

The following is a general discussion of the PPP loan forgiveness rules under Section 1106 of the CARES Act (“Act”). As of the date of this memo, the only guidance available is the law itself, interim rules issued on April 2nd and April 14th, and a list of FAQs. The Act requires Treasury to issue additional guidance by April 26th, but it has not done so at this time.

For purposes of this discussion we are assuming that all amounts spent during the 8-weeks after the initial disbursement by the lender are spent for covered costs and the only question is the amount of loan forgiveness. The definition of covered costs for purposes of loan forgiveness can be found in Section 1106(b) of the Act.

General Rules

The amount of loan forgiveness can be up to the full principal amount of the loan and any accrued interest. That is, the borrower will not be responsible for any loan payment if the borrower uses all the loan proceeds for covered costs and employee headcount and compensation are maintained at levels that avoid the cut back rules discussed below.

SBA Added 75% Rule

While the law allows the loan to be spent in any proportion on covered costs, the SBA in consultation with the Secretary determined that not more than 25% of the loan forgiveness amount can be attributable to non-payroll (rent, utilities, and mortgage interest) costs. The SBA and the Secretary believe that applying this threshold to loan forgiveness is consistent with the structure of the Act, which provides a loan amount 75 percent of which is equivalent to eight weeks of payroll (8 weeks / 2.5 months = 56 days / 76 days = 74 percent rounded up to 75 percent).

Cut Back Rules

The loan forgiveness amount will be reduced if the employer did not maintain staffing levels or payroll amounts. Both reductions can apply.

FTE Reduction Cut Back

The loan forgiveness amount is limited to the average number of full-time equivalent employees per month over the 8-week period divided by, at the election of the borrower,

- The average number of full-time equivalent employees per month during the period February 15, 2019 to June 30, 2019, or
- The average number of full-time equivalent employees per month during the period January 1, 2020 to February 29, 2020.

Seasonal employers are required to use the period February 15, 2019 to June 30, 2019.

The average number of full-time equivalent employees per month shall be determined by calculating the average number of full-time equivalent employees for each pay period falling within a month.

Example:

\$1 million PPP loan all spent on eligible costs. 90 FTEs during the 8-week period, 110 FTEs during the period February 15, 2019 to June 30, 2019, and 100 FTEs during the period January 1, 2020 to February 29, 2020. Borrower would elect to calculate the forgiveness reduction as: $90 \text{ FTEs} / 100 \text{ FTEs} = 90\% \times \$1 \text{ million} = \$900,000$ forgiveness cap, subject to the second cut back test, below.

> 25% Wage Reduction Cut Back

For any employee who did not earn more than \$100,000 of wages or salary, on an annualized basis, during any payroll period in 2019, the loan forgiveness amount will also be reduced dollar for dollar for any reduction in wages or salary during the 8 week period that is more than 25% of the wages or salary paid to that employee during the most recent full quarter prior to the 8 week period. This is tested on an employee-by-employee basis, not on all the employees as a group.

Based on the above definition, an employee making \$75,000 a year who is paid every 2 weeks and received a \$1,000 bonus in one pay period would be excluded $(\$2,885 + \$1,000) \times 26 = \$101,010$.

Rehire Rules

Any reduction in employee headcount or wage levels made between February 15, 2020 and April 26, 2020, will be not included in the above loan forgiveness cutback rules, provided employer has eliminated the reduction in the number of full time equivalent employees and has restored the salary or wages of 1 or more employees not later than June 30, 2020.

Under the rehire rules, there is no requirement to hire back the same employees to meet the full-time equivalent headcount rules. However, the wage restoration rules apply on an employee by employee basis.

How to Request Loan Forgiveness

A borrower will submit a request to the lender that is servicing the loan. We believe that the forgiveness request can be submitted as soon as the loan funds have been fully expended, or after the end of the 8-week covered period. The request will include documents that verify the number of full-time equivalent employees and pay rates, as well as the payments on eligible mortgage, lease, and utility obligations. The borrower must certify that the documents are true and that you used the forgiveness amount to keep employees and make eligible mortgage interest, rent, and utility payments.

For purposes of loan forgiveness, the borrower will have to document the proceeds are used for covered costs and at least 75% was used for payroll costs in order to determine the amount of forgiveness. Proceeds from any EIDL advance up to \$10,000 on the EIDL loan will be deducted from the loan forgiveness amount on the PPP loan.

The lender must make a decision on the forgiveness within 60 days. Reminder- the ability to defer the employer share of payroll taxes ends at the time the lender provides the loan forgiveness amount. The timing of the end of the deferral will be driven in part by when the borrower chooses to submit its request for forgiveness, since that starts the lender's review process.

When Does the 8-Week Covered Period Begin?

The eight-week period begins on the date the lender makes the first disbursement of the PPP loan to the borrower. The first disbursement of the loan must be made no later than ten calendar days from the date of loan approval.

What Questions are Unanswered

1. During the 8-week period how are the covered costs measured. Section 1106(b) includes the following- “the following costs incurred, and payments made during the covered period”. If this is read conservatively, then covered payroll costs will be reduced at the beginning and end of the covered period.
2. How to measure full time equivalent employees.
3. Seasonal Employer – Do we know technically what a seasonal employer is and when the line is crossed to use seasonal employer calculations?
4. Is the \$100,000 wage or salary per annualized 2019 period going to be changed or clarified under expected forthcoming guidance?
5. In determining 2019 annualized wages or bonuses, will one period payments, e.g. bonuses, be excluded from the calculation?
6. What is the order of the cut back rules, does one apply before the other and how and when does the 75% overall limitation get applied?
7. Cut Back Dollar Reduction – A literal interpretation of the statute 1106(d)(3)(A) says that the 25% pay reduction threshold is tested by comparing salary during the covered period of 8 weeks to the full prior quarter which would be approx. 13 weeks. Does not say to compare RATE of pay, but simply total pay. With all things constant, every employee would have a reduction greater than 25% when comparing amount of wages earned in 8 weeks compared to 13 weeks.
8. Will Treasury change/clarify the wage reduction test to be based on overall payroll costs vs. on an employee by employee basis.
9. Rehire – Any requirement to keep number of employees or level of pay beyond June 30th?
10. Rehire – Wage Restoration Amount – “...eliminated the reduction...” Does this mean which of the following –
 - a. That the full dollar value of the pay cut is paid to employee? -or-
 - b. That the annual salary level is restored, without any consideration for the reduced wages from 2/15 to date of restore? Also - Restore back to full wage prior to 2/15 or restore back to at least 75% of wage prior to 2/15?
11. The law says the loan forgiveness is not included in income. Will the IRS apply IRC 265, 108 or some other provision to say the expenses related to the forgiven amount are not deductible or that other tax attributes need to be reduced.
12. The employee headcount reduction rule needs to be rewritten to achieve the desired result by Congress.

This memo is for general guidance only. It is not a substitute for consultation with your tax advisor. This memo is based on the law in effect as of the date of the memo. As noted, there are many unanswered questions regarding the loan forgiveness calculation. Wipfli LLP does not undertake any obligation to update the memo for subsequent changes to the law.