

PPP UPDATE:

IT MAY BE TIME FOR LOAN FORGIVENESS

To say that 2020 has been a whirlwind may be a little bit of an understatement. The situation with the pandemic, shutdowns, and government response has forced business owners to be more reactive than proactive. For a time, the headlines each day brought information on new rules for companies to observe in order to be allowed to operate and new aid programs available for struggling businesses, such as the Paycheck Protection Program (PPP). The PPP itself has gone through revisions, which left business owners with questions through all phases of the program. Below is a short recap of the phases of the PPP and some thoughts on what next steps could look like.

Phase 1: PPP Loan Application

The PPP, a loan program designed to incentivize and supplement funding for employers in keeping their employees on payroll, was enacted as part of the CARES Act. The program granted funds based on payroll costs in the form of a loan that could potentially later be forgiven if the borrower met certain criteria. The first phase began with loan application which officially kicked off April 3. The original application deadline was June 30, which was extended to August 8. In order to apply, there was a requirement to document certain data including 2.5 times your monthly 2019 average of allowable payroll costs, observing a \$100,000 annual salary limitation.

Phase 2: PPP Loan Tracking

The second phase was the tracking of expenses related to the loan (initially 75% of the loan had to be spent on payroll and up to a maximum of 25% could be spent on rent, mortgage interest, and utilities). Many rule changes and clarifications have taken place since inception and the Small Business Administration (SBA) and Treasury Department steadily released updates and guidance in response to questions from lawmakers, business owners, and advocates. One of the most significant changes was extending the covered period for tracking expenses from 8 weeks to 24 weeks. This change, in the end, has more to do enabling borrowers to achieve 100% forgiveness than any other.

Phase 3: PPP Loan Forgiveness

The last phase of the PPP is Loan Forgiveness. Up until now, we have seen some banks and other entities recommend that borrowers wait to pursue forgiveness, in part, to allow banks to begin their process and develop responses to many of the questions that will arise for which there is still not guidance, and in part because borrowers have 10 months from the end of the loan covered period to file their forgiveness applications. There has also been the anticipation of possible additional legislation and/or SBA guidance that might make the forgiveness process more manageable, which did take place for loans under \$50,000. As of this writing, there have been no

significant changes or information releases since early October. Meanwhile, in the last 4 weeks, almost all banks have now opened up their process for loan forgiveness applications.

Pursuing Loan Forgiveness

We are now seeing some clients moving forward with applying for loan forgiveness. On November 2, we heard from our first client who received official forgiveness notification. From the time our client submitted their application until the bank provided them with SBA notification of official forgiveness was less than three weeks.

In talking with many CPA and Attorney alliances and listening to business advocacy groups, we are not anticipating anything new from the SBA or Treasury that might dramatically alter the process. With an application turned in this week, depending on how long the bank takes to process it and submit it to the SBA, it's possible that borrowers could still receive notice prior to the end of the calendar year.

Our recommendation today is that, if your bank has opened up their loan application process and if you are ready to apply, we don't see a reason now to wait any further.

In the meantime, below are some additional items that you may want to pay particular attention to.

EIDL Advance Loans

Your forgiveness application will have a place to indicate whether you received an EIDL advance. If you did, you will want to include that information, which will be deducted from your PPP Loan Forgiveness. Many business owners and advocacy groups have objected to this decision by the SBA because the EIDL advance loans were supposed to also be considered grants and forgiven. Deducting them here takes away PPP forgiveness. However, that is our interpretation of the rule as it currently stands.

EZ versus Full Form

You may use the EZ form if you did not reduce the number of employees during the year. See the language below. This doesn't change the forgiveness outcome; the EZ form is simply a shorter form.

“The Borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period (as defined below) compared to the period between January 1, 2020 and March 31, 2020 (for purposes of this statement, “employees” means only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000); AND The Borrower did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the Covered Period. (Ignore reductions that arose from an inability to rehire individuals who were employees on February 15, 2020 if the Borrower was unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020. Also ignore reductions in an employee's hours that the Borrower offered to restore and the employee refused. See 85 FR 33004, 33007 (June 1, 2020) for more details.”

You may also opt to use the full form to apply for forgiveness. If you met the criteria for the loan or a Safe Harbor, you should still be able to achieve 100% forgiveness regardless of the form you decide to use.

8-Week Period versus 24-Week Period

A borrower may choose to use either the 8-week or 24-week covered period. Now that the full 24-week period has been completed, it's easier to see how the potential Salary/Hourly Wage Comparison might compare between the two periods. This potential reduction exposure was required to run the full 24-week period for anyone using the 24-week period, even if they submitted their Loan Forgiveness Application prior to the end of this period.

Other than potential reductions, there is not another statutory advantage or disadvantage of using one period versus the other except as it relates to logistics and strategy. For example, if during the 8-week period, a borrower would have seen 75% of their loan amount met through payroll costs, this would require them to show the other 25% to be met through allowable non-payroll costs, such as rent, utilities and mortgage interest. If they used the 24-week period and found that 125% of their loan amount was met through payroll costs, then they could potentially achieve 100% forgiveness with only having to demonstrate payroll costs.

Another strategic difference has to do with potential reductions in forgiveness for either FTE count or Salary/Hourly Wage Comparison. Using the example above, if the borrower used the 24-week period with 125% of their loan amount in payroll costs, the reductions are applied against their total costs. It is the net costs after reduction that is then compared to the loan amount to determine forgiveness. Therefore, it's conceivable that a borrower may in fact have reductions but still be able to receive 100% forgiveness.

In most circumstances, **we recommend using the 24-week period** simply because, typically, the amount of payroll costs far exceeds the loan amount: this eliminates, in most cases, any reductions, makes the case easier to make and also eliminates the need to include non-payroll costs, thus simplifying the process.

Tax Impact

Regarding taxation, there remain some questions and uncertainty.

For federal business income tax purposes, The CARES Act stipulated that PPP loan forgiveness may be excluded from gross income by an eligible recipient. However, the IRS issued Notice 2020-32 in April 2020 which stated that expenses associated with the tax-free income are nondeductible. While this is not inconsistent with historic IRS guidance regarding nontaxable or tax-exempt income and related expenses, the result of this Notice is to reverse the tax-free benefit of the exclusion on the loan forgiveness, which we believe was Congress' original intent.

Where the uncertainty comes in has to do with the timing of loan forgiveness. If a borrower applies for and receives forgiveness in 2020, then the answer is simple. The loan proceeds that are forgiven do not count as income and the expenses that were paid by the loan proceeds are not deductible.

But let's assume that a borrower was to not receive forgiveness until 2021. Should they consider the expenses covered by the loan to be nondeductible in 2020? We don't know the answer to that.

If they go ahead and deduct the expenses in 2020, then what should happen when forgiveness is obtained later in 2021, after the fact? We don't know the answer to that either.

Based on what we're seeing so far, if you apply for forgiveness in the next couple of weeks, there is a possibility that you will receive forgiveness prior to year-end. If not, likely you will know prior to the timing of filing your return. If you do not receive forgiveness in time for tax filing you could either consider filing for an extension or take the most conservative approach and do not deduct the costs that were paid by the loan in 2020 and assume that forgiveness will take place at some point.

Regardless, we believe you should work closely with your CPA in this process and plan ahead in case there are estimated tax payments that need to be made.

(Note: We are not CPA's and we are not intending to provide tax advice. This is simply our understanding of the rules.)

Full Time Equivalent Employee (FTE) Safe Harbor 1

For purposes of the FTE calculations, we have been consulting with a number of our CPA alliances, and we all believe that all non-essential businesses whose employees cannot work from home in Texas should all be able to attest to the Safe Harbor 1 test, which says:

“The Borrower is exempt from the reduction in loan forgiveness based on a reduction in FTE employees described above if the Borrower, in good faith, is able to document that it was unable to operate between February 15, 2020, and the end of the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020, by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration, related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19.”

If you have had any point since March where you were forced to be closed or had reduced hours imposed on your operation for any length of time where not everyone could work from home, this may apply to you. This is a significant Safe Harbor. Regardless, please consult with your CPA for feedback on what might be best for your situation.

PPP Loan Payments

There has been confusion with many banks regarding when loan payments may begin. In some loan documents, the language has stipulated that the first payments against the loans could be scheduled as soon as November. In fact, according to the CARES Act and SBA guidance, borrowers have 10 months from the end of their loan period to file an application for forgiveness. As long as borrowers meet that time frame, there should be no payments required.

To help answer these questions, the SBA released a clarifying statement (please see this article in Journal of Accountancy: <https://www.journalofaccountancy.com/news/2020/oct/ppp-loan-repayments-deferral-period.html>) plus an FAQ (<https://www.sba.gov/sites/default/files/2020-08/PPP%20--%20Loan%20Forgiveness%20FAQs%20%28August%2011%2C%202020%29.pdf>), which addresses the 10 month time period in Question 3.

For More Information

In closing, we hope this information is helpful. We hope to see each of you achieve 100% PPP Loan Forgiveness!

We will continue to monitor this situation and release updates. For more information or assistance, please contact us at **210-495-8474**, toll-free at **1-888-757-2104**, or Info@BFGonline.com.



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