

PPP Loan Forgiveness

Update: December 8, 2020



ARIZONA
SMALL
BUSINESS
BOOT CAMP &
COLLECTIVE

RESPOND → PLAN → RETURN STRONGER



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Disclaimer

This presentation is based on relevant government guidance available as of December 7, 2020. There are many areas of the CARES Act, related guidance and the SBA's Loan Forgiveness Application that are unclear and additional clarification from the government is needed. In addition, there may be legislation in future weeks that modifies the program rules. This presentation includes our best interpretation of the guidance.

PPP Loan Forgiveness

- Applications
- Taxes
- 3rd Party Payroll Reports
- Loans and Loan Covenants
- Potpourri
- Open Q&A



Applications

Applications

- Most lenders are accepting loan forgiveness applications
- SBA has been processing and approving loan forgiveness for loans less than \$2M
- Timing of SBA approval has been as short as 7-10 business days

Applications

How to make your loan forgiveness application simple?

- Use gross wages only
- Most companies can report 24 weeks of gross wages and achieve 100% forgiveness
- Documentation requirements for all other types of costs are much more burdensome.



Applications

Examples:

- For rent: Copy of the lease, verification of rent payment (statement, cancelled check, EFT, etc.)
- For utilities: Copy of the invoice for the period that includes 2/15/20 to prove service was in place on that date, copies of the invoices being included as covered costs, verification of payment (statement, cancelled check, EFT, etc.)



Applications

- Uptick in chatter about a new COVID relief package in Congress
- Possible modification of loan forgiveness reporting requirements for loans up to \$150,000
- If your loan is more than \$50,000 but less than \$150,000 and you have significant FTE or wage reductions, consider waiting to apply for forgiveness

Applications

- Without further relief for small businesses, an additional 1.5-3M jobs may be lost
- Another round of PPP funding is being considered
- Expected qualifying provisions:
 - * 25-35% reduction in revenues in 2020
 - * Less than 300 employees



Taxes

Taxes

On November 18, the IRS put the nail in the coffin on deducting expenses associated with the use of PPP funds.



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Taxes

- Revenue Ruling 2020-27 clarifies that expenses associated with the use of PPP loan funds are not deductible in the tax year they are paid or incurred if there is a reasonable expectation of forgiveness.
- The ruling states that whether a borrower has filed for forgiveness or not, and whether a borrower has received a forgiveness decision or not, is irrelevant.

Taxes

Example:

Your business received a \$20,000 PPP loan. You spent all of it in 2020.

On your 2020 tax return, \$20,000 of your expenses are not deductible.



Sample Company		
2020 Income Statement		
	Forgiveness received in 2020	Forgiveness received in 2021
Revenue	100,000	100,000
Cost of goods sold	(45,000)	(45,000)
Gross Profit	55,000	55,000
Selling expenses	(12,000)	(12,000)
General & Administrative expenses	(24,000)	(24,000)
PPP Forgiveness income	20,000	-
Net income - book	39,000	19,000
Assuming no other book/tax differences.		
Net income - book	39,000	19,000
less: PPP Forgiveness income	(20,000)	-
add: PPP related expenses	20,000	20,000
Taxable income	39,000	39,000

Taxes

Notes:

- No guidance for businesses on how to actually report the non-deductible items on their 2020 tax return.
- No guidance on how this concept applies to a business that files a Schedule C, since there is no “wage deduction” for the owner on Schedule C itself.



Taxes



Example – Schedule C: Choose the 24 week period

- The formula for your forgiveness is:
2019 Form 1040, Schedule C, line 31
Divided by 12 * 2.5
Maximum of \$20,833

How is the concept of “nondeductible expenses” applied to the 2020 Form 1040, Schedule C?

SCHEDULE C
(Form 1040 or 1040-SR)

Profit or Loss From Business
(Sole Proprietorship)

OMB No. 1545-0074

2019
Attachment
Sequence No. **09**

Department of the Treasury
Internal Revenue Service (99)

Go to www.irs.gov/ScheduleC for instructions and the latest information.

Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships generally must file Form 1065.

Name of proprietor _____ Social security number (SSN) _____

A Principal business or profession, including product or service (see instructions) _____ **B** Enter code from instructions _____

C Business name. If no separate business name, leave blank. _____ **D** Employer ID number (EIN) (see instructions) _____

E Business address (including suite or room no.) _____
City, town or post office, state, and ZIP code _____

F Accounting method: (1) Cash (2) Accrual (3) Other (specify) _____

G Did you "materially participate" in the operation of this business during 2019? If "No," see instructions for limit on losses Yes No

H If you started or acquired this business during 2019, check here Yes No

I Did you make any payments in 2019 that would require you to file Form(s) 1099? (see instructions) Yes No

J If "Yes," did you or will you file required Forms 1099? Yes No

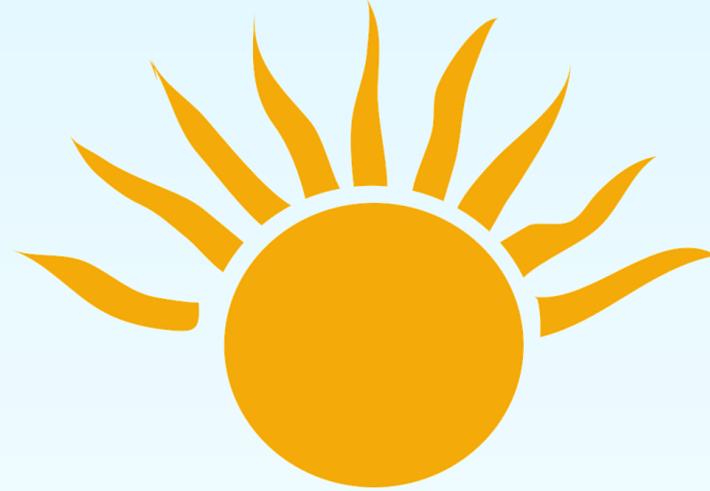
Part I Income

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked <input type="checkbox"/>	1
2	Returns and allowances	2
3	Subtract line 2 from line 1	3
4	Cost of goods sold (from line 42)	4
5	Gross profit. Subtract line 4 from line 3	5
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	6
7	Gross income. Add lines 5 and 6	7

Part II Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	8	18	Office expense (see instructions)	18
9	Car and truck expenses (see instructions)	9	19	Pension and profit-sharing plans	19
10	Commissions and fees	10	20	Rent or lease (see instructions):	
11	Contract labor (see instructions)	11	20a	Vehicles, machinery, and equipment	20a
12	Depletion	12	20b	Other business property	20b
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13	21	Repairs and maintenance	21
14	Employee benefit programs (other than on line 19)	14	22	Supplies (not included in Part III)	22
15	Insurance (other than health)	15	23	Taxes and licenses	23
16	Interest (see instructions):		24	Travel and meals:	
16a	Mortgage (paid to banks, etc.)	16a	24a	Travel	24a
16b	Other	16b	24b	Deductible meals (see instructions)	24b
17	Legal and professional services	17	25	Utilities	25
18			26	Wages (less employment credits)	26
19			27a	Other expenses (from line 48)	27a
20			27b	Reserved for future use	27b
28	Total expenses before expenses for business use of home. Add lines 8 through 27a	28			
29	Tentative profit or (loss). Subtract line 28 from line 7	29			
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method (see instructions). Simplified method filers only: enter the total square footage of: (a) your home: _____ and (b) the part of your home used for business: _____ Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30.	30			
31	Net profit or (loss). Subtract line 30 from line 29. • If a profit, enter on both schedule 1 (Form 1040 or 1040-SR), line 3 (or Form 1040-NR, line 13) and on Schedule SE, line 2. (If you checked the box on line 1, see instructions). Estates and trusts, enter on Form 1041, line 3. • If a loss, you must go to line 32.	31			
32	If you have a loss, check the box that describes your investment in this activity (see instructions). • If you checked 32a, enter the loss on both Schedule 1 (Form 1040 or 1040-SR), line 3 (or Form 1040-NR, line 13) and on Schedule SE, line 2. (If you checked the box on line 1, see the line 31 instructions). Estates and trusts, enter on Form 1041, line 3. • If you checked 32b, you must attach Form 6198. Your loss may be limited.		32a	<input type="checkbox"/> All investment is at risk.	
			32b	<input type="checkbox"/> Some investment is not at risk.	

Taxes



There is a ray of hope....

Congress is insisting they are going to legislate a change that would make the expenses deductible, while the loan forgiveness income remains nontaxable.

Sample Company					
2020 Income Statement					
	Forgiveness received in 2020	Forgiveness received in 2021	IF THE LAW CHANGES - Forgiveness received in 2020	IF THE LAW CHANGES - Forgiveness received in 2021	
Revenue	100,000	100,000	100,000	100,000	
Cost of goods sold	(45,000)	(45,000)	(45,000)	(45,000)	
Gross Profit	55,000	55,000	55,000	55,000	
Selling expenses	(12,000)	(12,000)	(12,000)	(12,000)	
General & Administrative expenses	(24,000)	(24,000)	(24,000)	(24,000)	
PPP Forgiveness income	20,000	-	20,000	-	
Net income - book	39,000	19,000	39,000	19,000	
Assuming no other book/tax differences.					
Net income - book	39,000	19,000	39,000	19,000	
less: PPP Forgiveness income	(20,000)	-	(20,000)	-	
add: PPP related expenses	20,000	20,000	-	-	
Taxable income	39,000	39,000	19,000	19,000	

Taxes

What are we doing?

- Compute 4th quarter estimated tax payments and extension payments both ways: current law or assuming expenses will be deductible
- Business owner then decides what to pay in. This is a business risk decision.
- 1040 filers – look at being “penalty proof”

Taxes



Avoiding estimated tax penalties – for 1040 filers

- Tax liability is less than \$1,000
- 2020 tax payments are lesser of:
 - 90% of current year tax
 - 100% prior year tax
- If AGI for 2019 was over \$150,000, the last point above increases to 110%

3rd Party Payroll Reports

3rd Party Payroll Reports

Most of the large 3rd party payroll providers are offering a PPP report that computes all of the payroll metrics:

- FTEs for the base and covered periods
- Wages and FTEs allocated between Table 1 and Table 2 for the Schedule A Worksheet
- Proper limitations applied to all wages
- Salary/Hourly wage reduction
- Some other payroll costs like retirement plan, health insurance and SUTA



3rd Party Payroll Reports



- Like any canned report, results depend on inputs
- Some formulas use hire and term dates to compute FTEs and/or the 25% salary/hourly wage reduction
- Errors in dates, missing dates, re-hires, etc. can cause the results to be incorrect
- Classification errors can also produce errors (hourly vs. salaried)

3rd Party Payroll Reports

- FTE results can be distorted if hours are not entered for salaried employees
- FTE results can be distorted if you have individuals that receive multiple types of pay (hourly, piece rate, etc.)
- Employees on furlough or FMLA can cause errors in results

3rd Party Payroll Reports

- Bonuses and OT may distort some 25% salary/hourly wage reduction computations
- Wages for unique pay like commissions, piece rate, etc. are beyond the capability of the formulas
- Owners tend to be included in Table 2 when they should be excluded and listed separately
- Classification between Table 1 and 2 is usually ok

Sidebar on Table 2...

The 'test' for who goes on Table 2 is odd:

- Principal place of residence is U.S., and
- Received compensation from the Borrower at an annualized rate of more than \$100,000 for any pay period in 2019

For a weekly payer, that's any pay period in 2019 with gross wages for an individual more than \$1,923 ($\$100,000 / 52$)

This can be ridiculously difficult and time consuming to determine

Table 1: List employees who:

- Were employed by the Borrower at any point during the Covered Period or the Alternative Payroll Covered Period whose principal place of residence is in the United States; and
- Received compensation from the Borrower at an annualized rate of less than or equal to \$100,000 for all pay periods in 2019 **or** were not employed by the Borrower at any point in 2019.

Employee's Name	Employee Identifier	Cash Compensation	Average FTE	Salary / Hourly Wage Reduction
FTE Reduction Exceptions:				
Totals:		Box 1	Box 2	Box 3

All 2020 hires go on Table 1, regardless of compensation level.

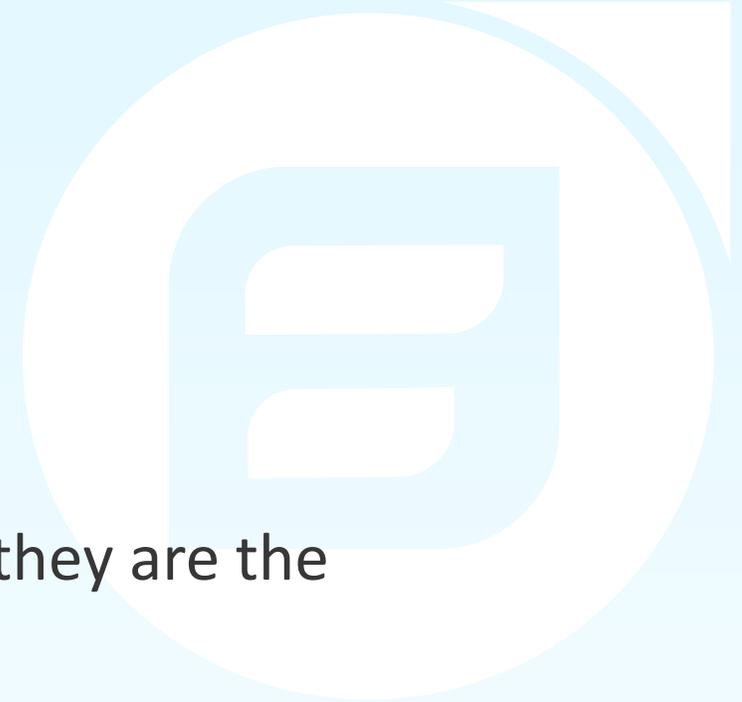
Table 2: List employees who:

- Were employed by the Borrower at any point during the Covered Period or the Alternative Payroll Covered Period whose principal place of residence is in the United States; and
- Received compensation from the Borrower at an annualized rate of more than \$100,000 for any pay period in 2019.

Employee's Name	Employee Identifier	Cash Compensation	Average FTE
Totals:		Box 4	Box 5

Benefit of Table 2?
Not subject to 25% salary/hourly wage reduction

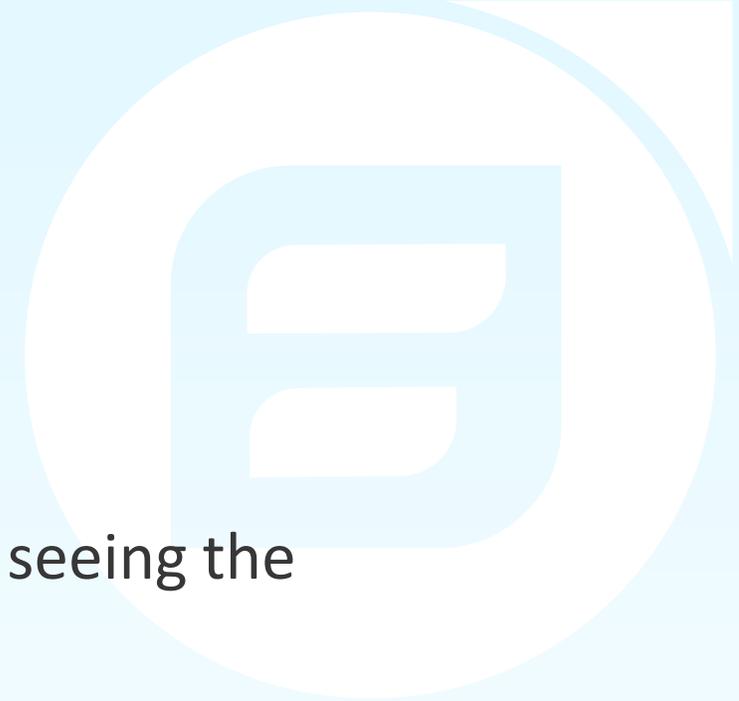
3rd Party Payroll Reports



Tips for using 3rd party payroll reports:

- Work with inputs to get the FTEs to be reliable, since they are the most cumbersome to compute
- Consider use of Simplified Method (1.0 and 0.5)
- Tie wages out to payroll registers for a few individuals and in total, to ensure the correct payroll dates are being included

3rd Party Payroll Reports



Tips for using 3rd party payroll reports:

- 25% salary/hourly wage reductions are where we are seeing the most errors
- Use of hire/term dates in the formulas skews the result
- Prepare a separate analysis using the data provided by the 3rd party payroll provider

3rd Party Payroll Reports



Tips for using 3rd party payroll reports:

- Review individuals included in Table 2
- Look at the source data, which is usually a separate tab within the report, to see if it looks reasonable
- Pull out Owners from Tables 1 and 2 and report wages separately on Schedule A. Make sure Owners are excluded from base period FTE computations.

PPP Schedule A		
Line1	Enter Cash Compensation (Box 1) from PPP Schedule A Worksheet, Table 1:	3,192,461.06
Line2	Enter Average FTE (Box 2) from PPP Schedule A Worksheet, Table 1:	360.60
Line3	Enter Salary/Hourly Wage Reduction (Box 3) from PPP Schedule A Worksheet, Table 1:	92,288.85
Line4	Enter Cash Compensation (Box 4) from PPP Schedule A Worksheet, Table 2:	291,692.41
Line5	Enter Average FTE(Box 5) from PPP Schedule A Worksheet, Table 2:	23.90
Line6	Total amount paid by Borrower for employer contributions for employee health insurance:	63,469.45
Line7	Total amount paid by Borrower for employer contributions to employee retirement plans:	0.00
Line8	Total amount paid by Borrower for employer state and local taxes assessed on employee compensation:	3,975.71
Line9	Total amount paid to owner-employees/self-employed individual/general partners:	0.00
Line10	Payroll Costs (add lines 1, 4, 6, 7, 8, and 9):	3,459,309.78
Line11	Average FTE during the Borrower's chosen reference period:	356.60
Line12	Total Average FTE (add lines 2 and 5):	384.50
Line13	FTE Reduction Quotient (divide line 12 by line 11) or enter 1.0 if FTE Safe Harbor is met:	1.00

Providing an accurate calculation of the loan forgiveness amount is the responsibility of the borrower, and the borrower attests to the accuracy of its reported information and calculations on the Loan Forgiveness Application Form. Interim Final Rule, SBA Docket Number 2020-SBA-0038.

This report has been compiled with payroll data from [REDACTED] to assist you in applying for forgiveness for your SBA PPP loan. The accuracy of the report depends on the payroll data within [REDACTED] the information you provide, and the report options you choose. Work with your lender, attorney, and accountant to determine the correct options for your company.

By providing this report, [REDACTED] is not providing legal or accounting advice. It is incumbent upon you to understand and apply the interim final rules, FAQ, and other guidance provided by the US Treasury, SBA, and your lender in generating your report.

PPP Schedule A Worksheet

Table 1

				COMPUTED BY 3rd party		CONCEDED BY BORROWER	CONTESTED BY BORROWER
Employee's Name	Employee Identifier	Cash Compensation	Average FTE	Salary / Hourly Wage Reduction			
Mike	9999	2,322.40	0.3	295.68		295.68	
Carol	9999	660.53	0.0	7,908.45			7,908.45
Marcia	9999	0.00	0.0	16,473.84			16,473.84
Jan	9999	0.00	0.0	683.04			683.04
Cindy	9999	0.00	0.0	6,138.96			6,138.96
Greg	9999	0.00	0.0	1,369.68			1,369.68
Peter	9999	0.00	0.0	6,357.12			6,357.12
Bobby	9999	0.00	0.0	4,215.84			4,215.84
Alice	9999	0.00	0.0	13,024.32			13,024.32
Ross	9999	0.00	0.0	2,084.64			2,084.64
Chandler	9999	0.00	0.0	3,470.16			3,470.16
Joey	9999	0.00	0.0	12,644.88			12,644.88
Monica	9999	0.00	0.0	3,568.80			3,568.80
Rachel	9999	0.00	0.0	3,916.08			3,916.08
Phoebe	9999	0.00	0.0	10,137.36			10,137.36
Totals:		Box 1 2,982.93	Box 2 0.30	Box 3 92,288.85		295.68	91,993.17

To Schedule A

Loans and Loan Covenants

Loans and Loan Covenants

- Every borrower signed a full set of legally binding loan documents
- Loans prior to June 5, 2020 have a 2-year maturity, loans after have a 5-year maturity
- Loans with a 2-year maturity can be renegotiated to 5-years with the lender (lender does not have to)

Loans and Loan Covenants

- The Flexibility Act extended the payment deferral period to the date that the SBA remits the forgiveness amount to the lender
- The SBA will also remit accrued interest on the forgiven portion of the loan
- Infers the borrower will have to pay the accrued interest on any unforgiven portion

Loans and Loan Covenants

- If a company received an EIDL Grant/Advance – this was \$1,000 per employee up to \$10,000 - and it provides sufficient documentation to receive 100% forgiveness, the company will still end up with a PPP loan in the amount of the EIDL Grant/Advance.
- Not talking about EIDL loans, just the Grant/Advance

~~decision to SBA.~~ If applicable, SBA will deduct EIDL Advance Amounts from the forgiveness amount remitted to the Lender as required by section 1110(e)(6) of the CARES Act. ~~If SBA determines in the course of its review that the~~

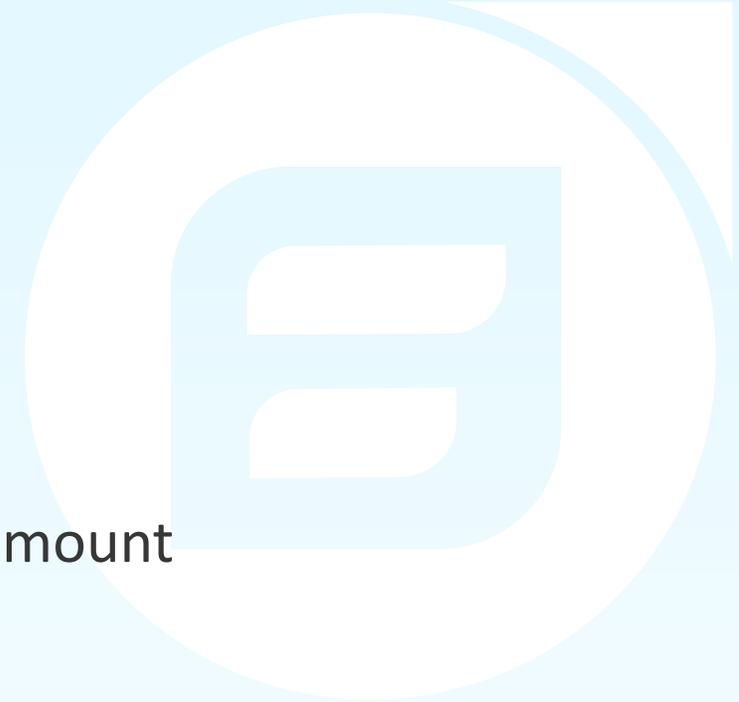
Loans and Loan Covenants



- Consider whether a PPP loan may be a violation of existing covenants on other debt:
 - PPP loan was from a different bank
 - PPP loan caused an interim ratio violation
 - Forgiveness might not happen by 12/31
- Discuss the PPP loan and any covenants with the lender and determine if a waiver for 2020 is needed, especially if a CPA is preparing compiled, reviewed or audited financial statements.

Potpourri

Potpourri



Mortgage interest and rent

- Amount claimed for interest or rent may not include any amount attributable to subleases
- Example: rent is \$10,000 per month, sublease is \$2,500 per month; only \$7,500 is includible
- Example: borrower owns the building, has a mortgage and subleases 25% (fair value) to an unrelated 3rd party; only 75% of the mortgage interest is includible

Potpourri

Related party rent

- Rent paid to a related party is an eligible covered cost, BUT only to the extent of the mortgage interest paid by the related party during the period
- No mortgage, no rent is includible
- Signed lease prior to 2/15/2020 is required

Potpourri



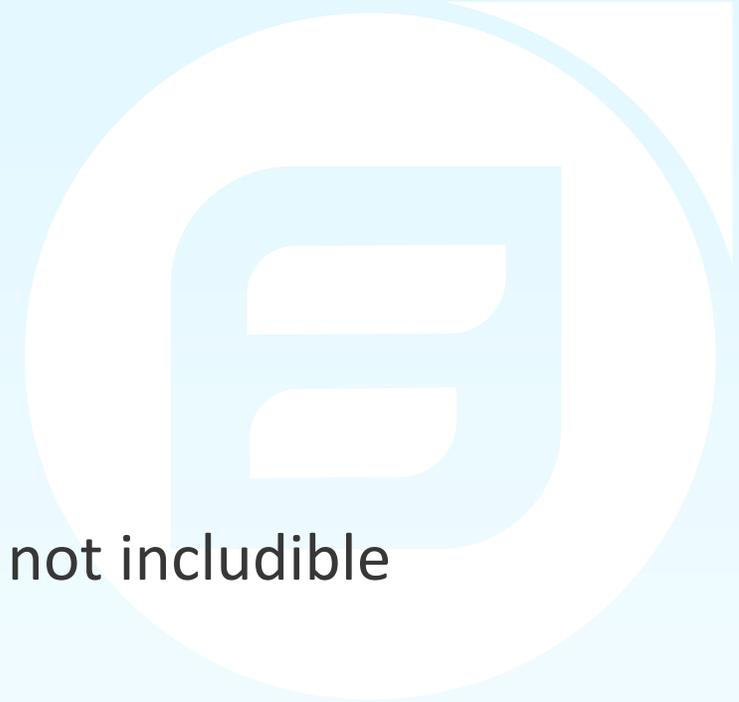
Owner restrictions

- Any reference to “Owner-employee” for S-corp and C-corp is owners with 5% or more stock ownership
- If an individual owns more than one business that received a PPP loan, the Owner compensation limit must be allocated among the loan forgiveness applications

Potpourri

Owner restrictions

- Health insurance premiums paid by the employer are not includible for 5%+ S-corp shareholders
- Compensation is limited
- Retirement plan contributions are limited



Q&A
