CALCULATING PPP LOAN FORGIVENESS: FREQUENTLY ASKED QUESTIONS

APRIL 29, 2020

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The following are real questions we have been receiving from business owners and tax professionals around the country, along with our best answers given the information we have today. How you proceed will depend on your specific situation, so please understand these responses are intended only as general guidelines and not specific advice. Some of these responses may change drastically when additional SBA guidance comes out, and when that happens we will be certain to update these. If you have any specific questions or concerns about how the PPP Loan forgiveness applies to you, please do not hesitate to contact one of our attorneys today.

1. Do federal taxes count as "payroll costs" for calculating the forgiveness?

   > Under the Cares Act, no. The language of the Cares Act specifically excludes taxes assessed or withheld under Chapters 21, 22 and 24 of the Internal Revenue Code, which includes FICA, Railroad Retirement Tax, and Withholdings on Federal Income Tax. However, on April 8 the SBA issued additional guidance in the form of its own FAQ which states that contrary to the definition of payroll costs found in the Act, payroll costs should be calculated on a "gross basis without regard to federal taxes imposed or withheld." As a result, the SBA interprets this to mean payroll costs are *not* reduced by the taxes imposed on an employee and required to be withheld by the employer, but payroll costs are also *not* increased by the employer's share of payroll costs. The following example is used: an employee receives gross pay of $4,000, of which $500 is withheld for federal taxes; The full $4,000 would count as payroll costs, however, the employer-side federal payroll taxes imposed on the $4,000 are excluded from payroll costs.

2. When should I start re-hiring?

   > Depending on need. The loan proceeds need to be used for covered expenses incurred and paid during the covered period. The sooner employees are back on the payroll the sooner those payroll costs can be incurred and paid. With that said, if the employees are not needed now, most employers will not want to incur a cost only to have it forgiven. When deciding on timing, keep in mind that reductions in workforce, salaries and wages that occur from February 15, 2020 to April 26, 2020 will be disregarded for purposes of reducing the forgiveness amount so long as the reductions are eliminated not later than June 30, 2020.

3. Can I pre-pay covered expenses, including payroll?

   > No. Again, expenses need to be incurred and paid during the covered period to be forgivable. With that said, there are open issues on whether payroll costs are deemed incurred and paid when funds are released to a third party payroll provider, or on the date it is paid to the employee. Most businesses are planning to take the former position unless contrary guidance is released in the interim.

4. If I am going to miss the 75% threshold for forgiveness, can I provide a one-time bonus to an employee to get over the threshold?

   > Yes, assuming the bonus does not cause the employee wages to exceed the $100,000 limitation on an annualized basis. For example, any employee can receive up to $15,384.61 during the Covered Period ($100,000 / 52 weeks) x 8 weeks = $15,384.61. There is speculation that bonuses need be administered in the "ordinary course," but any business qualifying for a PPP Loan is not operating in its ordinary course. Bonuses for hazard pay or similar designations are not prohibited by the Cares Act.

5. Do I forfeit forgiveness completely if I don't use 75% of my loan proceeds on covered payroll expenses?

   - No. Current SBA guidance provides that at least 75% of the *amount forgiven* must be used for covered payroll expenses. If you do not use 75% of the entire loan amount on covered payroll, the amount forgiven will be reduced based on the amount actually used towards covered payroll. For example, if you receive a loan for $100,000, and use $50,000 towards payroll and the rest towards other covered expenses, only $66,666 of the loan may be forgiven ($50,000 amount used towards payroll equals 75% of the *amount forgiven*). The remaining $33,334 would have a maturity of two (2) years and an interest rate of 1%.

6. What if my employees refuse to come back because they are making more through unemployment benefits?

   - You can hire new employees to replace them. Even if you can bring back some employees, but are in fear that you will end up paying employees more than the amounts which may be forgivable, it may make more sense to not re-hire employees. This is especially true where those employees are not engaged in productive work. This may seem counterintuitive, but employers should be careful to not end up in a position where they paid employees with loan proceeds for unproductive work, and then have to repay the loan used to pay those employees.
   - A secondary issue, as employers are beginning to re-open and re-hire, is whether employees refusing to come back to work will become ineligible for state unemployment benefits, and therefore the additional $600/week payable under the Cares Act. I have not seen any specific guidance from Minnesota on this exact situation. Currently, however, under the COVID-19 FAQ posted by Minnesota Unemployment Insurance, employees can meet work search requirements by staying in regular contact with employers about when work will resume. If an employee refuses to come back after receiving notice that work has resumed, they may be deemed to be taking a "voluntary, unpaid leave of absence," in which case their eligibility for unemployment benefits may be limited.

7. Should I pay employees who are not actually working?

   - Again this depends. If you can only pay some employees but not enough to reach the 75% threshold for total forgiveness, paying employees with borrowed funds who are not actually working is probably not a good business decision. When deciding whether to pay non-productive employees you need to consider the likelihood of reaching the 75% threshold for full forgiveness, the benefit of having those employees on your payroll if you miss it, and the total amount subsequently eligible for forgiveness. Even if you will reach the 75% threshold, additional reductions due to loss of headcount and wages need to be considered in these calculations.

8. Is the reduction in wages employee specific?

   - Yes. If an employee has a wage reduction in excess of 25%, to "eliminate" that reduction, that particular employee needs to have their wages increased to February 15, 2020 levels. The Cares Act does not appear to allow for the elimination of one employee's reduction by increasing the wages of another employee.

9. How does this work with employees who cannot or will not come back to work?

   - Unclear. Under the Cares Act, an employee who refuses to return to work would technically have a 100% reduction in his or her wages (this would also be a reduction in headcount). You can remedy the headcount reduction by hiring a new employee, but it is unclear if paying this new employee will eliminate the wage reduction of the former-employee.

10. How is the headcount for full-time equivalent employees calculated during the covered period?
    - Section 2301(c)(3) of the Cares Act, which deals with employee retention, points to Section 4980H of the Internal Revenue Code to define a full-time employee as one who works on average at least 30 hours a week. Further down in IRC Section 4980H, a full-time equivalent employee is determined by adding the hours of all non-full-time employees during the month and dividing by 120. However, the Cares Act also requires this determination to be made each pay period during the Covered Period. We are currently advising clients to add the total number of hours of non-full time employees and divide by 30, 60, or 120 depending on the pay period (30 if weekly, 60 if bi-weekly, and 120 if monthly). **More guidance is needed.**
11. If my loan is forgiven, will that count as discharge of indebtedness income subject to income tax?
    - Typically, when a loan is forgiven, the amount forgiven is taxable income. Under the Cares Act, the portion of the PPP Loan which is forgiven is excluded from this provision, and will not count as taxable income on the federal level. Whether it will be taxable at the state level is to be determined. Most states have conformity statutes which, in essence, state that they will conform with certain federal rules and determinations. The Minnesota Legislature has not yet decided whether to conform with the federal position on this issue, which has been the subject to discussion and reporting in the recent session. The discharge will not be taxable in those states which have updated their conformity to recognize the federal rules waiving discharge of PPP Loans from inclusion in income. Those states that fail or decide not to update their conformity statutes will tax the forgiven amounts as ordinary income subject to the state income tax rates.

Again, if you have specific questions or concerns not addressed here, or have a unique situation you want to discuss, please feel free to reach out to our office today.

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