Important New Details on PPP Loan Forgiveness

On August 4, 2020, the U.S. Small Business Administration (SBA) issued a set of frequently asked questions addressing loan forgiveness on its Paycheck Protection Program (PPP). The document incorporates several previously announced details, but several new clarifications were added that are highlighted below.

General Loan Forgiveness

- Sole proprietors, independent contractors, and self-employed individuals automatically qualify to use Form 3508EZ and should complete that application if the individual had no employees at the time of the PPP loan application and did not include any employee salaries in the computation of average monthly payroll in the Borrower Application Form.
- When a loan is fully forgiven, the borrower is not responsible for any loan interest.
- If a loan is partially forgiven, or if the forgiveness application is denied, any remaining balance must be repaid on or before the loan’s maturity date. Interest is accrued immediately after loan disbursement through the SBA’s remittance of the forgiveness amount. The borrower is responsible for paying accrued interest on any loan amount that is not forgiven. The lender must notify the borrower of the SBA’s remittance of the loan forgiveness amount (or that the SBA determined that no amount of the loan is eligible for forgiveness) and the date on which the borrower’s first payment is due.

Payroll Costs

- Payroll costs incurred during the Covered Period¹ (CP) or Alternative Payroll Covered Period² (APCP) but paid after the end of the CP are eligible for forgiveness if paid by the next regular payroll date.
- Payroll costs incurred before the CP but paid during the CP are eligible for loan forgiveness.
- Borrowers that pay employees twice a month or less frequently will have to calculate payroll costs for partial pay periods, i.e., borrowers will have to prorate payrolls that straddle the end of the CP or APCP.
- Payroll costs include all forms of cash compensation paid to employees, including tips, commissions, bonuses, and hazard pay. (Forgivable cash compensation per employee is limited to $100,000 on an annualized basis.)
- Loan forgiveness is not provided for group health benefits accelerated from periods outside the CP or APCP. Only the portion of the premiums paid by the borrower for coverage during the CP or APCP is included for loan forgiveness. In addition, any portion or health benefits paid by employees or beneficiaries are ineligible for loan forgiveness.
- Loan forgiveness is not provided for retirement benefits accelerated from periods outside the CP or APCP or for any portion of retirement benefits deducted from employees’ pay or paid by employees.
- If an owner is employed by more than one borrower, compensation is capped across all businesses he or she has an ownership stake in at $20,833 ($15,385 for borrowers that received a PPP loan before June 5, 2020) and are using an eight-week CP. However, an owner can allocate the capped amount across the different businesses. The owner compensation cap for loan forgiveness is further limited as follows:

¹ The CP is either the 24-week (168-day) period beginning on the PPP loan disbursement date, or if the borrower received its PPP loan before June 5, 2020, the borrower may elect to use an eight-week (56-day) CP.
² Borrowers with a biweekly (or more frequent) payroll schedule may elect to calculate eligible payroll costs using the 24-week (168-day) period (or for loans received before June 5, 2020, at the election of the borrower, the eight-week (56-day) period) that begins on the first day of their first pay period following their PPP loan disbursement date.
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- C Corporations – Cash compensation limited to 2.5/12th of 2019 cash compensation. Retirement and health benefits are in addition to the cap amounts; however, employer retirement contributions are limited to 2.5/12th of the 2019 employer retirement contribution.
- S Corporations – Same as C Corps except that for a 2 percent or more shareholder, cannot include health benefits as those are included in the cash compensation amount for those owner employees. Noncash compensation should be reported on lines seven and eight on Form 3508 and not part of cash compensation.
- Self-Employed Schedule C or F – Limited to 2.5/12th of the amount reported by the borrower on its 2019 Schedule C or F if submitted with the loan application. If it was not submitted, it must be submitted with the forgiveness application. It cannot include health insurance or retirement benefits.
- General Partners – Limited to 2.5/12th of their 2019 self-employment earnings shown on Box 14a (reduced by any Section 179 expense in Box 12, any unreimbursed partnership expenses deducted, and by certain depletion deductions), the net of which is multiplied by .9235. Cannot include a partner’s health or retirement benefits. **Compensation is only eligible for loan forgiveness if the payment to partners is made during the CP or APCP.**

This may require further clarification. Unless a partner is receiving guaranteed payments (partner equivalent of salary), there is no payment made; each partner just reports their allocable share of the partnership’s earnings.

- LLC owners - LLC owners must follow the instructions that apply to how their business was organized for tax-filing purposes for tax year 2019, or if a new business, the expected tax filing situation for 2020.

Nonpayroll Costs

**The APCP only applies to payroll costs. The CP always starts on the PPP loan disbursement date.**

- Nonpayroll costs incurred prior to but paid during the CP are eligible for forgiveness. Eligible costs include mortgage interest, business rent or lease payments, and utility charges.

A borrower’s 24-week CP runs from April 20 through October 4. On May 4, the borrower receives its April electricity bill and pays it on May 8. Although a portion of the electricity costs were incurred before the CP, these electricity costs are eligible for loan forgiveness because they were paid during the CP.

- Nonpayroll costs incurred during the CP but paid after the end of the CP are eligible for forgiveness if they are paid on or before the next regular billing date.

A borrower’s 24-week CP runs from April 20 through October 4. On October 6, the borrower receives its September electricity bill and pays it on October 16. These electricity costs are eligible for loan forgiveness because they were incurred during the CP and paid on or before the next regular billing date (November 6).

- Interest on unsecured credit is not eligible for loan forgiveness because the loan is not secured by real or personal property. Interest on unsecured credit incurred before February 15, 2020, is a permissible use of PPP loan proceeds but is not eligible for forgiveness. Interest on mortgages on real or personal property, e.g., auto loans, are eligible for loan forgiveness.

- Payments on renewed leases or refinanced mortgages are eligible for loan forgiveness if the obligation existed prior to February 15, 2020, and was renewed or refinanced during the CP.

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This treatment follows the computation of self-employment tax from IRS Form 1040 Schedule SE Section A line 4 and removes the "employer" share of self-employment tax, consistent with how payroll costs for a partnership's employees are determined.
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- A service for the distribution of transportation refers to transportation utility fees assessed by state and local governments. Payment of these fees by the borrower is eligible for loan forgiveness.

Loan Forgiveness Reductions

- The FTE Reduction Exception line in Table 1 of the PPP Schedule A should include all employees—even those who earn more than $100,000 in 2019 and are listed in Table 2 of Schedule A.
- Several examples were included for the calculation of the reduction in loan forgiveness amounts resulting from reductions in employee salary or hourly wage.
- Overtime and supplemental payments are not considered in determining a 25 percent wage reduction, only wages and salaries.

Conclusion

BKD will continue to follow this developing situation. As with most topics related to COVID-19, changes are being made rapidly. Please note that this information is current as of the date of publication. Visit BKD’s COVID-19 Resource Center to learn more. If you have questions about these changes, contact your BKD Trusted Advisor™ today.

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