

Paycheck Protection Loans

Acceptable Use of Funds (7(a)(36)(F))

During the period February 15, 2020 through June 30, 2020, the borrower may use the borrowed funds for:

- Payroll costs,
- Group health care benefits, including insurance premiums
- Interest on any mortgage obligation (not including prepayment or payment of principal)
- Rent
- Utilities
- Interest on any other debt incurred before February 15, 2020.

Paycheck Protection Loans

Loan forgiveness feature: Section 1106 of the CARES Act: If the PPA is used for its intended purposes, the first 8 weeks worth of certain payments shall be eligible for forgiveness on a tax-free basis (1106(b); 1106(i))

What payments are covered during the first 8 weeks?

- Interest on a mortgage incurred before February 15, 2020 (does not include any prepayment or payment of principal)
- Rent for a lease in force before February 15, 2020
- Certain utilities for which service started before February 15, 2020
- Payroll costs (same definition as under Section 7(a)(36)) For THIS purpose, loan forgiveness might not include payroll taxes and federal tax withholding on wages for the covered period (2.15.20-6.30.20)

Note: the SBA stated that not more than 25% of the forgiven amount can be for non-payroll purposes.

The limit cannot exceed the principal of the note (interest will still be owed) (1106(d))

Paycheck Protection Loans

Example. X Co. had \$480,000 of total payroll costs for 2019, resulting in a loan of \$100,000.

During the first 8 weeks after X Co. borrows \$100,000, it incurs:

- payroll costs of \$50,000.*
- Rent of \$25,000*
- Utilities of \$5,000*

X Co. is eligible for forgiveness of \$80,000 ($\$50,000 + \$25,000 + \$5,000$).

However, the SBA may limit the forgiveness portion of the rent and utilities to 25% of \$80,000, or \$20,000.

Thus, the total amount eligible for forgiveness would be \$66,667; \$50,000 of payroll costs (75% of \$66,667) and \$16,667 of other costs.

Paycheck Protection Loans

The amount eligible for forgiveness is reduced by multiplying the forgiveness amount by:

- (Section 1106(d)(2): The quotient obtained by dividing:
 - The average number of full-time equivalent employees of the borrower during the 8-week period from the date the loan originated, by
 - Either:
 - The average number of full-time employees per month from February 15, 2019 through June 30, 2019, or
 - The average number of full time employees per month from January 1, 2020 through February 29, 2020
 - Full time employees are determined by calculating the average number of full-time equivalents for each pay period falling within the month
- Seasonal employers use February 15, 2019 through June 30, 2019.

Paycheck Protection Loans

There is obviously a problem with this formula.

- If X Co. had an average of 20 employees from April 1- May 31, 2020 and 20 employees from February 15 – June 30, 2019, it has terminated NO employees. Yet, the formula would have you reduce the forgiveness amount by 20/20, or 100%.
- Or, if you dropped from 50 employees to 30, it would have you reduce forgiveness by 60%, even though X Co. only cut 20% of its staff. But...if X Co. cut 40 out of 50 employees, the ratio would be 10/50, and the reduction would be only 20%, even though X Co. cut 80% of its staff.
- Obviously, the proper formula is for the quotient to be subtracted from 1. So if you started with 50 employees and cut 10, you would divide 40 by 50, get 80%, and then subtract that from 1 to arrive at 20%. This 20% would then be multiplied by the forgiveness amount.

Paycheck Protection Loans

The amount eligible for forgiveness is also reduced by:

- The reduction in salary during the 8-week period of an employee earning less than \$100,000 (on an annualized basis) in excess of 25% of what the employee was earning in the most recent quarter before the 8-week period began.
- *Example. A, an employee of X Co. earned an annual salary of \$80,000 as of March of 2020. After X Co. takes out the Paycheck Protection Loan, A's salary is reduced to \$40,000. This was a greater-than 25% decrease in A's wages. Thus, the forgiveness amount is reduced by \$20,000, the amount by which the salary reduction (\$40,000) exceeds 25% of the A's salary during the most recent quarter (\$20,000).*
- *Or, is this excess of \$20,000 annualized for the covered period, resulting in a reduction of \$3,068 ($\$20,000/365*56$)?*

Paycheck Protection Loans

Restoration of Forgiveness

If an employer restores by June 30, 2020 any reduction in full-time equivalent employees or any substantially reduced wages that occurred during the period from February 15, 2020 until 30 days after passage of the CARES Act, when compared to February 15, 2020, the full forgiveness is again allowed.

- *Example. On February 15, 2020, X Co. had 40 employees before they were eventually cut down to 30 in April. On February 15, 2020, X Co. paid A a salary of \$60,000 that was reduced to \$30,000 on April 1st. Before June 30, 2020, X Co. rehires 10 employees and raises A's salary back to \$60,000. X Co. is entitled to the full \$440,000 forgiveness again.*
- *Step 1: determine FTEs on February 15, 2020 and salaries paid to those earning less than \$100,000 on February 15, 2020.*
- *Step 2: determine FTEs and salaries on the date 30 days after enactment of the CARES Act. (April 26, 2020) Determine any reduction in FTEs or salaries between Step 1 and Step 2.*
- *Step 3: Measure FTEs and salaries on June 30, 2020. As long as any reduction that occurred between Steps 1 and 2 have been restored by that date, the full forgiveness is allowed.*

Paycheck Protection Loans

Application for Forgiveness: Decision to be made by lender within 60 days (1106(e))

A borrower must apply for forgiveness, and the application must include:

- Documentation verifying the number of full-time equivalent employees on payroll and pay rates for the periods:
 - The covered period (8 weeks after the loan was taken out)
 - February 15, 2019 – June 30, 2019
 - January 1, 2020 – February 29, 2020
 - February 15, 2019 – June 30, 2019 (for a seasonal employer)
 - February 15, 2020 through 30 days after the enactment of the CARES Act
- This can be done with payroll tax filings, unemployment insurance filings, etc...
- Documentation, including cancelled checks, verifying payments on mortgages, rent and utilities
- A certification that the information is true and correct, and that the amount of forgiveness requested was used to retain employees.