Applied Knowledge series | April 2020

CARES Act of 2020: Paycheck Protection Program overview

The Paycheck Protection Program (PPP) is a new loan program for businesses, intended to provide funds to help companies financially impacted by COVID-19 keep employees on the payroll and their doors open.

The due diligence that the lenders are required to complete is significantly decreased. The lender needs to consider whether the business existed prior to February 15, 2020, and whether it had employees for whom the business paid salaries and payroll taxes, or independent contractors who were paid via 1099-MISC. The lender must also consider whether the current economic uncertainty makes the loan request necessary to support ongoing operation of the business. (See the SBA Borrower Application Form for a list of certifications.)

Who's eligible?

Most businesses are eligible as long as they have 500 or fewer employees (whether they're full-time or part-time)—including sole proprietorships, self-employed individuals, independent contractors, not-for-profit and veterans organizations, and Tribal business concerns. Accommodations and food service companies must have less than 500 employees per location and less than $500 million in revenue. Even some larger businesses may be eligible if they meet the SBA size standard for the number of employees for that industry—refer to this resource.

Note: The Act provides further guidance regarding "affiliated" entities (including investors) and eligibility. It's important to consult your attorney and lender to clarify whether affiliation rules apply to you.

How big can the loan be?

For companies in existence February 15 through June 30, 2019:

- The loan amount is limited to 2.5 times your monthly average payroll costs for the one year prior to the date of the loan, but no more than $10 million.
- If you have a seasonal business, the monthly payroll costs are calculated based on a 12-week period from either February 15, 2019, or March 15, 2019 (you choose), and ending June 30, 2019.

For companies not in existence February 15 through June 30, 2019:

- The amount of the loan is limited to 2.5 times the monthly average payroll costs from January 1 to February 29, 2020, but no more than $10 million.

In addition, if you already have an existing SBA 7(a) loan, including an Economic Injury Disaster Loan that you took out after January 31, 2020, the amount of the new loan may be increased to refinance the previous loan into this new loan.

What’s included in **payroll costs**? For each employee, consider:

- Salary, wages, commissions, or tips (capped at $100,000 on an annualized basis for each employee).
- Payments for vacation, parental, family, medical, or sick leave.
- Allowance for separation or dismissal.
- Payments required for the provisions of group health care benefits, including insurance premiums.
- Employer contributions to defined benefit or defined contribution retirement plans.
- State and local taxes assessed on compensation.
- If you’re a sole proprietor or independent contractor, include wages, commissions, income, or net earnings from self-employment, also capped at $100,000 on an annualized basis, that you paid to yourself.

  The SBA interim guidance clarifies that independent contractors don’t count as employees for the purposes of determining payroll costs. Instead, the intent is that those independent contractors apply on their own.

What’s excluded from payroll costs? For each employee, you must exclude:

- Compensation of the employee above an annual salary of $100,000, prorated.
- Taxes imposed or withheld for FICA, railroad wages, and Federal Income taxes.
- Compensation of employees living outside the United States.
- Wages for which the company receives a payroll tax credit under the sick leave or family leave provisions of the Families First Coronavirus Response Act.

What must the loan be used for?

You will need to certify to the lender that:

- The business needs the loan to support ongoing operations due to current economic conditions. The business must make this certification in good faith, taking into account current business activity and the ability of the business to access other sources of liquidity to support current operations.
- It will use the money to maintain the current workforce and pay mortgage interest, rent or lease payments, and utility payments.
- It has no other pending loans and has not received any loans between February 15 and December 31, 2020, for the same purpose.

Failure to use the funds for these purposes could result in fraud charges.

From the date of disbursement of the loan, no payments are due for six months, but interest begins to accrue. The loan administrator is authorized to defer payment for up to an additional six months.

The actual expenses that the loan can pay for are:

- Payroll costs (same list as defined above).
- Interest on any mortgage (but not principal).
- Rent or lease payments.
- Utilities payments.
- Interest on any other loan taken out before February 15, 2020.

- Refinancing an SBA EIDL loan made between January 31 and April 3, 2020.
- Any other purpose permitted by the SBA for 7(a) loans. The SBA.gov website provides a list of ways borrowers can use the money.

Loan forgiveness

In addition to making these SBA loans significantly easier to qualify for than before, the CARES Act provides that any portion of the loan that the business uses toward specific covered expenses may be forgiven.

For the first eight weeks of taking the loan, to the extent that you show documentation that you used the loan proceeds to pay the specified expenses (both incurred and paid during the eight-week period), you can apply for loan forgiveness. These are the expenses that count toward the loan forgiveness:

- Payroll costs (up to $100,000 annualized per employee, prorated over the eight weeks).
- Mortgage interest on business property (as long as the mortgage was incurred before February 15, 2020).
- Rent (as long as the lease agreement was in force before February 15, 2020).
- Utilities (as long as the service agreement with the utility company began before February 15, 2020).

Because the PPP loan is designed to encourage businesses to keep their employees, a reduction in headcount or salaries paid to employees reduces the amount of the loan that may be forgiven. For loan forgiveness, only full-time and full-time equivalent employees are included in headcount. (Though no guidance has been issued yet, for other SBA purposes, a full-time employee is one who works at least 30 hours per week, while a full-time equivalent employee is a group of employees who, in combination, are employed at least 30 hours per week.)

If you reduce headcount, the loan forgiveness is reduced proportionally:

Total forgivable loan amount	X	Avg. employees/mo. in 8-wk. period ÷ Avg. employees/mo. in prior period*	=	**Reduced forgivable loan amount**

* February 15–June 30, 2019, **or** January 1–February 29, 2020—you decide which period to use.

> **Example**: ABC corporation had an average of eight employees during February 15–June 30, 2019. ABC received a $30,000 loan from its bank under the PPP program on April 15, 2020. Due to a substantial decrease in customer orders, ABC had to lay off some employees in March, so the average number of employees from April 15 to June 10, 2020 (the eight-week period after they received the loan) was six. The amount of the loan that can be forgiven is reduced to 75% of the otherwise forgivable amount:
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> $30,000 x 6/8 ($30,000 x 75%) = $22,500 (new reduced amount that may be forgiven)

Similarly, according to the CARES Act, the total forgivable loan amount is also reduced for any reduction of salary or wages greater than 25% when comparing the eight-week period to the most recent full quarter that employee worked before the loan period.

However, only those employees who made less than $100,000 annualized in 2019 are counted. As such, it seems there's no penalty for a reduction of salary more than 25% for employees who earned more than $100,000 in 2019.

For businesses that reduced headcount or salaries of employees between February 15 and April 26, 2020, as long as the headcount is restored to the prior level, and salary is restored within the 25% amount before June 30, 2020, the temporary reduction will be ignored for purposes of determining the amount of loan that is forgivable. So in the above example, if ABC corporation rehires all the employees it laid off in March, there would be no reduction to the amount that can be forgiven. If a business owner offers to rehire an employee for the same hours and wages as before, headcount won't be reduced, even if the employee declines to return. It's important to provide documentation of the offer and refusal. (A refusal to return is likely to impact the employee's receipt of unemployment benefits.)

In addition to the provisions of the Act, the SBA interim guidance states that because the intention of the program is to maintain employment levels, no more than 25% of the forgiven amount may be for non-payroll costs incurred in the eight-week period. And to the extent that loan forgiveness is approved, both the principal and the accrued interest (of the deferral) will be forgiven.

The forgiven loan amount is not included in the taxable income of the business. Additionally, at least until further guidance is issued, it appears there's no prohibition from treating the expenses incurred (salary, rent, and such) as ordinary operating expenses of the business, which are deductible per traditional accounting principles.

The SBA interim guidance promises more specific information regarding loan forgiveness soon.

What are the terms of the loan for any amount not forgiven?

SBA interim guidance from the Treasury Department states that the loan will be due in two years and the interest charged will be 1%.

The PPP loans don't require collateral or a personal guarantee of the borrower. And you aren't required to show that you attempted to obtain credit elsewhere before applying for this loan.

Interaction with other programs

In addition to the PPP, the Act expanded the applicability of the SBA's Emergency Economic Injury Disaster Loan (EIDL) program. The business may apply for both loans as long as they are not intended to cover the same expenses. The EIDL program also contains a grant provision for $1,000 per employee, up to $10,000. The receipt of this grant reduces the amount of the PPP loan that qualifies for loan forgiveness. The EIDL and the associated grant are addressed separately (see CARES Act: Business Provisions for more information).

A few other benefits provided by the Act must also be considered when applying for the PPP loan or its forgiveness. The Act provides an Employee Retention Credit for certain wages paid to employees by businesses that are fully or partially shut down due to COVID-19 (see CARES Act: Business Provisions). This credit is not available to a business that has received a PPP loan.

Also, the Act allows an employer to delay the payment of the employer portion of Social Security tax (see CARES Act: Business Provisions). Beginning with the date a business receives PPP loan forgiveness, the delay of payment of future taxes is no longer permitted.

How to apply

According to the Treasury Department guidance, small businesses and sole proprietorships could start applying beginning April 3, 2020, and independent contractors and self-employed individuals starting April 10, 2020. (See the SBA Borrower Application Form.)

The PPP loan will be administered by the SBA but issued by participating commercial lenders until June 30, 2020. The SBA is working on detailed regulations to clarify various details of the program. New guidance continues to be issued. It's important to work closely with your lender and attorney to make sure you're eligible and maximizing all the benefits available under this program.

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