

Navigating the Next Steps with a Paycheck Protection Program Loan

How churches can prepare to apply for loan forgiveness.

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If your church successfully navigated the Paycheck Protection Program (PPP) [application process](#) and secured a loan, you now need to take immediate steps to ensure the funds are correctly handled and tracked during the next eight weeks. Doing so not only will ensure sound stewardship of these proceeds in the midst of the COVID-19 (coronavirus) outbreak, but it will also position your church to receive forgiveness for the loan, converting it into a nontaxable grant.

This article outlines the specific steps to take.

Applying for loan forgiveness

The CARES Act makes clear that the recipient of a PPP loan must apply to their lender for loan forgiveness. This application cannot be made any sooner than eight weeks after the loan originates. Future guidance from the US Small Business Administration (SBA) will describe the manner in which an application for forgiveness will be made.

Up to 100 percent of a PPP loan may be forgiven. The loan forgiveness amount is determined by first computing the amount of payments made for qualifying payroll costs, mortgage interest payments (but not payments or prepayments of principal), rent payments, and utility payments for the eight-week period that begins on the date the lender makes the first disbursement of the PPP loan to the borrower.

For this purpose qualifying payroll costs include:

- Salary, wages, commissions, or similar compensation;
- Cash tips or their equivalent;
- Payments for vacation, parental, family, medical, or sick leave;
- Severance payments;

- Employer payments for group health care coverage, including insurance premiums;
- Employer contributions to retirement plans; and
- Payments of state and local taxes assessed on employee compensation.

Note. Many banks did not allow the housing allowance to be included in calculating the amount of the PPP loan. In late April, the SBA finally issued guidance clarifying that a minister's housing allowance is includible in countable payroll costs. For additional information, see Richard Hammar's [analysis of the housing allowance](#) in relation to the PPP in [his FAQ](#).

When computing cash tips, an employer may use records of past tips or, if there are no such records, a reasonable, good-faith employer estimate of employee tips. This is especially important for any churches that engage in an activity, such as a coffee shop, where tips are an element of employee compensation.

Allowable payroll costs do *not* include:

- 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 Act (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 US. Mortgage and rent payment include such obligations that were in existence on or before February 15, 2020, and include obligations with respect to both real property (e.g., your church building) and personal property (e.g., a church-owned vehicle or equipment, such as a copier).

Utility payments include payments for electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020. It is not clear what is meant by "transportation." It is possible this would cover the cost of operating a church van or bus, but without further guidance, that may be an aggressive position. In addition, it is not clear whether internet access includes internet access installed in a minister or staff member's home. However, given current shelter-in-place and stay-at-home orders that require employees to work from home, this may be allowable.

Caution. For loan forgiveness to occur, the CARES Act states that the borrower must have *incurred and paid* the qualifying expenses during the eight weeks following receipt of the loan proceeds. The SBA informal guidance indicates that the borrower must pay the qualifying expenses for inclusion in the loan forgiveness. However, the SBA has not addressed how the term "incurred" is to be interpreted in this context. For example, if a borrower receives the loan proceeds on April 14 (marking the starting date for the eight-week period) and pays its usual semimonthly payroll on April 15, is the borrower permitted to include the full amount of the April 15 payroll cost in its loan forgiveness amount, even though 13 of the days in the pay period occurred before commencement of the eight-week period?

Similarly, if a borrower pays semimonthly payroll and received its PPP loan proceeds on April 16, 2020, its eight-week period would end on June 10, 2020, five days before it pays its June 15, 2020, payroll. Thus it would only have three pay periods during the eight-week period, even though the 2.5 factor used in computation for the maximum loan amount clearly contemplated covering payroll for two full-months.

What documentation must a borrower provide a lender to obtain loan forgiveness?

A borrower must submit an application for loan forgiveness that includes:

- Documentation verifying the number of full-time equivalent (FTE) employees on the payroll, hours worked by part-time employees (to facilitate the FTE computation), and rates of pay during both the eight-week period and the prior year measurement periods discussed in the section below regarding the headcount reduction factor. This documentation may include payroll tax filings filed with the IRS (e.g., IRS Form 941), and income, payroll, and unemployment insurance filings filed with state authorities. However, those documents may or may not include detail to the employee level. So be prepared to supplement this information with reports from your payroll processor that provide detail to the individual employee level.
- Documentation, such as invoices, canceled checks, payment receipts, and account statements or transcripts showing mortgage payments, rent payments, and utility payments.
- A mortgage statement or transcript from your lender verifying the amount of interest paid with each mortgage payment.
- A certification by an officer, often your board chair, board treasurer, board secretary, senior pastor, or executive pastor, as to the truthfulness of the information submitted and certifying the loan proceeds were used to retain employees, make mortgage interest payments, make rent payments, make utility payments, or were used for some combination of these purposes. Substantial penalties may apply if the signer knowingly makes a false statement. (For more guidance regarding who may be authorized to sign on behalf of your church see Richard Hammar's analysis in [Who Can Sign Church Documents?](#))
- Any other documentation the SBA Administrator determines is necessary.
Key point. Loan forgiveness is prohibited if a borrower fails to comply with these documentation requirements.

What factors will cause less than 100 percent of the loan to be forgiven?

There are five principal factors that will result in less than 100 percent loan forgiveness.

First, if the PPP loan borrower obtained an Economic Injury Disaster Loan (EIDL) advance, then that amount must be subtracted from the loan forgiveness amount.

Example. Assume your church borrowed \$150,000, had qualifying expenses totaling \$150,000, and also received an EIDL advance of \$10,000. In this case the amount forgiven will be \$150,000 less than the EIDL advance of \$10,000, or \$140,000. This will leave the church with a \$10,000 outstanding loan balance to be repaid at 1 percent interest over the two-year period that began on the date of origination with the first payment due six months after the date of origination.

Second, the SBA interim rule announced on April 2, 2020, requires that at least 75 percent of the loan proceeds be used on payroll costs. These costs include salary and wages, payments for group health insurance, including insurance premiums, employer retirement contributions, and taxes assessed on payroll by state and local authorities. If your church fails to meet this 75 percent threshold, then you will be required to repay that portion of the loan that caused you to not meet the 75 percent threshold.

Example. Assume your PPP loan amount is \$100,000. This means that you will need to expend at least \$75,000 on payroll costs to receive 100 percent loan forgiveness. If you only spend \$70,000 on payroll costs, then you will need to figure out the amount which, when multiplied by 75 percent, gives you \$70,000. This is determined by dividing your actual payroll costs by 75 percent. So in this example $\$70,000 \div 75 \text{ percent} = \$93,333.33$. This means your loan

forgiveness amount will be reduced by \$6,666.67 ($\$100,000 - \$93,333.33 = \$6,666.67$) and you will have an outstanding loan balance equal to this amount (\$6,666.67).

Third, wages paid to an employee for Expanded Family Medical Leave Act paid leave or Emergency Paid Sick Leave Act for which your church receives the allowable credit under the FFCRA are not includible in your payroll costs. While you may be aware of this possibility, the unknown is the rate at which employees will apply for these paid leave benefits during the eight-week measurement period.

And fourth and fifth, the remaining two sources of a reduction in your loan forgiveness amount are: (1) the headcount reduction factor, and (2) the salary and wage reduction amount. These are complex computations that are described in detail below.

Computation of the headcount reduction factor

To compute the average headcount reduction factor:

1. Compute the number of FTE employees per month employed during the eight-week period beginning on the loan origination date.
2. Divide the result, at the borrower's discretion, by either:
 - The average number of FTE employees per month employed by the borrower between February 15, 2019, and June 30, 2019; or
 - The average number of FTE employees per month employed by the borrower between January 1, 2020, and February 29, 2020.

If the employer is a seasonal employer, the denominator of the factor is the average number of FTE employees per month employed by the borrower between February 15, 2019, and June 30, 2019.

When the formula requires the employer to use the average number of FTE employees per month, the average is computed by adding the number of FTE employees paid on each payday during the month divided by the number of paydays during the month. The SBA has not provided guidance for how to perform this computation for partial months, such as February 15, 2020, through February 29, 2020. While guidance is pending, an approach that is consistent with the statute is to add the number of FTE employees paid on each payday during the partial month and divide this sum by the number of paydays during the partial month.

Caution. The CARES Act does not describe how part-time employee hours are to be converted to FTE employee hours. The SBA could determine that borrowers must use the calculation provided for in the Affordable Care Act. Until the SBA gives additional guidance, a borrower will not know which standard applies.

If the SBA decides to use the Affordable Care Act computation for computing full-time equivalent employees (perhaps a conservative approach), a full-time employee is an employee who works an average of 30 hours per week or more during a calendar month or at least 130 hours during a calendar month. To determine the full-time equivalency of employees working fewer than 30 hours per week:

1. Compute the total of all hours of service performed by non-full-time employees during a calendar month, but excluding any hours above 120 worked by an individual employee; and

2. Divide the resulting total by 120.

The total number of full-time employees for that pay period is then added to the full-time equivalent employees from that pay period to arrive at the total full-time equivalent headcount for the pay period.

An alternate method previously used by the SBA for FTE computations considers all employees working 30 or more hours per week as full-time. To compute the full-time equivalent for part-time employees, hours of employees working fewer than 30 hours per week are aggregated and divided by 40. The result of the full-time employees and the full-time equivalency computation are added together to determine the headcount.

It remains to be seen which standard will be adopted for Paycheck Protection loan forgiveness purposes.

Key point. Continue monitoring ChurchLawAndTax.com for updates as future guidance from the SBA is issued.

Example. Let's consider a simple example illustrating the headcount reduction factor. Assume that during the eight-week loan forgiveness measurement period the church has 15 full-time employees and 20 part-time employees. After applying the method the SBA announces for converting part-time employees into to FTEs, your church determines its total headcount for the eight-week period is 27. This is the numerator of the headcount reduction factor.

To compute the denominator, the church performs the same computation for converting part-time employees to FTEs for the period described above that will give you the best answer. If the church elects to use the period February 15, 2019, to June 30, 2019, it must compute the average number of FTEs for each month or part of a month, then average the monthly FTEs to arrive at the average FTEs over the entire period. If the result is less than or equal to 27 combined full-time and part-time FTEs, then that is the number you will want to use because you will end up with no reduction in headcount.

However, if comparison to that period does not produce a favorable result, you can choose the alternate period of January 1, 2020, to February 29, 2020. Note that it does not matter which of these computations you perform first and you are not required to compute both.

If we assume your lowest full-time and part-time FTE headcount in either the February 15, 2019 to June 30, 2019 period or the January 1, 2020 to February 29, 2020 period is 30 FTEs, then your headcount reduction factor will be $(30 - 27) \div 30$, or $3 \div 30$, which results in a headcount reduction factor of 10 percent.

If your loan forgiveness amount before taking the headcount reduction factor into account is \$100,000, then you will be required to reduce your loan forgiveness amount by 10 percent of \$100,000, or \$10,000. Your resulting loan forgiveness amount will then be \$90,000.

Computation of the salary and wage reduction amount

To compute the salary and wage reduction factor:

1. Determine which employees, if any, experienced a salary or wage reduction during the eight-week period beginning on the loan origination date that is in excess of 25 percent of the

employee's total salary or wages during the most recent full quarter of employment prior to the loan origination date. In making this determination, exclude any employee who received an amount of salary or wages during any pay period during 2019 which exceeded \$100,000 at an annualized rate of pay.

2. For each such employee, compute the amount by which the salary and wage reduction exceeds 25 percent.
3. The sum of the amounts computed in the preceding step is the salary and wage reduction amount.

To illustrate the salary reduction amount computation, consider the table below.

	Q1 2020 salary or wage	Annualized Rate of Pay During 2019	2019 Annualized Rate of Pay Exceeds \$100,000	Quarterly Rate of Pay During 8-week Period	Period Over Period Change in Rate of Pay	Actual Pay During 8-week Period	75% of Q1 2020 Pay for an 8-week Period	Salary and Wage Reduction Amount
Employee 1*	\$31,250.00	\$121,250.00	Yes	N/A	N/A	N/A	N/A	N/A
Employee 2**	\$15,000.00	\$58,200.00	No	\$12,750.00	-15%	N/A	N/A	N/A
Employee 3***	\$18,750.00	\$72,750.00	No	\$13,125.00	-30%	\$8,076.92	\$8,653.85	\$576.92

The computations in the table above assume weekly pay periods. However, until additional guidance is released, it is unclear how biweekly and semimonthly pay periods will be accounted for the purpose of the salary and wage reduction amount computation.

As you can see from the table above:

* Employee 1's 2019 compensation exceeded the \$100,000 threshold and is therefore not included in the salary and wage reduction amount computation.

** Employee 2's compensation is less than \$100,000, but her compensation was only reduced by 15 percent (on a quarter-over-quarter basis) and, therefore, she is excluded from the salary and wage reduction amount computation.

*** Employee 3's compensation was reduced by 30 percent (on a quarter-over-quarter basis) and, therefore, he is included in the salary and wage reduction amount computation, but only to the extent his salary was reduced by more than 25 percent between the first quarter of 2020 and the eight-week measurement period.

As the table shows, Employee 3's actual pay during the eight-week measurement period was \$8,076.92. If we convert his first quarter 2020 compensation to a comparable eight-week compensation amount, the result is $((\$18,750 \times 4) \div 52) \times 8$, or \$11,538.46. Seventy-five percent of \$11,538.46 is \$8,653.85. The difference between seventy-five percent of Employee 1's first quarter 2020 rate of pay and this compensation during the eight-week measurement period is \$8,653.85 – \$8,076.92, or \$576.92.

If your loan forgiveness amount before taking the salary and wage reduction amount into account is \$100,000, then your loan forgiveness amount will be \$100,000.00 – \$576.92, or \$99,423.08.

The headcount reduction factor and salary and wage reduction amount operate independent of one another. Therefore, either may apply, neither may apply, or both may apply.

Exception to the application of the headcount reduction factor and salary and wage reduction amount

There is an important exception to the application of the headcount reduction factor and salary and wage reduction amount where an employer rehires employees or restores the salary and wages of affected employees.

The headcount reduction exception factor applies where—during the period beginning on February 15, 2020, and ending on April 26, 2020 (the date 30 days after enactment of the CARES Act)—there is a headcount reduction that is eliminated by no later than June 30, 2020.

Similarly, the salary and wage reduction amount exception applies where, during the period beginning on February 15, 2020, and ending on April 26, 2020, there is a salary and wage reduction for one or more employees as compared to February 15, 2020, which is eliminated by not later than June 30, 2020.

The two exceptions operate independently of one another. Therefore, an employer may qualify for either one or both exceptions or neither.

Key point. The intent of the PPP loan is to retain employees and their general salary levels.

How long will it take to know a loan is forgiven?

The CARES Act stipulates that a lender must issue a decision regarding loan forgiveness within 60 days after the date it receives the application for loan forgiveness. However, borrowers should be prepared for delays in the process due to the fact that loan applications were all submitted within a short period and it follows that loan forgiveness applications will similarly be submitted within a narrow time frame.

Is the amount forgiven subject to unrelated business income tax?

The CARES Act explicitly states that the forgiven amount is excludible from gross income, notwithstanding the forgiven amount being treated as the cancellation of indebtedness.

What loan payment deferment options are available?

The interim rule announced on April 2, 2020, by the SBA states that payments of loan principal, interest, and fees will be deferred for six months. During this deferral period, interest will accrue on the outstanding loan balance. However, if the principal is forgiven, interest accrued through the date of forgiveness will also be forgiven. At present, it is unclear what portion of the loan interest will be forgiven if the loan principal is partially forgiven.

For any portion of a loan that is not forgiven, it is carried forward with a two-year term at an interest rate of 1 percent after the initial six-month deferral period.

Are PPP loan proceeds required to be deposited into—and accounted from—a separate bank account?

There is nothing in the CARES Act or subsequent SBA guidance that requires this. However, some churches may determine that depositing the PPP loan proceeds in a separate bank account and releasing them as qualifying expenditures are made may assist them in tracking qualifying expenditures and in ensuring any unexpended balance remains available for repayment.

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