WEBINAR Q&A

BADGER CPA & BFG

Disclaimer

Please know we hate the word “disclaimer” as much as you do. However, there still remains a great deal of guidance to come from the SBA. You will note in your loan documents, likely, there will be references to the language in the law and to further interpretation and guidance which is yet to come. We sincerely wish we had all the answers, but we simply do not at this point.

We do believe we understand the spirit of the law, and that is to incent employers to remain as fully employed as possible relative to the various lookbacks. With that in mind, we offer the following Q&A.

Q&A

1. **What can the PPP loan funds be used for? Once funded, what can be covered? What percentage must be payroll?**
   - The primary purpose of the PPP was to encourage employers to return to full staffing during this 8-week period. You can spend on non-payroll items, but the emphasis is on bringing your staff back and paying them during this period. The only way to get the loan forgiven is to pay the money out. You have to pay 75% or more to compensation to get forgiveness. No more than 25% can be paid on non-payroll compensation items.
   - There are some extra incentives to do that in terms of the two deductions that are built in. If you don’t have your employee count up to what it was during the lookback periods or don’t have your compensation at 75% of the lookback period, there are deductions for both of those. For example, if you only brought back 70% of people, you’re looking at a 30% deduction off of your loan forgiveness. If you’re only at 70% staffing, it’s an indication that you may have only 70%-80% of total compensation paid out. That 20%-30% would not be forgiven, in addition to the deductions. If compensation is less than 75% of lookback, then the difference is going to be another deduction.
   - The main thing is to have a measuring tool, so you know how you currently compare to the lookback periods.

2. **Please provide a high-level overview of forgiveness: how it is calculated and what are the various components?**
   - PPP proceeds are intended to help you pay the following:
     - o Employee compensation
     - o Rent; Equipment lease payments

- Utilities such as electricity, gas, water, transportation (not clear on what this is but one interpretation is fuel costs), phone and internet access for services that began before February 15, 2020
- Interest on debt that was in existence prior to February 15, 2020. Mortgage debt and business loans included.

- PPP loans will be forgivable depending on:
  - How you spend the proceeds
  - Whether you have or plan to have reduced your staffing and whether you will increase your staffing backing to your previous levels

- Forgiveness Deductions:
  You will owe money when your loan is due if you use the loan amount for anything other than payroll costs and those items listed above. No more than 25% of the forgiven amount may be for non-payroll costs, and 75% of loan proceeds must be applied to payroll costs in order to be forgiven.

  You also may owe money if you do not maintain your staff and payroll.
  - **Number of Staff:** Your loan forgiveness will be reduced if you decrease your employee headcount.

    More on the fulltime equivalent (FTE) employee calculation is addressed in a separate question.

  - **Level of Payroll**: Your loan forgiveness will also be reduced if you decrease salaries and wages by more than 25% for any employee who made less than $100,000 annualized in 2019.

    So far, no new guidance on this issue

    There is likely more guidance to come out regarding the measurement formula for this as well. For example, the language in the law says the forgiveness "shall be reduced by the amount of any reduction in total salary or wages…of any employee…during the covered period that is in excess of 25 percent of the total salary or wages…of the employee during the most recent full quarter during which the employee was employed before the covered period…"

    This doesn't address if the employee quits and you replace them. It doesn't say you can take total compensation and work the formula from there. And it doesn't say what happens if you terminated/laid off the employee and don't rehire them so they are no longer an employee.

    One assumption is that they will be looking at "equivalent" employees filling "equivalent" positions.

    Keep in mind that "total salary or wages" would include overtime, tips, allowances, commissions, bonuses, shift premiums, and so on, that were paid.

  - **Re-Hiring:** You have until June 30, 2020 to restore your full-time employment and salary levels for any changes made between February 15, 2020 and April 26, The exception may be owners who see a longer ramp up period following mid-late June and need cash and are willing to accept a 2-year 1% loan for access to capital.

2020. (Note: Doing so only affects the deduction for the number of employees. In order to not receive a deduction for the difference in compensation, the employee must be paid during the 8-week period.)

For employees you've laid off, to the fullest extent possible, we recommend you work now to reactivate them if your goal is to get the maximum loan forgiveness. For reduced hours/furloughed employees, you can simply begin payments to them. For all employees, we recommend you resume compensation commensurate to the daily/weekly average equal to at least 75% of their average levels in the first quarter of 2020.

We realize that there may be situations where there is not enough work for all employees to do. If possible, redeploying them in other capacities could be an option. In some cases, we recognize that you could be making payments to employees who will not be working, by your choice.

If employees are choosing on their own not to work where you otherwise have work for them, we do not recommend that you pay them. It may be preferable to send them a notice to report to work and interpret those who do not as having resigned and seek to replace them.

For any of these who may not have been receiving compensation or full compensation, while notice is not required, a letter or email from you would be acceptable letting them know they are expected to either report for work, if not forbidden by a "stay at home" order, or to be on call and to confirm their banking information and address is still the same.

- <u>Loan Forgiveness Request:</u>
  In an Interim Final Rule issued April 14, the SBA provided its process for submitting a request for forgiveness. The rule indicates that the request could be submitted as early as the end of the week 7 of the 8-week covered period.

Be thinking about how to report to your bank.

Any advance information from your bank about what they expect would be helpful.

To submit a request, the borrower needs to provide the following to the lender who, in turn, submits this to the SBA Administrator:

- the Paycheck Protection Program Application Form (SBA Form 2483) and any supporting documentation submitted with such application;
- the Paycheck Protection Program Lender's Application for 7(a) Loan Guaranty (SBA Form 2484) and any supporting documentation;
- a detailed narrative explaining the assumptions used in determining the expected forgiveness amount, the basis for those assumptions, alternative assumptions considered, and why alternative assumptions were not used;
- any information obtained from the borrower since the loan was disbursed that the lender used to determine the expected forgiveness amount, which should include the same documentation required to apply for loan forgiveness such as payroll tax filings, cancelled checks, and other payment documentation;
- and any additional information the Administrator may require to determine whether the expected forgiveness amount is reasonable.

Once the lender has submitted the request, the Administrator will "purchase the expected forgiveness amount of the PPP loan(s) within 15 days of the date on which the Administrator receives a complete report that demonstrates that the expected forgiveness amount is indeed reasonable."

See III.4.e (page 26) at the following link for documentation: https://www.sba.gov/sites/default/files/2020-04/PPP--IFRN%20FINAL.pdf

3. **We know that 25% of the loan can be used for rent, equipment lease payments (which some banks have accepted), and utilities (electricity, gas, water, phone/internet for services that began before 2/15). When we're talking about it covering payroll costs, what counts and how do you calculate it?**
    - Gross wages. Salary or hourly, or whatever formula you typically use.
        - Gross wages are capped at $100,000. This $100,000 is cash compensation before benefits. You can include all employer-paid benefits, even employees making $100,000 and over. Bonus is a part of this.
        - This equates to $15,384 maximum compensation over the 8-week period.
    - Retirement plan: Retirement contributions do not count toward the $100,000 cap, so there may be a strategy to fund retirement plans more versus bonuses because it doesn't count toward the cap. You could consider making profit sharing or cash balance contributions. Be careful with making a substantial contribution that affects ownership more than across the board employees because doing so runs afoul of what the intent was.
    - Benefits
    - Local tax
    - You cannot include the employer portion of payroll taxes.

4. **For employees making more than $100,000, are they capped at $100,000 or excluded completely?**
    - They are capped at $100,000 annualized. This does not include benefits costs.
    - For these employees making $100,000, you don't need to worry about the 25% decrease for these employees. For employees making less than $100,000, you need to pay at least 75% of their salary.

5. **What about if someone is making over $100,000: can you still pay them from non-loan funds?**
    - Yes, but you need to demonstrate to the bank/SBA that loan funds were used for allowable expenses.

6. **Does compensation include life insurance and disability?**
    - Potentially yes. Some are including it. The worst that could happen is that your bank says they won't accept that. The law specifically states group health insurance, but

you could argue that disability is health insurance. You could also consider including dental and vision.
- Some of this will depend on the bank. It's important for you to be in contact with the bank that processed your loan for their requirements.

7. If you allow employees to cash out PTO, does that count as benefits or cash compensation?

- PTO is eligible compensation. Any leave or severance you pay out counts as compensation.

8. Rehiring: The law says you can rehire by June 30. How does that work?

- They've said that, but there is no clarity in what that means or how it would work.
- We don't have a clear definition of FTE. The closest thing you'll find is the measurement used with ACA, which is measuring hours over a period of time. All full-time employees work 30+ hours; for part timers, you add up hours and divide by 120 to get the equivalent hours.
    - You have until June 30 to make it up. But using this calculation, how do you compare that one day to February 15?
- All this relates to a deduction that you could get.
    - If you are at less than 75% of your payroll, it is likely none of your loan will be forgiven, and you will need to pay it off in 2 years at 1% interest.
    - That may be fine. The business owner must make the decision based on their strategy.
    - Some may opt to do that in order to have some cheap capital even if it needs to be paid out over 2 years.
- There might end up being some flexibility on the FTE calculation based on if you brought people back, but you may struggle to reach the 75% total compensation calculation. Then there's also a wage reduction calculation for all earners under $100,000. If the strategy is to try to have as much forgiveness as possible, you'll need to have a plan to get your workforce up and running quickly. But as a business owner, you need to make the best decision for your company. Carefully consider staffing decisions to best protect your business from a long-term risk.

9. What if your employee count stayed the same in all relevant periods?

- If everything stays the same, you should be able to fulfill all of the requirements and achieve loan forgiveness.
- The organization best able to take advantage of this situation is the organization whose staffing is exactly the same as the lookback periods.

10. **What information do employers need to start tracking? How should employers compile the data?**

From the start date forward, we recommend that you track all expenses related to compensation, rent, utilities, and payments of interest on mortgage obligations incurred before February 15, 2020.

Some people are considering depositing the loan proceeds in a segregated account so that bank statements will be specific to this use. Many CPAs have suggested that it doesn't need to be this complicated. You can set up a separate account code in your chart of accounts and journal the expenses over.

- For some people, using a separate account may be cleaner, but for many, this would be a huge hassle.
- It could be to your detriment to make a change for the 8-week period. There is a large potential for error to move your cash flow structure for 8-week event.
- You really just need to match your cash flow to the loan. You can do that with accounting. You just need to report, how you spent the loan money.

Begin now accumulating any documents related to payroll costs, rent, utilities, and mortgage interest. These will be helpful when communicating with your lender regarding forgiveness.

Establish a separate ledger/worksheet in order to track all PPP-related cash expenses on a weekly basis.

In our payroll system, we are working on payroll reports that can easily be pulled into a worksheet to help you track your payroll-related expenses paid during the period.

In the meantime, please keep a record of applicable payroll costs from the start date.

You will want to be tracking your non payroll related costs (rent, utilities, and mortgage interest) to also load into your worksheet.

You will want to have your comparison/lookback FTE numbers as well as compensation for the appropriate time frames as a point of reference and comparison. For the measurement of deductions for loan forgiveness, the lookback period for comparison is either:

- the average number of FTE per month employed by the eligible recipient during the period beginning on February 15, 2019 and ending on June 30, 2019; or
- the average number of FTE per month employed by the eligible recipient during the period beginning on January 1, 2020 and ending on February 29, 2020.

For our Payroll Clients, we have been creating a report to pull compensation data and employee FTE counts out of our Payroll system. We will be able to then calculate compensation regularly during the 8-week period in relation to the primary forgiveness factors.

The first two will compare the current weekly totals to the appropriate look-back periods for:

1. full time equivalent employees,
2. compensation for each employee

Additionally, we will track total compensation against the total loan to verify it represents 75% or more.

11. Can the loan be used on all compensation? Are there any caveats?

The Act expressly excludes the PPP loan funds to be used for the following:

- Any compensation of an employee whose principal place of residence is outside of the United States.
- The compensation of an individual employee in excess of an annual salary of $100,000, prorated as necessary; this cap is cash compensation only. Employer-paid benefits are on top of this cap.
- Federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including the employer's share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees; the employee share of FIT and FICA is eligible as the "gross pay" is what is included in forgiveness.
- Qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act (Public Law 116–127).
- In addition
    a. SBA guidance from April 3 has stipulated payments to independent contractors (1099s) cannot be included in the calculation for your loan nor are they considered eligible expenses that can be forgiven.
    b. Indications are also that banks are not including K-1 income for purposes of calculating loan amounts. Presumably, they will also not be including non-W-2 income for purpose of calculating loan forgiveness.

12. What is an FTE? How do we calculate FTE?

- The definition of "Full Time Equivalent Employees" (or FTE) is still something that has not been defined for purposes of the PPP.

  For the measurement of deductions for loan forgiveness, the lookback period for comparison is either:

  1) the average number of FTE per month employed by the eligible recipient during the period beginning on February 15, 2019 and ending on June 30, 2019; or
  2) the average number of FTE per month employed by the eligible recipient during the period beginning on January 1, 2020 and ending on February 29, 2020.

  What is not defined is FTE. The DOL does not define a fulltime worker and leaves that up to employers. There are also definitions for benefit programs. ACA provides a formula that takes into consideration both part-time and fulltime employees. We did find reference to the ACA FTE calculation in the Employee Retention Credit Program which is also in the CARES ACT.

Therefore, our recommendation is the ACA and DOL definitions as regards to overtime rules for the lookback periods of either 2/15/19–6/30/19 or 1/1/20–2/29/20 and for the 8-week period. We can calculate this for our clients. The prudent person, we believe, would calculate it out for both periods to determine which to submit with their request for loan forgiveness.

We believe the key will be to be consistent in the way in which you make your calculations.

13. Do you have to pay the same employees you paid last year, or can you pay new employees?

- You can hire different people, but the banks will be looking at the role and compensation for that role. If someone leaves, you'll want to try to replace with an equivalent role.
- This doesn't apply to contract labor, so if you have contractors who could be treated as employees, you could evaluate converting them to a W-2 employee.
- The exception has to do with partners and LLC members. The SBA has clarified that these expenses are eligible.

14. Please talk about the 75% total employee compensation. I have an employee who is not working, so part timers are now working full time.

- If part timers were previously working 20 hours each, that would count as one FTE. That plus the full-time employee would be 2 FTE employees.
- Now, if the 2 part-time employees have gone to full time, you again have 2 FTE employees.
- 75% total compensation: this means that 75% of your loan must go toward payroll. You'll need to look at your compensation to make sure you're reaching that. For example, the 2 part-time employees could still fall below the full-time employee's salary rate.
- For FTE and compensation, if you lose someone at the $50,000 salary level, you could not rehire at $30,000 and take no other action because you'd miss the compensation requirement.

15. What constitutes the 8-week period. When does that begin?

A borrower must use the full loan amount within the 8-week covered period in order to receive full forgiveness.

Our interpretation is that the 8-week period begins the date your loan was funded (Start Date) and that only cash payments made during the 8-week period will count toward loan forgiveness. In other words, cash payments made in advance of the start date will not count, and accrued payments at the end of the 8-week period but not yet paid will not count.

In addition, any bonuses or other payments that were accrued and ultimately paid during the 8-week period should count.

You will probably not be exactly in sync with your payroll cycle. At BFG, we're tracking by payroll run, and the reports we produce are based on that. FTE counts are done per payroll run.

Once we get to 4 weeks into the 8-week period, you should begin to see what your trend lines are. At that point, you can probably do some forecasting.

16. If you had to close your business and can't open for another month or two, can you start your 8-week period later?

- No, the period starts once the loan is funded.
- In addition, you can't really wait to apply because the funds are first come, first serve.
- If your business is closed, you'll have a challenge with compensation and FTE average, and you will need to make strategic decisions about how you manage that.

17. I won't be able to bring all my employees back. What do I need to consider?

If full employment in terms of number of employees as compared to either of the lookback periods is not an objective, it will be important to keep track of the differences and be aware of the possible deductions from loan forgiveness. Managing cash will be both a strategic and a subjective process and may require some careful forecasting and analysis.

Where it is known that certain employees will not be reactivated, it may be advisable to retain an amount of cash from the loan equal to an approximate estimate of their compensation in the first quarter of 2020 in case you want to use that to repay that portion of the loan that may not be forgiven.

Now that the loan term has been reduced to 2 years, this loan may not appear as attractive as it did with a 10-year payback. Employers who have laid off more than half of their employees may want to consider whether or not they should participate.

For example, an employer who laid off 60% of their workforce is likely to receive a deduction in the forgiveness for their loan. So, depending on cash flow and cash reserves, it's possible that a significant percentage of the loan will not be forgiven and will be converted to a 2-year, 1% loan with possibly limited reserves to pay off.

We encourage you to forecast what your expenses, potential deductions and cash position will be before completing the loan process.

18. **If you offer people their job back, and they refuse to come back, can you meet your FTE requirement? What do you recommend?**
    - If you have someone who is choosing to stay home, and you have a job for them and your business is open, as long as you're keeping a reasonably safe work environment, you can send them a return to work notice and replace them if they do not return to work.
    - On the FTE side, unfortunately, it doesn't matter why they aren't working. It's purely: what is the count now and how that compares to the lookback period.

19. **Strategy: At the end of week 4, you will have built your reporting system and can look at things at a high level and make decisions.**
    - If you're close, you should be able to figure out some strategies to bring yourself up to the 75% level.
        - You may have a payroll that falls just outside of the 8-week period. You may decide to push payroll up into the 8-week period.
        - You may decide to bonus.
        - You may decide to pull an invoice from next month into 8-week period.
        - If you rehire some roles at a lower salary level, you could consider bonuses for other employees.
    - For other expenses:
        - If your building is owned by a separate entity, you may have a lease, which is an allowable expense.
        - Rent can be paid early, but consider that only 25% of the loan can be used on non-payroll expenses, so you can't pay too much extra rent. You may be able to pay early if you're within 30 days of the next payment.

20. **I heard that the PPP funds are all taken. Will there be more for this program?**

    An additional $300 Billion in funds has been appropriated to the Paycheck Protection Program. Only 6% of small businesses nationally were able to take advantage of the program previously before the funds were depleted. Banks should now be up and running with their programs, and it's reasonable to expect that this next round will go more quickly. <u>If you were not approved in the first round, we encourage you to contact your banker today and let them know you're interested in applying.</u>

21. **How likely is it that the guidelines will change?**

    Much is fairly solidified. We expect clarification on the rule that employees can be rehired by June 30 and on the FTE definition.

22. **What other programs in the CARES Act might be beneficial for employers?**
    - Employer Tax Deferment

      Effective beginning the 2nd Quarter 2020, almost all employers may defer the employee portion of Social Security (6.2%). The deferral is available through the end of 2020. Deferrals call for 50% payable by 12/31/2021 and the balance by 12/31/2022. It's basically an interest-free loan. Employers who received funding from the Paycheck Protection Program may participate up until the point they receive notice of partial or full forgiveness of their loan. Any deferments made up until that time will remain deferred.

If you are a Payroll client of BFG, a simple email saying that you would like to begin this deferral effective as of a designated date is all we need to implement this on your behalf.

https://www.irs.gov/newsroom/deferral-of-employment-tax-deposits-and-payments-through-december-31-2020

- Employee Retention Credits
  Any eligible employers who meet the following may receive a refundable tax credit for payments to employees up to 50% of their wages up to $10,000 until January 1, 2021. Employers who received funding from the Program Protection Program are not eligible:
  - Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19; or
  - Experiences a significant decline in gross receipts during the calendar quarter.

23. Would you please summarize the most important takeaways and what you'd consider to be best practices in order to maximize loan forgiveness?

- To repeat: from a high-level view, make sure that no less than 75% of the amount of loan is spent on payroll costs and not more than 25% of the loan may be used for non-payroll costs such as rent, utilities and mortgage interest. And strive to maintain the same number of employees as the lookback periods we mentioned.

- Our best advice is the following:

  1) **Plan to be at as close to full strength in number of employees (FTE) as possible during the 8-week period:**
     - **Consider bringing back laid off, reduced hours and furloughed employees**
     - **Consider paying all employees even if they are not able to accrue hours during this time**
  2) **Maintain at least the number of FTE you had during the 2/15/19–6/30/19 or 1/1/20–2/29/20 lookback periods**
  3) **Maintain as close to your monthly average of total compensation that you showed in the first quarter of 2020 (but not less than 75% of employees' previous compensation)**

4) **And again, make sure 75% is spent on payroll costs and no more than 25% of the total loan proceeds is spent on allowable non-payroll items (rent, utilities, and mortgage interest)**

If this all takes place, we believe your deductions should be minimal regardless of the final guidelines.

BusinessFinancialGroup.com

210-495-8474 / 1-888-757-2104

Business Financial Group provides corporate services, including human resources consulting, compliance and administration support, payroll and employee benefit program development and maintenance. We also provide group retirement and personal financial planning services.