

# Payroll Protection Program Loans Recap & Forgiveness Q&A

July 28, 2020

On June 30<sup>th</sup> (the original deadline for applying for a Payroll Protection Program loan) Congress extended the deadline for new PPP loan applications to August 8. With new COVID-19 cases blowing up across the country, new warnings about additional potential economic consequences, and \$130 billion left in this loan program, this extension is not surprising. Whether Congress will try to tweak the rules of the existing program once more, start a new program, or a combination of both remains to be seen. In the meantime, let's take a refresher course in where we are now, understanding that "now" is subject to change at any time.

***Important: All information contained herein is our opinion of the current regulations, which continue to lack clarity and guidance.***

## **A. Basic Loan Information**

1. PPP loan is backed by the Small Business Administration but administered by the banks.
2. Maximum loan amount was based on 2.5 months of payroll costs incurred by the borrower in 2019. Payroll costs for this purpose were considered to include gross wages, state unemployment taxes, health insurance payments, and retirement plan payments. For corporate owner-employees compensation/gross wages meant amounts reported on 2019 W-2's. For self-employed partners and sole proprietors, compensation meant net taxable profits on Forms K-1 or Schedule C.
3. Repayment terms - the SBA originally established a repayment period of 2 years. The Paycheck Protection Program Flexibility Act later revised it to 5 years. Loans received before June 5 were issued as 2-year loans. Loans received after June 5 were issued as 5-year loans. Borrowers who received their loans prior to June 5 may request that terms be changed to a 5-year period if the bank agrees, but the borrower must contact the bank and request the modification. The repayment period will NOT be automatically revised to the longer period. If you are not sure what terms you have, make sure to check your loan documents to determine if you should request this modification from your bank.
4. Interest Rate for any portion of the loan not forgiven will be 1%. Interest will accrue from date of receipt. Interest on loan amounts that are forgiven will be paid to the banks by the SBA, not the borrower.
5. Loan documents issued by the banks do not include information on forgiveness. Until a borrower applies for loan forgiveness and gets approved by both the bank and the SBA, all proceeds will be considered to be loans.
6. Forgiveness amounts – The entire loan principal may be forgiven, assuming borrowers are able to spend the funds on the approved categories of costs in the required percentages during the specified "covered period."

7. Covered period – The “covered period” is the period of time in which the borrower may spend the proceeds in the required categories to achieve forgiveness. Initially the covered period was identified as the 8 weeks following the borrowers’ receipt of the funds. The Flexibility Act later changed it to the 24-week period following the borrowers’ receipt of the funds.

24 weeks is now the default covered period, although borrowers have the option to use the original 8-week period if they prefer. It is assumed that only those who have spent the entire loan proceeds in appropriate qualifying amounts and in the appropriate categories during the first 8 weeks will avail themselves of that option. Payroll forgiveness calculations and caps are different under the 8-week and 24-week covered periods.

There are some “alternative” covered periods allowed only for payroll costs if a borrower’s payroll frequency is bi-weekly or weekly, but I will not cover that here. Email me with questions if you feel you need to consider an alternate covered period.

8. The last day to apply for a loan under this program is currently August 8, 2020.

## **B. Loan Forgiveness Q&A**

### **1. What may I pay with the loan proceeds in order to get the loan forgiven?**

Only the following categories of costs are eligible for forgiveness:

- a. Payroll costs - both cash compensation and non-cash compensation (must be 60% of the total amount to be forgiven)
- b. Rent or lease payments
- c. Utilities (electricity, gas, water, transportation, telephone, and internet)
- d. Interest on preexisting business loans on real or personal property (think of a car loan).

To be considered for forgiveness the expenses must be paid or incurred during each borrowers’ covered period.

### **2. What payroll costs are eligible for forgiveness?**

Payroll costs may include gross wages (cash compensation), health insurance costs paid by the employer for employees (but not owners of S corporations), employer payments of retirement plan costs for employees, and state unemployment taxes.

Payroll costs do not include the employer’s portion of payroll taxes or fees paid for payroll services.

Payroll costs do not include any compensation in excess of \$100,000 per individual annually. Employees making more than \$100,000 per year are limited to using \$100,000 in the forgiveness calculations. For example, for a borrower using a 24-week covered period, forgivable payroll costs for an employee making over \$100,000 are capped at \$46,154

(\$100,000 divided by 52 weeks times 24 weeks). If using an 8-week cover period, the maximum forgivable pay for the same employee would be \$15,385 (\$100,000 divided by 52 weeks times 8 weeks).

Compensation forgiveness for owners of S corporations (owner-employees) and self-employed individuals/general partners have the following caps:

- a. If using the 8-week covered period, forgivable amounts cannot exceed 8 weeks' worth of the 2019 compensation, and is capped at \$15,385 (\$100,000 divided by 52 weeks times 8 weeks). Forgiveness applies only to amounts paid or incurred during the covered period.
- b. If using the 24-week period, forgivable amounts cannot exceed 2.5 months' worth of 2019 compensation, and is capped at \$20,833 (\$100,000 divided by 12 months times 2.5 months.) Forgiveness applies only to amounts paid or incurred during the covered period.

**3. Can I just use payroll if my eligible payroll costs during the covered period are equal to or exceed the loan amounts?**

Yes. This is more likely to occur if the borrower is using the 24-week period, since the original loan amount was based on 2.5 months' worth of compensation, which is more than 8 weeks.

**4. What if my payroll costs do not add up to 60% of the total costs eligible to be forgiven?**

In that case, the amount of the eligible non-payroll costs will be reduced until the payroll costs are equal to 60% of the total forgiveness amount. With a loan of \$55,000, for example, if during the covered period the borrower has \$30,000 in eligible payroll costs and \$25,000 of eligible non-payroll costs for a total of \$55,000 in eligible forgiveness costs, the non-payroll costs would be reduced to \$20,000, so that the total payroll costs of \$30,000 would then represent 60% of the total, decreasing the allowable forgiveness costs to \$50,000. The remaining \$5,000 would then be subject to the repayment terms.

**5. What if I received my loan on May 1, and I paid employees on May 1 for wages earned the week ended before that ended on April 24?**

The guidance says costs "paid or incurred" during the covered period are eligible for forgiveness. Since your covered period began on May 1 and since the payroll checks or direct deposit transfers were dated May 1, this payroll should be eligible and count towards forgiveness even though it was incurred/earned prior to your covered period.

**6. What does "incurred" mean when determining what costs are eligible for forgiveness?**

In this case, "incurred" basically means earned, regardless of whether it is a payroll cost or a non-payroll cost. If an employee works 8 hours in one day, the cost of that day's pay has been incurred, even if not paid, and is eligible to be included in your total forgiveness as long as it is paid by the next normal payroll date.

If your covered period ends, say, on September 30, and your electric bill covers the period from September 16 to October 15 and is not due to be paid until October 30, the cost of the electricity from September 16 through September 30 has been incurred, although not paid, and meets the qualifications to be included in your forgiveness application, as long as it is paid by the regularly scheduled due date.

## 7. What is the deadline to apply for forgiveness?

There is no stipulated “due date” to apply for forgiveness. However, repayment of the loan amount will begin 10 months after the end of your covered period for any amounts not forgiven, so it would make sense to submit your application for forgiveness once your covered period has ended, or as soon as you have met the requirements to have the loan forgiven.

Unless you have decided to use the 8-week covered period, have spent all the loan proceeds, are fairly sure that all will be forgiven, and want to get this over with and never speak of it again, there is no rush to file for forgiveness. Once you file the forgiveness application with your bank, the bank has up to two months to approve and send on to the SBA. The SBA then has three months to confirm the approval.

To determine the end of a 24-week covered period, use the date you received the funds as day one, with the last day of the period being day 168.

## 8. I am the only owner of an S corporation and have no other employees. In 2019 I paid myself a salary of \$80,000. My company also paid for my health insurance premiums of \$15,000 and made a contribution of \$23,750 to my retirement plan. How much can I include as payroll costs on my forgiveness application?

As owner-employee of an S corporation, your health insurance premiums are not deductible to the corporation as insurance, but must be classified as additional wages and reported on your W-2. Therefore, for 2019, assuming your W-2 correctly reported box 1 wages of \$95,000 (\$80,000 in salary + \$15,000 of health insurance), your 2019 cash compensation would be \$95,000. *(If your W-2 preparer did not include your health insurance premiums as wages on your W-2, then your gross wages for this purpose would be only the \$80,000 that appeared on your W-2.)*

- a. Under an 8-week covered period, your forgivable payroll would be the lesser of 8/52nds of \$95,000 (\$14,615) or the amount actually paid or incurred during the covered period. (If your 2019 compensation had been \$130,000, forgiveness would be capped at \$100,000, so the maximum for cash compensation forgiveness for salaries exceeding \$100,000 would be 8/52nds of \$100,000 or \$15,385.)
- b. Under a 24-week covered period, the calculations are different for cash compensation for owner-employees. Instead of taking 24/52nds of the 2019 compensation, the forgiveness amount for the 24-week period is capped at the lesser of 2.5 months of your average 2019 monthly salary or \$20,833. In the example above, the owner’s payroll forgiveness for a 24-week covered period would be \$19,792 (\$95,000 divided by 12 months times 2.5 months).

- c. Retirement contributions are considered to be non-cash compensation and are not included in the cash compensation limitations. Retirement contributions eligible for forgiveness will be limited to the lesser of 8/52nds (8-week period) or 2.5 months (24-week period) of contributions paid for 2019 OR amounts paid for 2020 contributions during the covered period. In other words, if no contributions are paid during the covered period for 2020, forgivable costs would be zero.

**9. I received a PPP loan of \$50,000. I also received an advance grant under the EIDL program of \$10,000 and a loan under the EIDL program of \$75,000. How much of these loans can be forgiven?**

The advance \$10,000 “grant” received under the EIDL program does not need to be repaid. However, it will reduce the amount available for forgiveness under the Paycheck Protection Program. Therefore, even if you had \$50,000 of eligible PPP forgiveness costs paid or incurred during your covered period, the maximum forgiveness allowed under PPP would be \$40,000. Since your original PPP loan was \$50,000 and only \$40,000 was allowed as forgiveness, the remaining \$10,000 of the PPP loan would be subject to repayment. In total you will have received \$135,000, of which \$40,000 of the PPP loan will be forgiven, \$10,000 of the EIDL grant is “forgiven,” and you will be liable for loans to be repaid of \$10,000 of PPP funds and \$75,000 of EIDL funds.

**10. My business pays rent on its office under a 5-year lease that was effective starting in 2018. It also pays for off-site storage that we started renting in April of 2019. Are both these costs considered eligible non-payroll costs for forgiveness?**

The rent for the office is considered to be eligible for forgiveness; however, it is our opinion that the storage rent would not qualify for forgiveness, as the obligation to pay that rent was not in existence as of February 15, 2019.

**11. I am a business owner. By the time my business received a PPP loan, I had already applied for and was receiving unemployment. Can I continue to receive unemployment after receiving the PPP loan?**

I have received a number of questions similar to this. Although I have not seen where this has been specifically addressed in any of the guidance, my opinion is that, since the PPP loan’s major purpose is to provide funds to allow a business to rehire employees at their previous level of pay or to replace net income for self-employed individuals, then continuing to accept unemployment wages while compensating yourself with PPP funds would be considered “double-dipping” and would not be allowed under the state or federal unemployment rules. Since your replacement wages paid with PPP funds would need to be paid out and reported to the state employment agency in your quarterly reporting, I would expect this to be easily uncovered, and any receipt of excess unemployment would need to be paid back. And knowingly accepting unemployment while at the same time receiving paid compensation could be subject to other penalties. I would strongly suggest that you avoid this kind of situation.

**12. As the sole owner and employee of an S corporation, my salary for 2019 was calculated and reported at year end when net income was determined. I do not have a standard schedule for paying myself wages, such as weekly, bi-weekly or monthly. How do I establish “paid or incurred” wages during the covered period for forgiveness?**

You will need to establish (and pay) your 2020 salary on a minimum of a monthly schedule, based on the cash compensation you reported for 2019. For example, if your 2019 cash compensation was reported as \$36,000, you will need to pay yourself \$3,000 per month during the covered period. This means you will need to calculate and deduct all required payroll taxes and issue yourself a check for the net amount. These monthly payments will also need to be reported on your quarterly payroll reports, such as form 941, state withholding reports, and state unemployment reports. In order to get such payroll costs forgiven, you will be required to provide proof of payment and copies of the quarterly reporting. Although the maximum eligible for forgiveness will be two and a half months’ worth of your 2019 salary, a covered period of 24-weeks is close to being six months. In my opinion, I would continue to maintain a monthly salary payment schedule during the entire covered period to support your forgiveness calculations based on 2.5 months.

**13. My business rents a property owned by me (self-rental). Does rent paid to me in this situation qualify for forgiveness?**

Self-rental qualifies for forgiveness as long as there was a written lease in place prior to February 15, 2020.

**14. My spouse is employed in a business I own. Are his/her wages subject to the same forgiveness caps as mine as an owner-employee?**

As of now, the SBA has not addressed the rules of family attribution with regard to PPP forgiveness, so we are presuming your spouse’s wages will be forgivable under the same rules as any other employee.

**15. What are the PPP forgiveness penalties?**

There are two types of “penalties” that can reduce the forgiveness available.

- a. Reduction in full-time employees (based on hours worked) when compared to a base or measurement period, and--
- b. Reduction in excess of 25% in an employee’s wages from that which was paid during the base period.

Both these reductions may be avoided if an employer is able to bring either or both the full-time employee number or the level of compensation for individual employees back up to those established during the base period by December 31, 2020. If a borrower anticipates such a circumstance, it would seem prudent to delay filing the application for forgiveness until such levels have been re-established and can be documented.

(The calculations for these criteria are complicated and I will address them later in a future report.)

**16. Is there software available to calculate the information required for the forgiveness application?**

I have heard there is some software being offered. However, we have been told that banks may require applicants to use their own proprietary software to calculate your forgiveness information, so you should see how your bank wants you to proceed.

**17. There has been some mention in the news media that Treasury Secretary Mnuchin has suggested that smaller loans under a certain threshold (\$50,000? \$150,000? have been mentioned) may be forgiven without the need to provide verification of how the funds were utilized. Would this apply to my small loan?**

It is my understanding that there is a broad coalition of trade associations and advocacy groups, joined by the American Bankers Association, that is voicing support for a bipartisan bill that would expedite the forgiveness process. It calls for a one-page forgiveness form.

I suspect that the government is starting to realize two things: The banks and the SBA will be overwhelmed and be unable to administer this program in a timely manner, and the impact of COVID-19 is much bigger and longer lasting than they expected. Also, the longer 24-week covered period available to all borrowers, and the ability to escape from forgiveness reduction penalties due to the more borrower-friendly employment rules, makes it more likely that a substantial number of these loans will be 100% forgiven anyway. The cost of verifying compliance could be more than the funds returned to the government in the form of loan repayments and interest. I cannot predict the outcome of this proposal, but I can see why they might be considering it. The concerns about fraud may be considered minor in comparison to the overall relief provided by eliminating the need to approve the forgiveness applications of all those smaller loans, but we can only wait and see how it plays out in Congress.

The banks are also in somewhat of a holding pattern as they wait for more direction. So far as we know, none have yet opened the loan forgiveness application process. With the July 31 end of the \$600 individual unemployment payments, it is expected that updates and changes will come out of Congress before the end of the month, so banks are delaying implementing the forgiveness process.

***At this point we cannot advise that any borrower assume that this proposal will be taken up by Congress. If you have one of these smaller loans, I would strongly urge you to continue to follow all the current guidelines set out to meet the forgiveness requirements currently in place.***