Navigating PPP Loan Forgiveness: A Borrower's Guide to Best Practices

Written by Adam West, CPA and David Crabtree, CPA on April 17, 2020

The cornerstone of the CARES Act for small businesses is the Paycheck Protection Program (PPP). The PPP authorizes up to $349 billion of federally-guaranteed loans to qualifying small businesses. These loans are designed to be forgiven if employers keep employees on their payroll and spend the loan proceeds on qualified expenses.

Businesses were eligible to apply for a PPP loan beginning on April 3, 2020, and millions have applied since. As businesses' loans are funded, they now need to shift their focus to administering the use of the funds to ensure compliance and maximize loan forgiveness.

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Managing PPP Loan Proceeds

Loan proceeds used for an unauthorized purpose are not eligible for loan forgiveness. Under the CARES Act, a borrower that knowingly uses the funds for an unauthorized purpose may be subject to additional liability, such as charges for fraud. To help with compliance, we recommend that borrowers set up a separate bank account for the loan proceeds so that the funds are not comingled with other accounts. Maintaining a separate bank account will also aid in the recordkeeping process when applying for loan forgiveness. Expenses eligible for loan forgiveness include payroll costs[1], rent, utilities and mortgage interest on real or personal property debt obligations[2].

While the list of eligible expenses may seem relatively straightforward, several questions arise with respect to which expenses are eligible and how the loan proceeds can be spent. For example, if a borrower has its loan funded on April 14, 2020 and has payroll due on April 15, 2020 for the pay period from April 1 to April 15, 2020, does the entire payroll qualify as eligible payroll costs? Or is only the portion of payroll incurred from the date of loan funding considered as eligible payroll costs? The CARES Act refers to "costs incurred and payments made during the covered period." The covered period in this section of the CARES Act is defined as the eight-week period after the lender makes the first loan disbursement of proceeds. The "payments made" implies a cash basis of accounting. However, the "costs incurred" leaves open the possibility that Congress intended an accrual basis of accounting. Questions have also arisen as to whether a borrower can pay bonuses that accrued from an earlier period or whether a business can pre-fund retirement contributions for the eight-week covered period. The answers to these questions will need to be clarified in guidance from the Small Business Administration (SBA).

To aid in the recordkeeping requirements for loan forgiveness, there are things borrowers can begin doing immediately. For example, when paying a covered mortgage payment, we recommend writing separate checks for the interest and principal portions of the payment. A borrower that utilizes a separate bank account for PPP funds should consider transferring qualified payroll costs to an operating account for payroll as needed. During the eight-week covered period, separate funds should be used to pay the portion of an employee's salary that is in excess of $100,000 of annualized compensation, as well as the employer's portion of Social Security and Medicare taxes.

Managing Documentation for Loan Forgiveness

To ensure proper documentation for loan forgiveness, it is extremely important that borrowers maintain adequate substantiation for all eligible expenses as the funds are being spent. According to the CARES Act, borrowers must provide documentation to verify the use of funds on eligible expenses.

- Payroll Costs – Borrowers must provide documentation to verify the number of full-time equivalent (FTE) employees on payroll and pay rates for the period. This documentation should include payroll tax filings reported to the IRS and state income, payroll and unemployment insurance filings. We recommend tracking your FTE employee calculation each pay period.
- Mortgage Interest, Rent and Utilities – Borrowers should also provide documentation such as cancelled checks, payment receipts, transcripts of accounts or other documents verifying payments on covered mortgage obligations, covered lease obligations and covered utility obligations.

Additionally, borrowers must provide certification that the documentation presented for loan forgiveness is true and correct and the amount for which forgiveness is requested was used for eligible expenses. The SBA has said it will issue additional guidance on loan forgiveness, but at a minimum, borrowers should be prepared to document their expenses with the documentation noted above.

Understanding the PPP Loan Forgiveness Process

Determining the amount of loan forgiveness can be viewed as a four-part test.

First, borrowers must use PPP loan proceeds for payroll costs, mortgage interest, rent and utilities payments over the eight-week covered period after receiving the loan. It is important to note that the PPP Interim Final Rule published by the Treasury on April 2, 2020 provides that not more than 25 percent of the loan forgiveness amount may be attributable to non-payroll costs.

Second, borrowers must maintain headcount, as loan forgiveness will be reduced if a business decreases its FTE employee headcount. This is determined by dividing the average FTE employee headcount during the eight-week covered period by the headcount during one of the following periods, at the election of the borrower:

- Period from February 15, 2019 to June 30, 2019
- Period from January 1, 2020 to February 29, 2020

For seasonal businesses, the eight-week covered period is compared to the period from February 15, 2019 to June 30, 2019.

The result is multiplied by the loan proceeds spent on qualified expenses to determine the amount that is eligible for forgiveness.

Third, if a borrower decreases salaries and wages by more than 25% for any employee who did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than $100,000, then a portion of the loan may not be forgiven. Under the test to determine if there has been a 25% reduction in salary, borrowers are required to compare total salary and wages of an employee during the eight-week period to the most recent full quarter that the employee was employed. If an employee’s wages or salary decrease by more than 25%, then the difference in excess of 25% is not forgivable. Guidance is needed from the SBA to address several issues borrowers will face when calculating the 25% reduction. For example, how should bonuses, commissions or other forms of compensation be considered in this calculation for comparing compensation? Additionally, the periods being compared are not comparable based upon the number of weeks being computed, as the calculation requires the comparison of an eight-week period to a thirteen-week period.

The Act also contains what appears to be a safe harbor for rehires, such that a borrower will not have its loan forgiveness proportionately reduced if the decrease in FTE employee headcount and wages is eliminated by June 30, 2020. To prevent any reductions in the forgiveness provisions described above, **the final and fourth part of the loan forgiveness calculation provides that borrowers**

have until June 30, 2020 to restore FTE employee headcounts and salary and wage levels for any decreases made between February 15, 2020 and April 26, 2020. For purposes of this test, the number of FTE employees on or before June 30, 2020 is compared to the number of FTE employees on February 15, 2020. Although not confirmed by the SBA, we believe this provision is an all-or-nothing test. In other words, either the borrower restores ALL of its FTE employee headcount and wages by June 30, 2020, or it will not eliminate any proportionate reduction calculated in steps two and three.

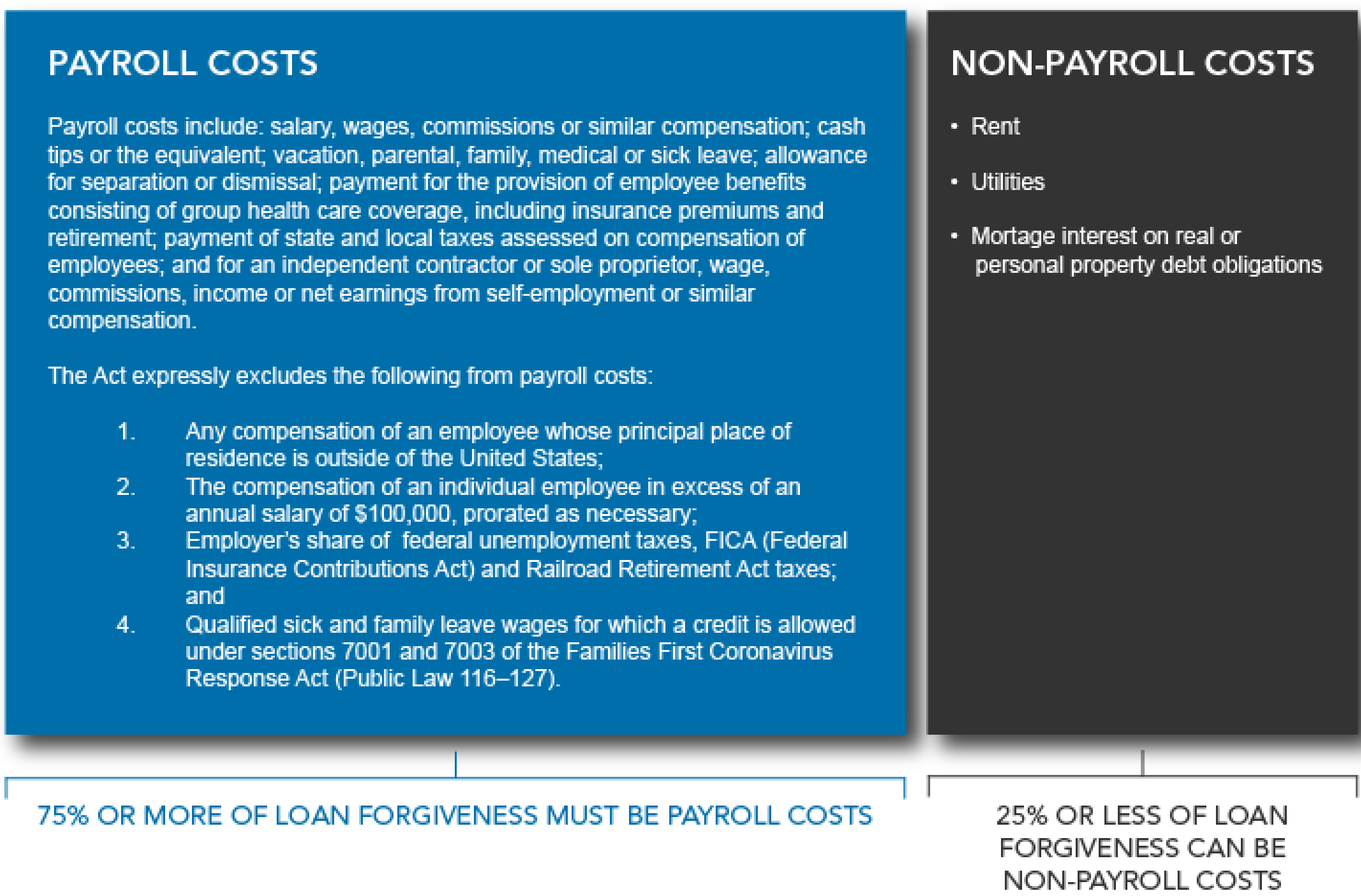
After the eight-week covered period following the loan origination date, borrowers have 90 days to submit loan forgiveness documentation to the lender. Then, the lender has 60 days to make a decision on loan forgiveness. Borrowers deferring the employer's portion of Social Security taxes under the CARES Act should be aware that they are no longer eligible to defer these taxes once they receive a decision on loan forgiveness from the lender.

Full-Time Equivalent Employees

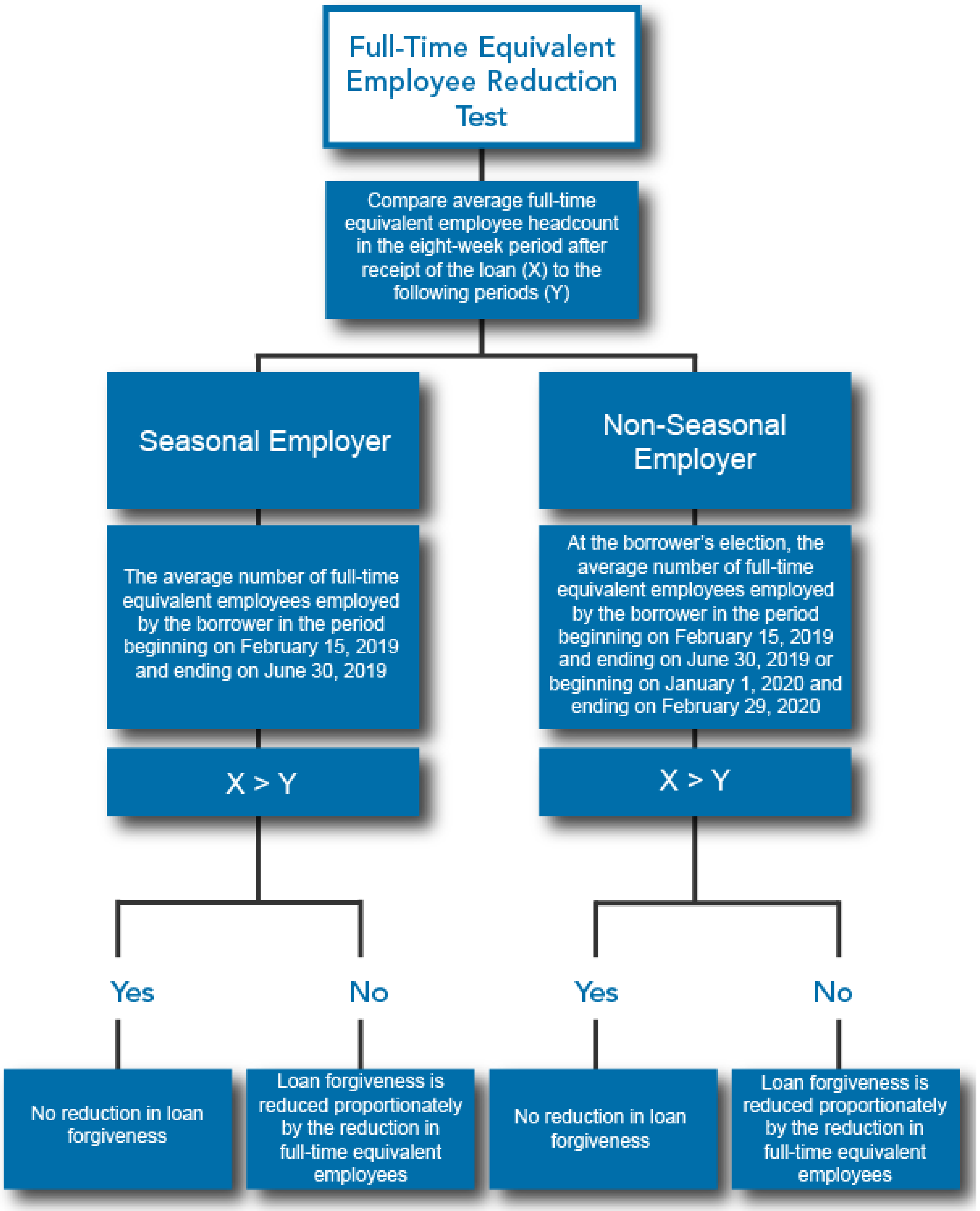
The SBA has not yet definitively stated how to calculate FTE employees. The general consensus is that this test will be similar to the Affordable Care Act (ACA) such that all employees who work 30 hours or more per week will be considered full-time employees. All employees working less than 30 hours will be considered part-time employees. The ACA treats any person who holds a full-time position as one FTE employee, and then calculates for part-time employees and adds the results. The hours of part-time employees are aggregated on a monthly basis and divided by 120 to determine the number of FTE employees.

Putting it All Together

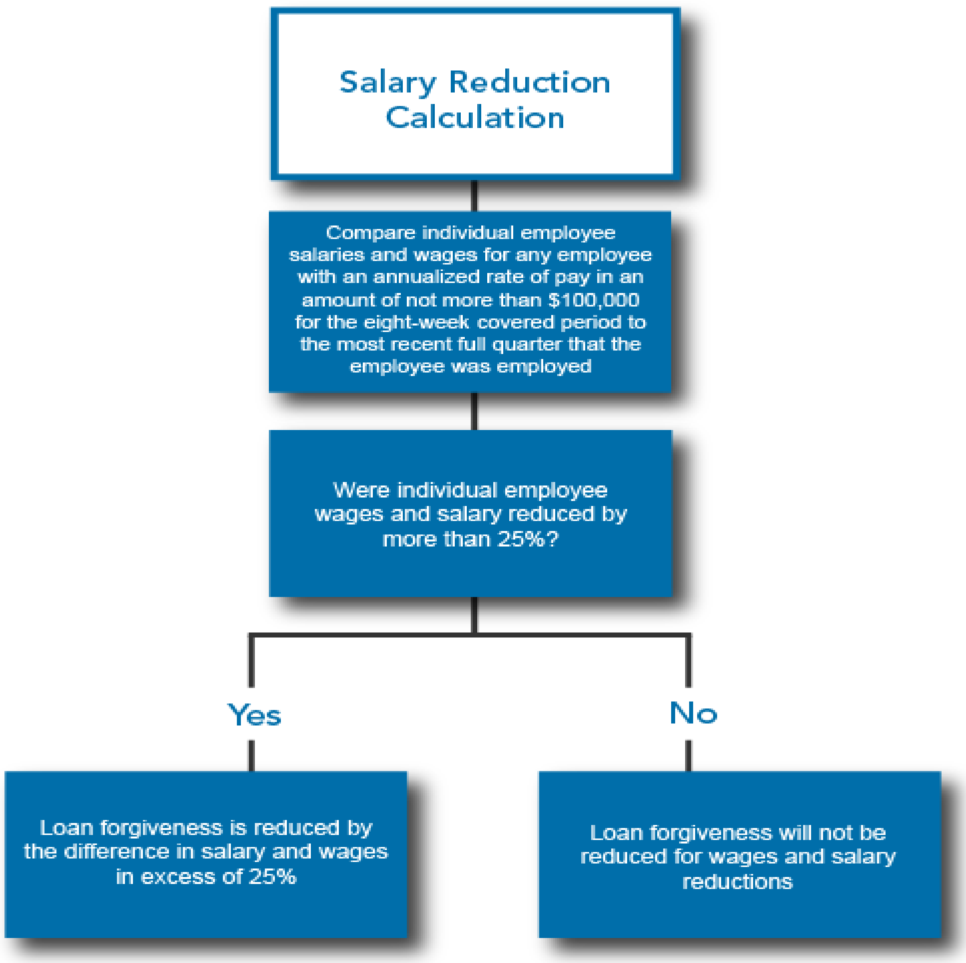
Step One – Loan Proceeds Spent on Qualified Expenses (Up to 25% can be Non-Payroll Costs) = Amount Eligible for Loan Forgiveness



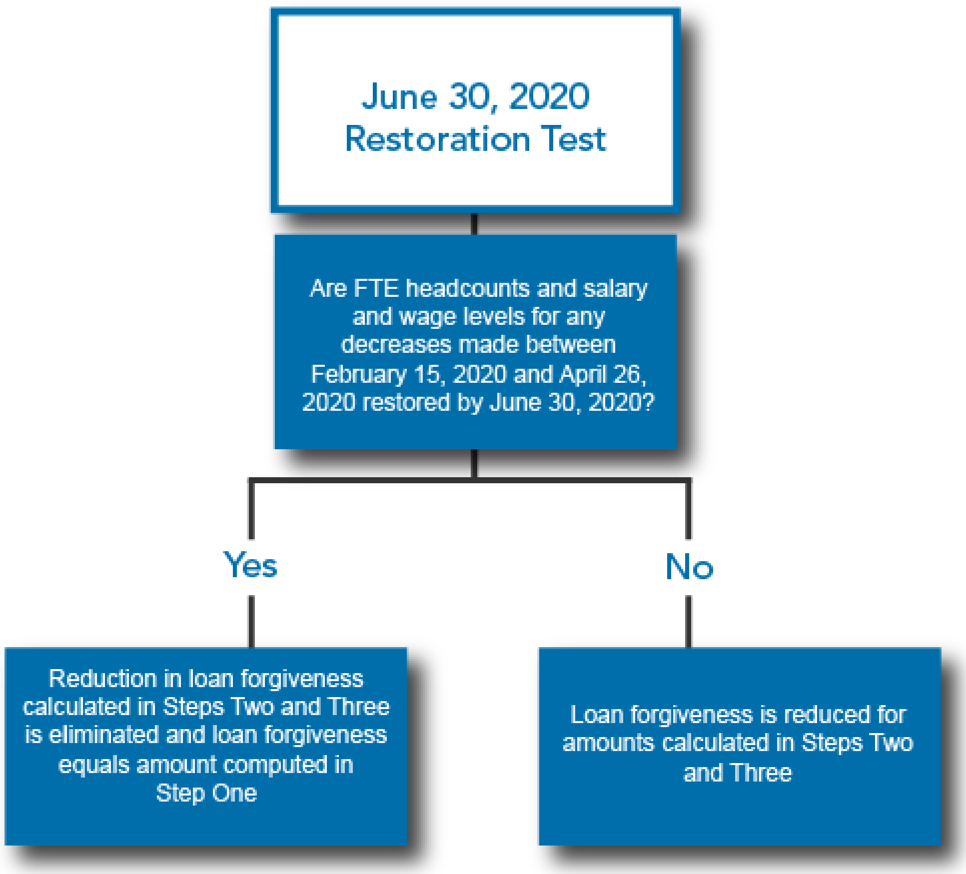
Step Two – Full-Time Equivalent Employee Reduction Test



Step Three- Salary Reduction Calculation



Step Four – June 30, 2020 Restoration Test



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As noted above, guidance is needed from the SBA to clarify several issues. While borrowers await guidance from the SBA concerning loan forgiveness, they should take steps now to ensure they are properly administering the use of the funds to stay in compliance and maximize loan forgiveness. Download a checklist for PPP Loan Program forgiveness here.

Should you have questions about documentation requirements or how to navigate the PPP loan forgiveness process, please contact your Warren Averett advisor or have a member of our team reach out to you.

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[1] Payroll costs include: salary, wages, commissions or similar compensation; cash tips or the equivalent; vacation, parental, family, medical or sick leave; allowance for separation or dismissal; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums and retirement; payment of state and local taxes assessed on compensation of employees; and for an independent contractor or sole proprietor, wage, commissions, income or net earnings from self-employment or similar compensation.

The Act expressly excludes the following from payroll costs:

1. *Any compensation of an employee whose principal place of residence is outside of the United States;*
2. *The compensation of an individual employee in excess of an annual salary of $100,000, prorated as necessary;*
3. *Employer's share of federal unemployment taxes, FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes; and*
4. *Qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act*

(Public Law 116–127).

[2] *Includes: any debt incurred during ordinary course of business before February 15, 2020 (mortgage on real or personal property), utilities in place before February 15, 2020 and leases in force before February 15, 2020.*

This article reflects our views at the time this article was written and should be used as reference only. We recommend that you talk to your Warren Averett advisor, or another business advisor, for the most current information or for guidance specific to your organization.

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