Paycheck Protection Program: Loan Forgiveness Requirements

If you were one of the lucky small businesses approved for a PPP loan, you likely feel pretty good knowing that an injection of money is coming your way. That money is backed by a 100% federal government guarantee (i.e., it will be forgiven) if it is used as specified by the CARES Act and Small Business Administration ("SBA"). Recently, the SBA came out with guidelines on how the money can be used if it is to be forgiven and the process of applying for forgiveness.

What costs are eligible for forgiveness?

PPP loans can be used for payroll costs, interest payments on a mortgage in existence on February 15, 2020, rent payments under a lease agreement in existence on February 15, 2020, or utility payments for services in existence on February 15, 2020. Payroll costs include salary, wages (including tips), commission, payments for vacation, parental, family, medical or sick leave, allowance for dismissal or separation, payments for provisions of group health care benefits (including insurance premiums), payments for retirement benefits, and state or local payroll taxes. Payroll costs do not include payments to independent contractors, cash compensation in excess of $100,000, prorated as necessary, employers' shares of federal payroll taxes, or any sick leave covered under the Families First Coronavirus Response Act.

However, a borrower's loan forgiveness amount will decrease if the borrower decreases full-time employee headcount or the borrower decreases salaries and wages by more than 25% for any employee that made less than $100,000 annualized in 2019. Employers have until June 30, 2020 to restore full-time employment and salary levels for any changes made between February 15, 2020 and April 26, 2020.

Additionally, the SBA has recently promulgated regulations requiring that 75% of the loan must go towards payroll directly if a business is to receive 100% PPP loan forgiveness. Essentially, the SBA is turning small businesses into an extension of the employment office. So, while employers *can* use their PPP loans for certain expenses outside of payroll costs, the SBA is encouraging borrowers to use the loans to pay employees.

How do I apply for forgiveness?

Borrowers can submit a request to the lender that is servicing their loan, including documents that verify the number of full-time equivalent employees and pay rates, payments on eligible mortgage interest, leases, and utility obligations. Borrowers must certify the documents are true and that the borrower used the PPP loan to keep employees and for other qualifying expenses. After submittal, the lender has 60 days to make a decision on the forgiveness.

Unfortunately, neither the Treasury Department nor the SBA has put out a form forgiveness application or issued guidance on which documents will need to be filed with the application. As such, The Maloney Firm recommends borrowers keep all documents associated with the PPP or that evidence their payroll, mortgage interest payments, lease payments, and utility payments – particularity tax documents and updated versions of the documents you filed with your loan application. Without knowing exactly what documentation employers will need to file with their forgiveness application, employers should cover all their bases and keep everything they can.

If your business managed to receive a PPP loan without filing all of the necessary application documents required by the CARES Act, your business will be required to provide certified copies of those documents with its forgiveness application. This includes documentation verifying the number of full time employees on payroll and payrates for the specified periods, including payroll tax filings reported to the IRS and state income, payroll, and unemployment insurance filings, documentation verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utilities, including cancelled checks, payment receipts, transcripts on accounts or other documents verifying payments, certifications. SBA can require any additional documentation it determines necessary, as well.

What if part or all of my loan is not forgiven?

If part or all of a borrower's PPP loan is not forgiven, the SBA is still providing favorable terms to the borrower. PPP loans have a fixed interest rate of 1.00%. The loan's maturity date (i.e., date it must be fully paid back) is two years, but there are no prepayment penalties or fees if a borrower wishes to pay back the loan earlier.

Is California providing tax forgiveness for PPP loans that are forgiven?

Currently, California is not providing tax forgiveness for PPP loans that are forgiven, meaning that California treats forgiven PPP loans as taxable income. While the CARES Act specifically excepts forgiven PPP loans from a business's taxable income, California has only conformed its tax code to the Internal Revenue Code as of January 2015. The important takeaway from California's conformity date is that, unless California also specifically excepts forgiven PPP loans from taxable income or brings its Internal Revenue Code conformity date to the present, forgiven PPP loans are taxable income in California.

How does a forgiven PPP loan affect other tax deductions?

Recent guidance by the IRS indicates small businesses that receive PPP loan forgiveness are going to lose other tax breaks a consequence. The IRS recently came out with a notice stating:

> no deduction is allowed under the Internal Revenue Code . . . for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan pursuant to [the CARES Act's PPP loan program] and the income is associated with the forgiveness is excluded from gross income for purposes of the [IRC under the CARES Act].

IRS Notice 2020-32; https://www.irs.gov/pub/irs-drop/n-20-32.pdf

Essentially, businesses are unable to double dip expenses – meaning they cannot use a forgiven PPP loan to pay an expense and also deduct that expense from their taxes. Of course, Congress could change this in a future piece of legislation. However, as of now, businesses are losing deductions for any otherwise deductible expense if it is paid for with forgiven PPP loan money.

Is your business likely to be audited?

On April 28, Treasury Secretary Steven Mnuchin stated that businesses that received more than $2 million in PPP loans will be fully audited by the SBA to ensure compliance with the CARES Act's PPP loan requirements. Businesses that received lesser loans will be spot checked. If your small business is one that received more than $2 million, expect to be audited. If you received $2 million or less, the probability of an audit is unclear. One small business lender consulted for this article indicated that he thinks no businesses that received less than $350,000 will be audited, and only businesses receiving between $350,000 and $2 million will be spot checked. Until more guidance from the Treasury Department or SBA becomes available, all businesses that received a PPP loan should anticipate and plan for an audit to ensure any potential audit proceeds smoothly.

Borrowers that received a PPP loan should do whatever is necessary to ensure that their loan is forgiven. While the Treasury Department and SBA have not outlined what documents will be required for loan forgiveness yet, businesses should begin collecting a trove of documents they believe might be even somewhat relevant – starting with updated versions of all of the documents they were required to submit with their loan application. Additionally, businesses should expect and begin planning for potential increased tax liability from the State of California for any forgiven PPP loan and a potential audit by the SBA.

For more information regarding this article, call The Maloney Firm at 310.540.1505.