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FEATURE

Payroll Protection Program, Employee Retention Tax Credits, and the Construction Industry

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How to take advantage of these programs and their effect on a strong bonding program

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The Consolidated Appropriations Act (the Act), which passed December 27, 2020, contained several important economic stimulus measures for businesses, including the payroll protection program (PPP) and the employer retention tax credit (ERTC).

Payroll Protection Program Expenses Used for Loan Forgiveness

One of the primary 2020 tax benefits provided in the Act is the ability to deduct expenses used to qualify for loan forgiveness. Originally, the IRS indicated that expenses related to loan forgiveness would not be deductible on tax

returns. Under the Act, these expenses are now deductible on your federal tax return. However, this is not necessarily the case at the state level. Not every state will allow forgiven loans to be tax-exempt income, and not every state will allow the expenses used for loan forgiveness to be deductible. This becomes exponentially more important if you are a multi-state operation. Keep in mind that not every state has made a decision, so planning and patience are recommended.

Payroll Protection Program – New Money Available for Loans

The Act provided for additional funds to be available for the Payroll Protection Program. Companies eligible for the first round of loans but did not receive them can apply before March 31, 2021. The rules are largely the same as for the original round of loans (e.g., 500 or fewer employees, no revenue reduction requirement, etc.).

There is also the ability for companies to take a Second Draw PPP loan if they qualify. The basic qualifications are to have received and spent your entire PPP 1 loan, employ 300 or fewer employees, and have a 25% gross receipts reduction in a 2020 quarter compared to the same quarter in 2019.

Now, these basic qualifications lead to a whole host of questions, especially in the construction industry. In general, the amount of gross receipts is measured using your tax basis of accounting and includes nearly every type of receipt, including revenue, interest, dividends, commissions, and more. The eligibility requirement generally uses a rolling 12-month average of employees – both full- and part-time. An individual counts as an employee for the month if s/he worked 40 hours in that month.

Employee Retention Tax Credit (ERTC)

The Act changed the credit for 2021 and allows companies that have a PPP loan to take the ERTC as well, as long as the same wages aren’t used for both programs. This is a common theme in the stimulus bills – no double dipping of costs. The ERTC for 2020 is unchanged, but more companies may

qualify because they are not automatically excluded for taking a PPP Loan. In general, the qualifications for ERTC are to have a government-ordered full/partial shutdown or a 50% gross receipts reduction when comparing a quarter in 2020 to the same quarter in 2019. If using the latter, the ERTC window remains open through the end of the quarter where gross receipts in 2020 are at least 80% of the 2019 corresponding quarter's gross receipts. The credit is 50% of wages paid during the ERTC window, with a maximum eligible annual wage of $10,000; therefore, the maximum credit is $5,000 per employee.

While one might initially think that the impact of PPP and ERTC on a strong bonding program would be that the new PPP debt would not be helpful in the short-term, closer scrutiny shows a positive impact to a construction company's bonding program from each of these economic stimulus items.

For 2021, the credit is available for the first two quarters. To qualify, a gross receipts reduction of 20% when comparing gross receipts for the 2021 quarter to the same 2019 quarter. A company can also use the prior quarter as a safe harbor to qualify for the current quarter. The government shutdown rule still applies. The amount of the credit is expanded to 70% of eligible wages, and eligible wages are $10,000 per quarter per employee. This means the maximum credit is $14,000 per employee.

Interaction of Payroll Protection Program and Employee Retention Credit Wages

Since the same wages cannot be used for both programs, there is an opportunity to choose certain wages and costs for each program to maximize a company's benefits under both. Each company situation is unique, as are the eligible costs for PPP and ERTC and the PPP loan forgiveness calculations. We recommend working closely with your CPA to determine your company's best allocation and result.

Effect on a Strong Bonding Program

While one might initially think that the impact of PPP and ERTC on a strong bonding program would be that the new PPP debt would not be helpful in the short-term, closer scrutiny shows a positive impact to a construction company's bonding program from each of these economic stimulus items.

A key factor in bonding is the quality of the contractor's employee base. Simply put, the higher the quality of the employees, the less risk the surety sees. The PPP and ERC programs allow contractors to retain employees during this time of economic turmoil. That employee stability lowers a company's bonding risk.

Equity, Debt and Liquidity

From a strictly financial perspective, the three legs of the stool are equity, debt, and liquidity. While a new loan on the books increases debt, the short-term nature of a PPP loan increases liquidity without affecting equity. When a PPP loan is forgiven, it moves to other income and will increase equity. The expenses paid with PPP funds decrease equity, so the net impact on equity is zero. PPP provides increased liquidity with zero equity impact and only a short-term increase in debt before it is converted to equity.