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Important Tax and Business Updates

Relief Measures

- Paycheck Protection Program Loans – Round 2
- 100% Depreciation of QIP Allowed Retroactively Under the CARES Act
- Additional Guidance Clarifying NOL Refund Claims Under the CARES Act
- FAQs Issued to Further Clarify Guidance on PPP Loans



Access past GYF webinars below:

- Business Valuation Amidst Uncertainty - Risks Creating Opportunities (5/1/20)
- Paycheck Protection Program - Forgiveness and Procedures (5/1/20)



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PAYCHECK PROTECTION PROGRAM

Loan Forgiveness And Procedures

May 1, 2020

Presented by:

Robert J. Grossman, Donald S. Johnston, and Michael E. Weber



PAYCHECK PROTECTION PROGRAM – BACKGROUND

- The Paycheck Protection Program (PPP) is made available from the Small Business Administration (SBA) to small businesses with loans to help pay up to eight weeks of payroll costs, mortgage interest, rent, and utilities during the Covid-19 (Coronavirus) pandemic and economic crisis
 - All payments of principal, interest and fees under the loans are deferred for at least six months
 - The loans are also forgiven for amounts of payroll costs, mortgage interest or rent obligations and certain utility costs incurred between February 15 and June 30, 2020
 - The amount forgiven is excluded from gross income and NOT considered cancellation of debt income for federal income tax purposes
 - The PPP loans are 100% guaranteed by the SBA



PAYCHECK PROTECTION PROGRAM – GUIDANCE

- The CARES Act mandated that all guidance be issued by the SBA within 30 days of the enactment of the legislation
 - That date has passed as of April 26, 2020
- While numerous technical matters remain unanswered, particularly with respect to the loan forgiveness provisions, there is currently no information available as to when this information might be released



Dr. Kelly A. Hunt, District Director - SBA Pittsburgh District Office

Dr. Kelly A. Hunt serves as the district director for the U.S. Small Business Administration (SBA) Pittsburgh District Office where she is responsible for the delivery and leadership of the agency's financial and business development programs in 27 counties in Western Pennsylvania.

Prior to her SBA appointment, Hunt was employed at California University of Pennsylvania where she spearheaded a strategic initiative to improve the overall entrepreneurial culture of the university community, which included the creation of the Entrepreneurial Leadership Center and Student Incubator. She also spent five years as a development specialist at the Southwestern Pennsylvania Commission where she implemented community and economic development initiatives throughout a nine-county region. Her work experience also includes curriculum development and instruction, having taught many undergraduate and non-credit courses in leadership, management, and business.

An entrepreneur herself, Hunt has hands-on experience starting and operating businesses in Pennsylvania. She also is involved in social entrepreneurship initiatives, through which she passionately inspires others to pursue entrepreneurship on a global level.

An Air Force veteran, Hunt served over nine years as a security policeman. She received a doctoral degree in organizational leadership, holds a master's degree in curriculum and instruction and a bachelor's degree in computer information systems management.

A native of Washington County, Hunt serves in a leadership capacity for four local organizations and has traveled internationally to help communities around the world. Hunt has been married to her husband, Terry, for 29 years; they are the parents of three grown children and are grandparents to seven granddaughters.



PAYCHECK PROTECTION PROGRAM – BACKGROUND

- PPP is an expansion of the SBA's 7(a) loan program
- PPP was instituted under the Coronavirus Aid, Relief and Economic Security (CARES Act), which was enacted on March 27, 2020 (just 34 days ago, as of May 1)
- The program was legislated to be directed by the SBA, in conjunction with the Treasury
 - As a result, prior SBA rules play a significant role in the mechanics of applying and obtaining the loan, as well as with the loan forgiveness requirements
- PPP Funding:
 - \$349 Billion in Round One
 - \$310 Billion in Round Two



PAYCHECK PROTECTION PROGRAM – BACKGROUND

- As per the SBA, 1.6 million small businesses (SMBs) successfully applied and obtained funds under Round One of the PPP
 - 75% of Round One loans were for less than \$150k
- Per SBA data, there are 30 million SMBs
 - Thus, only 5% of the nation’s SMBs obtained a loan from Round One
- Round Two adds another \$310 billion dollars to the program, with \$60 billion of those funds being specifically allocated to smaller lending institutions
 - Legislation for Round 2 was enacted Friday, April 24, 2020
 - Acceptance for applications began Monday, April 27, 2020



PAYCHECK PROTECTION PROGRAM – GUIDANCE

- Section 1102, **7(a) LOAN PROGRAM**, of the Coronavirus Aid, Relief, and Economic Security (CARES Act) P.L. 116-136
 - Enacted March 27, 2020
- Section 1106, **LOAN FORGIVENESS**, of the Coronavirus Aid, Relief, and Economic Security (CARES Act) P.L. 116-136
 - Enacted March 27, 2020
- Treasury Release, **PAYCHECK PROTECTION PROGRAM (PPP) INFORMATION SHEET – BORROWERS** (4 pages)
 - Released April 3, 2020



PAYCHECK PROTECTION PROGRAM – GUIDANCE

- SBA Release SBA-2020-0015, **FIRST INTERIM RULE**
 - Issued April 2, 2020; Effective April 15, 2020
- SBA Release SBA-2020-[], **SECOND INTERIM FINAL RULE**
 - Issued April 14, 2020, to supplement first rule with additional eligibility criteria/requirements
- SBA, in consultation with the Treasury, **PPP FREQUENTLY ASKED QUESTIONS (FAQS)**
 - Updated through April 29, 2020
- IRS Guidance, **NOTICE 2020-32**
 - Issued April 30, 2020, to address disallowance of deductible expenses related to PPP loans



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

- One of the most beneficial aspects of the PPP loan is the ability to have the loan forgiven if certain criteria are met
- The mechanics of loan forgiveness are rooted primarily in using the borrowed funds to maintain employment and wages at those levels that were in force in the borrower's operations prior to the onset of the pandemic and economic shutdown
- The determination of how much of those amounts borrowed under the PPP can, and will, be forgiven is a multiple-step process that requires consideration of the statutory language included in the CARES Act under Section 1106 and later issued guidance issued by the SBA, in conjunction with Treasury



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

- The PPP loan amount will be forgiven in its entirety, if the following conditions are met:
 - Not more than 25% of the forgiveness amount is used for non-payroll costs;
 - The employee headcount is maintained; and
 - Compensation levels for employees earning less than \$100,000 per year are maintained
- To the extent that any of these factors are not satisfied fully (or a business does not use the full amount of the PPP loan in the eight-week period after the loan is made), a portion of the loan will not be forgiven and must be repaid



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION OF THE FORGIVENESS AMOUNT

- Pursuant to Section 1106 of the CARES Act:

“...an eligible recipient [of a PPP loan] shall be eligible for forgiveness of indebtedness on a **covered loan** in an amount equal to the sum of the following costs **incurred** and **payments made** during the **covered period**.”

 1. Payroll costs
 2. Interest on covered mortgage obligation (no prepayments or principal)
 3. Any payment on any covered rent obligation
 4. Any covered utility payment



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

- **GENERAL DEFINITIONS**, pursuant to Section 1106 of the CARES Act:
 - Covered Loan – the PPP loan under Section 1102 of the CARES Act
 - Covered Mortgage Obligation – any indebtedness or debt instrument incurred in the ordinary course of business that:
 - a) is a liability of the borrower
 - b) is a mortgage on real or personal property and
 - c) was incurred before February 15, 2020



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

- **DEFINITIONS FOR CALCULATION – STEP 1**, pursuant to Section 1106 of the CARES Act:
 - Covered Period – the eight-week period beginning on the date of the origination of the loan
 - Covered Rent Obligation – rent obligated under a leasing agreement in force before February 15, 2020
 - Covered Utility Payment – payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

- **DEFINITIONS FOR CALCULATION – STEP 1**, pursuant to Section 1106 of the CARES Act:
 - Eligible Recipient – the recipient of the loan
 - Expected Forgiveness Amount – the amount of principal that a lender reasonably expects a borrower to expend during the covered period on the sum of any:
 - a) Payroll costs
 - b) Payments of interest on any covered mortgage
 - c) Payments of any covered rent obligations
 - d) Payments of covered utility costs



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

- **DEFINITIONS FOR CALCULATION – STEP 1**, pursuant to Section 1106 of the CARES Act:
 - Payroll Costs – defined the same as in Section 1102 for use in determining the amount of the maximum loan for which the applicant borrower might qualify for under the program; which includes:
 - a) Salary, wages, commissions, or tips (capped at \$100,000 annually per employee);
 - b) Employee benefits including costs for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payments required to provide group health care benefits including insurance premiums; and payment of any retirement benefit;
 - c) State and local taxes assessed on compensation; and
 - d) For a sole proprietor or independent contractor: wages, commissions, income, or net earnings from self-employment, capped at \$100,000



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

▪ DEFINITIONS FOR CALCULATION – STEP 1, pursuant to Section 1106 of the CARES Act:

Further clarification of Payroll Costs per the FAQs issued by the SBA:

– Payroll costs DO NOT include:

- Any payments made to an independent contractor
- Any adjustments to gross wages, either up or down, for federal payroll taxes including the employer's share of FICA taxes

– Payroll costs DO include:

- Any payments made to general active partners



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 1 (covered costs and loan forgiveness)

- Determine the date that the **eight weeks** begins and that marks the start of the "covered period"
 - The statute defines this date as the date of origination of the loan
 - The FAQs released by the SBA clarify this start date (in question 20) as the date the lender makes the first disbursement of the PPP loan to the borrower
 - In other words, the clock starts ticking the day your PPP loan funds are deposited in your bank account



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 1

- The AICPA issued recommendations on April 29, 2020, regarding the start of the covered period for payroll costs measurement, including:
 - The eight-week covered period under PPP should align with the beginning of a pay period, not the date loan proceeds are received
 - The eight-week period should commence once stay-at-home restrictions are lifted, not when loan proceeds are received



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 1

- Determine the total amount of loan proceeds utilized in the covered period for “incurred and paid” payroll costs and other allowable costs, i.e., the “covered expenses”
- If the covered expenses do not rise to the level of the loan proceeds, the difference does not qualify for forgiveness
- Example:
 - Company A borrows \$1,000,000 under the CARES Act PPP. In the covered period, Company A incurs and pays \$850,000 of covered expenses. The difference, or \$150,000, does not qualify for forgiveness and must be paid back.



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 1

- SBA 75/25 Rule Regarding Loan Forgiveness (Docket No. SBA-2020-0015)
 - Not more than 25% of the loan forgiveness amount may be attributable to non-payroll amounts expended from the loan proceeds
 - Although, not discussed in the statute, the Administrator (SBA) determined that the non-payroll portion of the forgivable loan amount should be limited to effectuate the core purpose of the statute



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 1

- Next, determine if that amount potentially qualifying for loan forgiveness was used in proper proportions to further qualify for loan forgiveness – was the amount incurred or paid from the remaining \$850,000 used 75% for covered payroll?
 - If yes, the eligible recipient moves to Step 2
 - If the “other, non-payroll” covered expenses exceed 25% of the remaining qualifying loan, there is a further limitation in Step 1
- Example:
 - Company A incurs or pays \$255,000 for non-payroll covered expenses in the covered period. The amount of Company A’s potential loan forgiveness is further reduced by the 5% excess (\$42,500), leaving \$812,500 as potential loan forgiveness.



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 2 (maintaining employee levels)

- Pursuant to Section 1106 of the CARES Act:
 - The amount of loan forgiveness will be reduced by any proportionate reduction in the number of employees retained during the covered period compared to one of two prior pay periods to be determined by the borrower in its sole discretion.
 - The amount of the loan forgiveness is reduced by multiplying the forgivable amount by the quotient (expressed as a percentage) obtained by dividing (X) the **average** number of full-time equivalent employees (FTEs) per month employed by the borrower during the Covered Period by (Y), the lower of one of two alternative pay periods.



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 2 (maintaining employee levels)

- This test is shown as:
 - Forgivable amount multiplied by the **lower** (expressed as a %) of:
 - $$\frac{\text{Number of FTEs during the Covered Period (i.e. the 8-week period)}}{\text{Number of FTEs during the period from 2/15/19 through 6/30/19}}$$
 - OR
 - $$\frac{\text{Number of FTEs during the Covered Period (i.e. the 8-week period)}}{\text{Number of FTEs during the period from 1/1/20 through 2/29/20}}$$
- Note that you are permitted to choose the better option, the one which provides the lower employee count (expressed as a %)



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 2

- This test is shown as:
 - $\$100,000 * 64/62 = \$ 100,000$ (no limitation)
 - $\$100,000 * 64/72 = \$ 88,888$
 - The higher ratio would be chosen as it would produce no FTE-related reduction to the forgivable loan amount
- For an eligible recipient that is **seasonal employer**, as determined by the SBA, the average number of FTEs per month employed by the borrower must be determined during the period beginning on February 15, 2019, and ending on June 30, 2019



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 2

- How are FTEs defined for purposes of this calculation?
 - The average number of full-time equivalent employees is determined by calculating the **average** number of full-time equivalent employees for each pay period falling within a month



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 3 (reduction relating to salary and wages)

- The amount of the loan forgiveness shall be reduced by the amount of any reduction in total salary or wages of any employee during the covered period which is in excess of 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the covered period.
 - Employees for this calculation are those 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
 - Employers with tipped employees may receive forgiveness for additional wages paid to those employees



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 3

- Wage reductions occurring between February 15, 2020, and 30 days following passage of the CARES Act will not reduce the amount of loan forgiveness, if by June 30, 2020, the borrower eliminates the reduction in employees or reduction in wages.



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 3

- Currently, the CARES Act includes a provision for a reduction in loan forgiveness for any employee whose compensation decreased by more than 25% from the 12-week quarter and the 8-week covered period. However, 8 weeks will naturally have 33% less payroll due to the fewer number of weeks in the time period.
 - AICPA Recommendation: Payroll reduction calculation should be done based on the average payroll per employee per week rather than the total compensation per employee in an 8-week period versus the prior quarter.
 - We strongly recommend using an average payroll per employee per week comparison as that approach is in line with the intent of the CARES Act and provides a clear indication if an employee's wages have been decreased.



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 3

- Recommendation: Payroll reduction calculation should be done based on the average payroll per employee per week rather than the total compensation per employee in an 8-week period versus the prior quarter.
- Example:
 - Employee B earns \$12,000 during the first quarter of 2020, Weekly Average = \$1,000
 - Employee B earns \$8,000 during the 8-week covered period, Weekly Average = \$1,000
 - Analysis: Employee B's total wage was reduced by 33% (\$4,000/\$12,000)
 - AICPA Recommendation: Employee B's weekly wage remained the same and, thus, there is no reduction in compensation



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 3

- Example:
 - Employee B earns \$12,000 during the first quarter of 2020, Weekly Average = \$1,000
 - Employee B earns \$6,000 during the 8-week covered period, Weekly Average = \$750
 - Analysis: Employee B's total wage was reduced by 50% ($\$6,000/\$12,000$)
 - AICPA Recommendation: Employee B's weekly wage was reduced by 25% ($\$250/\$1,000$)



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 3

- Example:
 - Employee B earns \$12,000 during the first quarter of 2020, Weekly Average = \$1,000
 - Employee B earns \$4,000 during the 8-week covered period, Weekly Average = \$500
 - Analysis: Employee B's total wage was reduced by 67% ($\$8,000/\$12,000$)
 - AICPA Recommendation: Employee B's weekly wage was reduced by 50% ($\$500/\$1,000$)



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 3

- Example:
 - Employee A had an annual salary during 2019 of \$200,000
 - Employer reduces A's salary by \$75,000
 - This will have no impact on employer's eligibility for loan forgiveness (for the wage test), even though the employer reduces A's salary by more than 25%, because A's salary is in excess of \$100,000.



PAYCHECK PROTECTION PROGRAM – LOAN FORGIVENESS

CALCULATION – STEP 3

- Wage Restoration Provision
 - If, by June 30, 2020, wages are restored for those employees who had a salary reduction from February 15, 2020, to April 26, 2020, there will be no decrease in loan forgiveness for this specific provision
 - If wages are not restored under this provision, loan forgiveness will be limited



PAYCHECK PROTECTION PROGRAM – OTHER MATTERS

- Forgivable PPP loans are excluded from federal taxable income
- Independent contractors and self-employed taxpayers and the PPP loans
- PPP loans and partners
- Loan forgiveness applications and their timing
 - What will the bank accept?
 - 60-day approval of forgiveness
- Financial reporting matters related to PPP loans



OTHER IMPORTANT (NON-PPP) MATTERS

- There were other (non-PPP-related) tax changes in the CARES Act
 - NOL changes, AMT credit changes, individual tax rebates, etc.
- State tax consequences of the CARES Act?
- Financial reporting related matters after the CARES Act?



QUESTIONS?

PPP or Tax-Related Issues should be directed to the presenters:

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THANK YOU!
