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The CARES Act: Are You Prepared for Paycheck Protection Program (PPP) Loan Forgiveness?

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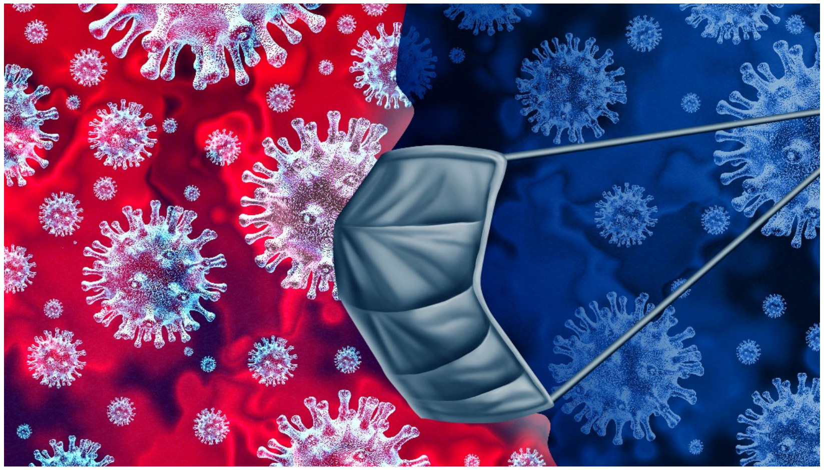
Disclaimer

This presentation is for educational purposes only. It addresses what we currently know about these recently signed laws and our understanding of how the applicable regulatory agencies will interpret these laws.



Coronavirus Aid, Relief, and Economic Security (CARES) Act
Paycheck Protection Program

On March 27, 2020, President Trump signed the CARES Act into law, providing over $2 Trillion in economic relief to individuals and businesses affected including $349 Billion available in loans for small businesses with less than 500 employees called the Paycheck Protection Program ("PPP"). Despite confusion among lenders and borrowers, the PPP was extremely popular, such that the initial funding was exhausted in just 13 days.

On April 23, Congress approved another relief package, which provides $250 Billion more in funding for the PPP. To address concerns that funds were not reaching the smallest business, the new bill also provides $30 Billion for community lenders, small banks, and credit unions. **<u>All indications are that the new funds will also go very quickly</u>**.

Who is Eligible? What is a "Small Business"?

- In general, a small business with fewer than 500 employees.
  - Except where the SBA has set a higher number based on industry.
- However, SBA rules combine "affiliates" when determining number of employees. Entities are "affiliates" when one controls or has the power to control the other, or a third party controls or has the power to control both entities.
- The affiliation rules do not apply to franchises assigned a franchise identifier code or businesses assigned a NAICS code beginning with 72 (accommodation and food industries).
- Businesses that employ less than 500 employees per location are also eligible if assigned a NAICS code beginning with 72.

What Else? Certification and Other Requirements

Among others, must make good faith certification that:

- (1) the uncertainty of current economic conditions makes the loan necessary to support ongoing operations;
- (2) funds will be used to retain workers and maintain payroll, or make mortgage payments, lease payment, and utility payments; and
- (3) no application pending for duplicative loan and no other applications made for same loan for the remainder of 2020.

- No collateral requirement
- No economic hardship requirement
- No lost revenue requirement
- No personal guarantee requirement
- But certifications include understanding of penalties for fraud

How Much can be Borrowed?

- The maximum loan amount shall be the lesser of $10 Million or:
  - **For most employers** – 2.5 times the average monthly “payroll costs” during the 12 months before the loan date.
  - **For seasonal employers** – 2.5 times the average monthly “payroll costs” from either the 12-week period beginning February 15, 2019, or March 1, 2019 through June 30, 2019.
  - **For new employers** – 2.5 times the average monthly “payroll costs” from January 1, 2020 through February 29, 2020 if in business (if not in business during the period from February 15, 2019 through June 30, 2019).
  - Add the outstanding amount of an Economic Injury Disaster Loan (EIDL) made between January 31, 2020 and April 3, 2020, less the amount of any “advance” under an EIDL loan (because the advance does not have to be repaid).

What Must the Loan be Used for?

- At least 75% of loan proceeds must be dedicated to “Payroll Costs”
- Costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums
- Payments of <u>interest</u> (not principal) on any mortgage obligation
- Rent (including rent under a lease agreement)
- Utilities
- Interest on any other debt obligations that were <u>incurred before issuance of the loan</u>
- Refinancing an SBA EIDL loan made between January 31, 2020 and April 3, 2020

What are “Payroll Costs”?

- “Payroll Costs” **<u>include</u>**:
  - salary, wage, commission, or “similar compensation”;
  - cash tip or equivalent;
  - payment for vacation, parental, family, medical, or sick leave;
  - “allowance for dismissal or separation” – i.e., severance;
  - payments “for the provisions of” group health care benefits, including insurance premiums;
  - payment of any retirement benefit; and
  - payment of <u>state or local tax</u> on the compensation of employees

What are not "Payroll Costs"?

- "Payroll Costs" **<u>exclude</u>**:
  - compensation of an employee in excess of an annual salary of $100,000, as prorated for the covered period ($15,385 for the 8 weeks);
  - payment of <u>federal tax</u> on the compensation of employees;
  - any compensation of an employee whose principal place of residence is outside of the United States; and
  - sick leave or family leave wages under the Families First Coronavirus Response Act

What May be Forgiven?

Loans may be forgiven—in whole or in part—if used for purposes authorized by the CARES Act.

- Amounts eligible for forgiveness are equal to the sum of costs **incurred** and **payments** made for:
  - "Payroll Costs"
  - Interest on mortgages
  - Rent
  - Utilities

How Does It Work?

A borrower may not have the entirety of its loan forgiven if:

1. Improper Use: Loan proceeds are used for other than payroll costs or covered mortgage interest, rent, and/or utilities paid during the covered period. If loan proceeds are used for unauthorized purposes, the borrower must repay those amounts and could be subject to additional charges from the SBA for knowing violations.

2. Failure to Maintain Headcount and Payroll Levels.
   A. Headcount
   B. Wages/Salaries

How Does It Work?

2. Failure to Maintain Headcount and Payroll Levels.

   A. Headcount: The amount of loan forgiveness may be reduced if there is a reduction in FTE.

   - the average number of **FTE** during the 8-week Covered Period of the loan

     DIVIDED BY:

   - the average number of FTE between February 15, 2019 and June 20, 2019; or
   - the average number of FTE between January 1, 2020 and February 29, 2020

   - Calculation differs slightly for seasonal employers and employers who were not in business between February 15, 2019 and June 30, 2019.

How Does It Work? – Example

ABC Company had an average of 100 FTEs during the period from February 15, 2019 and June 20, 2019. The company had an average of 80 FTEs during the 8-week Covered Period.

The loan forgiveness amount will be reduced by 20%.

How Does It Work?

2. Failure to Maintain Headcount and Payroll Levels.

   B. Wages/Salaries: The amount of loan forgiveness will also be reduced – dollar for dollar – if employees (who made less than $100,000 in annualized wages in 2019) receive a reduction in pay during the Covered Period of more than 25% of the total salary or wages of the employee during the most recent full quarter before the Covered Period.

How Does It Work? – Example

If Employee made $1,000 per week on average during Q1 2020, he must be paid at least $750 per week on average to maximize loan forgiveness. If he is paid $500 per week on average during that period, the forgiveness amount will be reduced by $2,000 ($250 per week for 8 weeks).

The Exemption

1. Reductions in headcount will not decrease the loan forgiveness amount if:
   - There is a reduction in full-time equivalent employees as compared to headcount on February 15, 2020;
   - The reduction takes place between February 15, 2020 and April 26, 2020; and
   - No later than June 30, 2020, the borrower fully eliminates the reduction.

2. Reductions in salary and wage levels will not decrease the loan forgiveness amount if:
   - There is a reduction in salary or wages of 1 or more employees (who were not paid over an annualized $100,000 in 2019) as compared to February 15, 2020;
   - The reduction takes place between February 15, 2020 and April 26, 2020; and
   - No later than June 30, 2020, the borrower eliminates the reduction below 75%.

How is Loan Forgiveness Obtained?

- An eligible recipient seeking loan forgiveness must submit to the lender:
  - Documentation verifying the FTE and pay rates for the applicable periods 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 covered mortgage obligations, payments on covered lease obligations, and covered utility payments;
  - Certification that the documentation is true and correct and the amount for which forgiveness is requested was used for permissible purposes.

What Happens to Unforgiven Amounts?

- 1% fixed interest rate
- Deferment of payment for 6 months following the date of the disbursement of the loan.
- Interest will continue to accrue during the 6 month deferment.
- Repayment must be made 2 years from issuance, but no penalty for early payment.

- If you end up with unspent PPP money you have 2 options:
  - Return the remaining amount to the lender;
  - Turn it into a low interest loan, which could help in difficult times.

Questions?

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