



Maximizing Forgiveness in Payroll Protection Program

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Our PPP Was Loan Approved What Now?

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Presenters

David Killion, Principal, Transaction Advisory



David is a Principal in the Brown Smith Wallace Transaction Advisory practice. He has more than 15 years of experience in strategic, analytical and financial roles. His experience includes managing and executing acquisitions, advising on tax-efficient structuring

and compliance, and monitoring equity investments. He has also been responsible for day-to-day CFO functions including debt structuring, bank compliance, financial reporting and treasury management.

Jen Vacha, Partner, Tax Services



Jen is a Partner in the Tax Services practice of Brown Smith Wallace and has more than 18 years of experience, specializing in not-for-profit, individual and small business returns. She is responsible for

the firm's not-for-profit tax engagements and provides oversight for other individual and business tax engagements. Jen enjoys working one-on-one with clients to minimize their tax obligations and help them understand their current tax position.

Today's Objectives

- Update on SBA Loan Programs
- Loan Terms
- Forgiveness & Documentation
- Accounting & Tax Implications
- Q & A
- Where to find resources



Update on SBA Loan Programs

Update on SBA Loan Programs Since Our First Webinar

- Interim Final Rule on Affiliation (04/03/20)
- FAQs for Faith-Based Organizations - PPP & EIDL (04/03/20)
- Interim Final Rule 2 (04/14/20)
- SBA Procedural Notice on Debt Relief (04/16/20)
- How to Calculate Maximum Loan Amounts (04/24/20)
- Interim Final Rule 3 on Notes & Eligibility (04/24/20)
- Interim Final Rule 4 on Seasonal Employers (04/27/20)
- PPP Loans FAQ Questions (04/27/20)

Update on SBA Loan Programs

- The ***Paycheck Protection Program and Health Care Enhancement Act*** was signed into law April 24, 2020.
 - \$310 billion added to PPP loan funding.
 - \$30 billion “set aside” for community lenders.
 - \$50 billion added to EIDL program loan funding.
 - \$10 billion added to EIDL advance grant program.
 - Agricultural enterprises engaged in the production of food and fiber, ranching and raising of livestock, aquaculture, and all other farming and agricultural industries are “eligible entities”.



Loan Terms

Loan Terms

- Loans *should* have the same general terms for all borrowers.
- The loan term will be 24 months.
- The loan will accrue interest at a rate of 1%, *per annum*.
- No pre-payment penalty.

Loan Terms

- PPP loans will have a payment deferral component.
- Loan payments will be deferred for six months.
- Interest will accrue on the loan during the deferral period.

Tip: Deferred interest will likely be due if not forgiven; so timing of forgiveness is key. Borrowers should check their loan documents to determine if the interest is added to principal, due with the first payment, or if the payment balloons at the end of the loan.



Forgiveness and Documentation

When does forgiveness start and how much?

- Loan forgiveness eligibility “period” begins with loan funding and ends eight weeks later.
- If used on eligible expenses, the forgiveness amount will be the amount spent during the eight-week forgiveness period, capped by the principal amount of the loan plus any accrued interest.
- The interest accrued on the portion of the loan that has been forgiven, will also be eligible for forgiveness.

What is the forgiveness process?

- Borrower will apply for forgiveness directly with their lender.
- SBA is providing lenders 60 days to approve requests.
- SBA will reimburse the lender within 30 days from the issuance of forgiveness.

Tip: The process will vary based on the lender, so we encourage all borrowers to maintain communications with their lender to ensure lender requirements are satisfied on a contemporaneous basis.

When should I request forgiveness?

- There is no “due date” for forgiveness.
- Documentation will be required to substantiate expenditures.
- The lender will govern the process.

Tip: We recommend filing promptly after the conclusion of the forgiveness period. The SBA has issued about 1.6 million loans and all were funded within a ten-day timeframe. Also, don't forget about accrued interest.

What “payroll” expenses are eligible for forgiveness?

- Compensation in the form of salary, wages, commissions, or similar.
- Cash tips or the equivalent.
- Payment for vacation, parental, family, medical, or sick leave.
- Allowance for separation or dismissal.
- Employee benefits consisting of group health care coverage and retirement.
- Payment of state and local taxes assessed on compensation.

Tip: The amounts for parental, family and medical leave listed above need to be exclusive of any wages submitted for tax credits under the Families First Coronavirus Response Act.

What “non-payroll” expenses are eligible for forgiveness?

- Interest on mortgages and other debt obligations.
- Rent and utilities payments.
- Interest payments on other debt obligations.
- Refinancing an Economic Injury Disaster Loan.

Tip: Obligations must have been in place as of February 15, 2020 and EIDL loans must have been made between January 31, 2020, and April 3, 2020.

Are there any limits on eligible costs?

- Compensation is limited to \$100,000 per employee; "compensation" includes monetary amounts (salary, wages, bonuses, tips, etc.)
- Non-payroll costs cannot include payments on principal.
- Expenses in periods beyond the forgiveness period cannot be accelerated or prepaid.

Tip: Be sure to exclude costs incurred prior to the forgiveness period including payments in arrears or past due.

What would cause a reduction in eligible loan forgiveness?

- The SBA has implemented a 25% limit on non-payroll expenses.
- Headcount reductions exclusive of re-hire exemption; percentage reduction.
- Payroll reductions of more than 25%; dollar-for-dollar reduction.

Tip: Estimate payroll and non-payroll expenditures during the forgiveness period to assess if they can meet the 75% / 25% split.

How do I calculate base period headcount?

- SBA defines “full-time” as an employee who averages 30+ hours per week.
- SBA defines “full-time equivalent” (FTE) as a combination of non-full-time employees who, in combination, average 30+ hours per week.
- The average headcount period for purposes of the loan forgiveness is either January and February 2020 or February 15 – June 30, 2019.

Tip: We recommend borrowers calculate the average headcount for both periods and elect the lower base for comparison.

How do I calculate base period payroll costs?

- The base period costs were previously disclosed during the application process in calculating the maximum loan amount.
- For most applicants, the base period payroll costs for calculating the loan amount was for the calendar year ended December 31, 2019. Some early applicants may have used a trailing twelve months.
- The base period for forgiveness is the most recent full quarter during which the employee was employed before the origination of a covered loan.

What if I already made reductions or pay cuts?

- Headcount and payroll reductions from February 15th to April 26th of 2020 are exempted from the calculation if restored by June 30th.
- The amount of loan forgiveness will be calculated without regard to changes made during this period if restored by the end of the covered period.

Tip: FTE count is not on an employee-by-employee basis, so it doesn't have to be the same person; this can even be a different mix of full-time and FTE employees.

How should I document loan uses?

- Documentation is required for loan forgiveness and should include:
 - Full-time and FTE employees on payroll,
 - Pay rates by employee for the periods covered,
 - Payments on covered mortgage obligations,
 - Payments on covered lease obligations,
 - Payments on covered utility payments, and
 - Payments of interest on other debt obligations.
- On a lender-by-lender basis, there may be other requirements.

Tip: Retain source documents including payroll registers, bank statements, invoices for interest, monthly rent agreements or invoices, and utility bills.

Do I need a separate bank account?

- Ideally, yes. We recommend the use of a different bank account for the PPP loan proceeds.
- The bank statement can be used as supporting documentation for the forgiveness application.
- A borrower can also use the activity to institute a weekly routine for gathering source documentation for any outflows from the account.
- We realized this is not practical for all borrowers and want to stress that documentation is more important than the physical separation of funds.

What if I have a balance left on my loan?

- Any monies remaining after loan after forgiveness will become a debt obligation of the borrower.
- The accrued interest on the balance remaining will not be forgiven.

Tip: The borrower should check the loan documents to understand the treatment of the accrued interest and payment terms for the remaining balance.



Accounting and Tax Implications

How do I record the loan on my financials?

- The loan should be recorded on your balance sheet.
- The current portion of the debt should be recorded as a current liability, and the portion extending beyond one year should be recorded as a non-current liability.

Cash	\$XXX,XXX.XX
SBA Forgivable Loan (Current)	\$XXX,XXX.XX
SBA Forgivable Loan (Non-Current)	\$XXX,XXX.XX

How do I record accrued interest?

- Interest will accrue on the loan balance beginning with loan issuance.
- The accrual will be expensed as incurred, and reported on the balance sheet as part of the month-end closing process.

Interest Expense	\$X,XXX.XX
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Accrued Interest	\$X,XXX.XX
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Tip: Review loan documents to understand the interest accrual. You may see a daily interest rate calculation with a 365-day year or the use of a 360-day year.

When forgiven, how do I adjust my financials?

- Loan forgiveness will require the recognition of debt extinguishment income.
- Extinguishment income will include both principal and accrued interest.

SBA Forgivable Loan (Current)	\$XXX,XXX.XX
SBA Forgivable Loan (Non-Current)	\$XXX,XXX.XX
Accrued Interest	\$X,XXX.XX
Gain on Debt Extinguishment	\$XXX,XXX.XX

Tip: It is crucial to record the income as other income, below the line from operating income, to prevent an overstatement of operating income.

What will my auditor need for this loan or forgiveness?

- Forgiveness must be evidenced by a letter of reprieve from the lender.
- The auditor will likely request additional documentation as part of their audit or review process.

Tip: Retain any records sent to the lender as part of the application or forgiveness process, as well as all loan documentation.

Will the loan require disclosures or footnotes?

- The loan issuance and forgiveness process will likely occur in its entirety during the 2020 reporting period, so most companies will not need year-end footnote disclosures.
- However, for fiscal year-ends that straddle this period or for companies who disclose footnotes quarterly, the standard debt footnote requirements will apply.
- The company should also consider relevant footnote disclosures and subsequent event disclosures relative to the impacts of COVID-19.

What are the entries if I have a balance left on the loan?

- Any monies remaining after forgiveness will become a debt obligation.
- The borrower also has the option to repay the loan amounts if any remain.

SBA Forgivable Loan	\$X,XXX.XX
Accrued Interest	\$X,XXX.XX
Cash	\$X,XXX.XX

To record the repayment of the loan, if repaid.

What are the entries if I have a balance left on the loan?

- As previously mentioned, any monies remaining after forgiveness will become a debt obligation.
- The borrower can retain the loan and make monthly payments.

SBA Forgivable Loan	\$X,XXX.XX
Accrued Interest	\$X,XXX.XX
Cash	\$X,XXX.XX

To record the recurring monthly entry, if not repaid.

What should I record on my Federal tax return?

- The loan forgiveness does not create cancellation of indebtedness income, which is typically included in taxable income.
- Since the loan forgiveness will be considered financial income, a permanent difference will need to be recorded on the tax return to adjust taxable income.

Tip: The tax implications of IRC §265 have not yet been determined. Under IRC §265, expenses relating to tax-exempt income are disallowed, which would create a net-zero impact for taxable income, if applicable. We believe this is contrary to the intent of the statute, and we are expecting clarification.

Will the states tax forgiveness?

- Many states have “rolling” conformity. These states conform fully with the existing IRC with all amendments. These states will not tax the forgiveness of federal loans under the PPP unless lawmakers in those states adopt a law expressly doing so.
- Other states have what is referred to as “static” conformity. These states conform with large amounts of the IRC, but not necessarily all the current year legislative amendments. Forgiveness in these states will depend on if, and when, the state updates their conformity.

Tip: Missouri & Illinois have rolling conformity.



Questions and Answers

Questions and Answers

Q: Are the expenses allowed in this period based on cash disbursement date or accrual basis or a combination?

A: The borrower should maintain their current method of accounting for income and expenses. We believe careful attention should be paid to those payroll expenses (monetary and non-monetary) that straddle loan funding date and cessation of the eight-week period. The borrower should use good faith to ensure expenses are not being shifted or accelerated into the forgiveness period.

Questions and Answers

Q: Would non-payroll benefits include dental and vision coverage?

A: There is no definitive guidance that includes vision and dental in the definition of healthcare benefits. However, the opposite is also true, that these benefits are excluded. We believe a reasonable argument can be made to include vision and dental coverage as part of employee benefits.

Questions and Answers

Q: For interest expense, does it include all interest on secured debt or just mortgage interest?

A: The legislation and guidance includes "debt on other outstanding obligations". We believe the mortgage interest component is included to subsidize those borrowers who own their real estate. We also believe the non-mortgage interest applies to all borrowers who have outstanding debt obligations.

Questions and Answers

Q: For rent and lease expense, does it include all operating leases or just real property leases?

A: Rent and utility expenses are intended to be the occupancy costs of the business.

Questions and Answers

Q: What is included in utilities?

A: Utilities include electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020.

Questions and Answers

Q: For the 25% payroll reduction, if someone is hourly and earns the same rate per hour, but has worked less hours, how does their pay get addressed?

A: There is some ambiguity in the legislation with regards to hourly workers. We believe the intent is to maintain the payroll of each employee whether that is a salaried or hourly worker. In the case of an hourly worker, we would suggest maintaining the combination of both hourly pay rate and average hours worked relative to the base period.



Resources

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CARES Act Response Team

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CARES Act Assistance

For guidance or assistance from the Brown Smith Wallace CARES Act Response Team, please complete the form below and we'll contact you as soon as possible.

First Name*

Last Name*

Company*

Email*

Phone

How can we help you?

On Friday, March 27, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) into law. This \$2 trillion economic relief package is the largest in US history, designed to stabilize our economy and help businesses and individuals weather the unprecedented financial disruption caused by the COVID-19 pandemic.

The accountants and business performance advisors at Brown Smith Wallace have assembled the CARES Act Response Team to help businesses and individuals:

- Understand the law's provisions
- Determine eligibility for emergency loans and grants, tax credits, rebates, tax deferrals, and more
- Develop a strategy for accessing and utilizing the aid

Our cross-functional team has extensive experience helping clients devise sound, financial strategies to help businesses accelerate growth and help individuals strengthen their personal financial position. Our accountants and business performance advisors have studied the CARES Act and are prepared to help you through this uncertain and



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