THE CARES ACT –

PAYCHECK PROTECTION PROGRAM (PPP) LOAN FORGIVENESS IMPLEMENTATION GUIDE

Main provisions & examples for assistance in understanding how the PPP loan will qualify for forgiveness.

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The PPP Loan Program Evolution Continues

As suspected back in May when Mercadien published its Paycheck Protection Program (PPP) Loan Forgiveness Implementation Guide, many rules have evolved and changed for both borrowers and lenders. It has been several weeks since we published the original version of this guide. Over these last several weeks, we have gathered the necessary information and studied the most recent guidance to publish this update, but certainly did not want to do it too soon otherwise we would find ourselves having to put out yet another "update" in the future. While we acknowledge that further clarification may be on the horizon, we are finally in receipt of loan forgiveness applications that were revised on June 16, 2020, an EZ version of the application for certain borrowers, and the Paycheck Protection Program Flexibility Act (PPPFA) together with amendments or updates to other Treasury and SBA guidance.

The PPPFA of 2020 was signed into law by President Trump on June 5, 2020. This Act changed key provisions of the PPP including provisions related to maturity of PPP loans, deferral of the PPP loan payments, and forgiveness calculations for the loans. This update picks up where we left off on May 8 and highlights the changes and clarifications that you need to understand in order to maximize the amount of forgiveness you are entitled to against the PPP loan.

Brief History - Owners of numerous small businesses, including those who are self-employed, applied for potentially forgivable loans under the Paycheck Protection Program (PPP) created as part of the Coronavirus Aid, Relief and Economic Security (CARES) Act. This program was designed to incentivize employers to maintain payroll and employee headcount throughout the COVID-19 crisis. Specifically, the three goals were to keep workforce off unemployment or reduce unemployment by June 30, support the economy, and retain or reclaim workforce to be "at the ready" for returning to operations. In our original ***Forgiveness Implementation Guide***, we laid out guidance to answer the 4 key questions business owners must address to be able to maximize PPP loan forgiveness. We continue to stress that cash flow management is the key business best practice while tackling the forgiveness planning.

What has Changed Within the 4 Key Questions?

Question #1 - Have we spent the funds on eligible expenses only?

In addressing this question, you need to determine what you can pay for (Covered Costs), and when you have to pay for it (Covered Period). Let's start with "when".

How long do we have to spend the loan? The PPPFA now allows businesses to use the proceeds of the PPP loan on allowable expenses through December 31, 2020, the "Covered Period" under Section 1102 of the Cares ACT. So, in theory, regardless of whether you are applying for forgiveness, you can continue to use the loan proceeds through the end of 2020. However, if you intend to apply for full forgiveness, you need to spend the loan in the 24-week period from the date the funding is deposited into your bank account.

What kind of expenses and costs can I spend the money on? Previously, we told you that you could spend the loan proceeds on payroll costs, rent, utilities and mortgage interest or interest on loans that were in effect on or before 2/15/2020. This has not changed. Payroll costs include:

- **Compensation** - includes wages, salaries, commissions, bonuses, combat/hazard pay, and paid time off (but only PTO that is not considered FFCRA compensation where you will submit for a credit against your employer share of FICA and Medicare taxes). So there are no changes to the definition of compensation considered to be covered payroll costs, however, there are changes to the maximum amounts of compensation allowed for the loan forgiveness calculations as follows:
    - Compensation is determined on an employee by employee basis and while you can pay compensation to your employees at whatever level you choose, the compensation that counts towards the forgiveness calculation may not exceed an amount to any employee that when annualized in the spending period, exceeds $100,000. (See spending period below.)
    - Owners of S and C corporations - the maximum compensation is the lesser of the W-2 amount for 2019 at 8/52 for an 8-week covered period, the W-2 amount for 2019 at 2.5/12 for a 24 week covered period or $100,000 ($15,385 for the 8-week covered period or $20,833 for the 24-week covered period).
- **Healthcare costs** - Continue to be forgivable costs however benefits for owners of S Corporations, C Corporations, self-employed sole proprietors and partners cannot be part of the forgiveness calculations.
- **Retirement benefits** - Continue to be forgivable costs however benefits for owners of S Corporations, C Corporations, self-employed sole proprietors and partners cannot be part of the forgiveness calculations.
- **Employer share of state and local payroll tax costs -** no changes
- **Self-employment income** (Schedule C for a sole proprietor or K-1 self-employment income of a partner is considered compensation – the maximum amount of compensation allowed is the same as described above for owners of S and C corporations, but the 2019 Schedule C income (or partnership K-1 income subject to self-employment income) is used.

Costs & Loan Forgiveness - In order to qualify for full loan forgiveness, you must spend the funds in a specified timeframe, on specified costs, and a specific percentage of the loan must be spent on payroll costs.

New Rules to Covered Period - The “Covered Period” in CARES Act Forgiveness Section 1106 describes the timeframe for how long you have to spend the money in order to maximize loan forgiveness. You now have 24 weeks from the date that your loan is funded to spend the proceeds on allowable costs through December 31, 2020. Previously, you had 8 weeks to spend the money, which had to be spent by June 30, 2020. As you will see later in the forgiveness discussion, if you received your loan prior to June 5, 2020, you can choose to use an 8-week forgiveness period or the 24-week forgiveness period.

New Rule for Payroll Costs - The total payroll costs must account for 60% of loan proceeds spent; previously they had to account for 75% of the loan proceeds spent.

Point of Clarification - The latest interim final rules and frequently asked questions make it clear that you cannot increase owner’s compensation in order to spend the loan proceeds on payroll related expenses. Without the limitations on C and S corporation owners, it would be possible to raise their salary to meet the 75% (now 60%) loan spending threshold without paying your other employees. In essence, S and C corp. shareholders now have the same limits that self-employed owners and partners have.

Annualized Compensation - As noted above, the maximum amount of compensation that you can consider towards the forgiveness amount is $100,000; it is imperative to note that this is $100,000 on an annualized basis.

New Rules to Payroll Costs Annualized – Due to the $100,000 compensation cap, you will need to calculate the maximum amount you can consider as each individual's compensation based on their regular payroll cycle. This excludes self- employed individuals, partners, and business owners which have a limited "owner compensation replacement cap". If you are using the new 24-week covered spending period for loan forgiveness you would compute the following caps:

Monthly	$ 8,333.33 x 6 payrolls = $ 49,998.00 (capped at $46,154.00)
Semi-monthly	$ 4,166.67 x 12 payrolls = $49,998.00 (capped at $46,154.00)
Bi-weekly	$ 3,846.15 x 12 payrolls = $ 46,154.00
Weekly	$ 1,923.07 x 24 payrolls = $ 46,154.00

Previous Rules to Payroll Costs Annualized – These rules are still used if you select the 8-week covered period:

Monthly	$ 8,333.33 x 2 payrolls = $ 16,666.66 (capped at $15,385.00)
Semi-monthly	$ 4,166.67 x 4 payrolls = $ 16,666.66 (capped at $15,385.00)
Bi-weekly	$ 3,846.15 x 4 payrolls = $ 15,385.00
Weekly	$ 1,923.07 x 8 payrolls = $ 15,385.00

Owner Compensation Replacement Cap

24-Week Covered Period	Lesser of 2.5 months of 2019 net profit or W-2 gross income up to $20,833.
8-Week Covered Period	Lesser of 8/52 (8 weeks' worth) of 2019 net profit or W-2 gross income up to $15,835.

Question #2 – Are the eligible expenses incurred or spent in the forgiveness covered period?

On May 15, 2020 the SBA published its PPP loan forgiveness application along with instructions for completing the application. The key takeaways for the application instructions include the following clarifications regarding spent and paid as well as certain expense clarification:

Expenses paid OR incurred - Borrowers may include eligible payroll and non-payroll expenses paid ***OR*** incurred during their 24-week or if electing 8-week period (covered period) after receiving their PPP loan.

Payroll - You can use payroll expenses that are paid or incurred during the covered period. Payroll expenses are considered paid on the day that the paycheck is distributed, or the borrower originates an ACH credit to the employee. Payroll expenses are incurred on the day they are earned. Payroll expenses that are incurred during the covered period but not paid during the last pay period of the covered period are eligible for forgiveness as long as they are paid on or before the next regular pay period.

Non-payroll expenses (mortgage, rent, and utilities) that are incurred during the covered period, and paid after the covered period, must be paid by the next billing cycle.

Alternative Payroll Covered Period - The PPP Loan Forgiveness Application allows borrowers to select an alternative payroll covered period. The alternative payroll covered period is the 8-week (56 day) or 24-week period beginning on the first day of the first pay period following the PPP loan disbursement date. Borrowers now have an option to calculate payroll expenses using an alternative payroll covered period that aligns with their regular payroll cycles.

Bonuses to Owners/General Partners - The Application states that the total amount paid to owner-employees, self-employed individuals and general partners is capped at $15,385 ($100,000/year) OR the 8-week equivalent of their applicable compensation for 2019, whichever is lower (if using the 24-week period, the cap is $20,833). This prevents owners, self-employed individuals, and general partners from increasing their compensation during the covered period to maximize forgiveness.

Covered Rent - The Application explicitly states that the amount of business rent or lease payments for **real or personal property** during the covered period, pursuant to lease agreements in force before February 15, 2020, are included in the non-payroll expenses. This can be for paid or incurred expenses.

Question #3 - Did I bring my employee headcount up to (or maintain my headcount at) the level in the base measurement period during my covered period?

Full Time Equivalents (FTE)

The goal of the PPP loan is to maintain workforce or bring employees back from unemployment. The loan forgiveness calculations require borrowers to calculate their FTE base in the covered period and then compare it to one of two base periods (2/15 - 6/30/2019 or 1/1 - 2/29/2020). Note that an owner/employee is **NOT** included in any FTE count.

If the FTE count is lower in the covered period when compared to the lower of the two base periods, you may wind up with less than 100% of loan forgiveness, unless you meet a safe harbor.

What's different with FTE calculations?

- An FTE is calculated using a 40 hour per week base (previously we advised you that is was 30 hours per week).
- You may choose one of two methods to calculate the FTEs in the covered period.
    1. Count each person that works 40 hours or more per week as 1 FTE and anyone that works less than 40 hours per week as a .5 FTE.
    2. Take all employees working under 40, add their hours together and divide by 40 to arrive at FTEs.

Whichever method you choose in the covered period must be used in the base period. Depending on your workforce you could find that one method is more advantageous than the other.

- **Safe harbor #1 -** If you were unable to operate between February 15, 2020 and the end of your covered period at the same level of business before February 15, 2020, due to compliance with guidance issued between March 1, 2020 and December 31, 2020 by CDC or OSHA, you check the box on the form. The documentation you should have to support this certification includes, but is not limited to copies of the COVID-19 requirements and guidance, which may vary by industry and state.

- **Safe harbor #2 -** Calculate 1) the average FTE between February 15, 2020 and April 26, 2020 and compare it to 2) the FTE in the pay period that includes February 15, 2020. If the result in the second calculation is greater than the result in the first calculation, compare the result of the second calculation to FTE on the earlier of December 31, 2020 or the date of the forgiveness application. If the Final Safe Harbor FTE is greater than the second FTE result, then the Safe Harbor's satisfied.

  If the Final Safe Harbor FTE is less than the second FTE result, Safe Harbor doesn't apply. It also doesn't apply if the first calculation is greater than the second calculation. In these two instances there is an FTE reduction that can reduce forgiveness.

- You calculate FTEs by taking the employees on the payroll during the covered period, then calculate your base period FTEs.

- You are not penalized if you offer an employee their position back, but they refuse or cannot work the same hours. However, you must make a good faith written offer, for the same salary or number of hours, and document the reason why they did not come back or could not work their old hours. Additionally, you must inform the unemployment office of the employee's rejection within 30 days of said rejection.

- You are not penalized if you fired an employee for cause, however, you must document the facts and circumstances.

Question #4 - Did I reduce any of my employees' salaries who were working in the first full calendar quarter by more than 25% prior to my receiving a PPP Loan?

This calculation is done for employees whose compensation on an annualized rate was $100,000 or less during 2019. Any employee above this rate is disregarded for the salary reduction calculations.

You must create a list of all employees who were paid during the covered period and calculate each employee's average annual salary or hourly rate for that period. You then need to calculate that person's average annual salary or hourly rate in the first quarter of 2020. If the hourly rate in the covered period is more than 25% lower than in the first quarter of 2020, you will need to make a calculation to determine how much of the loan will not be forgiven due to this pay reduction. For employees who are paid a salary, you must make the same comparison by calculating the average annual compensation amounts from the covered period and the base period.

Some final clarifications on Question 4 that we could not answer in our original Implementation Guide:

1. How are businesses supposed to calculate the compensation per pay period? Is it total pay, average pay or some other amount?

- Answer - if the employee is paid hourly you use their hourly rate (including overtime) in each period. If they are salaried, you take their average pay per pay period and annualize that amount. You then do the same for the first quarter and compare the two.

2. Quarter 1 is a 12- or 13-week timeframe as compared to the 8-week spending timeframe - this is apples and oranges and the CARES Act doesn't specify how to deal with it. Additional guidance is needed.
   - Update - This doesn't matter now since you use the covered period of 8 or 24 weeks (or some other period between the two) that is your specific covered period and calculate the average in that period. You then compare that to the average in the 1st quarter of 2020.
3. What happens if my employee refuses to come back from unemployment or if they are scared to come back? The SBA FAQ's have indicated that the loan forgiveness won't be impacted by employees who were offered their jobs back, but who would not accept - more guidance on how to handle and document this issue is required.
   - Answer - Document the circumstances in writing with signatures of the employee if possible. Based on the instructions on the forgiveness application, you won't need to submit this to the bank or the SBA with the forgiveness application, however you need to keep it on hand in case they request it.
4. Exception to remedy the reduction in loan forgiveness due to reduced pay rate - guidance is needed to determine how to apply this exception but generally if you restore the pay rate to the rate that the employee made on 2/15/2020, you can avoid a loan forgiveness reduction.
   - While this is not crystal clear, we understand that the ACT and the published guidance imply that pay restoration to the level in the first quarter 2020 reference period, by the date of the forgiveness application or December 31, 2020, whichever is earlier, will cure a reduction to the forgiveness amount.

The Loan Forgiveness Process

We now know that:

- Forgiveness is not all or nothing. You can get partial forgiveness based on the lower of three factors (example- if the 60% payroll cost is lower than total eligible costs and also lower than the total loan, then the 60% payroll cost is the amount forgiven.) The amount of forgiveness can be up to the full principal amount of the loan and any interest. However, to receive the full amount of forgiveness the borrower must use at least 60% of the loan for payroll cost and not more than 40% of the loan forgiveness amount may be attributable to non-payroll costs.
- Loans made on or after June 5, 2020 will have a 5-year maturity term and for loan made prior to that date, the bank can agree to extend maturity from 2 to five years. (We don't think this is likely to happen all that often.)
- If a borrower submits the forgiveness application within 10 months from the last day of its covered period, the borrower will not have to make any payments on the loan before the date the SBA remits the forgiven amount to the lender.
- Confirms that August 8, 2020 is the last day a lender can obtain an SBA loan number for a PPP loan.

Mercadien has been working with many clients to help them determine how to maximize their loan forgiveness. While the information we now know is helpful in clarifying the calculations, the computations required to support the forgiveness application remain cumbersome and complex. Many of the larger payroll providers are preparing software programs to assist their clients with submitting the loan applications, however as we have seen to date, the information can contain errors depending on how you have your payroll set up in their systems.

The new forgiveness applications (long form and the EZ version) make it clear what documentation you will need to supply to the bank with your forgiveness application. However, we advise that you maintain support for all of the numbers you report on the forms in case the bank requests such documentation. This includes schedules and computations as well as any documents from employees terminated for cause, refusals to return to work or inability to return to their former hours.

Select Resources:

- The CARES ACT - https://www.congress.gov/bill/116th-congress/senate-bill/3548/text?q=product+actualizaci%C3%B3n
- Paycheck Protection Program Loans Frequently Asked Questions (FAQs) - https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf
- PPP Loan Forgiveness Application - https://www.sba.gov/sites/default/files/2020-05/3245-0407%20SBA%20Form%203508%20PPP%20Forgiveness%20Application.pdf
- Mercadien's Original Paycheck Protection Program Loan Forgiveness Implementation Guide - https://www.mercadien.com/resource/paycheck-protection-program-ppp-loan-forgiveness-implementation-guide/

Mercadien's team of experts can help you prepare the required loan calculations, compile the necessary documentation, complete and submit the application and answer your questions about the PPP and other relief options available. We're also available to assist you in evaluating your budget and cash flow needs, working as an advisor and sounding board to help you manage your way through the upcoming months. Complete the COVID-19 Assistance Request form on our website or contact your engagement partner to get started.

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