

# Key Points on Applying for a 2<sup>nd</sup> Draw PPP loan if You Are A Corporation Filing an 1120-S Tax Return

**NOTE:** This guidance is meant for corporations that file their tax forms on Form 1120, U.S. Income Tax Return for an S Corporation.

**You will find guidance on how to calculate your loan amount at the end of this document.** There are some key differences in applying for a 2<sup>nd</sup> Draw PPP Loan vs. your first go-round – primarily in terms of what you’ll need to certify in your application and how you can calculate the 25% reduction in gross earnings you need to demonstrate to be eligible for a second loan – that we encourage you to review before you start addressing your loan amount.

**A special note for LLCs that file taxes using Form 1120-S:** If you are an LLC that reports your taxes on Form 1120S because you elected to be taxed as an S Corporation, you cannot include owner’s compensation reflected on your K-1s. You’ll note below that there is no provision for K-1 distributions in the loan amount guidance, because it is not an eligible expense for PPP loans.

Please read through these advisories before jumping to the loan amount guidance at the end. Thanks.

## What Are Your Key Eligibility Tests?

You must certify that you experienced at least a 25% reduction in “gross receipts” in 2020, as compared to 2019. In general, SBA defines gross receipts as “all revenue in whatever form received or accrued (based on your accounting method), from whatever source.” You can review our website FAQ for SBA’s complete definition if you need more detail to make this determination.

You can establish this decrease on either an annual or a quarterly basis.

Look below to find more about the specific documentation requirements based on the size of your loan.

You can’t have more than 300 employees at the time of your 2<sup>nd</sup> Draw PPP loan application.

For larger businesses, just be mindful that, in determining size eligibility, SBA counts each person you employ as one employee – whether they are full-time or part-time. So: If you have 200 full-time employees and 150 part-time employees, you have too many employees to qualify.

You need to have spent all the money you received in your first PPP loan.

You do not have to have completed the forgiveness process to apply for a 2<sup>nd</sup> Draw PPP loan – but you will need to certify that you’ve spent all the funds from your first loan for PPP-eligible purposes.

You need to certify that you are currently in business – or plan to resume operations.

The SBA’s guidance on this point reads in part:

This provision prohibits an entity that has gone out of business and has no intention of reopening from receiving a PPP loan....PPP was not intended to support businesses that have permanently closed. A borrower that has temporarily closed or temporarily suspended its business but intends

to reopen remains eligible for a PPP loan.

If you have had to discontinue operations temporarily because of local conditions during the COVID crisis, you are still eligible if you plan to reopen.

## **What Documentation Do You Need to Provide Us Upfront?**

If you are applying for a loan less than \$150,000, you will primarily need to provide us with the materials requested in the online application you will fill out.

If you are applying for a loan greater than \$150,000, see notes below for additional information we'll need to document your 25% reduction in gross receipts.

We will contact you if we determine we need any other documents after we have done a thorough review of our file from your first loan.

## **How Can You Document Your 25% Reduction in Gross Receipts for A Loan Less than \$150,000?**

**If you are seeking a 2<sup>nd</sup> Draw PPP loan less than \$150,000, you do not have to provide us with upfront documentation of your 25% or greater reduction in “gross receipts” when you apply for your 2<sup>nd</sup> Draw PPP.** You must provide us with proof of the reduction when you are ready to seek forgiveness of your loan or at any time upon SBA request. SBA randomly reviews PPP loans from every lender and may conduct a review at any time, before or after the forgiveness process, for up to 4 years.

SBA will not forgive your PPP loan if you cannot provide documentation of the required reduction at forgiveness. In that case, you would have to pay off the full amount of your 2<sup>nd</sup> Draw PPP loan over a 5-year period.

Before you apply, you should review your financial statements and get comfortable that you have experienced at least a 25% reduction and will be able to document that when it is time to apply for forgiveness. Here are some tips on how to do that.

### **If you were in business for all of 2019:**

You will be able to verify your 25% drop in gross receipts using either annual or quarterly data.

If you are demonstrating your 25% reduction on an annual basis, you will need to compare your filed 2019 Form 1120-S, U.S. Income Tax Return for an S Corporation, with your 2020 annual operating results, calculated in line with what you will file in your 2020 taxes.

You can use a more informal method, but you'll want to feel confident that your 2020 Form 1120-S, when filed, will demonstrate a 25% or greater reduction. At forgiveness, we'll need to collect a copy of your final filed 2020 Form 1120-S to verify the reduction.

To calculate your “gross receipts” for both 2019 and 2020 based on your Form 1120-S:

- Add line 6 (total income) plus line 2 (cost of goods sold)

Here's an example of the calculation you need to make:

- If your 2019 gross receipts were \$50,000, and your 2020 gross receipts were \$30,000, then:
- $\$30,000/\$50,000 = 0.6$
- $1 - 0.6 = 0.4$

Thus, you experienced a 40% revenue reduction for the year – and would easily meet the SBA 25% revenue reduction test.

NOTE: Your prior PPP loan is not considered “income” for purposes of determining your 2020 gross receipts. (PPP loans are not considered income for tax purposes.)

If you are certifying your 25% reduction on a quarterly basis, you will want to do several things:

- You will want to ensure you'll have evidence at forgiveness that you experienced the 25% drop in any one 2020 quarter as compared to the 2019 quarter to which you're comparing your 2020 results. For instance, if you choose to use Q2, you need to show that your gross receipts in Q2 2020 were at least 25% lower than they were in Q2 2019.
- You basically follow the same process as we have outlined above for an annual reduction: Compare the gross receipts for those quarters and conclude whether you have a reduction of at least 25%.
- While you don't need to give it to us now, you will need to have financial records from the 2019 and 2020 quarters ready for forgiveness. Documentation might include your quarterly financial statements, business bank statements showing your revenues, Form 1099-MISC (if you receive these forms from customers), your business invoices, etc. If at the time of forgiveness, your filed 2020 Form 1120-S documents at least a 25% annual reduction as compared to your filed 2019 Form 1120-S, that should be sufficient documentation of your reduction as well.

NOTE: Your prior PPP loan is not considered “income” for purposes of determining your 2020 gross receipts. (PPP loans are not considered income for tax purposes.)

**If you were not yet in business in Q1 2019:**

At forgiveness, you will need to provide documentation that you experienced at least a 25% drop in gross receipts during any one quarter of 2020 as compared to your results in either Q2, Q3 or Q4 2019.

To verify for yourself that you experienced a 25% reduction, you should follow the documentation guidelines outlined above.

**If you were not yet in business in Q1 and/or Q2 2019:**

At forgiveness, you will need to provide documentation that you experienced at least a 25% drop in gross receipts during any one quarter of 2020 as compared to your results in either Q3 or Q4 2019.

To verify for yourself that you experienced a 25% reduction, you should follow the documentation guidelines outlined above.

**If you were not yet in business during Q1 through Q3 2019:**

At forgiveness, you will need to provide documentation that you experienced a drop in gross receipts of at least 25% during any one quarter of 2020 as compared to your results in Q4 2019.

To verify for yourself that you experienced a 25% reduction, you should follow the documentation guidelines outlined above.

**How Can You Document Your 25% Reduction  
for A Loan More than \$150,000?**

**If you are seeking a 2<sup>nd</sup> draw loan greater than \$150,000, you will need to provide us upfront documentation that you experienced a 25% reduction in “gross receipts” as defined by the SBA. Please follow the process that fits the nature of your business:**

**If you were in business for all of 2019:**

You can provide documentation of your 25% drop in gross receipts using either annual or quarterly data.

If you are demonstrating the 25% reduction on an annual basis, you will need to compare your filed 2019 Form 1120-S, U.S. Income Tax Return for an S Corporation, with the information that will go into your 2020 Form 1120-S.

You can use a more informal method, but you’ll want to feel confident that your 2020 Form 1120-S, when filed, will demonstrate the 25% or greater reduction. You need to provide a copy of your filed 2019 Form 1120-S and your draft 2020 Form 1120-S to us now, and at forgiveness, we’ll need to collect a copy of your final filed 2020 Form 1120-S to verify the reduction.

To calculate your “gross receipts” for both 2019 and 2020 based on your Form 1120-S:

- Add line 6 (total income) plus line 2 (cost of goods sold)

Here’s an example of the calculation you need to make:

- If your 2019 gross receipts were \$300,000, and your 2020 gross receipts were \$180,000, then:
- $\$180,000/\$300,000 = 0.6$
- $1 - 0.6 = 0.4$

Thus, you experienced a 40% revenue reduction for the year – and would easily meet the SBA 25% revenue reduction test.

NOTE: Your prior PPP loan is not considered “income” for purposes of determining your 2020 gross receipts. (PPP loans are not considered income for tax purposes.)

If you are demonstrating your 25% revenue reduction on a quarterly basis, you will need to do several things:

- You will need to provide documentation that you experienced the 25% drop in any one 2020 quarter as compared to the 2019 quarter to which you're comparing your 2020 results. For instance, if you choose to use Q2, you need to show that your gross receipts in Q2 2020 were at least 25% lower than they were in Q2 2019.
- You basically follow the same process as we have outlined above for an annual reduction: Compare the gross receipts for those quarters and conclude whether you have a reduction of at least 25%.
- You will need to give us financial records from the 2019 and 2020 quarters that you are using to show your gross receipts dropped by at least 25%. Documentation might include your quarterly financial statements, business bank statements showing your revenues, Form 1099-MISC (if you receive these forms from customers), your business invoices, etc.

NOTE: Your prior PPP loan is not considered "income" for purposes of determining your 2020 gross receipts. (PPP loans are not considered income for tax purposes.)

**If you were not in business in Q1 2019:**

You will need to provide documentation that you experienced a drop in gross receipts of at least 25% during any one quarter of 2020 as compared to your results in either Q2, Q3 or Q4 2019.

To demonstrate your 25% reduction, follow the quarterly basis documentation rules outlined above.

**If you were not in business in Q1 and/or Q2 2019:**

You will need to provide documentation that you experienced a drop in gross receipts of at least 25% during any one quarter of 2020 as compared to your results in either Q3 or Q4 2019.

To demonstrate your 25% reduction, follow the quarterly basis documentation rules outlined above.

**If you were not in business during Q1 through Q3 2019:**

You will need to provide documentation that you experienced a drop in gross receipts of at least 25% during any one quarter of 2020 as compared to your results in Q4 2019.

To demonstrate your 25% reduction, follow the quarterly basis documentation rules outlined above.

## **How Can You Use Your 2<sup>nd</sup> PPP Loan?**

The SBA has expanded the ways you can use your PPP loan proceeds:

- Payroll costs - you still must spend at least 60% of your loan on eligible payroll costs;
- Rent or lease payments;
- Interest payments on mortgages or secured debt;
- Utilities payments;

- Operating expenses for certain business software and cloud computer services – such as for accounting and payroll, sales and billing, etc.
- Property damage costs related to rehabbing your building following “public disturbances that occurred during 2020,” if these costs were not covered by your insurance;
- Certain costs related to contracts, orders or purchase orders made with your goods suppliers; and
- Certain expenses related to complying with state and federal standards related to protecting your workers on the job from the effects of COVID 19.

(Review our website FAQ document for more details on eligible expenditures.)

Please check all boxes on your application that you think you will want to use your PPP loan to pay.

We hope this information helps you figure out how a PPP 2<sup>nd</sup> draw loan might help your business. We look forward to hearing from you soon!

## **Additional Guidance on How to Calculate Your Loan Amount**

The basic formula for calculating your PPP loan amount is fairly simple:

- You decide which 12-month time period you want to use for your loan: calendar year 2019 or 2020. (See notes below for exceptions for newer organizations.)
- You add up all the eligible payroll expenses you had for the 12-month time period you've designated.
- Divide by 12.
- The result is your "average monthly payroll."
- Your loan amount is 2.5 times the amount of your average monthly payroll.

### **What exactly can and can't you include in the PPP monthly payroll?**

Here is a quick summary of what can and can't go in the PPP monthly payroll calculations, according to ADP Payroll Services Guidance:

You can include:

- Employee gross pay (from line 5c column 1 on your quarterly Form 941 filings)
- All employer-paid state and local taxes on employee gross pay, such as state unemployment insurance
- Employer-paid employee health care benefits, including insurance premiums
- Employer-paid employee retirement benefits, including defined-benefit or defined-contribution retirement plans and employer 401(k) contributions

Applicants can't include:

- Gross pay for any employee that exceeds \$100,000 on an annualized basis
- The employer portion of federal employment taxes (i.e., Social Security and Medicare)
- Payments to independent contractors (note, however, independent contractors themselves can apply for a PPP loan)
- Workers compensation premiums
- Federal unemployment tax
- Compensation of any employees whose principal place of residence is outside of the U.S
- Qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act

### **What are the documents needed to justify your loan?**

We must collect some official or third-party documentation to justify the monthly payroll you are claiming as the basis for your loan. According to SBA/Treasury guidance, we'll need to have in our files the following documents relevant to the 12-month payroll period you wish to use for your 2<sup>nd</sup> Draw PPP that we'll need to establish eligibility, such as:

- Payroll processor records from a recognized third-party payroll processor, showing identifying information (such as a logo and/or letterhead) from the processor that prepared the report, which includes equivalent information as is shown on your IRS Form 941s and state employee wage and unemployment insurance filings
- Payroll tax filings (IRS Form 941 – Quarterly Federal Tax Return); please include all your 941 forms for 2019 and 2020
- Detailed vendor receipts for other expenses you’re claiming, such as health and retirement benefits

If you do not have some of the above documents, you may include:

- IRS Form 940, Annual Federal Unemployment Tax Return
- 2019 tax returns

We must have third-party or official documentation to support your calculations. Internally prepared P&L documents, by themselves, will not be sufficient. Once we have received your filings, we may need to ask you for additional documents to help us review your application.

### **What time period can you use to calculate “average monthly payroll”:**

#### Most Businesses:

You may use these time frames for the 12-month period on which to base your loan:

- January 2019 - December 2019
- January 2020 – December 2020
- the most recent 12-month period (if that’s not Jan-Dec 2020 at the time of your application).

#### Newer Businesses:

- If you started operations in the middle of 2019 but did not operate for the full calendar year, you can calculate your total payroll as outlined above – but you can divide that amount by the number of months you were in business for the year (instead of 12) to get your average monthly payroll. (See notes on the calculator attached in your online application.)
- If you started operations between Jan. 1, 2020, and Feb. 15, 2020 (but remember that you have to have been in operation by Feb. 15, 2020 to be eligible, and you have to show the 25% reduction between your Q1 2020 results and another quarter in 2020), you can (1) calculate your eligible total payroll for 2020, and divide that amount by the number of months you were in operation in 2020 to get your average monthly payroll. (See notes on the calculator attached in your online application.)

#### Seasonal Businesses:

If your business is seasonal, (1) you may calculate your average monthly payroll by adding up your payroll for any 12-week period between Feb. 1, 2019 and Feb. 1, 2020. (2) You then divide that amount by three to arrive at your monthly payroll base.

For more detailed advice on detailed questions about how to calculate your loan amount, please refer to our online FAQ at: <https://www.self-helpfcu.org/business/loans/paycheck-protection-program-loans>.