

Guidance for Payroll Protection Program (PPP) Loans

By: Pat Shannon, HCA President

Dated April 30, 2020

While the loan forgiveness features of the Paycheck Protection Program loans (“*PPP Loans*”) have made PPP loans very attractive to eligible small businesses, borrowers wanting to take advantage of loan forgiveness need to comply with the detailed requirements; otherwise, all or a portion of their PPP Loans may not be subject to forgiveness. Complicating the situation is the fact that, at the present time, there are some open issues and ambiguities as to some of the forgiveness requirements. This article summarizes current guidance on the loan forgiveness provisions and raises some of the ambiguities and open issues that need further clarification. The SBA is expected to issue additional guidance on or before May 1, 2020.

Q: What if I do not get my PPP Loan until after May 4, 2020?

Answer: Since no loans can be given after Jun 30, 2020; May 4, 2020 is the last loan date that would allow 56 days for the forgiveness period. The program guidance states that only costs incurred between Feb 15, 2020 and Jun 30, 2020 will count toward forgiveness.

But what’s still unclear:

- Will you be allowed to use costs incurred between Feb 15, 2020 and Jun 30, 2020 that predate your loan disbursement.

Q: What costs paid with PPP Loan proceeds may be subject to forgiveness?

Answer: A borrower of a PPP Loan will be eligible for forgiveness of that portion of the PPP Loan equal to the sum of “*costs incurred and payments made*” during the eight-week period following the first date the PPP Loan was disbursed (the “*Covered Period*”) for:

- Payroll costs (including additional wages to tipped employees but excluding amounts paid to independent contractors)
- Interest (but not principal) payments on a mortgage that was in existence on Feb. 15, 2020, on real or personal property
- Rent payments on leases in existence on Feb. 15, 2020

- Utility payments for electricity, gas, water, transportation, telephone or internet service for which service began before Feb. 15, 2020

But what's still unclear:

- Does a particular cost need to be both “*incurred*” and “*paid*” during the Covered Period or can such costs be incurred during the period and paid after the period, or vice versa?
- Can a cost incurred prior to the Covered Period (such as payroll costs for part of a payroll period that began before the start of the Covered Period) which is paid during the period qualify for forgiveness?
- Can a cost incurred during the Covered Period but not paid until after the Covered Period (such as payroll costs for a payroll period ending after or lease payments not due and payable during the Covered Period) qualify for forgiveness?
- What precisely does “incurred” mean in this context?

Q: Are there costs that are not forgivable?

Answer: Yes, costs not subject to loan forgiveness include the following:

- The amount of PPP Loan forgiveness can be up to the full principal amount of the loan and, pursuant to a FAQ issued by the SBA, may also include any accrued interest.
- However, not more than 25% of the forgiveness amount can be attributable to non-payroll costs (i.e., interest, rent and utility payments).
- Additionally, any amounts expended for improper uses (i.e., uses other than those subject to potential forgiveness) are not subject to forgiveness.

But what's still unclear:

- Whether rent paid to a related party of the borrower is forgivable is an open issue, although the CARES Act and current guidance do not expressly differentiate between third party and affiliated payments.
- Payments made for interest on non-mortgage debt does not seem to be subject to forgiveness, even though they are costs that can be paid with PPP Loan proceeds.

Q: What else can reduce a PPP Loan forgiveness amount?

Answer:

- The amount of a PPP Loan that can be forgiven is subject to reduction on the basis of a reduction in the number of FTE employees and a reduction in wages and salary of employees (see below).
- The maximum forgiveness amount for a PPP Loan will be reduced dollar for dollar by the amount of any advance received under Economic Injury Disaster Loan program.

But what's still unclear:

- Whether payments made by self-employed individuals for mortgage interest, rent payments and utility payments are forgivable, or is the forgiveness amount limited to only what is on Schedule C.

Q: How is forgiveness affected by a reduction in FTE employee count?

Answer:

- The amount of forgiveness available will be reduced according to the formula $A = B(X/Y)$. where:
 - - “A” is the amount of PPP Loan forgiveness reduction
 - “B” is the maximum loan forgiveness otherwise available
 - “X” is the average monthly number of FTE employees from Feb. 15, 2020 - June 30, 2020
 - “Y” is the average monthly number of FTE employees during the period (at the borrower’s election) of (i) the period from Feb. 15, 2019 through June 30, 2019 or (ii) Jan. 1, 2020 through Feb. 29, 2020 (subject to different rules if business not in operation at that time or if employs seasonal employees).
 - If a reduction of FTE employees occurred during the period beginning on Feb. 15, 2020 and ending on Apr. 26, 2020 (the “*Testing Period*”)

results in a lower FTE employee count during the Testing Period than that of Feb. 15, 2020, a borrower can rehire employees (or potentially hire new employees) on or before June 30, 2020 sufficient to take the June 30, 2020 FTE employee count up to the FTE employee count on Feb. 15, 2020 and thereby eliminate the forgiveness reduction that would otherwise have applied relating to the reduction of FTE employees during the Testing Period. But, depending on the circumstances, this may or may not fully eliminate the reduction.

But what's still unclear:

- How should FTE employees be counted? Is the FTE employee count based only on the number of hours worked for a given employee or, for example, are two half-time employees counted as one FTE employee?
- What about employees that have quit, retired, or been terminated, laid off or furloughed? Neither the CARES Act nor current guidance is clear on whether “ex” employees are taken into account in calculating the forgiveness reduction on account of (i) the reduction calculated on the basis of FTE employee count, (ii) the reduction calculated on the basis of compensation reduction, or (iii) both.
- How soon and for how long do rehired or newly hired employees need to work in order for the borrower to have eliminated any reduction in FTE employee made during the Testing Period count by June 30, 2020?

Q: How is forgiveness affected by a reduction in compensation paid?

Answer:

- The amount of forgiveness available will be reduced by the amount of any reduction in total wages and salary of any employee earning an annualized salary of less than \$100,000 during the Covered Period in excess of 25% as compared to the total wages and salary of that employee during the last full quarter in which the employee was employed immediately prior to the date of the first disbursement of the PPP Loan.
- If the total salary and wages of one or more employees during the Testing Period as compared to the total salary and wages for each such employee on Feb. 15, 2020 and, on or before June 30, 2020 the borrower restores such employees' total wages and salary to 100% of the wages and salaries prior to the reduction, the forgiveness

reduction that would otherwise have applied to the compensation reduction during the Testing Period is presumably eliminated. But, depending on the circumstances, this may or may not fully eliminate the reduction in the forgiveness amount.

But what's still unclear:

- As this point it is not clear whether the forgiveness amount will be reduced by 100% of the compensation-based reduction discussed above, or only the amount that is in excess of 25%.
- A notable open question in this area is the application of these provisions in circumstances where an employee is terminated, quits, retires, is terminated, laid off or furloughed during the Testing Period and the borrower hires a new employee at the same total salary and wages on or before June 30, 2020 and whether that action eliminates the potential forgiveness reduction that would otherwise have occurred.
- The CARES Act speaks only in terms of “the most recent full quarter during which the employee was employed” prior to the start of the Covered Period thus leaving open the question of whether the correct baseline period for measurement is (a) the three full months before the Covered Period, (b) the last full calendar quarter of the borrower or (c) the last full fiscal quarter of the borrowers for borrowers with non-calendar quarter fiscal years.
- Given the CARES Act specification of a comparison to the prior “quarter,” it is not currently clear if a reduction in pay for a person hired during the Covered Period would be included in the calculation of the compensation-based reduction discussed above in the forgiveness amount.
- As noted above, the compensation based reduction requires a comparison of (a) total salary and wages for a given employee during the 8-week Covered Period to (b) the total salary and wages of that employee during the most recent full quarter (i.e., 12 weeks), which raises a significant issue on the calculation of this reduction.

Q: What else can reduce a PPP Loan forgiveness amount?

Answer:

- The maximum forgiveness amount for a PPP Loan will be reduced dollar for dollar by the amount of any advance received under Economic Injury Disaster Loan program.

But what's still unclear:

- Whether payments made by self-employed individuals for mortgage interest, rent payments and utility payments are forgivable or if forgiveness is limited to only what is on Schedule C.

Q: What happens to a portion of a PPP Loan that is not forgiven?

Answer: Any amount not forgiven continues as a loan on the original terms (i.e., 1% interest per annum, no payments for the initial six months of the term and a maturity date 2 years from the date of disbursement).

Q: What documents will be needed to apply for forgiveness?

Answer: The CARES Act provides that a borrower must submit an application to the funding lender or current loan servicer together with the following:

- documentation verifying the number of FTE employees and their pay rates during the Covered Period including payroll tax filings reported to the IRS and State income, payroll and unemployment insurance filings;
- documentation, in the form of cancelled checks, payment receipts, account transcripts or other documents, evidencing payments of mortgage interest, lease payments and utility payments eligible for forgiveness;
- a certification by a representative of the borrower that documentation provided is true and correct and the amount for which forgiveness is requested was used to retain employee and make payments eligible for forgiveness; and
- any other documentation the Small Business Administration (“SBA”) may require.

But what's still unclear: The SBA will be issuing additional guidance with respect to PPP Loan forgiveness which guidance may add or modify the documentation requirements.

Q: What is the timing for determining how much of a PPP Loan has been forgiven?

Answer: The CARES Act requires the lender or servicer to issue a decision on the forgiveness application within sixty days of its receipt of the application.

But what's still unclear:

- At this point there is no additional guidance on how the lender will advise the borrower of the forgiveness amount or document the forgiveness.
- There is no current guidance on when a borrower can apply for forgiveness. However, the earliest any application could be made would be after the expiration of the Covered Period as only after that point would the borrower be able to provide the required documents evidencing forgivable costs.

Q: What are the tax effects of forgiveness?

Answer:

- A borrower will not have to include the forgiveness amount in its gross income for federal income tax purposes.

But what's still unclear:

- Whether a borrower will have to include the forgiveness amount in its gross income for state and local income tax purposes.
- Whether the costs and expenses paid with forgiven PPP Loan proceeds are deductible for federal and state income tax purposes.

Q: Will bankers be allowed to re-amortize PPP loans after forgiveness or will the original amortization on the whole loan amount stand?

Answer:

- Current guidance to bankers does not allow this.

But what's still unclear:

Will new guidance be issued allowing re-amortization after forgiveness?

Q: What should a borrower do to get guidance on these open issues and ambiguities?

Answer: The language used in the CARES Act and corresponding SBA Interim Final Rules and Frequently Asked Questions leaves open a significant number of issues with respect to the application of the PPP Loan forgiveness provisions in some circumstances. The CARES Act requires the SBA to issue regulations and guidance on the implementation of the forgiveness provisions of the PPP Loan program not later than April 26, 2020. But even after additional guidance is issued, most borrowers will continue to confront issues of interpreting the rules in order to maximize the availability of loan forgiveness.