PPP Loan Forgiveness

The webinar will begin shortly.

CERTIFIED PUBLIC ACCOUNTANTS
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SBA Forgiveness Rules

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Paycheck Protection Loans

- Loan forgiveness feature: Section 1106 of the CARES Act, as modified by the PPP Flexibility Act: If the PPP is used for its intended purposes, the first 24 weeks worth of certain payments shall be eligible for forgiveness on a tax-free basis (1106(b); 1106(i))
- What payments are covered during the covered period?
  - Payroll costs
  - Interest on a mortgage on real or personal property incurred before February 15, 2020 (does not include any prepayment or payment of principal)
  - Rent for a lease in force before February 15, 2020
  - Certain utilities (electricity, gas, water, transportation, telephone, or internet access) for which service started before February 15, 2020
- Not more than 40% of the forgiven amount can be for non-payroll purposes.
- The limit cannot exceed the principal of the note (interest will still be owed) (1106(d))
- Any remaining balance for loans after June 5, 2020 will be five years. It is still two years for pre-existing loans, but may be renegotiated with lenders.

Paycheck Protection Loans

- Application Process
  - To receive loan forgiveness, a borrower must complete and submit the Loan Forgiveness Application (SBA Form 3508 or lender equivalent) to its lender (or the lender servicing its loan).
  - As a general matter, the lender will review the application and make a decision regarding loan forgiveness. The lender has 60 days from receipt of a complete application to issue a decision to SBA. If the lender determines that the borrower is entitled to forgiveness of some or all of the amount applied for under the statute and applicable regulations, the lender must request payment from SBA at the time the lender issues its decision to SBA. SBA will, subject to any SBA review of the loan or loan application, remit the appropriate forgiveness amount to the lender, plus any interest accrued through the date of payment, not later than 90 days after the lender issues its decision.
  - A borrower may submit the application BEFORE the end of the covered period; for example, if all funds have been expended. Any salary reduction (discussed later) will still be accounted for over the full covered period, however.

Paycheck Protection Loans

- Application Process
  - The lender is responsible for notifying the borrower of the forgiveness amount. If only a portion of the loan is forgiven, or if the forgiveness request is denied, any remaining balance due on the loan must be repaid by the borrower on or before the maturity of the loan. If the amount remitted by SBA to the lender exceeds the remaining principal balance of the PPP loan (because the borrower made scheduled payments on the loan after the initial deferment period), the lender must remit the excess amount, including accrued interest, to the borrower.
  - The general loan forgiveness process described above applies only to loan forgiveness applications that are not reviewed by SBA prior to the lender's decision on the forgiveness application. In a separate interim final rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities, SBA will describe its procedures for reviewing PPP loan applications and loan forgiveness applications.

Paycheck Protection Loans

- Deferral
  - If you submit to your lender a loan forgiveness application within 10 months after the end of your loan forgiveness covered period, you will not have to make any payments of principal or interest on your loan before the date on which SBA remits the loan forgiveness amount on your loan to your lender (or notifies your lender that no loan forgiveness is allowed).
  - Your lender must notify you of remittance by SBA of the loan forgiveness amount (or notify you that SBA determined that no loan forgiveness is allowed) and the date your first payment is due. Interest continues to accrue during the deferment period.
  - If you do not submit to your lender a loan forgiveness application within 10 months after the end of your loan forgiveness covered period, you must begin paying principal and interest after that period.
  - For example, if a borrower's PPP loan is disbursed on June 25, 2020, the 24-week period ends on December 10, 2020. If the borrower does not submit a loan forgiveness application to its lender by October 10, 2021, the borrower must begin making payments on or after October 10, 2021.

Form 3508, PPP Loan Forgiveness Application

- Start with the Worksheet to Schedule A
  - Table 1: compensation for employees who earned less than $100,000 annualized in 2019. These are the only employees who are subject to the wage/hourly rate reduction test to determine a reduction in loan forgiveness.
  - Table 1 is also where FTEs will be computed for these employees, and FTEs will be added back in if an exception exists for lost FTEs.
  - Table 2: compensation for employees who earned more than $100,000 annualized in 2019. Also determine FTEs for each employee.
- Next, to Schedule A
  - Pull payroll costs and FTEs from Table 1 and Table 2 of the Worksheet to Schedule A
  - Input non-compensation payroll costs (health insurance, retirement plan contributions, and certain state taxes on compensation)
  - On Line 9, enter compensation costs for owner-employees.
  - Also determine FTE reduction quotient.
- Finally, Form 3508.
  - Start with total payroll costs from Schedule A. Add nonpayroll costs. Reduce for wage reduction. Multiply net by FTE reduction quotient.
  - Forgiveness is lesser of three numbers. To be discussed later.

Covered Period

- Payroll Costs:
  - Default: 24-week (168-day) period beginning on the day you received the funds.
  - Alternative Payroll Covered Period: Borrowers with a biweekly (or more frequent) payroll schedule may elect to chose the 24-week (168 day) period beginning on the first day of the first pay period following the disbursement date, allowing a business to neatly align its covered period with the beginning of a pay period.
    - Thus, if you received your PPP loan on April 12, and the first day of your next pay period is April 14, you may elect to count the payroll costs — and only the payroll costs — for the 24-week period beginning April 14, 2020, rather than the 24-week period beginning April 12, 2020.
    - If you elect to use the "alternative payroll covered period," you HAVE to use it everywhere that the alternative payroll covered period is an option.

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Covered Period

- Payroll Costs:
  - Alternatively, a borrower who took out a loan prior to June 5th may elect to use the pre-Flexibility Act covered period of 8 weeks.
  - If you use this covered period:
    - You still get until December 31, 2020 to replace FTE/salary (unless you apply for forgiveness before that date).
    - You still get to use 40% of your costs for non-payroll purposes (as opposed to 25%).

Payroll Costs

- Payroll costs; Bucket 1:
  - Cash compensation in the form of:
    - Wages, commission, salary, bonus
    - Cash tips or equivalents
    - Vacation, parental, family, medical or sick leave,
    - Severance, separation pay, and any retirement benefit
  - The above amounts are capped at $100,000 annualized, or $46,154 for the 24-week period ($15,385 for an elected 8-week period).
  - Additional limitations are imposed on owner-employees. To be discussed later.
  - Salary, wages, or commission payments to furloughed employees during the covered period are eligible for forgiveness.
  - Bonus: eligible for forgiveness. Thus, an employer could "bonus" employees to reach maximum 24-week compensation of $46,154.
  - These amounts will go on Table 1 and Table 2 of the Worksheet to Schedule A.

Payroll Costs

- Payroll costs; Bucket 1:
  - Payroll costs for self-employed taxpayers reporting on Schedule C
    - Purely mechanical: the payroll costs are the "owner compensation replacement," equal to 2.5/12 of Line 31 of the 2019 Schedule C, maxed out at $20,833 (for a 24-week covered period; 8/52 of 2019 Schedule C – capped out at $15,384 – for an 8-week covered period.
    - Thus, for a self-employed taxpayer, payroll costs have nothing to do with payments made during the covered period.
    - The cap applies across ALL BUSINESSES.
  - This amount goes on Line 9 of Schedule A.

Payroll Costs

- Payroll costs; Bucket 1:
  - Payroll costs for owner-employees.
    - Who is considered an owner-employee? Any shareholder with a 5% or more interest in a C or S corporation. It is not clear if attribution rules apply.
    - The payroll costs for an owner-employer are capped at the LESSER of:
      - $20,833 for a 24-week covered period ($15,384 for an 8-week covered period), or
      - 2.5/12 of 2019 cash compensation (8/52 for an 8-week covered period). This amount goes on Line 9 of Schedule A.

Payroll Costs

- Payroll costs; Bucket 1:
  - Payroll costs for general partners.
    - Guaranteed payments, and (presumably) the partner's share of all income during the covered period (but how do you compute this in real-time?")
    - These payroll costs are limited to the lesser of:
      - $20,833 for the 24-week period, or
      - 2.5/12 of the 2019 Schedule K-1 (IRS Form 1065) Net earnings from self-employment, computed from box 14a (reduced by any section 179 expense deduction claimed, unreimbursed partnership expenses claimed, and depletion claimed on oil and gas properties) multiplied by 0.9235.
  - This amount goes on Line 9 of Schedule A.

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Payroll Costs

- Payroll costs; Bucket 2:
  - For EMPLOYEES (but not employee-owners), in addition to the $46,154 24-week cap payroll costs include employee benefits for the following:
    - Amounts paid for employer contributions for employee health insurance, including employer contributions to a self-insured, employer-sponsored group health plan, but excluding any pre-tax or after-tax contributions by employees.
    - Employer contributions to employee retirement plans, excluding any pre-tax or after-tax contributions by employees.
    - Amount paid by the borrower for employer state and local taxes assessed on employee compensation (e.g., state unemployment insurance tax).
  - Retirement plan contributions – but not health care costs -- when paid on behalf of an S corporation owner-employee, are forgivable in addition to the $20,833 cap. C corporation owner-employees get both in addition to the cap. For a general partner or self-employed taxpayer, neither are forgivable.
  - These amounts are reported on Lines 6, 7 and 8 of Schedule A.

Payroll Costs

- When are payroll costs paid or incurred?
  - Payroll costs are paid on the day the paychecks are distributed or the borrower originates an ACH credit transaction. Thus, you could presumably receive PPP loans on April 26 and immediately pay – as part of your regular payroll process – wages that had been earned by the employees for the previous two weeks, and include the amounts in the forgiveness calculation because the amounts had been PAID within the covered period.
  - The application instructions further provide that payroll costs are incurred on the day they are earned, before providing additional flexibility by allowing the payroll costs incurred for your last pay period of the 24-week period to be eligible for forgiveness as long as they are paid no later than the next regular payroll date.

Payroll Costs

- When are payroll costs paid or incurred?
  - X Co has biweekly pay periods.
  - The payroll is paid two days AFTER the end of the pay period.
  - If X Co. receives a PPP loan on June 1:
    - If it sticks with the default 24 week period, it will be able to include:
      - The amount PAID on June 8 for payroll for May 24 – June 6, and
      - The amount incurred from June 7 – November 15.
      - A total of 175 days.
    - If X Co. chooses the alterative payroll period, it will be able to include:
      - The amounts PAID on June 8 for payroll for May 24 – June 6, and
      - The amount incurred from June 7 – November 22.
      - A total of 182 days.

Non-Payroll Costs

- Non-payroll costs: Covered Period
  - For non-payroll costs (mortgage interest, rent, utilities), there is no alternative covered period. The covered period begins on the date the borrower receives the loan proceeds and lasts 168 days. You can elect, however, to use an 8-week covered period.
- Non-payroll costs: Paid or Incurred
  - These costs are eligible for forgiveness if paid during the period, even if they relate to periods prior to the covered period.
  - These costs are also eligible for forgiveness if incurred during the covered period, and paid before the next regular due date, even if that due date is after the end of the covered period.
  - It appears these costs – other than for mortgage interest – may be PREPAID during the covered period. Why would they allow this? Because as we'll see, the amount of forgiveness attributable to non-payroll costs cannot exceed 40% of the total. This tends to police itself.

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Non-Payroll Costs

- Non-payroll costs: Mortgage interest
  - Does not include principal.
  - Cannot be prepaid.
  - The mortgage must have been outstanding prior to February 15, 2020. It's OK if it was refinanced after that date.
  - Includes debt secured by real OR personal property;
    - Mortgage interest on warehouse
    - Interest on an auto loan for a vehicle used for business

Non-Payroll Costs

- Non-payroll costs: Rent
  - The lease must have been in place prior to February 15, 2020. It's OK if it was renewed after that date.
  - No limit on prepayment.
  - Again, it appears the SBA is going to let you have at it, because of the 40% cap on total forgiveness applied to non-payroll costs.
  - Includes rent for both real estate and personal property:
    - Rent for warehouse;
    - Lease for business auto.

- Related party rent: the amount of loan forgiveness requested for rent or lease payments to a related party is no more than the amount of mortgage interest owed on the property during the Covered Period that is attributable to the space being rented by the business, Any ownership in common between the business and the property owner is a related party for these purposes. The borrower must provide its lender with mortgage interest documentation to substantiate these payments. While rent or lease payments to a related party may be eligible for forgiveness, mortgage interest payments to a related party are not eligible for forgiveness.

Non-Payroll Costs

- Non-payroll costs: Utilities
  - The service agreement must have been in place prior to February 15, 2020.
  - There does not appear to be any prohibitions on prepayment.
  - Again, it appears the SBA is going to let you have at it, because of the 40% cap on total forgiveness applied to non-payroll costs.
  - Includes the cost of electricity in the warehouse you rent or gas you use driving your business vehicle.
    - Electricity, water, gas, transportation, telephone, or internet access.
      - Transportation: A service for the distribution of transportation refers to transportation utility fees assessed by state and local governments. Payment of these fees by the borrower is eligible for loan forgiveness.
      - The entire electricity bill payment is eligible for loan forgiveness (even if charges are invoiced separately), including supply charges, distribution charges, and other charges such as gross receipts taxes.

Interim Computation

- An interim computation of forgivable amount is performed:
  - Compensation costs (capped at $46,154 per employee; or at the lesser of a) $20,833 or b) 10/52 of the 2019 amount for owner-employees; or 10/52 of Form 2019 Schedule C Line 31 for self-employed taxpayers and general partners.)
  - Non-compensation payroll costs +
  - Non-payroll costs =
  - Total forgivable costs.
- BUT: this amount can be reduced if the borrower either:
  - Reduces salary of certain employees during the covered period (not a big hit), or
  - Reduces FTES during the covered period (a BIG hit).

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Salary/Rate Reduction

- Salary/Rate Reduction: The amount eligible for forgiveness is reduced if the employer cuts the salaries of certain employees by a certain amount during the covered period.
  - Only applies to an employee who is new in 2020, or who was employed during 2019, but during NO single pay period during 2019, was paid wages or salary at an annualized rate of pay of more than $100,000.
  - Are bonuses considered "wages or salary?" If A got paid $75,000 in 2019 but received a $5,000 bonus during a two-week pay period, are they removed from the computation?
  - The reduction is computed on an employee-by-employee basis.
  - Any salary reduction is reported on Table 1 of the Worksheet to Schedule A.

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Salary/Rate Reduction

- Salary/Rate Reduction
  - The reduction in forgiveness amount is required if the reduction in wages/hourly rate over the 24-week period is in excess of 25% of the total wages/hourly rate of the employee during the period from January 1, 2020 through March 31, 2020.
  - For purposes of computing the annual salary in the base period, no bonus is included.
  - The reduction is limited to 24/52 (8/52 if you elect an 8 week period) of the excess of 75% of the base period salary over the amount received during the covered period.
  - The reduction in forgiveness is not required to the extent salary/rate reduction is attributable to a reduction in hours:
    - A, an hourly employee, had been working 40 hours a week during the first quarter of 2020 at a rate of $20/hr.
    - During the covered period, A's hours are cut to 20 hours/week, but the pay rate remains the same at $20/hr.
    - Even though A's TOTAL pay has decreased by 50%, no reduction is required because the rate of pay has remained constant.

Salary/Rate Reduction

- Salary/Rate Reduction
  - Example. Employee A was paid an annual salary of less than $100,000 for 2019. A was paid $24,000 during the 24-week covered period. A was paid $20,000 for the period January 1, 2020, through March 31, 2020.
    - Step 1: A's average annual salary was $52,000 for the 24-week covered period ($24,000/24*52).
    - Step 2: A's average annual salary was $80,000 for the period January 1, 2020, through March 31, 2020 ($20,000 *4).
    - Step 3: $52,000/$80,000 = 65%.
    - Step 4: n/a as step 3 is less than 75%
    - Step 5: Before application of the safe harbor, A's employer would reduce forgiveness attributable to A by the following amount: $80,000 * 75% = $60,000. $60,000 - $52,000 = $8,000. $8,000/52*24 = $3,692.

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Salary/Rate Reduction

- Salary/Wage Reduction Restoration
  - Per-Hour Example
    - A was paid $20/hour from January 1, 2020 through March 31, 2020.
    - A's pay was cut to $12/hour during the covered period.
    - Assume A's pay was not increased before December 31, 2020.
    - To determine the reduction:
      - Multiply $20*75% ($15) and subtract $12 = $3
      - Take A's average hours worked per week from January 1, 2020 through March 31, 2020: assume it is 20
      - Multiply 20 by $3 = $60.
      - Multiply $60 by 24 = $1,440.

Salary/Rate Reduction Restoration

- Salary/Wage Reduction Restoration
  - The reduction is not required, however, if a safe harbor is met. Whether the safe harbor is met is determined via the following steps:
    - Step 1: Determine the annual salary or hourly wage as of February 15, 2020. Is this just for a moment in time?
    - Step 2: Determine the average annual salary or hourly wage for the period from February 15, 2020 through April 26, 2020.
    - Step 3: If Step 2 is greater than Step 1, the safe-harbor does not apply. If Step 2 is less than Step 1, proceed to Step 4.
    - Step 4: Determine the average annual salary or hourly wage for the employee as of the EARLIER of 1) the date the application for forgiveness is submitted, or December 31, 2020. Again, is this for a moment in time? If that amount is equal to or greater than Step 1, the safe harbor has been met.
    - In other words, the SBA will ignore a reduction in salary during the covered period relative to the 1st quarter of 2020, but ONLY IF that salary is restored to what it was on February 15, 2020, by the earlier of the date you submit your application for forgiveness, or December 31, 2020.

Salary/Rate Reduction Restoration

- Salary/Wage Reduction Restoration
  - Continuing the previous example, assume that on February 15, 2020, A was being paid an annual salary of $75,000. After the arrival of COVID-19, however, A's average salary for the period February 15, 2020 through April 26, 2020, was reduced to $55,000. It was further reduced for much of May, which is what resulted in A being paid only $8,000 for the covered period. By December 31, 2020, however, A's annual salary was increased to $75,000.
  - Even though A's salary has returned only to the amount he was paid on February 15 ($75,000) and not the amount he was paid throughout the first quarter ($80,000), the safe harbor is met and no reduction is required.

FTE Reduction

- FTE Reduction
  - The amount of loan forgiveness may ALSO be reduced if the borrower reduces headcount during the covered period. Just as we saw with the reduction resulting from reduced salary, however, the reduction may be ignored if a safe harbor is satisfied.
  - Your forgiveness is reduced if your average number of full-time equivalent employees (FTEs) during the covered period is less than the average number of FTEs for any of the following periods, at your election:
    - The period beginning on February 15, 2019 and ending on June 30, 2019; or
    - The period beginning on January 1, 2020 and ending on February 29, 2020, or
    - For a seasonal employer, as determined by the SBA, either of the two previous periods or any 12-week period between May 1, 2019 and September 15, 2019.

FTE Reduction

- FTE Reduction
  - There are four exceptions where you can lose part or all of an FTE, and not have to reduce the FTE count.
  - Exception 1:
    - The borrower made a good faith, written offer to restore the reduced hours of such employee during the covered period or the alternative payroll covered period.
    - The offer was for the same salary or wages and same number of hours as earned by such employee in the last pay period prior to the reduction in hours.
    - The offer was rejected by the employee.
    - The borrower maintained records documenting the offer and its rejection; and

FTE Reduction

- FTE Reduction
  - There are four exceptions where you can lose an employee, and not have to reduce the FTE count.
  - Exception 2-4:
    - The employee was fired for cause,
    - The employee voluntarily resigned, or
    - The employee requested and received a reduction in hours.
  - In exceptions 1-4, the employer adds these "lost" FTEs back into the computation of FTEs during the covered period. But what amount do they add back in? Whatever amount of FTE the employee was during the covered period?
  - These amounts will be reported on Table 1 of the Worksheet to Schedule A.

FTE Reduction

- How to compute FTEs
  - To determine the average full-time equivalent employees (FTEs) for the 24-week covered period (or the alternative payroll covered period, if elected, or any other periods where it's required), for each qualifying employee:
    - Determine the average number of hours PAID (not worked) per week for the applicable period;
    - Divide the average number of hours worked per week and divide by 40, before rounding to the nearest tenth. The maximum amount for each employee is 1.0.
    - Alternatively, you can skip the math and use 1.0 for every employee who worked 40 hours per week and 0.5 for every employee who didn't meet that standard. Either way you get there, you will ultimately arrive at the average FTE throughout the relevant covered period.

FTE Reduction

- How to Compute FTEs
  - Example. X Co. borrowed a $100,000 PPP loan on April 10, 2020. X Co. incurred $100,000 of costs eligible for forgiveness over the next 24 weeks. For the 24-week period beginning April 10, X Co. had the following employees:
    - A, who averaged 45 hours per week during the period,
    - B, who averaged 40 hours per week during the period,
    - C, who averaged 28 hours per week, and
    - D and E, who averaged 20 hours per week.
  - For the 24-week covered period, X Co. had 3.7 FTEs:
    - A: 45/40 capped at 1.0; B: 40/40 = 1.0; C: 28/40 = .7; D &E: 20/40 = .5 each
  - If X Co. chose instead to use the simplified method, it would have 3.5 FTEs:
    - A: 45/40 capped at 1.0; B: 40/40 = 1.0; C: 28/40 = .5; D &E: 20/40 = .5 each

FTE Reduction

- FTE Reduction
  - Example. X Co. borrowed a $100,000 PPP loan on April 10, 2020. X Co. incurred $100,000 of costs eligible for forgiveness over the next 24 weeks. For the 24-week period beginning April 10, X Co. had the following employees:
    - A, who averaged 45 hours per week during the period,
    - B, who averaged 40 hours per week during the period,
    - C, who averaged 28 hours per week, and
    - D and E, who averaged 20 hours per week.
  - For the 8-week covered period, X Co. had 3.7 FTEs:
    - A: 45/40 capped at 1.0; B: 40/40 = 1.0; C: 28/40 = .7; D &E: 20/40 = .5 each
  - Assume further that for the periods February 15, 2019 through June 30, 2019, and January 1, 2020 through February 29, 2020, X Co. had the following employees:
    - A, who averaged 45 hours per week during the period,
    - B, who averaged 40 hours per week during the period,
    - C, who averaged 40 hours per week,
    - D and E, who averaged 28 hours per week, and
    - F and G, who averaged 40 hours per week.

FTE Reduction

- FTE Reduction
  - For those 8-week periods, X Co. had 6.4 FTEs:
    - A: 45/40 capped at 1.0
    - B: 40/40 = 1.0
    - C: 40/40 = 1.0
    - D &E: 28/40 = .7 each
    - F & G: 40/40 = 1 each
  - Thus, before considering any safe harbor or reinstatement, X Co.'s amount eligible for forgiveness of $100,000 must be reduced by multiplying $100,000 by 3.7/6.4. Thus, the forgiveness is tentatively capped at $57,813.
  - This quotient is reported on Line 7 of Form 3508, Application of Forgiveness.

Safe Harbor for FTE Reduction #1

- FTE Reduction Restoration
  - Safe harbor #1: The borrower must first use the methodology described above to determine FTEs for two additional periods:
    - The period from February 15, 2020, through April 26, 2020, and
    - For the pay period that includes February 15, 2020,
  - If the average FTEs for the first period is less than the FTEs for the second period, the borrower must then compare the average FTEs for the second period to the total FTEs as of the EARLIER OF:
    - The date the application is submitted, or
    - December 31, 2020.
  - If FTEs have been restored on that earlier of date, no reduction is required.
  - Example. Continuing the example above, assume X Co. had 4.2 FTEs for the period February 15, 2020, through April 26, 2020, and 4.5 FTEs on February 15, 2020. X Co. then reduced the hours of some of their employees and terminated others, resulting in only 3.7 FTEs for the covered period. Because X Co. had more employees on February 15, 2020, then during the period February 15, 2020, through April 26, 2020, X Co. must then compare the number of FTEs on February 15, 2020 – 4.5 – to the number on December 31, 2020. Provided the number of FTEs on December 31, 2020 is equal to or greater than 4.5, no reduction in forgiveness is required.

Safe Harbor for FTE Reduction #2

- FTE Reduction Restoration
  - Safe harbor #2: NEW UNDER THE FLEXIBILITY ACT:
  - The Borrower is exempt from the reduction in loan forgiveness based on a reduction in FTE employees described above if the Borrower, in good faith, is able to document an inability to rehire individuals who were employees of the eligible recipient on February 15, 2020; and an inability to hire similarly qualified employees for unfilled positions on or before December 31, 2020.
  - Borrowers are required to inform the applicable state unemployment insurance office of any employee's rejected rehire offer within 30 days of the employee's rejection of the offer. The documents that borrowers should maintain to show compliance with this exemption include, but are not limited to, the written offer to rehire an individual, a written record of the offer's rejection, and a written record of efforts to hire a similarly qualified individual.

Safe Harbor for FTE Reduction #3

- FTE Reduction Restoration
  - Safe harbor #3: NEW UNDER THE FLEXIBILITY ACT:
  - The Borrower is exempt from the reduction in loan forgiveness based on a reduction in FTE employees described above if the Borrower, in good faith, is able to document that it was unable to operate between February 15, 2020, and the end of the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020, by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration, related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19.
  - Such documentation must include copies of applicable COVID Requirements or Guidance for each business location and relevant borrower financial records.

Safe Harbor for FTE Reduction #3

- FTE Reduction Restoration
  - Example: A PPP borrower is in the business of selling beauty products both online and at its physical store. During the covered period, the local government where the borrower's store is located orders all non-essential businesses, including the borrower's business, to shut down their stores, based in part on COVID-19 guidance issued by the CDC in March 2020. Because the borrower's business activity during the covered period was reduced compared to its activity before February 15, 2020 due to compliance with COVID Requirements or Guidance, the borrower satisfies the Flexibility Act's exemption and will not have its forgiveness amount reduced because of a reduction in FTEs during the covered period, if the borrower in good faith maintains records regarding the reduction in business activity and the local government's shutdown orders that reference a COVID Requirement or Guidance as described above.

Putting it All Together

- Ultimate Computation: forgiveness is limited to the lesser of three numbers
  - Payroll costs + non-payroll costs – salary reduction * FTE reduction quotient
  - Principal balance of the loan
  - Payroll costs (and only payroll costs) / 60% (this ensures that the non-payroll cost portion of forgiveness is capped at 40% of total forgiveness)
- Once the lesser of the three is determined, the SBA will reduce the forgiveness amount by the amount of any EIDL Advance Amounts received by the borrower.

A New Option: Form 3508EZ

- Who can use it?
  - You have to be able to check ONE of the three boxes:
  - Box 1: The Borrower is a self-employed individual, independent contractor, or sole proprietor who had no employees at the time of the PPP loan application and did not include any employee salaries in the computation of average monthly payroll in the Borrower Application Form (SBA Form 2483).

A New Option: Form 3508EZ

- Who can use it?
  - You have to be able to check ONE of the three boxes:
  - Box 2: The Borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period (as defined below) compared to the period between January 1, 2020 and March 31, 2020 (for purposes of this statement, "employees" means only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount more than $100,000)
  - AND
  - the Borrower did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the Covered Period. (Ignore reductions that arose from an inability to rehire individuals who were employees on February 15, 2020 if the Borrower was unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020. Also ignore reductions in an employee's hours that the Borrower offered to restore and the employee refused.

A New Option: Form 3508EZ

- Who can use it?
  - You have to be able to check ONE of the three boxes:
  - Box 3: The Borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period (as defined below) compared to the period between January 1, 2020 and March 31, 2020 (for purposes of this statement, "employees" means only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount more than $100,000);
  - AND
  - The Borrower was unable to operate during the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020 by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration, related to the maintenance of standards of sanitation, social distancing, or any other work or customer safety requirement related to COVID-19.

Application Process

Brandon Loeschner, CPA, CISA, CGMA

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Applying the Rules The Application (Form 3508)

- One page
- Straight forward application
- Total of 11 Lines to complete

Paycheck Protection Program
Loan Forgiveness Application Revised June 16, 2020

OMB Control Number 3245-0407
Expiration Date: 10/31/2020

PPP Loan Forgiveness Calculation Form

Business Legal Name ("Borrower")	DBA or Tradename, if applicable	
Business Address	**Business TIN (EIN, SSN)**	**Business Phone**
		( ) -
	Primary Contact	**E-mail Address**

SBA PPP Loan Number:_____ **Lender PPP Loan Number:** _____

PPP Loan Amount:_____ **PPP Loan Disbursement Date:** _____

Employees at Time of Loan Application: _____ **Employees at Time of Forgiveness Application:** _____

EIDL Advance Amount:_____ **EIDL Application Number:** _____

Payroll Schedule: The frequency with which payroll is paid to employees is:

☐ **Weekly** ☐ **Biweekly** (every other week) ☐ **Twice a month** ☐ **Monthly** ☐ **Other** _____

Covered Period:_____ to _____

Alternative Payroll Covered Period, if applicable:_____ to _____

If Borrower (together with affiliates, if applicable) received PPP loans in excess of $2 million, check here: ☐

Forgiveness Amount Calculation:

Payroll and Nonpayroll Costs
Line 1. Payroll Costs (enter the amount from PPP Schedule A, line 10): _____

Line 2. Business Mortgage Interest Payments: _____

Line 3. Business Rent or Lease Payments: _____

Line 4. Business Utility Payments: _____

Adjustments for Full-Time Equivalency (FTE) and Salary/Hourly Wage Reductions
Line 5. Total Salary/Hourly Wage Reduction (enter the amount from PPP Schedule A, line 3): _____

Line 6. Add the amounts on lines 1, 2, 3, and 4, then subtract the amount entered in line 5: _____

Line 7. FTE Reduction Quotient (enter the number from PPP Schedule A, line 13): _____

Potential Forgiveness Amounts
Line 8. Modified Total (multiply line 6 by line 7): _____

Line 9. PPP Loan Amount: _____

Line 10. Payroll Cost 60% Requirement (divide line 1 by 0.60): _____

Forgiveness Amount
Line 11. Forgiveness Amount (enter the smallest of lines 8, 9, and 10): _____

SBA Form 3508 (06/20)
Page 1

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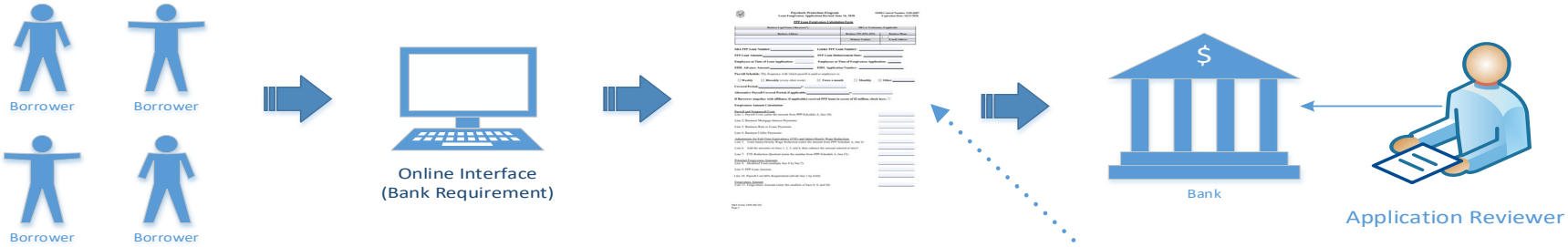
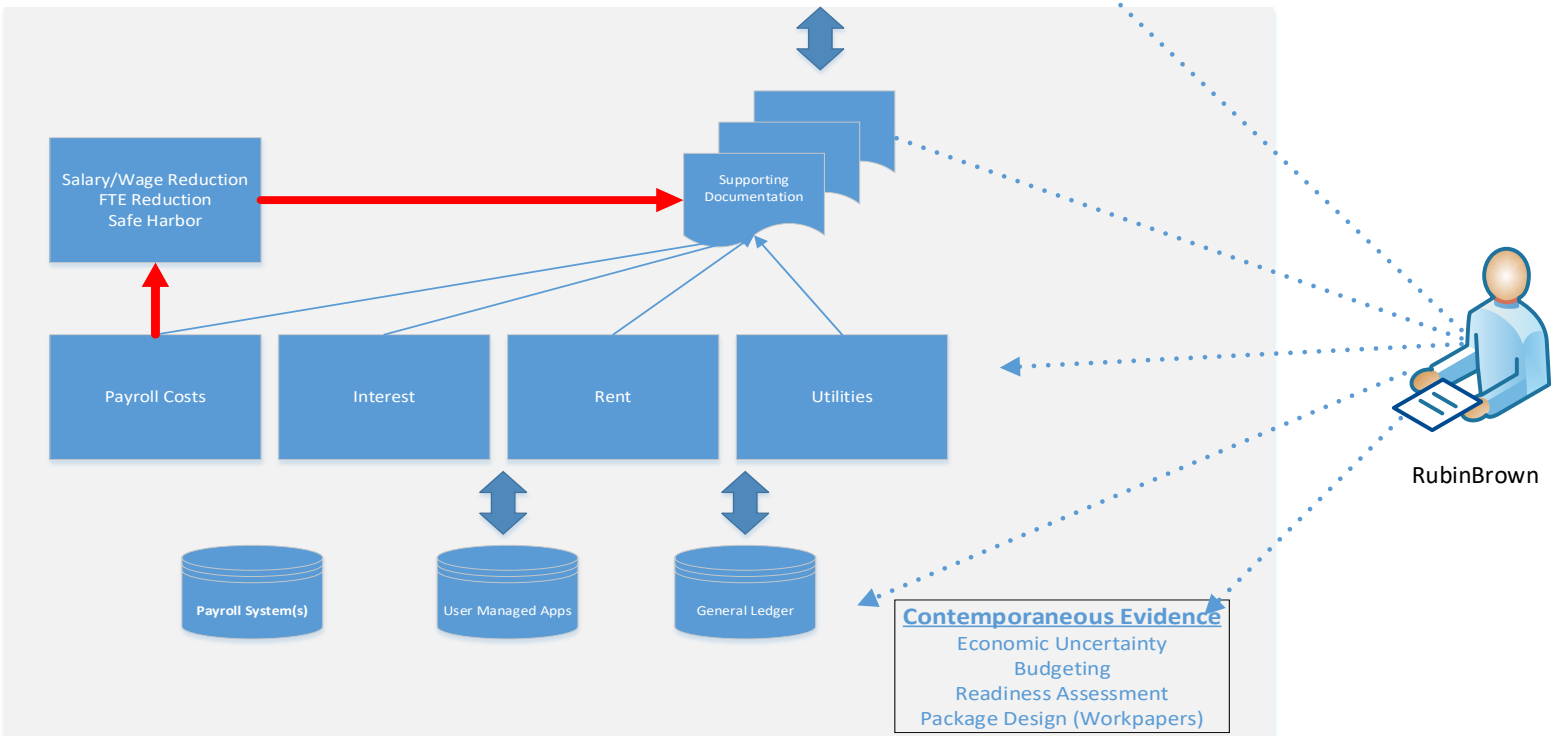
Applying the Rules - The Process





Borrower Has to Show Their Work

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Focusing Borrowers Efforts

- Forgiveness Application Package Preparation
- Forgiveness Application Compliance Review
- Technical Consultation
- "Need Analysis" Memo to Loan File
- Cash Flow Projections
  - If your loan is over $2M your loan will be reviewed by the SBA to ensure your business situation necessitated the loan.
  - As part of your support for the loan you will want to have a cash flow projection in your documentation.

Financial Reporting

Eric Janson, CPA

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PPP Loan Accounting

- PPP loans from SBA are forgivable based on meeting certain employment and expense metrics.
- Broad impact on many entities.
- Due to the unique circumstances of the program, and lack of one size fits all accounting guidance, the accounting requires careful consideration.

PPP Loan Accounting

- Bank has 60 days to review forgiveness application after it is received, then SBA has another 90 days for its review.
- We have not seen actual paperwork from bank or SBA, and don't know form and content.
- As more information becomes available, our guidance may change.

Non-authoritative Guidance

- AICPA – TQ&A 3200.18 Borrower Accounting for a Forgivable Loan Received Under the Small Business Administration Paycheck Protection Program.
- AICPA Center for Plain English Accounting – PPP Loan Accounting Developments Timing and Manner of Derecognition In Focus, Dated July 22, 2020.

Accounting Models

- ASC 470 – Debt
- ASC 450-30 – Gain Contingencies
- ASC 958-605 – Not-for-Profit Revenue Recognition
- IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance

ASC 470

- Loan is treated as debt, and interest is accrued in accordance with terms of agreement.
- Debt and any related interest are derecognized when paid, or when legally released by the creditor. We expect that the forgiveness will be by the SBA, and not the bank.
- Debt forgiveness is recorded as a gain (other income) when legal release is met.

ASC 958-605 Not-for-Profit Revenue Recognition

- Although written for not-for-profits, other entities may apply by analogy.
- A conditional promise to give is recognized when the condition or conditions are substantially met.
- Recognize revenue when conditions are met (displayed separately from revenue recognized under ASC 606).
  - May result in partial recognition depending on when conditions are met.

IAS 20

- International standard, not US GAAP, but provides information from a recognized accounting standards setter.
- IAS 20, paragraph 10:
- "a forgivable loan from the government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan."

IAS 20

- IAS 20, paragraph 12:
- "GOVERNMENT GRANTS SHALL BE RECOGNISED IN PROFIT OR LOSS ON A SYSTEMATIC BASIS OVER THE PERIODS IN WHICH THE ENTITY RECOGNISES AS EXPENSES THE RELATED COSTS FOR WHICH THE GRANTS ARE INTENDED TO COMPENSATE."

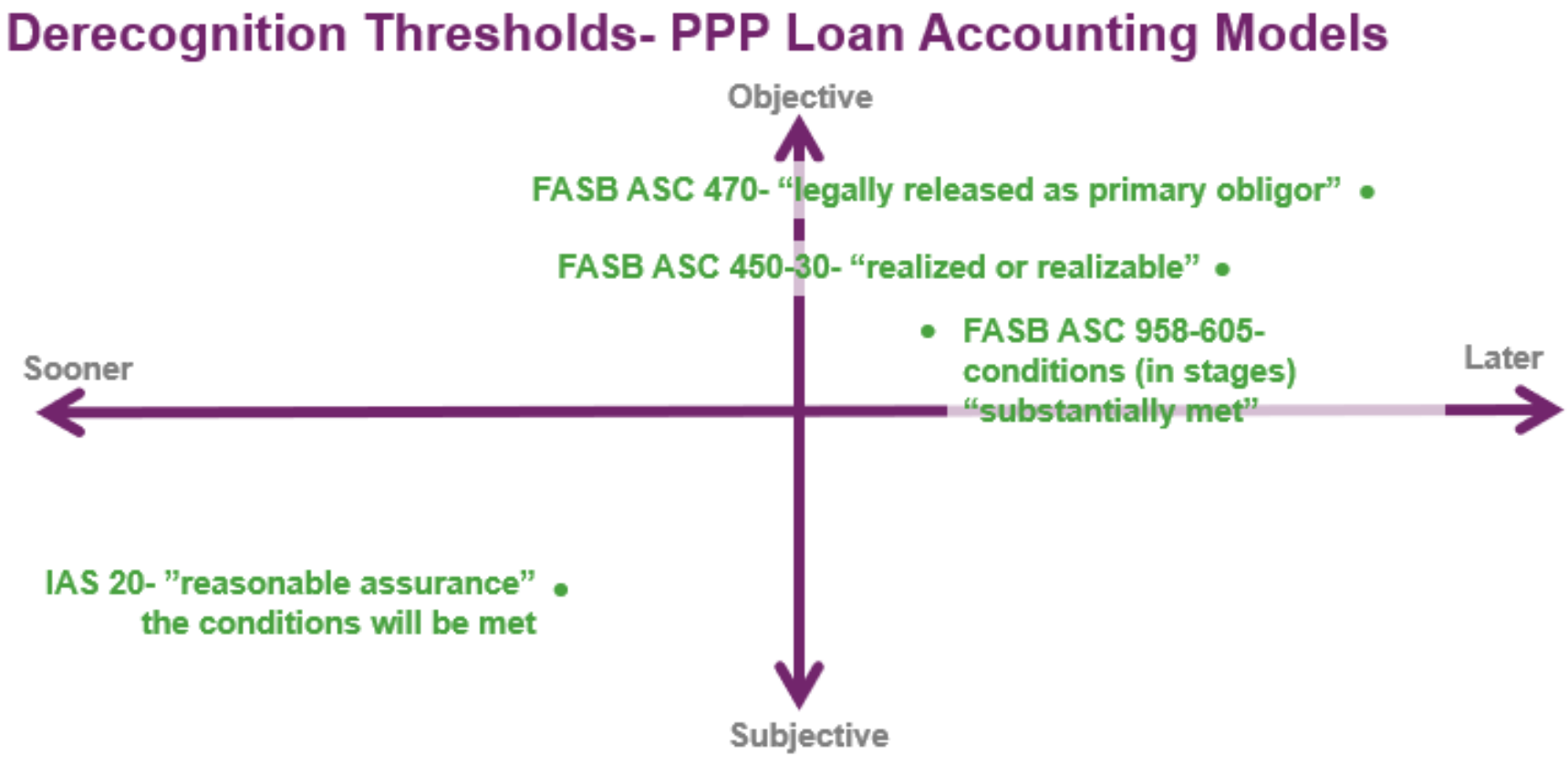
IAS 20

- IAS 20, paragraph 29:
- "Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense."

Balance Sheet Presentation

- If the loan is accounted for under ASC 470, it would be classified as current and long-term in accordance with its stated payment terms, and no forgiveness would be assumed.
- If the loan is not accounted for under ASC 470, then various approaches could be considered, but we believe classifying using the stated maturities is the most practical option.

Accounting Model Comparison



* Graphic from AICPA CPEA

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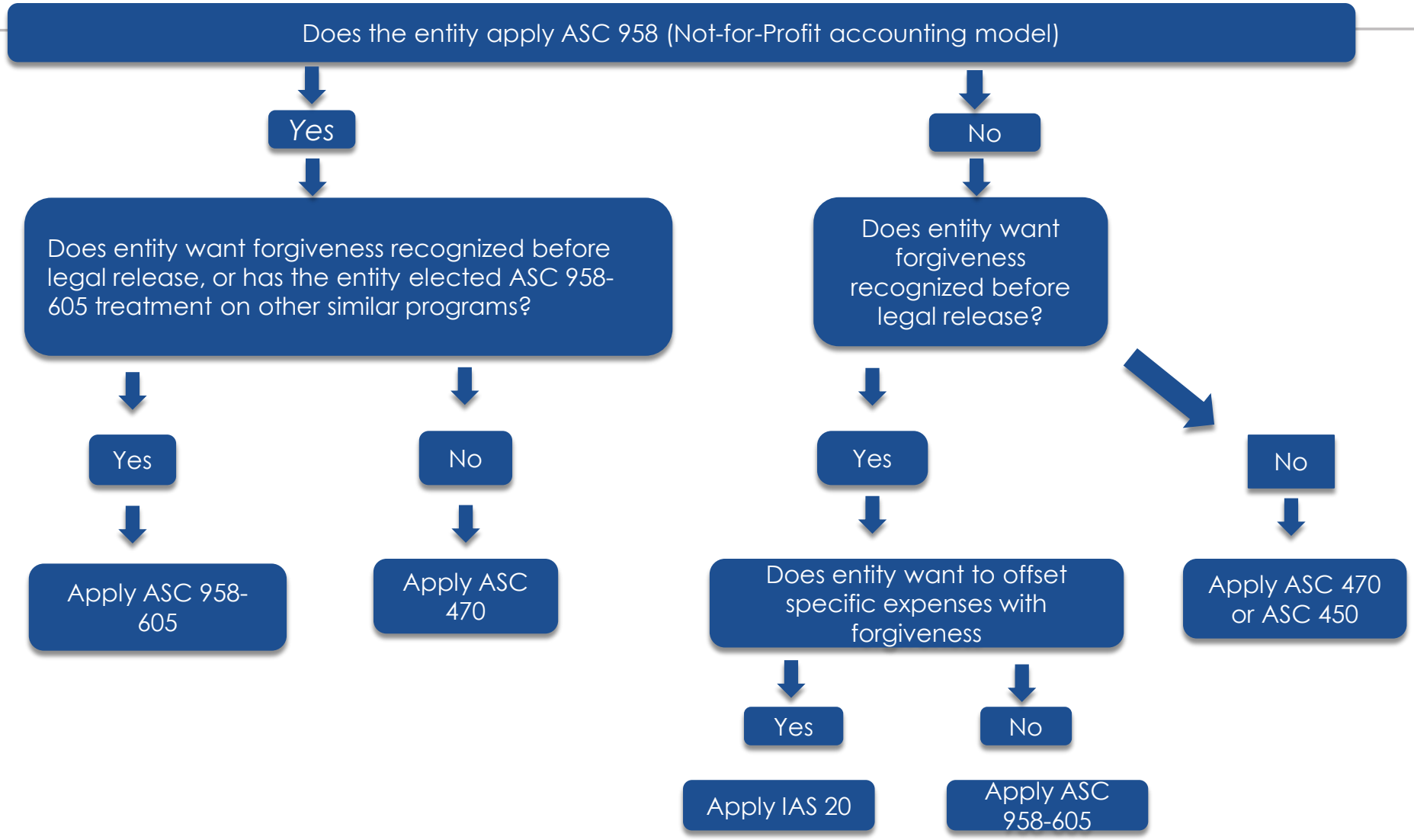
Decision Tree



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Tax Implications

Henry Rzonca, CPA

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Tax Treatment

- What we know
  - Forgiveness does NOT trigger cancellation of indebtedness income for tax purposes.
  - CARES Act Section 1106(i):
    - TAXABILITY. – For purposes of the Internal Revenue Code of 1986, any amount which (but for this subsection) would be includible in gross income of the eligible recipient by reason of forgiveness described in subsection (b) shall be excluded from gross income.
  - If recorded for book purposes, reverse for tax purposes.

Tax Treatment

- What we don't know (for sure):
  - Are the underlying expenses that create the forgiveness deductible?
  - IRS Notice 2020-32 says they are not deductible.
  - "Other activities" suggest they should be deductible.
- What do we do?

Tax Treatment

- Underlying expenses that create the forgiveness
  - Expenses made during a prescribed period for
    - Payroll
    - Employee benefits related to healthcare
    - Mortgage interest
    - Rent
    - Utilities
    - Interest on any other existing debt obligations
- These expenses are incurred before receiving actual forgiveness of the PPP loan.

Tax Treatment

- IRS Notice 2020-32 (released April 30, 2020) says
  - CARES Act did not address whether deductions otherwise allowable under the Code for payments of eligible section 1106 expenses by a recipient of a covered loan are allowed if the loan is subsequently forgiven.
  - Section 265(a)(1) of the Code provides that no deduction is allowed that is allocable to one or more classes of income wholly exempt from tax.
  - The purpose of Section 265 is to prevent a double tax benefit.
  - Cares Act section 1106(i) results in a class of exempt income under section 1.265-1(b)(1) of the Regulations.
- In summary, the Notice provides expenses that create the forgiveness are not deductible for tax purposes.

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Tax Treatment

- "Other activities" suggest the expenses that create the forgiveness should be deductible.
- Advocacy letters written by the AICPA
  - May 28 letter to Representative Lizzie Fletcher
  - July 20 letter to Nancy Pelosi and Mitch McConnell (Recommendations for Phase Four Federal Legislation)
  - August 4, 2020 letter to Nancy Pelosi and Mitch McConnell
- Congressional intent
- Bipartisan support
- So where do we go from here?

Tax Treatment

- RubinBrown Recommendation
  - Disallow expenses if forgiveness has been received from the SBA at the time the tax return is filed
  - This is a general rule, client specific facts should be considered
  - Applicable for tax return and estimated tax purposes
- Rationale - Section 265 expense disallowance (IRS Notice) is not applicable until there is tax- exempt income.
- If clarification becomes available after the filing of the return that is inconsistent with the method used to file the return, amend the applicable tax return, do not "fix" in a subsequent return filing.
- Other considerations – Research credit, 199A, state tax treatment, extend tax return filing to allow for clarification.
- Fiscal year filers – must decide soon.

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RubinBrown Service Offerings

- Financial Statement Audit / Review / Compilation
- Benefit Plan Audits
- SEC Advisory
- Accounting Consulting (e.g., revenue recognition)
- Accounting Methods Review
- Nexus Consulting
- Property & Sales Tax Compliance and Consulting
- Tax Compliance (Business, Individual, Trust, Gift)
- Research and Experimentation Tax Credit
- Tax Credits and Incentives Consulting
- Estate Planning
- Outsourced Accounting
- Staffing – Permanent and Temporary
- Financial Planning
- Investment Advisory (RIA)
- Cyber Security
- Data Analytics
- Financial Modeling
- Fraud & Forensics Consulting
- Internal Audit
- IT ERP Solutions
- Litigation Support
- Mergers and Acquisitions
- Process Improvement
- Service Organization Controls (SOC1 / SOC2)
- Valuation

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For questions, please reach out to your RubinBrown contact or email Info@RubinBrown.com.

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