The Payroll Protection Program
What You and Your Clients Should Know

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March 13, 2020: COVID-19 Emergency Declaration issued

March 27, 2020: Coronavirus Aid, Relief, and Economic Security Act (CARES Act) legislation signed into law

April 2, 2020: SBA issued Interim Final Rule clarifying and changing the PPP loan program under CARES Act

April 6, 2020: Most local lending institutions begin accepting PPP loan applications

April 14, 2020: SBA issued Interim Final Rule for PPP loans for sole proprietors and independent contractor

April 24, 2020: Congress approved additional $484B relief package – Payroll Protection Program & Healthcare Enhancement Act

Through May 6, 2020: Department of the Treasury/SBA FAQ guidance published and updated

Today: Forgiveness guidance in the form of a draft Forgiveness Application and Instructions was issued on May 15, 2020 which answered many questions but left some unanswered; mixed messaging as to whether more guidance can be expected.
Paycheck Protection Program ("PPP")

- $659 Billion Expansion of SBA 7(a) business loan program.
- Initial $349 Billion tranche was boosted on April 24 by additional $310 Billion tranche.
- Liberalizes eligibility for and requirements of 7(a) program.
- CARES Act sets forth the possibility for PPP loan forgiveness under certain circumstances.
- Guidance continues to be issued by Treasury and the SBA, and the program continues to evolve at a rapid pace.
Overview of SBA 7(a) Program

- NOT loans directly from the Federal Government.
- Federal Government guarantees loans made by eligible lenders to eligible borrowers.
- “Small business concerns” are eligible to participate – tied to earnings and industry-specific employee count (based on NAICS Code).
Expansion of General 7(a) Eligibility

- Expands eligibility beyond “small business concerns”.
- Other businesses and certain non-profits with no more than 500 employees are eligible.
- 500 employee cap can be exceed for certain excepted industries (based on NAICS code).
- The number of employees is considered on an affiliated-company basis, such that all businesses under common control would count employees in the aggregate.
  - The affiliation rule is waived for businesses in the hospitality/restaurant businesses (within NAICS code 72), franchises, and recipients of Small Business Investment Company (SBIC) investment.
Expansion of General 7(a) Eligibility (con’t)

Alternate Size Standard: Subsequence guidance also states that a business can qualify for a PPP loan if it met both tests in SBA’s “alternative size standard” as of March 27, 2020:

1. maximum tangible net worth of the business is not more than $15 million; and
2. the average net income after Federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than $5 million.
Borrowers must make a good faith certification as follows:

- That “current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant”:
- Acknowledge that the loan shall be used to retain workers and pay eligible expenses
- That the applicant does not have an application pending for a loan for the same purpose or that the applicant has received any other loan for the same purposes through December 31, 2020.
The Good Faith Certification Question

Treasury FAQ #31 (released on April 23) provides additional guidance for this certification, by stating that:

- “Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.”

- Any borrower that applied for a PPP loan prior to April 23 and repays the loan in full by May 7 will be deemed by SBA to have made the certification in good faith.

Treasury FAQ # 43 (released on May 5) extended this safe harbor repayment date through May 14, and stated that additional guidance will be forthcoming.

Treasury FAQ # 46 (released on May 13) created a “safe harbor”: Any borrower that, together with its “affiliates,” received PPP loans with an original principal amount of less than $2 million will be deemed to have made the required certification concerning the “necessity” of the loan request in good faith.
Automatic Review for Loans in Excess of $2 Million

- In FAQ #39 (released on April 29), SBA and Treasury announced that they will review all loans in excess of $2 million, and “other loans as appropriate.”
- The FAQ states that this review is intended to “further ensure PPP loans are limited to eligible borrowers in need.”
- Additional guidance implementing this procedure will be forthcoming.
Maximum Loan Amount

- The maximum loan amount for each PPP borrower is the lesser of (a) 2.5 times the Borrower’s average total monthly payroll costs over the previously 12 months and (b) $10 million.
  - Formula slightly varied for seasonal or new businesses.

- “Payroll costs” includes:
  - for employers, health care benefits, vacation, family and sick leave, retirement benefits and other additional similar costs; and
  - for Sole Proprietors, independent contractors, and Self-Employed Individuals, the sum of payments of any compensation that is a wage, commission, income, net earnings from self-employment, or similar compensation.

- “Payroll costs” excludes:
  - Salary of individual in excess of $100,000;
  - Any compensation of an employee whose principal place of residence is outside the United States;
  - Qualified sick and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act; and
  - Certain federal payroll taxes.
$20 Million Limit for Single Corporate Group

- The Interim Final Rule released by the SBA on April 30 further restricted the availability of the PPP for affiliates.
- This rule stated that “businesses that are part of a single corporate group shall in no event receive more than $20,000,000 of PPP loans in the aggregate.”
- For purposes of this limit, businesses are part of a single corporate group “if they are majority owned, directly or indirectly, by a common parent.”
- This limitation was effective with respect to any loans that were not disbursed as of April 30, 2020.
Permitted Uses of PPP Loan Proceeds

- Proceeds of the loans can ONLY be used for
  - “payroll costs,”
  - rent (real and personal property) payments,
  - utility payments,
  - mortgage interest payments, and
  - interest payments on other debt.

- The restriction on use of proceeds applies whether or not the loan is forgiven.

- Although not stated in the CARES Act, guidance suggests that no more than 25% of the loan proceeds may be used for non-payroll costs.
Loan Forgiveness

Borrowers could be eligible for loan forgiveness in an amount equal to the sum spent (or in some cases incurred) during the 8 weeks after the loan funding date on:

- “payroll costs”
- interest payment on any mortgage incurred before 02/15/2020
- rent on any lease in force before 02/15/2020
- utilities for which service began before 02/15/2020

Maximum forgiveness is total principal amount.

Consistent with use limitation, guidance suggests that no more than 25% of the forgiveness amount may be used for non-payroll costs.

The SBA Forgiveness Application establishes an “alternative payroll covered period” that borrowers can elect to use instead, which would start with the 1st day of the 1st pay period following loan funding.

- The alternative payroll covered period is available only to borrowers with a bi-weekly (or more frequent) payroll schedule.
- The alternative 8-week period is applicable only to “payroll costs.” All other non-payroll costs will use the normal 8-week “covered period” starting on the PPP loan funding date.
- There has also been some efforts in Washington to allow for a larger or more flexible covered period in order to permit borrowers to more fully spend loan proceeds in a forgivable manner.
Reduction in Loan Forgiveness

- The amount of loan forgiveness will be reduced:
  - Payroll Based:
    - Proportionally based on full time equivalent employee headcount during the 8 week period as compared to an historical period elected by borrower.
      - The Application creates a formula to determine each borrower’s “FTE Reduction Quotient.” That quotient is determined by dividing the average FTE headcount during the applicable covered period by the average FTE headcount during the applicable historical period selected; and
    - By an amount equal to any reductions in salary in excess of 25% of an employee’s total salary or wages as compared to the last quarter that the employee was employed.
    - Preliminary Forgiveness Amount = (Payroll costs + Non-payroll costs – any applicable Salary/Wage Reduction) x (FTE Reduction Quotient)
  - 75/25 Qualified Spending Rule Overlay
    - Divide total payroll costs during the chosen applicable covered period by 0.75. If that result is less than the forgiveness amount determined by applying the preliminary forgiveness formula above, then the forgiveness amount will be the lesser amount.
    - Example: $4M loan with $2M spent on payroll and $2M spent on non-payroll with no wage or FTE reductions in play. Because the spending is 50/50 the $4M of otherwise forgivable loan is reduced to $2,666,667 in order to force the 75/25 permissible ratio (e.g., $4M/.75 equals $2,666,667 of which 75% ($2M) was spent on payroll.)
Loss of Forgiveness “Cure”. There are provisions for avoiding any loss of forgiveness due to wage reductions and FTE reductions that occurred between February 15, 2020 and April 26, 2020.

Wage Reductions:
- A borrower who made a wage cut between February 15, 2020 and April 26, 2020 can avoid a forgiveness reduction based on reduced salary or wages if it restores annual salary or hourly wages by June 30, 2020 to the same level that existed on February 15, 2020.
- Importantly, a borrower who did not cut wages between February 15, 2020 and April 26, 2020, and instead cut wages after April 26, 2020, will not be eligible for the safe harbor even if the borrower restores wages by June 30, 2020.
- Like the reduction itself, the safe harbor is considered on an employee-by-employee basis.
- Note that a restoration of wages to 75% of the historical annual salary or hourly wages is not sufficient to qualify for the safe harbor. The restoration needs to be to 100%.

FTE Reductions:
- To the extent a borrower’s loan forgiveness is reduced as a result of having a FTE Reduction Quotient less than 1.0, the borrower may qualify for the safe harbor and eliminate the reduction if both of the following conditions are met:
  - the borrower reduced its FTE headcount in the period from February 15, 2020 to April 26, 2020; and
  - the borrower then restored its FTE headcount by not later than June 30, 2020 to its FTE headcount in the borrower’s pay period that included February 15, 2020 (this appears to be an all or nothing proposition and is not scalable).
Other Considerations/Open Questions

Important Information regarding Forgiveness

- Accurate documentation will be required, including
  - Complete payroll verification, including payroll tax filings; state income, payroll, and unemployment insurance filings.
  - Evidence of payment of covered mortgage obligations, payments on lease obligations, and utility payments.
Loan Term for any portion not forgiven:

- 6 month deferment for interest and principal; interest will continue to accrue
- Accrue interest at 1%
- Two year maturity
- No requirements for collateral or personal guaranty; other traditional SBA requirements waived
Relevant Tax Issues

- Taxpayer who borrows under the Paycheck Protection Program is ineligible for the payroll tax credit available under Section 2301 of the CARES Act for certain qualified wages.
- For US Federal tax purposes, forgiven amounts will not be taxable cancellation of indebtedness income.
- IRS’s position, laid out in a recent announcement, is that otherwise ordinary and necessary business expenses paid with forgivable loan dollars will be denied a federal income tax deduction.
  - Since announced, certain lawmakers have stated that this position is inconsistent with congressional intent and they have vowed a legislative fix. It remains to be seen whether we’ll see such a change.
Q&A

You have Questions
We have Answers
Thank You

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