The Road to PPP Loan Forgiveness and Payroll Tax Relief under the CARES Act

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Sponsored by the ABA Section of Taxation
Presenters

- **Allie Petrova**, *Managing Attorney*, Petrova Law, Greensboro, NC
- **Noelle Geiger**, *Partner*, Green & Sklarz LLC, New Haven, CT
- **Ivan H. Golden**, *Partner*, Hahn Loeser & Parks, LLP, Chicago, IL
- **Robb Longman**, Partner, Longman & Van Grack, LLC, Bethesda, MD
- **Jonathan Zimmerman**, Partner, Morgan Lewis & Bockius LLP, Washington, DC
Objectives

At the end of the program, attendees should have an understanding of the following:

- Permissible and impermissible uses of PPP loan proceeds
- Which uses of PPP loan proceeds qualify and do not qualify for loan forgiveness
- How can PPP loan recipients maximize their loan forgiveness amounts
- How can borrowers apply for PPP loan forgiveness
- What other relief is available to businesses that are not eligible for or do not receive PPP loans
Background of the Paycheck Protection Program (PPP)
The Coronavirus Aid Relief and Economic Security Act (CARES Act) became effective March 27, 2020.

Businesses with employees began applying for PPP loans on April 3, 2020.

Self-employed individuals could begin applying for PPP loans on April 10, 2020.

The SBA announced on April 16, 2020, that the initial $349 billion appropriation was exhausted.

On April 23, 2020, Congress appropriated an additional $310 billion, including $60 billion set aside for lending by community banks and credit unions.
Qualifying for a PPP Loan and for Loan Forgiveness
Paycheck Protection Program

• Loans for businesses to continue to pay employees during an 8-week covered period.

• PPP Loans may be used for the following expenses:
  o Wages, commissions, and other income of employees
  o Vacation, parental, family medical and sick leave
  o Payments of group health care benefits, including insurance premiums
  o Payment of retirement benefits (employer share)
  o Payment of state and local taxes
  o For self-employed individuals, income replacement based on 2019 net profit, not to exceed $100,000 pro rated for the covered period.

• Excluded:
  o Compensation of an employee in excess of $100,000 annually, prorated for the covered period
  o Employer’s share of federal payroll taxes (e.g., Social Security and Medicare)
  o Compensation of employees whose principal place of residence is outside the United States
  o Qualified sick leave of Family Medical Leave Act (FMLA) for which a credit is available under the Families First Coronavirus Response Act (FFCRA)
Who is Eligible for a PPP Loan?

- Almost all businesses are eligible for PPP loans
  - Less than 500 employees (full-time, part-time or other basis), calculated pursuant to SBA regulations; or
  - An applicable number of employees as determined by the SBA based upon the type of business
  - Businesses in certain industries are ineligible (e.g., life insurance, financial businesses, businesses without payroll, private clubs, certain “sin” businesses)

- Inclusion of sole proprietors, independent contractors and other self-employed individuals
  - Submit income and expenses information as required by the SBA

- Businesses with more than one location
  - NAICS code beginning with 72 (accommodations and food service)
  - Not more than 500 employees at one location
  - Waived affiliation rules
    - NAICS code beginning with 72
    - Businesses operating as a franchise that is assigned a franchise identifier by SBA
Borrower Requirements

- Borrower shall make good faith certification that (among other things):
  - “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant”;
  - Funds will be used to maintain payroll and for other qualified expenses;
  - The applicant has not applied for or received another loan under the PPP.
- Recent SBA guidance has created uncertainty about whether businesses with access to cash or lines of credit can give the required certification.
- PPP borrowers have until May 7 to return their loans without penalty.
Maximum Loan Amount

• The Lesser of:
  o Average monthly payroll based upon the previous year multiplied by 2.5, plus the outstanding amount of an Economic Injury Disaster Loan ("EIDL") made between January 31 and April 3, 2020 for the same purpose;
    o EIDLs made for other purposes are not refinanced into a PPP
  o If not in businesses from February 15, 2019 through June 30, 2019, amount determined by:
    o the average monthly payroll from January 1-February 29, 2020, multiplied by 2.5, plus the outstanding amount of an EIDL made between January 31 and April 3, 2020, for the same purpose.
  o For businesses that have seasonal workers the amount will be determined by the SBA
  o Or $10,000,000
Lender Information

- All approved SBA lenders can make PPP loans
- Additional lenders will be added by SBA or Treasury Secretary
- Consideration for lenders:
  - Business in operation on February 15, 2020
  - Had employees who were paid
  - Paid independent contractors
- Loan fees are waived
- Borrower not required to represent that it cannot obtain credit elsewhere
- No personal guarantee required
- No collateral required
Allowable Uses of PPP Loans and Uses Eligible for Forgiveness
Allowable Uses of PPP Loans

- Payroll Costs (up to $100,000, pro rated for the covered period, or $15,385 per employee)
- Owner compensation replacement (up to $15,385 per owner)
- Payments of group healthcare benefits for paid sick leave, medical or family leave and insurance payments
- Mortgage interest (no prepayment of principal)
- Rent
- Utilities
- Interest on other debt incurred prior to February 15, 2020

- Payroll Costs must account for at least 75 percent of the use of PPP loan proceeds
PPP Loan Forgiveness

- Up to the entire amount of loan principal and accrued interest can be forgiven if proceeds are used for:
  - Payroll costs (at least 75 percent)
  - Covered mortgage interest (mortgage entered into before Feb. 15, 2020)
  - Covered rent (lease entered into before Feb. 15, 2020)
  - Covered utility payments (service started before Feb. 15, 2020)
- Amounts eligible for forgiveness are narrower than allowable uses of proceeds
- Borrowers cannot deduct otherwise eligible expenses (payroll, rent, utilities, interest) to the extent the borrower receives forgiveness that is excluded from gross income
- Forgiveness amount includes “costs incurred and payments made” during the 8-week period beginning on loan origination date
- Costs incurred or payments made outside the covered period are not eligible for forgiveness
Loan Forgiveness and Taxable Income
Loan Forgiveness and Taxable Income

• Under the CARES Act, any PPP loan forgiveness amount that would otherwise be included in a borrower’s gross income is expressly excluded from gross income

• This is an exception to the general rule that cancellation of debt is included in gross income

• The forgiveness seemingly makes a PPP loan truly “free money” to the extent a borrower qualifies for forgiveness, except…
Loan Forgiveness and Taxable Income

- **IRS Notice 2020-32**, published April 30, 2020, disallows a deduction for any expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered PPP loan.

- Notice 2020-32 acknowledges that all allowable and forgivable uses of PPP funds – payroll costs, covered rent obligations, covered utility payments, and mortgage interest – are deductible under Sections 162 or 163(a).

- Notice 2020-32 concludes, however, that Section 265 disallows any otherwise allowable deduction for the amount of any payment of an eligible expense to the extent of the resulting loan forgiveness.

- IRS’s rationale is that disallowance is necessary to prevent a double tax benefit.
Reductions in Headcounts and Salaries
Reductions in Headcount and Salaries

- A borrower’s forgiveness amount generally is reduced by multiplying the forgiveness amount by a fraction:
  - The numerator of which is the borrower’s average number of full-time equivalent ("FTE") employees during the covered period; and
  - The denominator of which is the lesser of:
    - The borrower’s average number of FTE employees between February 15 and June 30, 2019; or
    - The borrower’s average number of FTE employees between January 1 and February 29, 2020.
Reductions in Headcount and Salaries

Example

• Assume a borrower’s forgiveness amount is $1 million
• The borrower had 90 FTE employees during the covered period and 100 FTE employees during the testing period.
• In this example, the borrower’s forgiveness amount would be reduced to $900,000 ($1 million x 90/100)

Note: Even if a borrower’s forgiveness amount is not automatically reduced, a borrower with reduced headcount or payroll may be unable to spend all of its PPP loan proceeds within the covered period.
Reductions in Headcount and Salaries

- A borrower’s forgiveness amount also is reduced by the amount of any reduction in salary or wages paid to any employee who earned $100,000 or less, on an annualized basis, during each pay period in 2019, to the extent such reduction exceeds 25 percent of the total salary and wages paid to such person during the last full quarter.

- There appears to be a clear error in the statute because an employee’s salary and wages during the 8-week covered period will always be more than 25 percent less than the employee’s salary and wages during the 13-week prior quarter.
Reductions in Headcount and Salaries

• Example: an employee who earns $100,000 annually will earn $25,000 during a 13-week period ($100,000 x 13/52) and $15,385 during an 8-week period ($100,000 x 8/52).

• SBA is expected to issue guidance on how to apply the salary reduction provision.

• A borrower’s forgiveness amount is not reduced due to reductions in headcount or salaries that are “eliminated” by June 30, 2020.

• Unclear what it means for the reductions to be eliminated:
  • When is FTE measured?
  • Must borrowers repay prior reductions in salary or wages?
Maximizing Loan Forgiveness
Maximizing Loan Forgiveness

- Maintain headcount and the salaries of employees earning less than $100,000 to the greatest extent possible
- Consider making midyear contributions to employees’ retirement plan
  - These payments are counted *in addition to* the $15,385-per-employee limit
- Ensure rent, mortgage interest, and utilities *incurred during the covered period* are paid
- Consider accelerating a payroll period
- Deposit PPP funds in a separate bank account
- Keep all documents regarding use of PPP funds
- Remember, at least 75% of PPP funds shall be used for payroll
- Timely file federal and state payroll tax returns and state unemployment insurance filings
Applying for Loan Forgiveness and Repaying PPP Loan Balance
Applying for Loan Forgiveness

- A borrower seeking forgiveness of a PPP loan must submit an application to the lender that includes:
  - documentation verifying the number of FTE employees on the payroll and their pay rates for the covered period, including:
    - payroll tax filings reported to the IRS (i.e., Forms 941); and
    - state income, payroll, and unemployment insurance filings.
  - Documentation including canceled checks, payment receipts, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, covered lease obligations, and covered utility payments;
Applying for Loan Forgiveness

• Certification from an authorized representative of the borrower that:
  • The documentation presented is true and correct; and
  • The amount for which forgiveness is requested was used to retain employees, make interest payments on covered mortgages, make payment on covered rent obligations, or make covered utility payments; and
  • Any other documentation required by the SBA Administrator or the lender
  • Lenders may require their own documentation for this purpose
Maturity Date – Interest and Deferment

- Any balance remaining after loan forgiveness must be repaid over 2 years
- Interest rate for all borrowers is 1%
- No payment of interest or principal is due for 6 months beginning on the loan origination date
- Balance must be repaid over 18 months
- In addition, there will be no prepayment penalty
Applying for Loan Forgiveness

- Lenders who receive an application for loan forgiveness must issue a decision within 60 days.
- There is no statutory deadline for borrowers to submit a loan forgiveness application.
- However, borrowers generally should apply as soon as possible to ensure the application is timely approved and that no necessary documentation is missing.
- All PPP loans in excess of $2 million will be reviewed by the SBA before forgiveness is approved.
Employee Retention Credit and Social Security tax deferral
CARES Act Employee Retention Credit

• Provides eligible employers with a refundable payroll tax credit equal to 50% of qualified wages paid from March 13, 2020 through December 31, 2020, up to a maximum credit of $5,000 per employee.

• Key Questions
  • Does the employer qualify?
  • Which employees received qualified wages?
  • How is the credit claimed?
Retention Credit – Eligible Employer

- An employer is an eligible employer for a calendar quarter if either of the following applies:
  - Its operations were fully or partially suspended during the quarter by a governmental shut-down order; or
  - Its gross receipts declined by more than 50% compared to the same quarter in 2019.
- The suspension test applies separately for each quarter.
- An employer that qualifies under the gross receipts test remains eligible for the credit until the end of the quarter in which gross receipts rebound to 80% of the previous year’s level (but no later than the end of 2020).
- Affiliated employers are treated as a single employer, based on a 50% ownership threshold.
- Government entities and employers receiving emergency SBA loans under the paycheck protection program are not eligible for this credit.
Retention Credit – Qualified Wages

- For employers that averaged more than 100 full-time employees in 2019, “qualified wages” are limited to wages (including health benefits) paid to employees who are not providing services due to a shutdown or slowdown.
- For employers that averaged 100 or fewer full-time employees in 2019, “qualified wages” include wages (including health benefits) paid to all employees.
- Qualified wages do not include wages used in the computation of sick or family leave credits.
- According to IRS FAQs issued last week…
  - If employees are paid full-time wages for part-time work, the “excess” wages qualify.
  - Severance pay does not qualify; the recipient must continue to be an “employee”.
  - PTO does not qualify if paid pursuant to a pre-existing program.
  - Health benefits qualify only if paid with other wages.
Retention Credit – Claiming the Credit

• There are several ways to claim the credit
  • Retain employment taxes the employer otherwise would remit to the IRS.
  • Claim an expedited advance from the IRS using Form 7200.
  • Claim the credit on quarterly Form 941 filings.
  • Pay employment taxes initially, and file a refund claim with the IRS.
• The credit may be claimed in addition to the deferral of Social Security taxes.
• Employers claiming the credit should prepare contemporaneous documentation explaining why they qualify.
CARES Act Payroll Tax Deferral

- Provides that employers may delay payment of 100% of the employer share of Social Security tax (6.2% rate) on wages where such taxes are due between the CARES Act enactment on March 27, 2020 and January 1, 2021.
- The deadline for paying the first 50% of the deferred taxes is December 31, 2021, and the deadline for paying the remaining 50% of taxes is delayed until December 31, 2022.
- The tax deferral is available regardless of workforce size.
- An employer receiving an emergency SBA loan under the paycheck protection program that is forgiven is not eligible for the payroll tax deferral, for periods after the loan is forgiven.
- May be claimed in addition to the retention credit.
For more information

Ivan H. Golden, Esq.
Hahn Loeser & Parks LLP
200 W. Madison Street
Chicago, IL 60606
312-637-3070
igolden@hahnlaw.com

Allie P. Petrova, Esq.
Petrova Law PLLC
629 Green Valley Road
Greensboro, NC 27408
3336-310-210
petrova@petrovalaw.com

Robb A. Longman, Esq.
Longman & Van Grack, LLC
10411 Motor City Drive, Ste. 750
Bethesda, MD 20817
(240) 324-7705
rlongman@lvglawfirm.com
For more information

Noelle Geiger, Esq.
Green & Sklarz, LLC
1 Audubon Street, 3rd Floor
New Haven, CT 06511
203-836-9312
ngeiger@gs-lawfirm.com

Jonathan Zimmerman
Morgan, Lewis & Bockius LLP
1111 Pennsylvania Ave NW
Washington, DC 20004
(202) 739-5212
Jonathan.zimmerman@morganlewis.com
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