

B S L B V

May 8, 2020

You Received a PPP Loan, What Now?

II. Forgiveness Basics & Steps to Maximize Forgiveness

Loan amounts may be forgiven if used for approved expenses during the 8-week covered period after receiving the loan. The interim rule reads that 75% of the loan proceeds must go to payroll costs during the 8 week period for loan forgiveness to apply, but we believe that employers should still receive some form of forgiveness if they do not use 75% of the loan proceeds towards payroll costs. If an employer uses less than 75% of the loan amount for payroll costs during the 8 week period, it is likely that an employer will see a reduction in the overall possible forgiveness because at least 75% of loan proceeds were not used towards payroll expenses. This reduction could be a dollar for dollar reduction to the forgiveness that is representative of the dollar for dollar difference between 65% and 75% of the loan proceeds being used towards payroll expenses. So for example, if you use only 65% of the PPP loan for payroll expenses, then the total amount of forgiveness would be reduced by 10% because 75% of the proceeds were not used towards payroll expenses. Again, we anticipate the SBA will provide more detailed guidance on the loan forgiveness, including a more detailed breakdown of formulas or calculations that will be used by lenders to determine forgiveness. The total loan forgiveness will be reduced if: (1) full-time employee headcount is decreased; or (2) salaries and wages are decreased by more than 25% for any employee who made less than \$100,000 annualized in 2019. The employer will have until June 30, 2020 to remedy this reduction in workforce or wages.

The decision on forgiveness will come from the lender after they are presented documentation from the small business. The forgiveness process will likely require an application form, a worksheet to help with forgiveness calculations, and documents that support the forgiveness request. Lenders are required to make the forgiveness determination within a 60-day period after the application is submitted. It remains unclear whether SBA will be issuing standards forms to lenders to follow, or whether lenders will be permitted to create their own forms for the forgiveness application. Small businesses should be thorough in documenting the uses of the PPP proceeds and treat it as if the loan would be audited similar to an audit of a tax return by the IRS. A small business owner should make it easy for the lender to see the uses of the proceeds and have the sufficient documentation to submit to the lender.

It is suggested that small businesses begin preparing in advance to create less work on the back end when applying for forgiveness. This can be done by documenting specific employer details that will be needed in the forgiveness formula calculation. Small businesses should document and track payroll hours and expenses per employee over the actual 8 week covered period of the PPP. Employers should track payroll hours for period of time from February 15, 2019 thru June 30, 2019, and payroll hours for period 1/1/2020 thru 2/29/2020. Employers should also track the average payroll from 1/1/2020 through 3/31/2020. Employers should document the full time employee count as of 6/30/2020. Some or all of these details will be needed at the forgiveness application time for the lender to assess the forgivable amount and whether that forgiveness is reduced due to: (1) a reduction in the count of full time equivalent employees (FTEE); or (2) if individual employees have a 25% or greater reduction in compensation during the 8 week covered period as compared to their compensation in the prior quarter they worked.

Besides tracking the information of your employees as mentioned above, the best practice of a small business at this time would be to keep documentation of all transactions in which PPP proceeds are used. Organize lease agreements, utility bills, mortgage and loan note documentation, and the correlating proof of payment to those obligations during the covered period. A representative of the business will be required to submit a certification providing that the amount for which forgiveness is requested was used for appropriate purposes. Loans that are forgiven under the PPP are not subject to federal taxation as discharge-of-indebtedness income. The CARES Act specifically excludes the forgiveness from gross income, but we expect further guidance from this as well.

Aside from using the PPP proceeds for the intended purposes under the Act, an employer should attempt to maximize the forgiveness as noted above by doing what they can to maintain, restore, and/or increase the full time employee headcount and payroll during the 8 week period following receipt of the loan. The usage of the PPP loan for the permissive uses will mean the most forgiveness possible, but how to minimize the reduction of forgiveness is left to be seen fully. For example, if an employer receives a PPP loan, can they replace a previously laid off employee with a new employee, or does it need to be the same employee that was laid off in order to see the maximum amount forgiven. This is not clear at this time. So an employer can be faced with the decision of laying off an employee, but increasing or maintaining the same payroll expenses for the employees that remain. The PPP loan in this situation can be used for payroll expenses, but the forgiveness amount may be reduced if an employer does not rehire the employee that was laid off or restore salaries that were reduced. A recent FAQ published by the SBA clarified that a borrower's PPP loan forgiveness amount will not be reduced if the borrower laid off an employee, offered to rehire the same employee, but the employee declined the offer to rehire. To qualify for this exception, the borrower must make a good faith, written offer to rehire, and the employee's rejection of that offer must be documented by the borrower. The FAQ states that employees and employers should be aware that employees who reject offers of re-employment may forfeit eligibility for continued unemployment compensation.

These questions are going to have to be answered by the SBA, but small businesses should continue to work closely with the lender and seek the assistance of tax professionals to achieve the most benefit of the PPP loan. The CARES Act also provided additional tax breaks, including a retroactive amendment to the Tax Cuts and Jobs Act of 2017, allowing taxpayers to carry back net operating losses from 2018, 2019, and 2020 to the prior five years. This would allow taxpayers to file an amended return and have the ability to get a cash refund now. The CARES Act also accelerated the ability for corporations to use alternative minimum tax credits. Companies are able to claim alternative minimum tax credits for as early as 2018 tax year, which can be another mechanism to get cash quick. In addition to the tax credits, tax professionals can help a borrower understand best uses of PPP proceeds and documentation of those uses. A recent IRS notice, 2020-32, released on April 30, 2020, concludes that when the payment of business expenses results in the forgiveness of a PPP loan, such as payroll costs or rent, those business expenses will not be deductible for tax purposes. According to the IRS, this treatment prevents a "double tax benefit" and is consistent with Section 265(a)(1) of the Internal Revenue Code, which generally provides that no tax deduction is available for expenses that are paid with tax-exempt dollars. It is of note that legislation was recently introduced in the U.S. Senate on May 5, 2020 that would overrule the IRS notice discussed above.