

## MEMORADUM: CARES ACT (H.R 748) REGARDING PAYROLL PROTECTION LOANS

To: Our clients  
From: Michael Di Pietro, CPA  
Date: March 30, 2020

### Subject: PAYROLL PROTECTION LOANS

Passed Friday, 27<sup>th</sup>

The CARES Act will deliver \$2.2 Trillion to Americans across the United States.

- Implemented mostly thru
  - Treasury Department
  - SBA & Private Lenders
  - IRS
  - Federal Reserve

There are several components to the Act regarding small businesses. This memo will focus on the Payroll Protection Loans and will be followed by a memo on “Business Tax Provisions”, etc.

### PAYROLL PROTECTION LOANS

**Payroll Protection Loans:** eligible for employers with 500 or fewer employees (For food service companies, it's 500 employees/ location).

- Full **or** Part time employees are included
- Loan Amount = 2.5x the monthly payroll (not to exceed \$10 Million or \$4 million/ month average monthly payroll)
- **Independent Contractors** and **Sole Proprietors** may apply

The loan **proceeds** can be used for payroll costs as well as **mortgage interest, rent, utilities, and other debt obligations** (credit card?) incurred before the covered period (February 15- June 30, 2020).

- Payroll Loan is capped at \$100k/ employee pro-rated for the covered period (i.e \$40k wages/ employee from 2/15-6/30/2020)
- It appears (but not 100% certain) this includes K-1 distributions where the K-1 constitutes their compensation (i.e partnerships)

## NATURE OF LOAN

The loan is unsecured without requiring even personal guarantees or collateral. However, you must be certain that the loan is being used only for authorized purposes. An Inspector General will be appointed for just this purpose and any unauthorized use will backfire and result in penalties, taxes and fines.

### Small Business “Payroll Protection Loans”

#### Nature of Loan

- Nonrecourse ( unless used for unauthorized purposes)
- No personal guarantee of borrower’s owners
- No collateral requirement
- Borrower’s certification:
  - The uncertainty of the economic climate necessitates the loan
  - Funds will be used for “covered expenses”
  - No other similar loan applications
  - Between February 15, 2020 and December 31, 2020 recipient has not received and will not receive other similar loans.

## ADDITIONAL ELEMENTS

- No requirement to seek credit elsewhere
- Maximum Maturity of 10 years
- Interest rate not to exceed 4%
- No P & I payments for at least 6 months (SBA to write rules to specify mechanism) and;
- No prepayment penalties

## OTHER CRITERIA

- Businesses that receive SBA disaster assistance loans for COVID-19 support payroll **cannot also get a CARE loan** for the same purpose.
- All businesses that apply are **presumed to qualify**
- The program is planned to be **open within 10 days (April 6<sup>th</sup>)** and applicants should **receive cash the same day.**

## LOAN FORGIVENESS

- Covered businesses who receive CARE loans may seek forgiveness of the portion of the loan that relates to payroll expense, mortgage payments, rent, and utilities.
  - Mortgage debt or lease obligation must have been incurred before February 15, 2020
  - Act references a “mortgage” on “personal property” which is unclear
- Expected Loan Forgiveness:
  - Payroll costs, rent/mortgage obligations, and utilities.

- The term “Payroll Costs” means: “salary, wage, commission, or similar compensation,” certain fringe benefits, termination pay, health/insurance benefits, retirement benefits, state and local tax on compensation, self-employment income for sole-proprietors and independent contractors: all capped at \$100,000 per employee.

With regard to mortgage payments, it is not clear, but only the interest (not principle) portions may be forgivable.

**You must file an application for loan forgiveness** and the lender is to make a decision on loan forgiveness within 60 days.

The **forgiveness will be reduced** if **employees are terminated** during the covered period **or** if workers’ **salaries are reduced**.

The comparison will be comparing the level of employment between February 15<sup>th</sup> and “30 days after enactment” (I’m not sure what this means – will need further clarification) and the level of employment on June 30<sup>th</sup>. The process for comparison needs further clarification.

## HOW TO OBTAIN LOAN FORGIVENESS

### Checklist of Documents Required to Apply for Loan Forgiveness

- Payroll tax filings with IRS (Form 941)
- State income, payroll ,and unemployment insurance filings
- Cancelled checks, payment receipts, etc. verifying actual payment of covered expenses
- Certification under oath that (a) the information provided is trust and accurate and (b) the loan was used to retain employees and pay covered expenses
- Such other requirements imposed by the SBA

## LOAN FORGIVENESS CALCULATION

Essentially you first have to calculate the number of full-time equivalent employees (FFTE) per month for one month of the covered period.

For example, let us say from February 15, 2020 through March 15, 2020 you have 6 full time employees and 2 part time employees. That equals 7 full time employees. Let us say your loan is \$100,000. You take the amount of the loan and you multiple it by the **quotient** of the FFTE above (2/15-3/15/2020) and the **average** FFTE from 2/15- 6-30/19 (or if you like, the average FFTE from 1/1-2/29/2020). Notice that one period is 2019 and the other is 2020.

If your numerator and denominator is the same, you have 100% loan forgiveness, (\$100,000 divided by 7/7= \$100,000 forgiveness). The forgivable loan is COD (cancellation of debt) income, **but not taxable**

## CALCULATING THE ELIGIBLE LOAN AMOUNT

### Example

- Eric's Café applies for a paycheck protection loan.
- The business had \$2,000,000 in payroll costs for the 1-year period, for a monthly average of \$166,667.00.
- Eric's Café is entitled to loan equal to the lesser of (a) \$416,667.50 {\$166,667 in average payroll costs \* 2.5}, or (b) \$10 million.

## LOAN FORGIVENESS FOR COVERED EXPENSES

If the \$416,667.50 is used for **covered expenses**, the loan is forgivable, and the Cod income will not be taxable income. The portion of the loan uses for **non-covered** expenses (eg. Office supplies) is not forgiven, but payments on that portion of the loan is deferred for six months, can be paid over as much as 10 years with a maximum interest rate of 4%.

Also, salaries in excess of \$100k cannot be forgiven.

## EIDL LOANS

The SBA offers Economic Injury Disaster Loans (EIDL) which can provide up to \$2 Million of financial assistance. An EIDL loan can cover be used to offset the unforgivable portions of the CARE loans. The loans can be used to pay fixed debts, payroll (not covered by CARE loans), accounts payable, and other bills that could have been paid had the disaster not occurred.

## EMERGENCY EIDL GRANTS

- \$10,000 grant disbursed while an entity is waiting on whether it will receive an SBA loan
- Disbursed within 3 days
- May be used for COVID-19 related sick pay, payroll, certain operational expenses, rent/mortgage, other debt obligations
- Applicant must be eligible to receive a covered loan

You should contact the SBA immediately to begin the loan process for such loans. I will try to issue a memorandum later this week with regard to these SBA loans.

## REDUCTION OF LOAN FORGIVENESS DUE TO LAY OFF'S OR SALARY REDUCTIONS

### Reductions in Wages

- If employer reduced salary/wages in excess of 25% during covered period and did not cure the reduction by June 3, 2020, then reduce forgiveness of loan by the amount of the salary/wage reduction in excess of 25%.
- Use employee's salary/wages for most recent full quarter of employment when calculating whether reduction is in excess of 25%.

### Example

- Eric reduces Amanda's salary from \$50,000 to \$30,000, a 40% reduction.
- This exceeds the 25% floor. 25% of \$50,000 = \$37,500
- Thus, loan forgiveness is reduced by \$7,500

### Rehiring Employees

- If employees were laid off between February 15<sup>th</sup> and 30 days after enactment of the Act, so long as they are rehired by June 30<sup>th</sup>
- These provisions are unclear and will require rule making

## CHECKLIST

### Checklist for Seeking a Payroll Protection Loan

- Proof of existence (i.e. 2019 tax return) as of March 1, 2020
- Payroll journal, W-2s, K-1s, 1099s, and other proof of compensation for the 1 year prior to the loan
  - Health insurance contract, and proof of premium payments
  - Exclusion: compensation in excess of \$100,000, federal payroll taxes, ex patriate compensation, qualified sick pay compensated under
- Mortgage statements and proof of payment
- Lease agreements and proof of payment
- Utility bills