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Changes Made to PPP Loan Forgiveness Rules

The Paycheck Protection Program Flexibility Act, signed into law on June 5, 2020, attempts to address many concerns expressed by the small business community around the Paycheck Protection Program (PPP) aimed at providing COVID-19 relief. The law provides major concessions and guidance for PPP borrowers who desire to qualify for forgiveness of the loans.

PPP Borrowers Get Concessions, Additional Guidance on Forgiveness

The Paycheck Protection Flexibility Act of 2020 loosens several of the Paycheck Protection Program's (PPP's) more onerous restrictions regarding loan forgiveness.

The new law follows the May 22, 2020, release of an interim final rule from the U.S. Department of the Treasury and the Small Business Administration (SBA) on PPP loan forgiveness requirements, which includes:

- Tripling the time allotted for small businesses and other PPP loan recipients to spend the funds and still qualify for forgiveness of the loans
- Changing the threshold for the amount of PPP funds required to be spent on payroll costs to qualify for forgiveness to 60% of the loan amount.

The guidance also addresses the calculation of full-time employees and total salary or wages for purposes of loan forgiveness reductions.

The PPP in a Nutshell

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) established the PPP to help employers cover payroll during the ongoing COVID-19 pandemic.

The recent Interim Stimulus Plan added another \$310 billion to the PPP, which is administered by the SBA. The CARES Act originally allotted \$349 billion to the program, but those funds were depleted in less than two weeks.

The program is open to U.S. businesses with fewer than 500 employees — including sole proprietors, self-employed individuals, independent contractors, and nonprofits — affected by COVID-19. The loans may be used to cover payroll, certain employee healthcare benefits, mortgage interest, rent, utilities and interest on any other existing debt for the “covered period.”

Under the CARES Act and subsequent guidance, the covered period ran for eight weeks after loan origination. The PPP Flexibility Act extends that period to the earlier of 24 weeks after the origination date or December 31, 2020.

PPP loan proceeds applied to cover payroll, mortgage interest, rent, and utilities are subject to 100% forgiveness if certain criteria are met. Earlier Treasury Department regulations indicated that eligible nonpayroll costs couldn't exceed 25% of the total forgiveness amount, but the PPP Flexibility Act raises the threshold to 40%.

At least 60% of the loan must be spent on payroll costs to qualify for any forgiveness. For unforgiven costs, the new law extends the repayment period from two years to five years. However, employers are still required to maintain their staff headcount and payroll to qualify for full forgiveness.

Loan forgiveness may be reduced if:

- The average weekly number of full-time equivalent (FTE) employees is reduced, or
- Salaries and wages are cut by more than 25% for any employee who made less than \$100,000 annualized in 2019.

Borrowers originally had until June 30, 2020, to restore full-time employment and salary levels from reductions made between February 15, 2020, and April 26, 2020, and avoid reductions in the forgiveness amount. The PPP Flexibility Act extends that deadline to December 31, 2020.

The Covered Period

Although the CARES Act provides that the covered period runs for eight weeks from the date of origination, the May 22 guidance lays out an alternative covered period. Borrowers with a biweekly, or more frequent, payroll schedule can elect to base their calculations on the eight-week period beginning on the first day of their first pay period following the disbursement date. The PPP Flexibility Act does not address this particular alternative. Presumably the SBA will modify the alternative period to 24 weeks. It remains to be seen whether the reference periods by which to compare terminations of employees and compensation reductions, for purposes of reducing loan forgiveness, will also be extended.

Note that the alternative covered period is available only for calculating payroll costs; it doesn't apply to calculating mortgage interest, rent, or utilities. And, if a borrower does use the alternative period to compute payroll costs, it must also use that alternative period to calculate FTE employees and salary or wage reductions.

Eligible Amounts

The May 22 guidance clarifies that payroll costs paid or incurred during the covered period are eligible for forgiveness. Nonpayroll costs are eligible for forgiveness if paid during the covered period or incurred during that period and paid on or before the next regular billing date, even if the billing date is after the covered period.

According to the guidance, payroll costs include bonuses and hazard pay, as well as salary, wages, and commission payments to furloughed employees (as long as they don't exceed an annual salary of \$100,000, as prorated for the covered period). They're considered paid on the day paychecks are distributed.

Payroll costs are deemed to be incurred on the day the employee's pay is earned. Payroll costs incurred but not paid during the borrower's last pay period in the covered period are eligible for forgiveness if paid on or before the next regular payroll date.

The guidance makes clear that costs related to personal property (for example, office equipment) are eligible nonpayroll costs. Mortgage interest payments for real or personal property are included, as well as rent or lease payments for real or personal property. Advance payments on mortgage interest, however, are not eligible for forgiveness. Utility payments include payments for electricity, gas, water, transportation, telephone, and internet access.

The FTE Reduction

The May 22 guidance spells out that when determining whether an adjustment in the forgiveness amount is necessary due to an FTE reduction, the number of FTE employees is calculated using a 40-hour workweek. For each employee, the average number of hours paid (not worked) per week is divided by 40. The maximum for each employee is capped at 1.0 FTE employee.

For employees who were paid for less than 40 hours per week, borrowers can calculate the average number of hours the employee was paid per week during the covered period. The guidance also provides a simplified method, under which employees who work 40 hours or more per week are assigned a 1.0, and those who work less are assigned a 0.5. Borrowers must select one of these two approaches and apply it consistently to all part-time employees.

The amount of loan forgiveness may be reduced if the average weekly FTE during the covered period is less than its average FTE in (1) the period of February 15, 2019, through June 30, 2019, (2) the period of January 1, 2020, through February 29, 2020, or (3) in the case of seasonal employers, either of the preceding periods or a consecutive 12-week period between May 1, 2019, and September 15, 2019. The borrower can elect which period to use as its reference period. The good news is that the comparison isn't made against the last full quarter worked, as some borrowers feared.

The May 22 guidance also includes exceptions for employees who:

- Reject a good faith offer to return at the previous pay and hours (borrowers must maintain documentation of the offer and rejection and notify the state unemployment office of an employee's rejected offer within 30 days of the rejection), and
- During the covered period, were fired for cause, voluntarily resigned, or voluntarily requested and received a reduction in hours.

Any FTE reductions due to these reasons won't reduce the forgiveness amount.

The PPP Flexibility Act adds a new exemption based on employee availability. For the period from February 15, 2020, through December 31, 2020, the amount of loan forgiveness won't be reduced due to a reduction in the number of FTE employees if a borrower (1) is unable to rehire an individual who was an employee on or before February 15, 2020, or (2) can demonstrate an inability to hire similarly qualified employees on or before December 31, 2020.

The exemption also applies if the employer is unable to return to the same level of business activity it was operating at before February 15, 2020, due to governmental requirements or guidance issued from March 1, 2020, through December 31, 2020, related to COVID-19 safety standards.

The Salary/Wage Reduction

The CARES Act indicates that the forgiven loan amount may be reduced if the total salary or wages of any applicable employee is reduced more than 25% of the "total salary or wages" in "the most recent full quarter during which the employee was employed before the covered period." With the covered period running only eight weeks, borrowers fretted that the total wages in the covered period would almost certainly fall more than 25% compared to a full quarter.

The PPP Flexibility Act doesn't address this concern, but the SBA's loan forgiveness application does. In making the determination of whether salary or wages were reduced 25%, it compares "average annual salary or hourly wage" for the relevant periods — not total wages.

In addition, to ensure that borrowers aren't doubly penalized, the May 22 guidance directs that the salary/wage reduction applies only to the portion of the decline in employee salary and wages that isn't attributable to the FTE reduction.

Delayed Payment of Payroll Taxes

The PPP Flexibility Act also takes steps to ensure borrowers have full access to the CARES Act's payroll tax deferment, which is intended to provide businesses with adequate capital to withstand the COVID-19 pandemic. The new law provides that the delayed payment of employer payroll taxes on top of the receipt of a PPP loan does not constitute impermissible double dipping, and the exclusion that prohibits any business receiving loan forgiveness from deferring its payroll taxes has been eliminated.

All businesses, including those receiving loan forgiveness, are now able to defer the deposit and payment of the employer's share of Social Security tax that would otherwise be deposited during the period beginning March 27, 2020, and ending December 31, 2020.

IRS Clarification on Deductibility of PPP-funded Expenses

Unfortunately, recent guidance from the IRS states that no deduction is allowed for an expense that's otherwise deductible if the payment of the expense results in forgiveness of a PPP loan. It explains that, to prevent a double tax benefit, IRC Sec. 265 disallows a deduction for any amount otherwise allowable

as a deduction that's allocable to tax-exempt income (other than interest). The IRS asserts that forgiven PPP funds constitute such tax-exempt income.

In other words, the IRS maintains that a business shouldn't be allowed to avoid taxable cancellation of debt income on forgiven PPP loan amounts and also to deduct the payments made with those loan amounts. The result for borrowers essentially is an offset of the tax benefit — the forgiven amounts are excluded from gross income but the deduction(s) for those amounts are eliminated.

The IRS may not have the last word on the deduction issue, though. Members of Congress are signaling that the expenses paid by forgiven PPP loan proceeds should indeed be tax deductible. For example, both Sen. Charles Grassley (R-IA), the chair of the Senate Finance Committee, and Rep. Richard Neal (D-Mass.), the chair of the House Ways and Means Committee, have indicated that the IRS interpretation runs contrary to the goal of the PPP. They've said they would like the discrepancy to be remedied legislatively in the near future.

It's also possible that a borrower will challenge the IRS stance in court. Or, the IRS simply could succumb to pressure from the public, Congress, and/or the administration and reverse its interpretation.

California Conformity

Any forgiveness of the PPP loan is not subject to taxation for federal income purposes. California has not conformed to the federal law changes found in the CARES Act or the PPP Flexibility Act. However, there is a possibility that California might pass legislation to adopt many of these stimulus provisions when the California legislature comes back into session. For now, California taxes any of the PPP debt that is forgiven as income from the discharge of indebtedness, unless other statutory exclusions apply.

Fast and Furious

The rules for the PPP — whether in legislative, regulatory, or other forms — continue to emerge at a brisk pace, often updating previous guidance. We can help ensure you are satisfying all of the requirements to obtain a loan and secure full forgiveness.

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