

## DISCLAIMER:

Rules and guidance are continually changing. Anything we discuss today COULD be subject to change by SBA/US Treasury/IRS.

For businesses that have received PPP loans, many questions remain unanswered, including details on one of the key features of the PPP.....loan forgiveness. The U.S. Small Business Administration (SBA) is required to issue guidance on loan forgiveness. Many businesses and their advisors are eagerly awaiting this guidance. However, they have issued and continue to update a Frequently Asked Questions document.

[https://home.treasury.gov/system/files/136/Paycheck\\_Protection\\_Program\\_Frequently\\_Asked\\_Questions.pdf](https://home.treasury.gov/system/files/136/Paycheck_Protection_Program_Frequently_Asked_Questions.pdf)

### KEY QUESTIONS ON PPP LOAN FORGIVENESS

Loan forgiveness is based on certain costs over an 8-week period (the covered period). When does the covered period begin?

The covered period begins on the date the lender makes the first disbursement of the loan.

What costs are eligible for loan forgiveness?

At least 75% of the loan amount must be used for certain "Payroll Costs" incurred and paid during the covered period and only up to 25% of the loan amount can be used for "Non-payroll costs", such as Rent, Utilities, and Interest. Amounts paid outside of these parameters will not be forgiven.

A very simple example is: A business receives a \$1 million PPP loan, but doesn't spend 75% on payroll costs (\$750,000) and only spends \$600,000, and spends \$400,000 on the other covered items, the loan forgiveness is limited to  $\$600,000 / .75 = \$800,000$ . This would breakdown as \$600,000 in payroll costs and \$200,000 in other costs forgiven and \$200,000 will not be forgiven.

The intent of the CARES Act PPP loan is to keep employees working at wages comparable to pre-COVID-19 levels. It is important for businesses to consider strategies for maximizing loan forgiveness, while also balancing their short-term and long-term needs. In some situations, it may be more beneficial to continue furloughs or other workforce reductions in the short-term, and pay back any unforgiven loan amount over time at a low interest rate. Other businesses may take steps to increase payroll costs during the covered period by rehiring employees and providing incentive bonuses. Each business must evaluate what is best for them.

The following are payroll costs eligible for loan forgiveness and payroll costs which are not:

- Payroll costs that are eligible for loan forgiveness:
  - Salary, wages, commission or similar compensation (recent SBA guidance states that payroll costs include all cash compensation, including a housing stipend or allowance)
  - Payments for vacation, parental, family, medical or sick leave
  - Allowance for dismissal or separation
  - Payments for the provision of group health care benefits, including insurance premiums
  - Payments for employer's portion retirement benefits
  - Employer paid State or local payroll taxes
  
- Payroll costs that are not eligible for loan forgiveness:
  - Payments to an independent contractor
  - Compensation in excess of \$100,000 (must use employee's annualized wages)
  - The employer's share of federal payroll taxes (social security and medicare)
  - Qualified sick leave and qualified parental leave wages for which credit is allowed under the Families First Coronavirus Response Act (FFCRA)
  
- Non-payroll costs which are eligible for loan forgiveness:
  - Rent payments under leasing agreements in existence on Feb. 15, 2020. These payments can be to a third-party lessor or a related party lessor. At this time, without further guidance, we think this means leases of real property (not personal property, such as equipment).
  - Utility payments for electricity, gas, water, transportation, telephone (land lines and cell lines) and internet for which service was in existence on Feb. 15, 2020.
  - Interest payments on "covered mortgage obligations" incurred in the ordinary course of business that are the liability of the business/borrower on real or personal property (equipment used as collateral with UCC-1 filing) and that was in existence on Feb. 15, 2020.

Are there limitations on loan forgiveness?

Yes, loan forgiveness is limited as follows:

- Not more than 25 percent of the loan forgiveness amount can be attributable to non-payroll costs (i.e., mortgage interest, rent and utilities)

Additionally, the loan forgiveness amount will be reduced if the business has reduced its number of full-time equivalent (FTE) employees or has reduced the salary or wages of certain employees based on the following formulas:

Formula for reduction in FTE employees:

The loan forgiveness amount is subject to reduction by multiplying it by the following fraction:

- The numerator of which is the average number of FTE employees per month employed by the borrower during the covered period
- The denominator of which is, at the election of the borrower, either:
  - The average number of FTE employees per month employed by the borrower during the period beginning Feb. 15, 2019, and ending June 30, 2019
  - The average number of FTE employees per month employed by the borrower during the period beginning Jan. 1, 2020, and ending Feb. 29, 2020
  - Then multiply that fraction by the costs eligible for loan forgiveness

For seasonal employers, as determined by SBA, the denominator is the period beginning Feb. 15, 2019, and ending June 30, 2019.

The CARES Act doesn't define Full-Time Equivalent employees. Typically, employee hours are added up and then divided by either full-time (40 hour work week) payroll equivalents or  $\frac{3}{4}$  time (30 hours work week), then the result is the number of FTEs. The Act is silent on this issue. We are waiting for guidance.

Formula for reduction in wages (guidance is still needed):

The loan forgiveness amount is subject to reduction by an amount determined as follows:

1. Identify all employees, who did not receive during any single pay period in 2019, wages or salary at an annualized rate of pay of more than \$100,000 (each, a covered employee)
2. Compare each covered employee's wages or salary during the covered period to his or her wages or salary during the first quarter of 2020
3. For any covered employee whose wages or salary during the covered period decreased by more than 25 percent
  - a. Multiply the first quarter wages or salary by .75
  - b. Subtract the product from the covered period wages or salary
4. Add all amounts computed under number three above

The aggregate dollar amount calculated as set forth above will reduce the loan forgiveness amount.

Reductions in the number of FTE employees, or reductions in salary or wages, that occurred between Feb. 15, 2020, and April 26, 2020, will not reduce the loan forgiveness amount if, by June 30, 2020, the borrower eliminates the reductions.

What about SBA Advance/Grant and EIDL Loans?

- Proceeds from any advance up to \$10,000 on an Economic Injury Disaster Loan (EIDL) will be deducted from the loan forgiveness amount. We are waiting for more guidance on this. Many businesses received the advance (up to \$10,000 or \$1000 per employee) or an actual EIDL loan AFTER they received the PPP funding due to the timing of when the SBA disaster application was opened (before the CARES Act created the PPP loan).

What terms apply to any loan amount that is not forgiven?

The principal amount of the PPP loan and any accrued interest that is not forgiven will continue as a loan on its original terms, including:

- A maturity date which is two years from the date of disbursement
- No payments during the first six months
- An interest rate of one percent per annum
- No prepayment penalty (prior notice of prepayment may be required if the loan has been sold on the secondary market)

What documentation must be submitted with an application for loan forgiveness?

To receive loan forgiveness, the CARES Act requires that the borrower submit (we don't have guidance on how exactly this will be done yet) an application to the lender /SBA. Applicants should consider documenting :

- Documentation verifying the number of FTE employees on the payroll and pay rates for the covered period and the prior periods included in the formulas for determining any reduction in loan forgiveness, including payroll tax filings reported to the Internal Revenue Service and state income, payroll and unemployment insurance filings
- Documentation, including cancelled checks, payment receipts, transcripts of accounts or other documents verifying payments on mortgage obligations, rent payments (including the lease agreements) and utility payments
- A certification from a representative of the business authorized to make such certifications that:
  - § The documentation presented is true and correct
  - § The amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation or make utility payments
- Any other documentation SBA determines necessary

It will be important for businesses to keep detailed records regarding the use of the PPP loan during the covered period. Businesses should start keeping detailed records beginning on day one of the covered period, insist on receipts and keep an organized system for document storage. While not required under the CARES Act or SBA guidance, PPP loan proceeds may be deposited into a separate bank account, with only costs eligible for loan forgiveness paid out of that account. Good recordkeeping will be critical in maximizing the amount of loan forgiveness. It will be very important for you to stay in touch with your Lender during this time.

A good tool to use for tracking is to set up an Excel worksheet similar to the example below. Businesses may also want to consider a tracking costs in their accounting systems to "tag" or "classify" transactions related to PPP forgiveness. There is no right or wrong way to do this. Each business must establish a process that fits best for them.

PPP Loan Usage Tracking									
Company name:	XYZ Company								
PPP Loan Amount	\$ 150,000.00	Spending Summary		Amount		%			
Origination Date	4/11/2020	Payroll and benefits		51,840.00	85.85%				
8 Week Date	6/6/2020	Other Costs		8,541.00	14.15%	cannot exceed 25%			
Pay periods per year	24	Total		60,381.00	100.00%				
Individual Pay Cap	\$ 4,166.67	Check		60,381.00					
Remaining PPP Loan Proceeds	\$ 89,619.00								
	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Total
Gross wages	29,652.00	14,859.00							44,511.00
Employer paid Retirement plan match	625.00	298.00							923.00
Company portion of health insurance benefits	4,250.00	4,250.00							8,500.00
SUTA	123.00	65.00							188.00
L&I - Employer portion only	100.00	100.00							200.00
Less: Excess over Pay Cap	(1,623.00)	(859.00)							(2,482.00)
<b>Total payroll and benefits</b>	<b>33,127.00</b>	<b>18,713.00</b>	-	-	-	-	-	-	<b>51,840.00</b>
Rent	3,500.00	3,500.00							7,000.00
Electric	500.00	550.00							1,050.00
Gas	50.00	40.00							90.00
Water	45.00	40.00							85.00
Internet	158.00	158.00							316.00
Phones									-
Transportation									-
Interest on a mortgage									-
<b>Total Other Costs</b>	<b>4,253.00</b>	<b>4,288.00</b>	-	-	-	-	-	-	<b>8,541.00</b>
Employee Name	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Total

How does the PPP Loan Forgiveness effect a business's income taxes?

- The IRS clarified that the PPP loan amount forgiven is not taxable to the business.
- The IRS has also recently clarified that the expenses related to forgiveness paid with PPP loan proceeds are NOT tax deductible (you can't double dip, in other words)
- Businesses who received PPP proceeds are not allowed to also participate in the Employee Retention Credit program (which is a payroll tax credit program)

#### SOME ISSUES THAT NEED FURTHER CLARIFICATION

- Many small businesses will be closed at the time their loan is funded due to stay at home orders that have not been lifted or for other reasons. Will the covered period be modified or extended?
- It is unclear what the phrase "costs incurred and payments made" means. Does a cost have to be incurred and paid during the covered period, or are costs that were incurred prior to and paid during the covered period or incurred during and paid after the covered period eligible for forgiveness? Accrual or cash basis?
- The CARES Act and current guidance do not define rent. Are items such as common area maintenance (CAM) charges, insurance and taxes that are often defined as "additional rent" in a lease agreement included? Are lease agreements limited to leases of real property? What about personal property leases?
- How is "full-time equivalent employees" defined?

- How will SBA make a determination that a business is a "seasonal business?"
- It may be necessary for businesses to continue to furlough or lay off employees even after receiving PPP loan proceeds. What happens then?
- What happens if it may not be possible for businesses to rehire employees or increase wages by June 30, 2020. Will the time periods that determine whether a business has eliminated a reduction in employees or wages be adjusted?
- The CARES Act requires that the lender make a decision on loan forgiveness not later than 60 days after the date the lender receives the application. Will there be further guidance on the application and approval process for loan forgiveness?
- AND SO MANY MORE.....