

The Long and Winding Road ...to PPP Loan Forgiveness

The U.S. Department of Treasury (Treasury) and the U.S. Small Business Administration (SBA) issued on May 15, 2020 long awaited guidance and the application needed for loan forgiveness under the Paycheck Protection Program (PPP). Not unlike the lyrics to Paul McCartney's ballad, "The Long and Winding Road", the guidance describes the many ways the SBA has tried to get us to the doorstep of loan forgiveness. There are many wild and windy days ahead as we travel this long and winding road, but the process has begun. Readers should understand that not all questions have been answered and, as in the past, this initial guidance may change. Once again, we ask that you be flexible as you read the guidance and apply it to your situation. Things will likely change and calculations will be tweaked as we approach the end of the 8 week "covered period" in the Paycheck Protection Program. "The Long and Winding Road" was the last single released by the Beatles. It's not likely this forgiveness application will be the last released by the SBA.

The PPP guidance was provided as part of an 11 page document which includes a series of instructions, worksheets and certifications which borrowers will complete and submit to their lender as the application requesting full or partial forgiveness of the PPP loan proceeds.

Guidance Comes in Different Forms

In prior months the SBA has issued two other forms of guidance. These were Interim Final Rules (IFR) and FAQs addressing a myriad of questions and issues that arose throughout the PPP process. It is very likely that additional IFRs and FAQs will be issued before the first PPP loans reach the end of the 8 week covered period and the loan forgiveness process begins.

SBA Delivers Borrower Friendly News

The guidance which was provided as part of the forgiveness application is largely good news for borrowers. Interpretations of and modifications to prior PPP rules were borrower friendly both in terms of flexibility in measuring expenses within the 8 week period and interpretations of expenses that qualify for payment with PPP proceeds and ultimately qualifying for forgiveness. The following section of this alert addresses key issues in the PPP loan forgiveness process addressed by the SBA's application and instructions.

1. **Costs Incurred and Paid During the Covered Period.** Perhaps one of the most significant questions resulting from prior PPP guidance concerned whether or not eligible costs had to be both incurred and paid during the 8 week covered period beginning immediately after the receipt of the loan proceeds. Payroll costs are deemed to be incurred on the day that the employee's pay is earned and considered to be paid when checks are distributed or the employer originates an ACH credit transaction.

The question has been answered very favorably and in a flexible way. Both payroll and non-payroll expenses that were either paid or incurred during the borrower's 8 week covered period will qualify for forgiveness. This interpretation simplifies payroll costs eligible for forgiveness. Payroll costs which were incurred but not paid during the final payroll period within the 8 week covered period are now eligible for forgiveness if paid on or before the next regularly scheduled payroll date. Consequently, it is not necessary for weekly and bi-weekly payers to schedule an extra interim pay period that falls within the 8 week covered period.

Retirement Plans – More Guidance Needed

To date, all guidance regarding payroll costs resulting from employer funded retirement plan contributions has been silent as to the required payment date for the contributions. It remains to be seen whether borrowers can claim forgiveness relative to a 2019 profit-sharing payment paid during the 8 week period or if 2020 retirement plan contributions must be paid during the 8 week period and are limited to amounts based on employee compensation paid during the 8 week period.

Impact of "Incurred and Paid" on Non-Payroll Costs

Non-payroll costs which are eligible for forgiveness must also be incurred during the covered period and either paid during the covered period or on or before the next regular billing date after the end of the covered period to be included for forgiveness. Thus, borrowers cannot prepay non-payroll expenses such as utility payments, building rent, or equipment lease payments that were not incurred during the 8 week covered period.

2. **Alternative Payroll Covered Period.** To provide additional flexibility, the application creates a new option for PPP borrowers with weekly or bi-weekly payroll schedules. The instructions explain that an alternative payroll covered

period may be elected by the borrower so that for purposes of measuring payroll the borrower may calculate payroll costs qualifying for forgiveness during an 8 week period that begins on the first day of the first pay period after receipt of the loan proceeds and ending 56 days later. The alternative payroll covered period applies only to calculating eligible payroll costs and not non-payroll costs such as rent or utility payments.

Consistency Required

Finally, if a PPP borrower elects the alternative payroll covered period in determining eligible payroll for forgiveness purposes, it must also use that alternative period for calculating reductions from forgiveness based on the full time equivalent employees (FTEs) and related wage reductions. Consequently, borrowers electing to use the alternative payroll covered period must apply the alternative payroll covered period whenever there is a reference in the forgiveness application to the covered period or alternative payroll covered period.

3. **Eligible Non-payroll Costs.** There has been no change in the requirement that eligible non-payroll costs cannot exceed 25% of the total loan forgiveness amount. Eligible non-payroll costs may not be double counted. Non-payroll costs that were both paid and incurred within the 8 week period can only be considered as an eligible expense once.

Qualified Lease Payments Expanded

Another question that has existed since the beginning of the PPP loan process is whether or not covered lease payments pertained solely to real estate rented by the borrower or if leases for business equipment would also qualify for forgiveness. We now know from the instructions that eligible lease payments include both real and personal property leases. It will be necessary, however, to provide a copy of the current lease agreement in existence before February 15, 2020 and receipts or canceled checks verifying payments pertaining to the covered period.

4. **Full Time Equivalent (FTE) Calculations.** The CARES Act which implemented the PPP loan process introduced the concept of full time equivalent employees. Loan forgiveness would be reduced based on the reduction in the borrower's average monthly FTEs. The CARES Act, however, did not directly define or explain the calculation of FTEs. There was widespread speculation and acceptance that for PPP purposes the FTE calculation would be applied in a manner consistent with the Affordable Care Act (Obamacare) which contained a

30 hours per week definition for an FTE. However, the application and instructions issued on May 15, 2020 by the SBA explains that the calculation for FTEs is determined on a per employee basis by dividing each employee's average weekly hours by 40 and rounding to the nearest one-tenth representing a typical 40 hour work week. This will likely require a recalculation of the number of FTEs for each PPP borrower. The guidance also states that an employee working more than 40 hours cannot be more than 1 FTE.

A simplified calculation may also be used at the borrower's election. Employees working 40 hours or more per week are assigned a 1.0 FTE and those working less than 40 hours are assigned a .5 FTE. This simplified method must also be applied to the calculation of reference period FTEs explained in the following section.

5. **Reduction in FTEs Impacts Loan Forgiveness.** A borrower's loan forgiveness amount will be reduced if its average weekly FTE employees during the covered period (or the alternative payroll covered period, if so elected) is less than the FTE average during the borrower's FTE reference period. You may recall from earlier alerts that the FTE reference period consisted of one of three time periods:
 - February 15, 2019 to June 30, 2019
 - January 1, 2020 to February 29, 2020
 - In the case of seasonal employers either of the two periods above or a consecutive 12 week period between May 1, 2019 and September 15, 2019.

Non-seasonal employers are permitted to choose the more advantageous calculation between the first two bullet points above. If a reduction in average FTE level occurred during the 8 week covered period, the FTE reduction amount is then determined by dividing the covered period average FTE by the reference period FTE.

6. **Safe Harbor and Exceptions to the FTE Reduction.** The forgiveness application provides a number of exceptions and a safe harbor eliminating the loss of forgiveness as a result of FTE reduction. Employment reductions occurring as a result of the following situations will not reduce a borrower's PPP loan forgiveness amount:
 - a. ***Employee Choosing Not to Return.*** Any positions for which the borrower made a good faith, written offer to rehire an employee during the 8 week covered period (or alternative payroll covered period, if selected) but was rejected by the employee will not result in the loss of loan forgiveness. The most frequent example of this situation is when the employee's

unemployment compensation payments exceed the employee's payroll from the employer.

- b. ***Non-Economic Related Reductions.*** Employees who during the 8 week covered period or alternative payroll covered period were (1) fired for cause, (2) voluntarily resigned or (3) voluntarily requested and received a reduction in their working hours will not result in loss of loan forgiveness.

New Employees

There was also a question that involved whether or not new employees could be included in the FTE count. The instructions answer this question affirmatively by stating that the employee exceptions above can only be used if the borrower has not already replaced that employee with a new employee.

Safe Harbor for FTE Reduction

Additionally, a borrower may escape the FTE reduction entirely if both the following safe harbor conditions are met and payroll expense increases during the covered period or alternative payroll covered period:

- a. The borrower reduced FTE employee levels during the period from January 15, 2020 through April 26, 2020 and
 - b. The borrower restores its FTE employee count by no later than June 30, 2020 to the FTE employee level in the payroll period which included February 15, 2020.
7. **Salary or Hourly Wage Reduction.** The forgiveness amount that a PPP borrower may enjoy is reduced if an employee's average annual salary or hourly wage during the 8 week covered period (or alternative payroll covered period) is reduced to less than 75% of the employee's annual salary or hourly wage for the period between January 1, 2020 and March 31, 2020.

In perhaps the most tedious calculation, this salary or wage reduction is determined on an employee by employee basis and is not an average for all the borrower's employees and compensation. There is, however, a safe harbor for this calculation which may prove important to the PPP borrower. If an employee's average annual salary or hourly wage as of February 15, 2020 is less than or equal

to that employee's average annual salary or hourly wage as of June 30, 2020, no reduction in PPP forgiveness will be required.

8. **Non-Taxable Income vs. Non-Deductible Expenses.** While the CARES Act specifically provided that any PPP loan forgiveness would not be taxable, the IRS issued guidance (IRS Notice 2020-32) indicating that any expenses attributable to calculating the loan forgiveness would not be deductible. [click here](#)

- . Some members of Congress have indicated that the IRS guidance is in opposition to their intent and they would move to overrule the IRS guidance. While legislation has been drafted to do that, it is unknown if it will become law.

Supporting Documentation Required for the Loan Forgiveness Application

1. **Payroll:** Documentation verifying the eligible cash compensation and non-cash benefit payments from the Covered period (or, if elected, the Alternative Payroll Covered Period) consisting of:
 - a. Payroll account statements or third-party payroll service provider reports
 - b. Payroll tax forms for the periods that overlap with the Covered Period (or if elected, the Alternative Payroll Covered Period) including payroll tax filings reported to the IRS and state quarterly wage reporting and unemployment insurance tax filings.
 - c. Payment receipts, canceled checks or account statements documenting the contributions to employee health insurance and retirement plans.
 - d. Documentation regarding any employee job offers and refusals, firings for cause, voluntary resignations, and written requests by any employee for reductions in work schedule.
2. **FTE:** Documentation identifying the average FTE employees on payroll during the Reference Period selected by the borrower. Documents may include payroll tax filings reported to the IRS and state quarterly wage reporting and unemployment insurance tax filings.
3. **Eligible Non-payroll Costs:** Documentation verifying the existence of the costs prior to February 15, 2020 and eligible payments made during the Covered Period which began on the date of receipt of the loan and ends 56 days later.

Borrower's Certifications Required for Forgiveness

Borrowers seeking forgiveness will be required to certify a number of representations when making application for forgiveness. These certifications and representations are as follows:

1. The dollar amount of the forgiveness requested
 - (i) was used to pay costs eligible for forgiveness,
 - (ii) includes all applicable FTE Reductions and Salary/Hourly Wage Reductions,
 - (iii) does not include eligible non-payroll costs in excess of 25% of the amount requested and
 - (iv) does not exceed 8 weeks' worth of 2019 compensation for any owner/employee or self-employed individual/general partner (capped at a maximum of \$15,385 per individual)
2. An acknowledgement that the government may pursue recovery of PPP loan amounts and/or civil or criminal fraud charges if the funds were knowingly used for unauthorized purposes
3. The borrower accurately verified payments for the eligible payroll and non-payroll costs
4. The borrower submitted the required documentation to its lender verifying payroll costs, covered mortgage interest, covered rent and lease obligations and covered utility payments
5. The information in the application and supporting documents is true and correct in all material respects and an acknowledgement that making false statements to obtain forgiveness is punishable by imprisonment and/or fines under various federal statutes
6. The tax documents submitted to its lender are consistent with tax documents submitted, or to be submitted, to the IRS and state tax authorities, and

7. The SBA may request additional information and failure to provide the information requested may result in a denial of loan forgiveness or a determination that the borrower was ineligible for the PPP loan.

As we have mentioned above in numerous other email alerts issued on the PPP topic, we urge you to remain flexible as we travel the long and winding road of this process. We expect that additional IFRs and FAQs will be issued by the SBA and/or Treasury. The rules and requirements for forgiveness will change before this process is over. This was a massive employment support program developed and rolled out in a very short time frame in an attempt to stabilize jobs during the COVID-19 pandemic. The final calculation of PPP loan forgiveness will be complicated and fluid.

Updated Forgiveness Calculator

We will be modifying the Excel based PPP forgiveness calculator which we provided to you when the PPP loan process began several weeks ago. These modifications will take into consideration all of the changes identified above as well as changes resulting from the IFRs and FAQs issued since release of Version 1 of the calculator. Upon completion of the calculator, we will make it available on our website for downloading.

We recognize that this is a highly complex area and one with which you have no prior experience. Please contact the Gold Gerstein Group LLC partner or staff accountant with whom you work as questions arise in this process or as you complete your application for loan forgiveness. Since many of our partners and staff are working remotely from home, please consider contacting us by email as it will likely be the most convenient method for initially reaching us.

This information has been provided by Gold Gerstein Group, LLC.

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