Dannible & McKee, LLP

Certified Public Accountants and Consultants

Delivering **Confidence**

2020 Tax Update for Construction

Presented by
Joseph A. Hardick, CPA, CCIFP
Tax Partner

Dannible & McKee's Annual Construction Conference

December 15, 2020

Disclaimer

Circular 230

Any tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions.

Ordinary Individual Income Tax Rates

- **Individual Income Tax Rates**

  Present Law:

  - 37% top marginal rate.

  Biden Platform:

  - **Increase top marginal rate to 39.6% for those with taxable income above $400,000**.
  - Those with less than $400,000 of income would not have a tax increase.

LT Capital Gains & Qualified Dividends

Present law:

- Taxed at 0%, 15% or 20% depending on income.
- 3.8% NIIT on incomes over $200,000 single and $250,000 married joint.
- TCJA created Qualified Opportunity Zones (QOZ) which allow for deferral of capital gains.

Biden Platform:

- For taxpayers with **income over $1 million, tax at top ordinary income tax rate of 39.6%**.
- **Public disclosure** of people who receive **QOZ tax benefits** to show impact on local residents.
- Possible splitting of qualified dividends to be taxed as ordinary income.

Individuals

- **Itemized Deductions**

  Present Law:

  - The TCJA increase the standard deduction available to all taxpayers. However, it eliminated personal exemptions and further limited or eliminated other itemized deductions.
  - Itemized deduction changes under the TCJA sunset after 2025.

  Biden Platform:

  - **Restores the Pease limitation** on itemized deductions for taxable income above $400,000.
  - **In addition, a cap on itemized deductions at 28% of value**.
  - Eliminate **SALT cap**.

- **Student Loans and Education**

  Biden Platform - Tax-free forgiveness of all student loans after 20 years on income-based repayments. (To be expanded??)

Payroll & Self-Employment Taxes

- **Payroll Taxes & Self-Employment Taxes**

  Present Law:

  - 6.2% Social Security tax on wages up to $142,800 (2021 limit) paid by both the employer and employee.
  - 1.45% Medicare tax on all wages paid by both the employer and employee.
  - 0.9% Medicare tax on wages in excess of $200,000, $250,000 if married paid only by employee.
  - 12.4% Social Security tax on self-employment earnings up to $142,800 (2021 limit).
  - 2.9% Medicare tax on all self-employment earnings.

  Biden Platform:

  - Keeps the FICA & Social Security wage cap's existing threshold of $142,800 (indexed).
  - **Applies the 6.2% FICA tax on both employer and employee on wages earned above $400,000**.
  - Applies the 12.4% tax on all self-employment income over $400,000.
  - **The 6.2%/12/4% tax would not apply to wages or self-employment income between $142,800 and $400,000**.

- **Medicare for All Premium Tax** - Biden currently does not has a public proposal for this, that has been released.

Example 1

- John and Marsha have income of $1,000,000 for John's business as a YouTube celebrity. John's tax return will look like this for 2020:

	2020		2021 (??)	
Self-employed (S/E) income	$ 1,000,000		$ 1,000,000	
Interest income	40,000		40,000	
Qualified dividends	60,000		60,000	
Total income	1,100,000		1,100,000	
Deduction for S/E tax (50%)	(25,230)	(A)	(59,584)	(A)
Standard deduction	(24,800)		(24,800)	
Taxable income	$ 1,049,970		$ 1,015,616	
S/E tax (100%) (2*A)	50,460		119,168	
Income tax (B)	317,717	(B)	323,159	(B)
Total tax	$ 368,177		$ 442,327	

Investment & Business

- **Carried Interest**

  Present Law:
  - Requires separate holding period tracking for gains allocated to partners who obtain partnership interest in connection with the performance of services.
  - Carried interest would need to **be held for a minimum of 3 years in order to receive long-term capital gain** treatment upon sale.

  Biden Platform:
  - No current public proposal related to this item, but the Obama Administration proposed to change tax treatment of **carried interest from capital to ordinary**.
  - Democrats support a change on this item.

- **Qualified Business Income Deduction (QBID) - (Section 199A)**

  Present Law - Taxpayers who have domestic (QBID) from a partnership, S corporation, or sole proprietorship. may be entitled to up to a 20% deduction.

  Biden Platform:
  - **Phases out the QBID for filers with taxable income above $400,000**.
  - **Disallow QBID for real estate investors**.

Investment & Business

- **Like-Kind Exchange – Biden Platform:**
  - **Repeal of like-kind exchanges of real property for taxpayers with income over $400,000**.

- **Retirement Accounts – Biden Platform:**
  - **Eliminate deduction** for retirement contributions and **replace with a flat 26% tax credit**.
  - **Create an automatic 401(k) option** for workers whose employer doesn't offer a retirement option.

- **Corporate Income Tax Rate – Biden Platform:**
  - **Increase flat tax rate from 21% to 28%.**
  - **15% minimum tax on book income** with U.S. – based income of **$100 million or more**.
  - **10% offshoring surtax** on profits of U.S. companies operating overseas and selling in the U.S.
    - This surtax would **raise the effective corporate tax rate to 30.8%**.

Tax Credits

- **Renewable Energy Credit - Biden Platform:**
  - Restore electric vehicle tax credit.
  - Expands several renewable-energy-related tax credits, including tax credits for carbon capture, use, and storage as well as credits for residential energy efficiency.

- **Manufacturing Credit - Biden Platform:**
  - Establish an advanceable 10% "Made in America" tax credit for activities that restore production, revitalize existing closed or closing facilities, retool facilities to advance manufacturing employment, or expand manufacturing payroll.

- **First-Time Home Buyers - Biden Platform:**
  - Create **$15,000 tax credit for first-time home buyers**.
  - Create a refundable **tax credit for renters** aimed at holding rent and utility payments at 30% of income.

Tax Credits

- **Child and Dependent Care Credit, Child Tax Credit & Earned Income Credit - Biden Platform:**
  - Expands from a maximum of $3,000 in qualified expenses to $8,000 ($16,000 for multiple dependents) and Increases maximum credit rate from 35% to 50%.
  - For 2021 and as long as economic conditions require, increases the Child Tax Credit (CTC) from a maximum value of $2,000 to $3,000 for children 17 or younger, while providing a $600 bonus credit for children under 6. The CTC would also be made fully refundable, removing the $2,500 reimbursement threshold and 15% phase-in rate.
  - Expands the Earned Income Tax Credit (EITC) for childless workers aged 65.

Other Considerations

- **Biden promised to reverse the most "egregious" tax breaks in the Tax Cuts and Jobs Act (TCJA).**
  - Does that include:
    1. Definition of small contractor ($25,000,000 in revenue). Allowing us to use restricted tax methods of accounting, such as completed contract, cash, or other non-460 methods.
    2. Lower income thresholds for implementation of AMT on corporations.
    3. Additional restrictions on utilization of tax attributes (NOL's).

Transfer Tax

- **Gift/Estate/GST Tax Exemption**

  Present Law:
  - Exemption per donor of $10 million, with indexing for inflation through 2025, and a return to pre-TCJA levels on January 1, 2026.
  - $11.58 million per donor in 2020.

  Biden Platform:
  - Return the estate tax to 2009 levels, which would reduce the estate and GST exemption to **$3.5 million per taxpayer**.
  - May implement a lifetime **gift and GST exemption of $1 million per taxpayer**.

- **Estate/Gift/GST Tax Rates**
  - **Present Law** - Top rate of **40%**
  - **Biden Platform** - A return to 2009 levels may implement a top rate of **45%**.

Transfer Tax

- **Basis Step-Up.**

  Present Law:

  - Inherited assets receive a basis equal to the fair market value as of the date of death (or alternate valuation date).

  Biden Platform:

  - Eliminate step-up in basis and possibly tax unrealized capital gains at death on assets not passing to a surviving spouse or charity.

2021 New York State Budget Extends and Amends Several Tax Credits

- The 2020-2021 New York State Budget was signed on April 3, 2020 and includes no new taxes, continues to phase in tax cuts for the middle class, enacts the strongest Paid Sick Leave program in the nation, and advances other progressive priorities.
- The spending plan also grants Governor Andrew Cuomo extraordinary powers to withhold or reduce payments to schools and local governments as the year progresses if the coronavirus threatens state collections.
- Even before the coronavirus began to fully unfold, the budget deficit was projected to be at least $6 billion, but is now estimated to grow to $25 billion or more.

2021 New York State Budget Extends and Amends Several Tax Credits

- Like many other states, New York is depending upon more aid from the Federal government to help make up this deficit. The state is also considering lowering state spending by $8 billion, and freezing hiring, new contracts, and pay raises.
- There are also several proposals being talked about to raise taxes on the rich – (multi-millionaires) to help cut the budget deficit.

PPP Loan Forgiveness Tax Issues

- CARES Act provides that PPP loan forgiveness amount is **excluded from gross income**.
  - However, the IRS issued ***IRS Notice 2020-32*** stating that pursuant to ***IRC Section 265***, the **expenses paid that are allocable to the loan forgiveness are not deductible** up to the amount of the loan forgiveness.
  - Furthermore, the IRS issued ***Rev. Rul. 2020-27*** stating that if a Taxpayer has a reasonable expectation of forgiveness, **the expenses allocable to the loan forgiveness are not deductible in 2020, regardless of whether you apply for and/or receive forgiveness in 2020 or 2021**.

- CARES Act (Section 2301) **Employee Retention Tax Credit** provision is **not available** if PPP loan is received.

- CARES Act (Section 2302) **Employment Taxes Payment Deferral** provision **was not originally available** if PPP loan is forgiven.
  - The PPP Flexibility Act modified this to **now allow for the employment tax deferral** even if all or a portion of the PPP loan is forgiven.

Other Business Changes

Recovery Period for Real Property Shortened

- The cost recovery periods for most real property are 39 years for non-residential real property and 27.5 years for residential rental property.
- ***Cares Act - Qualified Improvement Property (QIP).***
  - Provides a technical correction to the TCJA, and specifically **designates (QIP) as 15-year property** for depreciation purposes.
  - Prior to this correction, QIP fell into the 39-year recovery period for nonresidential rental property.
  - Effective for property placed in service after December 31, 2017.
  - **Consider amending 2018 or/or 2019 tax returns** which could also create an NOL to carryback to prior years. Due by 10-15-21 *(Rev. Proc. 2020-25).*
  - **Can make an accounting method change** in current year to "catch up" depreciation by filing **Form 3115** *(Rev. Proc. 2020-25).*

Limitation on Interest Deductions for Businesses

- **Prior Law -** Businesses were allowed to deduct 100 percent of their business interest expense.

- **TCJA -** Interest deductions for businesses with **average annual gross receipts over $26 million** for the 3 prior years generally are **limited to 30%** of the corporation's **adjusted taxable income**.
  - ***Adjusted Taxable Income*:** Defined as the taxpayer's taxable income, computed without regard to:
    - Any item of income, gain, deduction or loss that is not properly allocable to a trade or business;
    - Any business interest expense or business interest income;
    - The amount of any net operating loss (NOL) deduction under Code Section 172;
    - The amount of any QBI deduction allowed under Code Section 199A; and
    - For tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization or depletion.
  - Disallowed interest can be carried forward indefinitely.
  - Special reporting rules apply to partnerships and S corporations.
  - **No sunset provision.**

Limitation on Interest Deductions for Businesses

- **CARES Act Changes.**
  - Temporarily and retroactively **increases the taxable income limitation from 30% to 50% for tax years beginning in 2019 and 2020**.
  - Amending a 2019 return to reflect an increased interest deduction could result in an NOL in 2019 that could be carried back to prior years.

Excess Business Losses and Net Operating Losses

- **TCJA:**
  - **Excess Business Loss Limitation**
    - Modified existing tax law on excess business losses by limiting losses from all types of business for noncorporate taxpayers.
    - Disallowed excess business losses of noncorporate taxpayers if the amount of the loss is in excess of $250,000 ($500,000 in the case of a joint return).
    - Excess business losses that are disallowed are treated as a net operating loss carryover to the following taxable year.
  - **Net Operating Loss (NOL)**
    - Elimination of NOL Carryback for losses incurred after December 31, 2017.
    - For losses in tax years beginning after December 31, 2017:
      - The NOL deduction was limited to 80% of taxable income.
      - The NOL is allowed to be carried forward indefinitely, subject to the 80% taxable income limitation.

Excess Business Losses and Net Operating Losses

- **CARES Act:**
  - **<u>Modification of rules relating to excess business loss limitation</u>**.
    - Retroactively modifies the loss limitation for noncorporate taxpayers so they can deduct excess business losses arising in 2018, 2019, and 2020 (with losses arising in tax years beginning after December 31, 2020 and before January 1, 2026 continuing to be subject to the limitation).
    - The provision also includes retroactive technical corrections to the TCJA. Thus, the provision clarifies that excess business losses don't include any deduction under Code Section 172 (net operating loss deduction) or under Code Section 199A (qualified business income deduction).
    - The provision restates the excess loss carryover rule to provide that a disallowed excess loss is an NOL for the tax year for purposes of determining any NOL carryover to later tax years (rather than being automatically treated as an NOL carryover to the next tax year).

Excess Business Losses and Net Operating Losses

- **CARES Act**:
  - **Modification of rules relating to net operating loss (NOL) carrybacks**.
    - NOLs arising in a tax year beginning after December 31, 2017 and before January 1, 2021 can be carried back to each of the five tax years preceding the tax year of such loss.
    - Election can be made to forego the carryback period (needs to be done by the due date of the 2020 tax return).
    - Carryback Refund Claims for 2019 loss are due December 31, 2020.
    - Losses prior to 2019 can be carried back but amended returns must be filed to claim the refund.

Excess Business Losses and Net Operating Losses

- **Modification of rules relating to net operating loss (NOL) carrybacks**.
  - EXAMPLE:
    - $600,000 NOL generated in 2018.
    - Option to Carryback to 2013 or carryforward to 2019 and 2020.
    - Income in 2013 is the same as 2020:

Taxpayer wages	$	150,000
Spouse wages		150,000
S-corp income		300,000
Total AGI	$	600,000

Excess Business Losses and Net Operating Losses

- **<u>Excess Business Loss and NOL Carryback.</u>**
  - EXAMPLE:

	2020	2013
AGI	$ 600,000	$ 600,000
QBI	(60,000)	-
Standard deduction	(24,800)	(12,200)
Taxable income	$ 515,200	$ 587,800
Federal tax	$ 129,910	$ 180,415

Future Legislation

- **Details of the Biden Tax Plan**
  - Phases out the qualified business income deduction (Section 199A) for filers with taxable income above $400,000.
  - EXAMPLE:

	2020	Biden Plan
AGI	$ 600,000	$ 600,000
QBI	(60,000)	-
Standard deduction	(24,800)	(24,800)
Taxable income	$ 515,200	$ 575,200
Federal tax	$ 129,910	$ 158,970

New York State Treatment of Federal Changes Under the CARES Act

NYS Treatment of Federal Changes Under the CARES Act

- On April 3, 2020, New York became the first state to decouple from several features of the CARES Act for corporate business and personal income taxes. The state decoupling extended to New York City taxes, as well.
  - **Business Interest Expense - Section 163(j)**:
    - By decoupling, the State will not follow the CARES Act's increasing the limitation from 30% of ATI to 50% of ATI for the 2019 and 2020 tax years. Thus, a separate IRC Section 163(j) calculation and tracking of the New York limit will be required along with any resulting carryover of excess interest expense not utilized.
  - **Net Operating Losses**:
    - New York provides its own NOL deduction and carryback rules and had already decoupled from the Federal rules prior to the CARES Act modifications.
    - New York has not adopted the NOL carryback amendment of five years, as provided by the CARES Act. The NOL carryback period for New York is two years.
    - New York has not adopted the temporary suspension of the NOL limitation under the CARES Act. As a result, the NOL deduction is still subject to the taxable income limitation of 80% for New York.
    - This creates lots of issues for personal New York NOLs.

NYS Treatment of Federal Changes Under the CARES Act

- **Excess Business Losses**:
  - New York will continue to limit Excess Business Losses. As a result, affected State taxpayers must track and modify their allowable and limited Excess Business Losses independent of the amounts provided under the CARES Act used for Federal purposes.
- **Qualified Improvement Property (QIP)**:
  - New York has decoupled from the provisions under the CARES Act allowing taxpayers to designate QIP property placed in service after December 31, 2017, as 15-year property, eligible for 100% bonus depreciation. As a result, the State will require taxpayers who placed QIP into service during 2018 through 2020 to expense the cost over a 39-year life. This will create additional differences between Federal and State depreciation computations.

New York State New Paid Leave for COVID-19

Paid Leave for COVID-19

- Legislation was signed on March 18, 2020, job protection and pay was provided for New York employees who have been quarantined due to COVID-19.
- Paid sick time for quarantine leave depends on employer size (number of employees) and annual income.
- Job protection applies for the duration of the order of quarantine or isolation.
- Employees and the employer submit forms to employer’s insurance carrier, who processes and must pay or deny within 18 days of receipt.

Paid Leave for COVID-19

1 to 10 Employees; Net Income up to $1M*	1 to 10 Employees; Net Income over $1M*	11 to 99 Employees	100+ Employees	Public Employers (any size)
New paid sick days are not required. Paid Family Leave and disability benefits apply	5 paid sick days	5 paid sick days	14 paid sick days	14 paid sick days

*Net income is determined based upon the employer's previous tax year.

Note - employment size is determined as of January 1, 2020.

Paid Leave for COVID-19

- Paid leave for COVID-19 does not apply to quarantine required due to voluntary travel to any state affected by the NYS travel advisory.
- For paid sick leave (COVID-19), employee benefit uses their "regular rate of pay" (if they had been working).
- After COVID-19 paid leave is used, employees may be eligible to receive Paid Family Leave.
- If employee is not showing symptoms and is able to work remotely from home, COVID-19 paid leave is not available.

CARES ACT:
Payroll Tax Provisions

Employee Retention Credit for Employers Subject to Closure Due to COVID-19 *(Act Section 2301)*

- **FAQ's on IRS website:** https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act.

- Provides for a **refundable payroll tax credit for 50% of qualified wages** paid by eligible employers to certain employees during the COVID-19 crisis.
  - **Credit limited to employer paid employment taxes**.
    - IRC Section 3111(a) - old-age, survivors, and disability insurance. **FICA (6.2 %)**.
    - IRC Section 3221(a) - Railroad Retirement Act (RRTA) insurance (6.2%).
    - **Does not apply to Medicare portion (1.45%)**.

Employee Retention Credit for Employers Subject to Closure Due to COVID-19 *(Act Section 2301)*

- An **Eligible Employer** is any employer, including non-profits, which is carrying on a trade or business **during calendar year 2020**, with respect to any calendar quarter in which:
  - **Operations are fully or partially suspended** during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to the coronavirus disease 2019 (COVID–19); **or**
  - Where there is a "**significant decline in gross receipts**."

Employee Retention Credit for Employers Subject to Closure Due to COVID-19 *(Act Section 2301)*

- **Significant decline in gross receipts**:
  - **Beginning with the first calendar quarter** beginning after December 31, 2019, for which gross receipts for the calendar quarter are **less than 50% of gross receipts** for the same calendar quarter in the prior year; and
  - **Ending with the calendar quarter** following the first calendar quarter beginning after a calendar quarter described above for which gross receipts of such employer is **greater than 80% of gross receipts** for the same calendar quarter in the prior year.

Employee Retention Credit for Employers Subject to Closure Due to COVID-19 *(Act Section 2301)*

- The term "**qualified wages**" includes health benefits and is capped at the first $10,000 in wages paid by the employer to an eligible employee.

- **Qualified wages**:
  - For employers who had an average number of full-time employees in 2019 of **100 or fewer**, all employee wages are eligible, **regardless of whether the employee is furloughed**.

  - For employers who had **greater than 100** average number of full-time employees in 2019, only the wages of **employees who are furloughed or face reduced hours** as a result of their employers' closure or reduced gross receipts are eligible for the credit.

Employee Retention Credit for Employers Subject to Closure Due to COVID-19 *(Act Section 2301)*

- Limitations.
  - No credit is available with respect to an employee for any period for which the employer is **allowed a Work Opportunity Credit** (Code Section 21) with respect to the employee.
  - **Not available to employers receiving PPP Loans** under Section 1102 of the Act.
- The credit applies to wages paid after March 12, 2020 and before January 1, 2021.
- The IRS is granted **authority to advance payments** to eligible employers and to waive applicable penalties for employers who do not deposit applicable payroll taxes in anticipation of receiving the credit.
  - **New IRS Form 7200**.

Joseph A. Hardick, CPA, CCIFP
Tax Partner

Email: jhardick@dmcpas.com

Web: www.dmcpas.com

Address:
DM Financial Plaza
221 South Warren Street
Syracuse, NY 13202

Phone: (315) 472-9127, ext. 161

Scan to add Joe to your contacts.

Questions

APPENDIX 1

Paycheck Protection Program

Paycheck Protection Program (PPP)

- The CARES Act established the PPP Loan program.
- PPP loans were made available to businesses and certain non-profit organizations **with 500 employees or less** (including affiliates).
- Applicants have to **certify economic need and uncertainty**.
- Loan amount was determined based on **average monthly "payroll costs"** incurred during a base period (generally incurred in 2019) **multiplied by 2.5**, limited to $10,000,000.
- **Up to 100% of the PPP loan is forgivable** if certain spending requirements are met during the "covered period."
- **Covered period is the 8-week or 24-week period** after the loan proceeds were disbursed.

PPP Loan Borrower Certification Requirements

- An eligible recipient applying for a covered loan **must make a good faith certification** to the lender that:
  - The **uncertainty of current economic conditions makes necessary** the loan request to support the ongoing operations of the eligible recipient.
  - The borrower is taking into account their current business activity and their ability to **access other sources of liquidity** to support their ongoing operations **in a manner that is not significantly detrimental to the business.**
  - The borrower will **use the funds to retain workers** and maintain payroll or **make mortgage, lease, and utility payments**.
    - **Note, there appears to be no tracing rule as to the use of the proceeds**.
  - **Not more than 40% (was 25%)** of the loan proceeds will be **used for non-payroll costs**.

PPP Loan Forgiveness Amount

- An eligible recipient is eligible for forgiveness of indebtedness on a covered loan in an amount equal to the sum of the following **costs incurred** and **payments made** during **the 8-week or 24-week period beginning on the date of the origination of a covered loan but ending not later than December 31, 2020**:
  - **Payroll Costs** - Must be **at least 60%** of loan forgiveness amount.
  - **Non-Payroll Costs** - Must **not exceed 40%** of loan forgiveness amount.
    - **Interest Payments** on indebtedness or a debt instrument incurred in the ordinary course of business that is:
      - A liability of the borrower;
      - Is a **mortgage on real or personal property**; **and**
      - Was incurred before February 15, 2020.
    - **Rent Payments** made under a lease agreement **dated before February 15, 2020**.
      - Make sure **written related party lease agreements** are in place.
      - **Related party lease payments are limited to mortgage interest owed on the property**.
    - **Utility Payments** related to the distribution of **electricity, gas, water, transportation, telephone or internet access** for which service began before February 15, 2020.

PPP Loan Forgiveness Amount

<u>Payroll Costs Include</u>:

- The sum of payments of any compensation with respect to employees that is a:
  - **<u>Salary, wage</u>**, commission, or similar compensation;
  - Payment of **<u>cash tip</u>** or equivalent;
  - Payment for **<u>vacation, parental, family, medical or sick leave</u>**;
  - Allowance for **<u>dismissal or separation</u>**;
  - Payment required for the provision of **<u>group health care benefits, including insurance premiums, and retirement</u>**; or
  - Payment of **<u>state or local tax assessed</u>** on the compensation of employees.
- Salary (cash compensation) for each employee is limited to an annual salary of $100,000 prorated based on the Covered Period.

Loan Forgiveness - Covered Period

- **When does the covered period (24 weeks or 8 weeks) begin** to determine the amount of the forgiveness for the PPP loan?
- The covered period **begins on the date the lender makes the first disbursement** of the loan.
- **Borrowers who received loans prior to June 5, 2020** can elect an 8-week covered period or a 24-week covered period.
- **Borrowers who received loans on or after June 5, 2020** will have a 24-week covered period.
- The loan forgiveness application released on May 15, 2020 provides for an "**alternative payroll covered period**."
  - Borrowers with a biweekly (or more frequent) payroll schedule may elect to calculate eligible payroll costs using the 24-week (or 8-week if elected) period that **begins on the first day of their first pay period following their loan disbursement date**.

PPP Loan Forgiveness - Compensation Caps

Non-Owner Employee Compensation Caps

- **8-week Covered Period** - $15,385.
- **24-week Covered Period** - $46,154.

Owner-Employees or Self-Employed Individuals

- **8-week Covered Period** - 2.5/12 of 2019 compensation capped at $15,385.
- **24-week Covered Period** - 2.5/12 of 2019 compensation capped at $20,833.

PPP Loan Forgiveness - Compensation Caps

- **C Corporations**:
  - Owner-employee - Any owner who is an employee.
  - Cash compensation amount - Payments made or incurred during the Covered Period limited to the above caps.
  - Employer state and local payroll taxes, health insurance and retirement contribution payments capped at 2.5/12 of 2019 amounts.
    - These amounts do not count in the $15,285/$20,833 caps.

- **S Corporations**:
  - Owner-employee - Any owner who is an employee.
  - Cash compensation amount - Payments made or incurred during the Covered Period limited to the above caps.
  - Employer state and local payroll taxes, health insurance and retirement contribution payments capped at 2.5/12 of 2019 amounts.
    - These amounts do not count in the $15,285/$20,833 caps.
  - Employer contributions for health insurance for 2% or more owner-employees **are not eligible for forgiveness**.

PPP Loan Forgiveness - Compensation Caps

- **<u>Schedule C & F Filers</u>**:
  - Owner Compensation Replacement - Determined based on 2.5/12 of 2019 net profit on Schedule C and F, capped at above amounts.
  - Employer contributions for state or local taxes, health insurance and retirement contributions **<u>for owners are not eligible for forgiveness</u>**.
- **<u>General Partners</u>**:
  - Partner Compensation - Determined based on payments made during the covered period and limited to 2.5/12 of 2019 Schedule K-1 self-employment earnings multiplied by .9235 and capped at above amounts.
  - Employer contributions for state or local taxes, health insurance and retirement contributions **<u>for partners are not eligible for forgiveness</u>**.

Loan Forgiveness Reductions

- The CARES Act specifically **requires certain reductions in a borrower's loan forgiveness amount based on**:
  - **Reductions in FTEs**; or
  - **Reductions in employee salary and wages during the covered period**.

- These reductions are subject to an important **statutory exemption** for borrowers who have **rehired employees and restored salary and wage levels by December 31, 2020** (with limitations).

- **FTEs are calculated** using either of the following:
  - For each qualifying employee, **divide number of hours per week by 40; or**
  - **Use 0.5** for every employee that works **less than 40 hours**.

Reduction of Loan Forgiveness - FTEs Reduction

- **What effect does a reduction in a borrower's number of FTEs have on the loan forgiveness amount**?
  - In general, a reduction in FTE employees during the Covered Period reduces the loan forgiveness amount by the same percentage as the percentage reduction in FTE employees.
  - **The borrower must first select a reference period**: (i) February 15, 2019 through June 30, 2019; (ii) January 1, 2020 through February 29, 2020.
    - In the case of a **seasonal employer**, **either of the two preceding methods** or a **consecutive 12-week period between May 1, 2019 and September 15, 2019**.
  - If the average number of **FTE employees during the Covered Period is less than during the reference period**, the total eligible expenses available for **forgiveness is reduced proportionally** by the percentage reduction in FTE employees.
  - **For example**, if a borrower had 10.0 FTE employees during the reference period and this declined to 8.0 FTE employees during the covered period, the percentage of FTE employees **declined by 20 percent and thus only 80 percent of otherwise eligible expenses are available for forgiveness**.

Reduction of Loan Forgiveness - Reduction in Wages

- The amount of **loan forgiveness shall also be reduced** by the amount of any **reduction in total salary** (based on average annual salary or hourly wage) of any employee **during the period February 15, 2020 and April 26, 2020** that is **in excess of 25%** of the **total salary** (based average annual salary or hourly wage) of such employee **between January 1, 2020 and March 31, 2020**.
  - **This reduction rule only applies to employees who did not receive** during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount **more than $100,000**.
  - To ensure that borrowers are **not doubly penalized**, the salary reduction **applies only to the portion of the decline in employee salary that is not attributable to the FTE reduction**.

Loan Forgiveness Reductions - Salary Restoration

- **Question**: If a borrower **restores reductions made to employee salaries and wages by not later than December 31, 2020,** can the borrower avoid a reduction in its loan forgiveness amount?

- **Answer:** Yes. If certain employee **salaries and wages were reduced** between **February 15, 2020 and April 26, 2020** but the borrower **eliminates those reductions by December 31, 2020 or earlier**, the **borrower is exempt from any reduction in loan forgiveness** amount that would otherwise be required due to reductions in salaries and wages.

Loan Forgiveness Reductions - FTE Safe Harbors

- **Question**: If a borrower **restores reductions made to FTE employees by not later than December 31, 2020**, can the borrower avoid a reduction in its loan forgiveness amount?
- **Answer:** Yes, if borrower meets one of the following safe harbors:
- **Safe Harbor #1:**
  - If the Borrower reduced its FTE employee levels in the period beginning February 15, 2020, and ending April 26, 2020; and
  - The Borrower then restored its FTE employee levels by not later than December 31, 2020 to its FTE employee levels in the Borrower's pay period that included February 15, 2020.
- **Safe Harbor #2:**
  - Borrower documents an inability to return to the same level of business activity as before February 15, 2020, due to compliance with safety requirements established or guidance issued by the government (HHS, CDC, or OSHA) during the period March 1, 2020 through December 31, 2020 related to COVID–19.

Loan Forgiveness Reductions - Employee Declines

- **Question:** Will a borrower be subject to a reduction to its forgiveness amount due to a reduction in FTE employees during the Covered Period if the **borrower offered to rehire** one or more laid off employees, **but the employees declined**?

- **Answer:** In calculating its loan forgiveness amount, a borrower may exclude any reduction in FTE employees if the borrower is able to document in good faith the following:
  - **An inability to rehire individuals** who were employees of the borrower on February 15, 2020 **and**;
  - **An inability to hire similarly qualified individuals** for unfilled positions on or before December 31, 2020.
- Borrowers are required to **inform the applicable state unemployment insurance office** of any employee's rejected rehire offer within 30 days of the employee's rejection of the offer.

- **The documents that borrowers should maintain** to show compliance with this exemption include the written offer to rehire an individual at the same salary and hours, a written record of the offer's rejection, and a written record of efforts to hire a similarly qualified individual.

Loan Forgiveness Reductions - Employee Termination, Etc.

- **Question**: Will a borrower's loan forgiveness amount be reduced **if an employee is fired for cause, voluntarily resigns, or voluntarily requests a schedule reduction**?

- **Answer**: No. In these cases, the borrower may count such employee at the same full-time equivalency level before the FTE reduction event when calculating the FTE employee reduction penalty.

PPP Loan Forgiveness Application

- **SBA Provides Three Different PPP Loan Forgiveness Applications**
  - **Form 3508S -** Only for borrowers that received a PPP loan for 50,000 or less.
  - **Form 3508EZ -** For borrowers that **meet one of the following**:
    - Borrower is a self-employed individual with no employees;
    - Borrower did not reduce the salaries or wages of any of their employees (making $100,000 or less in 2019) by more than 25% during the Covered Period compared to the period 1/1/20 - 3/31/20, **and** did not reduce the number of employees or hours of employees between 1/1/20 and the end of the Covered Period (unless safe harbors apply); **or**
    - Borrower did not reduce annual salary or hourly wages of any employee (making $100,000 or less in 2019) by more than 25% during the Covered Period compared to the period 1/1/20 - 3/31/20, **and** was unable to operate during the Covered Period at the same level of business activity as before 2/15/20, due to compliance requirements established by HHS, CDC or OSHA related to COVID-19.
  - **Form 3508 -** For borrowers that aren't allowed to file Form 3508S or 3508EZ.

Loan Forgiveness Application Documentation Requirements

- An eligible recipient seeking loan forgiveness **shall submit to the lender an application** which shall include the following:
  - **Documentation verifying the number of FTEs** on payroll and pay rates.
  - **Payroll tax filings** reported to the IRS and State income, payroll, and unemployment insurance filings.
  - **Documentation, including cancelled checks, payment receipts**, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments.
  - **Certification from an authorized representative of the eligible recipient that**:
    - The documentation presented is true and correct; and
    - **The amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation, or make covered utility payments**.

PPP Loan Necessity Questionnaire

- Applicants (including affiliates) who obtained a **PPP loan of $2 million or more** must complete one of the following questionnaires when applying for loan forgiveness.
  - **Form 3509 - For-Profit Borrowers**.
  - **Form 3510 - Non-Profit Borrowers**.
- Same or similar questionnaire may be used by SBA for PPP loans under 2 million that are audited.

Loan Forgiveness Approval Process

- Once the loan forgiveness application is submitted to the lender, the lender has **60 days** to review and approve the application and submit their decision to the SBA.
- The SBA then has **90 days** to approve the application.
- **The borrower may submit the loan forgiveness application any time before the maturity date of the loan.**
- However, If the borrower **does not apply for forgiveness within 10 months after the last day of the Covered Period**, payments are no longer deferred, and the borrower must begin making payments on the loan.

Unforgiven Portion of PPP Loan Terms

The terms and interest rate of the unforgiven portion of the loan is as follows:

- **The interest rate will be 1%**.
- The **maturity of the loan** is 2 years for loans made prior to June 5, 2020 and 5 years for loans made on and after June 5, 2020.
- Loans with a maturity of 2 years **can be extended to 5 years with the agreement of the lender**.
- **Payments are deferred** until a determination of the amount of forgiveness is made by the SBA.
- Interest will accrue on the loan beginning with disbursement.