PAYROLL PROTECTION PROGRAM- *AFTER* THE ENACTMENT OF THE ECONOMIC AID ACT

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Traditional values, innovative ideas

ECONOMIC AID TO HARD - HIT SMALL BUSINESSES, NONPROFITS AND VENUES ACT

On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act (the Act) became law as a part of the Consolidated Appropriations Act, 2021.

The Act provides $284.5 billion of additional funding for the Paycheck Protection Program (PPP2) through the U. S. Small Business Administration (SBA).

As of March 3, 2021, 2.4 million loans were approved and there is $120 billion still available for loans.

PPP2 loan process differs significantly from the first round because there is a verification process at the time of application to deter fraudulent applications. 20-25% of PPP loan applications meet challenges being processed by the SBA E-Tran loan system. There is the potential for 65 different error codes that can take weeks for the borrow to clear.

ELIGIBILITY

Any of the following businesses that were in operation on February 15, 2020

- Businesses, non-profit organizations, veteran's organizations or Tribal businesses with less than 500 employees
- Sole proprietors, independent contractors, and self-employed persons- excludes individual partners in a partnership
- Business with a NAICS code that begins with "72" that has more than one location and employees less than 500 per location (accommodations and food service
- 501(c)(6) with fewer than 300 employees (subject to lobbying cost limits)
- Local newspapers, TV and radio stations (NAICS codes that begin with 511110 or 5151, subject to limitations on media content)
- Housing cooperatives with 300 or fewer employees

AFFILIATION RULES

For PPP2 loan eligibility purposes, entities are subject to the affiliation rules under 13 C.F.R. 121.301 in determining whether they have met the 500 employee requirement.

In general, affiliation is based on the ability/power to control

- Affiliation based on ownership – an entity is deemed an affiliate of an individual or entity that owns, or has the power to control, more than 50% of the entity's voting equity,
- Affiliation attributable to stock options, convertible securities and agreements to merge (including agreements in principle)
- Affiliation based on management – affiliation exists where a CEO, president, officer, managing member or partner who controls the management of both a loan applicant and another entity or entities, and
- Affiliation based on identity of interest – affiliation exists when there is an identity of interest between close relatives with identical or substantially identical business or economic interests

The affiliation rules are waived for:

- Businesses with an NAICS code of 72 (such as hotels and restaurants), that have no more than 500 employees per location,
- Businesses operating as a franchise that is assigned a franchise identifier code by the SBA, and
- Any business that receives financial assistance from a small business investment company licensed under section 301 of the Small Business Investment Act of 1958.

AMOUNT OF LOAN FOR FIRST DRAW BORROWERS

First draw loans for **borrowers with employees** are calculated as 2.5 times average monthly payroll costs, up to **$10 million.**

- Average monthly payroll costs can be based on calendar 2019, calendar 2020 or the 12-month period prior to loan application. - Average monthly payroll is adjusted for items such as compensation paid to an employee in excess of $100,000 on an annualized basis, compensation to non-US residents, and other adjustments.
- Payroll includes gross wages and tips (capped at $100,000 annualized) plus employer contributions to employee group health, life, disability, vision and dental insurance; retirement contributions; and state and local taxes assessed on employee compensation (i.e. SUTA).
- For seasonal employers the loan amount is based on 2.5 times the average monthly payroll costs for any 12-week period between Feb. 15, 2019 and Feb. 15, 2020. (A seasonal employer (1) operates for no more than seven months in a year, or (2) earned no more than 1/3 of its receipts in any six months in the prior calendar year.)
- Entities that did not exist for the full one-year period before Feb. 15, 2020, should calculate the maximum loan amount based on 2.5 times payroll cost paid or incurred as of the date of the application divided by the number of months costs were paid or incurred.
- Businesses that are part of a single corporate group are limited to no more than $20,000,000 of first draw PPP loans.

ELIGIBILITY FOR SECOND DRAW PPP LOANS

The following entities may be eligible if they were in operation on February 15, 2020 and received a first draw previously:

- 300 employees or less
  - Note: first draw loans are available for borrowers with 500 or fewer employees)
  - This is based on headcount and includes all full- or part-time employees.
  - Guidance has not been provided as to what timeframe is to be used in calculating the headcount.
- 25% reduction in gross revenue between comparable quarters in 2019 and 2020 (Note: this is not a requirement of first draw loans regardless of whether they are issued in 2020 or 2021).
- At time of application, borrower **has used or will use** all first draw PPP funds (including the amount of any increase of a first draw) on eligible expenses on or before expected date of the second draw loan disbursement.

*It is **not a requirement that forgiveness** of the first draw loan has been applied for or been received. However, some lenders are requiring that the application for forgiveness for the first draw has been submitted.*

AMOUNT OF LOAN FOR SECOND DRAW BORROWERS

Second draw loans for borrowers with employees are calculated as 2.5 times average monthly payroll costs, up to **$2 million.** Borrowers with a NAICS code that begins with 72 (such as hotels and restaurants) are eligible for loans up to 3.5 times average monthly payroll costs.

- Borrower can choose to calculate average monthly payroll based on 2019, 2020 or the 12-month period prior to when the loan is made. Average monthly payroll is adjusted for items such as compensation paid to an employee in excess of $100,000 on an annualized basis, compensation to non-US residents, and other adjustments.
- Payroll includes gross wages and tips (capped at $100,000 annualized) plus employer contributions to employee group health, life, disability, vision and dental insurance; retirement contributions; and state and local taxes assessed on employee compensation (i.e. SUTA).
- For **seasonal employers** the average monthly payroll costs are calculated based on any 12- week period between Feb. 15, 2019 and Feb. 15, 2020.
- For **entities that did not exist** for the full one-year period before Feb. 15, 2020, average monthly payroll costs are calculated as payroll cost paid or incurred as of the date of the application divided by the number of months costs were paid or incurred.

CALCULATING DECLINE IN GROSS RECEIPTS

- For borrowers in operation all four quarters of 2019, compare gross receipts during the first, second, third, or fourth quarter in 2020 to the same quarter in 2019 to determine if there was a 25% or greater revenue reduction.
- The SBA has stated that **only calendar quarters** are to be used for this calculation.
- Borrowers can choose to use annual 2020 gross receipts compared to 2019 to simplify the calculation. Annual tax forms will be required to substantiate the decline; if tax forms are not available, a copy of the applicant's quarterly income statements or bank statements must be provided.

Gross receipts includes, all revenue in whatever form received or accrued (in accordance with the entity's accounting method) including:

- Sales of products or services
- Interest, dividends, royalties
- Rents
- Fees or commissions
- Reduced by returns and allowances

CALCULATING DECLINE IN GROSS RECEIPTS (CONTINUED)

Gross receipts **do not include** the following:

- **net capital gains or losses**;
- taxes collected for and remitted to a taxing authority if included in gross or total income (such as sales or other taxes collected
- proceeds from transactions between a concern and its domestic or foreign affiliates;
- and amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker.

Forgiven first draw PPP loans and EIDL loans/advances are excluded from gross receipts. However, other forms of grants and other relief funds, such as Provider Relief Funds, Higher Education Emergency Relief Funds, state and local grants, etc. have not been specifically addressed.

DOCUMENTATION REQUIREMENTS

- For loans greater than $150,000, documentation of revenue reduction is necessary at the time of the loan. Documentation may include relevant tax forms, including annual tax forms, quarterly financial statements or bank statements.
- For loans of $150,000 or less, documentation is not required with the loan application, but will be required with loan forgiveness application.
- Other documentation requirements as to payroll costs will vary depending on whether the borrower is using the same payroll information as the first draw application and the same lender.
- Economic necessity certification and questionnaires- entities applying for a first or second draw are required to certify that “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”

HAVE YOU APPLIED FOR PPP LOAN FORGIVENESS?

PPP Forgiveness Statistics as of 2/25/21

Total 2020 PPP volume	5.3M
Forgiven	1.7M
Under review	242K
Applications not yet received	3.2M

Total 2020 PPP Volume = $521.2B
$159.8B has been forgiven*

*Many PPP Forgiveness Applications above $2 million well past 90 day period

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FORGIVENESS OF A FIRST OR SECOND DRAW PPP LOAN

The provisions for forgiveness have been updated and apply to both first and second draw loans. Borrowers can qualify for forgiveness of PPP loans up to the full principal amount of the loan and accrued interest if:

- The loan proceeds are used for forgivable purposes during the borrower's covered period;
- Employee and compensation levels are maintained or, if not, an applicable safe harbor or exemption applies; and
- At least 60 percent of the PPP loan proceeds are required to be used for payroll costs to achieve full forgiveness of the loan.

Generally, a reduction in the number of employees or the rate of pay affects the forgiveness of the loan.

- If a borrower decreases salaries and wages by more than 25% for any employee who made less than $100,000 annualized in 2019, loan forgiveness will be reduced.
- If the number of FTEs decreases, loan forgiveness will be reduced.
- Safe harbors and exceptions are available in some circumstances.

COSTS ELIGIBLE FOR FORGIVENESS

The additional categories of eligible expenses can be used in determining the amount of costs for any second PPP loans, or first draw loans if the loan hasn't already been forgiven.

Payroll costs (or owner income replacement for self-employed borrowers)

- Payroll costs used in determining the Employer Retention Credit are not eligible for loan forgiveness
- The Act expanded allowable payroll costs to include group insurance payments for vision, dental, disability and life insurance.

Mortgage interest, if you had the mortgage before February 15, 2020

- Mortgage interest paid to related parties is not eligible for forgiveness.

Rent paid on leases dated before February 15, 2020

- Rent to related parties is subject to limitations based on the amount of mortgage interest the related party pays during the covered period.

Utilities for services that began before February 15, 2020

COSTS ELIGIBLE FOR FORGIVENESS (CONTINUED)

The Act added these additional costs that are eligible for forgiveness.

Covered operations expenditures: payments for any business software or cloud computing service that facilitates business operations, product or service delivery, the processing, payment, or tracking of payroll expenses, human resources, sales and billing functions, or accounting or tracking of supplies, inventory, records and expenses.

Covered property damage costs: costs related to property damage and vandalism or looting due to public disturbances that occurred during 2020 that was not covered by insurance or other compensation.

Covered supplier costs: expenditures made by a borrower to a supplier of goods for the supply of goods that are essential to the operations of the borrower at the time at which the expenditure is made; and is made pursuant to a contract, order, or purchase order.

Covered worker protection expenditures: operating or a capital expenditures to facilitate the adaptation of the business activities of an entity to comply with requirements established or guidance issued related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID–19.

HOW AND WHEN TO APPLY FOR FORGIVENESS

Borrowers can apply for forgiveness once they've used all the loan proceeds for which they are requesting forgiveness.

Borrowers can apply for forgiveness any time up to the maturity date of the loan.

If borrowers do not apply for forgiveness within 10 months **after the last day of the covered period**, then loan payments are no longer deferred, and borrowers will be required to begin making loan payments to their lender.

The Act allows borrowers to select their loan forgiveness covered period. The covered period begins on the date the loan proceeds are disbursed and **ends on any date the borrower chooses** that is between 8 weeks and 24 weeks after the covered period begins.

Borrowers of second draw loans exceeding $150,000 must submit their first draw forgiveness application either before or simultaneously with the second draw forgiveness application. Applications for first and second draws must be made on separate forms.

HOW AND WHEN TO APPLY FOR FORGIVENESS (CONTINUED)

The Act did provide a simpler forgiveness application process for loans of $150,000 or less, as we had all anticipated.

Form 3508S, the streamlined forgiveness application for loans under $50,000, was revised to allow for streamlined forgiveness for loans under $150,000.

- Sign and submit a one-page form
- Attest to complying with PPP requirements
- Report loan amount
- Report number of employees retained
- Report estimate of loan amount spent on payroll
- Retain records - 4 years for employment; and 3 years for other records
- Will be required to provide documentation to substantiate loss of revenue when applying for forgiveness of a second draw loan

HOW AND WHEN TO APPLY FOR FORGIVENESS (CONTINUED)

The revised Form 3508S and two additional revised loan forgiveness applications were released on January 19, 2021:

- Form 3508EZ – for use by borrowers who did not reduce the annual salary or hourly wages of any employee (whose annualized salary was $100,000 or less) by more than 25% during the covered period, compared to the most recent full quarter preceding the covered period and did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the covered period, **or** was unable to operate during the covered period at the same level of business activity as prior to February 15, 2020 due to compliance with government health and safety requirements or guidance issued during specified timeframes.
- Form 3508 – for use by all other borrowers ineligible to use Forms 3508S and 3508EZ.

ADDITIONAL RELIEF AS A RESULT OF THE ACT

Impact of EIDL Advances

Borrowers who also received an EIDL advance, the Act eliminates the requirement that EIDL advances be subtracted from PPP loan forgiveness. The SBA has indicated that any EIDL advance amounts previously deducted from a borrower's forgiveness will be remitted to the lender, along with interest.

Tax deductibility of PPP expenses

The Act also provides relief for borrowers by stating that for federal income tax purposes, expenses paid with a PPP loan are deductible if otherwise eligible. The forgiveness of the PPP loan is not taxable either. The IRS issued Revenue Ruling 2021-02 on January 6, 2021 acknowledging the Act.

ADDITIONAL RELIEF AS A RESULT OF THE ACT

State tax treatment of PPP Forgives and Expenses

DE → forgiveness not taxable and expenses deductible

MD → forgiveness not taxable and expenses, specific guidance has not been issued

PA → forgiveness not taxable and expenses deductible, City of Philadelphia will also follow for BIRT and NPT

NJ → forgiveness not taxable and expenses deductible

ADDED RELIEF- *BUT NOT WITHOUT ADDED COMPLEXITY*

The Act provides additional relief to entities by allowing the use of both PPP loans and Employee Retention Credits (ERC).

ERC allows eligible entities to receive a refundable payroll tax credit on qualified wages paid to employees after March 13, 2020. This provision is retroactive to 2020.

However, a borrower cannot use the same wages for PPP forgiveness and ERC.

Utilizing non-payroll costs for forgiveness (subject to the 60-40 payroll requirement), as well as payments for the various other types of eligible non-payroll costs (and not qualified wages for the ERC) may provide access to ERC and allow the borrower to maximize the benefits of both PPP and ERC.

EMPLOYER RETENTION CREDIT

The original ERC was enacted as part of the CARES Act, but you were not eligible for the credit if you obtained a PPP loan. The Act made significant changes retroactive to 2020 which permits eligible employers that received a PPP loan to claim the employee retention credit, although the same wages cannot be counted both for seeking forgiveness of the PPP loan and calculating the employee retention credit.

For 2020, the ERC can be claimed by employers who paid qualified wages after March 12, 2020, and before January 1, 2021, and who experienced a full or partial suspension of their operations or a significant decline in gross receipts. The credit is equal to 50 percent of qualified wages paid, including qualified health plan expenses, for up to $10,000 per employee in 2020. The maximum credit available for each employee is $5,000 in 2020.

The Act also extended ERC into the first and second quarters of 2021 (through June 30, 2021), but with different rules for the credit.

EMPLOYER RETENTION CREDIT (CONTINUED)

Employer Retention Credit

	2020 ERC	**2021 ERC**
Eligible Employer	Employers of any size, including tax exemp employers	Employers of any size, including tax exemp employers; colleges, univesities and public
Eligible Quarterly Wages Paid	Business operations are fully or parital suspended **due to a government order limiting operations due to COVID-19; or** **50% or greater decline** in gross receipts in a calendar quarter in 2020 compared to the same quarter in 2019; and each successive quarter in 2020 **until the quarter after their gross receipts go back up to within 80% of gross receipts** for the same quarter in 2019	Business operations are fully or parital suspended **due to a government order limiting operations due to COVID-19; or** **20% or greater decline** in gross receipts in a calendar quarter in 2021 compared to the same quarter in 2019 or the preceding calendar quarter to 2019; and each successive quarter in 2020 **until their gross receipts go back up to within 80% of gross receipts** for the same quarter in 2019

EMPLOYER RETENTION CREDIT (CONTINUED)

Employer Retention Credit

	2020 ERC	2021 ERC
Aggregation Rules for Related Employers	parent-sub or brother-sister controlled goups based on >50% ownership; or	parent-sub or brother-sister controlled goups based on >50% ownership; or
	*aggregation rules normally used to determine related entities for purposes of qualifired retirment plan & other employee benefits	
Qualified Wages	Include gross wages and allocable group health care benefits; and less than 100 full-time employees, all wages; other employers, wages paid to employees not rendering services	Include gross wages and allocable group health care benefits less than 500 full-time employees, all wages; other employers, wages paid to employees not rendering services
Credit Rate	50% of qualified wages	70% of qualified wages

EMPLOYER RETENTION CREDIT (CONTINUED)

Employer Retention Credit

	2020 ERC	**2021 ERC**
Wages paid during this period	March 13, 2020 - Dec 31, 2020; and	Jan 1, 2021 - June 30, 2021
	*excludes wages paid that have been paid for with PPP loan proceeds or used for FFCRA or FMLA tax credis	
Maximum wages per employee	$10,000 per employee for the year	$10,000 per employee per quarter (up to $20k per employee)
Maximum credit	$5,000 per employee (for entire year)	$7,000 per employee/per quarter
To claim the credit	- Reduce payroll tax deposits for federal income taxes, SS and Medicare for both employer and employee - Claim on your timely filed 941 - Can file Form 7200 - Can file amended 941 for up to 3 years after from April 15, of the calendar year the 941 applies to. (2020 can be amended through April 15, 2024)	

INTERACTION OF PPP LOAN FORGIVENESS AND ERC

Example: Timeline for 2020 Wages

EXAMPLE OF ERC AND PPP

Facts: Employer X received a $1,000,000 PPP loan and reported $1,500,000 of payroll costs for the covered period April 22, 2020 to October 6, 2020 on the PPP loan forgiveness application ***that was already filed***. Employer X also incurred $100,00 of rent expenses during the covered period which was not reported on the loan forgiveness application.   The entire loan was forgiven.

***What to do*:**

- Should Employer X be permitted to claim the ERC for any qualified wages paid from March 13, 2020 through December 31, related to the $500,000 of wages reported on the loan forgiveness application?
- Can I modify the application to report the $100,000 of rent expenses not reported on the original application since these amounts are in excess of expenses needed for loan forgiveness?
- Can I recalculate my payroll amount using all of the newly allowed expenses for loan forgiveness?

*Borrower only needs $600,000 (60% spent on payroll) of the $1,500,000 of payroll which leaves $900,000 of wages potentially available for ERC credit.

FINANCIAL STATEMENT PRESENTATION

Debt Model Presentation

Entity Type:	Commercial Business
Loan amount:	$1,000,000
Interest Rate:	1% (which would accrue monthly interest of $833)
Loan Received:	April 22, 2020
Year-End:	December 31, 2020
Forgiven Date:	February 1, 2021 (SBA notification date)

FINANCIAL STATEMENT PRESENTATION (CONTINUED)

- Your initial accounting upon receipt is to debit (increase) Cash for $1,000,000 and credit (increase) Note Payable PPP for $1,000,000.
- Monthly you would accrue $833 interest- until the loan is forgiven by the SBA. Debit Interest Expense and credit Accrued Interest.
- Upon forgiveness, debit Note Payable PPP for $1,000,000, debit Accrued Interest and credit an income account called Forgiveness of PPP Loan (expected approach)

Reporting on your Income Statement

There is no authoritative guidance on the classification of forgiveness of PPP loans on the income statement, but is expected the most common approach will be to record as a gain on the extinguishment of debt. It may also be included as a separate line item as other income.

There may even be an argument to net the forgiveness with the associated expenses, with disclosure in the notes but this will lead to comparability issues.

FINANCIAL STATEMENT PRESENTATION (CONTINUED)

Reporting on your Balance Sheet

There is also no authoritative guidance for classification on the balance sheet under FASB ASC 470, it depends on the facts and circumstances.

If the entity intends to repay the loan, you should classify in accordance with contractual payment terms of the debt, like any other debt (current vs. long-term)

If the entity intends to apply for forgiveness, must make a decision to either:

- classify the entire balance based on contractual terms, as above; or
- classify the portion expected to be forgiven as current debt if application for forgiveness is expected to be filled in the current operating cycle or it has already been filed; then any amount not expected to be forgiven is classified based on contractual provisions

FINANCIAL STATEMENT PRESENTATION (CONTINUED)

Reporting on your Statement of Cash Flows

Initial proceeds are cash flows from financing activities.

Forgiveness of the loan is a noncash financing activity.

Also, when forgiveness is recognized, the non-cash gain is deducted from net income, similar to how depreciation appears at the top of the operating activities section of the statement.

Disclosure Considerations

No specific disclosure requirements for PPP loans that would differ from any other debt, disclose general information about the debt agreement: the amount borrowed, interest rate, repayment provisions, maturity date, and the amount outstanding at year-end.

If broken out between current and long-term liabilities, included in the disclosure which outlines maturities of debts for the five years after the balance sheet date in accordance with the contractual provisions of the agreement when the entity intends to repay the loan.

FINANCIAL STATEMENT PRESENTATION (CONTINUED)

Disclosure Considerations (continued)

Forgiveness after year end is considered a *Subsequent Event*. You do not adjust the loan balance on the financial at year end. You are likely to have a mismatch of expenses and forgiveness between periods, the matching principle is not mandatory in U.S. GAAP.

Debt model requires legal release in order for derecognition. Filing the application for forgiveness alone is not legal release, and not indicative of an event that took place prior to issuance of statements. You must have been granted forgiveness by the SBA before the financial statements are issued to have a subsequent event.