

PPP Loan Forgiveness Guidelines

May 13, 2020 | **CLIENT ALERTS**

The Paycheck Protection Program (PPP) created by the CARES Act allows for the borrower to have all or part of the loan amount forgiven, pursuant to certain conditions prescribed in the CARES Act. If the PPP loan proceeds are utilized correctly, all of the PPP loan may be forgiven with no payments required to be made by the borrower.

How can my PPP loan be forgiven?

A PPP borrower must utilize the loan proceeds in a particular way for all or part of their loan to be forgiven. In order to qualify as a forgivable expense, the proceeds must be used in one of the following manners:

- Payroll costs, including health care and retirement benefits;
- Mortgage or other debt interest, provided the debt was outstanding prior to February 15, 2020;
- Rent; and
- Utilities.

If the PPP proceeds are used in any other way than the four uses prescribed above, those amounts will not be eligible for forgiveness. Further, if it is found that the proceeds were intentionally used for a non-forgivable purpose, an audit by federal authorities may be the first step in determining whether further investigation for civil and criminal enforcement should follow. That said, a civil or criminal investigation could begin without an initial audit, and could be based on other information available to the federal government. If a borrower learns that it is a target of a PPP-related investigation, it should seek legal advice immediately.

In addition, guidance released by the Department of the Treasury requires that a minimum of 75% of the PPP loan proceeds **MUST** be used on payroll costs. This means that a maximum of 25% of the proceeds may be used for mortgage and debt interest, rent and utilities. The 75% requirement is a floor, so a borrower can spend more than 75% of the PPP proceeds on payroll costs, but they cannot spend more than 25% on the other three items.

The amount a borrower is eligible to have forgiven is the amount actually spent on these four items during the eight-week period of time beginning on the date the borrower receives the loan funds (“Funding Date”). The 75% requirement also applies to the amounts actually spent, so if a borrower receives a PPP loan for \$1 million, but only spends \$500,000 of the loan, the 75% requirement will apply to the \$500,000, not the \$1 million.

Any amounts not spent, and therefore unable to be forgiven, may be repaid immediately, as there is no prepayment penalties associated with the PPP, or converted into a traditional loan that must be repaid in two years from Funding Date at 1% interest. Payments will be deferred for six months from the Funding Date.

Can my forgiveness be reduced in any way?

Under current guidelines, the forgiveness of any PPP loan may be reduced due to two factors. The factors impacting forgiveness are the:

- Number of employees; and
- Amount of salaries or wages paid.

The number of employees is the average number of employees that were actively employed by the borrower during the eight-week forgiveness period. Any percent reduction in the number of employees will proportionately reduce the amount of forgiveness the borrower is eligible for. For example, if the borrower has reduced their workforce by 25% through lay offs or furloughs due to the COVID-19 pandemic, their potential forgiveness will be reduced by 25%.

To get the ratio of the average number of employees employed during the eight-week forgiveness period, the borrower must compare the average number of employees during the period of February 15, 2019, through June 30, 2019, or January 1, 2020, through February 29, 2020.

The second consideration is a reduction in any employee's salary greater than 25%. This is a separate and additional consideration from the number of employees. If the borrower lays off or furloughs employees, the reduction in salary costs due to those reductions will not also factor into this calculation. Any reduction in an employee's salary greater than 25% will lead to a proportionate reduction in the borrower's forgiveness amount. It is currently unclear exactly how the proportionate reduction will work as it remains undefined whether a 26% reduction in salary would lead to a 1% or a 26% reduction.

The period used to compare the salaries paid in the most recent full quarter the employee was paid, so in this case Q1 of 2020.

I have laid people off and/or reduced employee salaries. Do I have any options?

Despite these two potential ways the amount the PPP loan can be forgiven, the CARES Act states that any reduction in the number of employees or a reduction in salary greater than 25% may be remedied by June 30, 2020. If the borrower hires back any employees laid off or furloughed and/or increases any salaries cut more than 25% by this June 30, 2020, deadline, they will still qualify for full forgiveness, despite not being able to during the eight-week forgiveness period. However, any employees laid off or any reduction in salary that occurs or occurred after April 26, 2020, will not be able to be remedied pursuant to the CARES Act.

How do I actually get my loan forgiven?

First, the proposed forgiveness amount is calculated, and any applicable reductions are taken out. The calculated total is then provided to the lender who furnished the loan with any associated backup information requested. The CARES Act allows the lender 60 days to make a final determination on the amount of the PPP loan that will be forgiven. If a borrower applies quickly enough for forgiveness, it is likely they will not have to worry about making any payments on the PPP loan given the six-month deferral of payments.

Will there be any additional information released regarding loan forgiveness?

The Department of the Treasury will be issuing their official guidance on forgiveness in the near future. This will hopefully answer any and all of the questions that continue to go unanswered due to ambiguity in the CARES Act and its subsequent guidance. This summary will be updated in light of any changes or expansions made once the guidance is available.

Has the Treasury Department issued any other guidance impacting borrowers?

On May 13, 2020, the Department of the Treasury updated their Frequently Asked Questions guidance with Question 46. Question 46 provides clarity to the previously published Questions 31 and 37. Questions 31 and 37 stated that a PPP borrower needed to certify that the loan proceeds were necessary to maintain their current operations and that the borrower did not have access to alternative sources of liquidity, including but not limited to the debt and capital markets. Additionally, Questions 31 and 37 stated that all PPP loans granted above \$2 million would be subject to further scrutiny to ensure that their certifications were valid.

Question 46 provides a safe harbor for most PPP borrowers, stating that any borrower who received a PPP loan under the \$2 million audit threshold will be automatically deemed to have made the application in good faith. The Department of the Treasury expands on this decision stating that the safe harbor is appropriate because those borrowers whose loans fall under the \$2 million threshold are less likely to have access to alternative liquidity sources due to the current economic environment. Further, those borrowers whose PPP proceeds exceed the \$2 million threshold may still qualify for the PPP loan they received, but that determination will be based on their individual circumstances that will be reviewed by the Small Business Association (SBA). If a borrower who receives a loan over the \$2 million threshold is found to be unable to demonstrate their need for a PPP loan, the SBA will require the loan amount to be repaid by the borrower and their lender will be notified that such borrower is ineligible for PPP loan forgiveness. The only instance a PPP borrower can be found to have acted in bad faith, subjecting themselves to the civil and criminal penalties in the False Claims Act, is if they were to not repay the PPP proceeds that have been converted into a traditional loan.

Question 46 reduces the likelihood, but does not preclude borrowers that have borrowed less than \$2 million from the PPP from being audited by the SBA. Therefore, it is recommended that any PPP borrower still document their need for the loan, focusing on any factors that demonstrate how the COVID-19 pandemic has impacted their business now and in the future, as well as any factors that existed prior to the COVID-19 pandemic.

If you have any questions regarding the forgiveness of your PPP loan, or any other PPP-related questions, please reach out to us at Lippes Mathias Wexler Friedman.