Updated Legal and Accounting Guidance on CARES Act Loans

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Kyung Kim is a partner who has almost 25 years of experience in providing tax, accounting, auditing, and consulting services to her clients in various industries. She provides personalized services to help clients better manage their financial matters and also collaborates with their other professional advisors. She is a member of AICPA and NH Society of CPA. She is the Treasurer of the New Hampshire Estate Planning Council and the Treasurer and Finance Committee Chair of New Hampshire Women's Foundation.

Cory M. Vargo, CPA
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Cory Vargo is a partner who focuses his tax practice on private equity and corporate acquisition and divestiture due diligence, international tax structuring, and tax compliance. He authored an article, "Carried Interest Taxation and Private (and Horizontal) Equity," in the 2012 edition of Tax Notes that has been cited multiple times by the Congressional Research Service Committee on Private Equity Taxation's annual report. Cory also participates in national tax policy dialogue and has spoken at various tax events. He is a member of AICPA and Maine Society of CPA.

Frank Saglio, CPA
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Frank Saglio is a senior manager in Wipfli's tax practice, with over 10 years of public accounting experience. He focuses on tax planning and compliance for individuals, trusts and estates, and closely held businesses in a wide variety of industries. He is a member of AICPA and NH Society of CPA. He is co-Treasurer and Finance Committee co-chair of Families in Transition.

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Agenda

1) Welcome and Overview
2) Update on SBA Disaster Loans
3) PPP Loan Overview and Update on Status of Program
4) PPP Borrower Certification - the latest guidance
5) PPP Calculating Loan Forgiveness
6) PPP Loan Forgiveness - the latest guidance & recommendation on tracking use of proceeds
7) Employee Retention Tax Credit
8) Payroll Tax Deferment
9) Other Useful CARES Act Tools for Businesses
10) Continuing Employer Obligations & FFCRA
11) Question and Answer

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SBA Economic Injury Disaster Loans

- **SBA Disaster Loans –**
  - Maine was first state to obtain necessary disaster certification of all counties
  - New Hampshire – all ten counties approved disaster certification
  - Up to 30 year term, 3.75% rate with no repayment for 4 months
  - Small businesses (functionally most businesses in Maine) Please review the loan application at disasterloan.sba.gov for more details on the loan process, but you will need to provide, at a minimum:
    - Completed SBA loan application (SBA Form 5).
    - Tax Information Authorization (IRS Form 4506T) for the applicant, principals and affiliates.
    - Complete copies of the three most recent Federal Income Tax Returns. If you do not have your 2019 Tax return complete, please returns for 2016 - 2018.
    - Schedule of Liabilities (SBA Form 2202).
    - Personal Financial Statement (SBA Form 413).
    - Financial statements for business.

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Paycheck Protection Program: Eligibility & Terms

Eligibility

- Businesses (including nonprofits, sole proprietorships, self-employed individuals, and independent contractors) with 500 or fewer employees, in operation on Feb. 15, 2020, who need the PPP Loan to support ongoing operations, are eligible
- Special affiliation rules, further expanding eligibility, discussed on next slide
- Borrowers must certify that PPP Loan will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments
- Other disaster relief, such as EIDL loans, may in some instances be refinanced as a PPP Loan and/or permitted alongside PPP Loans (if not for same purpose/amount)

Loan Terms

- Maximum loans lesser of (1) $10M or (2) 2.5x Pre-COVID-19 monthly payroll costs
- 1% fixed interest rate
- Two-year terms (payments deferred for six months; interest accrues)
- Each eligible business can only apply for one PPP Loan

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Paycheck Protection Program: Special Affiliation Rules

SBA loans are typically subject to aggregation with affiliates. The SBA affiliation test is complicated, but generally includes aggregation of investors who have certain controls features over the subject company. During the covered period, the affiliation test for PPP Loans does not apply to:

- Any business with not more than 500 employees per physical location that, as of the date on which the covered loan is disbursed, is assigned a NAICS code beginning with 72 (generally the hospitality industry – restaurants, hotels and similar)
- Any business operating as a franchise that is assigned a franchise identifier code by the SBA.
- Any business concern that receives financial assistance from a licensed SBIC (a privately-owned investment company that is licensed by the SBA).

A new SBA rule issued April 30, 2020 provides that, notwithstanding the suspension of affiliation rules for the above categories of businesses, under no circumstances will a "corporate group" be allowed to receive more than $20 million in loans total.

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Paycheck Protection Program: Certification

An eligible recipient applying for a covered loan shall make a good faith certification:

- That the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient;
- Acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- That the eligible recipient does not have an application pending for a loan under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan; and
- During the period beginning on February 15, 2020 and ending on December 31, 2020, that the eligible recipient has not received amounts under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan.

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Paycheck Protection Program: Implications of Certification (1 of 2)

This is the million dollar question on every borrower's mind these days, and concern has only been heightened since Mnuchin's announcement that every borrower receiving $2 Million or more will be "audited by the government" prior to receiving forgiveness. Although the press has focused on this promise/threat, we are waiting on the promised guidance of how those audits will be implemented, particularly given that the uncertainly they have fomented is guaranteed to exacerbate the layoffs and cuts that the PPP loans were intended to stave off.

- **Plain Reading of Certification**. The certification states that the "uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient." There is a world of wiggle room in this statement. Even access to liquidity doesn't mean you still wouldn't need the loan. A forgivable loan vs. access to other credit lines that must be repaid with interest have very different impacts on a small business. This could spell the difference between choosing to lay off workers and/or make other cuts, particularly given the fiduciary obligations of a company to the business and its shareholders. Additionally, the inability to access other sources of credit was specifically removed as a condition to PPP loan eligibility in the CARES Act, presumably including access to capital or reserves. Draining all or significantly all of a company's reserves instead of laying off unnecessary workers (whose jobs are otherwise preserved by a PPP loan as one of its express intents) is also an arguable breach of fiduciary obligation, subject to the scope of those reserves. If a borrower's reserves are sufficient to fund operations to outlast the crisis (again, a term very difficult to define), it is likely vulnerable to argument that it should return the proceeds because the certification was not made in good faith.

Paycheck Protection Program: Implications of Certification (2of 2)

- **Economic Uncertainty.** No one has a crystal ball to determine outcome, but in terms of what "necessary" means, if a company has seen no supply chain interruptions, drops in demand or revenue, or increases in costs, and does not reasonably anticipate any, it is also vulnerable to arguments that it should return loan proceeds.

- **Small Businesses Versus Large Companies**. The statute made a sweeping exception for franchises and NAICS 72s that it is now trying to walk back from. These companies are very different from most small businesses. Further, in its most recent guidance, issued April 30, the SBA has now provided that a single corporate group is capped at an aggregate loan of $20 Million, which addresses some of the aggregate loans received by NAICS 72 corporate groups north of $50 Million.

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Paycheck Protection Program: Calculating Loan Amount

Loan Amounts Based on Pre-COVID-19 Employment Levels

- Generally, maximum loan is lesser of (1) $10M or (2) 2.5x Pre-COVID-19 monthly payroll costs

- Pre-COVID-19 payroll costs determined during one of two look-back periods:
  - (1) One-year period leading up to date of application; OR
  - (2) Calendar year 2019
- Payroll costs have specific definition under CARES Act. They include:
  - Employee cash benefits up to $100,000/year gross salary (prorated for 8-week period)
  - Group retirement costs;
  - Group health and other insurance premiums;
  - State and local employment taxes paid by employer; and
  - Payments for vacation, parental, family, medical, or sick leave costs (except those costs that are eligible for credit under Families First Coronavirus Response Act)

- Payroll costs are relevant to loan *amount* and loan *forgiveness*

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Paycheck Protection Program: Calculating Loan Forgiveness

Loan Forgiveness for Eligible Costs During 8 Weeks Post-Origination

- "Costs incurred and payments made" during the eight weeks that follow origination may be forgiven. These costs are a subset of allowable uses, and they include:
  - "Payroll costs"
  - Rent; mortgage *interest;* and utilities
- Only 25% of loan forgiveness may be for non-payroll costs

Loan Forgiveness May Be Reduced for Workforce Reductions

- Whatever portion of the loan is eligible for forgiveness will be *reduced* (or eliminated) based on reductions to (1) number of full-time equivalent employees; and/or (2) wages (beyond 25% reduction) for employees who earn less than $100,000
- Loan forgiveness penalty based on pre-April 26 reductions will be eliminated if an employer re-hires, or increases salaries, to pre-COVID-19 levels by June 30, 2020

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PPP Loan Forgiveness

As of today the guidance available is the CARES Act itself, the SBA FAQ's and interim final rules last updated and issued as of April 14th.

The Act requires SBA to issue additional guidance by April 26th, but it has not done so at this time.

For purposes of this discussion we are assuming that all amounts spent during the 8-weeks after the initial disbursement by the lender are spent for covered costs and the only question is the amount of loan forgiveness.

The definition of covered costs for purposes of loan forgiveness can be found in Section 1106(b).

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PPP Loan Forgiveness General Rules

- The amount of loan forgiveness can be up to the full principal amount of the loan and any accrued interest is paid by the SBA. That is, the borrower will not be responsible for any loan payment if the borrower uses all the loan proceeds for covered costs and employee headcount and compensation are maintained at levels that avoid the cut back rules discussed below.

- While there is the potential for full amount forgiveness, it will be crucial for business owners to properly follow the various calculation mechanics to be eligible for this and SBA has stated overall intent to emphasize covering payroll costs.

- To the extent the loan is not fully forgiven the balance is payable over a two year period (with payments deferred for 6 months) with interest at 1%.

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Potential Reductions in Loan Forgiveness

- The intent of the program is to continue to maintain staffing and wage levels.
- There are two potential cutbacks if work force or the amount of payroll is reduced:
  - Number of full time equivalent employee (FTE) cut back.
  - Reduction in amount of salaries and wages paid.

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Full Time Equivalent Employees Cut Back

The loan forgiveness amount is limited to the average number of FTE per month over the 8-week period divided by, at the election of the borrower,

(1) - The average number of FTE per month during the period February 15, 2019 to June 30, 2019, **or**	(2) - The average number of FTE per month during the period January 1, 2020 to February 29, 2020.	Seasonal employers are required to use the period February 15, 2019 to June 30, 2019.	The loan forgiveness amount will be reduced if the employer did not maintain **staffing levels or payroll amounts.** Both reductions can apply.

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Full Time Equivalent Employees Retention Cut Back

Example:

- $1 million PPP loan all spent on eligible payroll costs.
- 90 FTEs during the 8-week period,
- 110 FTEs during the period February 15, 2019 to June 30, 2019,
- and 100 FTEs during the period January 1, 2020 to February 29, 2020.

Borrower would elect to calculate the forgiveness reduction as: 90 FTEs / 100 FTEs = 90% X $1 million = $900,000 forgiveness cap, subject to the second cut back test, below.

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>25% Wage Retention Cut Back

- For any employee who did not earn more than $100,000 of wages or salary, on an annualized basis, during any payroll period in 2019,
  - the loan forgiveness amount will also be reduced dollar for dollar for any reduction in wages or salary during the 8 week period that is more than 25% of the wages or salary paid to that employee during the most recent full quarter prior to the 8 week period. *Tested employee-by-employee.*
- Based on the above definition, an employee making $75,000 a year who is paid every 2 weeks and received a $1,000 bonus in one pay period would be excluded ($2,885 + $1,000) X 26 = $101,010.
  - Observation –There is no forgiveness penalty for reduction of compensation to employees earning >$100,000. Also, it is not necessary to reduce compensation to $100,000 or less. Only the excess will not be eligible for the forgiveness.

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Favorable Rehire Rules

- Any reduction in (1) employee headcount or (2) wage levels made between February 15, 2020 and April 26, 2020, will be not included in the respective loan forgiveness cutback rules, provided employer has eliminated the reduction in the number of FTE's or has restored the salary or wages of 1 or more employees not later than June 30, 2020.
- Under the rehire rules, there is no requirement to hire back the same employees to meet the FTE headcount rules. However, the wage restoration rules apply on an employee by employee basis.

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How to Request Loan Forgiveness

- A borrower will submit a request to the lender that is servicing the loan.
- We believe that the forgiveness request can be submitted as soon as the loan funds have been fully expended, or after the end of the 8-week covered period.
- The request will include documents that:
  - Verify the number of full-time equivalent employees and pay rates,
  - Payroll tax filings reported to the IRS and State tax authorities and
  - Documentation of payments on eligible secured debt, lease, and utility obligations.
- The borrower must certify that the documents are true and that you used the forgiveness amount to retain employees and make eligible secured debt interest, rent, and utility payments.

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Important PPP Forgiveness Unanswered Questions

- During the 8-week period, how are covered costs measured? Conservative reading of the law indicates certain payroll costs could be reduced at the beginning and end of the covered period.
- How to measure full time equivalent employees?
- How to specifically apply wage cut back dollar reduction (25% reduction)?
- Will one period payments (e.g., bonuses) be excluded from the wage calculation?
- Any requirement to keep number of employees or level of pay beyond June 30th?
- Others?

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Employee Retention Tax Credit

- Refundable payroll tax credit equal to 50% of "qualified" wages paid between March 13, 2020 and December 31, 2020, capped at $10,000 per employee
- Eligible Employer is any employer (including tax-exempt organizations) in business during 2020 whose operation or business is
  - Fully or partially suspended due to a COVID-19 shutdown order, or
  - Gross receipts during any quarter of 2020 declined by more than 50% when compared to the same quarter in the prior year
- "Qualified" wages
  - Employers with more than 100 full-time employees in 2019 – only wages paid to employees when they are <u>not providing services</u>
  - Employers with 100 or fewer full-time employees - <u>all wages</u>

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Employee Retention Tax Credit (Continued)

- IRS issued draft version of Form 941 – Employer's Quarterly Federal Tax Return
  - Will be used beginning with Q2 (April 1 to June 30) due July 31
- Can be combined with payroll tax deferral
- Not eligible if you received PPP loan
- Aggregation rules apply in determining whether the employer has –
  - More than 100 full-time employees
  - Business operation fully or partially suspended
  - Significant decline in gross receipts
  - Received a PPP loan

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Payroll Tax Deferment

- Available to all employers without size restriction
- Employers can defer their payment of the employer's share of social security tax attributable to the period from March 27, 2020 through December 31, 2020
  - Also applies to self-employed individuals – they can defer 50% of social security tax imposed on self-employed income
- The deferred payroll taxes are payable as follows –
  - 50% required to be paid by December 31, 2021, and
  - 50% required to be paid by December 31, 2022
- Does not apply if employer has had PPP loan forgiven
- Can be combined with Employee Retention Credit

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Other Useful CARES Act Tools for Businesses

- Modifications for Net Operating Losses (NOLs)
- Modifications of Limitation on Losses for Taxpayers other than Corporations
- Credit for Prior Year Minimum Tax Liability of Corporations
- Modification of Limitation on Business Interest
- Technical Amendment for Qualified Improvement Property

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Modifications to Net Operating Loss Rules

- Prior law – NOLs generated after 2017 can only offset 80% of taxable income and cannot be carried back, although they can be carried forward indefinitely
- Under the Act,
  - NOLs arising in tax years beginning in 2018, 2019, or 2020 can be carried back for five years (Where you may have been in a higher tax bracket than going forward)
  - The 80% limitation is removed for tax years 2018 through 2020 (including for carrybacks), but returns again in 2021

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Modifications to Net Operating Loss Rules

- Taxpayers who choose not to take advantage of the new NOL carryback must affimatively elect to forego the carryback period
- Special rules apply for NOLs related to fiscal years that started in 2017 and ended in 2018 – they can now be carried back two years
- Deadline for filing Forms 1045 or 1139 for 2018 extended to July 27, 2020.

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Limitation on Losses for Taxpayers other than Corporations

- Prior law due to TCJA –
  - Losses of pass-thru businesses and sole proprietors subject to excess business loss limitation of $250,000 (single) / $500,000 (married) at the individual investor level
  - Any excess carries forward to following tax year as an NOL
- Under the Act, this excess business loss limitation is removed for tax years 2018, 2019 and 2020 (opportunity for amended returns if limitation applied)
- This change may allow some taxpayers to create an NOL in those years that can be carried back under the changes discussed on the prior slide

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Credit for Prior Year Minimum Tax Liability for Corporations

- Current law – The Tax Cuts and Jobs Act (TCJA) repealed the corporate alternative minimum tax (AMT), and made AMT credits refundable over several years
- Under the CARES Act –
  - The deduction of any remaining refundable AMT credits is accelerated to the tax year beginning in 2019, or
  - Taxpayer can elect to claim the entire refundable AMT credit in tax year beginning in 2018

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Limitation on Business Interest Expense

- Prior law – TCJA limited the deductibility of business interest expense to 30% of adjusted taxable income (ATI). Any excess expense carries forward to future years.

- Under the Act, this 30% limitation is increased to 50% of ATI for tax years beginning in 2019 and 2020, thus, giving taxpayers an opportunity to deduct some additional interest expense that may have otherwise been disallowed. Can elect out of increase.

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Limitation on Business Interest Expense

- For tax years beginning in 2020, taxpayers may elect to calculate the limitation based upon their ATI for their tax year beginning in 2019, a likely favorable change given that most taxpayers are expected to have higher taxable income in 2019 than 2020.
- Partnerships cannot use the new 50% limit for 2019. Instead, interest at the partnership level is passed out to the partners and carries over to 2020. Under the Act, in 2020 half of that interest will be fully deductible by the partners while the other half will remain suspended until the partnership allocates excess taxable income to the partners.

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Technical Amendment for Qualified Improvement Property

- Prior law– Due to a drafting error in the TCJA legislation, qualified improvement property (QIP) was subject to a 39-year depreciable life and not eligible for bonus depreciation
- Under the CARES Act, this glitch is fixed to retroactively allow for a 15-year depreciable life on qualified improvement property and allow taxpayers to claim bonus depreciation on such property

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Technical Amendment for Qualified Improvement Property

- Due to the retroactive nature of this provision, taxpayers will either –
    - Amend prior year return(s)
    - File an automatic Form 3115, request for change in accounting method in lieu of amending prior year returns and claim a cumulative catch-up deduction for the additional depreciation on the qualified improvement property

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Employment & Practical Considerations

Continuing Employment Obligations

- WARN Act and state mini-WARN issues if layoffs or furloughs are anticipated at the end of 8-week period.
- Continuing your workforce (without layoff or furlough) with the PPP loan means that employment laws continue to apply
    - Emergency Paid Sick Leave Act
    - Emergency Family & Medical Leave Expansion Act
    - Pre-COVID-19 laws: Family & Medical Leave Act, Maine Whistleblower Protection Act, non-discrimination laws.
- Expansion of Unemployment Compensation (Pandemic and Emergency Increase)
    - Effect on considerations of forgiveness of PPP loans

Returning to Work During COVID-19

- Governors' Orders – returning to work
- Potential changes to employer liability
- OSHA and CDC Guidance

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Q&A

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Resources

1) www.wipfli.com/covid-19-resource-center

2) www.bernsteinshur.com

3) https://disasterloan.sba.gov/ela/Information/Index

4) https://home.treasury.gov/policy-issues/top-priorities/cares-act/assistance-for-small-businesses

5) https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act

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