Four Steps to Maximize Your CARES Act PPP Loan Forgiveness

A key tool to help small businesses weather the COVID-19 storm is the CARES Act Paycheck Protection Program ("PPP") loan. The CARES Act allocates $349 billion to the PPP loan and as of April 16, 2020 the SBA indicated that this appropriation of funds has been fully utilized.

Don't worry - if your PPP Loan application was not processed by your bank or the SBA in time, you should still pursue filing an application as Congress is considering an expansion of the funding (potentially another $300B).

With many PPP borrowers having received their loan proceeds or expecting to receive them soon, borrowers should be planning now to take action in four critical areas. This will help ensure maximum loan forgiveness and should be on business owners' to-do list. Because the forgiveness rules are complex and financial modeling is essential, DGC has a team dedicated to calculating loan forgiveness and guiding business owners during this challenging time. The following summarizes our recommended next steps.

1. PPP Funds May be Used Only for Allowable Uses!

PPP loan recipients must certify that the funds will be used for purposes that are authorized under the CARES Act.

The SBA issued an Interim Final Rule on April 2, 2020 (which was subsequently updated) that requires PPP applicants to certify that the funds will be used to retain workers and maintain payroll or make mortgage interest payments (not principal payments), rent payments, utility payments and interest payments (not principal payments) on any other debt obligations that were incurred before February 15, 2020 (note only interest on mortgage debt is included in the loan forgiveness calculation discussed below).

While the PPP loan is not a recourse loan, if the PPP loan funds are used for unauthorized purposes, the loan can be converted into a recourse liability. In such cases, the SBA may be able to come after the loan recipient or its shareholders, members, or partners for an unpaid loan if they use the PPP funds for unauthorized purposes.

We recommend that recipients of PPP loans deposit the funds in a separate bank account to be used only for authorized expenses. This will help remind business owners that the loan funds are to be used only for specific authorized costs and also helps provide appropriate tracing of the funds. This separate account should not have cash management sweep features, which could sweep the funds for repayment of existing bank lines of credit and further complicate the audit trail.

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If the PPP loan funds have not been fully consumed by paying allowable costs during the 8-week period ending June 30, 2020 these funds are available for future use, but only for allowable costs incurred in subsequent months. It is important to remember that the certification to use the funds for allowable costs is for the life of the loan and does not end on June 30, 2020.

2. Develop A Deep Understanding of How The PPP Loan Forgiveness Rules Work!

The amount of loan forgiveness can be up to the full principal amount of the loan and any accrued interest. The loan will be eligible to be forgiven if the borrower uses all the loan proceeds for authorized costs during the eight-week period following the PPP loan funding. Authorized costs include payroll costs, payments of interest on mortgage obligations, rent, and utility payments. The mortgage, utility service, and rent agreements must have been in place before February 15, 2020. Compensation rates are also limited to $100,000 annualized per individual employee and partner during the eight-week period. The Interim Rule also provided guidance that not more than twenty-five percent of the loan forgiveness amount may be attributable to non-payroll costs. The allowable costs ratio aligns the calculation of the forgiveness amount to the core objective of the Act of keeping workers paid and employed.

The more complicated part of the forgiveness rules lies in understanding two additional tests for loan forgiveness:

1. Requirement to restore full time equivalent ("FTE") employee headcount and,
2. Restoration of salary and wage levels.

Knowing how these rules work will help you make proper business decisions to maximize the PPP loan forgiveness amount.

The first forgiveness test determines whether there is a forgiveness reduction related to whether you retained employees during the eight-week period. This is calculated based upon the quotient obtained by dividing the average number of FTE's per month (calculated by pay period) employed during the 8-week post funding period by, at the election of the borrower:

a. The average number of FTE's per month employed by the borrower for the period February 15, 2019 and ending on June 30, 2019; or
b. The average number of FTE's per month employed by the borrower for the period January 1, 2020 and ending on February 29, 2020.

If the result is 100% or greater, there is no reduction in loan forgiveness related to this test. Accordingly, if the result is less than 100%, then the loan forgiveness percentage is reduced to that result.

The second loan forgiveness reduction test looks at salary and wage levels during the eight-week post funding period. This appears to be an employee by employee calculation whereby the loan forgiveness amount will be reduced by the reduction in salary/wages during the eight-week period post funding that is in excess of 25 percent of the total salary or wages of the employee paid during the period January 1, 2020 to March 31, 2020. (This test does not apply to an employee who earned over $100,000 annualized in salary/wages during 2019.)

Reductions in loan forgiveness can be offset and create a benefit if any FTE or salary/wage reduction occurring during the period February 15, 2020 through April 26, 2020 is fully restored

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not later than June 30, 2020. However, if you wait to bring employees back until later in the eight-week post funding period, your payroll costs will be lower, resulting in a lower loan forgiveness amount.

3. Start to Organize Your Documentation Now!

Borrowers have to make decisions now on the timing of re-hiring employees and salary/wage levels and will need to understand how these decisions will impact the amount of PPP loan forgiveness. Preparing baseline data now is necessary to help ensure that the best business decisions are made. The most important data in formulating this assessment is employee census data. Frankly, payroll has the most significant impact on the loan forgiveness amount (target goal of 75% of the loan amount).

Key employee census data includes the following by pay period (in excel format):

a. Employee name (not social security number);
b. Salary & wage amounts;
c. Date of hire and termination;
d. Hours worked;
e. Names of employees whose principal place of residence is not in the United States;
f. Group health care costs (if not captured as part of payroll system);
g. Retirement costs (if not captured as part of payroll system); and
h. State unemployment costs.

Census data by pay period for the following time periods:

a. Calendar 2019;
b. January 1, 2020 to current date; and
c. Future pay periods through June 30, 2020.

Business owners may ask: Why calendar 2019 data and why by “pay period”?

As to the first question: Calendar 2019 employee census data is necessary because the salary/wage reduction does not apply to any employee who during any single pay period during 2019 made an annualized rate of pay in an amount more than $100,000. Borrowers need to know who counts in the salary/wage reduction calculations. Be careful as bonus amounts paid at year-end could result in an employee being excluded.

As to the second question: The “per pay period” is required for both the $100,000 annualized salary/wage amount and also the FTE determination.

It cannot be emphasized enough that it is imperative to “document, document, document.”

Borrowers will also need to maintain documentation of the use of their PPP funds. The CARES Act expressly requires that the borrower be able to adequately document the use of the funds in order to obtain forgiveness.

Borrowers will ultimately be required to submit a request for loan forgiveness to the lender that is servicing the loan. This documentation may include cancelled checks, payment receipts, transcripts of accounts, payroll returns (941 & 940) and other documentation. Certain payroll costs such as employer paid group health benefits and retirement costs may not be maintained in the payroll system so external third-party documentation will be required.

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4. Work Closely with Accounting Professionals to Maximize the Forgivable Amount!

Borrowers need to work closely with accounting professionals to ensure that they maximize the forgivable amount of the loan. As discussed above, the forgiveness rules are complex and there is a lot of data analysis required to help organize the data into an actionable format. Accountants understand complex financial data sets and are well positioned to be an advisor on creating "what if scenarios" to help business owners make the best decisions. Financial modeling will become an important tool in the decision-making process.

Accounting professionals are also closely monitoring guidance updates from the Treasury Department and SBA. There are a lot of unanswered questions that need to be addressed by the SBA which will be important for you to understand in real time. We are ready to help provide you with the advice you need and in a timely fashion.

This article was drafted on April 18, 2020 and future Treasury and/or SBA guidance may change the analysis contained herein.

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