



and compensation levels are maintained.”

(See PPP Information Sheet: <https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf>)

Remind me again, Why did I think this was a good idea?

The idea behind PPP: Business owners—including those who are self-employed—can apply for a loan of 2.5 times their average monthly expenses. Once they get the loan, they are to spend the funds during the next eight weeks on approved expenses—mostly for payroll—and if they do so, they can apply to have the entire amount forgiven.

Why do I want to get this right?

Treasury Secretary Mnuchin indicated that loans of \$2 million or more will be audited and the Treasury will hold firms “criminally liable” if they did not meet the program’s terms. If the loan is found not to be “necessary,” criminal fines of up to \$1,000,000 and imprisonment for up to thirty years can be imposed.

(See: <https://www.nytimes.com/2020/05/06/business/small-businesses-loans-ppp-coronavirus.html>)

Yikes.

But, please know, that if you are diligently working with your CPA and banker to provide accurate documentation of expenses and certifying your need for the funds, you should be just fine.

OK, now that you have my attention, What do I need to do?

The Paycheck Protection Program loan forgiveness has two main components

- 1 - Spending your PPP funds on the right things
- 2 - Tracking and proving your spending

What should I know?

Please keep in mind this information is changing rapidly and is based on our current understanding of the programs as of May 7, 2020. It can and likely will change. Accordingly, please do not rely solely on this for your financial decisions. We encourage everyone to consult with their lawyers, CPAs and bankers. Lastly, note this piece covers forgiveness for Paycheck Protection Program loans, not Economic Injury Disaster Loans (EIDLs).

Bankers are new to your disclaimer list. Why?

Lenders are the first group reviewing your request for forgiveness. It’s a good idea to check in with the lender on how they are interpreting things.

What’s the Goal?

The Treasury’s guidelines for PPP loan forgiveness spell out that:

“Loan amounts will be forgiven as long as: 1) Loan proceeds are used to cover payroll costs, and most mortgage interest, rent, and utility costs over the 8-week period after the loan is made; and 2) Employee

You likely started this process by depositing the loan proceeds in a separate bank account apart from your primary business account.

From there, you'll make payments for approved expenses, thereby starting the documentation process.

Regarding spending the PPP funds, you used the hyper-legal term, "...the right things..." Can you break that down into layman's language for me?

First, you need to know about the SBA's 75/25 rule.

Spend at least 75% of the funds on payroll costs *

- Salaries
- Wages
- Vacation pay
- Parental and family leave
- Retirement plan contribution
- Medical benefits
- Sick leave
- Other health benefits

Spend the remaining 25% of the funds on approved expenses

- Mortgage interest
- Rent
- Utilities

N/B: For the mortgage interest, rent, and utilities expenses to be forgivable, the mortgage/ rent/utilities expenses can't be brand new-they had to be in effect prior to February 15, 2020.

Ugh, you've got one of those dreaded asterisks next to the term payroll costs. Am I supposed to start reading footnotes?

Nope, we've got you covered right here. No need to go down to the basement of this page looking for footnotes. Besides, there could be *Murder Wasps* down there.

The asterisk was to draw your attention to other items that can also be considered as payroll costs.

The CARES Act states that payroll includes:

- Payment of cash tips or equivalent (based on

employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips),

- Allowance for dismissal or separation;
- Payment of State or local tax assessed on the compensation of employees; plus
- **For sole proprietors or independent contractors, wages, commission, income, or income from net earnings from self-employment, or similar compensation. ***

It does not include:

- The compensation of an individual employee in excess of an annual salary of \$100,000, as prorated for the covered period;
- Federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including the employee's and employer's share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees;
- Any compensation of an employee whose principal place of residence is outside the United States;
- Qualified sick and family leave wages for which a credit is allowed under Sections 7001 and 7003 of the Families First Coronavirus Response Act.

Also note that payments to independent contractors are not covered by payroll. Independent contractors should apply for PPP on their own.

Sorry for the long list, but I needed to include that to keep you informed and to avoid the sting of the Compliance department.

Come on! Another asterisk – this time on the comp for self-employed? It's like an infestation! What gives with the self-employed?

If you're self-employed, you are operating under slightly different rules, particularly if you don't have employees. The primary difference for is that self-employed owners were given a PPP loan based on 2019 net profit, not 2019 payroll records.

In its mid-April guidance for the self-employed, the SBA states:

"[I]f you have employees, you should submit Form 941

and state quarterly wage unemployment insurance tax reporting forms or equivalent payroll processor records that best correspond to the covered period (with evidence of any retirement and health insurance contributions).

“Whether or not you have employees, you must submit evidence of business rent, business mortgage interest payments on real or personal property, or business utility payments during the covered period if you used loan proceeds for those purposes.

*“The 2019 Form 1040 Schedule C that was provided at the time of the PPP loan application must be used to determine the amount of net profit allocated to the owner for the eight-week covered period. ... (For purposes of loan forgiveness it is appropriate to require self-employed individuals to rely on the **2019 Form 1040 Schedule C** to determine the amount of net profit allocated to the owner during the covered period.”*

(Ed. Note: Go to *Line 31 on Schedule C* to find your number.)

For the owner, that amount is presumably automatically forgiven, since the SBA has not asked for any additional information. In other words, *there’s no need to try to figure out how to pay yourself over the eight-week period in order to obtain forgiveness.*

Forgiveness can be up to the full principal amount of the loan plus accrued interest if the loan funds are spent on these other expenses:

1. Payroll costs including salary, wages, and tips, up to \$100,000 of annualized pay per employee (for eight weeks, a maximum of \$15,385 per individual),
2. Covered benefits for employees (but not owners), including health care expenses, retirement contributions and state taxes imposed on employee payroll paid by the employer (such as unemployment insurance premiums),
3. Payments of interest on mortgage obligations on real or personal property incurred before February 15, 2020,
4. Rent payments on lease agreements and
5. Utility payments

N/B: It does not include contributions toward retirement or health insurance

benefits on behalf of self-employed owners.

What about partners and partnerships?

Partners may not submit separate PPP applications, but they can be included in the partnership’s loan application to the extent of the self-employment income of the “general active partners” up to \$100,000 annualized.

According to the SBA in its article, *How to Calculate Maximum Loan Amounts – By Business Type*, partnerships include in the calculation of net earnings from self-employment as reported on **box 14a of the Schedule K-1**, reduced by certain items and multiplied by .9235 to remove the employer’s share of self-employment tax, and limited to \$100,000 on an annualized basis. Box 14a includes guaranteed payments for services, so these payments are included in the calculating the maximum loan amount, and presumably would be included in the forgiveness calculation too.

This guidance isn’t clear whether a partnership will be required to make distributions to its partners within the 8-week period, or whether the *owner compensation replacement* model for Schedule C will be used.

If I’ve made personnel changes, I’ve heard that not all will be forgiven. What do I need to know about that?

Regardless of the type of employer, you can lose a portion of the forgiveness if you:

- You spend less than 75% of the loan on payroll costs
- You reduce full-time employees compared to 4/1/19 – 6/30/20
- If you reduce your employee’s salary or wages to less than 75% of the base salary or wages of such employee during the prior quarter

Ok, thanks for the general overview of the forgiveness rules. What’s a good way to keep track of the expenses?

- Keep your CPA happy, record the PPP deposit as a loan on your books.
- Over the next eight weeks, complete bookkeeping on all financial transactions
- Record the expense amount

- Record the vendor/payee
- Record the category of the expense (Utilities, Rent, Payroll, etc.)
- Record the date of the transaction
- Record the purpose of the transaction
- Store the receipt or official record (such as payroll records)

Glad you went to Store for that last one. You were starting to sound like a “broken record”. What’s Next?

- At the end of eight weeks, add up the total amount spent on forgivable categories
- Include documents verifying the number of full-time equivalent employee and their pay rates as well as the payments on eligible mortgage, lease, and utility obligations
- Certify that the documents are true and that you used the forgiveness amount to keep employees and make eligible payments
- Apply for forgiveness through your lender, who has 60 days to forgive you. (A banker’s forgiveness, the ultimate oxymoron?)
- Once the amount of forgiveness has been confirmed by your lender, adjust that amount out of the “Loan” section of your ledger, into a **“Non- Taxable Gains” ledger**
- If you didn’t get full forgiveness of the loan, any remaining amounts will stay in the **“Loan”** category on your books
- You’ll have two years to pay it back at a 1% interest rate – no APR calculations as there are no fees

(See: <https://www.elliottdavis.com/ppp-accounting-loan-forgiveness/> and ASC 405-20, *Extinguishments of Liabilities* and ASC 470-50, *Debt Modifications and Extinguishments*)

Is it true that the expenses paid with PPP dollars are still tax deductible?

Recently issued, IRS Notice 2020-32 sets out that you

can’t claim tax deductions, even for the wages, rent, etc. that are normally fully deductible.

In making the announcement, the IRS couldn’t resist throwing a little shade toward the drafters of the PPP. The Notice points out that while Congress told us PPP loan forgiveness is not taxable income, they said nothing about deducting the expenses paid for with tax-free loan proceeds.

Sources:

CARES ACT: <https://www.congress.gov/bill/116th-congress/house-bill/748/text#toc-HCC079DAB5D724A3B9AE86D4E64A83BBE>

SBA PPP Interim Final Rule: https://www.sba.gov/sites/default/files/2020-04/PPP--IFRN%20FINAL_0.pdf

SBA Interim Final Rule Supplement:

https://home.treasury.gov/system/files/136/Interim-Final-Rule-Additional-Eligibility-Criteria-and-Requirements-for-Certain-Pledges-of-Loans.pdf?utm_medium=email&utm_source=govdelivery

“Paycheck Protection Program How to Calculate Maximum Loan Amounts-By

Business Type,” Small Business Administration, April 24, 2020, <https://home.treasury.gov/system/files/136/How-to-Calculate-Loan-Amounts.pdf>,

IRS Notice 2020-32: <https://www.irs.gov/pub/irs-drop/n-20-32.pdf>

Disclaimers

A couple of items before the standard disclaimer:

1. Include your banker in your preparation for forgiveness.
2. Now more than ever, include your CPPPA.

