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Calculating Your Loan Forgiveness Under the Paycheck Protection Program*

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One of the most complex parts of the Paycheck Protection Program (PPP) is calculating loan forgiveness. The new PPP loan forgiveness applications reflect changes to the PPP made by the Paycheck Protection Flexibility Act of 2020, P.L. 116-142, which became law June 5. The applications and instructions are available in the links below:

- Revised PPP Loan Forgiveness Application and instructions
- EZ PPP Loan Forgiveness Application and instructions

Please note that SBA and Treasury have continually provided updates regarding the PPP so guidance and instructions are subject to change.

Payments Eligible for Forgiveness

Only costs incurred and/or payments made for qualifying expenses during the ***"covered period"*** will result in forgiveness. The covered period is either:

(1) the 24-week (168-day) period beginning on the day the borrower receives the loan (disbursement date), or

(2) if the Borrower received its PPP loan before June 5, 2020, the borrower may elect to continue to use their original eight-week (56-day) covered period. In no event may the covered period extend beyond December 31, 2020.

For payroll costs only, the borrower may choose an ***"alternative payroll covered period"*** beginning on the first day of the first pay period following the disbursement date.

The following qualifying expenses will be eligible for forgiveness during the covered period:

- **Payroll costs**** –Includes salaries (annual compensation up to $100,000 per employee – a maximum of $15,385 per employee during an 8-week covered period or $46.154 during a 24-week covered period), group health care benefits, retirement benefits, state/local payroll taxes on employee compensation, paid leave, and allowances for dismissal or separation.

  For **owner-employees**, compensation is limited to eight weeks' worth (8/52) of 2019 owner-employee compensation (up to $15,385) for an **eight-week covered period** or 2.5 months' worth (2.5/12) of 2019 owner-employee compensation (up to $20,833) for a **24-week covered period**, in total across all businesses. Compensation includes cash compensation and *may* include health and retirement benefits for certain owners.

  - Cash compensation has been interpreted by the SBA/Treasury to be W-2 wages or self-employment income that the owner-employee pays self-employment taxes on, such as Schedule C, line 31 or Schedule K-1, line 14a.
  - C-corporation owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement and health insurance contributions made on their behalf.
  - S-corporation owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement contributions made on their behalf, but employer health insurance contributions made on their behalf cannot be added because those payments are already included in their employee cash compensation.
  - Schedule C or F filers are capped by the amount of their owner compensation replacement, calculated based on 2019 net profit.
  - General partners are capped by the amount of their 2019 net earnings from self-employment (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235.
  - Self-employed business owners, including Schedule C or F filers and general partners, may not include health or retirement benefits as eligible payroll costs.

- **Mortgage interest** - Any payment of interest on mortgage obligation (not including any prepayment of or payment of principal on a mortgage obligation) that was incurred before February 15, 2020.

- **Rent** - Any payment of rent under a leasing agreement in force before February 15, 2020.

- **Utilities** - Utility payments for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020.

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.

At least 60% of the PPP loan proceeds must be spent on payroll costs, regardless of timing.

How Forgiveness May be Reduced

There are at least five scenarios where your loan forgiveness could be reduced:

1. **If all loan proceeds are not spent in the 24-week covered period** – Any loan proceeds that exceed qualifying expenses incurred during the 24-week covered period, or by December 31, 2020, whichever is sooner, will not be forgiven.

2. **If you don't spend 60% of the total loan on payroll.** At least 60% of the total PPP loan must be spent on payroll costs, regardless of timing, to qualify for loan forgiveness.

3. **If you reduce the number of full-time equivalent employees** – This scenario is a bit more complicated. First, determine the average number of full-time equivalent employees (FTEEs) during each pay period in the 8-week covered period. The average is then compared to a base period. Employers may choose to use either (a) February 15, 2019 – June 30, 2019 or (b) January 1, 2020 – February 29, 2020 as a base period. The amount of loan forgiveness is then reduced proportionately to the drop in FTEEs.

To calculate the number of FTEEs a business employs, for each employee, divide the total number of hours worked per week by 40 and then round to the nearest tenth. For example, an employee who works 40 hours a week would count as 1.0 FTEE (40/40=1.0). An employee who works 30 hours a week would count as 0.75 (30/40), which is then rounded up to 0.8. Alternatively, borrowers may choose to use a simplified method that assigns a 1.0 for employees that work 40 or more hours a week and 0.5 to employees that work fewer than 40 hours a week.

Example: An employer applies for and receives a $100,000 PPP loan. The employer had 10 FTEEs from February 15, 2019 – June 30, 2019, and 20 FTEEs from January 1, 2020 – February 29, 2020. During the 8-week covered period, the employer drops down to an average of 6 FTEEs. The employer chooses to use the February 15, 2019 – June 30, 2019 base period because it is more beneficial. The employer is eligible to have 6/10 = 60% of its $100,000 loan forgiven, or $60,000.

Additionally, if the borrower makes a good faith offer to rehire an employee during the covered period and is rejected by the employee, that reduction in FTEEs will not count. Similarly, employees that are (a) fired for good cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction in hours will not count as a reduction in FTEEs.

4. **If employee wages are cut by more than 25%** – This step requires you to break out a calculator and look at every employee who made less than $100,000 in 2019 individually. Each employee's average salary/hourly wage between January 1, 2020 and March 31, 2020 is compared to the 8-week covered period, prorated to a 52-week pay scale for salaried employees, to see if there was a reduction in salary by more than 25%.

- Determine the allowed reduction in salary/wages up to 25%. An employee earning $1,000/wk. ($52,000 yearly salary) could have their salary reduced to $750/wk. ($39,000 yearly salary) before a loan forgiveness reduction is applied.

- An hourly employee earning $20/hr. could have their wages reduced to $15/hr. before a loan forgiveness reduction is applied. Note that for hourly employees, overtime pay is factored into the calculation as well.

- If the reduction in wages exceeds the allowed amount, calculate the penalty as: (total reduction in pay – allowed reduction in pay) * 8 weeks. For example, a salaried employee earning $1,000/wk. has their pay reduced to $500/wk. during the covered period. Loan forgiveness would be reduced by: ($500 - $250) * 8 weeks = $2,000.

5. **You received an EIDL advanced grant** – If you received an advance up to $10,000 on the EIDL loan, it will be subtracted from the PPP loan forgiveness amount.

Can I Avoid Forgiveness Reduction?

You can avoid forgiveness reduction by restoring any reduction in FTEEs and/or wages by December 31, 2020.

If a borrower reduced FTEEs between Feb. 15 and April 26, the reduction may be cured if they restore the number of FTEEs to the number of FTEEs employed before February 15, 2020. A reduction in FTEEs will not apply:

- If the borrower is able to document that they were not able, in good faith, to fill the vacant positions with the same employee or a similarly qualified employee.

- If the borrower can document that business is unable to return to former levels because of COVID-19 precautions, including standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19.

If a borrower reduced average wages, the reduction may be cured if they restore average wages to their pre-February 15, 2020 level.

** This alert was developed by NFIB based on the information currently available regarding the PPP loan program and our best interpretation of the CARES Act, the SBA Interim Final Rules, the PPP Loan Forgiveness Applications, the Paycheck Protection Flexibility Act of 2020, and related guidance; however, the PPP loan program is evolving rapidly and future guidance from Treasury or the SBA may alter the interpretation of the CARES Act, the Interim Final Rule, the Loan Forgiveness Application, and the analysis set forth in this alert. NFIB cannot provide legal or tax advice and is not responsible for any errors or omissions related to an individual business's situation.*

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