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More PPP funding approved, questions remain unanswered

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On April 24, 2020, U.S. President Donald Trump signed into law a $484 billion stimulus package, including an additional $310 billion of funding for the Paycheck Protection Program (PPP), which ran out of funds earlier this month. The additional funding will allow small businesses previously unable to secure funds under the PPP an opportunity to obtain forgivable loans to keep employees on the payroll.

For these businesses and the millions of other businesses that have already received PPP loans, many questions remain unanswered, including details on one of the key features of the PPP, loan forgiveness. The U.S. Small Business Administration (SBA) is required to issue guidance on loan forgiveness within 30 days after enactment of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), or April 26, 2020. Many businesses and their advisors are eagerly awaiting this guidance.

This article provides an overview of certain key questions SBA has answered regarding loan forgiveness, along with a number of unanswered questions that SBA will hopefully address in future guidance. Additionally, it also addresses recent guidance from SBA (FAQ question 31) regarding the good faith certification required to be made at the time of application for a PPP loan that has created uncertainty and concern for many businesses.

Answers to key questions on PPP loan forgiveness

Though many questions remain unanswered, SBA has addressed the following questions regarding loan forgiveness.

Loan forgiveness is based on certain costs over an 8-week period (the covered period). When does the covered period begin?

The covered period begins on the date the lender makes the first disbursement of the loan.

What costs are eligible for loan forgiveness?

The actual amount of loan forgiveness is determined based on certain costs incurred and payments made during the covered period. Payroll costs are the main cost eligible for forgiveness under the PPP. The following are payroll costs eligible for loan forgiveness and payroll costs which are not:

- **Payroll costs that are eligible for loan forgiveness:**
  - Salary, wages, commission or similar compensation (recent SBA guidance states that payroll costs include all cash compensation, including a housing stipend or allowance)
  - Payments for vacation, parental, family, medical or sick leave
  - Allowance for dismissal or separation

    - Payments for the provision of group health care benefits, including insurance premiums
    - Payments for retirement benefits
    - State or local payroll taxes

- **Payroll costs that are not eligible for loan forgiveness:**
    - Payments to an independent contractor
    - Cash compensation in excess of $100,000
    - The employer's share of federal payroll taxes
    - Qualified sick leave and qualified parental leave wages for which credit is allowed under the Families First Coronavirus Response Act (FFCRA)

Additional non-payroll costs which are eligible for loan forgiveness:

- Interest payments on a mortgage incurred in the ordinary course of business on real or personal property and that was in existence on Feb. 15, 2020
- Rent payments under leasing agreements in existence on Feb. 15, 2020
- Utility payments for electricity, gas, water, transportation, telephone or internet for which service was in existence on Feb. 15, 2020

It is important for businesses to consider strategies for maximizing loan forgiveness, while also balancing their short-term and long-term needs. In some situations, it may be more beneficial to continue furloughs or other workforce reductions in the short-term, and pay back any unforgiven loan amount over time at a low interest rate. Other businesses may take steps to increase payroll costs during the covered period by rehiring employees and providing incentive bonuses.

Are there limitations on loan forgiveness?

Yes, loan forgiveness is limited as follows:

- Not more than 25 percent of the loan forgiveness amount can be attributable to non-payroll costs (i.e., mortgage interest, rent and utilities)
- Proceeds from any advance up to $10,000 on an Economic Injury Disaster Loan (EIDL) will be deducted from the loan forgiveness amount

Additionally, the loan forgiveness amount will be reduced if the business has reduced its number of full-time equivalent (FTE) employees or has reduced the salary or wages of certain employees based on the following formulas:

Formula for reduction in FTE employees:

The loan forgiveness amount is subject to reduction by multiplying it by the following fraction:

- The numerator of which is the average number of FTE employees per month employed by the borrower during the covered period
- The denominator of which is, at the election of the borrower, either:
    - The average number of FTE employees per month employed by the borrower during the period beginning Feb. 15, 2019, and ending June 30, 2019

- The average number of FTE employees per month employed by the borrower during the period beginning Jan. 1, 2020, and ending Feb. 29, 2020

For seasonal employers, as determined by SBA, the denominator is the period beginning Feb. 15, 2019, and ending June 30, 2019.

Formula for reduction in wages:

The loan forgiveness amount is subject to reduction by an amount determined as follows:

1. Identify all employees, who did not receive during any single pay period in 2019, wages or salary at an annualized rate of pay of more than $100,000 (each, a covered employee)
2. Compare each covered employee's wages or salary during the covered period to his or her wages or salary during the first quarter of 2020
3. For any covered employee whose wages or salary during the covered period decreased by more than 25 percent
    1. Multiply the first quarter wages or salary by .75
    2. Subtract the product from the covered period wages or salary
4. Add all amounts computed under number three above

The aggregate dollar amount calculated as set forth above will reduce the loan forgiveness amount.

Reductions in the number of FTE employees, or reductions in salary or wages, that occurred between Feb. 15, 2020, and April 26, 2020, will not reduce the loan forgiveness amount if, by June 30, 2020, the borrower eliminates the reductions.

What terms apply to any loan amount that is not forgiven?

The principal amount of the PPP loan and any accrued interest that is not forgiven will continue as a loan on its original terms, including:

- A maturity date which is two years from the date of disbursement
- No payments during the first six months
- An interest rate of one percent per annum
- No prepayment penalty (prior notice of prepayment may be required if the loan has been sold on the secondary market)

What documentation must be submitted with an application for loan forgiveness?

To receive loan forgiveness, the CARES Act requires that the borrower submit an application to the lender. The application must include the following:

- Documentation verifying the number of FTE employees on the payroll and pay rates for the covered period and the prior periods included in the formulas for determining any reduction in loan forgiveness, including payroll tax filings reported to the Internal Revenue Service and state income, payroll and unemployment insurance filings
- Documentation, including cancelled checks, payment receipts, transcripts of accounts or other documents verifying payments on mortgage obligations, rent payments and utility payments
- A certification from a representative of the business authorized to make such certifications that:

1. The documentation presented is true and correct
2. 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 utility payments

- Any other documentation SBA determines necessary

It will be important for businesses to keep detailed records regarding the use of the PPP loan during the covered period. Businesses should start keeping detailed records beginning on day one of the covered period, insist on receipts and keep an organized system for document storage. While not required under the CARES Act or SBA guidance, PPP loan proceeds may be deposited into a separate bank account, with only costs eligible for loan forgiveness paid out of that account. Good recordkeeping will be critical in maximizing the amount of loan forgiveness.

Can lenders rely on borrower documentation for loan forgiveness?

Yes. A lender does not need to conduct any verification if the borrower submits documentation supporting its request for loan forgiveness and attests that it has accurately verified payments for eligible costs.

Issues that need further clarification

The covered period for loan forgiveness has already begun for a number of businesses and many questions remain unanswered, including:

- Many small businesses will be closed at the time their loan is funded due to stay at home orders that have not been lifted or for other reasons. Will the covered period be modified or extended?
- It is unclear what the phrase “costs incurred and payments made” means. Does a cost have to be incurred and paid during the covered period, or are costs that were incurred prior to and paid during the covered period or incurred during and paid after the covered period eligible for forgiveness?
- The CARES Act and current guidance do not define rent. Are items such as common area maintenance (CAM) charges, insurance and taxes that are often defined as “additional rent” in a lease agreement included? Are lease agreements limited to leases of real property? Are rent payments to related parties eligible (although the CARES Act and current guidance do not specifically distinguish between third parties and related parties)?
- How is “full-time equivalent employees” defined? Additionally, how will furloughed employees, employees on paid leave, employees on reduced schedules, or employees who have voluntarily terminated or refused to come back to work be treated?
- How will SBA make a determination that a business is a “seasonal business?”
- It may be necessary for businesses to lay off employees after April 26, 2020. Further, it may not be possible for businesses to rehire employees or increase wages by June 30, 2020. Will the time periods that determine whether a business has eliminated a reduction in employees or wages be adjusted?
- The CARES Act requires that the lender make a decision on loan forgiveness not later than 60 days after the date the lender receives the application. Will there be further guidance on the application and approval process for loan forgiveness?

PPP FAQ question 31

On April 23, 2020, SBA and the U.S. Department of the Treasury updated the Frequently Asked Questions (FAQ) document with question 31.

> ***31. 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.*

Lenders may rely on a borrower's certification regarding the necessity of the loan request. Any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith.

Question 31 and its answer appear to be in direct response to the recent publicity surrounding certain large, publicly-held restaurant chains that applied for and received PPP loans. Unfortunately, the answer is vague and has created more questions and uncertainty for businesses that received or are applying for PPP loans and otherwise meet the eligibility requirements.

Businesses are required to take into account their current business activity. Should they also consider the anticipated impact on future business activity and ongoing operations? Further, it is unclear what is meant by "other sources of liquidity" and "significantly detrimental." The focus in the answer on other sources of liquidity seems at odds with the suspension of the requirement that borrowers must be unable to obtain credit elsewhere.

While further guidance from SBA is necessary, a business that is applying for a PPP loan (or has already received a PPP loan) should carefully document the financial information, projections and other information that was considered in making its certification that the loan is necessary to support ongoing operations.