Your Firm LLC

Paycheck Protection Program: Loan Forgiveness Guidelines

The Paycheck Protection Program was launched to help small businesses retain employees and maintain operations through the COVID-19 pandemic. The program provides loans that are backed by the SBA and completely forgivable if the loan proceeds are used to pay specific expenses. This document provides information about the loan forgiveness provision in addition to the calculations used to determine your forgivable amount.

The Basics

Once a PPP loan is approved, your lender must disburse the loan proceeds to you within 10 calendar days.

The amount of debt forgiven is based on eligible expenses incurred during the Covered Period which is an 8-week period starting when the loan is funded to your bank account. Since only incurred expenses are eligible for debt forgiveness, you may not prepay expenses. Eligible expenses include payroll costs, and rent, utilities, and business mortgage interest that were in force prior to February 15, 2020. At least 75% of the expenses must be for payroll costs and the remaining 25% may be non-payroll costs.

The amount of debt forgiven is not included as taxable income when you file your tax return next year. However, the expenses you pay with the forgiven loan proceeds are not tax-deductible.

There are stipulations for each type of expense, which we will cover below.

Payroll Expenses

At least 75% of the loan must be used for payroll costs for employees who live within the United States to qualify for forgiveness. Payments to independent contractors or compensation to employees whose primary residence is outside the U.S. are not considered eligible expenses.

Payroll costs must be incurred during the Covered Period which is the 8-week period from the date of loan disbursement. However, if your payroll schedule is biweekly or more frequent, you may elect to calculate eligible payroll costs using the 8-week period that begins on the first day of your first pay period following your Loan Disbursement Date. This period is called the "Alternative Payroll Covered Period".

Payroll costs incurred but not paid during your last pay period of the Covered Period or Alternative Payroll Covered Period are eligible for forgiveness if paid on or before the next regular payroll date. This keeps you from having to pay employees in the middle of a payroll period.

Eligible payroll costs include:

- Salary, wages, commissions, or similar compensation
- Cash tips or the equivalent
- Payment for vacation, parental, family, medical, or sick leave
- Allowance for separation or dismissal

The total allowed compensation is capped at $100,000 annualized per employee; this equates to a maximum of $15,385 per employee prorated for the 8-week covered period.

Owner compensation is allowed but capped at the lower of eight weeks' worth of 2019 compensation or $15,385 per individual.

Employee benefit costs such as group health care coverage, including insurance premiums, retirement contributions, and the employer's portion of state and local taxes are eligible expenses.

Federal taxes including FICA, Railroad Retirement Act taxes, and income taxes do not qualify as eligible expenses. Proceeds for qualified sick and family leave wages, for which a credit is allowed under the Families First Coronavirus Response Act, do not qualify as eligible expenses either.

Headcount and Compensation Calculations

There are additional requirements which state that the forgiveness amount may be reduced if the employer fails to maintain employee headcount and compensation levels.

Headcount Requirement

The headcount requirement states that you must maintain your average number of full-time eligible employees during the 8-week period following the Loan Disbursement Date. This number is based on one of two base periods: February 15 to June 30 of 2019 or January 1 to February 29 of 2020. The base period you use is up to your discretion. If you are a seasonal employer, you can use a consecutive twelve-week period between May 1 and September 15 of 2019.

To determine whether you meet the headcount requirement, divide the average number of full-time equivalent employees you had during the 8-week Covered Period or Alternative Covered Period by the average number of full-time equivalent employees you had during your selected base period, either February 15 to June 30 of 2019 or January 1 to February 29 of 2020. The resulting number should be equal to or higher than 1 to meet the headcount requirement. If the number is less than 1, then your forgiveness amount will be reduced proportionally.

Headcount Requirement

$$\frac{\text{Avg \# Employees per pay period during the 8-week period}}{\text{Avg \# Employees during the base period* } (2/15/19 - 6/30/19) \text{ or } (1/1/20 - 2/29/20)} = \text{Employee Headcount Ratio (should be} \geq 1)$$

*Seasonal employers will use 12 weeks between 5/1/19 - 9/15/19

Compensation Requirement

You must also maintain compensation levels for each individual employee during the 8-week Covered Period or Alternative Covered Period. If you reduce the total compensation for any eligible employee by more than 25% as compared to their compensation during the period of January 1 to March 31 of 2020, then the amount forgiven will be reduced.

The compensation requirement applies to employees who did not receive, during any single pay period during 2019, wages or salary of more than $100,000 on an annualized basis. So if you pay twice a month and had an employee who made more than $4,166 in any single pay period in 2019, then the compensation requirement would not apply to that specific employee.

Compensation Requirement

\+ Avg annualized compensation during covered or alternative covered period.

− (Avg annualized compensation from Jan 1 - Mar 31, 2020) X .75

= Annualized decrease in compensation beyond allowed 25% reduction

÷ 52 weeks X 8 weeks

= Decrease in your forgivable amount (if negative)

Rehiring Employees

You may need to rehire employees who were previously laid-off or furloughed in order to meet the headcount and compensation requirements. If you make an offer in good faith to rehire the employee and they reject your offer, you can exclude them from the headcount and compensation calculations. Make sure you have written documentation of both the offer and the employee's rejection. Also, if an employee does reject an offer for rehire, they may forfeit eligibility for continued unemployment compensation.

Additionally, if during the Covered Period or Alternative Covered Period, you fired an employee for cause, or if an employee voluntarily resigned, or voluntarily requested and received a reduction of their hours, and that position was not filled by a new employee, you can exclude them from the headcount and compensation calculations.

Finally, there are safe harbor exceptions for the full-time employee and compensation levels. If you reduced the number of full-time equivalent employees between February 15 and April 26 of 2020, but then restore the number of full-time equivalent employees by June 30 of 2020 to the February 15 level, then the baseline forgivable amount will not be reduced for a reduction in full-time employees. An equivalent safe harbor exists for restoring compensation levels, so if you restore reduced compensation by June 30, then the baseline forgivable amount will not be reduced for a reduction in compensation levels.

Eligible Non-Payroll Expenses

As stated earlier, other approved expenses include utilities, rent, and business mortgage interest. To qualify, however, the obligations must have been in force prior to February 15, 2020.

Utilities can include electricity, gas, water, transportation, telephone, or internet access.

Business mortgage interest includes any interest you pay on a mortgage for real or personal property. Please note that while interest expense is an eligible expense, payment for mortgage principal is not an eligible expense.

All eligible non-payroll costs must be paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date, even if the billing date is after the Covered Period.

As mentioned earlier, you cannot prepay expenses to qualify for loan forgiveness.

Loan Forgiveness Calculations

To determine the amount of loan forgiveness, you'll calculate the sum of eligible payroll costs, business mortgage interest, rent and utility expenses. We will call this your Baseline Forgiveness Amount.

Second, subtract the amount of compensation reduction beyond the allowed 25% as discussed in the compensation requirements from the Baseline Forgiveness Amount.

Third, multiply that net amount by the percentage reduction in full-time equivalent employees. If you met the safe harbor requirement, then you don't need to do this. This will result in your Modified Total Forgiveness Amount.

Your actual loan forgiveness amount, however, will be the lesser of your Modified Fotal Forgiveness Amount, the amount of your PPP loan or your total payroll costs divided by .75.

Loan Forgiveness Calculation

Forgivable amount is the lesser of:

1) Modified Forgiveness Amount
2) PPP Loan Amount
3) Payroll Costs ÷ .75

Baseline Forgiveness Amount
\- Amount > 25% Decrease in Compensation

= Net Amount
X Employee Headcount Ratio (if less than 1)

= Modified Forgiveness Amount

Final Thoughts

While this provides a good foundation for PPP loan forgiveness guidelines, the SBA is continuously providing additional guidance on the PPP loan program and the debt forgiveness provision. We suggest maintaining excellent documentation throughout your loan process while also consulting our professionals and your loan officer on a regular basis. If you have any questions or would like to discuss, please contact us. We're always here to help.

About Your Firm LLC

We have hand-picked a team with tax, auditing, accounting, business and management advisory expertise in a multitude of fields, including healthcare, professional-services firms, commercial contractors, home builders, real estate companies, manufacturing and distribution companies, dealerships, non-profit organizations and pension funds.

We have the expertise and the resources to provide not only the critical services you need during these evolving economic times, but also, importantly, to build for the future. Our strategic alliances with professional organizations across the country allow us to bring our clients the talent and expertise of national firms with the high-touch service of a local firm. While we remain focused on the core services of tax, accounting and audit, we expand and offer you the business consulting needed to remain competitive. We believe the success of our clients is the greatest measure of our own.

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