The Basics of the PPP Forgiveness Guidelines

The Paycheck Protection Program was enacted to help relieve small businesses from the financial effects of the COVID-19 pandemic. This program provides over $600 billion in low-interest emergency loans to small businesses. These loans are backed by the SBA and are completely forgivable if the loan proceeds are used to pay specific expenses.

In this whitepaper, we will cover the current guidelines regarding PPP loan forgiveness.

The Basics of PPP Forgiveness

Once a PPP loan is approved, your lender must make a one-time, full disbursement to you within 10 calendar days.

The amount of debt forgiven is based on eligible expenses incurred during the covered period which is an eight-week period starting when the loan is funded to your account. You may not prepay expenses.

Eligible expenses include payroll costs, and rent, utilities, and business mortgage interest that were in force prior to February 15, 2020.

At least 75% of the expenses must be for payroll costs and the remaining 25% may be non-payroll costs.

The amount of debt forgiven is not included as taxable income when you file your tax return next year. However, the expenses you pay with the forgiven loan proceeds are not tax-deductible.

There are additional stipulations for each type of expense, which we will cover below.

Payroll Expenses

At least 75% of the loan must be used for payroll costs for employees who live within the United States to qualify for forgiveness. Payments to independent contractors or compensation to employees whose primary residence is outside the U.S. are not considered eligible expenses.

Payroll costs must be incurred during the covered period which is the 8-week period from the date of loan disbursement. However, if your payroll schedule is biweekly or more frequent, you may elect to calculate eligible payroll costs using the 8-week period that begins on the first day of their first pay period following your PPP Loan Disbursement Date and this period is called the "Alternative Payroll Covered Period". This helps avoid having to track payroll expenditures in the middle of a payroll cycle.

Payroll costs incurred but not paid during your last pay period of the Covered Period or Alternative Payroll Covered Period are eligible for forgiveness if paid on or before the next regular payroll date. This keeps you from having to pay employees in the middle of a payroll period.

Eligible payroll costs include:

- Salary, wages, commissions, or similar compensation
- Cash tips or the equivalent
- Payment for vacation, parental, family, medical, or sick leave
- Allowance for separation or dismissal

The total allowed compensation is capped at $100,000 annualized per employee; this equates to a maximum of $15,385 per employee prorated for the 8-week period.

Owner compensation is allowed but capped at the lower of eight weeks' worth of 2019 compensation or $15,385 per individual.

Employee benefit costs such as group health care coverage, including insurance premiums, retirement contributions, and the employer's portion of state and local taxes are also eligible expenses.

Federal taxes including FICA, Railroad Retirement Act taxes, and income taxes do not qualify as eligible expenses. Nor do proceeds for "qualified sick and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.

Headcount and Compensation Requirements

There are additional requirements which state that the forgiveness amount may be reduced if the employer fails to maintain employee headcount and compensation.

Headcount Requirement

The headcount requirement states that you must maintain your average number of full-time eligible employees during the 8-week period following the loan disbursement date. This number is based on one of two base periods: February 15 to June 30 of 2019 or January 1 to February 29, 2020. The base period you use is up to your discretion. If you are a seasonal employer, you can also use a consecutive twelve-week period between May 1st and September 15th of 2019.

To determine whether you meet the headcount requirement, divide the average number of full-time equivalent employees you had during the 8-week covered or alternative covered payroll period by the average number of full-time equivalent employees you had during your selected base period, either February 15 to June 30 of 2019 or January 1 to February 29 of 2020. The resulting number should be equal to or higher than 1 to meet the headcount requirement. If the number is less than 1, then your forgiveness amount will be reduced proportionally.

Headcount Requirement

Avg # Employees
per pay period
during the 8-week period

Avg # Employees
during the base period*
(2/15/19 - 6/30/19)
or
(1/1/20 - 2/29/20)

=

Employee
Headcount Ratio
(should be >= 1)

*Seasonal employers will use 12 weeks between 5/1/19 - 9/15/19

Compensation Requirement

You must also maintain compensation levels for each individual employee during the 8-week covered or alternative covered period following the loan disbursement date. If you reduce the total compensation for any eligible employee by more than 25% as compared to their compensation during the period of January 1 to March 31, 2020, then the amount forgiven will be reduced.

The compensation requirement applies to employees who did not receive, during any single pay period during 2019, wages or salary of more than $100,000 on an annualized basis. So if you pay twice a month and had an employee who made more than $4,166 in any single pay period in 2019, then the compensation requirement would not apply to that specific employee.

Compensation Requirement

\+ Avg annualized compensation during covered or alternative covered period.

− (Avg annualized compensation from Jan 1 - Mar 31, 2020) X .75

= Annualized decrease in compensation beyond allowed 25% reduction

÷ 52 weeks X 8 weeks

= Decrease in your forgivable amount (if negative)

Rehiring Employees

You may need to rehire employees who were previously laid-off or furloughed in order to meet the headcount and compensation requirements. If you make an offer in good faith to rehire the employee and they reject your offer, you can exclude them from the headcount and compensation calculations. Make sure you have written documentation of both the offer and the employee's rejection. Also, if an employee does reject an offer for rehire, they may forfeit eligibility for continued unemployment compensation.

Additionally, if during the covered period, you fired an employee for cause, or if an employee voluntarily resigned, or voluntarily requested and received a reduction of their hours, and that position was not filled by a new employee, you can exclude them from the headcount and compensation calculations.

There are safe harbor exceptions for the full-time employee and compensation levels. If you reduced the number of full-time equivalent employees between February 15 and April 26 of 2020, but then restore the number of full-time equivalent employees by June 30 of 2020 to the February 15 level, then the baseline forgivable amount will not be reduced for a reduction in full-time employees. An equivalent safe harbor exists for restoring compensation levels, so if you restore reduced compensation by June 30th, then the baseline forgivable amount will not be reduced for a reduction in compensation levels.

Eligible Non-Payroll Expenses

As stated above, other approved expenses include utilities, rent, and business mortgage interest. To qualify, however, the obligations must have been in force prior to February 15, 2020. Utilities can include electricity, gas, water, transportation, telephone, or internet access.

Business mortgage interest includes any interest you pay on a mortgage for real or personal property. Please note that payment for mortgage principal is not an eligible expense.

All eligible non-payroll costs must be paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date, even if the billing date is after the Covered Period. And, please be aware that even if you choose to calculate payroll costs for the alternative covered period, all non-payroll costs must be for the Covered Period.

As mentioned earlier, you cannot prepay expenses to qualify for loan forgiveness.

Loan Forgiveness Calculations

To determine the amount of loan forgiveness, you'll calculate the sum of eligible payroll, business mortgage interest, rent and utility expenses, which we will call your baseline forgiveness amount. Second, subtract the amount of compensation reduction beyond the allowed 25% as discussed in the compensation requirements. Third, multiply that net amount by the percentage reduction in full-time equivalent employees. That will result in your modified total forgiveness amount. Your actual forgiveness amount however, will be the lesser of your modified total forgiveness amount, the amount of your PPP loan or your total payroll costs divided by .75.

Loan Forgiveness Calculation

	Baseline Forgiveness Amount
-	Amount > 25% Decrease in Compensation
=	Net Amount
X	Employee Headcount Ratio (if less than 1)
=	Modified Forgiveness Amount

Forgivable amount is the lesser of:

1) Modified Forgiveness Amount

2) PPP Loan Amount

3) Payroll Costs ÷ .75

Final Thoughts

As you probably know, the SBA has been providing additional guidance on the Paycheck Protection Loan Program on a continuous basis. We suggest maintaining excellent documentation related to your loan and what you pay with the loan proceeds. We also suggest consulting our professionals and your loan officer continuously to stay up to date on the latest guidance and ensure that you are properly following all of the guidelines. If you have any questions or would like to discuss, please contact us. We're always here to help.

About Heard, McElroy & Vestal

In 1946, S. Berton Heard, Charles McElroy and Charles Vestal founded Heard, McElroy & Vestal, LLC in Shreveport, Louisiana. Together, this trio of professionals established the firm as a pillar of trust, integrity and competence, with the mission to create solutions and provide opportunities for our clients, our people, and our communities. HMV is one of the largest public accounting and consulting firms in Northwest Louisiana, servicing our clients throughout the states of Louisiana, Arkansas, Texas, Mississippi, Oklahoma and Tennessee from offices in Shreveport and Monroe. Our firm is comprised of over one hundred (100) employees: Partners, Of Counsel Partners, Senior Managers, Managers, additional Professional Staff and Administrative Staff. Our Professional Staff includes more than fifty (50) certified public accountants who obtain additional certifications which are Accredited in Business Valuation (ABV), Certified Fraud Examiners (CFE), Not-for-Profit Certificate holders, Certified Valuation Analysts (CVA), Personal Financial Specialists (PFS), and Certified Mineral Managers (CMM). Our team of professionals brings together many years and diversification of experience, providing a network of knowledge and resources and allowing for industry and niche specialization. Not one CPA can offer the range and quality of services a firm of our size is able to provide, while remaining small enough to deliver personalized service and attention to our clients with consistency on engagements. HMV's strategic associations include Aliign Mineral Management, LLC, Business Valuation Consultants, LLC and HMV Wealth Advisors, LLC.

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