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Loan Forgiveness Under the CARES Act Paycheck Protection Program

Understanding the Forgiveness Provisions and What Businesses Need to Do Now to Maximize Loan Forgiveness

Thursday, April 23rd, 2020
10:00AM – 11:00AM



Program Panelists

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A VERY Brief History of the CARES Act's Paycheck Protection Program Loans

- Paycheck Protection Program loans (“PPP”) were passed into law on March 27, 2020 as part of the CARES Act (the “Act”)
- Loans must be used only for payroll costs, as defined in the Act, and other specific expenses
- Loan proceeds must be spent during an 8-week period immediately following the funding of the loan (the “Covered Period”)





Overview of the PPP Loan Process

- The PPP loan process can be viewed as having two distinct phases:
 - Phase 1 - The loan application process, which includes preparing detailed calculations to determine the maximum amount of borrowing
 - Phase 2 – the loan forgiveness, which will require planning and certain calculations be made to ensure maximum loan forgiveness



Phase 1 – The Loan Application Process/Maximum Borrowing Calculation

- The applicant can borrow the lesser of \$10M or 2.5 times calculated average monthly payroll cost, as defined in the Act (the “Payroll Costs”)
- The Act defines Payroll Costs as wages (capped at \$100K per employee), plus health insurance, retirement benefits, and state unemployment insurance
- The calculation must be prepared on an employee-by-employee basis



Phase 1 – The Loan Application Process

Calculation of Maximum Borrowing Amount – Illustrative Example

- Business has average monthly Payroll Costs (defined under the Act) of \$40,000
- Business qualifies for a \$100,000 PPP loan, calculated as follows:

Description	Amount	
Average monthly Payroll Costs	\$ 40,000	
Multiplier	2.50	
Calculated Payroll Costs	100,000	(A)
Maximum covered loan per Cares Act	10,000,000	(B)
Lesser of (A) or (B) - Max covered loan	\$ 100,000	



Phase 2 – Loan Forgiveness

- The Act requires that the following 3 tests be met during the Covered Period for a loan to be forgiven:
 - Test 1 – 75% of funds utilized for Payroll Costs
 - Test 2 - Full time equivalent employee (“FTE”) comparison test
 - Test 3 - 25% compensation test



Test 1 – 75% of Funds Utilized for Payroll Costs

- Pursuant to the Act's provisions, funds must be utilized for:
 - Payroll Costs (as defined by the Act)
 - Rent
 - Utilities – electric, gas, water, telephone, internet
 - Certain “covered” mortgage Interest
- 75% of funds must be utilized for Payroll Costs
- Any funds not utilized in the prescribed manner will not be forgiven





Test 1 - 75% of Funds Utilized for Payroll Costs

Assumptions for Illustrative Example

- Assume the subject entity utilizes the funds as follows:
 - \$65,000 for Payroll Costs
 - \$25,000 for rent
 - \$10,000 for utilities





Test 1 - 75% of Funds Utilized for Payroll Costs

Loan Forgiveness Calculation - Illustrative Example

Description	Calculation	%
Covered loan from lender	\$ 100,000	
Unused PPP funds, if any	-	
PPP funds utilized	\$ 100,000	100.0%
Payroll Costs	65,000	65.0%
Rent	25,000	25.0%
Utilities	10,000	10.0%
Total PPP funds utilized	\$ 100,000	100.0%
Amount forgiven based on Test 1	\$ 90,000	
Amount not forgiven based on Test 1	\$ 10,000	



Test 2 – Full Time Equivalent Employee (“FTE:”) Comparison Test

- This test compares the average number of monthly FTE’s during the Covered Period to a period before the health crisis (the “Base Period”)
- If a business reduces their average monthly FTE headcount during the Covered Period, as compared to the Base Period, then a portion of its loan will not be forgiven



Test 2 – Full Time Equivalent Employee (“FTE:”) Comparison Test

- The SBA defines a full-time equivalent employee (“FTE”) as someone who works 30 hours per week or 130 hours per month
- For example, if a borrower has 3 part-time employees who work an average of 10 hours per week, the three together are considered 1 FTE



Test 2 – Full Time Equivalent Employee (“FTE”) Comparison Test

- The following periods can be used to determine the average number of monthly FTE’s during the Base Period:
 - Option 1 - February 15, 2019 to June 30, 2019
 - Option 2 - January 1, 2020 to February 29, 2020
 - Option 3 - For seasonal businesses, February 15, 2019 to June 30, 2019



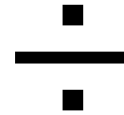


Test 2 – Full Time Equivalent Employee (“FTE”) Comparison Test

PPP Loan
Funds Utilized



Average monthly
FTEs during the 8-
week Covered Period



Option 1:

Average monthly FTEs from
Feb 15, 2019 to June 30,
2019

Option 2:

Average monthly FTEs from
Jan 1, 2020 to Feb 29, 2020

For Seasonal Employees:

Average monthly FTEs from
Feb 15, 2019 to June 30,
2019





Test 2 – FTE Comparison Test

Loan Forgiveness Calculation - Illustrative Example

FTE Count - Covered Period		Average	
May 2020		4.00	
June 2020		4.00	
Average over Covered Period		4.00	
FTE Count - Option 1 for Base Period		Average	
February 15, 2019 to February 28, 2019		5.00	
March 2019		5.00	
April 2019		5.00	
May 2019		5.00	
June 2019		5.00	
Average over Selected Months		5.00	
FTE Count - Option 2 for Base Period		Average	
January 2020		6.00	
February 2020		6.00	
Average over Selected Months		6.00	
Selection of Percentage for Test 2		Option 1	Option 2
FTE Count - Covered Period		4.00	4.00
FTE Count - Base Period		5.00	6.00
Percentage		80.0%	67.0%
Select Option Nearest 100%		80.0%	



Test 3 – 25% Compensation Test

- Loan forgiveness will decrease if compensation levels of certain employees are not maintained during the 8-week Covered Period
- The hurdle rate for a decrease to compensation is 25%
- For example, if an employee was earning the equivalent of annualized compensation of \$50,000 and over the 8-week Covered Period estimated annual compensation decreased to \$30,000, that would represent a \$20,000, or 40%, decrease in compensation
- In this example, for this employee, there would be a reduction in loan forgiveness of \$3,000 for the 15% (40% less 25% hurdle rate) \$20,000 decline in compensation over the 8-week Covered Period





Test 3 – 25% Compensation Test

Loan Forgiveness Calculation - Illustrative Example

		1st Q 2020 Convrt.			
	1st Qtr 2020	8 Week	May 2020	June 2020	8 Week Cov Per
Employee Name	Gross Comp	Gross Comp	Gross Comp	Gross Comp	Gross Comp
Employee 1	\$ 22,000	\$ 14,000	\$ 7,000	\$ 7,000	\$ 14,000
Employee 2	20,000	12,000	5,000	5,000	10,000
Employee 3	18,000	11,000	4,000	4,000	8,000
Employee 4	16,000	10,000	-	-	-
Employee 5	14,000	9,000	1,000	1,000	2,000
	\$ 90,000	\$ 56,000	\$ 17,000	\$ 17,000	\$ 34,000





Test 3 – 25% Compensation Test

Loan Forgiveness Calculation - Illustrative Example

	1st Q 2020 Convrt. 8 Week Gross Comp	8 Week Cov Per Gross Comp	Reduction Gross Comp	Percent Decline	Percent Decline Over 25%	Reduction to Loan Forgiveness
Employee 1	\$ 14,000	\$ 14,000	\$ -	0.0%	0.0%	\$ -
Employee 2	12,000	10,000	(2,000)	-16.7%	0.0%	-
Employee 3	11,000	8,000	(3,000)	-27.3%	2.3%	68
Employee 4	10,000	-	(10,000)	-100.0%	75.0%	7,500
Employee 5	9,000	2,000	(7,000)	-77.8%	52.8%	3,694
	\$ 56,000	\$ 34,000	\$ (22,000)			\$ 11,263





Bringing it All Together.....

Summary of Loan Forgiveness Tests 1, 2 and 3

Description	Detail by Test	Cumulative Loan Forgiveness
Amount Borrowed - PPP Loan	\$ 100,000	\$ 100,000
Reduction to loan forgiveness:		
Test 1 - 75% funds utilized	<10,000>	90,000
Test 2 - FTE comparison test*	<18,000>	72,000
Test 3 - 25% compensation test	<11,263>	60,737
2-Year Loan Amount		<u>\$ 39,263</u>

* 20% not forgiven in illustrative example:	
Loan forgiveness (after test 1)	\$ 90,000
Test 2:	
Loan forgiveness reduction percent	x20%
Loan forgiveness reduction amount	<u>\$ 18,000</u>





Rehiring Employees During the Covered Period

- What do the current CARES Act provisions tell us?
- How do you plan to bring back employees who were laid off or furloughed?
- Who has a crystal ball?
- When will additional guidance be forthcoming?





The "Flip Side" of Loan Forgiveness

- Loans not forgiven will have the following terms:
 - 2-year term
 - 1% interest rate
 - 6-month deferral of first loan payment (from loan origination date)



Interplay of Tests

- Understand how adjusting expenses paid during the Covered Period, including levels of compensation, to maximize forgiveness in one test can have unintended consequences in another test.
- For example, what happens if compensation is “controlled” during the covered period to meet the 25% compensation test? How does this Test 3 strategy impact Tests 1 and 2?





Records and Supporting Documents for Loan Forgiveness

- FTE headcount and salary information
- Payroll records, 941's
- Lease agreements
- Copies of rent and utility invoices/checks



Other Planning Tips

- Maintain up-to-date historical accounting and payroll records during the Covered Period
- Consider segregating loan proceeds in a separate bank account
- During the Covered Period, track compliance with loan forgiveness planning
- Important...once the Covered Period ends, you cannot undo how loan proceeds were spent!





RISK!!!

- Following the loan forgiveness rules, as currently written, several provisions need further clarification
- Certain provisions are “gray”additional guidance from the SBA is still needed
- Some recurring questions:
 - Should I bring back ALL of my employees during the Covered Period?
 - What happens if I prepay certain expenses?
 - What are the risks?



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Q&A



More to come...

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THANK YOU!!

