rules related to Federal net operating losses (NOLs) such that NOLs generated after 2017 could not be carried back and utilization was limited to 80% of taxable income in future years.

The CARES Act allows for a five-year carryback of Federal NOLs generated in tax years beginning in 2018, 2019, or 2020 and removes the 80% taxable income limitation for NOL deductions for tax years beginning before January 1,

2021 (i.e., it allows an NOL to fully offset taxable income in the “temporary window,” which is the period of time beginning with the earliest carryback year and ending with the last tax year beginning before January 1, 2021). Overpayments created by carrying an NOL back to a year that includes taxable income from the “toll charge” may be applied to reduce future installment payments that would otherwise be owed, rather than being immediately refundable.

The CARES Act also makes a retroactive technical correction to the 2017 tax reform act to allow NOLs arising in tax years beginning in 2017 and ending in 2018 to be carried back two years.

QUESTION 4.1

What are the potential tax accounting implications related to the Federal NOL changes?

PwC response

Taxable income in prior carryback years is one of the four sources of taxable income provided by ASC 740 to support realization of deferred tax assets. Valuation allowances may no longer be necessary for existing NOL deferred tax assets if those NOLs can now be carried back to offset taxable income in prior years. The tax effect of releasing the valuation allowance on existing NOL deferred tax assets as a result of the CARES Act should be recorded discretely in the period of enactment.

Companies should consider all impacts of carrying back the NOLs to prior periods.

The Federal tax rate changed from 35% to 21% as a result of the 2017 tax reform act. The tax rate differential should be considered for any NOLs that are expected to be carried back to a year before the tax rate change was effective. This rate differential may impact the tax provision in several ways (see [Example 1](#)) including:

- The tax benefit for remeasuring deferred tax assets related to prior year NOLs (i.e., tax years ending in 2018 and 2019) expected to be carried back should be recorded discretely in the period of enactment.
- Any existing temporary differences (currently recorded at a 21% rate) that are expected to reverse during the year and become part of a loss that will be carried back to a 35% year should be remeasured to 35% discretely in the period of enactment.
- The tax benefit for the rate differential related to losses recognized during the current year should be included in the annual effective tax rate (AETR).

Other tax attributes that were utilized in those years (e.g., foreign tax credits, R&D credits) may now be carried forward as deferred tax assets that must be assessed for realizability. In addition, there could be other knock-on effects for items that are impacted by changes in taxable income, including (but not limited to) foreign-derived intangible income (FDII), global intangible low-taxed income (GILTI), base erosion and anti-avoidance tax (BEAT), the domestic production activities (Section 199) deduction, and alternative minimum tax (AMT). These items may impact the amount of the rate differential previously

discussed (i.e., the carryback of a loss may result in a reported tax benefit that is less than the 14% rate differential between 35% and 21%).

The 80% taxable income limitation is only waived for NOLs that are utilized (deducted) in tax years beginning before January 1, 2021. Any post-tax reform NOLs that are carried forward because they are not utilized within the temporary window will continue to be limited to 80% of taxable income as a result of the 2017 tax reform act. When assessing NOL-related deferred tax assets for realizability, companies may need to consider whether taxable income from reversing temporary differences will provide a source of income at 100% or 80% depending on when they are expected to reverse. As a reminder, taxable temporary differences related to indefinite-lived assets (e.g., “naked credits”) are not considered a source of income for finite-lived NOLs. However, they would be a source to consider (subject to the 80% taxable income limitation) if indefinite-lived deferred tax assets exist.

Finally, the balance sheet presentation should reflect when the NOLs are expected to be monetized. For example, a current tax receivable would be recorded if the NOL is expected to generate a cash tax refund within the current year. However, if an NOL is carried back to a toll charge year and will only result in a reduction to a future installment payment, the impact should instead be recorded as a reduction to the outstanding toll charge liability.

EXAMPLE 1

Discrete vs AETR treatment of accounting for change in NOL carryback tax law

Assume a company with a December 31 year end expects to carry back any 2020 taxable loss to a pre-reform period when the tax rate was 35%. For simplicity, this example ignores any knock-on impacts of carrying back the NOL to a prior period (e.g., freeing up credits initially utilized in the carryback year). The company forecasts book losses of \$250 each quarter, for a total book loss of \$1,000 for the year. The company has unfavorable permanent differences of \$60. The company expects net movement in its temporary differences during the year to reduce taxable income by \$200. The composition of the movement in temporary differences is as follows:

Deductible/ (taxable) temporary differences	1/1/2020 (beginning of year)	Activity	12/31/2020 (end of year)
Temp Diff A (full reversal)	\$100	(\$100)	\$ -
Temp Diff B (partial reversal)	(500)	300	(200)
Temp Diff C (no reversal)	(300)	-	(300)
Temp Diff D (originating)	-	(400)	(400)
Total	(\$700)	(\$200)	(\$900)

Temporary difference A is expected to fully reverse in the current year and Temporary difference B is expected to partially reverse in the current year. Temporary difference C is not expected to reverse in the current year (e.g., already fully amortized tax-deductible goodwill). Temporary difference D originates during the current year and will reverse in subsequent years.

Determine the tax provision for the year

Current provision		Deferred provision	
Book loss	(\$1,000)	1/1/2020 deferreds	(\$700)
Perms	60	@ 21%	(147)
Temps	(200)		
Taxable loss	(1,140)	12/31/2020 deferreds	(\$900)
Tax rate	35%	@ 21%	(189)
Current benefit	(\$399)	Deferred expense	\$42

The total tax benefit is \$357 (\$399 benefit + \$42 expense).

Determine discrete impact of remeasuring beginning of year deferreds that will reverse in the current year

Reversing temporary difference	Measured @ 21% (A)	Measured @ 35% (B)	Discrete amount (A) - (B)
Temp Diff A — (\$100)	\$21	\$35	(\$14)
Temp Diff B — \$300	(63)	(105)	42
Total	(\$42)	(\$70)	\$28

Note that Temporary difference C is not included in the above calculation because there is no tax impact in the current year (i.e., the rate is 21% at both the beginning and end of the year). Temporary difference D is not included in the above calculation because it originates in the current year and is therefore captured in the next calculation.

Calculate the interim provision

	AETR
Estimated full year pre-tax loss	(\$1,000)
Estimated full year perms	60
Estimated full year pre-tax plus perms	(940)
Tax rate for current year loss	35%
Tax benefit on current year loss	(329)
AETR impact — originating differences ¹	(56)
Estimated full year income tax benefit	(385)
Estimated AETR	38.5%

¹ Temporary difference D, which originates in the current year, generates a permanent difference that impacts the rate. This is because the impact on the current provision will be recorded at the 35% carryback rate, but the temporary difference will reverse and impact the deferred provision at a 21% rate. This 14% rate differential, multiplied by the gross originating difference of \$400, yields a permanent rate impact of \$56.

Quarter	YTD loss x AETR	YTD benefit	YTD discrete expense	Total YTD provision
Q1	(\$250) x 38.5%	(\$96)	\$28	(\$68)
Q2	(\$500) x 38.5%	(\$193)	\$28	(\$165)
Q3	(\$750) x 38.5%	(\$289)	\$28	(\$261)
Q4	(\$1,000) x 38.5%	(\$385)	\$28	(\$357)

Additional resources:

- For more on valuation allowances, see PwC's [Income taxes](#) guide, Chapter 5
- For more on changes in tax laws and rates in an interim period, see PwC's [Income taxes](#) guide, Section 7.4

QUESTION 4.2

What should a company that has been party to an acquisition or disposition transaction in a carryback year consider when carrying back NOLs as a result of the CARES Act?

PwC response

Parties to transactions entered into after enactment of the 2017 tax reform act may not have included language in their legal agreements regarding the carryback of post-reform NOLs generated by the acquired entity to earlier tax years. When a company has been acquired in recent years, NOLs attributable to the acquired company may be carried back to a consolidated tax filing group that is different than the one it currently belongs to. For example, assume an acquirer's consolidated tax group generates a loss of \$100, and \$10 of that loss is attributable to the acquired entity. If the acquirer's consolidated tax group carries back that \$100 loss to a year in which the acquired entity was part of the seller's consolidated tax group, the seller will receive the refund associated with the \$10 of loss generated by the acquired entity. The parties must then determine if some or all of that refund will be paid to the acquired entity/acquirer. In cases when such agreements did not address the possibility of a loss carryback, the parties will need to reach an accord on how this situation will be handled.

The acquirer may decide to forgo carryback of its consolidated group NOLs. However, the situation described above is not unique to NOLs, and forgoing carryback is not an option that is available for all attributes (e.g., research and development credits, foreign tax credits). It is possible that carrying back NOLs, even to post-acquisition periods, could "free up" previously utilized attributes that might be required to be carried back to a pre-acquisition period. Accounting considerations for these attributes would be similar to accounting for the NOLs.

In the situation when the acquired company elects to carryback its NOL to a prior consolidated tax group, to the extent the NOL is based on taxable income

that the acquired company contributed to the prior tax filing group in the carryback years and the carryback is permissible under the tax law, the accounting for the benefit of the loss carryback through the income tax provision is most appropriate. We believe this is consistent with the separate return approach to allocating income taxes to a member of a consolidated group. Conversely, any benefit resulting from the ability to carry back the loss and offset taxable income of other group members would generally be recorded outside of the income tax provision since such tax benefits would not have been available on a separate return basis. By the same token, any difference between (a) the tax benefit as determined under the separate return basis and (b) the amount ultimately received or receivable from the prior tax filing group (due, for example, to a negotiated discount or holdback) should be reflected outside of the income tax provision.

The above guidance would apply similarly to a situation when an entity has been spun off during the carryback period.

Additional resources:

- For more on changes in tax laws and rates in an interim period, see PwC's [Income taxes](#) guide, Section 7.4
- For more on indemnification arrangements, see PwC's [Income taxes](#) guide, Section 15.8
- For more on the tax law change, see PwC's [Insight: Global structuring — CARES Act permits NOL carrybacks, increases interest deduction limitation](#)

Limitations on interest deductions

The 2017 tax reform act also expanded the applicability of the interest limitation rules under Internal Revenue Code (IRC) Section 163(j), which limits a taxpayer's deductible interest expense to 30% of adjusted taxable income (ATI) for the year. The non-deductible interest expense can be carried forward indefinitely. For tax years beginning in 2019 and 2020, the CARES Act increases the ATI limitation from 30% to 50% and allows a taxpayer to elect to use 2019 ATI in determining the 2020 limitation. Some taxpayers may want to elect out of the increased limitation or choose not to use the 2019 ATI in determining the 2020 limitation because of the interaction of Section 163(j) with other provisions, such as BEAT.

QUESTION 4.3

What are the potential tax accounting implications related to the changes to the Section 163(j) interest expense limitation?

PwC response

The current year tax effects resulting from the increased ATI limitation and election to utilize 2019 ATI when determining the limitation for 2020 should be reflected in the current year AETR.

The income tax effects of changes in the prior year ATI limitation should be accounted for discretely in the interim period that includes the date of enactment. These effects might include changes in the valuation allowance and the knock-on effects from the change in taxable income as a result of the increased deduction. For example, there might be a decrease in the valuation allowance because the increased ATI limitation results in less of a Section 163(j) carryforward from 2019. On the other hand, credits that were originally claimed on the prior return (e.g., foreign tax credits, R&D tax credits) may now be carried forward and require a valuation allowance.

Companies should also consider other impacts of the increased 2019 ATI limitation, such as the impact on FDII, GILTI, and BEAT.

With the legislation enacted so close to the end of the quarterly reporting period for many companies, a question may arise as to whether decisions regarding elections must be made in the current period or if they can be deferred as more work and modeling is performed. Management should make its best estimate as to how it will treat these items based on information that is known or knowable as of the balance sheet date and account for the items in a consistent manner when preparing their financial statements.

Additional resources:

- For more on valuation allowances, see PwC's [Income taxes](#) guide, Chapter 5
- For more on changes in tax laws and rates in an interim period, see PwC's [Income taxes](#) guide, Section 7.4

Alternative minimum tax refunds

The corporate alternative minimum tax (AMT) was repealed as part of the 2017 tax reform act. AMT credits from prior tax years could be carried forward as refundable credits over several tax years through 2021. The CARES Act accelerates the ability of companies to receive refunds of AMT tax credits related to tax years beginning in 2018 and 2019.

QUESTION 4.4

What are the potential tax accounting implications related to the acceleration of refundable AMT credits?

PwC response

AMT credits may have been presented as a receivable (classified as current/noncurrent for companies that present a classified balance sheet) or a deferred tax asset in the prior period balance sheet. The presentation of refundable AMT credits in the current balance sheet should be updated to reflect the timing of when the credits are expected to be monetized. For example, if a calendar year company expects to accelerate the refund of the entire AMT credit to 2018 or 2019, it should be presented as a current receivable rather than a noncurrent receivable or a deferred tax asset.

Qualified improvement property

The CARES Act makes a technical correction to the 2017 tax reform act to provide a 15-year recovery period for qualified improvement property (QIP). This technical correction makes QIP eligible for bonus depreciation and is effective as if enacted as part of the 2017 tax reform act.

QUESTION 4.5

What are the potential tax accounting implications related to the technical correction for QIP?

PwC response

The impact of the QIP technical correction on any position taken in a prior period should be recorded discretely in the interim period that includes the date of enactment.

The technical correction constitutes new information that may allow for recognition of a tax position taken in a prior period that did not previously meet the more-likely-than-not recognition threshold under ASC 740-10-25-6. Any related changes to interest or penalties accrued for the tax position should be accounted for in the same period. Further, companies may plan to file amended returns for prior periods to claim a benefit, which could result in a refund receivable or a reduction in a payable and a change in deferred taxes.

Companies should consider the potential rate impact if additional deductions as a result of the QIP technical correction will create or increase NOLs that can be carried back to a year with a 35% tax rate.

Additional resources:

- For more on changes in recognition and measurement of tax positions, see PwC's [Income taxes](#) guide, Section 15.5

Scope

QUESTION 4.6

What forms of government assistance are within the scope of ASC 740, *Income Taxes*?

PwC response

While many forms of government credits and incentives may be codified in tax law and may be claimed on a tax return, they may not be subject to ASC 740. A number of features can make these credits and incentives more akin to a government grant or subsidy. The application of income tax accounting is warranted if a particular credit or incentive can be claimed only on the income tax return and can be realized only through the existence of taxable income. When there is no connection to income taxes payable or taxable income (i.e.,

the credits are realizable in cash by the company regardless of whether the company has an income tax liability), we believe the benefit should be accounted for outside of ASC 740.

For example, a company that qualifies for the Employee Retention Credit in the CARES Act would receive a refundable payroll tax credit for 50% of wages paid to employees during the COVID-19 crisis. Since the credit is calculated based on wages and reduces an employer's payroll tax, it is not considered a tax based on income and therefore should be accounted for outside of ASC 740 and would likely be treated as a grant (see [Question 5.1](#)).

Additional resources:

- For more on the scope of ASC 740, see PwC's [Income taxes](#) guide, Chapter 1

Payroll taxes

QUESTION 4.7

The CARES Act allows employers to defer payment of certain payroll taxes for up to two years. Does this deferral have an impact on a company's income tax provision?

PwC response

Prior to the CARES Act, payroll taxes generally would have been deductible for income tax purposes in the same period that they were expensed for book purposes under the "recurring item exception" of the Internal Revenue Code. However, if a company defers payment of its payroll taxes as a result of the CARES Act such that the recurring item exception no longer applies, accrued payroll taxes would not be deductible until the tax year in which they are actually paid.

If the book expense and tax deduction are expected to occur in different periods, a deferred tax asset would need to be recorded for the deductible temporary difference related to the payroll tax accrual. For companies that are expecting to carry back current-period NOLs to a pre-tax reform year, there could be an unfavorable impact in the annual estimated effective tax rate related to this temporary difference (see [Question 4.1](#)).

Additional resources:

- For more on changes in tax laws and rates in an interim period, see PwC's [Income taxes](#) guide, Section 3.2

State taxes

QUESTION 4.8

What are the potential state income tax implications of the CARES Act?

PwC response

The potential state income tax implications of the federal CARES Act depend on the manner in which a state conforms to the Internal Revenue Code (IRC) and whether the state has decoupled from or has a modification that impacts the specific federal IRC sections affected by the CARES Act.

The threshold state income tax question is whether and how a state conforms to the IRC. How a particular state adopts the IRC directly affects the application of enacted federal changes to a company's taxable income computation.

States that begin the determination of state taxable income with federal taxable income generally do so in one of the following ways:

- Rolling conformity (i.e., a state that explicitly conforms to or adopts the IRC changes automatically)

The state income tax implications of the federal CARES Act should be accounted for within the period that includes the federal enactment date of March 27, 2020. However, companies should review whether a rolling conformity state decouples or modifies a specific IRC section. For example, some states may conform generally to the IRC on a rolling basis but decouple from the interest expense deduction limitation under IRC Section 163(j), which was modified by the CARES Act.

- Fixed date conformity (i.e., a state that explicitly adopts the IRC as of a fixed date)

These states will need to enact conforming legislation to apply any changes as a result of the CARES Act. For example, consider a fixed date conformity state that has adopted the IRC after enactment of the 2017 Tax Cuts and Jobs Act and does not specifically decouple from Section 163(j). The CARES Act increase in the calculation of interest deductible in a given year to 50% of adjusted taxable income would not be operative without legislation to update the state's conformity to a post-CARES Act version of the IRC.

The state income tax implications of the federal CARES Act should not be accounted for until the period that includes the enactment date of the state legislation. The impact of the state legislation would not be accounted for in a period before enactment even if the legislation is enacted before the financial statement issuance date and/or is retroactive to an earlier period.

Additional resources:

- For more on changes in tax laws and rates in an interim period, see PwC's [Income taxes](#) guide, Section 7.2
- For more on state tax implications of the CARES Act, see PwC's [Insight: State and local tax — State tax implications of phase 3 relief](#)

Grants and employee retention credits

QUESTION 5.1

How should a business entity account for government assistance that is not accounted for under ASC 740 (e.g., grants, employee retention credits)?

PwC response

There is no US GAAP that specifically addresses the accounting by business entities for government assistance. Thus, determining the proper accounting treatment for government incentives by business entities can be challenging and will likely depend on an analysis of the nature of the assistance and the conditions on which it is predicated.

ASC 105, *Generally Accepted Accounting Principles*, describes the decision-making framework when no guidance exists in US GAAP for a particular transaction. Specifically, ASC 105-10-05-2 instructs companies to first look for guidance for a similar transaction or event within US GAAP and apply that guidance by analogy. If no guidance for similar transactions is identified, a company may consider nonauthoritative guidance from other sources (for example, guidance issued by other standard-setters). In this context, IFRS includes a specific standard, IAS 20, *Accounting for Government Grants and Disclosures of Government Assistance*, that may be relevant.

ASC 958-605 contains the US GAAP on grant accounting, including guidance on evaluating whether government grants are exchange or nonexchange transactions. See our [healthcare newsletter](#), which while published prior to the Consolidated Appropriations Act contains principles and guidance that continue to be applicable. However, ASC 958-605 excludes from its scope transfers of assets from governments to business entities. As a result, forms of government assistance provided to business entities would not be in the scope of ASC 958-605, but it may be applied by analogy under ASC 105-10-05-2.

Alternatively, companies may look to IAS 20. ASC 958-605 and IAS 20 differ in a few key areas when it comes to accounting for government grants.

	ASC 958-605	IAS 20
Recognition when conditions are present	When the conditions have been substantially met	When there is reasonable assurance that the entity will comply with the conditions and that the grant will be received
Timing and pattern of recognition	When grant is awarded or, if conditional, immediately once the condition is substantially met Recipients should also consider whether grantor-imposed restrictions exist.	Using a systematic basis over the periods in which the entity recognizes the related expenses or losses that the grants are intended to compensate When the grant becomes receivable if it compensates for expenses or losses already incurred
Presentation of grant income	Grant income is presented on a gross basis (i.e., grant revenue or other income)	May be reported separately as "other income" or deducted from the related expense

With regard to the evaluation of conditions, IAS 20 does not define "reasonable assurance" but it is generally considered to be similar to the notion of "probable" as used in ASC 450, *Contingencies*. ASC 958-605, however, does not permit a company to consider probability or intent in evaluating whether a condition has been or will be achieved; instead, under ASC 958-605, grant income is recognized only when the condition has been substantially met.

Education provisions

The CARES Act provided approximately \$14 billion to higher education institutions, including approximately \$12.6 billion distributed to institutions using a formula based on student enrollment. Of the amount allocated to each institution under this formula, at least 50% must be granted to students to help cover expenses related to the disruption of campus operations due to coronavirus such as food, housing, course materials, technology, health care, and child-care expenses. The Consolidated Appropriations Act provided an additional \$22.7 billion to higher education institutions, some of which must be granted to students to cover similar expenses.

QUESTION 5.2 (updated January 2021)

How should higher education institutions account for the funding received that is required to be passed through to students?

PwC response

We believe that higher education institutions receiving this funding should record the grants as contribution revenue in accordance with ASC 958-605-55-76 because they can choose the beneficiary of the funds. For the CARES Act funding, the Department of Education had stated that each institution “may develop its own system and process for determining how to allocate these funds, which may include distributing the funds to all students or only to students who demonstrate significant need.” The Department of Education has not yet issued additional guidance related to the new Consolidated Appropriations Act funding.

Timing of recognition for government assistance

QUESTION 5.3 (updated January 2021)

The Consolidated Appropriations Act appropriated funding for various government assistance programs, many of which are continuations of programs established or funded by the CARES Act; however, additional information about specific grants may be provided in 2021. Should companies account for government assistance outside the scope of ASC 740 in the period the Consolidated Appropriations Act was enacted (the period that includes December 27, 2020) or in the period when information about specific grant requirements is provided?

PwC response

It depends. Generally, to recognize a government grant under either ASC 958-605 or IAS 20, a company would need to be able to estimate the amount of the grant and have an understanding of grant conditions or restrictions. For some provisions of the Consolidated Appropriations Act, sufficient information may have been available to begin accounting for the government assistance in the period that includes December 27, 2020 even if certain clarifying guidance is provided after the end of the period.

In other circumstances, sufficient information was not known as of December 31, 2020, in which case companies may need to wait until 2021 to account for the assistance. For example, the Consolidated Appropriations Act includes additional funds for the Higher Education Emergency Relief Fund (HEERF). Although institutions may have received funds from the HEERF in 2020, the Consolidated Appropriations Act changed the formula for determining the amounts institutions could receive, and also the amounts required to be spent

on direct student aid. Therefore, we believe recipients should not account for the grants until clarifying guidance has been issued.

Companies that have received or expect to receive grants that do not meet the requirements for recognition in 2020 should consider disclosure of the grants as a subsequent event in their financial statements for the period ended December 31, 2020.

Paycheck Protection Program

One of the programs established by the CARES Act is the Paycheck Protection Program (PPP). The PPP involves a loan originated by a participating Small Business Administration (SBA) lender (generally a financial institution) which is designed to provide an incentive for small businesses to keep employees on the payroll. It is possible that all, none, or a portion of the loan used for eligible expenses will be forgiven. If all or a portion of the loan is not forgiven, the borrower is responsible for repayment. TQAs released by the AICPA in June 2020 address elements of the accounting for loans within the program under the original CARES Act.

QUESTION 6.1

Should the lender (i.e., bank) account for loans originated under the Paycheck Protection Program as a loan or as a facilitation of a government grant?

PwC response

The instrument is legally a loan with a stated principal, interest rate, and maturity date. The bank is expected to collect amounts due from either the borrower or SBA as guarantor. As a result, we believe the bank should account for this arrangement as a loan.

QUESTION 6.2

Is the guarantee from the SBA considered “embedded” or is it a “freestanding contract”? Should the guarantee be considered in estimating credit losses on the loan?

PwC response

Our understanding is that the SBA guarantee exists at the inception of the loan and throughout its life. If the loan is transferred, we understand that the guarantee transfers with it and that the arrangement does not contemplate the loan existing without the SBA guarantee unless it is determined the lender violated an obligation under the agreement.

For companies that have adopted ASU 2016-13 (which includes the CECL model), the guarantee would not meet the definition of a freestanding contract as defined by ASC 326-20-20. ASC 326-20-30-12 requires credit enhancements that mitigate credit losses (other than those that are considered

freestanding contracts) to be considered in estimating credit losses. Since the guarantee is considered “embedded,” it should be considered when estimating credit losses on the loan.

The treatment would be similar for companies that have not adopted ASU 2016-13 as in practice, embedded guarantees that are not freestanding financial instruments are generally considered in determining the allowance for credit losses under ASC 450 or ASC 310.

QUESTION 6.3

As part of the PPP, lenders will receive a fee from the SBA. How should a lender account for the fee?

PwC response

As noted in Question 6.2, the guarantee is “embedded” in the loan and is part of the same “unit of account.” Although it is a single unit of account, the arrangement involves multiple counterparties: (1) the bank, (2) the borrower, and (3) the SBA that will be looked to for payment if the borrower either (a) meets the conditions to have the loan forgiven or (b) defaults on its obligation. The fee was paid to the bank by one of the counterparties. In effect, the SBA is paying a fee on behalf of the borrower that would have ordinarily been paid by the borrower.

The fee received from the SBA should be accounted for as a loan origination fee under ASC 310-20. As a result, it should be deferred and amortized over the life of the loan (or the estimated life, if the company qualifies and elects to apply the guidance in ASC 310-20-35-26 through ASC 310-20-35-32) as an adjustment to yield.

Lenders should consider the guidance in ASC 450 related to fees that may be subject to clawback by the SBA or not received. Under this guidance, a loss contingency should be established when it is probable that events or conditions causing a loss have occurred and the amount of the loss is estimable.

QUESTION 6.4

How should a recipient (i.e., a borrower) of funds under the PPP loan program account for the arrangement?

PwC response

A loan obtained through the PPP is, in legal form, a loan from a participating SBA lender that is guaranteed by the SBA. Therefore, borrowers should account for the arrangement as a loan in accordance with ASC 470. As discussed in [Question 3.1](#), a borrower should not impute interest on the loan if the rate is determined to be a below-market rate due to the scope exception in ASC 835-30-15-3(e) for government-mandated interest rates. If all or a portion of a loan is ultimately forgiven, the borrower should record income from the

extinguishment of its obligation when it is legally released from being the primary obligor in accordance with ASC 405-20-40-1.

If a business entity concludes that it is reasonably assured (i.e., probable) that all or a portion of the loan will be forgiven pursuant to the terms of the PPP, we believe it would also be acceptable for an entity to conclude that the amount eligible for forgiveness is an in-substance government grant. In light of guidance from the SBA and US Department of the Treasury, including [FAQs](#) updated as of December 9, 2020, we believe it may be difficult for a company to assess whether forgiveness of the loan is reasonably assured in advance of confirmation of forgiveness by the SBA. For example, the SBA has indicated it will review certain loans following the lender's submission of the borrower's application for loan forgiveness for compliance with program requirements, including whether the borrower had an adequate basis for the required certification concerning the necessity of the loan request. Companies should monitor future communications from the SBA that may impact their accounting conclusions.

As discussed in [Question 5.1](#), there is no specific US GAAP guidance for government grants. However, it may be appropriate for business entities to analogize to IAS 20 within IFRS, which contemplates forgivable loans as one potential form of a government grant. Under that guidance, an entity would recognize grant income for amounts reasonably assured of being forgiven as it incurs the eligible expenses to which the grant relates. The income from the grant may be presented in the income statement as a separate line item, such as "other income," or as a reduction of the related expenses.

If a not-for-profit entity concludes the PPP loan is an in-substance government grant, the entity should account for the loan as a conditional contribution in accordance with ASC 958-605, and would not recognize grant income until the conditions are substantially met.

Borrowers should provide transparent disclosure regarding the accounting conclusions for PPP loans and the resulting impact to the financial statements, and also consider potential impacts to risk factor and liquidity disclosures, when applicable.

Disclosures

QUESTION 7.1

What disclosures should a company include in the financial statements related to government assistance received through the CARES Act?

PwC response

Current US GAAP contains no specific disclosure requirements related to government grants outside of the disclosures in ASC 740 for assistance provided through the income tax regime and ASC 958-605 for not-for-profit entities. However, companies should consider disclosing the impact of any CARES Act provision utilized or expected to be utilized to the extent that it has, or is likely to have, a material impact on the company's financial statements. Disclosures that may be appropriate include:

- Significant terms and conditions of the government assistance, such as the form of the grant (e.g., refund of taxes paid, cash, or other assets), magnitude of the assistance, duration of the assistance, interest rate (if the form of the assistance is a loan), provisions that require repayment to the government, and other unfulfilled conditions or contingencies
- Accounting policies used to account for the government assistance (for example, whether it is recognized immediately into income or recognized over a period of time, which financial statement line items are affected, and where recognized). This is consistent with a discussion at the FASB's meeting on May 20.

To have a deeper discussion, contact:

Heather Horn

Partner

Email: heather.horn@pwc.com

Maria Constantinou

Director

Email: maria.constantinou@pwc.com

For more PwC accounting and reporting content, visit us at pwc.com/cfodirect. On the go? Take our podcast series with you at pwc.com/cfodirect/podcasts.