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SBA PPP Loans – Calculations and Considerations for Maximizing Forgiveness

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Loan forgiveness is a key feature of the Paycheck Protection Program (PPP) administered by the Small Business Administration (SBA) pursuant to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). If PPP loan proceeds are spent in accordance with the loan forgiveness rules and guidelines, all or a substantial portion of the loan amount may be forgiven, effectively transforming PPP loans into grants. Accordingly, it will be critical for PPP loan recipients to understand how much of their loan may be forgiven and how various company actions can impact that figure. Appropriate planning now can help companies maximize their loan forgiveness in the future.

This alert reviews the framework underpinning loan forgiveness calculations, describes how layoffs and salary reductions can negatively impact loan forgiveness and discusses the application process and documentation required for loan forgiveness.

How does a company calculate the expected loan forgiveness amount of its PPP loan?

PPP loan recipients can apply for and receive loan forgiveness of all or a portion of a PPP loan in an amount equal to the funds the borrower can *document* that it paid in qualifying expenses during the eight weeks following loan origination. Specifically, borrowers can seek loan forgiveness for amounts spent on "payroll costs," mortgage interest, rent and utilities (collectively, the Expected Forgiveness Amount).

Notably, no amounts spent on these qualifying expenses outside of this eight-week period are forgivable, and the SBA has stated that no more than 25% of the loan forgiveness amount may be attributable to non-payroll costs.

When does the eight-week loan forgiveness window begin?

The eight-week period for paying qualifying expenses subject to loan forgiveness begins on the date that the lender makes its first disbursement of PPP loan proceeds to a borrower.

How are “payroll costs” defined?

Payroll costs for purposes of loan forgiveness are defined the same way that payroll costs are defined for purposes of calculating a borrower's loan amount, i.e., the total amount of any compensation to employees in the form of a salary, wage, commission, cash tip, payment for leave, severance, group health care benefit, retirement benefit and state or local taxes assessed on employee compensation.

Importantly, the *exclusions* from payroll costs are the same as well. Payroll costs may not include: (1) compensation to an individual employee in excess of an annual salary of $100,000 (not including the value of non-cash benefits), (2) the employer's share of FICA taxes, (3) compensation to employees whose principal place of residence is outside the US, (4) qualified sick or family leave for which credit is allowed under the Families First Coronavirus Response Act or (5) compensation to independent contractors or sole proprietors.

How are non-cash benefits treated for purposes of the $100,000 annual salary cap?

As noted above, non-cash benefits are excluded from the $100,000 annual salary cap. Accordingly, for those employees whose annual salary would otherwise exceed the cap, the cap for each such individual employee will be increased on a dollar-for-dollar basis for (and payroll costs will include) the value of non-cash benefits received by the employee, including employer contributions to defined-benefit or defined contribution retirement plans; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums; and payment of state and local taxes assessed on compensation of employees.

What mortgage interest, rent payments and utility payments qualify for loan forgiveness?

Amounts paid in interest on a mortgage obligation on real or personal property that the company incurred in the ordinary course of business before February 15, 2020, may be included in a forgiveness calculation, as is rent paid pursuant to a lease agreement in force prior to February 15, 2020. Utility payments include "payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020." Loan proceeds may be used to pay for interest on debts obligations incurred *before* February 15, 2020, but such expenses are not subject to loan forgiveness.

Does a borrower need a separate bank account to track the expenses?

Using a separate bank account to hold and disburse PPP loan proceeds is not required, but it may be prudent to help track and document spending. However a borrower approaches tracking, it should ensure that it can fully document the amounts it spends in the eight-week period and the specific nature of those expenses. This documentation will form the basis of the loan forgiveness amount.

What if a fourth payroll date falls outside the eight-week period? Can the borrower accelerate it?

The SBA has not specifically addressed whether this is permissible. Absent guidance, a company should ensure it does not deviate substantially from its ordinary payroll practices (such as paying unusual bonuses) for the purpose of increasing its loan forgiveness amount; however, taking relatively minor measures (like accelerating a payroll date that will otherwise occur and for which the amounts are validly earned) are less likely to be problematic.

What if the borrower has or will conduct layoffs or implement salary reductions?

Conducting layoff and reducing salaries or wages is contrary to the policy underlying the PPP loan regime, and loan forgiveness will be negatively impacted by such cuts. Specifically, the amount of the PPP loan actually forgiven by the SBA will be reduced in two ways:

1. First multiplying the *Expected Forgiveness Amount*, as reduced for non-payroll costs in excess of 25% of such Expected Forgiveness Amount if necessary, by the quotient obtained by dividing (a) the average number of full-time equivalent employees per month that the borrower employed during the eight-week period beginning on the date of the origination of the loan, by (b) the average number of full-time equivalent employees per month that the company had either

    i. from February 15, 2019, through June 30, 2019, or
    ii. from January 1, 2020, through February 29, 2020.[1]

2. Then subtracting the amount by which (a) the reduction in the total salary or wages of each employee during the eight-week period beginning on the date of the origination of the loan, as annualized exceeds (b) 25% of the employee's salary or wages during the most recent full quarter during which the employee was employed, as annualized.[2]

What if a borrower rehires employees and/or raises salaries back to their prior level?

Restoring employees to work and raising salaries and wages following a pay cut can mitigate reductions to loan forgiveness. Where layoffs or salary reductions occurred between February 15, 2020, and April 26, 2020, the loan forgiveness amount will not be reduced if the reductions in personnel and salaries are undone prior to June 30, 2020. To accomplish this, the company must, by June 30, 2020, rehire employees such that its full time equivalent employee levels are at least where they were as of February 15, 2020, and reinstate all salaries and wages for employees making less than $100,000 during all pay periods in 2019 that were reduced by more than 25% back to the level of those salaries and wages as of February 15, 2020.

If a company has deferred the payment of the employer's share of Social Security tax under section 2302 of the CARES Act, is it still eligible for PPP loan forgiveness?

Yes. However, once an employer receives a decision from its lender that its PPP loan is forgiven, the employer may not utilize the deferral for the employer's share of Social Security tax due after that date. The amount of the deposit and payment of the employer's share of Social Security tax that the employer deferred through the date on which the loan is forgiven continues to be deferred and will be due on the applicable dates provided in section 2302 of the CARES Act (i.e., December 31, 2021, and December 31, 2022).

An employer that receives a PPP loan is not eligible for the employee retention credit under section 2301 of the CARES Act.

When should borrowers expect to begin the loan forgiveness process with its lender?

We expect borrowers to be able to begin working with lenders on loan forgiveness applications no later than the end of the eight-week loan forgiveness period. The CARES Act requires lenders to make decisions on loan forgiveness within 60 days of the applicant's request.

What documentation will borrowers need to provide its lender?

The CARES Act requires PPP loan recipients seeking loan forgiveness to submit an application to their lenders including (1) documentation verifying the number of full-time equivalent employees on payroll and pay rates during the applicable periods (i.e., the periods of time described in the question above regarding layoffs and salary reductions) (payroll tax filings, and state income, payroll and unemployment filings) and (2) documentation verifying payments on mortgage and rent obligations and utilities. The SBA may issue additional guidance on the form of this "application" and documentation required, and lenders may also require specific additional information and materials.

What if a borrower contracts with a third-party payer such as a payroll provider or Professional Employer Organization (PEO) to process payroll and report payroll taxes?

Payroll documentation provided by the payroll provider that indicates the amount of wages and payroll taxes reported to the IRS by the payroll provider for the borrower's employees will be considered acceptable PPP payroll documentation. Relevant information from a Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers, attached to the PEO's or other payroll provider's Form 941, Employer's Quarterly Federal Tax Return, should be used if it is available; otherwise, the borrower should obtain a statement from the payroll provider documenting the amount of wages and payroll taxes.

Are there any certifications that accompany the request for loan forgiveness?

In requesting loan forgiveness, a representative of the borrower must certify that the documentation is true and correct, and "the amount for which forgiveness is requested was used to retain employees" and to make payments for qualified mortgage interest, rent and utilities.

What happens if there is a balance on the loan that is not forgiven?

Unforgiven loan balances will be treated as a loan, fully-guaranteed by the SBA, and for which no personal guarantee or collateral is required. Payments of principal and interest will be deferred for six months from disbursement, though interest will accrue during this deferment period. PPP loans have a two-year maturity and a one percent (1.00%) interest rate.

Can a borrower continue to use PPP loan proceeds after the eight-week loan forgiveness period expires?

Yes. While the loan forgiveness amount is based on certain expenses paid in the first eight weeks following distribution, a borrower can continue to use any remaining loan proceeds after that time. While the CARES Act itself states that June 30 is the cutoff date for spending loan proceeds, we anticipate that the SBA will clarify that this deadline represents a cutoff date for making PPP loans, and not to a borrower's use of loan funds.

What are the permitted uses of the proceeds, as distinguished from the uses that form the basis of calculating the loan forgiveness amount?

PPP loan proceeds can be used for payroll costs, health care benefits, mortgage interest, rent, utilities, and interest on any other debt obligation that was incurred before February 15, 2020. At least 75% of the PPP loan proceeds must be used for payroll costs. As noted above, however loan forgiveness applies only to payroll costs, mortgage interest, rent and utilities paid in the first eight weeks following disbursement.

Careful attention to the manner in which, and documentation required to establish, an applicant's loan forgiveness amount will ensure companies are maximizing this important benefit of the PPP. New guidance is frequently emerging and may further clarify various aspects of the loan forgiveness calculation and process, which applicants should take into account. Notably, U.S. Treasury Secretary Steven T. Mnuchin and U.S. Small Business Administrator Jovita Carranza issued a statement on Tuesday that the SBA and Treasury "will review all loans in excess of $2 million…following the lender's submission of the borrower's loan forgiveness application." Cooley is monitoring these updates as well and will continue to publish future alerts on our **coronavirus resource hub**.

Notes

1. Borrowers may choose which denominator will result in a lower forgiveness reduction. Additionally, when

calculating FTEs, "the average number of full-time equivalent employees shall be determined by calculating the average number of full-time equivalent employees for each pay period falling within a month."

2. Notably, this reduction only applies for employees who did not receive, during a single 2019 pay period, salary or wages at an annualized rate of pay over $100,000 (i.e., a company may reduce the salary of any >$100,000 earning employee without impacting the forgiveness amount).

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