COVID-19

Paycheck Protection Program Forgiveness

What Borrowers Need to Know

As of May 5, 2020

The Paycheck Protection Program (PPP) provides loans to help small businesses support ongoing business operations and keep employees on payroll. The Small Business Administration (SBA) will forgive all or a portion of loans if certain conditions are satisfied. If you were already approved for a PPP loan or are in line to be approved in Round Two, there is important information you need to be aware of now.

STATUS OF GUIDANCE

The CARES Act, approved on March 27, 2020, provides that the Administrator of the SBA has thirty (30) days to issue guidance regarding the "how to" of forgiveness (i.e. "cancelled indebtedness") of the PPP loans issued to borrowers. The majority of that guidance has not yet been issued. Unfortunately, many borrowers have already received PPP loan funds and need to make decisions now. Borrowers can glean some insight from the language of the CARES Act itself.

DETERMINING FORGIVENESS GENERALLY[1]

The following must occur within eight (8) weeks of disbursement of the PPP loan proceeds in order to be eligible for complete[i] forgiveness:

i) **Must be spent to be forgiven**: Only loan proceeds that are eligibly spent within eight (8) weeks (the "covered period") are forgivable. The clock starts running on the first day the lender disburses any portion of the PPP Loan amount to the borrower.

ii) **75/25 Rule**: Loan proceeds must be used for "covered" expenses (75/25)[ii]

(1) At least 75% of PPP loan proceeds **must** be spent on "Payroll Costs" to receive forgiveness.

(2) No more than 25% of PPP loan proceeds (or no more than 1/3 of the amount spent on Payroll Costs) may be spent on the following non-payroll expenses.[iii]

(a) Interest payment on a "covered mortgage" - A "covered mortgage" is an indebtedness that was incurred in the ordinary course of business, AND that: a) is a liability of the borrower, b) is a mortgage on real or personal property, AND c) was incurred before February 15, 2020.

(b) "Covered rent obligation" - If the leasing agreement was in force before February 15, 2020.

(c) "Covered utility payment" - For a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020.

iii) What are "Payroll Costs"?[iv]

(1) Salary, wages, commissions, or other commission capped at $100,000 per employee per year[v] for employees (not including independent contractors[vi]) who primarily reside in the U.S.;
(2) Cash tips or equivalent;
(3) Costs related to the continuation of group healthcare benefits;
(4) Vacation, parental, family, medical, or sick leave (except qualified sick leave and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act);
(5) Payment of retirement benefits;
(6) Payment of state or local tax assessed on the compensation of employees; and
(7) Allowance for dismissal or separation.

Headcount Reduction Penalty: A reduction in the average number of Full-Time Equivalent Employees ("FTEEs") during the Covered Period **WILL** result in the reduction to the borrower's forgiveness of the PPP loan, unless the reduction is ***eliminated*** by June 30, 2020.[vii] When calculating the forgiveness amount, borrowers have two (2) options:[viii]

Option 1

[Eligible Payroll Costs + mortgage interest + rent + utilities within the 8-week covered period]

X {Average # of FTEEs employed during the 8 week covered period}
{Average # of FTEEs employed/month from 2/15/2019 – 6/30/2019}

Option 2

[Eligible Payroll Costs + mortgage interest + rent + utilities within the 8-week covered period]

X {Average # of FTEEs employed during the 8 week covered period}
{Average # of FTEEs employed/month from 1/1/2020 – 2/29/2020}

Salary Reduction Penalty: A reduction to the salary or wages during the eight (8) week covered period for employees who earned $100,000 or less in 2019 that is greater than 25% of the amount the same employee earned in the first quarter of 2020 will result in a Reduction Penalty (i.e., the forgiven amount will be reduced), unless the reduction is eliminated by June 30, 2020.[ix] How to calculate reduction in forgiveness due to Salary Reduction:

i) Calculate 25% of each employee's total salary and wages in the first quarter of 2020 ("Applicable Limit");
ii) Determine the total amount of reduced salary and wages for the employee during the eight (8) week covered period ("Actual Pay-cut"); and
iii) Reduce the forgiveness amount by the amount the Actual Pay-cut exceeds the Applicable Limit.

FORGIVENESS APPLICATION PROCESS

i) Borrower submits forgiveness application[x] to lender (at a time TBD by the SBA)
ii) Lender must make a final determination within 60 days of receiving a forgiveness application (further guidance/regulations forthcoming)
iii) Lender reviews application and supporting documentation, and submits to the SBA for final approval

DOCUMENTATION THAT MAY BE REQUIRED FOR FORGIVENESS APPLICATION

i) Payroll tax filings (as reported to the IRS);
ii) State income, payroll, and unemployment insurance filings;
iii) Bank statements, cancelled checks, payment receipts;
iv) Proof of cost AND payment of covered: mortgage interest, rent, utility payments;
v) Certification/Confirmation of # of FTEEs;
vi) Certification/Confirmation of FTEE salary comparison (pre 2/2020 to covered period); and
vii) Certification that the forgiveness requested was used to retain employees and make eligible debt payments.

WHAT IF THE LOAN (OR PORTION OF LOAN) IS NOT FORGIVEN?

i) All payments deferred for six (6) months from the initial disbursement of PPP loan proceeds (but interest will accrue).
ii) Any amounts not forgiven must be repaid over the eighteen months following deferral period.
iii) 1% interest rate.
iv) There is no prepayment penalty. Thus, if 100% of the received funds are not able to be used for eligible purposes, the borrower may repay the unused funds immediately to mitigate accrual of additional interest.

If you have any questions or need assistance, please reach out to one of our experts:

Jennifer LaTosch
248.727.1486
jlatosch@jaffelaw.com

Ian Evans
248.727.1444
ievans@jaffelaw.com

Eric Novetsky
248.727.1406
enovetsky@jaffelaw.com

Alexander Shiffman
248.727.1611
ashiffman@jaffelaw.com>

Emily Schey
248.727.1402
eschey@jaffelaw.com

Joshua Borson
248.727.1362
jborson@jaffelaw.com

The foregoing is only a general summary and is being provided with the understanding that Jaffe Raitt Heuer & Weiss, P.C. is not rendering legal, tax or other professional advice, positions or opinions on specific facts or matters and, therefore, assumes no liability whatsoever in connection with its use.

[i] After backing out any EIDL funds received.

[ii] If expenditures toward Non-Payroll Costs exceed 1/3 of the amount expended on Payroll Costs, it is possible the Loan will not be forgiven. By way of example, for a $100,000 PPP loan, if $74,000 is spent toward Payroll Costs and $26,000 is spent toward Non-Payroll Costs, the Non-Payroll costs exceed 25% of the total loan amount – resulting in no forgiveness, and the Borrower will be required to repay the loan in full (principal plus interest). It might be beneficial to consider paying employees a greater amount (but not to exceed an amount that would result in excess of $100,000/year), contribute a greater amount to retirement, etc. However, to calculate the maximum amount that can be utilized toward Non-Payroll Costs, first calculate what Payroll Costs will be for the covered period – Non-Payroll Costs may not exceed 1/3 of that amount, in order to receive forgiveness.

[iii]Note that for independent contractors, interest payments on a covered mortgage, rent, or utility payments are only eligible if they can be claimed on the 2019 Form 1040 Schedule C. In other words, if an independent contractor has no business rent or business utilities, these items are not eligible to calculate the loan amount or calculate loan forgiveness.

[iv] **Excluded** from Payroll Costs are: 1) compensation for an individual employee that would exceed $100,000/year; 2) certain federal taxes withheld/imposed; 3) any compensation for an employee who principally resides outside of the US; and 4) qualified sick leave and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.

[v] A Borrower that employs tipped workers may receive forgiveness for additional wages paid to those tipped workers.

[vi] Independent contractors cannot be included in the calculation of Payroll Costs, as those individuals have the ability to seek a loan on their own behalf. Further, Payroll Costs and eligible expenses are calculated differently for independent contractors and sole proprietors. More precisely, Payroll Costs are calculated utilizing reportable income from 2019 Schedule C, Line 31. Eligible expenses for independent contractors are likewise determined in a different manner per updated guidance by the SBA. (See Interim Final Rule "#3", 13 CFR Part 120, RIN 3245-AH36)

[vii] A headcount reduction penalty can be avoided if the headcount reduction occurred prior to April 26, 2020 and the Borrower eliminates the reduction no later than 6/30/2020 (by rehiring or new hires).

[viii] Seasonal employers are subject to different rules. To calculate the average number of seasonal employees to determine eligibility = {Payroll costs + mortgage interest + rent + utilities} x ({Average # of FTEEs employed during the 8 week covered period} ÷ {The average number of FTEEs per month employed from 2/15/2019 to 6/30/2019})

[ix] A Salary Reduction Penalty can be avoided if the reduction occurred prior to April 26, 2020 and is eliminated no later than 6/30/2020.

[x] The Borrower is required to certify that the information provided on the Application and all supporting documentation is true and accurate. The Lender is **not** required to verify the truth and/or accuracy of the provided information. The penalty for not providing, in good faith, truthful or accurate information could result in criminal liability ranging from 2-30 years in prison, and in fines ranging from $5,000-$1,000,000. The mere acceptance and approval of the Application by the Lender is **not** a determination of the Borrower's eligibility. Borrowers are strongly encouraged to carefully review their Application prior to submission.