

Understanding the SBA Payroll Protection Loans Program Under the CARES Act of 2020

Information contained in this document is provided as a reference for business owners who want to understand how their business can determine the amount of SBA Payroll Protection Loan they might qualify for and how to determine if their business will also qualify for loan forgiveness.

This document is our interpretation of the rules described in Division A, Title I, Keeping American Workers and Paid Employed Act, which is part of [H.R. 748-6, the Coronavirus Aid, Relief, and Economic Security Act \(CARES Act\)](#) of 2020. It should not be interpreted as providing legal advice.

SUMMARY

An SBA loan can be taken for any small business with fewer than 500 employees. Contact the bank your business normally works with to apply for a loan through their SBA program.

The maximum loan amount is = 2.5 x average monthly expense for payroll amounts. Payroll costs include wages, salaries, and the employer share of health insurance and retirement plan contributions. Payroll to any employee that is greater than \$100,000 per year is not included in this calculation.

Self-employed persons can also qualify for the loan program. Self-employment income must be documented via tax return filings with IRS and 1099-Misc forms received.

The purpose of the Payroll Protection Loan is to give small businesses 8 weeks of funds to cover payroll and certain overhead. No collateral is required for these loans. Loan funds can be used for payroll, as well as rent, utilities, and mortgage interest on obligations incurred prior to Feb 15, 2020.

To the extent loan proceeds are used to pay these obligations over an 8-week period beginning on the date the loan originates, the loan may be forgiven. To be granted 100% loan forgiveness, the following criteria must be met over the 8-week period following the loan origination date:

1. 100% of proceeds must be expended to pay for costs incurred and payments made for payroll, mortgage interest, rent, and utilities.
2. Employees earning \$100,000 or less must receive at least 75% of the pay that they earned in most recent full quarter (January 1 – March 31, 2020).
3. The average number of workers working full-time (or equivalent full-time if the business employs part-time workers) must be equal to or greater than the average number of employees who worked full-time during one of the following periods of time:
 - a. At the election of the borrower, either:
 - i. February 15, 2019 through June 30, 2019; or
 - ii. January 1, 2020 through February 29, 2020.

- b. In the case of an eligible recipient that is seasonal employer, the average number of full-time equivalent employees per month employed by the eligible recipient February 15, 2019 through June 30, 2019.

If after February 15, 2020, the business has reduced the number of full-time equivalent employees during the applicable period used by the business, the business has until June 30 to bring the number of equivalent employees back to full time employment.

Amounts not forgiven under the program have a 10-year loan term with an applicable interest rate of less than 4%.

Examples for figuring Payroll Protection Loan Amounts

Example: Self-employed applicant

Jake, a sole proprietor, earned a business profit in 2019 of \$50,000. He works from his home office and has no employees. He decides to apply for the new SBA payroll protection program loan. Jake figures his loan amount as follows:

$50,000 / 12 \text{ months} = \$4,167$ average net income (self-employed payroll equivalent)

$\$4,167 \times 2.5 \text{ months} = \$10,417$.

Jack will apply for a loan in the amount of \$10,417. Upon receipt of loan funds, Jake should pay himself \$10,417 over the next 8 weeks. At the end of the 8-week period, Jack should apply for loan forgiveness in accordance with the Payroll Protection Loan program instructions.

Example 2: S Corporation applicant

Dan owns a therapy center, called Dan's Therapy Center, Inc. His clinic employs 3 full-time employees, in addition to himself and his wife. Dan wants to apply for the new SBA Payroll Protection Loan Program. His loan origination date is April 1, 2020.

For the period beginning March 1, 2019 – June 30, 2019, Dan's Therapy Center had 5 full-time employees, which is the same number it had for the first quarter of 2020. Dan wants to obtain a SBA Payroll Protection Loan and spend loan proceeds in ways that meet requirements for 100% loan forgiveness. Use the following information to determine the amount Dan can borrow and how much he must pay to his employees to achieve 100% debt forgiveness.

Dan's Therapy Center can borrow 2.5 times its average monthly payroll for the 1-year period ending on the loan origination date. Column 1 of the table on the next page shows qualifying wages paid for the one-year period prior to the loan origination date total \$271,200. Note, Dan's annual wage is \$104,000, however, because the maximum annual wage for any employee used to figure the loan amount is limited to \$100,000 or less, the amount shown as paid to Dan in column 1 is \$100,000. Dan determines his loan amount of \$56,500 as follows:

$\$271,200 / 12 \text{ months} = \$22,600$ average payroll per month.

$\$22,600 \times 2.5 = \$56,500$.

Employee	Column 1	Column 2	Column 3	Column 4	Column 5	Column 6
	Wages paid for 1-year period prior to loan origination (Maximum \$100,000 per employee)	Average monthly wages paid for 1-year period prior to loan origination (Maximum \$100,000 per employee annualized)	Wages paid during first quarter 2020 (13-weeks) (Maximum \$100,000 annualized)	Average wages paid per week in 1 st quarter 2020 (Maximum \$100,000 annualized)	8 weeks of average 1 st quarter 2020 payroll (Maximum \$100,000 annualized)	Minimum required wage for 8-weeks under loan forgiveness rules (8 weeks average wage x 75%)
Dan:	\$100,000	\$8,333	\$25,000	\$1,923	15,384	\$11,538
Spouse:	40,000	3,333	10,000	769	6,152	4,614
Employee 1:	41,600	3,467	12,000	923	7,384	5,538
Employee 2:	41,600	3,467	10,400	800	6,400	4,800
Employee 3:	48,000	4,000	12,000	923	7,384	5,538
Total	271,200	\$22,600	\$69,400	5,338	42,704	\$32,028

To qualify for 100% loan forgiveness, Dan must show that his business meets the following criteria:

1. Employees must be paid at least 75% of their average weekly wages as computed over the 1st quarter of 2020.
2. The number of full-time equivalent employees for the 8-week period following loan origination must be equal to or greater than the number of full-time equivalent employees employed during the period beginning on March 1, 2019 and ending on July 30, 2019

Meeting the 75% of wages test

To be eligible for debt forgiveness, Dan's Therapy Center must be sure to pay each employee at least 75% of their average wages for the most recent calendar quarter. Refer to the table above to determine the amount Dan must pay out to achieve 100% loan forgiveness as follows:

- **Column 4** shows average wages paid for the first quarter of 2020 as a weekly average.
- **Column 5** shows the total of average weekly wages multiplied by 8 weeks.
- **Column 6** shows:
 - 75% of average weekly wages that must be paid to each employee in the 8-week period following the loan origination date, and
 - the minimum amount of loan proceeds that must be spent on payroll as a total for the 8-week period is \$32,028.

Dan's business has suffered a serious hit because of COVID 19. He wants to meet the requirements for 100% forgiveness on his loan while minimizing total business payroll and maximizing income for his employees. The CARES act is providing for \$600/week of unemployment benefits in addition to regular state unemployment benefits. Dan decides to sign his business up for his state's [workshare unemployment](#) program. Under the terms of this program, Dan's employees can share days off during each week and receive unemployment benefits for their unpaid days off. Giving his workers unpaid days off will save cash Dan needs to keep his business afloat and maximize his employees' use of federal and state unemployment benefits. Workshare rules are summarized as follows:

- Dan's Therapy Center must enroll in the workshare program.
- A minimum of 3 employees must be enrolled in the program.
- Workers must have hours cut a minimum of 20% but not more than 40% each week.

Meeting the number of equivalent full-time employees test

To qualify for 100% loan forgiveness, Dan's business must maintain full-time employment for his workers. Full-time employment is considered to be 30 hours or more per week. Dan's full-time employees normally work a 37.5-hour week based on five 7½-hour-long workdays each week. Dan wants to achieve full-time equivalent employment for his employees for the loan forgiveness program while also reducing work hours by 20-40% so his employees can receive workshare unemployment benefits. Dan can meet requirements for both programs as follows:

1. He reduces each employee's hours worked by 20% by switching each employee from 5 days per week to 4 days per week. This will reduce each employee's work week from 37.5 hours to 30 hours. Each employee is eligible for workshare unemployment on their day off.
2. 30 hours is considered full-time employment. Dan's business will qualify for 100% loan forgiveness because he is maintaining a 30-hour workweek for his employees.

Because of reduced demand for his business, he places his employees on a rotating work schedule. Each employee will receive 75% of their average wage for the 1st quarter of 2020 for the 4 days they work each week. His employees will each take one unpaid day per week and claim unemployment benefits for their unpaid days under the workshare program.

Loan forgiveness can equal an amount paid during the 8-week period following the origination date of the loan that is for:

1. payroll, plus
2. rent, utilities, and mortgage interest, provided these expenses relate to agreements in place prior to February 15, 2020.

For the 8-week period beginning on the loan origination date, Dan's Therapy Center, Inc., had the following expenses:

Rent	\$ 10,000
Utilities	<u>600</u>
Total	\$10,600

Dan is careful to make sure he pays his employees the required minimum amount so that his loan can be forgiven in full. During the 8-week period beginning on the date Dan received his loan proceeds, he paid the following wage amounts out to his employees:

Employee 1	5,538
Employee 2	4,800
Employee 3	<u>5,538</u>
Total	\$15,876

After paying rent, utilities and Employees 1, 2 and 3, Dan can use the remaining loan proceeds to pay himself and his spouse to achieve 100% loan forgiveness.

Loan amount	\$56,500
Less payroll to Employees 1, 2 and 3	15,876
Less rent and utilities	<u>10,600</u>
Loan balance to pay Dan and Spouse	\$30,024

From the \$56,500 loan amount, Dan subtracts rent, utilities and wages paid to Employee 1, 2 and 3 for the 8-week period and determines that the remaining loan amount \$30,024 will be used to pay himself and his spouse as follows:

Dan	\$24,000
Spouse	<u>6,024</u>
Total	\$30,024

Assuming he meets all forgiveness criteria, his CARES Act Payroll Protection Loan in the amount of \$56,500 can be forgiven. At the conclusion of the 8-week test period for the loan, Dan must submit an application for loan forgiveness to his bank. Dan will also be required to submit documentation verifying the number of full-time employees on payroll and their pay rates for the periods of time under consideration.

The lending bank must make a determination on loan forgiveness within 60 days of receipt of the loan forgiveness application. Loan forgiveness approval requires extensive record-keeping to show how amounts were calculated and spent.

Forgiven loan amounts are not treated as taxable income by the IRS.

Dan may fail to achieve the requirements for 100% debt forgiveness if any of the following events occurs during the eight-week period following loan origination:

1. The number of full-time employees drops below 5.
2. Wages paid fall below 75% threshold limits.
3. Loan proceeds are not fully spent on qualifying expenditures.

Should Dan's Therapy Center fail to meet one or more of the requirements for 100% debt relief, the business may still qualify for partial debt relief. Any debt that doesn't qualify for forgiveness has a 10-year loan repaying period with an interest rate that must under 4%.