PAYCHECK PROTECTION PROGRAM

Issues and Complications

American Academy of Attorney-CPAs - April 6, 2020

Presenters for AAA-CPA

- Daniel S. Rosefelt,
- Chair, Education Committee, American Academy of Attorney-CPAs
- Daniel Rosefelt & Associates LLC 4800 Hampden Ln. Suite 200, Bethesda MD 20814
- drosefelt@RosefeltLaw.com Direct (301) 358-5830

- William LeVay,
- President, American Academy of Attorney-CPAs
- FCA Corp. 791 Town & Country Blvd. Suite 250, Houston Texas 77024-3925
- wlevay@fcacorp.com Direct (713) 260-1440

PPP resources:

<u>Links</u>

- SBA Paycheck Protection Program
- AICPA Coalition Recommends PPP Applicants Use Gross Payroll Approach in Calculations
- AICPA Update on PPP Calculations under the CAREs Act
- U.S. Treasury PPP Assistance for Small Businesses

<u>Attachments</u>

- CARES Act PPP provisions
- SBA PPP Interim Rule
- PPP Application Form 2483
- US Treasury PPP Fact Sheet
- US Treasury FAQ

CARES Act:

On March 27, 2020, the President signed the Coronavirus Aid, Relief, and Economic Security Act (the **CARES Act**) to provide emergency assistance and health care response for individuals, families, and businesses affected by the coronavirus pandemic.

- **Key Features:**
- **Paycheck Protection Program (PPP)** cover costs of retaining employees and certain business expenses.
- **Emergency Economic Injury Disaster Loans (EIDL)** and Emergency Economic Injury **Grants** can provide a quick infusion of up to $10,000 with in 3 days of applying for an EIDL **.**
- **Small Business Debt Relief Program** assists in keeping up with payments on current or potential SBA loans.

CARES Act: Payroll Protection Program History

Key points to remember:

- Senate version - Small Business Interruption Loans
- Final version– Payroll Protection Program signed March 27th by the President
- U.S. Small Business Administration – Interim Final Rule was issued April 3rd to implement PPP
- PPP Borrow Application Form 2484 current version is (04/20)
- SBA is authorized to guarantee $350 billion of PPP loans through June 30, 2020.

CARES Act: Payroll Protection Program

- **The Small Business Administration** (SBA) received funding and authority through the Act to modify existing loan programs and establish a new loan program to assist small businesses nationwide adversely impacted by the COVID-19 emergency.
- **Section 1102** of the Act permits SBA to guarantee loans under a new program titled the "**Paycheck Protection Program.**"
- **Section 1106** of the Act provides for **forgiveness** of up to the full principal amount of qualifying loans **guaranteed** under the **Paycheck Protection Program.**
- The SBA issued an **interim final rule** as published in the federal register to implement Sections 1102 and 1106 of the CARES Act in.

SBA Interim Final Rule

(Effective April 2, 2020)

What Borrowers Need to Know and Do?

PPP Loan Eligibility:

- If you have **500 or fewer employees**;
- Whose principal place of **residence is in the United States**; or
- A business that operates in a certain industry and meet the applicable SBA employee-based **size standards for that industry**;
- You are a **small business concern** defined in section 3 of the SBA Act;
- An IRC 501(c)(3) **tax-exempt nonprofit organization**; IRC 501(c)(19) **Veterans organization**; SBA 31(b)(2)(C) **Tribal business**; or any other **business**; and
- You were **in operation on February 15, 2020** and either had employees for whom you paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC.

What Borrowers Need to Know and Do?

PPP Loan Eligibility also includes:

- If you are an individual who operates as a **sole proprietorship**, an **independent contractor** or **eligible self- employed individual**, and was in operation on **February 15, 2020.**
- You must also submit **documentation** as necessary to establish eligibility such as payroll records, payroll tax filings, or Form 1099- MISC, or income and expenses from a sole proprietorship.
- Borrowers that do not have such documentation must provide **other supporting documentation**, such as bank records, sufficient to demonstrate the qualifying payroll amount.

Paycheck Protection Program Borrower entities

PPP Borrower Application Form 2483:

Check One: ☐ Sole proprietor ☐ Partnership ☐ C-Corp ☐ S-Corp ☐ LLC

☐ Independent contractor ☐ Eligible self-employed individual

☐ 501(c)(3) nonprofit ☐ 501(c)(19) Veterans organization

☐ Tribal business (sec. 31(b)(2)(C) of Small Business Act) ☐ Other

Caution: Different PPP filing dates: 4/3 for Sole proprietors & 4/10 for SE individuals & Independent contractors.

You are <u>in</u>eligible for a PPP Loan if:

- You are engaged in any activity that is **illegal** under federal, state, or local law;
- You are merely a **household employer**;
- An owner of 20 percent or more owner with **criminal record**; or
- **Delinquent** SBA or federal borrower.

How much can I borrow?

The maximum PPP loan amount is the lesser of:

- $10 million or
- An amount calculated using a payroll-based formula specified in the Act.

How to calculate maximum amount I can borrow?

Step 1: Aggregate **payroll costs** from the last 12 months for employees whose principal place of residence is the United States. *Caution: 2019 calendar year should be used. The instructions for Form 2483 direct the applicant to use 2019 calendar year. The Interim Rule advises Lenders to use the calendar for verification. Also, AICPA advises to use 2019 calendar year.*

Step 2: Subtract any compensation paid to an employee in **excess of an annual salary** of $100,000 and/or any amounts paid to an independent contractor or sole proprietor in excess of $100,000 per year. ***Caution:*** *Only the independent contractor gets benefit of these on their own PPP application.*

Step 3: Calculate **average monthly payroll costs** (divide the amount from Step 2 by 12).

Step 4: Multiply the average monthly payroll costs from Step 3 **by 2.5.**

Step 5: Add the outstanding amount of an Economic Injury Disaster Loan (**EIDL**) made between January 31, and April 3, 2020, **less** the amount of any "**advance**" under an EIDL COVID-19 **[grant]** (because it does not have to be repaid).

Caution: See PPP provisions in the CARE Act for alternate payroll cost dates to aggregate for seasonal workers and those not in business on February 15, 2019.

Our Example: (Interim Rule has more Examples)

- **Annual payroll:** $1,500,000
- $150k per year employee <u>worked only 9 months</u>
- **Subtract compensation amounts in excess** of an annual salary of $100,000:
- Actual Salary received $112,500,
  - *Annual max prorated $100,000/12*9 = $75,000*
  - *Excess $112,000 -75,000 = $37,000* ***to be subtracted***
- **Average monthly qualifying payroll:**

  ($1,500,000 -37,000)/12 = $121,917
- **Multiply by 2.5** = $304,792
- **Maximum loan amount** is $304,792

What qualifies as "payroll costs?"

- Compensation to US employees in the form of salary, wages, commissions, or similar compensation;
- Cash **tips** or the equivalent (based on employer records or good-faith estimate;
- Payment for vacation, parental, family, medical, or sick leave;
- Allowance for separation or dismissal;
- Payment for the provision of employee benefits consisting of **group health** care coverage, including insurance premiums, and **retirement;**
- Payment of **state and local taxes** assessed on compensation of employees; and
- For an independent contractor or sole proprietor, wage, commissions, income, or net earnings from self-employment or similar compensation.

Caution: The last item is not a payroll cost to an employer; instead, this is the allowable payroll cost/income of a SE person on their own PPP loan application.

Excluded from Payroll Costs Definition:

- Compensation of non-US employee whose principal place of residence is **outside of the United States;**
- Compensation of an individual in **excess of an annual salary of $100,000, prorated as necessary;**
- **Qualified sick and family leave wages for which a credit** is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act;
- Federal employment taxes imposed or withheld **between February 15, 2020 and June 30, 2020**, including the employee's and employer's share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees.

Caution: Payroll taxes should not be excluded if calendar year 2019 is used for computing average payroll cost. More to follow on this . . .

Do independent contractors count as employees for purposes of PPP loan calculations?

No, independent contractors have the ability to apply for a PPP loan on their own, so they do not count for purposes of a borrower's PPP loan calculation.

What are the PPP loan terms?

- The interest rate will be one percent. Down from 4% in the Senate bill, but up from 0.5%.
- Loan is deferred until six months following disbursement. Interest will still accrue.
- The maturity is two years in the Interim Rule, even though the Act is up to 10 years.
- Only one PPP loan per eligible borrower.

Is there enough money?

- *PPP is "first-come, first-served?"*
- $349 billion of PPP loan funds available.
- Per the US Treasury:
  - *Starting April 3, 2020, small businesses and sole proprietorships can apply.*
  - *Starting April 10,2020, independent contractors and self-employed individuals can apply.*
  - *We encourage you to apply as quickly as you can because there is a funding cap.*

Can the PPP Loan be forgiven in whole or in part?

- Yes. Loan forgiveness can be up to the full PPP principal and accrued interest;
- Depends on:
  - *Total amount of payroll costs,*
  - *Payments of interest on mortgages,*
  - *Rent payments on leases*
  - *Utility payments under service agreements dated before February*

Loan Forgiveness: 75% must be for payroll (Per the SBA Interim Rule)

- Not more than 25 percent of the loan forgiveness amount may be attributable to non- payroll costs.
- The Administrator has determined in consultation with the Secretary that 75 percent is an appropriate percentage for payroll costs in light of the Act's overarching focus on keeping workers paid and employed.
- This 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).

Caution: This is in the SBA Interim Rule but not the PPP Act.

Do independent contractors count as employees for purposes of PPP loan forgiveness?

No, independent contractors have the ability to apply for a PPP loan on their own, so they do not count for purposes of a borrower's PPP loan forgiveness.

Proceeds of PPP can be used for:

- Payroll costs (as defined in the Act and in the Interim Rule);
- Group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- Mortgage interest payments (but not principal payments);
- Rent payments;
- Utility payments;
- Interest payments on any other debt obligations that were incurred before February 15, 2020 (*Observation: This is not listed as a use for forgiveness in Act*;) and/or
- Refinancing an SBA EIDL loan made between January 31st and April 3, 2020.

Strategic issue: Borrowers need to have a plan: Best to use proceeds to stay in business vs. spending 75% of funds in 8 weeks to obtain forgiveness.

Tip: Best to set up a designated PPP bank account and reimburse the business for authorized PPP expenditures.

SBA EIDL and PPP Loans:

- If you received an SBA loan from January 31, 2020 through April 3, 2020, you can apply for a PPP loan.
- If your EIDL loan was not used for payroll costs, it does not affect your eligibility for a PPP loan. If your EIDL loan was used for payroll costs, your PPP loan must be used to refinance your EIDL loan.
- Proceeds from any advance up to $10,000 on the EIDL loan will be deducted from the loan forgiveness amount on the PPP loan.

If PPP loan funds are used for unauthorized purposes:

- SBA will direct you to repay those amounts.
- If you knowingly use the funds for unauthorized purposes, you will be subject to additional liability such as charges **for fraud**.
- If one of your shareholders, members, or partners uses PPP funds for unauthorized purposes, SBA will have **recourse against the shareholder,** member, or partner for the unauthorized use.

Certifications need to be made:

PPP application form 2483 requires an authorized representative of the applicant must certify in good faith.

What Do Lenders Need to Know and Do?

Confirm the dollar amount of average monthly payroll ***costs for the preceding calendar year*** *by reviewing the payroll documentation submitted with the borrower's application (per the Interim Rule).*

What forms do I need and how do I submit an application?

The applicant must submit SBA Form 2483 (Paycheck Protection Program Application Form version (04/20).

What do Both Borrowers and Lenders Need to Know and Do?

- Lenders do not have to apply the “credit elsewhere test
- The guarantee percentage is 100 percent.
- No collateral will be required.
- No personal guarantees will be required.
- All loans will be processed by all lenders under delegated authority and lenders will be permitted to rely on certifications of the borrower in order to determine eligibility of the borrower and the use of loan proceeds.

PPP Issues and Complications

Interim Final Rule and The CAREs Act on Payroll Cost and withholding

- The Cares Act
  - *Payroll cost shall not include:*
  - *''(bb) taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code of 1986 during the covered period;*
  - *''(iii) the term 'covered period' means the period beginning on February 15, 2020 and ending on June 30, 2020;*
- Interim Final Rule:
  - *Expressly excluded from the definition of payroll costs:*
  - *Federal employment taxes imposed or withheld between February 15,2020 and June 30, 2020, including the employee's and employer's share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees;*

Tip: This is not an issue if you use calendar year 2019 to compute average payroll cost.

PPP Strategic Considerations:

Threshold issue:

- *Is the goal to stay in business? If so, may be best to use proceeds for rent and other allowable costs, and not to seek PPP forgiveness. Instead, let the PPP become a loan a 1% and use the funds to keep the business in mothballs until the economy starts up.*
- *If seeking forgiveness, borrower needs to spend 75% of funds in 8 weeks after getting the PPP loan in order to obtain forgiveness. This may not work or help many businesses.*
- *Borrowers need to address "going concern issue" and have a plan.*

AICPA now agrees with using the gross for payroll cost now withholding

- For the calculation of the average monthly payroll cost, applicants should use gross payroll (including tax expenses) — based on 2019 data — for the PPP loan application and forgiveness.
- Our recommendation is based upon both the word and intent of the law. Neither the CARES Act itself nor the guidance the Small Business Administration (SBA) released Thursday evening specifically stated that payroll taxes should be excluded from the calculation. Additionally, based upon statements from members of Congress, it appears that the intent of the Act was to base the salary calculation on gross payroll with no adjustment for federal taxes. This ensures that payroll tax expenses are not passed on to the small businesses in need.

Caution: AICPA earlier loan calculators did not use gross wages.

Sole proprietor vs. Eligible Self-employed Individual

- The PPP requires Sole Proprietor certification that the “uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient”, but
- The PPP defines “eligible self-employed individual” by cross reference to the meaning given section 7002(b) of the Families First Coronavirus Response Act (FFCR) and requires that an <u>individual:</u>
  - In quarantine subject to an official order.
  - Been told to self-quarantine by a health provider,
  - Be symptomatic and be seeking a medical diagnosis;
  - or is caring for someone in quarantine a student of a closed school or day care cent
  - or is experiencing other substantially-similar condition

  Caution: If a PPP applicant first applied for FFCR as an eligible self-employed individual, they may need to file the same under PPP and be stuck with a later filing date of April 10th vs. April 3rd.

Reduction for PPP Forgiveness Based on Reduction in Number of Employed under the Cares ACT:

Loan forgiveness shall be reduced by the percentage equal to the difference obtained by subtracting . . . (i) the quotient obtained by dividing—

- (I) the average number of full-time equivalent employees per month employed by the eligible recipient during the covered period; by
- (II) (aa) the average number of full-time equivalent employees per month employed by the eligible recipient during the period beginning on March 1, 2019 and ending on June 30, 2019; or
- (bb) in the case of an eligible recipient that is seasonal employer, as determined by the Administrator, the average number of full-time equivalent employees per month employed by the eligible recipient during the period beginning on March 1, 2019 and ending on June 30, 2019; from (ii) 1.

Caution: This is in the CARES Act but omitted in the SBA Interim Rule.

Reductions to PPP Foregiveness Based on Reduction in Number of Employed under the Cares ACT:

Loan Forgiveness Reduction for FTE Employee Headcount:

$$Forgiveness\ eligible\ costs \times \frac{Avg.FTE\ Employees\ per\ Month\ During\ the\ Covered\ Period}{Avg.FTE\ Employees\ per\ Month\ Feb.15{,}2019 - June\ 30{,}2019} = Forgiveness$$

Caution: This is in the PPP Act, but not the SBA Interim Rule.

Reductions in PPP Forgiveness Relating to Salary & Wages in the CARES Act:

- (A) IN GENERAL.—The amount of loan forgiveness under this section shall be reduced by the amount of any reduction in total salary or wages of any employee described in subparagraph (B) during the covered period that is in excess of 25 percent of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the covered period.
- An employee described in is any employee who did not receive during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than$100,000.

Caution: See the U.S. Treasury Fact Sheet which excludes employees paid in excess of $100k per year; also, this is not in the SBA Interim Rule. Also, the most recent full quarter will likely be first quarter 2020. Compares a 25% reduction in 13-week quarter to a reduction in 8 weeks following issuance of the PPP loan. This is problematic apples and oranges.

Can I charge my client for preparation of the loan application?

AICPA

- No, "Agent fees will be paid out of lender fees. The lender will pay the agent. Agents may not collect any fees from the applicant." per Department of Treasury
- But - "If a CPA firm is charging fees for advising the small business in deciding which loan program and tax relief program is best for their business, we think it is reasonable that those fees would fall outside this provision of the CARES Act. Thus, a firm can perform services outside of loan preparation assistance, and those fees would be paid by the client." AICPA
- But AICPA says many CPA firms are not charging.
  - *Client relations*
  - *Application is simple only hard part is "average monthly payroll costs"*
  - *Payroll companies are not charging for providing the data*
  - *PPP ask for self certification*

PPP Agent Fees

- Lenders may not collect any fees from the applicant.
- Who can be an agent? An agent is an authorized representative and can be:

  ☐ An attorney; ☐ An accountant; ☐ A consultant; ☐ Someone who prepares an applicant's application for financial assistance and is employed and compensated by the applicant; ☐ Someone who assists a lender with originating, disbursing, servicing, liquidating, or litigating SBA loans; ☐ A loan broker; or☐ Any other individual or entity representing an applicant by conducting business with the SBA.

How will agents be compensated? Agent fees will be paid out of lender fees. The lender will pay the agent. Agents may not collect any fees from the applicant. The total amount that an agent may collect from the lender for assistance in preparing an application for a PPP loan (including referral to the lender) may not exceed:

- One (1) percent for loans of not more than $350,000;
- 0.50 percent for loans of more than $350,000 and less than $2 million; and
- 0.25 percent for loans of at least $2 million.

US Treasury Site – Confusion on Self-Employment and PPP Filing Dates.

Per the U.S. Treasury:

- Small Businesses are Eligible and uses term “self-employed individuals” without the “eligible” modifiers as used in the CARES Act.
- When to Apply:

  Starting April 3, 2020, small businesses and sole proprietorships can apply.

  Starting April 10, 2020, independent contractors and self-employed individuals can apply, but omits the term “eligible” which is what is on the form. This may be a trap for many who have not applied for FFCR.

U.S. Treasury - Only FAQ Issued:

- Question: … PPP Interim Final Rule states that lenders must "[c]onfirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application." Does that require the lender to replicate every borrower's calculations?
- Answer: **No.** Providing an accurate calculation of payroll costs is the responsibility of the borrower, and the borrower attests to the accuracy of those calculations on the Borrower Application Form. Lenders are expected to perform a good faith review, in a reasonable time, of the borrower's calculations and supporting documents concerning average monthly payroll cost. For example, minimal review of calculations based on a payroll report by a recognized third-party payroll processor would be reasonable. In addition, as the PPP Interim Final Rule indicates, lenders may rely on borrower representations, including with respect to amounts required to be excluded from payroll costs. If the lender identifies errors in the borrower's calculation or material lack of substantiation in the borrower's supporting documents, the lender should work with the borrower to remedy the issue.

Thank you for listening.