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Subject: Alan Gassman, Brandon Ketron, Lawrence Starr & Kevin Cameron - Newly Published PPP Loan Forgiveness Application Provides Important Guidance for Borrowers

"On Friday, May 15th, the SBA released borrower-friendly instructions, a documentation retention list, and a relatively simple Loan Forgiveness Application (the 'Application') that will help Borrowers and their advisors organize and calculate PPP loan forgiveness. The instructions and Application provide important guidance on how the SBA will view expenses incurred during the 8 week testing period, which is the date the lender makes the first disbursement of the PPP loan to the borrower, and expenses paid shortly before or after the testing period in a reasonable fashion. As would be expected, there are inconsistencies and new questions that arise between previous guidance and the newly published Application and its instructions."

LISI Commentators **Alan S. Gassman** and **Brandon L. Ketron**, with contributing authors **Lawrence C. Starr** and **Kevin A. Cameron**, provide members with important and timely commentary on the recently released PPP Application and instruction package, including the practical planning implications resulting therefrom. Members who wish to learn more about the PPP Application/instruction package should consider watching the upcoming webinars **LISI** is offering on this topic this week. Simply click this link to learn more: Application/instruction package webinars

Alan S. Gassman, J.D., LL.M. is a partner in the law firm of **Gassman, Crotty & Denicolo, P.A.,** and practices in Clearwater, Florida. Alan is a frequent contributor to LISI, and has published numerous articles and books in publications such as BNA Tax & Accounting, Estate Planning, Trusts and Estates, and Interactive Legal and is coauthor of Gassman and Markham on Florida and Federal Creditor Protection and several other books on Estate and Estate Tax Planning, Trust Planning, Creditor Protection Planning, and associated topics. Alan and David Herzig will be presenting on "The Aftermath of PPP Loans and Other COVID-19 Concerns" at the 46th Annual Notre Dame Tax Institute which is taking

place October 29-30 in South Bend, Indiana. You can contact Jerry Hesch at jhesch62644@gmail.com for more information. Alan's email address is agassman@gassmanpa.com.

Brandon Ketron, CPA, JD, LL.M. is an associate at the law firm of **Gassman, Crotty & Denicolo, P.A.**, in Clearwater, Florida and practices in the areas of Estate Planning, Tax and Corporate and Business Law. Brandon is a frequent contributor to LISI and presents webinars on various topics for both clients and practitioners. Brandon attended Stetson University College of Law where he graduated cum laude, and received his LL.M. in Taxation from the University of Florida. He received his undergraduate degree at Roanoke College where he graduated cum laude with a degree in Business Administration and a concentration in both Accounting and Finance. Brandon is also a licensed CPA in the states of Florida and Virginia. His email address is brandon@gassmanpa.com.

Lawrence C. Starr, FLMI, CLU, CEBS, ChFC, CPC, EA, ATA, QPFC is President of Qualified Plan Consultants, Inc. (QPC), a West Springfield, Massachusetts firm providing Pension and Profit Sharing plan consulting, administration and actuarial services on a fee-for-service basis. QPC does not market any products and works with many area accountants, attorneys and insurance professionals. Though their over 500 clients are primarily found in New England, QPC provides services all over the country.Larry received his Masters of Business Administration in Economics and Finance with a specialty in Insurance from the University of Hartford where he has also served on the adjunct faculty. In addition, he was a member of the faculty of the University of Connecticut for over fourteen years where he taught courses in Pension and Profit Sharing, Social Security, and related areas. He is a frequent lecturer and speaker and has participated in many seminars all across the country.

Kevin A. Cameron, MBA, CPA is the owner of **The Cameron Company, PA** and a managing member partner of **C&L Value Advisors, LLC**. Kevin is also the developer of the PPP Loan Forgiveness Calculator, which is a unique and client friendly dynamic spreadsheet and planning tool that CPAs and other financial professionals can use for planning and compliance that will soon be available for purchase exclusively from LISI. Kevin's firm provides comprehensive accounting, tax preparation and planning, and advisory services. Kevin provides tax planning services using

a proprietary system he developed in 1991. He actively works with clients in numerous areas of business advisory services, including strategic planning and implementation, mergers and acquisitions, growth management, business coaching, systems development and improvement, and team and people-management. Kevin is a member of the Results Accountants Network and the CPA+ Network. These organizations are dedicated to helping CPAs work more effectively with clients in the areas of business development. He has served as a two term President of the Kiwanis Club of Tampa Bay, a member of the University of Tampa Alumni Association, a Boy Scouts of America Leader and Leader-trainer, and a former member of The Executive Committee.

Here is their commentary:

EXECUTIVE SUMMARY:

On Friday, May 15th, the SBA released borrower-friendly instructions, a documentation retention list, and a relatively simple Loan Forgiveness Application (the "Application") that will help Borrowers and their advisors organize and calculate PPP loan forgiveness. The instructions and Application provide important guidance on how the SBA will view expenses incurred during the 8 week testing period, which is the date the lender makes the first disbursement of the PPP loan to the borrower, and expenses paid shortly before or after the testing period in a reasonable fashion. As would be expected, there are inconsistencies and new questions that arise between previous guidance and the newly published Application and its instructions.

FACTS:

The Application and its instructions resolve a number of important issues that Borrowers and their advisors have been hoping would be clarified in a reasonable and understandable manner.

We give the SBA a high grade for what they have done on this, although full guidance is far from having been received, making it difficult for businesses to forecast how much forgiveness they will have, and thus how many employees they can keep.

Primary areas of new guidance and clarification are as follows:

1. **Alternative Time Periods for Payroll Costs, As Well As the Ability to Take Into Account Payroll Costs Incurred During the Eight Week Covered Period, As Long As Employees Are Paid On or Before the Next Regular Payroll Date.**

   Payroll expenses need not be both "paid and incurred" during the exact 8 week period (56 days) that begins on the day that first loan proceeds are received. Prior to this guidance, the language of the CARES Act and previous regulations and FAQs indicated that only payroll that was actually paid during the 8 week time period for services rendered by employees during that 8 weeks, plus PTO (where applicable) used during that 8 weeks, would be forgiven.

   Based upon the new Application instructions, payroll that is funded during (or shortly after) the 8 week testing period can qualify for forgiveness as long as the payroll is handled in a conventional fashion, but the language quoted below is directly from the Loan Forgiveness Application instructions and should be closely followed:

   > *Payroll costs incurred but not paid during the Borrower's last pay period of the Covered Period (or Alternative Payroll Covered Period) are eligible for forgiveness if paid on or before the next regular payroll date. Otherwise, payroll costs must be paid during the Covered Period (or Alternative Payroll Covered Period).*

   There is no specific mention of health insurance or retirement plan contributions in the above language, so hopefully further guidance on this and forgivable expense payment timing will be forthcoming.

   The Application additionally allows the Borrower the option to choose between the "Covered Period," which is the 56 day period immediately following the day of receipt of the first loan money, or an "Alternative Payroll Covered Period," which aligns with the payroll schedule of the Borrower if it is bi-weekly or more frequently.

If elected, the Alternative Payroll Covered Period begins on the first day of the Borrower's first pay period following the date that the Borrower received the first PPP funds, and will end on the 56th day thereafter. This assumes that all Borrowers pay the employees in full on the final day of each pay period.

A Borrower that elects into the Alternative Payroll Covered Period must also account for the other items considered as "payroll costs," being employee health insurance, retirement plan contributions, and state and local taxes assessed on employee compensation during the same period of time, but there is no guidance on exactly what dates these need to be paid by. Additionally, Borrowers that elect the Alternative Payroll Covered Period cannot use such period for non-payroll cost tracking, and must therefore keep track of rent, interest and utilities for the "Covered Period" (the first 56 days after the receipt of the first PPP loan amount), subject to the "paid after incurred in the normal course of business" rule described in Section 2 below.

We encourage employers who are presently paying employees on a monthly payroll schedule to begin paying bi-weekly before they receive their PPP loan funds in order to be eligible for the Alternative Payroll Covered Period.

No Delay of 8 Weeks for Businesses That Are Still Shut Down. Unfortunately, the above appears to be the only relief provided with respect to the start date of the 8 week "Covered Period". Many have recommended that the start date of the Covered Period be delayed for businesses still under government-mandated shut down orders. Treasury Secretary Mnuchin indicated in a March 15th news interview that there are no plans to take this problem into account, sounding the death knell for countless restaurants, bars, and other businesses whose jobs support the economy, along with the leased spaces and landlord, supplier, and tax receipts that disappear with them.

2. **<u>Flexibility Provided for Payments of Interest, Rent and Utilities in Normal Course of Business.</u>**

Expenses for interest, rent and utilities, as defined in the rules, will be forgivable if incurred during the Covered Period and paid, to some extent, in the normal course of business thereafter.

The instructions provide as follows:

> *An eligible non-payroll cost 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. Eligible non-payroll costs cannot exceed 25% of the total forgiveness amount. Count non-payroll costs that were both paid and incurred only once.*

We do not believe that the above language will apply to health insurance or retirement plan contributions, because they are considered to be "payroll costs" under the applicable terminology, but we hope that subsequent guidance will be issued to clarify this.

One of our favorite authors, Tony Nitti, the Tax Geek, writing on his amazing Forbes Blog, reads the above language to mean that Borrowers can be in arrears on interest, rent and utilities incurred before the 8 week period begins, and thus receive forgiveness both for those amounts incurred before and during the 8 week period, if paid pursuant to the rule set forth in the language above. This may be possible, but may also be prevented by subsequent guidance.

3. **<u>Rent and Interest on Secured Loans and Security Agreements and Leases May Cause Forgiveness.</u>**

If in effect on February 15th, rent and interest paid on business assets (including non-real estate business assets), and interest paid on loans secured by security agreements will be eligible for forgiveness.

Interest on mortgage payments will presumably include interest on debt that is secured by personal (non-real estate) assets such as furniture and equipment under security agreements, and forgivable rent expense can include rent paid for the use of personal (non-real estate) business assets, which may include corporate vehicles, copiers, postage meters and other rented assets so long as the debt was “incurred” on or before February 15th by a binding loan arrangement.

It is unknown whether below market value loans or leases may be modified to reflect their fair market value after the February 15th date. Because of this, many Borrowers may try to amend their current undervalued loan and lease agreements to reflect fair market value and pay fair market value during the Covered Period, while they wait for further guidance before filing the Application in order to determine whether the forgiveness will apply to the rate of interest or rent that was applicable under the original agreement in effect on February 15, 2020, or whether the higher amounts paid during the 8 week period may be used. As it reads now, however, it seems more likely that the cost eligible for forgiveness is the cost that was “in force before February 15, 2020.”

There is no guidance on whether “lease payments” made on a “financing lease” where the lease arrangement is considered to be a purchase for financial statement and tax purposes will be includable for forgiveness. Many equipment, furniture, and automobile leases that are considered to be amortized loan arrangements for income tax and financial reporting purposes may nevertheless be treated as leases under these rules, or the SBA may require that they be considered as debt, so that the forgiveness would only apply to that part of each payment that would be considered to be interest under applicable tax or accounting principles.

4. **<u>What about prepayments of business rent or lease payments?</u>**

On page 2 of the Application, the explanation for Line 2 (business

mortgage interest payments) specifically adds a final sentence that reads: "Do not include prepayments" (emphasis added). However, in the explanation for Line 3 (business rent or lease payments), there is no such prohibition. Would payment of the next 6 months of rent count toward the 25% limit? It appears that the answer is yes (at least until we get even more guidance to correct the guidance already issued). Based upon the above, Borrowers who do not have sufficient non-payroll expenses to maximize forgiveness may wish to prepay rent during the 8 week period in case the amount of the prepayment can be forgiven. Again, there is little downside risk since the rent is going to be paid anyway at some near point in time.

5. **Uncertainty of Utility Definition.**

The inclusion of expenses “internet access” and “transportation” as part of the definition of “utilities” is reinforced in language of the Application, which provides the following definition for “covered utility payments”:

> *(c) covered utility payments: business payments for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020 (“business utility payments”).*

We are still not sure if “gas” can include gasoline for “transportation” or what “transportation” means because of the uncertainty as to whether it can be stated that such service began before February 15, 2020.

6. **The 75% Rule is Not Hard-and-Fast.**

The SBA’s interim final rule providing that loan recipients must expend 75% of the loan on payroll costs, health insurance, and pension expenses or loan forgiveness will be limited has caused much confusion.

Many experienced advisors and writers on the topic interpreted this rule as requiring recipients of PPP loans to spend at least 75% of such funds on payroll, health insurance, and pension expenses, or not receive any forgiveness.

The newly issued Application instructions include calculations that clarify that this is not an “all or nothing” requirement, and loan forgiveness can still apply even if 75% of the loan amount is not spent on payroll cost. The Application provides that “eligible non payroll costs cannot exceed 25% of the total forgiveness amount.” To apply this limitation, Borrowers first determine their payroll, health insurance, and retirement plan expenses (“Payroll Costs”), and then Borrowers add not more than 33.33% of the Payroll Costs in other non-payroll forgivable expenses (i.e. rent, utilities, and interest) to determine their loan forgiveness amount.

For example, if the loan is $200,000, and only $120,000 is spent on Payroll Costs and the other $80,000 is spent on non-payroll costs, the Borrower will only be able to count $40,000 in non-payroll costs ($120,000 x 33.33% = $40,000). This results in a total of $160,000 in potential loan forgiveness consisting of $120,000 of payroll costs (75% of the total forgiveness amount) and $40,000 on non-payroll costs (25% of the total forgiveness amount).

7. **<u>Reduced Workforce and Compensation Reduction Ratios.</u>**

The Application also provides instructions and guidance on how to calculate the reduction in total forgiveness when there is a reduction in the number of “full time equivalent” employees, or a reduction in employee salaries of more than 25% for employees making under $100,000 annually. The instructions state that the reduction applies to the total amount of loan forgiveness, therefore forgivable amounts for rent, interest and utilities are also reduced if there is a reduction in the number of employees or salaries.

8. **<u>What Retirement Plan contributions count: Paid OR Accrued?</u>**

In what appears to be a possible change in the SBA pronouncements, the new Loan Forgiveness Application can be read to allow for contributions to retirement programs that are incurred OR paid during the Covered Period to count in the determination of total payroll costs and forgiveness. Assuming that this is correct (and we see no reason why it should not be), then contributions actually made during the Covered Period or Alternative Payroll Covered Period (the applicable 8 weeks) will be included in payroll costs and subject to forgiveness, regardless of what year those contributions are attributed to.

This would be a very favorable development and would encourage and reward employers who still have retirement plan contributions due for the 2019 year to contribute those funds during the 8 weeks for the benefit of workers who will need retirement benefits, or may withdraw or borrow from the plans under the new CARES Act $100,000 per employee withdrawal or borrowing rules that apply to qualified plan participants where permitted by the employer. In addition, it appears that contributions made during the 8 weeks that are allocated for the 2020 plan year can also be included.

The above interpretation comes from the bottom of page 1 of the Application, which provides that the Borrower should "Enter total eligible payroll costs incurred or paid (emphasis added) during the Covered Period or Alternative Payroll Covered Period." at Line 1.

As an example, a client that contributes $200,000 a year to a defined benefit pension plan that has not yet been funded for 2019 or 2020 will be able to contribute as much as $400,000 to the plan during the 8 week period to receive $400,000 of forgiveness that might otherwise not be available if other expenses are not sufficient for full forgiveness of the PPP loan, although such forgiveness will be reduced if there has been either or both of (a) a substantial reduction in the workforce or (b) a more than 25% reduction in pay rates for one or more non highly compensated (under $100,000 a year)

employees. These reduction of forgiveness rules are now mechanized and clarified in the Application and instructions. It is therefore possible that judicious use of retirement plan funding could provide 100% (not just 75%) of the payroll requirement without even requiring any payroll to actually be paid to employees.

Consider this surprising example: ABC, Inc. is a one person business (no rank-and-file employees) operating as a corporation with a defined benefit plan that will allow for annual funding of $200,000. The 100% stockholder is the only employee of the business, and has no concern about the reduction in workforce or compensation tests. If he included his compensation (limited to $100,000) plus $200,000 for his retirement funding in his application for funds, and received those amounts, simply funding the defined benefit plan at this point could provide full 100% forgiveness. Was this windfall intended? Maybe not, but it appears to be how the current rules will work, barring any further guidance or changes.

It should be noted that the same rules should apply to any employer health insurance payments made for benefits attributable to periods before, after and during the 8 week period since those payments, like retirement plan payments, are indistinguishable from any other eligible payroll costs.

If the employer should have non-tax qualified "retirement plans", such as those known as Top Hat Plans and/or Rabbi Trusts, the payroll costs appear to also include payments to these types of plans since the statute just references “retirement plans” and not qualified plans.

We would be remiss to not mention another possible source of funds involving retirement plans. The CARES Act added a special limited time loan option where a retirement plan that allows loans (it is the employer's option as to whether to allow this or not) can provide that the statutory loan limit of $50,000 maximum can be modified for a short period this year to a maximum of $100,000 (but no more than 100% of the employee's account balance). An employer might therefore make a contribution to a plan that can count toward the

forgiveness amount (as discussed above), and then up to this $100,000 amount could be borrowed from the plan by the employee owner and loaned to the business so that cash flow to the business is enhanced. While this is certainly possible, Co-Author Larry Starr strongly recommends that it be a contingency of last resort, because adding these loan provisions to the plan will permit ALL the participants to receive such loans (they cannot be discriminatory) and this is no time for the employer to get into the banking business with its employees. These loans require just as much attention by the employer as the bank would apply to its own portfolios of loans. Plus there is the issue of possible default on the loan to the plan, which would result in taxable income to the individual on the $100,000, but without funds being available to pay the taxes since the money was loaned back to the business which has possibly failed. In a plan that has no employees other than the owner, this option might be more attractive, but the risks outlined above must be considered.

Advisors may consult with pension experts to determine what compensation needs to be paid to maximize retirement plan contributions for a given year. Profit sharing and other defined contribution plan contributions are generally limited to a percentage of compensation for each participant each year, while defined benefit (including cash balance plans) contributions can be based upon a 3 year average of the past highest compensation amounts paid to each employee.

It is of course possible that the SBA will plug this planning opportunity into future guidance that may be given. Clients should be advised that there is some risk that forgiveness may not ultimately be determined in this very liberal manner and may only apply to part of these payments that is calculated in some other manner, such as those amounts attributed on a pro-rata basis to 8 weeks of actual pension contributions (8/52nd's of total 2020 employer plan contributions). If further guidance is not received prior to approaching the close of the 8 week period, the employer will have to decide whether they want to contribute such significant funds to their retirement plan with the possibility that it may not all qualify for

forgiveness. If the employer is going to fund the plan at that level for the 2020 year anyway, then putting the funds in during the 8 week period has no downside risk and allows for the possibility that it might all qualify as compensation for the forgiveness calculation. A reasonable recommendation is that it may be best to file the Loan Forgiveness Application as soon as possible after the 8 week period has ended and before the rules on this may be changed or clarified.

9. **Vulnerability Still Lingers for Independent Contractors, Proprietors and Partners in Partnerships.**

The Application and instructions confirm prior guidance that self-employed individuals (sole proprietors; including independent contractors and individuals who are general partners in a partnership) will not be allowed to include the costs of their own health insurance or retirement plan contributions in the determination of total eligible payroll costs for purposes of forgiveness. It also appears that those amounts should not have been included in the application for the funds in the first place and those entities that did include those amounts in the application for PPP funds may need to consider paying those amounts back as soon as possible, although the previous guidance was not clear on whether expenses paid for health insurance and pension contributions for working partners would result in forgiveness. The authors are not aware of any reason that Borrowers who operate businesses in entities taxed as disregarded or partnerships should be treated differently than those that run their businesses under entities taxed as S corporations, C corporations, or not-for-profit/religious organizations.

The newly issued instructions for what is known as "PPP Schedule A" provide that the "Payroll" will include total amounts paid by the Borrower for "**employee** health insurance…[and] employer contributions to **employee** retirement plans…[and] state and local taxes assessed on **employee** compensation…" (emphasis added). Partners in a partnership are not considered to be "employees" for tax purposes, even though shareholders of S Corporations and C Corporations are employees. The SBA seems to be determined that

partners and sole proprietors will simply not get to include these items. Of course, it is always possible that additional guidance (or Congressional modifications, which the authors believe are appropriate to cure this gross inequity) might change this prohibition.

The instructions for Line 9 of the Application provide for the inclusion of "any amounts paid to owners (owner-employees, a self-employed individual, or general partners). This amount is capped at $15,385 (the 8 week equivalent of $100,000 per year) for each individual," and reference is made to the April 14, 2020 Interim Final Rule, which indicates that partnerships would include health insurance and retirement plan expenses for "employees" in determining the amount that can be borrowed. Earlier guidance did not clearly indicate whether such items would be limited to monies paid for **employee** health insurance and retirement plans (as opposed to allocations on behalf of partners who work for the partnership) with respect to forgiveness. Earlier guidance did include definite prohibition for sole proprietors, and some commentators believed the same would apply to any self-employed individual, including partners in a partnership.

Larry Starr has been of this opinion since the first restriction on sole proprietor/self-employed individuals was issued. He has been notifying his clients and industry advisors for weeks that this is the likely interpretation. Larry notes that the decision of the SBA to NOT allow self-employed (both sole proprietors and partners in a general partnership) to include expenses paid for health insurance and retirement plan contributions for owners is dramatically unfair to such entities. As noted above, a sole shareholder in an S corporation will get to include his or her full benefit costs (health insurance and retirement plan contributions) for the loan and forgiveness, while the individual who elected to be treated as unincorporated is discriminated against and will not be allowed to receive these benefits within the PPP structure. There is still hope that this might be modified, but the SBA did not do so in this release of the Loan Forgiveness Application.

Conclusion

While the form is not perfect, the SBA deserves credit for providing one with needed flexibility. The issues with the form are similar to the issues surrounding some of the requirements for taking the loans in the first place, which are inconsistent treatments and unclear language. Despite these hiccups, borrowers at least have a better idea about their expected amount of loan forgiveness.

Hopefully the SBA will issue further flexible and lenient regulations and guidance to address these issues, rather than issuing more limitations.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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