You Received Your PPP Loan or Your Application is in Process: ***What You MUST Do Now***

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Housekeeping

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Agenda

- Forgiveness definitions and calculations for the Paycheck Protection Program
- Current steps to take to maximize forgiveness of a PPP Loan

First: Do You Need to Give the Money Back?

- FAQ #31 (published April 23, 2020)
- **QUESTION:** Do businesses owned by large companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP Loan?
- **ANSWER:** In addition to reviewing applicable affiliation rules to determine eligibility, all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP Regulations at the time of the loan application. Although ***the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere (as defined in section 3(h) of the Small Business Act), borrowers still must certify in good faith that their PPP loan request is necessary.*** Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." ***Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.*** *For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.*

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Forgiveness – Where it is detailed within CARES

- Division A/ Title I – Keeping American Workers Paid and Employed Act
  - Each Division of the Act operates with it's own definitions
- Two sections within Title I of Division A govern the PPP Loan program:
  - **Section 1102** – details PPP loan eligibility and availability calculations
  - **Section 1106** – details Loan Forgiveness
    - This section introduces some new and/or slightly altered definitions to be used for determining forgiveness
    - Where this section is silent, we refer back to definitions in Section 1102 to the extent they are there. In some cases (such as with FTE), there is no definition anywhere in the statute. Anticipate clarifying definitions to come soon in future guidance published by the SBA and Treasury

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Forgiveness Factors – The 75% guideline

- General guideline is to spend a minimum of 75% of total loan balance on "payroll costs" and other 25% on "allowable uses."
- 75% guideline is not part of the actual language of the CARES Act. It was introduced in subsequent guidance primarily focused on loan availability calculations.
- Why 75%? – Guideline provided based upon following rationale:
  - Maximum loan = 2.5 months of 2019 average monthly payroll
  - 2.5 months is approximately equivalent to 10 weeks
  - Forgiveness is tied to how funds are used during 8 weeks after receipt.
  - If payroll levels are maintained for the 8 weeks, translates to 8/10ths of the loan being spent on payroll costs. 8/10ths is 80% which is rounded down to about 75%.
- ABSENT FRAUD, do not be overly concerned about 75% threshold. Use it as it was intended – a guideline.

Forgiveness Factors – Permissible Uses for Loan Proceeds

- Forgiveness is not available at all unless the proceeds are spent on the specific uses designated under the CARES Act as permissible
- ***Maximum Forgiveness*** is tied to the ***sum*** of the following expenses during the 8-week** period:
  - Payroll costs
  - Utilities
  - Rent/mortgage interest
- **amounts paid during the 8-weeks following actual disbursement of loan proceeds to the borrower or principal balance of loan (whichever is less) = maximum forgiveness
- ***Note***: we await further guidance on whether expenses are determined on a cash or accrual basis. For now, with loan availability calculations utilizing a cash-basis accounting method, presumption is forgiveness calculations will follow.

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Forgiveness Factors: Payroll Costs

- ***"Payroll costs" include:***
  - Gross payroll amounts
    - Note that gross payroll is <u>not</u> the equivalent of Box 1, W-2 income
    - Includes ALL gross payroll, such as: severance, vacation, commissions, etc.
  - Costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums
    - Employer portions only
    - Need clarification of whether expenses relate to period where costs are incurred, period where costs are due, or both

Forgiveness Factors: Other Permissible Uses

- Permissible expenses for the remaining 25% include:
  - Interest on mortgages
  - Rents
  - Utilities
  - Generally, the obligation or service agreement needs to have been in existence prior to 2/15/2020.
  - *Note: Interest on business debt was noted as a permissible use in Section 1102 which discusses PPP Loan eligibility and availability. However, Section 1106 detailing forgiveness only refers to interest on mortgages and does not specifically reference interest on business debts as a permissible use for loan proceeds.*
  - *Note: Unclear on types of "rent" other than business premises*

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Percentage of Forgiveness Tied to Headcount

- Take the total amount spent on permissible uses during the 8-week period and multiply it by the following ratio:
  - ***Numerator =***
    - Average # of FTE employees per month employed during the 8-weeks following receipt of loan proceeds
  - ***Denominator =***
    - Average # of FTE employees per month during 2/15/19 through 6/30/19
    - Or, the average # of FTE employees per month during 1/1/2020 through 2/29/2020

Forgiveness is Also Prorated Where Salary Levels are NOT Maintained

- Examination of salaries paid during initial 8-weeks following loan disbursement to borrower
- Compared to total salary or wages of that employee during the most recent full quarter
- Only factored in where that reduction is greater than 25%
- Applies to employees making $100k or less

Reductions to Employees Earning More than $100k Annually

- Salary reductions that do not cause an individual to fall below $100k prorated over the 8-week period should ***not*** factor into forgiveness
  - CARES allows a complete disregard for any reductions made for someone making more than $100k a year
  - Maximizing total forgiveness requires payout of the same amount of wages accounted for when determining available loan amount (assumes a high earner accounted for at least $100k in that calculation)

What About the Option to Fix Things?

- CARES provides an opportunity for employers to “fix” things and have headcount or salary reductions entirely disregarded in determining forgiveness.
- We currently have zero clarification on how to implement these provisions.

Correcting a Reduction in Headcount

- A “fix” is permitted where:
  - An employer reduces headcount or salary between 2/15/2020 and 4/26/2020
    - Compared to headcount on 2/15/2020
    - Period accounts for 30-day window after CARES went into effect
    - Note that dates have already passed
  - Employer is allowed to ”fix” reduction by increasing the headcount of FTE employees by 6/30/2020
    - We do not expect this to translate to allowing a fix where all employees are hired back on 6/29/2020.
    - Expect it to be interpreted as opportunity to increase “average” monthly headcount

Correcting a Reduction in Headcount

- Questions left unanswered:
  - What about voluntary separations that an employer has no control over?
  - What about employees that are not included in payroll calculations due to FFCRA funding their paid leave?

Correcting a Reduction in Salary

- A “fix” is also allowed where
  - At least 1 employee had their salary reduced by more than 25% and the employer eliminates that reduction by 6/30/2020
  - **Questions left unanswered:**
    - Does this mean the salary shortage has to be fully paid by 6/30/2020?
    - Is it enough if the salary reductions is eliminated by that date?
    - How to account for a salary reduction that occurs because paid time is funded through the FFCRA?

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What Will Happen With the Balance That is Not Forgiven?

- All loans have the same terms
  - Maturity of 2 years
  - Fixed interest rate of 1.0%
- Loan payments deferred for 6 months – interest will accrue during deferral period
- No pre-payment penalty

FFCRA Leave

- Don't forget about FFCRA requiring employers with less than 500 employees to provide paid leave in certain circumstances.
- This needs to be accounted for when determining amounts considered in Paycheck Protection Loans (can't double-dip)
- Your payroll provider should be creating a separate pay code to track this time so that it's ***not*** accounted for in a report of "gross payroll" being used to substantiate forgiveness in regards to a PPP Loan

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Unemployment

- My people are all out collecting unemployment already, do I need to bring them back?
  - You need to include them on payroll and issue wages to them (it can be paying out vacation time, severance, etc.)
  - *If you do not* add employees back to payroll, you will want to prepare to pay back that portion of your loan proceeds as it will not be eligible for forgiveness.

Qualified Disaster Payments Under 139

- If you are contemplating use of these, know that they function as expense reimbursements – not issued through payroll and/or taxed as wages.
- This, they are NOT a permissible "payroll cost" that you can use PPP Loan proceeds for.

Example:

- ABC Company obtained $745,000 in PPP loan proceeds
  - 75% = $558,750 (the minimum that should be spent on “payroll costs”)
    - Assuming maximum loan sought and obtained, loan principal indicates weekly gross payroll costs of $68,769.23
    - 8 weeks of “payroll costs” = $550,153.85
  - 25% = $186,250 (the maximum that should be spent on utilities, rent and mortgage interest)

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Example: Spending a Minimum of 75% on Payroll

- Account for gross payroll – all amounts reflecting taxable wages to an individual
  - Can include housing allowance, auto allowance, etc.
  - Cash compensation capped at $100k annually (over 8-week period, total cap = $15,384.62)
  - General partners not paid W-2 wages can account for the same amount in distributions or draws (2019 Schedule K-1)
  - On top of the cap of $15,384.62 per employee, you also add all of the following:
    - Employer share of benefit costs,
    - Employer retirement contributions,
    - and unemployment taxes (state and local)

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Example: Total Payroll Costs for ABC Company

- Employer pays additional $3k/month for health insurance and pension contributions
- Maximum gross payroll of $15,384.62 plus $6,000 (2 months of benefit costs) plus unemployment taxes paid
  - Maximum approximate “payroll cost” per employee of $21,384.62
  - Any wages paid to employee in excess will be disregarded for purposes of forgiveness calculations

Example: Proration for Headcount

- Employer had 30 average monthly FTE employees during 2/15/19 through 6/30/19 = this is the denominator for forgiveness ratio
- Average FTE employees during upcoming 8 weeks is ***unknown***** but this is the numerator that will be divided by 30 to determine percentage of loan forgiveness that may result because of a reduction in headcount
  - ***remember, you can fall below because of voluntary resignations. There is no exception yet noted for this.*

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Example: Proration for Headcount

- Assuming average headcount during immediate 8-weeks after receipt of loan is 27 FTE
  - 27/30 = 90%
  - This percentage is multiplied by the sum of total loan proceeds spent on forgivable payroll costs or other forgivable expenses.
  - In this example, paying only 27 FTEs versus 30 resulted in $705,000 spent on “permissible costs” out of the $745,000 principal amount.
    - 90% * $705,000 = $634,500 of loan eligible for forgiveness.

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Example: Forgiveness with Salary Reductions

- In this example, the Company also reduced salaries 25% across the board
  - Salary reductions that were implemented for individuals that make more than $100,000 a year can be disregarded entirely.
  - Salary reductions for others can also be disregarded since they don't exceed 25%

Example: Don't Forget the Fix Option

- CARES is clear that an opportunity to correct reductions in headcount or salary will be provided
- In this example, we may be able to get forgiveness back up to 100% if we increase the headcount
  - For now, it is conservative to assume that ABC Company could bring back those 3 individuals and resume the payroll during the 8 week period if they want to avoid the proration being applied to reduce forgiveness.

Documentation Required for Loan Forgiveness

- May vary depending upon bank preferences and/or forthcoming guidance
- CARES mentions the following specific items to provide to a lender to verify calculations for forgiveness:
  - Payroll tax filings (both state and federal)
  - Cancelled checks
  - Payment receipts
  - Transcripts of accounts verifying payments made
  - Certification from a person authorized to do so on behalf of the business that the documentation is true and correct and the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation, or make covered utility payments.

What to Do Next

- Determine your 8-week measurement period for use of loan proceeds.
- Determine 75% minimum guideline for payroll costs. Try to meet/exceed that guideline if possible.
- Be cognizant of how reductions in headcount or salary may affect you and be prepared to repay corresponding portion of loan proceeds that won’t be eligible for forgiveness.
- Prepare/store documentation to expedite loan forgiveness application.

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