



# Managing Your Business Through the Covid-19 Crisis

## How to Maximize Debt Forgiveness

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# Welcome



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# Today's Agenda

- Review of Paycheck Protection Program (PPP)
- Additional PPP and EIDL Loans
- Final SBA Rules on PPP Loans and Loan Forgiveness
- Forgiveness Overview
- PPP Loan Forgiveness Application
- Bank Makes Decision
- Misuse of PPP Funds
- Business Realities

# Today's Presenters



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# Review of Paycheck Protection Program (PPP)

- The CARES Act instituted the Paycheck Protection Program (PPP)
- Provides loans between April 3, 2020 and June 30, 2020 of up to \$10 million at 1% interest to employers with:
  - 500 or fewer employees residing in the U.S. (*the number of employees can be higher if the company meets SBA small company size standards*), or
  - A maximum tangible net worth of \$15 million as of March 27, 2020, and an average net income of \$5 million or less over the previous two fiscal years
- Other company size rules that should be considered (*restaurant and hospitality companies and affiliated businesses*)
- Intended to help companies impacted by COVID-19 to retain their employees and assist in covering certain specified qualified costs
- PPP loan amount is based on 2.5 times the borrower's average monthly payroll costs

# Additional PPP and EIDL Loans

- Original \$349 billion allocated to the PPP ran out in under 2 weeks
- New funding would add \$310 billion to the fund
  - \$30 billion for loans made by federal insured lenders with assets between \$10 billion and \$50 billion
  - \$30 billion for loans made by community financial institutions, and small federally insured banks and credit unions with assets under \$10 billion
- It could be exhausted within 10 days
- Another \$50 billion in small business funds (not included in the PPP program) for the SBA's Economic Injury Disaster Loan (EIDL) program
  - Provides working capital loans of up to \$2 million that small businesses may use to pay fixed debts, payroll, accounts payable, and other bills that can't be paid because of the impact of a disaster
- The SBA will also receive \$10 billion for small business EIDL grants of up to \$10,000 for disaster relief

# Final SBA Rules on PPP Loans & Loan Forgiveness

- We still do not have the final Small Business Administration (SBA) rules on how the forgiveness provisions will work
- In its interim rules dated April 2, 2020, the SBA stated that it will issue additional guidance on loan forgiveness
- The SBA is required to issue final guidelines on loan forgiveness within 30 days of March 27, 2020 (the day the CARES Act was enacted)
- Additional guidance may change and/or clarify the manner in which loan forgiveness and related reductions in loan forgiveness are calculated

**RULES**

# Forgiveness Overview

- The CARES Act provides that PPP loans can be forgiven up to 100% of the amount borrowed if the company meets certain criteria, including:
  - Loan proceeds are used to cover “payroll costs”, mortgage interest, rent paid on leases, and utility costs that are paid over the 8-week period that begins the date the loan is made (the “benefit period”);
  - Employee headcounts are maintained;
  - Compensation levels are maintained for employees earning \$100,000 or less; and
  - Not more than 25% of the loan amount is used for qualified non-payroll costs
- If a portion of the loan is not forgiven, the remaining amount of the loan is due and payable within 2 years, accruing interest at 1% per annum
- Interest and principal payments are deferred for a 6-month period from the date of the loan, though interest will accrue during that 6-month deferment period
- The Act further provides that the amount forgiven will be tax-free for federal purposes



# Eight-Week Period

- Begins when the PPP loan proceeds are received
- Forgiveness is based, in part, on “[approved] costs incurred, and payments made during [the eight-week period],”
- Must keep meticulous records of what you spent PPP funds on and when
- Budget and allocate these funds once they arrive
  - Open a separate deposit account solely for the PPP funds and then write checks from that account
  - Spend as much as you can on designated payroll costs incurred during the eight-week period (*under the SBA’s interim rule if you do not spend at least 75% of the loan proceeds on payroll costs, the dollar amount of the shortfall from 75% reduces the amount of forgiveness*). It is currently unclear if the 25% cap is applied on the loan amount or the amount eligible for forgiveness
  - All remaining proceeds not spent on payroll costs should be spent on the three other approved costs: covered rent, covered utilities, and covered mortgage interest

# 75% Rule

- PPP “provides a loan amount 75 percent of which is equivalent to eight weeks of payroll (8 weeks / 2.5 months = 56 days / 76 days = 74 percent rounded up to 75 percent)”
- If your average monthly payroll has declined at all since the 12-month period used to compute the loan amount, you will struggle to reach 75% for the eight weeks
- If your payroll costs don't quite reach 75%, you could consider whether to declare a special “thank you” bonus to rank-and-file employees during the eight weeks
- Even if you don't achieve total forgiveness, you are left with a very nice two-year loan at 1% interest



# Self Employed

- Limited to 8 weeks divided by 52 weeks multiplied by Line 31 of the 2019 Form 1040 Schedule C
- Unclear if mortgage interest, rent and utilities costs can also be forgiven on top of this amount



# Headcount Reduction

- Amount paid out in approved costs for the eight-week period determines your maximum forgiveness
- However, this can be further reduced due to declines in headcount
  - Measure the number of full-time equivalents (FTEs) during the eight-week period
  - The average number of FTEs per month is calculated based on the average number of FTEs for each pay period falling within a month
  - Compare to the FTEs you had in either of two baseline periods:
    - 2/15/19 to 6/30/19; or
    - 1/1/20 to 2/29/20, whichever has fewer FTEs
  - If you had 10% fewer FTEs in the eight-week period than in your baseline period, then your loan forgiveness is proportionately reduced, by that same 10%



# Salary/Wage Reduction

- Identify all employees during the eight-week period whom you employed at any point during 2019 and “who did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000”- (“below-100 people”)
  - Above 100 people immune?
  - Impact of bonus paid in a single pay period?
- Determine each employee’s average salary/wage rate for the first quarter of 2020
- If 1/8th of the total amount of salary/wages paid to the employee for the eight-week period is at least 75% of their average weekly rate during Q1 of 2020, then there is no further reduction in loan forgiveness
- But if the employee had a reduction in salary/wages such that their pay for the eight-week period went down by more than 25%, then the dollar amount of the portion beyond 25% reduces, dollar-for-dollar, the amount of loan forgiveness

# Relief

## ■ Headcount Reduction

- If by June 30, 2020 you bring your FTE levels back up to where they were at February 15, 2020, then that excuses whatever reduction in forgiveness was attributable to a drop in headcount between February 15, 2020 and April 26, 2020
- The CARES Act wording is that the employer by June 30 “has eliminated” that reduction in the number of FTEs
- We await guidance from the SBA on precisely what this means



## ■ Salary/Wage-Related Reduction

- If by June 30, 2020 you have restored the salary/wage levels of the below-100 people to at least the level existing on February 15, 2020, then that excuses any salary/wage level reductions which occurred between February 15, 2020 and April 26, 2020
- The statutory wording is that the employer “has eliminated” the reduction in salary/wage



# Definitions

- **Payroll costs** - “Payroll costs” including salary, wages, commissions, a partner’s guaranteed payments, and partner’s share of income subject to self-employment income (up to a maximum annualized amount of \$100,000 per employee/partner), group healthcare benefits, medical or sick leave, retirement benefits, and state or local taxes assessed on the compensation of employees. Payroll costs should also include severance pay and bonuses, subject to the annualized cap, subject to further SBA guidance
- **Covered rent** - rent obligated under a leasing agreement in force before February 15, 2020 (*presumably includes bona fide equipment leases in addition to office leases*)
- **Covered utilities** - means payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020
- **Covered mortgage interest** - means interest on any pre-February 15, 2020 indebtedness or debt instrument incurred by the borrower in the ordinary course of business, if secured by a mortgage on real or personal property (not including any prepayment of interest on a mortgage obligation)

# Related-Party Rent

- It is noted that many companies may own the real estate their business occupies, often in a separate affiliated entity
- There is currently no differentiation between unrelated third parties and related entities
- It is not yet known whether the qualifying expense in this scenario will be the rent paid to the affiliate or the interest on the mortgage the affiliate pays, which is likely a smaller amount
- Hopefully, the SBA will provide clearer instructions in their final guidance to be issued





# Can You Deduct Payments Made With Forgiven Funds?

- Amounts forgiven on a PPP loan “shall be excluded from gross income”
- But §265 of the Internal Revenue Code provides that expenses “allocable to” tax-exempt income are not deductible
- This prevents a “double dipping” whereby a taxpayer would otherwise get both a deduction and tax-exempt income related to the same transaction or investment
- There’s no reason to believe it couldn’t apply to expenses paid with forgiven PPP proceeds
- It could generate a loss that can now be carried back to collect a refund of previously paid taxes
- Congress could simply amend Section 265 to accommodate this situation. They’ve done it before



# PPP Loan Forgiveness Application

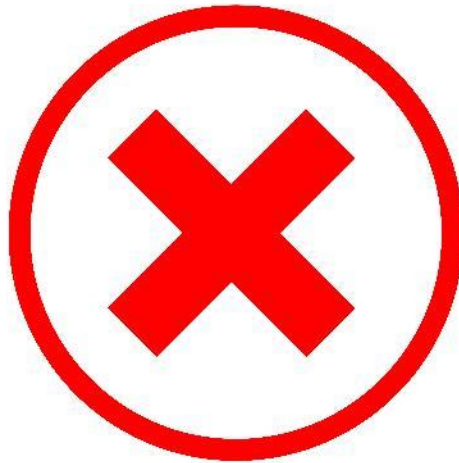
- A PPP loan recipient seeking loan forgiveness will be required to submit the following to their lender:
  - A formal application yet to be released by the SBA;
  - Documentation verifying the number of full-time equivalent employees on payroll and pay rates for the referenced periods including payroll tax filings to the IRS, state income, payroll and unemployment insurance filings and payroll registers, among other support;
  - If you work with a PEO, you should save your payroll invoices supporting the payroll costs, employee benefits, and retirement benefits paid;
  - Documentation supporting other covered expenses (mortgage interest, rent, utilities) including canceled checks, payment receipts, account statements, invoices, and/or other documents;
  - Certification from your company representative that the documentation presented is true and correct and the amount for which forgiveness is requested was used to retain employees, and /or make payments on a covered expense; and
  - Any other documentation the SBA determines necessary

# Bank Makes Decision

- The PPP lender is required to make a decision on loan forgiveness no later than 60 days after an application has been submitted
- PPP loan amounts forgiven will be paid by SBA directly to the lender
- As long as the lender receives the required documentation and certifications from the borrower, the lender will not be subject to SBA enforcement action or penalties if it chooses to forgive the loan
- In the absence of guidance, every lender will come up with their own interpretation of key terms and computational formula. Some lenders have asserted the following:
  - If the client did not use 75% of the loan proceeds on payroll costs during the covered period, NONE OF THE LOAN would be forgiven
  - Any PPP loan funds not used within 8 weeks for allowable purposes must be immediately returned to the bank

# Misuse of PPP Loan Funds

- Pursuant to the SBA Interim Rules, if PPP funds are used for unauthorized purposes, the SBA will direct you to repay these amounts
- If you knowingly use the funds for unauthorized purposes, you will be subject to additional liability such as charges for fraud
- If a shareholder, member, or partner uses PPP funds for unauthorized purposes, the SBA will have recourse against these individuals for the unauthorized use



# Business Realities

- Forgiveness is certainly an important part of the CARES Act incentives for small businesses to retain as many employees as possible and to keep up their wage levels
- However, the ultimate objective for those who own and operate such a company will be to protect the long-term health of the business
- If business realities are such that you are unable to achieve 100% forgiveness, at worst, this is a 1% loan with a two-year payback period with no collateral and no personal guarantee
- These are artificially favorable terms and offer a significant injection of cash to help support your company's operations
- The loan forgiveness features of the Paycheck Protection Program are complex and will require detailed planning, precise execution, and meticulous documentation

# Questions





# Contact Us

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