



# The Math on PPP Loan Forgiveness – Part 1



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# Rule Sources

- Coronavirus Aid, Relief, and Economic Security (CARES) Act
  - <https://www.congress.gov/116/bills/hr748/BILLS-116hr748enr.xml>
  - Section 1102 – Paycheck Protection Program (PPP) added to the SBA's 7(a) Loan Program subsection (36).
  - Section 1106 – provides rules for Forgiveness under the PPP
- U.S. Small Business Administration Interim Final Rules (Yes, that's what it's called). Implements and provides guidance for Sections 1102 and 1106
  - <https://home.treasury.gov/policy-issues/cares/assistance-for-small-businesses>
  - Focusing Today's webinar on Section 1106 - Forgiveness
- Changes on a regular basis. Follow the FAQs provided by SBA
  - <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>

# I got my money, now what?

- To Maximize Forgiveness a borrow must:
  1. Spend entire loan proceeds during 8-week “covered period” on:
    - Payroll Costs (75% minimum)
    - Interest on any covered mortgage obligation incurred before 2/15/20
    - Covered rent obligation incurred before 2/15/20
    - Covered utility payment
      - No more than 25% of the forgivable amount can be attributable to non-Payroll costs (1/3 of Payroll Costs).
  2. Employ as many FTEs (avg. per month) during 8-week period as was employed during an elected prior period
  3. Pay each employee during 8-week period at least 75% of Avg. annual wages paid each employee during the most recent full quarter prior to 8-week pd.

# Mulligan, Hail Mary, Exemption Provided

2 Circumstances, reduction of Loan Forgiveness is reduced

1. If the avg. number of FTEs drop from 2/15/20 – 4/26/20 and, the reduction is eliminated by 6/30/20
2. If there is a reduction in wages to 1 or more employees during 2/15/20 – 4/26/20 and, the reduction is eliminated by 6/30/20

# Requesting Forgiveness

- Application will be filed to request the loan to be forgiven by the lender within 90 days of end of 8-week period.
  - Lender has 60 days to review the request for forgiveness.
- Documentation to substantiate the amount of forgiveness requested:
  - Payroll Tax filings to IRS
  - State income, payroll and unemployment insurance filings
  - Receipts, cancelled checks or payment verification of mortgage interest, rent and utility payments.
- Should you house funds and pay from a single segregated bank account?

# Taxation of Forgiven Debt

- Cancelled debt is generally taxable however,
- CARES Act Section 1106(i) excludes from gross income the debt forgiven under Section 1106(b).
- Internal Revenue Code Section 265 disallows deductions otherwise allowable which is allocable to income exempt from tax.
  - Will the deductions paid for by PPP funds be deductible to the extent the Loan is forgiven?

# Unforgiven Debt

- 6 month deferment period of any payment from the date the loan is disbursed from the lender.
- 2 year repayment period
- 1% Interest
  
- Accrued interest plus principal is eligible for forgiveness.



# Core Purpose of the PPP

- Not more than 25% of the loan forgiveness amount may be attributable to the non-payroll costs
- Resources devoted primarily to payroll (aka, Paycheck Protection)
- Focus to keep workers paid and employed
  
- 75% equivalent to 8-weeks of payroll
  - (8 weeks / 2.5 months = 56 days / 76 days = 74%) (ROUNDED to 75%)
    - $8 / 52 = 15.38\% \times 365 \text{ days} = 56.15 \text{ days}$
    - $2.5 / 12 = 20.83\% \times 365 \text{ days} = 76.04 \text{ days}$
    - Sets the payroll bar lower than  $2 / 2.5 = 80\%$

# Misuse of Funds

- PPP funds used for unauthorized purposes will need to be repaid.
- IF YOU KNOWINGLY USE THE FUNDS FOR UNAUTHORIZED PURPOSES, you will be subject to additional liability such as charges for fraud.
- Misused funds can entitle SBA to recourse against perpetrator

# Self-Employed Individuals

- Special Rules – Guidance provided on April 14, 2020
  - <https://home.treasury.gov/system/files/136/Interim-Final-Rule-Additional-Eligibility-Criteria-and-Requirements-for-Certain-Pledges-of-Loans.pdf>
  - Includes rules for Partners in Partnerships
- 2019 Schedule C Net Income capped at \$100,000
  - 8-weeks worth (8/52) - \$15,385 max forgiveness
  - “Owner Compensation Replacement”
  - No covered benefits for Owners included in base or forgiven amount.
- Wages and benefits paid to employees and other authorized obligations similar to other businesses.

# The Math...4 Step Process

**Step 1** – of the full loan amount, determine the amount spent on Payroll and other eligible costs during the 8-week period and compare the % of Payroll costs to total spent.

1. PPP Loan =	\$ 100,000
2. Amount Used for Payroll Costs -	(\$ 71,000)
3. Amount used for other eligible Costs -	<u>(\$ 24,000)</u>
4. Amount Potentially Forgivable	\$ 95,000
5. Limitation on other costs (75/25)	<u>(\$ 333)</u>
6.	\$ 94,667

Note: PR<75%, other costs limited to PR Costs / 3.

# The Math...4 Step Process

**Step 2** – Avg. FTEs per month for 8-week period divided by either of:

- The avg. FTEs per month – 2/15/19 – 6/30/19 OR
- The avg. FTEs per month – 1/1/20 – 2/29/20

Hint: You want your denominator to be the smaller average of the two...

FTEs equal the avg. number of employees you have over a given period defined as one body per 40 hour work week. Divide # of regular hours (not exceeding 40 / wk for any employee) by # of weeks.

Ex. 8,000 hours / 8 weeks / 40 hrs = 25 FTEs

Amount Potentially Forgiven x % above = Amount not Forgivable

# The Math...4 Step Process

**Step 3** – Compare all employees making less than \$100,000 annually and compare their annualized wages for the 8-week period against full preceding quarter annualized wages.

1. Employee #1 – determine avg. annual salary based on avg. wage rate for 1Q 2020 by pay period. Ex. Q1 Pay =  $\$10,000 / 13 \text{ weeks} = \$769.23 / \text{wk}$ 
  - On a 52 week year - \$40,000 annually
  - OT Counts for this purpose
2. Employee #1 – 8-week period Pay =  $\$4,500 / 8 \text{ weeks} = \$562.50 / \text{wk}$ 
  - On a 52 week year - \$29,250 annually
3. Divide  $\$29,250 / \$40,000 = 73.125\% = \text{Fail for this employee}$
4. Reduce amount of Loan forgiven dollar for dollar by \$115
  - $\$769.23 / \text{wk} \times 8 \text{ weeks} \times 75\% = \$4,615 - \$4500 = \$115$

# The Math...4 Step Process

- **Step 4a** - Compare drop in FTEs from 2/15/20 – 4/26/20; if those lost “jobs” are fully restored by 6/30/20 the forgiveness reduction due to FTE count is eliminated. Note: all jobs lost must be restored in order for this amount to be restored. It is Pass or Fail, we think.
- **Step 4b** - Additionally, of the Employees with reduced wages below the 25% threshold, ONLY if those employee wages dropped from 2/15/20 – 4/26/20 and are restored entirely by 6/30/20 to 2/15/20 levels, the forgiveness due to Wage reduction is eliminated. Note: all employees that caused the forgiveness reduction must be restored; not just some of them, for this amount to be restored. It is Pass or Fail, we think.

# Examples...

- Z Company borrowed \$100,000 in PPP money on April 22, 2020. Over the next 8-weeks, Z Company spent \$50,000 on payroll costs and \$40,000 on rent and utilities. Z Company's loan forgiveness is limited to \$66,667.
  - \$50,000 of Payroll Costs = 75%
  - \$16,667 of rent and utilities = 25%
- Non-Payroll costs can only be 25% of the forgivable amount; which in this case is  $\$50,000 / 75\% = \$66,667$



# Examples...

- **8 weeks is NOT 2 Months (8.67 wks).** Thus, even keeping payroll at the EXACT SAME PACE may not yield 100% forgiveness.
- Z Company has \$3.6M in payroll costs for 2019. Their PPP loan was \$750,000. During 8 weeks Z company will pay out \$553,850 in payroll costs and use the remaining \$196,150 for rent and utilities.
  - $\$3.6\text{M} / 12 = \$300,000 \times 2.5 = \$750,000 \times 75\% = \$562,500$
  - $\$3.6\text{M} / 52 = \$69,231 \times 8 = \$553,850$
- All is NOT forgiven.
  - $\$553,850 / 75\% = \$738,470 = \text{Forgivable Amount}$
  - $\$750,000 - \$738,470 = \$11,530 \text{ NOT FORGIVEN}$
  - $\$738,470 \times 25\% = \$184,620 - \$196,150 = \$11,530 \text{ overspent on Non-Payroll} - \text{Check based on "interim final rule"}$ .

# Interpretations...

## “Costs incurred AND payments made” (Sec. 1106(b))

- BOTH incurred (accrual basis) and paid (cash basis) during 8-week period?
- Borrow on 4/22/20 – Does Payroll incurred on April 10<sup>th</sup> count if paid on 4/23?
- Can you pre-pay July rent on June 17<sup>th</sup> at the end of the 8-week period?
- CARES Act specifically bars prepayment of mortgage interest, but doesn't specifically mention anything else...
- We think the test will be primarily cash basis during 8-week period, but guidance here will be useful.

# Interpretations...

- CARES Act allows funds to be spent on payroll costs, mortgage interest, rent, utilities and “interest on any other debt obligations that were incurred before the covered period”. This is Sec. 1102.
- Sec. 1106, which discusses items eligible for forgiveness, left out “interest on any other debt obligations that were incurred before the covered period”.
- Was this intentional?
- Where does that leave a business owner in paying for their regular LOC interest or auto loans during the covered period? Will that amount be forgiven?

## THINGS TO DO NOW...

- Loan x 75% = Payroll Costs; Balance to Rent, utilities, mtg. int.
  - Calendar your 8-week “Covered Period” for timing of payments.
- Compute FTE count averages at 2/15/19 – 6/30/19 and 1/1/20 - 2/29/20 to know what you need to employ during 8-week period. FTE base hours should be consistent (30,40).
  - Ex.  $15,295 \text{ hours} / 2 \text{ months} / 172 \text{ avg. hrs per mos.} = 44.46 \text{ FTEs}$ 
    - Also know FTEs at 2/15/20 and 4/26/20 for jobs lost and replenished exemption
- For E/E’s under 100K annualized; using Q1 wages, know the pay rate for each employee.
  - Ex.  $\text{Q1 Pay} = \$10,000 / 13 \text{ weeks} = \$769.23 / \text{wk}$ 
    - Also know E/E payrate at 2/15/20 and 4/26/20 for wage reduction exemption