Paycheck Protection Program (PPP) Loan Forgiveness

Note: All information provided below is based on the information available as of 04/13/2020. The U.S. Department of Treasury is expected to issue its interim guidance on 04/27/2020, at which time the information below could be out of date. This letter is general in nature and is not intended to be nor should it be treated as tax advice. Please contact your accountant at Trout CPA if you have specific questions about the frequently asked questions and how it may affect you.

1. **The PPP Loan Application requested the number of employees. My company did not calculate full-time equivalents (FTEs) when reporting the number of employees; they used a head count that was significantly more. Is that a problem?**
   The application reporting of number of employees was for the purpose of determining if the applicant qualified for the loan (under 500 employees). The number reported here is completely unrelated to the FTE calculation that we expect to be used in the calculation of PPP Loan Forgiveness.

2. **What time period is used to calculate FTEs for PPP Loan Forgiveness?**
   The base period is the borrower's choice of either Average FTEs employed between 2/15/2019 - 6/30/2019 or FTEs employed between 1/1/2020 - 2/29/2020.

3. **If an employee works 60 hours/week, does that count as 2 FTEs?**
   No. An employee is considered one FTE once they work 30 hours in a week. Additional hours worked by this employee are not considered in the FTE calculation.

4. **How are FTEs for part time employees calculated?**
   For employees who work under 30 hours in a week, their hours are totaled together and divided by 30 to arrive at the number of FTEs for part time employees.

5. **How are FTEs taken into consideration for PPP Loan Forgiveness?**
   The borrower's average FTEs during the 8-week loan forgiveness period should equal the number of employees during the base period (see Question 2) to receive complete PPP Loan Forgiveness.

Accounting | Tax | Advisory

6. **What happens to the PPP Loan Forgiveness if the FTEs during the 8-week loan forgiveness period are less than the Average FTEs employed between the selected base period (see Question 2)?**
A portion of the PPP Loan would not be forgiven. To determine how much would not be forgiven as a result of reduced FTEs, multiply costs eligible for PPP Loan Forgiveness by using the following formula:

Average FTEs during the loan forgiveness period	**÷**	**Average FTEs during the base period**

<u>Example:</u> An employer has 30 FTEs in the 8-week loan forgiveness period, but 40 FTEs in the base period. This employer has a loan forgiveness ratio of 30/40 or 75%. As a result, only 75% of the total costs eligible for loan forgiveness are forgiven.

7. **Are there any provisions in the CARES Act that allow a grace period to rehire employees who were furloughed or laid off in the initial crisis time prior to the passage of the CARES Act?**
Yes. If, during the period beginning on 2/15/2020 and ending 4/27/2020 (30 days after the enactment of the CARES Act), there was a reduction in FTEs compared to the number of FTEs on 2/15/2020, an employer can rehire the same number of FTEs no later than 6/30/2020 to avoid application of this PPP Loan Forgiveness reduction calculation (see Question 6).

8. **If the borrower reduced employees' pay during the 8-week loan forgiveness period, will there be any reduction in PPP Loan Forgiveness?**
PPP Loan Forgiveness is reduced by the amount of any reduction in an employee's total salary and wages during the 8-week loan forgiveness period in excess of 25% of the total salary or wages paid to the employee during the most recent full quarter in which the employee was employed before the 8-week loan forgiveness period.

This only applies to employees earning no more than $100,000, on an annualized basis, during any pay period in 2019.

<u>Example:</u> *Employee A* made $13,000 for the quarter ending 03/31/2020 or $1,000 per week. During the 8-week loan forgiveness period the employer pays the employee $500 per week. For this employee the borrowers PPP Loan Forgiveness is reduced by $250 per week (the 50% reduction in pay less 25% times $1,000 per week) or $2,000 for the 8-week loan forgiveness period.

9. **Are there any provisions in the CARES Act that allows a grace period to reinstate wages for employees who had their pay reduced in the initial crisis time prior to the passage of the CARES Act?**
Yes. If the borrower reduced the salary or wages of its employees between 02/15/2020 and 04/27/2020 (30 days after the enactment of the CARES Act) as compared to their salaries or wages on 02/15/2020, the borrower may "eliminate the reduction" in their compensation before 06/30/2020, and avoid this reduction of PPP Loan Forgiveness.

It is currently unclear how to apply this provision of the PPP Loan Forgiveness; additional guidance is necessary.

We believe "eliminate the reduction" means "by 06/30/2020 the borrower is paying an employee in salary or an hourly basis at the same rate used at 02/15/2020 for that employee."

Others have interpreted "eliminate the reduction" to mean "borrowers have to pay the difference between the employee's weekly rate of pay at 02/15/2020 times 8-weeks less what was actually paid during the 8-weeks."

10. **What is the maximum amount a borrower can pay an employee over the 8-week loan forgiveness period?**
    For loan forgiveness purposes, the maximum amount that can be paid to employees is no more than the 8-week equivalent of a $100,000 annual salary; this equates to $1,923/week or $15,384 for the 8 weeks.

11. **Can borrowers give rehiring bonuses? What is maximum amount?**
    There is no guidance on bonuses at this time. We anticipate guidance by 04/27/2020.

12. **If borrowers are not open and not allowed to have staff come in, how are borrowers calculating hours worked?**
    This is an area that needs additional guidance.

13. **If there is nothing productive for our employees to do, should we continue to pay them?**
    Currently, from a financial perspective, we believe this may not be a good business decision. If employees are not able to work, the borrower should consider not paying them and keep them on unemployment.

    In addition, there are employee costs like workers' compensation, social security, and Medicare costs borrowers incur that are not eligible for PPP Loan Forgiveness. Therefore, there is a cost the Government is not paying for the employer to carry these employees on their payroll. On the other hand, by using the funds to pay for eligible payroll costs, you increase the non-payroll costs portion of the forgiveness (i.e. 25% bucket – rent, utilities, etc.)

    However, there may be other, non-financial reasons to keep an employee on payroll. For example, if a borrower has a key employee who the borrower wants to maintain a level of goodwill with to make sure they do not look for a job elsewhere, it may make sense to keep them on payroll while they are not actively working.

    Each borrower will have to evaluate their employee base to determine whether it makes sense to pay employees who are not working from a financial and employee relations perspective.

14. **[Follow up to Question 13] If a borrower is not allowed to be open and their staff is not employed during this time, doesn't this mean the borrower won't have some of its loan forgiven?**
    That is correct – borrowers may not have enough eligible payroll costs to have 100% of the loan forgiven. It's important to remember in this situation if the borrower did not spend the money on payroll costs, the borrower should have money left that can pay off the loan. There are no prepayment penalties.

    In the event there is no cash left when it comes time to start repayment, the loan is very borrower friendly. The repayment period of the loan is over 2 years at 1% interest.

15. **If a borrower decides to offer to pay staff while they are at home, what happens if these former employees don't want to come back until the borrower is allowed to re-open? Some employees may be making more on unemployment.**
    Employers can tell employees they have work, and to come back to work. Employees may then choose not to go back to work since they may make more money on unemployment than working. If this happens, consult with a human resources expert or employment attorney, and consider terminating these employees. Be prepared to document with Pennsylvania (or your employees' home state) Office of Unemployment Compensation the employees were let go for just cause and therefore should not be eligible for UC Benefits.

    It's important to note, payroll and FTE count, under the PPP Loan Forgiveness, does not necessarily mean the same people are employed by 06/30/2020 as were before 02/15/2020. The PPP Loan Forgiveness considers this outside the employer's control. New employees can be hired to replace terminated employees.

16. **The CARES Act states borrowers have until 6/30/2020 to reach full FTEs for PPP Loan Forgiveness. Does that mean borrowers can hire back a couple of people the first 5 or 6 weeks and then the rest at the very end when borrowers are hopefully open and need more help?**
    We believe this is the case.

17. **[Follow up to question 16] Do borrowers need to pay employees 75% of what they would have made over the whole 8-week loan forgiveness period or just for those 2 weeks?**
    This is an area that needs additional guidance. Borrowers would need to get their number of FTEs restored and any reduction in payroll restored by 06/30/2020 to qualify for PPP Loan Forgiveness. See questions 7 and 9 for comments on how the reduction in pay and FTEs might work.

    We believe borrowers would not need to cover the employees for the whole 8-week loan forgiveness period. The PPP Loan Forgiveness amount starts with whatever qualified payroll borrowers have during the 8-week loan forgiveness period.

18. **Is the bank the judge on if the borrower meets the conditions on forgiveness? How do borrowers get all requirements 100% confirmed and in writing so they don't get surprised?**
    The bank will be working with borrowers and hopefully will have good templates and guidance for this process. This will probably look different for each bank, although the underlying rules will be the same.

    We believe the additional guidance provided by Treasury starting on 04/27/2020 will give borrowers and banks the clarity to help borrowers make strong submissions of forgiveness.

    Unfortunately, it will be difficult to have no surprises. We suggest working with the bank as much as possible during the 8-week loan forgiveness period on this calculation.

19. **Does the CARES Act state that no more than 25% of PPP Loan proceeds can be used for anything other than payroll?**
    The CARES Act does not state this. The interim guidance from SBA on the PPP Loan Forgiveness stated no more than 25% can be used for non-payroll costs. It is currently unclear whether the CARES Act wording or the SBA interim guidance will take precedent in calculating PPP Loan Forgiveness.

20. **[Related to question 19] What kind of non-payroll costs are allowed and still qualify for loan forgiveness?**
    This question relates to businesses other than 1040 Schedule C businesses. See question 21 for a similar question for 1040 Schedule C businesses. We expect these two lists (question 20 and 21) to be aligned in future Treasury guidance. This is an area that needs additional guidance.

    The CARES Act and all subsequent guidance provided by the SBA and Treasury have provided a list of non-payroll costs that PPP Loan proceeds can be used for and still have the loan qualify for forgiveness. Below is a current list of items that will qualify. We expect this list to expand as Treasury provides additional guidance.

    - Interest payments on a mortgage loan incurred before 2/15/2020 and secured by real or personal property. The interest expense must be on payments made in the normal course of the loan, not as part of an accelerated or prepayment arrangement.
    - Rent payments on a lease agreement in force before 2/15/2020.
    - Utilities bills (including, but not limited to, electricity, gas, water, transportation, telephone, or internet) which were in service, but not incurred, before 2/15/2020.

21. [Related to question 19] What kind of non-payroll costs are allowed and still qualify for loan forgiveness for a 1040 Schedule C business?

This question relates to 1040 Schedule C businesses. See question 19 for a similar question for businesses other than 1040 Schedule C businesses. We expect these two lists (questions 20 and 21) to be aligned in future Treasury guidance.

This is an area that needs additional guidance.

The CARES Act and subsequent guidance provided by Treasury related to 1040 Schedule C businesses have provided a list of non-payroll costs that PPP Loan proceeds can be used for and still have the loan qualify for forgiveness. Below is a current list of items that will qualify. We expect this list to expand as Treasury provides additional guidance.

- Interest payments on a mortgage loan incurred before 2/15/2020 and secured by real or personal property.
    - This includes mortgage for a warehouse or an auto loan for a vehicle the borrower uses to perform business.
    - The interest expense must be on payments made in the normal course of the loan, not as part of an accelerated or prepayment arrangement.
    - Interest payments on other debt obligations that were incurred before 2/15/2020 are not eligible for PPP Loan forgiveness.
- Rent payment on a lease agreement in force before 2/15/2020, which includes rent expense on a warehouse or a vehicle the borrower uses to perform business.
- Utility bills (including, but not limited to, electricity or gas used to drive a business vehicle) which were in service, but not incurred, before 2/15/2020.

22. [Related to question 21] Are there any other differences regarding PPP Loan Forgiveness that 1040 Schedule C business owners should be aware of?

- One significant difference between 1040 Schedule C businesses and other businesses is PPP Loan proceeds can only be used on expenses which have been claimed (or were entitled to be claimed) on the 2019 1040 Schedule C.
    - As an example, if the borrower did not claim or was not entitled to claim utility expenses on the 2019 1040 Schedule C, loan proceeds cannot be used for utilities.
- Owners can be compensated out of the loan proceeds, and have the PPP Loan Forgiveness based on the following calculation from the 2019 1040 Schedule C:

Schedule C Net Profit (not to exceed $100,000)	÷	**52**	×	**8**

- Loan proceeds can be used on employee benefits (e.g. employer health insurance expense or employer retirement contributions) and be eligible for PPP Loan Forgiveness as part of the calculation of payroll costs. However, payments for owner health insurance and owner retirement contributions are not eligible for PPP Loan Forgiveness.

23. **[Related to question 22] The 1040 Schedule C borrower's calculation of PPP Loan Proceeds was based on a different calculation of owner's compensation then what is used in the PPP Loan Forgiveness. Is that correct?**
In the case of a 1040 Schedule C who has no employees, yes. The PPP Loan proceeds were calculated using a different formula based on the 2019 1040 Schedule C:

Schedule C Net Profit (not to exceed $100,000)	÷	**12**	×	**2.5**

The PPP Loan Forgiveness calculation is calculated using the formula indicated in question 22:

Schedule C Net Profit (not to exceed $100,000)	÷	**52**	×	**8**

This results in a lower number for PPP Loan Forgiveness then was used to calculate the amount of PPP Loan Proceeds.

Example: An attorney, who has no employees, makes $200,000 a year in 2019 Schedule C Net Profit. To calculate the amount of PPP Loan proceeds the attorney would be eligible for:

$$(\$100{,}000 \div 12) \times 2.5 = \$20{,}833$$

The attorney takes the maximum amount of owner's compensation allowed under the PPP Loan Forgiveness calculation:

$$(\$100{,}000 \div 52) \times 8 = \$15{,}385$$

24. **Is a 1040 Schedule C business eligible for a PPP Loan if it reported a net loss on line 31 on its 2019 1040 Schedule C?**
No

25. **Can a business use PPP Loan proceeds to pay rental payments to properties owned by one or more of the business owners (self-rental) and have these payments included in the 25% of non-payroll costs forgiven?**
This is an area that needs additional guidance. Currently, there is no guidance in the CARES Act or any of the Treasury Interim Guidance which precludes self-rentals from receiving payments for rent from PPP Loan proceeds and not being included in the PPP Loan Forgiveness.

While this area is currently unclear, it is certain that as with other rental properties, there must be a lease agreement in force before 2/15/2020 to qualify for loan forgiveness.

26. **In order to qualify for PPP Loan Forgiveness, should a borrower set up a separate bank account to receive the loan proceeds?**
It is not required, but we recommend setting up a separate bank account.

As part of the PPP Loan Forgiveness process, we expect banks to require proof of used funds. Separating the PPP Loan proceeds usage from regular bank payments will assist borrowers in providing this proof.

There are other logistical issues that can arise in using a borrower's primary bank account to receive these funds.

As an example, if the borrower uses a line of credit and a nightly sweep from their bank account to prevent NSF checks, a deposit of the PPP Loan proceeds in the borrower's primary bank account could be automatically swept to reduce the outstanding line of credit.

27. **Can a borrower use PPP Loan proceeds for any payroll taxes and have that payment qualify for PPP Loan Forgiveness?**
    Yes, but it's limited. Currently, the only payroll taxes eligible for PPP Loan Forgiveness are state and local employer paid taxes. In the 1040 Schedule C business guidance, the Treasury indicated this meant state unemployment insurance premiums. These taxes are considered payroll costs and would be included in the 75% of PPP Loan proceeds required to be used to qualify for PPP Loan Forgiveness.

    No other payroll taxes have been indicated as eligible for PPP Loan Forgiveness.

28. **What documentation will I need to submit to my lender for loan forgiveness?**
    You should be prepared to submit the following information:
    - IRS Form 941 Employer's Quarterly Federal Tax Return for the quarter that includes the 8-week period.
    - Quarterly state unemployment forms for the quarter that includes the 8-week period.
    - Payroll reports for payrolls incurred and paid during the 8-week period.
    - Copies of qualified leases and related payments during the 8-week period.
    - Copies of utility invoices and proof of payment during the 8-week period (i.e. canceled check, bank statement, etc.).
    - Copies of loan and mortgage statements showing qualified interest incurred and paid during the 8-week period. You should also have proof of payment (i.e. canceled check, bank statement, etc.).

Trout CPA
Accounting | Tax | Advisory

For questions or assistance, please contact one of our trusted business advisors.

LANCASTER	MECHANICSBURG	CARLISLE
1705 Oregon Pike	930 Century Drive, Suite 104	62 W Pomfret Street
Lancaster, PA 17601	Mechanicsburg, PA 17055	Carlisle, PA 17013
717-569-2900	717-697-2900	717-243-4822