

CARES Act – PPP Loan Forgiveness

The SBA has released guidance on the PPP loans in a very scattered manner. This email pulls all that guidance together into one description of how the PPP loan forgiveness is calculated.

The original amount of the PPP loan was 2.5 times the average monthly payroll of the borrower for a base period. Any wages over \$100,000 per year were excluded from this calculation. The forgiveness of the loan is based on the amount spent on specific purposes in an eight-week period. The allowable purposes are payroll (including certain benefits), rent, utilities, and interest on secured debt. The amount of loan forgiveness may be reduced for reductions in the business's FTE employees or reductions in employee wages. Since the enactment of the CARES Act, the SBA has issued guidance on almost every aspect of the loan forgiveness calculation.

Timing of the Eight-Week Period for Calculating Loan Forgiveness

The eight-week period for expenditures that count for loan forgiveness generally begins on the date the initial loan proceeds are deposited into the business's bank account. However, the business can elect a different period that is used only for the payroll cost portion of the calculation. Electing businesses can use the eight-week period that begins on the first day of the next payroll period after the deposit of the loan proceeds. Even if the business makes this election, the eight-week period for non-payroll costs still begins with the date the loan proceeds are deposited to the business's bank account.

Use of Cash Versus Accrual Accounting on Expenditures

The language of the CARES Acts was unclear regarding whether the forgiveness was based on the payments during the eight-week forgiveness period or based on the costs that are incurred during the eight-week period. The SBA addressed this issue by allowing both. A borrower can include costs if they were paid during the eight-week period. In addition, the borrower can include costs that were incurred during the eight-week period but not paid until the following invoice period. Thus, depending on the timing that the business uses for paying its expenditures, more than eight-weeks of costs may be included in the calculation. Note that the business must pay the incurred costs before the end of the next billing cycle in order to count them toward the debt forgiveness.

For example, assume that a business pays two utility invoices for \$500 during the eight-week loan forgiveness period. Furthermore, the eight-week period ends half way through the following billing period. The business pays the \$500 bill for the following period before the end of the next billing period. This business can include \$1,250 of these utilities toward the debt forgiveness (The two paid invoices plus half of the next invoice for the utilities incurred during the eight-week period).

Payroll Costs

Payroll costs paid or incurred during the eight-week period for loan forgiveness can be applied toward the loan forgiveness amount subject to a couple of limitations. These limitations apply at the employee level, so the calculation is very detailed. Note that the employer has two options for selecting the eight-week period as discussed in "Timing of the Eight-Week Period for Calculating Loan Forgiveness" above.

The employer needs to total the gross wages paid to the employee during the eight-week period. This wage figure is before any employee taxes or employee deductions. Next the employer needs to calculate the accrued wages at the end of the eight-week period. This is the amount of gross wages that the employee has earned but not yet been paid since the last payroll period. The SBA refers to the total of these gross wage amounts as cash compensation.

The business should then total the employer payments for health-insurance, qualified retirement benefits, and state and local employer taxes (state unemployment and local occupational privilege taxes) by employee. The SBA refers to these costs as non-cash benefits.

The total wages for each employee that count toward debt forgiveness are limited. The calculation of the limitation depends on whether the employee is also an owner of the business. At this point in time, the SBA has not applied any de minimis exceptions to the ownership rules for any employees with very small ownership in the business.

If the employee is not an owner of the business, the total cash wages are limited to \$15,385. For non-owner employees, the non-cash benefits are not subject to the \$15,385 limitation.

If the employee is an owner of the business, there are two limits that apply. First, the \$15,385 limitation applies to the total that can be applied to the loan forgiveness. Not only is the cash compensation limited to this amount but the health-insurance, retirement benefits, and state and local employer taxes are also subjected to the limit.

The second limitation that applies to owner-employees is that the total applied toward the debt forgiveness cannot be more than 8/52 of the 2019 compensation including non-cash benefits. For owners with at least \$100,000 in 2019 compensation, this additional limitation will not have any effect on the calculation.

For self-employed individuals, the amount of income that applies toward the debt forgiveness is 2/52 of the 2019 self-employment income. This total debt forgiveness for self-employment income is limited to \$15,385 for each self-employed person.

The business will need to include the following documentation with the application for loan forgiveness:

- Payroll reports documenting the cash compensation paid to each employee during the eight-week period,
- Bank statements showing the payments if the employer processes their own payroll,
- Tax forms (or equivalent reports from a third-party payroll service provider) for the periods that overlap the eight-week period,
- State quarterly business and individual employee wage reporting and unemployment insurance tax filings to the states,
- Payment receipts, cancelled checks, or account statements documenting the employer contributions to employee health insurance and retirement plans if they are included in the forgiveness calculation,
- Documentation of the average number of FTE employees during the base period the business has used for the FTE calculation.
- Documentation of the average number of FTE employees during the eight-week forgiveness period.

Non-Payroll Costs

Borrowers may apply certain non-payroll costs toward debt forgiveness on the PPP loans. However, the SBA has limited these costs to 25% of the total amount of loan forgiveness. The costs that can be used for loan forgiveness are rent, interest on secured loans, and utilities if these costs relate to arrangements that existed as of February 15, 2020.

Both real estate and tangible personal property (i.e. equipment leases) rent count towards loan forgiveness. The business will need to submit one of the following as documentation of the payments:

- Copy of current lease agreement and receipts or cancelled checks verify eligible payments
- Lessor account statements from February 2020 and from the eight-week forgiveness period plus the month after the period.

The interest on the secured loans include loans that are secured by real estate as well as loans secured by tangible personal property. The loans must have been in existence on February 15, 2020. The business will need to submit one of the following items for documentation:

- Lender amortization schedule and payment receipts or copies of cancelled checks,
- Lender account statements from February 2020 and the months included in the eight-week forgiveness period plus the month after the period.

Business utility payments include electricity, gas, water, transportation, telephone, or internet access. The business will need to submit copies of one of the following:

- Invoices from February 2020 and those paid during the eight-week period, and one of the following to document the payments
 - Receipts,
 - Cancelled checks, or
 - Account statements.

Reductions of Loan Forgiveness Amounts

The amount of loan forgiveness must be reduced by reductions in FTEs from the base period as well as for reductions in pay of employees. However, there are exceptions so that some reductions may not reduce the loan forgiveness amount.

Reduction for Reducing the FTEs

As a general rule, a business must reduce the amount of loan forgiveness proportionally for reductions in employee FTEs from a base period. The percentage reduction applies to the total loan forgiveness, not just the payroll cost portion. However, there are exceptions to these reductions. The business has the following options for choosing a base period for calculating the reduction:

- February 15, 2019 through June 30, 2019,
- January 1, 2020 through February 29, 2020, or
- If the employer is a seasonal employer, any consecutive twelve-week period between May 1, 2019 and September 15, 2019. The SBA has not yet issued guidance defining the term "seasonal employer".

The business has two options for calculating FTEs. However, the same methodology must be used for all purposes. Those options are:

- Total each employee's hours for the base period. If an employee works at least 40 hours per week, that employee counts as 1 FTE. If the employee works less than 40 hours per week, the number of average weekly hours during the base period divided by 40 hours per week produces the FTE of the employee. For example, if an employee averages 30 hours per week, that employee would count as 0.75 FTE (30 hours/40 hours).
- Each employee working at least 40 hours per week would represent 1 FTE. Each employee working less than 40 hours per week would represent 0.5 FTE.

The exceptions to these rules complicate the calculation but can greatly benefit the business. Following are the exceptions:

- If the business restores the FTEs to the average for the base period by June 30, 2020, there is no reduction to the loan forgiveness. Note that as the rules currently stand, this exception is all or nothing. An employer doesn't receive partial credit for restoring a portion of the FTE reduction.
- If the business makes a bona fide written offer to the employee to return to their position at the same pay and the same hours but the employee rejects the offer, that employee does not count as a reduction in the FTEs. However, the employer must document the rejection of the offer and notify the state unemployment office of the rejection within 30 days of the employee's rejection of the offer.
- If an employee voluntarily leaves employment, that employee does not count toward the reduction in FTEs.
- If a business terminates an employee for cause, that employee does not count toward the reduction in FTEs. The business must document that the termination was for cause.

In addition to the FTE reduction, the business must reduce its loan forgiveness for the amount of reductions in employee pay over 25%. However, there are three exceptions to this reduction:

- If the business paid the employee an annualized wage of \$100,000 or more for any pay period in 2019, there is no reduction for that employee. For example, if a business paid an employee \$1,000 per week on a weekly payroll in 2019 and gave the employee a Christmas bonus in one of the December paychecks, that employee would have been paid \$2,000 for one weekly payroll period in 2019. That annualizes to \$104,000 and any reduction in the employee wage would not create an adjustment to the loan forgiveness amount.
- If the employee is restored to their former base pay amount by June 30, the wage reduction adjustment does not apply.
- To the extent that the reduction in pay was due to a reduction in the work hours for the employee, the reduction does not apply.

The reductions in the amount of forgiveness are applied before the comparison to the amount of the loan on the SBA form. As a result, the reductions will not always actually reduce the amount of loan forgiveness. For example, assume that a business has an \$80,000 PPP loan. The business has \$100,000 of eligible costs for loan forgiveness. The business also has a 15% reduction in FTEs. When the business applies the 15% reduction to the \$100,000 in eligible costs, the result is \$85,000. Since this amount is higher than the loan amount, the full \$80,000 of loan is still forgiven.

Effect of EIDL Loan Advance

The amount of loan forgiveness is reduced by any advances the borrower received on EIDL loans. Note that the business has the option of rolling the EIDL loan advance into the PPP loan. Doing so increases the total amount eligible for forgiveness.

Application for Loan Forgiveness on Form 3508

To receive forgiveness on the PPP loan, the business must submit SBA Form 3508 to the SBA along with all the required documentation. The form includes several sections that must be completed. The first section is general information to allow the bank and SBA to identify the borrower, the loan, and the periods that apply for the eight-week period and the base period.

The next section is a summary calculation that totals the costs that apply toward loan forgiveness. Then the calculation adjusts for any reductions for reduced FTEs (or wages) and then compares it to the total amount of the loan amount to calculate the total loan forgiveness.

The next section of the form is a series of certifications that the business must make in order to have loan forgiveness apply.

PPP Schedule A follows the certification and calculates the payroll cost portion of the forgiveness on a summarized basis.

PPP Schedule A Worksheet is where the bulk of the detail calculations are performed. It splits employees into those who made less than \$100,000 in all 2019 pay periods, and those who made more than \$100,000 in all 2019 pay periods. Detailed payroll information is then provided for those employees.

Proposed Changes in Congress

There are proposed bills in the House and the Senate that would eliminate the requirement that 75% of the loan forgiveness be for payroll costs and extend the eight-week period for loan forgiveness. In addition, there are proposals to eliminate the reduction for FTEs. Although passage of bills is uncertain until Congress votes on them, there seems to be substantial support in Congress for making changes. If your business is affected by these items, you should consider waiting to submit your application for debt forgiveness to avoid needing to amend it.

In addition, the SBA seems to constantly adjust and add to the rules for the program. We will continue to keep you up to date on new developments.