

The following article is located at: <https://www.churchlawandtax.com/web/2020/may/starting-your-churchs-ppp-loan-forgiveness-process.html>

## Starting Your Church's PPP Loan Forgiveness Process

Follow these application instructions to help ensure the maximum amount of your loan converts to a nontaxable grant.

**Ted Batson, CPA and Tax Attorney**  [Bio](#)

Last Reviewed: June 2, 2020

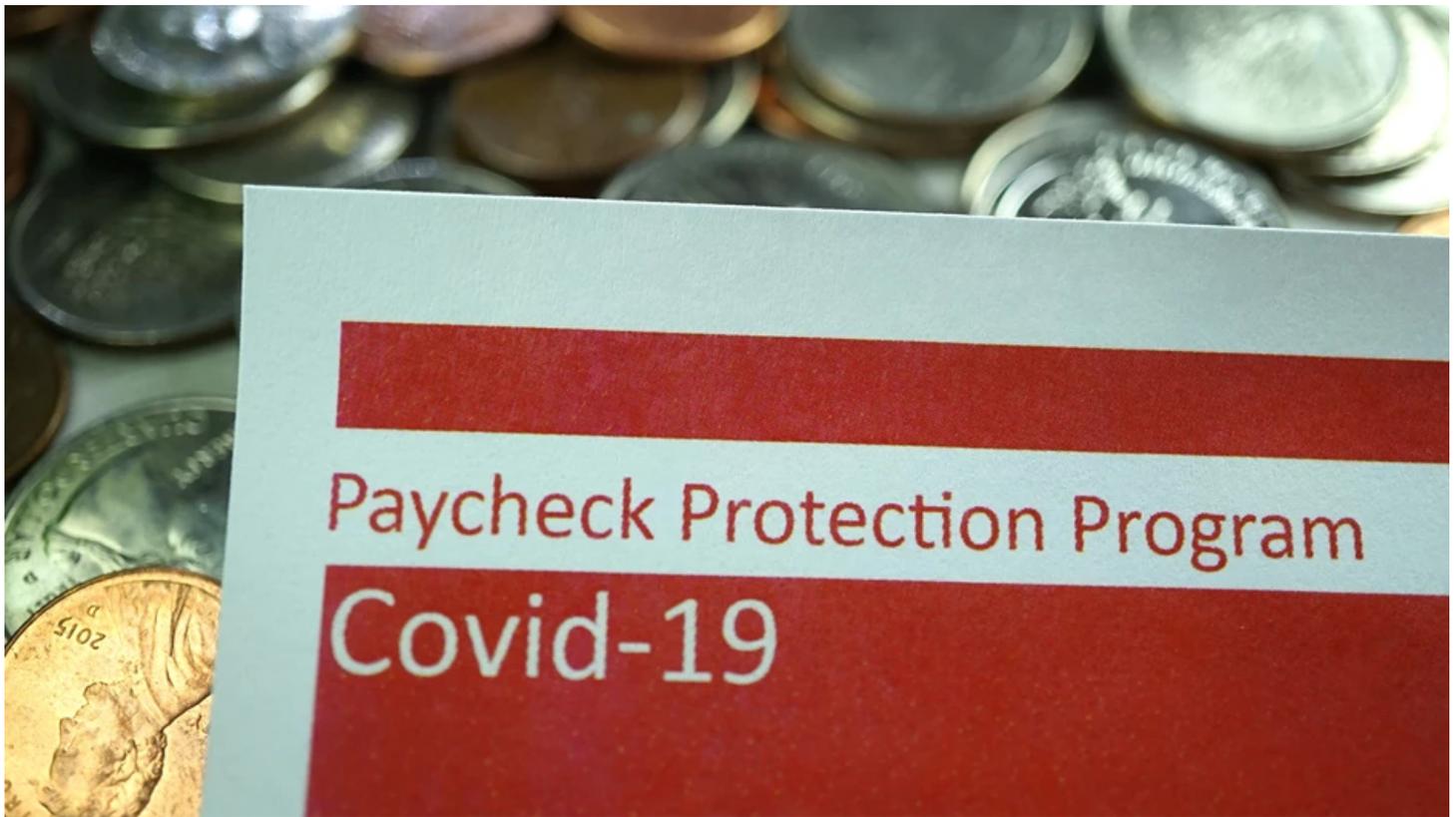


Image: Kameleon007 | Getty

**Editor's Note:** After this article published, the US Small Business Administration on May 22, 2020, issued two new interim rules. The first one specifically speaks to includible costs and various computations required by the CARES Act (the Loan Forgiveness Interim Final Rule (IFR)). The second one addresses the PPP Loan Forgiveness Application review process (the Review Process Interim Final Rule (IFR)). "Editor's Notes" are included in the sections where information has been updated.

One of the most valuable features of the CARES Act's Paycheck Protection Program loans for small businesses, nonprofits, and churches is the ability for recipients to apply to have the loans converted into nontaxable grants if certain criteria are met.

Details about the forgiveness process were uncertain until May 15, 2020.

That's when the US Small Business Administration (SBA) released [the loan forgiveness application](#) and accompanying schedules and instructions. The instructions address several crucial questions, but leave others unanswered.

This article discusses the major guidance contained within the application and instructions, including the SBA's response to managing the eight-week covered period, non-payroll related expenses paid outside the period, the computation of full-time equivalent employees, and several other important topics.

The SBA [also announced](#) that further regulations and guidance regarding the forgiveness application will be forthcoming. Further regulations came on May 22, 2020, when the Treasury Department and the SBA issued two interim final rules (IFRs) addressing PPP loan forgiveness, as noted throughout this article.

In addition to these two interim final rules, we expect the SBA to release additional explanatory FAQs regarding loan forgiveness.

Church leaders will want to follow the application instructions carefully to help ensure as much of their loans are eligible for conversion as possible.

## Background on PPP loan forgiveness

Before diving into the PPP Loan Forgiveness Application, let's review the basics of PPP loan forgiveness. A PPP loan may be forgiven to the extent the loan proceeds (or an amount equivalent to the loan proceeds) are spent on qualifying expenses incurred and paid during an eight-week covered period (the Covered Period) commencing with the date on which PPP loan funds are first disbursed, regardless of whether the loan funds are disbursed over multiple days. The concept of "incurred and paid" will be discussed below, along with additional details on the Covered Period.

Qualifying expenses fall into four categories:

1. Payroll costs;
2. Mortgage interest;
3. Rent; and
4. Utilities.

### Payroll costs

At least 75 percent of the recipient's loan proceeds must go toward payroll costs. As described in the [First Interim Final Rule](#), qualifying payroll costs consist of a variety of items, including:

- Compensation to employees (whose principal place of residence is the United States) in the form of salary, wages, commissions, or similar compensation;

---

In a [free video](#), CPA and tax attorney Ted Batson offers an overview of the loan forgiveness application process, along with answers to common questions church leaders are asking about the process.

---

- Cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips);
- Payment for vacation time, and parental, family, medical, or sick leave;
- Allowance for separation or dismissal;
- Payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums, and retirement;
- Payment of state and local taxes assessed on employee compensation; and
- For an independent contractor or sole proprietor who separately applied for a PPP loan, wages, commissions, income, or net earnings from self-employment or similar compensation.

Allowable payroll costs do not include:

- Payments by an employer to independent contractors (in [FAQ 15](#) the SBA made it clear that because independent contractors may apply for their own PPP loan, they are not includible in an employer's PPP payroll costs for loan application purposes or for the purpose of loan forgiveness);
- Salary and wages paid to an employee in excess of \$100,000 computed on an annualized basis;
- Wages paid to employees under the Expanded Family Medical Leave Act and Emergency Paid Sick Leave Acts (both contained within the [Families First Coronavirus Response Act](#) (FFCRA)) for which the employer receives the credits provided by the FFCRA;
- The employer's share of FICA and Medicare taxes; and
- Payroll costs related to employees whose principal place of residence is not in the United States.

A few words of explanation are useful here. First, [FAQ 32](#), published on April 24, 2020, clarified that all cash compensation is includible in payroll costs, including a "housing stipend or allowance." Thus, it is now clear that a minister's housing allowance is includible in payroll costs for both the purpose of the loan application and the forgiveness application.

Second, the definition of payroll costs for the purpose of applying for a PPP loan is identical to the definition of payroll costs for the purpose of applying for PPP loan forgiveness. While the SBA has not specifically addressed the question of whether payroll costs omitted during the loan application process may nonetheless be included in payroll costs submitted for loan forgiveness, it does not appear that this omission will be a barrier to including such otherwise eligible payroll costs in your church's loan forgiveness calculation. For example, if your PPP loan application did not include the minister's housing allowance, there is nothing—yet—in the loan forgiveness application that would preclude your church from including the minister's housing allowance in the payroll costs submitted for forgiveness.

Third, the PPP Loan Forgiveness Application instructions clarify that the exclusion of salary and wages paid in excess of \$100,000 on an annualized basis means the maximum amount of salary and wages that can be included for an individual employee for the Covered Period is  $\$15,385 = \$100,000 \div 52 \times 8 = \$15,385$ . This limit only applies to salary and wages. It does not apply to an employee's allocable share of group health care benefits and retirement benefits.

Fourth, in [FAQ 16](#), the SBA clarified that payroll costs begin with gross wages and are not reduced for an employee's federal income tax withheld or an employee's share of FICA and Medicare tax (payroll taxes). However, the FAQ makes it clear that the *employer share* of payroll taxes is *not includible* in payroll costs.

*Editor's Note: The May 22, 2020, Loan Forgiveness IFR specifically addresses bonuses and hazard pay. Information in this section has been updated accordingly.*

Fifth, the Loan Forgiveness IFR clearly states that bonuses and hazard pay are forgivable payroll costs as a form of "other similar compensation." The Loan Forgiveness IFR places only two restrictions on including bonuses and hazard pay in forgivable payroll costs:

1. The amount must be paid during the Covered Period or Alternative Payroll Covered Period, or, if incurred during either covered period, the portion incurred during the applicable covered period and paid with the first payroll date following the close of the applicable covered period may be included in the forgivable amount; and
2. The amount of the bonus and/or hazard pay combined with salary, wages, commissions, and other similar compensation may not exceed \$100,000 on an annualized basis (i.e., \$15,385 for the eight-week applicable covered period).

Sixth, the SBA has yet to address the scope of benefits that qualify as group health care coverage. From the quoted text above, it is clear this includes employer-paid premiums for group health insurance. It is likely the term includes employer-paid premiums for group vision and dental insurance plans to the extent they are separate policies from a group health insurance plan.

However, it is unclear how employer payments to the following plans are treated:

- Qualified Small Employer Health Reimbursement Arrangements;
- Individual Coverage Health Reimbursement Arrangements;
- Excepted Benefit Health Reimbursement Arrangements; and
- Health Savings Accounts.

Seventh, it is clear that employer costs related to a self-insured health plan are includible. However, the SBA has not provided guidance regarding how these costs are to be computed.

Eighth, it is clear that "state and local taxes assessed on compensation of employees" includes state unemployment tax. In the absence of guidance to the contrary, it is likely this provision includes state programs such as California's Employment Training Tax (ETT) and State Disability Insurance. New York's disability insurance premium may be includible if it is incurred and paid during the Covered Period. However, New York's paid family benefit amount may be paid by an employer or the employee and it is not clear that it is a tax. Therefore it is likely not includible. Finally, worker's compensation insurance is not a tax assessed on employee compensation. Therefore, in the absence of guidance to the contrary, it is unlikely to be an includible expense.

## **Mortgage interest**

*Editor's Note: The May 22, 2020, Loan Forgiveness IFR addresses mortgage interest in greater detail. Information in this section has been updated accordingly.*

Mortgage interest is clearly stated to include "[i]nterest payments on any business mortgage obligation on real or personal property that was incurred before February 15, 2020 (but not on any prepayment or payment of principal." There are two key takeaways from this quoted text.

First, the mortgage obligation must be a business mortgage obligation. This shouldn't preclude an allocable share of interest related to a bona fide home office, but it does emphasize that there must be a connection to a trade or business, or in the case of a church or nonprofit, a connection to its ministry or exempt activity. Further, there is no requirement that the real property or equipment currently be in use, but the mortgage obligation must qualify as a "business mortgage obligation." This would appear to disallow the inclusion of mortgage interest on property held for investment.

Second, while prior guidance referenced both real and personal property, it did not do so with the clarity found in the Loan Forgiveness IFR. Thus, the rule includes mortgages on land and buildings and mortgages on equipment and other personal property, including automobiles and office equipment.

The SBA has yet to release guidance regarding mortgages or construction loans in existence on February 15, 2020, that were subsequently refinanced or converted to permanent mortgages after February 15, 2020.

## Rent

*Editor's Note: The May 22, 2020, Loan Forgiveness IFR addresses rent in greater detail. Information in this section has been updated accordingly.*

Rent is clearly stated to include "[p]ayments on business rent obligations on real or personal property under a lease that was in force before February 15, 2020." As with mortgage interest, the rent obligation must be a "business rent obligation." Similarly, the rule includes rent obligations on land, buildings, and equipment and other personal property, including automobiles and office equipment.

The SBA has yet to provide clarity as to whether payments for certain services billed by a landlord along with rent (e.g., property insurance) are includible. Note that to be eligible for inclusion in forgivable expenditures, the lease agreement giving rise to the rent payment must be an obligation of the applicant.

While the SBA has not addressed this specific question, it is our belief that rent must be paid to a third party. It would be an aggressive position to treat an internal allocation that is characterized as "rent" (such as between a church and the church's own preschool program that is not a separate legal entity) as rent for purposes of both a PPP loan application and an application for PPP loan forgiveness.

## Utilities

Payments for the following utilities are included in forgivable PPP loan expenses:

- Electricity;
- Gas;
- Water;
- Transportation;
- Telephone (this should include cellphone contracts on which your church is the contracting party); or
- Internet service.

The utility service must have been in place on February 15, 2020. The SBA has yet to provide a definition of what is includible in transportation costs. Further, the SBA has not stated whether sewer service, trash collection, cellphone allowances for bring-your-own-device programs, or allowances for home internet service supporting work-from-home arrangements are allowable expenses.

Payments for church parsonage utilities have not been addressed in specific SBA guidance. It would appear that a reasonable argument could be made that these utilities are either part of the cash compensation paid to a minister (in which case they would count as payroll costs in satisfying the 75-percent payroll cost threshold) or as the payment of utilities on church property.

## Overview of the application

The [application](#) is available on the Treasury Department website. The application will be filed with the lender servicing your church's PPP loan at the time you submit your application, but note that this may not be the lender from whom your church received its loan.

The lender may choose to use an electronic version of the application. It is unclear what degree of flexibility the lender will have to deviate from the SBA-published application, but you should expect the application will be substantively the same. While the application is submitted to the lender, it is the SBA that will review the application and determine the loan forgiveness amount.

The application consists of:

- A core form (PPP Loan Forgiveness Calculation Form) that summarizes the component parts of the forgiveness calculation;
- A Schedule A that computes the payroll costs net of reductions;
- A Schedule A Worksheet that is used to compute full-time equivalent employees and the Salary/Wage Reduction amount; and
- A Borrower Demographic Form.

Only the core form and Schedule A are required to be filed. The Borrower Demographic Form is optional and does not appear applicable to nonprofit organizations.

## Certifications

As with the [PPP Loan Application](#), the PPP Loan Forgiveness Application includes several certifications. A loan forgiveness applicant must make the following certifications:

- That the dollar amount for which loan forgiveness is being requested:
  - Was used for eligible expenses;
  - Takes into account applicable deductions for any decrease in full-time equivalent headcount and/or salary and wage reductions;
  - Does not include non-payroll costs in excess of 25 percent of the amount of loan forgiveness requested; and
  - In the case of any owner-employee, self-employed individual, or general partner, does not include more than eight weeks' worth of 2019 compensation.
- That the applicant understands that the federal government may pursue recovery of loan amounts and/or pursue civil or criminal fraud charges if the applicant knowingly used PPP loan funds for unauthorized purposes.

- That the applicant has accurately verified the payments for the eligible payroll and non-payroll costs for which the applicant is requesting forgiveness.
- That the information contained in the PPP Loan Forgiveness Application and all supporting documentation and forms is true and correct in all material respects. Further, the applicant understands that knowingly making a false statement to obtain forgiveness of a PPP loan is punishable under the law by fines and/or imprisonment. (Depending on the federal statute violated, the fine may range from not more than \$5,000 to a fine of not more than \$1 million and the term of imprisonment may range from a term of two years to a term of 30 years).
- That tax documents the applicant submitted to the lender are consistent with those the applicant has or will submit to the Internal Revenue Service (IRS) and/or a state tax or workforce agency. This certification also serves as permission for the lender to share these documents with the SBA.
- That the applicant understands, acknowledges, and agrees that the SBA may request additional information for the purposes of evaluating the applicant's eligibility for both the PPP loan and for loan forgiveness. Further, a failure to provide additional information requested by the SBA may result in a determination that the applicant was ineligible for the PPP loan or a denial of loan forgiveness.

There are a few takeaways from reviewing these certifications.

First, the focus is largely on the completeness and accuracy of the information supplied both on the face of the application and in supporting documentation.

Second, while the references to fines and civil or criminal fraud charges should be taken to heart, they are standard terms and should not make an applicant fearful.

Third, while in [FAQ 46](#) the SBA created a safe harbor around the [good-faith certification](#) in the PPP loan application for loans with original principal amounts of less than \$2 million, the SBA has reserved the right to review loan eligibility in conjunction with the loan forgiveness application for other reasons. Among the eligibility rules the SBA could review during the forgiveness process are:

- Whether the organization receiving a PPP loan had more than 500 employees, or alternatively, more than the number of employees specified in the size standard published by the SBA for the employer's industry (see [13 C.F.R. 121.201](#) and FAQ 8 in [Frequently Asked Questions for Faith-Based Organizations Participating in the Paycheck Protection Program and the Economic Injury Disaster Loan Program](#)); and
- Whether the organization properly applied the SBA affiliation rules (see the section on Affiliation below).

## Timing of eligible payroll costs

The instructions state that eligible payroll costs are “payroll costs paid *and* payroll costs incurred during the eight-week (56-day) Covered Period . . .” (emphasis added). In addition, the instructions to Line 1 of the application state that the applicant should “Enter the total eligible payroll costs incurred *or* paid during the Covered Period or the Alternative Payroll Covered Period” (emphasis added).

There are two possible ways the quoted text above can be interpreted. First, the construction of the phrase “payroll costs paid *and* payroll costs incurred” can be read to be disjunctive. In other words, either condition may be satisfied in determining whether a given payroll cost is eligible for forgiveness. This interpretation is bolstered

by the repeated reference to “payroll costs” before the words “incurred” and “paid.” It is further bolstered by the use of the word “or” between the words “incurred” and “paid” in the instructions to Line 1 of the application.

However, a second interpretation is that the use of the conjunction “and” in the phrase “payroll costs paid *and* payroll costs incurred” is conjunctive, meaning both conditions must be true at the same time. This interpretation is bolstered by a more nuanced reading of the instructions and highlighting these four points:

1. The instructions not only reference the eight-week Covered Period, but make a point of emphasizing that this period is 56 days in length.
2. The instructions clarify that “Payroll costs are considered incurred on the day that the employee’s pay is earned.” This appears to be a reference to the employee having actually worked on that day.
3. The instructions provide a workaround for payroll incurred (i.e., earned) but not paid during the 56-day Covered Period, by permitting such costs to be included so long as they are “paid on or before the next regular payroll date.”
4. If payroll costs could be “incurred” or “paid,” then there would be no reason to create the Alternative Payroll Covered Period because the combination of including payroll paid during the Covered Period and permitting the workaround for the last payroll period that concludes after the Covered Period would resolve the dilemma created by the Covered Period failing to align with pay periods.

Reading these four points together results in an interpretation that ensures that every employer that pays employees for 56 days of payroll qualifies for 56 days of payroll costs—and no more.

If the first interpretation described above is correct, it would create the perverse result that the number of days of payroll forgiveness would vary from employer to employer based on the number of days in a given employer’s pay periods and the date on which the employer’s PPP loan funds were initially disbursed.

For example, assume the following facts:

- Employer A and Employer B each received their PPP loan funds on Monday, April 20, 2020.
- The Covered Period for each employer therefore concludes on Sunday, June 14, 2020.
- Employer A pays employees each week on Friday.
- Employer B pays employees biweekly on Fridays.
- Employer B’s next payroll date after April 20 is Friday, April 26.

If the first interpretation is correct, then both Employer A and Employer B would include their full payrolls paid on April 26, despite the fact that Employer B’s payroll covers seven more days than Employer A’s payroll.

Now fast forward to the end of the Covered Period. Because the Covered Period is an even number of weeks, the last payroll for both employer’s after Sunday, June 14, would occur on Friday, June 19. Each employer would only include payroll paid on that Friday that is also incurred (i.e., earned). So both employers would include the same number of days of payroll costs on this end of the Covered Period.

The end result is that if first interpretation is correct, Employer B was able to include 65 days of payroll costs in the forgiveness amount while Employer A was able to include 58 days in the forgiveness amount.

For this article, we assume the second interpretation is correct.

# Managing the Covered Period

Much has been written about the Covered Period during which allowable payroll and non-payroll costs must be expended as specified in the CARES Act. The Covered Period commences on the date the lender [first disbursed](#) loan funds to the borrower. The instructions to the application explicitly state the Covered Period includes the date of disbursement. To illustrate this point, the instructions describe a loan applicant whose PPP loan funds are disbursed on Monday, April 20, 2020. Thus the first day of the Covered Period is April 20 and the last (56th) day is Sunday, June 14, 2020.

The SBA has addressed the principal concerns regarding this time period in three significant ways.

## Payroll costs incurred or paid, or both?

*Editor's Note: The May 22, 2020, Loan Forgiveness IFR addresses payroll costs (incurred, paid, or both) in greater detail. Information in this section has been updated accordingly.*

The Loan Forgiveness IFR defines four key terms relating to payroll costs:

1. Payroll costs are generally **incurred** on the day the employee's pay is earned (i.e., on the day the employee worked). For employees who continue to be paid even though they are not performing work (e.g., because of a stay-at-home order), payroll costs are deemed incurred based on the work schedule established by the employer, which would generally follow the schedule the employee would have worked if he or she were able to perform work.
2. Payroll costs are considered **paid** on the day that paychecks are distributed to employees or the employer or its agent originates an ACH credit transaction in favor of the employee.
3. The **Covered Period** begins on the date of the first disbursement of the borrower's PPP loan proceeds from the lender and runs for eight consecutive weeks.
4. The **Alternative Payroll Covered Period** begins on the first day of the first payroll cycle within the Covered Period and runs for eight consecutive weeks.

The Loan Forgiveness IFR makes it clear that "payroll costs paid *or* incurred during the eight consecutive week (56 days) covered period are eligible for forgiveness." (Emphasis added.) In addition to the above statement, payroll costs *incurred* during the Covered Period, but *paid* on or before the next regular pay date after the conclusion of the Covered Period (or the Alternative Payroll Covered Period, if elected) are eligible for forgiveness.

Subject to any further guidance contained in the promised FAQs or any future interim final rules, this statement of the rule appears to remove any doubt that payroll costs relating to days worked prior to the commencement of the Covered Period are includible, even though such costs were not incurred during the Covered Period. In addition, payroll costs incurred up to the 56th day of the Covered Period are eligible for forgiveness, even though they are paid outside the Covered Period (or the Alternative Payroll Covered Period). The Loan Forgiveness IFR does not provide specific guidance for cases where an employer uses differing pay periods for hourly versus salaried employees or has pay periods that are offset from pay dates to accommodate the recording of hours worked by hourly workers.

Where payroll costs are both paid and incurred during the Covered Period or the Alternative Payroll Covered Period, they may only be included once in eligible payroll costs.

**Example.** Assume the following facts regarding Trinity Church's payroll:

- Trinity utilizes a bi-weekly payroll schedule (i.e., every other week).
- Trinity's Covered Period begins on Monday, June 1, 2020 and concludes on Sunday, July 26, 2020.
- The last day of Trinity's payroll period that includes June 1 is Saturday, June 6, 2020. Employees are paid on this date or if the date falls on a weekend they are paid on the Friday preceding the weekend, which in this case is Friday, June 5, 2020.
- In each bi-weekly payroll, salaried employees are paid for days worked through the last day of the payroll period. However, due to the need to record hours worked for hourly employees in the payroll system, the cutoff date for recording and paying hourly employees is three business days prior to the payroll period end date, which in this case is Wednesday, June 3, 2020.

Based on the foregoing facts, the full amount of Trinity's June 6 payroll is eligible for forgiveness because it was during the Covered Period. There is no requirement to adjust the eligible amount to account for days paid but not incurred during the Covered Period (i.e., days worked before June 1). Nor is there a requirement to adjust for the staggered days of pay incurred between salaried and hourly employees.

**Example.** Assume the same facts as the preceding example with the following additional information:

- Trinity's June 7 - June 20, June 21 - July 4, and July 5 - July 18 payroll periods represent amounts fully incurred and paid during the Covered Period and, therefore, are fully eligible for forgiveness.
- Trinity's July 19 - August 1 payroll period crosses the last day of Trinity's Covered Period (July 26, 2020). This pay period includes pay incurred through July 26 for both hourly and salaried employees.

Based on these facts, to determine the portion of the August 1 payroll costs eligible for forgiveness, Trinity will need to compute the payroll costs incurred from July 19 - July 26 for both salaried and hourly employees that are included in the August 1 payroll. Only this portion of the August 1 payroll is eligible for forgiveness.

## Alternative Payroll Covered Period

*Editor's Note: The May 22, 2020, Loan Forgiveness IFR addresses the Alternative Payroll Covered Period in greater detail. Information in this section has been updated accordingly.*

The Alternative Payroll Covered Period is only available for employers using bi-weekly or more frequent pay periods. In addition, if the Alternative Payroll Covered Period is selected, it must be used each time a reference to the Covered Period is made in connection with payroll costs.

**Example (from the Loan Forgiveness IFR).** Assume the following facts regarding Faith Church's payroll:

- Faith utilizes a bi-weekly payroll schedule (i.e., every other week).
- Faith's Covered Period begins on Monday, June 1, 2020, and concludes on Sunday, July 26, 2020.
- The first day of Faith's first payroll period after June 1, 2020 is Sunday, June 7, 2020.

Based on these facts, Faith may choose to select an Alternative Payroll Covered Period that commences on Sunday, June 7, 2020, and concludes on Saturday, August 1, 2020. Payroll costs paid during the Alternative Payroll Covered Period are eligible for forgiveness. In addition, any payroll costs incurred during the Alternative Payroll Covered Period but not paid until the first regular payroll date after August 1, 2020 are eligible for forgiveness.

**Example.** Assume the same facts as above, but further assume that while the first bi-weekly payroll period begins on Sunday, June 7, 2020 and ends on Saturday, June 20, 2020, the actual pay date lags by three business days to Wednesday, June 24, 2020 to allow for the entry of hours into the payroll system. Following this through the Alternative Payroll Covered Period, this means the June 24, July 8, and July 22 pay dates will occur within the Alternative Payroll Covered Period.

However, the pay date for the pay period that begins on Sunday, July 19, 2020 and ends on Saturday, August 1, 2020 will not occur until Wednesday, August 5, 2020. Because all of the days represented by the August 5 pay date represent payroll costs incurred on or before August 1 and August 5 is the first regularly scheduled pay date after August 1 (the last day of the Alternative Payroll Covered Period), the full amount of payroll paid on August 5 is eligible for forgiveness. In this example, 56 days of payroll costs *incurred* are eligible for forgiveness, since the selection of the Alternative Payroll Covered Period did not result in the inclusion of any payroll costs paid during the Alternative Payroll Covered Period but incurred prior to the start of the Alternative Payroll Covered Period.

## Compensation paid to furloughed or laid-off employees

*Editor's Note: The May 22, 2020, Loan Forgiveness IFR addresses compensation paid to furloughed or laid-off employees in greater detail. Information in this section has been updated accordingly.*

Noting that the purpose of the Paycheck Protection Program is to “enable[e] borrowers to continue paying their employees even if those employees are not able to perform their day-to-day duties, whether due to lack of economic demand or public health considerations,” the Loan Forgiveness IFR clarifies that compensation paid to furloughed workers in the form of salary, wages, commissions, or similar compensation is eligible for loan forgiveness. This eligibility is subject to the \$100,000 annualized earnings cap on eligible compensation.

## Non-payroll costs

*Editor's Note: The May 22, 2020, Loan Forgiveness IFR addresses non-payroll costs in greater detail. Information in this section has been updated accordingly.*

Non-payroll costs (i.e., mortgage interest, rent, and utilities) are includible if they are:

- Paid during the Covered Period; or

- Incurred within the Covered Period and paid on or before the next regular billing date, even if the billing date is after the Covered Period.

**Example (adapted from the Loan Forgiveness IFR).** The Covered Period for Joyful Heart Ministries (JHM) begins on June 1, 2020 and ends on July 26, 2020. JHM receives its May electricity bill covering the period May 1 – May 31, 2020 on June 8 and pays it on June 10. JHM receives its June electricity bill covering the period June 1 – June 30, 2020 on July 9 and pays it on July 13. JHM receives its July electricity bill covering the period July 1 – July 31, 2020 on August 10 and pays it on August 14.

The full amount of the May and June electricity bills is eligible for loan forgiveness because these bills were paid during the Covered Period. In addition, the portion of the July bill covering the period of July 1 – July 26 is eligible for forgiveness because the July bill was paid on the next regular billing date in August.

**Observation.** The example above makes it clear that the simplified approach the SBA has chosen means that more than 56 days of electricity costs are includible in the forgiveness amount. In the example, a total of 87 days of electricity costs are includible.

In addition, the rule would allow the inclusion of non-payroll related costs incurred months earlier but paid during the Covered Period to be included in the forgiveness amount, subject only to the requirement that 75 percent of the forgiveness amount be related to payroll costs.

## How is the 75 percent payroll cost rule applied?

The [First Interim Final Rule](#) requires that “[a]t least 75 percent of the expected forgiveness amount . . . be for payroll costs.” The PPP Loan Forgiveness Application mechanically applies this rule at Line 10 by dividing the total payroll costs reported on Line 1 by 0.75. The resulting amount is then compared to (a) the PPP loan amount and (b) the sum of payroll costs (adjusted by the salary/wage reduction amount and headcount reduction factor) and non-payroll costs. The smallest of these three amounts then becomes the loan forgiveness amount.

The bottom line is that you need to spend at least 75 percent of your total PPP loan includible expenditures on payroll.

**Example.** Assume the following:

PPP loan amount	\$100,000
Total payroll costs (before adjustments for salary/wage reduction or headcount adjustment factor)	\$70,000
Dollar amount of salary/wage reduction and headcount adjustment factor	\$10,000
Non-payroll costs	\$15,000

The three amounts to compare are:

PPP loan amount	\$100,000
Total payroll costs ÷ 0.75	\$93,333
Total forgivable payroll costs and non-payroll costs less salary/wage reduction and headcount adjustment factor	\$75,000

The smallest of the three amounts is \$75,000. Therefore this is the loan forgiveness amount.

Note that it is clear from the PPP Loan Forgiveness Application that a failure to use at least 75 percent of your loan proceeds for payroll costs will *not* result in the total forfeiture of loan forgiveness. It will only reduce the amount that will be forgiven.

## Salary and wage reduction amount

*Editor's Note: In the Loan Forgiveness IFR issued on May 22, 2020, it clarifies that the focus is on changes in the rate of an employee's weekly (in the case of salaried workers) or hourly rate of pay. This section has been updated accordingly.*

The Salary and Wage Reduction Amount (SWRA) considers whether an employee's weekly salary or hourly wage during the Covered Period declined by more than 25 percent when compared to the period beginning on January 1, 2020, and ending on March 31, 2020 (the most recent full calendar quarter before the Covered Period).

**Caution.** This discussion represents the author's best interpretation of the ambiguous language provided in the initial instructions and the Loan Forgiveness IFR.

For the purpose of this computation, exclude any employee who received during any pay period in 2019 more than \$100,000 in wages or salary on an annualized basis. Since this exclusionary rule applies to wages or salary, do not consider bonuses or other similar supplemental earnings when determining the applicability of the rule.

For reference, the table below shows the amount of gross wages or salary that equates to \$100,000 on an annualized basis:

Pay Period Frequency	Amount

Monthly	\$8,333.33
Semimonthly	\$4,166.67
Biweekly	\$3,846.15
Weekly	\$1,923.08

The SWRA computation first looks at whether an employee's *rate of pay* has decreased by more than 25 percent. If an employee's rate of pay has changed by more than 25 percent, then the computation converts the amount of the decrease into a dollar amount.

**Example.** Consider the following employee roster and methods and rates of pay.

Employee	Method of Pay	Average Rate of Pay		
		Covered Period	Prior Calendar Qtr	Change in Rate of Pay
John	Salary	\$1,058/week	\$1,481/week	(28.57%)
Sue	Salary	\$1,635/week	\$1,731/week	(5.56%)
Ellen	Salary	\$1,250/week	\$1,250/week	0.00%
Mary	Hourly	\$17.50/hour	\$27.50/hour	(36.36%)
Bill	Hourly	\$22.00/hour	\$25.00/hour	(12.00%)
Steve	Hourly	\$23.00/hour	\$23.00/hour	0.00%

In this simple example, Sue, Ellen, Bill, and Steve experienced a decrease in average annual salary or hourly wage of less than 25 percent. Therefore, they do not contribute toward any salary and wage reduction amount. John and Mary, however, each suffered a greater than 25 percent decrease in their salary or hourly wage. Therefore, the next portion of the calculation must be performed.

	John	Mary
(a) Average rate of pay for prior quarter	\$1,481/week	\$27.50/hour
(b) 75% of Prior Calendar Qtr Rate of Pay	\$1,111/week	\$20.63/hour
(c) Average rate of pay for the Covered Period	\$1,058/week	\$17.50/ hour
(d) Row (b) less row (c)	\$53	\$3.13/hour
(e) For salaried workers, multiply the result in row (d) by 8 and divide the result by 52	$\$53 \times 8 =$ \$424	
(f) Average hours worked per week in the Prior Calendar Quarter		40
(g) Multiply the amount on row (f) by the amount on row (d)		\$125
(h) multiply the amount on row (g) by 8		\$1,000

In conclusion, the total salary reduction amount in this example is  $\$424 + \$1,000$ , or  $\$1,424$ .

Note that the instructions do not provide guidance on the following relevant points:

- How is the average annual salary or hourly wage computed for an employee who is hired during the first quarter?
- What is the effect on the computation of an employee's average annual salary or hourly wage when an employee is hired, furloughed, laid off, or terminated, with or without cause, during the Covered Period?

## Computing full-time equivalent employees

The instructions provide the following process for computing full-time equivalent employees (FTEs):

1. For each employee, determine the number of hours paid each week during the period for which FTEs are being computed.
2. For each employee, compute the average number of hours paid per week during the relevant period.
3. For each employee, divide the amount from Step 2 by 40, rounding the result to the nearest tenth. The result should not be greater than 1. Then an employee who works on average more than 40 hours per week can never count as more than one employee.
4. Sum the amounts computed in Step 3.

**Caution.** This is the author’s best attempt to interpret the somewhat ambiguous text of the instructions.

Note that this computation looks at the number of hours for which you paid an employee. Accordingly, in the circumstance where an employee was kept on the payroll but was not performing services, they are included in the FTE computation based on the number of hours you chose to pay them.

The instructions provide a simplified method for completing the FTE calculation. In this version, an employee working at least 40 hours a week counts as 1 FTE, an employee working less than 40 hours a week counts as 0.5 FTE. If you choose to use the simplified method, you must use it for all FTE calculations.

If the number of employees in each category has been stable across all time periods, the simplified method should produce a comparable result that will not negatively affect the outcome of the various tests. However, if there is more than an insignificant amount of movement between employees working 40 or more hours per week and employees working fewer than 40 hours a week, you should avoid the simplified method.

**Example.** Assume an employer has seven employees. John, Sue, Ellen, and Sally are salaried employees who each work 40 hours per week. Mary is an hourly employee who works 40 hours a week while Bill and Steve are hourly employees who work less than 40 hours per week. Bill’s hours are steady while Steve’s vary from week to week. During the Covered Period, the hours worked for all seven employees are as follows.

Employee Name	Hours Worked Per Week								Avg. Hours Worked Per Week	Avg. FTEs over Covered Period
	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8		
John	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	1.0
Sue	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	1.0
Ellen	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	1.0
Mary	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	1.0
Bill	25.00	25.00	25.00	25.00	25.00	25.00	25.00	25.00	25.00	0.6
Steve	12.00	15.00	10.00	14.00	17.00	20.00	12.00	15.00	14.38	0.4
Sally	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	1.0
<b>Totals:</b>	<b>237.00</b>	<b>240.00</b>	<b>235.00</b>	<b>239.00</b>	<b>242.00</b>	<b>245.00</b>	<b>237.00</b>	<b>240.00</b>	<b>239.38</b>	<b>6.0</b>

In this example, there are seven employees, but this converts to six FTEs for the Covered Period.

Your church will need to compute FTEs for at least five periods:

1. The Covered Period or, if elected, the Alternative Payroll Covered Period;
2. The reference period you select;
3. The payroll period that includes February 15, 2020;
4. The period February 15, 2020, through April 26, 2020; and
5. June 30, 2020.

Your payroll service provider may be able to perform these computations for you.

## Full-time equivalent reduction quotient

The full-time equivalent reduction quotient (FTEQR) is an adjustment to the loan forgiveness amount. A careful reading of CARES Act section 1106(d)(2)(A) validates that the PPP Loan Forgiveness Application correctly applies the FTEQR to both payroll costs and non-payroll costs. The FTEQR is computed on Schedule A using Lines 11 through 13.

The FTEQR is computed by dividing the total average FTEs during the Covered Period by the total average FTEs during a reference period. The quotient may never be greater than 1.0. A borrower may choose from up to three different reference periods:

1. February 15, 2019, to June 30, 2019 (a period of 19 weeks);
2. January 1, 2020, to February 29, 2020 (a period of 9 weeks); or
3. (For seasonal employers only) any 12-week consecutive period between May 1, 2019, and September 15, 2019.

**Example.** Assume the following FTE headcounts:

During the Covered Period: 30.2

During the period February 15, 2019, to June 30, 2019: 29.3

During the period January 1, 2020, to February 29, 2020: 31.5

Using the February 15, 2019, to June 30, 2019 measurement period, the FTEQR is  $30.2 \div 29.3 = 1.03$ , which by rule converts to 1.0.

Using the January 1, 2020, to February 29, 2020, measurement period, FTEQR is  $30.2 \div 31.5 = 0.9587$ .

Because you have the choice of measurement periods, your church would choose the February 15, 2019, to June 30, 2019, measurement period as this period results in no reduction of your church's loan forgiveness amount.

## Full-time equivalent reduction quotient relief in certain cases

*Editor's Note: The Loan Forgiveness IFR issued on May 22, 2020, clarifies information in this section. It has been updated accordingly.*

The Loan Forgiveness IFR provides for FTERQ relief in four instances:

1. Where an employer makes a good-faith, written offer to rehire an employee during the Covered Period and the employee declines, see [FAQ 40](#);
2. Where an employee is terminated for cause;
3. Where an employee voluntarily resigns (presumably this includes retirement); and
4. Where an employee voluntarily requests and receives a reduction in hours.

With respect to offers to rehire a furloughed or laid-off employee, the Loan Forgiveness IFR details specific steps and documentation requirements to be eligible for this exception, including that:

1. The employer made a good faith, *written* offer to rehire the employee or restore reduced hours;
2. The offer was for the same salary or wages and the same number of hours as earned by the employee in the last pay period before he or she was furloughed, laid off, or had his or her hours reduced;
3. The employee rejected the offer;
4. The employer maintained records documenting the offer and the rejection; and
5. **The employer informed the applicable state unemployment insurance office of the employee's rejection of the offer of employment *within 30 days of the employee's rejection of the offer.***

This last requirement is new. The Loan Forgiveness IFR states that the method by which an employer can report the employee's rejection of the offer of re-employment to the applicable state unemployment insurance office will be posted on the SBA's website.

With respect to terminations for cause, voluntary resignations, or voluntary reductions in hours, employers are required to "maintain records demonstrating that each such employee was fired for cause, voluntarily resigned, or voluntarily requested a schedule reduction."

The nature of the relief is that you are permitted to include employees described in these four exceptions in your FTE headcount for the Covered Period. However, if you replace an employee described in items 1 through 4, you are not allowed to include them in this FTE adjustment (because this would mean the position represented by the otherwise excepted employee would be double-counted).

Notably missing from this list is the normal annual temporary cessation of operations by a seasonal employer, preschool, or school.

## FTE Reduction Safe Harbor

The CARES Act provides a safe harbor for employers who decreased their FTE headcounts at the outset of the COVID-19 pandemic and then restore headcounts by June 30, 2020. You are eligible for this safe harbor if two conditions are met:

1. You had a decrease in your FTE headcount during the period February 15, 2020, through April 26, 2020; and
2. Your headcount on June 30, 2020, is greater than or equal to your headcount on February 15, 2020.

To calculate your eligibility for the FTE Reduction Safe Harbor, complete the following steps:

Step 1. Compute your FTE headcount for the payroll period that included February 15, 2020.

Step 2. Compute your FTE headcount for the period February 15, 2020, through April 26, 2020.

Step 3. If your FTE headcount in Step 1 is greater than your FTE headcount in Step 2, then you reduced your FTE headcount and you must demonstrate that you restored your FTE headcount to avoid a reduction in loan forgiveness. Therefore, proceed to step 4.

Step 4. Compute your FTE headcount at June 30, 2020. If your FTE headcount at June 30, 2020, is greater than or equal to your FTE headcount in Step 1, then you are eligible for the FTE Reduction Safe Harbor and your loan forgiveness amount will not be reduced.

## Interaction of the FTE Reduction Quotient and the Salary and Wage Reduction Amount

*Editor's Note: The Loan Forgiveness IFR issued on May 22, 2020, clarifies information in this section. It has been updated accordingly.*

The Loan Forgiveness IFR clarifies that employers will not be doubly penalized by salary and wage reductions that are attributable to an FTE reduction. To this end, the salary and wage reduction computation only applies to the portion of a decline in an employee's wages that is *not* attributable to an FTE reduction.

**Example (from the Loan Forgiveness IFR).** Bill is an hourly employee of Omega Children's Services. Bill's hourly wage during the first calendar quarter was \$18.00 per hour and remained at \$18.00 per hour throughout Omega's Covered Period. However, during the Covered Period, Bill's hours were reduced from 40 hours per week to 20 hours per week. Because Bill's hourly rate of pay did not change, any change in Bill's total pay is solely attributable to a change in his FTE status. Accordingly, Omega's loan forgiveness amount is not reduced by an SWRA with respect to Bill. However, unless Bill is restored to 40 hours a week by June 30, 2020, Omega will have a reduction in its forgiveness amount due to an FTE Reduction Quotient that is less than 1.

## What about Economic Injury Disaster Loan advances?

The CARES Act specifies that the PPP loan forgiveness amount is reduced by any amount of an Economic Injury Disaster Loan (EIDL) advance your church receives. The PPP Loan Forgiveness Application addresses this by capturing the amount of your church's EIDL advance and the EIDL application number assigned to you when you obtained your advance. But the instructions then include this cryptic statement: "If applicable, SBA will deduct EIDL Advance Amounts from the forgiveness amount remitted to the Lender." Accordingly, if you enter an EIDL advance amount on your loan application, expect that the actual amount of your loan forgiveness will be the amount shown on Line 11 of the PPP Loan Forgiveness Application less the amount of your EIDL advance.

## What happens if your loan is not fully forgiven?

If your loan is not fully forgiven you have two options.

First, you can repay the unforgiven part in full. There is no prepayment penalty, although you will likely have to pay interest at the annualized rate of 1 percent on the unforgiven balance from the date the loan disbursed until the date you pay the loan back. You will want to ask the lender servicing your loan for a loan payoff amount.

Second, you can choose to pay the unforgiven portion back over the remaining life of the loan.

**Caution.** There is a potential trap here. If the loan repayment schedule is computed using the original principal balance of your loan, it is likely that (after the expiration of the loan deferral period) you will have large monthly payments due relative to the unforgiven balance. This will effectively mean the loan term is much shorter than the two-year term in the loan agreement.

## Required documentation

The instructions to the PPP Loan Forgiveness Application include a detailed list of supporting documentation that should be gathered in support of your application. The instructions clarify documentation that must be submitted with the loan application, along with documentation that should be maintained by the applicant but is not required to be submitted. Significantly, applicants are instructed to maintain this documentation for a period of “six years after the date the loan is forgiven or repaid in full.” In addition, the documents are to be made available upon request to an authorized SBA representative or a representative of the SBA’s Office of Inspector General.

## Affiliate relationships

The application requires organizations that, together with their affiliates, received PPP loans in the aggregate with an *original* principal balance of more than \$2 million to check a box. Presumably this means that an affiliate whose own original principal balance is less than \$2 million must check this box if it is a member of an affiliate group that borrowed more than \$2 million in the aggregate.

Note that in its [Second Interim Final Rule](#) published in the Federal Register on April 15, 2020, the SBA addressed the application of the affiliation rules to faith-based organizations. The SBA acknowledged “that the organizational structure of faith-based entities may itself be a matter of significant religious concern” and that US Supreme Court precedents guarantee to faith-based organizations “the ‘power to decide for themselves, free from state interference, matters of church government as well as those of faith and doctrine’” (citing *Kedroff v. St. Nicholas Cathedral of Russian Orthodox Church in N. Am.*, 344 U.S. 94, 116 (1952)).

In addition, the federal Religious Freedom Restoration Act (RFRA), together with Supreme Court precedents, prevent the government from substantially burdening the exercise of religion without a compelling governmental interest. The SBA has determined that applying the SBA affiliation rules to faith-based organizations would impose a substantial burden without a compelling governmental interest.

For this reason, the affiliation rules:

. . . do not apply to the relationship of any church, convention or association of churches, or other faith-based organization or entity to any other person, group, organization, or entity that is based on a sincere religious teaching or belief or otherwise constitutes a part of the exercise of religion. This includes any relationship to a parent or subsidiary and other applicable aspects of organizational structure or form.

However, to avoid the application of the affiliation rule, a faith-based borrower must make a “reasonable, good-faith interpretation” that the affiliation rules should not apply to a given relationship because the relationship is “based on a sincere religious teaching or belief” or in some manner “constitutes a part of the exercise of

religion.” The application of this standard to a church, or an association or convention of churches or their integrated auxiliaries, is likely to be more straightforward than its application to parachurch ministries.

## Outstanding questions

The PPP Loan Forgiveness Application and instructions fail to address every question we’ve received and reinforce some of the structural issues inherent in the CARES Act.

For example, questions remain regarding:

- Whether it is permissible to include the cost of buying back accrued vacation in forgivable payroll costs;
- Whether PPP loan proceeds can be used to make special, unscheduled employer retirement plan contributions and whether such retirement plan contributions are includible in forgivable payroll costs;
- Whether a portion of rent paid in advance of the Covered Period for time periods contained within the Covered Period is a forgivable amount; and
- The manner in which the normal cessation of operations of preschools and schools before the conclusion of the Covered Period impacts the headcount reduction factor and salary/wage reduction amount.

*Ted Batson is a CPA and tax attorney, and serves as a partner and Professional Practice Leader – Tax for CapinCrouse LLP, a national CPA and consulting firm. He speaks and teaches frequently for national conferences and organizations on exempt organization and charitable giving matters.*

This content is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought. "From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers and Associations." Due to the nature of the U.S. legal system, laws and regulations constantly change. The editors encourage readers to carefully search the site for all content related to the topic of interest and consult qualified local counsel to verify the status of specific statutes, laws, regulations, and precedential court holdings.