

PAYCHECK PROTECTION PROGRAM

CARES Act update: Understanding PPP loan forgiveness

May 19, 2020

Loan forgiveness calculation (high-level)

$$\begin{array}{r} \text{Baseline Forgiveness Amount} \\ - \text{25\% Pay Reduction Haircut} \\ \hline \end{array}$$

- ← Qualifying expenses during "covered period"
- ← Did employees make 75% of average weekly wage?

Preliminary Forgiveness Amount

$$\begin{array}{r} \text{Preliminary Forgiveness Amount} \\ \times \text{FTE "Haircut" Ratio} \\ \hline \end{array}$$

- ← What percentage of employees did we retain?

Loan Forgiveness Amount

- ← Amount also reduces tax expenses

Should a borrower expect for all of its loan to be forgiven?

- While the intent of the program has been stated to effectively be a ‘grant’ to the borrower we have seen in most modeling cases that a borrower should expect to have some amount of the loan outstanding at the end of the covered period. Subject to additional clarification from the SBA this remaining amount can be substantially attributed to the following:
 - a) A discrepancy between the borrowing amount (average monthly payroll based on a two month period times 2.5) and the covered period (eight-weeks).
 - b) The amount of qualified non-payroll costs (can only be a maximum of 25% of the loan forgiveness amount).
 - c) FTE Ratio reduction

Baseline forgiveness amount

- Payroll costs + rent / mortgage int. / utilities for eight week period beginning with receipt of funds (“covered period”)
- Note difference in measurement period
- Payroll costs
 - Same definition as for application for loan amount
 - Gross wages = Medicare wages + employee health insurance
 - Do not subtract employee withholding
 - Retirement payments, unemployment insurance, severance

Baseline forgiveness amount (cont.)

- Payroll costs, cont.
 - Alternative covered period for biweekly or weekly payroll
 - “Accrual” option for end of period – but not for beginning?
 - Paid is either day checks are issued or day of ACH credit
 - Possible inclusion of more than 8 weeks of pay for those with covered periods beginning on date other than payroll date
 - Owner provision – based on 8 weeks of 2019 compensation/earnings
 - Appears to be intended for self-employed / Sch. C
 - Does it apply to partners in partnerships or S corporation shareholders?

Baseline forgiveness amount (cont.)

- Rent / mortgage interest / utilities
 - Must be entered into prior to February 15, 2020
 - Areas of uncertainty
 - Mortgages on personal property?
 - Asset-based lending arrangements?
 - Fuel for business vehicles? Business agreements entered into for a service?
 - “Distributed” utilities?
 - Similar provision for utilities that are due after the end of covered period but “incurred” during covered period
 - Opportunity to include more than 8 weeks of costs?

Salary and wage deduction (25% pay reduction) haircut

- Congressional intent
- Loan forgiveness is reduced by the amount by which AVERAGE compensation reductions exceed 25% in comparative periods
- Comparison periods are eight week period post loan receipt vs. January 1 – March 31, 2020
- Exceptions
 - EEs with pay annualizing > \$100k
 - Offers extended and declined to former employees
 - Fired for cause, resigned or requested reduced hours

Full-time employee (FTE) equivalent “haircut” ratio

- Congressional intent
- Baseline forgiveness amount X FTE haircut ratio
- Ratio
 - Numerator – Avg. FTEs for eight weeks after receipt
 - Denominator – FTEs during one of two periods:
 - 2/15/2019 – 6/30/2019, or
 - 1/1/2020 – 2/29/2020
 - Exception for seasonal employers
 - June 30, 2020 Restoration clause

Example

- Assumptions

- Average payroll for twelve months - \$100k
- Average health insurance for 12 months - \$10k
- Monthly rent / utilities / mortgage interest - \$10k
- Average FTEs during post-loan period – 15
- Average FTEs during pre-COVID 19 period – 20
- 1 Employee salary cut from \$1k/ week to \$500/week

- Loan amount

- 2.5x payroll of \$100k = \$250k
- 2.5x health insurance of \$10k = \$25k
- Total loan amount = \$275k

Example (cont.)

- **Baseline loan forgiveness**
 - eight weeks of payroll - \$184,615 ($\$100,000 * 12 / 52 * 8$)
 - Note gap between \$250k on loan!
 - eight weeks of health insurance - \$18,462 ($\$10,000 * 12 / 52 * 8$)
 - Note gap between loan of \$25k!
 - eight weeks of rent / mortgage int./ utilities - \$18,461
- **Baseline loan forgiveness = \$221,538 (81% of loan)**
 - Loan amount of \$275k

Example (cont.)

- 25% pay reduction haircut
 - Allowed to reduce pay 25% of 1st Q average
 - $\$1,000 * 75\% = \750 , average pay was $\$500$, so reduction in baseline forgiveness of $\$250$
 - Subtract $\$250$ from baseline forgiveness in Step 1 ($\$221,538 - \250)
- FTE haircut
 - FTEs during eight week period / FTE during pre-COVID
 - $15 / 20 = 75\%$
 - Adjusted Baseline forgiveness X FTE ratio
 - $75\% \times \$221,288 = \$165,966$ (61%)

Example (cont.)

Original Loan Amount	275,000
Baseline Forgiveness Amount	221,538
25% Pay Reduction Haircut	(250)
	<input type="text"/>
Preliminary Forgiveness Amount	221,288
Preliminary Forgiveness Amount	221,288
FTE "Haircut" Ratio	<u>75%</u>
Loan Forgiveness Amount	<u>165,966</u>
Remaining Loan Amount	109,034
Forgiveness %	60.35%
Loan Amount Forgiven	165,966
Tax Cost of Lost Deductions	<u>(58,088)</u>
Net Cash Flow Benefit of PPP	<u>107,878</u>

What will be needed to substantiate these expenses? – Page 10

- PPP Loan Forgiveness Application Form
- PPP Schedule A
- Payroll documentation
 - Account statements or p/r service documentation
 - Tax forms (Form 941, unemployment insurance, etc.)
 - Receipts, cancelled checks, etc. showing contributions for insurance, benefits, etc. included in forgiveness amount
- FTE Documentation
 - FTEs for Feb 15 – June 30, 2019, or January 1 – Feb 29, 2020, or May 1 – September 15, 2019

What will be needed to substantiate these expenses?

- Nonpayroll expenses
 - Verification of existence prior to 2.15.20
 - Payment verification during covered period
 - Lender amortization schedule for interest
 - Lease or rent agreements and payment verification
 - Proof of utility existence at 2.15.20 and payment during covered periods
- Not required to submit, but keep anyways
 - Detail of Salary/Wage reduction calculation, documentation supporting exclusion from factor
 - Documentation for any employees refusing return, firing for cause, resignations, request for reductions
 - FTE Safe Harbor reduction, if applicable

RSM US LLP

+1 800 274 3978

rsmus.com

This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute audit, tax, consulting, business, financial, investment, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. RSM US LLP, its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person. Internal Revenue Service rules require us to inform you that this communication may be deemed a solicitation to provide tax services. This communication is being sent to individuals who have subscribed to receive it or who we believe would have an interest in the topics discussed.

RSM US LLP is a limited liability partnership and the U.S. member firm of RSM International, a global network of independent audit, tax and consulting firms. The member firms of RSM International collaborate to provide services to global clients, but are separate and distinct legal entities that cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party. Visit rsmus.com/aboutus for more information regarding RSM US LLP and RSM International.

RSM, the RSM logo and *the power of being understood* are registered trademarks of RSM International Association.

© 2020 RSM US LLP. All Rights Reserved.