

How much of Your Paycheck Protection Program Loan Will be Forgiven?

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A look at the Paycheck Protection Program (“PPP”)

- The process of applying for the PPP was intense for applicants and professional advisors
- CARES Act is **ambiguous**, and the **clarifying guidance** that followed **was sparse on details** and filled with **confusing language**
- No shortage of anxiety as businesses attempted to participate within a banking system that was unprepared to help business owners apply for the PPP

Initial Steps when you receive your PPP loan:

- Set up a separate bank account to hold the funds and only withdraw from the account monies used to pay qualifying expenses.
 - At the end of the 8-week week period, you will have to prove your use of funds for any forgiveness
- Create a file to save the documentation for the expenses as this documentation will be needed to support any forgiveness.

Initial Steps when you receive your PPP loan:

- Documents to put in the file would be
 - Payroll registers for each payroll paid
 - Rent invoices, utilities bills, medical, dental and other benefits insurance bills along with the calculations for the employer portion (only pull the employer portion from the funds), retirement plan matches that are funded, etc....
- Pull only the funds supported by the documents as they are being paid to employees or the vendors.
- Determine the maximum amount of Non-Payroll Costs that can qualify for loan forgiveness. SBA has said that that no more than 25% of the forgivable amount of a PPP loan can be attributable to non-payroll costs. (PPP loan of \$100K X 25% = \$25k Non-Payroll)

What Costs are Forgivable?

- **Payroll costs** – What constitutes “payroll costs” was a hot topic as companies were applying for PPP loans. When the dust settled, the SBA clarified that payroll costs include
 - Gross salaries and wages of employees up to a cap of \$100,000 per year,
 - Employer-paid health insurance,
 - Employer-paid 401k matching contributions, and
 - Employer-paid state and local taxes on payroll (e.g., unemployment insurance), among
 - Payroll costs **do not** include the employers Social Security & Medicare match
- **Non-Payroll Costs**
 - **Rent Obligations** – This includes payments under a lease agreement in force before February 15, 2020. This most likely refers to leases of real property, such as office space. Not clear if equipment leases are a qualifying expense.
 - **Utilities** – The CARES Act defines utilities narrowly to include: electricity, gas, water, transportation fuel costs for business vehicles, telephone, or internet service for which service began before February 15, 2020.
 - **Interest** – The CARES Act uses a term “covered mortgage obligation,”

What does “Costs incurred and payments made” within 8-weeks?

- Requirement that only “costs incurred and payments made” within the 8-week period will be forgiven needs further guidance
- **One interpretation** could mean **BOTH “Incurred AND Paid”** within the 8-week period
 - Funded April 15
 - Can’t use any of the funds for payroll incurred before April 15th
 - Can’t use any of the funds for rent incurred before April 15th or after June 15th

What does “Costs incurred and payments made” within 8-weeks?

- Other interpretation could be more liberal - does not require any particular expense to be both paid AND incurred but rather accommodates BOTH “**COSTS incurred**” and “**PAYMENTS made**”
 - Can use any of the funds for payroll incurred before April 15th but paid during the 8-week period
 - Can use any of the funds for rent incurred before April 15th or before June 15th but paid during the 8-week period
- While allowing for prepayment of expenses may appear illogical, remember that the CARES Act specifically bars prepayment of mortgage interest during the covered period, BUT only mortgage interest

Is the amount of the PPP loan that was forgiven taxable income?

- CARES Act states that amounts forgiven on the PPP loan “**shall be excluded from gross income**”
- However, Code Section 265 of the Internal Revenue Code provides that **expenses “allocable to” tax-exempt income are NOT deductible**
 - This prevents “double dipping”
 - Prevents creating a loss that can now be carried back to collect a refund of previously paid taxes
- Congress could amend Code Section 265 to accommodate this situation – need to continue to watch

Can a business have Self-Rental Payments forgiven?

- Many business owners have real estate in a separate legal entity
- CARES Act allows business to pay Rent Costs during the covered period
- CARES Act does **NOT** differentiate between payments to unrelated third parties and related entities
- We are waiting for guidance if rent payments extend to “leased equipment”. CARES Act does not indicate it would not qualify

How to Calculate your Maximum Forgiveness

■ Headcount Adjustment Factors

- Determine the Average Number of FTEs*

1. Measured Period

Using 2019 – 2/15/19 to 6/30/19 **

or

Using 2020 – 1/01/20 to 2/29/20

2. Covered Period - 8-Week Period (from PPP funding)

* FTE's has been defined as a person that works 30 hours in a week

** Note: Seasonal **Employers must use** – 2/15/19 to 6/30/19

How to Calculate your Maximum Forgiveness

- Example of Headcount Adjustment in determining Forgiveness
 - Loan Amount: \$500,000 (all funds were spent on Qualifying Expenses)
 - Average # of FTEs during “measured period” from 2/15/19 to 6/30/19 = 75
 - Average # of FTEs during “covered period*” = 55
 - PPP Calculation = $55 / 75 = 73\%$
 - Maximum loan forgiveness = $\$500,000 \times 73\% = \$365,000$
 - Therefore, the Company will need to repay $\$135,000$ of the loan over 18 months at 1% annual interest rate starting 6 months after funding

*- covered period is the 8-weeks following funding of the PPP

- This formula does not seem to make sense and looking for further guidance

How can you “Correct” reductions of Forgiveness?

■ Head Count Adjustments - General Observation

- CARES Act states that this **reduction will be ignored** if **no later than June 30, 2020** the business **restores the employee levels** to what they were during the measured period.
- *It is currently unclear mechanically how you would employ the correction. Do the employees need to be on payroll and paid by June 30, 2020 to meet the Correction requirement?*
- **We NEED clarifying guidance**

How to Calculate your Maximum Forgiveness

■ Headcount Adjustments – General Observation

- There are still many questions related to this
 - What are the limits on rehiring? Can you rehire for a completely different person or position? Do temporary employees count? Can a business owner hire their own spouse or child to meet payroll costs and headcount?
- **We NEED clarifying guidance**

How to Calculate your Maximum Forgiveness

■ Wage Adjustment

- Penalty for Companies who reduced wages per employee by more than 25% compared to the most recent quarter before the PPP loan was made
 - Businesses only need to consider employees who makes \$100,000 or less per year
 - The statute compares an 8-week period to 3-month period (will need further guidance)

How to Calculate your Maximum Forgiveness

■ Wage Adjustment

■ Example of Wage Adjustment

- Loan issue date: April 1, 2020
 - Employee's salary in Q1 2020 = \$20,000
 - Employee's salary during 8-week covered period = \$13,000
 - Amount of forgiveness reduction: $(\$20,000 - \$13,000) - (\$20,000 \times 25\%) = \$2,000$
- We NEED clarifying guidance

Who determines the Forgiveness?

- The Lender has 60 days to make a decision on forgiveness
- The CARES Act requires the lender to receive the required documentation and certifications from the borrower
- The Lender will not be subject to SBA enforcement action or penalties if it chooses to forgive the loan
- Without guidance each Lender will determine their interpretation of key terms and computational formula and just as the case with the determination of the maximum loan amount

If you have further questions please
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