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Living with a PPP Loan

Staying in Compliance and Maximizing Forgiveness

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Program Agenda

Now that you've gotten your PPP loan, you need to start thinking about a whole new set of questions:

- What expenses can I pay with the PPP loan proceeds and how fast do I need to pay them?
- How do I maximize PPP loan forgiveness?
- What is the process for getting PPP loan forgiveness?
- Are there any obligations in the PPP loan documents that will affect my business?
- Will my PPP loan be subject to agency review?

Note: Many aspects of the PPP loan life cycle lack guidance or, even with guidance, remain ambiguous. Where necessary, we have made judgment calls in the absence of clear guidance.

Q1: Now that I've gotten my PPP loan, what's next?

A1: PPP loan proceeds must be used to pay payroll and certain other qualifying costs (Permitted Payments as discussed in Q&A-3) during the eight-week period beginning on the date on which the PPP loan is originated (the "***8-Week Period***").

Q2: Can I delay the start of the 8-Week Period by not signing the loan documents?

A2: Not really.

A borrower must submit all required PPP loan documentation within 20 days of PPP loan approval. A lender must cancel a PPP loan if the required PPP loan documentation is not submitted within the 20-day window.

Q3: What expenses can I pay with loan proceeds during the 8-Week Period?

A3: During the 8-Week Period, PPP loan proceeds can be used to pay the following payments (the "***Permitted Payments***"):

- Cash compensation to W-2 employees (U.S. only), such as salary, bonus, severance, vacation and sick leave pay and tips ($15,385/employee cap),
- W-2 employee benefits, such as health care expenses and retirement contributions (no cap),
- State payroll taxes, such as state unemployment insurance (no cap),
- Rent on leases (real or personal property) (25% cap),
- Utilities (25% cap), and
- Interest on any secured debt and any unsecured debt incurred before 2/15/20 (25% cap).

Q4: What happens if I can't spend all loan proceeds on Permitted Payments during the 8-Week Period?

A4: If a borrower does not spend all PPP loan proceeds during the 8-Week Period, current guidance indicates that the unspent proceeds cannot be used at all and must be immediately repaid (and also does not count towards loan forgiveness). We hope that the SBA will provide further guidance on this point.

Note: Loan documents can differ on this point, with some treating the tardy expenditure of the loan proceeds as an unauthorized use while others allow the tardy use but reduce loan forgiveness by payments made after the 8-Week Period.

Q5: Is there a minimum amount I must use to pay Payroll Costs?

A5: Yes. Under SBA guidance, at least 75% of PPP loan proceeds must be used for "Payroll Costs." No more than 25% of a PPP loan may be used to pay rent, interest, and utilities.

"***Payroll Costs***" means cash compensation paid to U.S. employees (*e.g.,* salary, commissions, and tips), leave-related pay (*e.g.,* vacation and parental, family, medical, or sick leave), severance, employee benefits consisting of group health care coverage and retirement benefits, and state and local employment taxes.

Note 1: In determining Payroll Costs, the $15,385 per employee cap applies to cash compensation only (as noted in Q&A-3), not employee benefits.

Note 2: Cash compensation exceeding the per-employee cap is excluded from Payroll Costs, resulting in a ***non-permitted use*** and loss of loan forgiveness.

Q6: What happens if I can't spend at least 75% of my loan proceeds on Payroll Costs?

A6: If a borrower does not spend the required 75% minimum on Payroll Costs during the 8-Week Period, the shortfall cannot be used for any other purpose and must be immediately repaid (and also does not count towards loan forgiveness) – another ***non-permitted use*** and loss of loan forgiveness

Note: Many loan documents do not properly reflect SBA guidance on this required minimum use of PPP loan proceeds for Payroll Costs. Instead, some loan documents allow borrowers to use less than the required 75% (without requiring repayment) and reduce loan forgiveness by the shortfall in Payroll Costs.

Q7: Are distributions to LLC members (or partners) treated as "Payroll Costs?"

A7: Under current guidance, it appears that 92.35% of the net earnings from self-employment of an LLC member (or partner) should be treated in the same manner as Payroll Costs, including the application of the various income limitations and payment caps.

S corporation dividends do not count as Payroll Costs.

Q8: Can I use PPP loan proceeds for Permitted Payments that are past due or not yet due?

A8: Under existing guidance, it is probable that PPP loan proceeds can be used to pay Permitted Payments during the 8-Week Period, even if those Permitted Payments are past due or arose prior to the 8-Week Period. The payment of past-due or previously-accrued Permitted Payments should also count for purposes of loan forgiveness.

On a more aggressive note, it may be possible to use PPP loan proceeds to pre-pay Permitted Payments, even though the Permitted Payments will not be due or incurred until after the 8-Week Period. However, based on existing guidance, borrowers should proceed with caution when considering a pre-payment strategy.

Q9: How does loan forgiveness work?

A9: PPP loan principal is canceled to the extent of Forgiveness Payments (Q&A-10) made during the 8-Week Period.

Note 1: Not all Permitted Payments count as Forgiveness Payments.

Note 2: Forgiveness Payments may be reduced for lay-offs and wage reductions.

Note 3: A borrower pays no income tax on loan forgiveness income but cannot claim deductions for Forgiveness Payments.

Q10: What expenses paid during the 8-Week Period count towards loan forgiveness?

A10: The following payments ("***Forgiveness Payments***") during the 8-Week Period count towards PPP Loan forgiveness:

- Cash payments to W-2 U.S. employees , such as salary, bonus and tips ($15,385 per employee cap),
- W-2 employee benefits, such health care expenses and retirement contributions (no cap),
- State payroll taxes, such as state unemployment insurance (no cap),
- Rent on leases (real or personal property) dated before 2/15/20 (25% cap),
- Utilities under service agreements dated before 2/15/20 (25% cap), and
- Interest on secured (real or personal property) debt incurred before 2/15/20 (25% cap).

Q11: Do lay-offs reduce PPP loan forgiveness?

A11: Yes.

Forgiveness Payments are scaled back in proportion to any workforce reduction (unless the borrower restores employment to pre-RIF levels by June 30, 2020).

Note: A borrower can terminate independent contractors without any reduction in Forgiveness Payments.

Q12: How do lay-offs reduce Forgiveness Payments?

A12: Forgiveness Payments are reduced proportionately, by comparing (a) the average number of full-time equivalent employees during the 8-Week Period to (b) the average number of full-time equivalent employees during one of two alternative base periods (as chosen by the borrower, the 2/15 - 6/20/19 period or the 1/1 - 2/29/20 period).

Q13: Who is a full-time equivalent employee (FTE)?

A13: Current guidance is unclear. However, based on references to Internal Revenue Code Section 4980H in the CARES Act and until further guidance, the following employees should be treated as FTEs:

1. For the 1/1 to 2/29/20 period, an employee employed for the entire period with more than 240 hours (8 weeks * 30 hours) or exempt, and
2. For the 2/15 to 6/20/19 period, an employee employed for the entire period with more than 540 hours (18 weeks * 30 hours) or exempt.

For an hourly part-timer, take hours worked and divide by 240 or 540 depending on the time frame used.

For an exempt employee, divide the weeks worked by the total weeks in the relevant time period.

Q14: Do wage decreases reduce Forgiveness Payments?

A14: Yes.

If an employee making $100,000 or less suffers a wage decrease of more than 25% during the 8-Week Period (as compared to the last full calendar quarter prior to the 8-Week Period), the excess wage reduction for the 8-Week Period reduces the amount of the Forgiveness Payments.

Note: Up to 25% of any wage reduction is "free" and does not reduce Forgiveness Payments (*i.e.*, no "first dollar" reduction). No wage reduction for a highly-compensated employee counts against Forgiveness Payments.

Q15: Does employee hiring or restoring wages avoid loss of Forgiveness Payments?

A15: Yes, if the employer restores headcount or the reduced wages by June 30, 2020, but only if the lay-offs or wage reductions occurred during period beginning on February 15, 2020, and ending on April 26, 2020.

There is no guidance on how long a borrower must retain re-hired employees or maintain wages to preserve loan forgiveness.

Q16: What if a laid-off employee refuses to come back to work by June 30?

A16: The SBA promises additional guidance excluding laid-off employees whom the borrower offered to rehire (for the same salary/wages and same number of hours) from the headcount reduction rule. The additional guidance will specify that, to qualify for this exception, the borrower must have made a good faith, written offer of rehire, and the employee's rejection of that offer must be documented by the borrower.

Q17: Can I see a step-by-step application of the loan forgiveness calculation?

A17: Sure.

Step 1: For the 8-Week Period, determine Forgiveness Payments (subject to caps).

Step 2: For either (a) 1/1 to 2/29/20 or (b) 2/15 to 6/30/19, calculate average FTEs. ***Take the lower FTE result***.

Step 3: For 8-Week Period, calculate (a) average FTEs or (b) average FTEs under rehiring cure rule (in Q&A-15). ***Take the higher FTE result.***

Step 4: Divide Step 3 FTE result by Step 2 FTE result.

Step 5: Multiply Forgiveness Payments by Step 4 fraction.

Step 6: For employees employed during 8-Week Period, determine wage reduction amount in accordance with Q&A-14 and Q&A-15.

Step 7: Deduct Step 6 result from Step 5 result for net Forgiveness Payments.

Step 8: Deduct Step 7 result from loan principal. ***Remaining principal must be repaid***.

Q18: What is the "loan forgiveness" process and how long does it take?

A18: A borrower must submit an application for loan forgiveness to the lender. After reviewing the application, the lender forwards the loan forgiveness application to the SBA for final approval.

Q19: Do the PPP loan documents put any restrictions on how I run my business?

A19: Yes.

While a PPP loan remains outstanding, most loan documents prohibit the borrower from:

- Making any changes to its ownership or business structure (including through a merger or other similar transaction),
- Making a distribution to an equity owner if the distribution would adversely affect the borrower's financial condition, and
- Transferring (including by pledge) or disposing of any assets except in the ordinary course of business.

Q20: How aggressively is the SBA reviewing PPP loans?

A20: As part of the loan forgiveness process, the SBA has announced its intention to review every PPP loan over $2 million and says it will review smaller loans as appropriate.

Disclaimer

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