



K&L GATES

# PPP Forgiveness: What You Should Know About the Application and Instructions

May 20, 2020

## AGENDA

- Overview of Process
- Payroll Costs
- Cash vs Accrual Issues
- Reductions & Safe Harbors
- Non-Payroll Costs
- Unforgiven Amounts
- Best Practices & Risks



## FORGIVENESS PERIOD - ALTERNATIVES

- 8-weeks beginning on:
  - Date of loan disbursement ( “Covered Period”)
    - **Can** be used for payroll costs
    - **Must** be used for non-payroll costs
  - First day of the first payroll period after disbursement (“**Alternative** Covered Period”)

## PAYROLL COSTS – WHAT IS INCLUDED

- Salaries, wages, commissions, tips, “similar compensation”
  - Compensation to self-employed “partners”
  - Bonuses
  - Hazard pay
  - **Capped at \$15,385 (= 8/52 of \$100k)**
- Vacation, parental, family medical, or sick leave;
- “Allowances” for separation or dismissal;
- Retirement and health care benefits, including insurance premiums;
- Employee-side FICA; and
- Employer-paid state or local taxes assessed on pay (state unemployment insurance tax)

## PAYROLL COSTS – WHAT IS NOT INCLUDED

- Employer-side FICA;
- Cash comp >\$100k (annualized) to any employee;
  - As expected, the application caps individual comp at \$15,385 (8/52 of \$100k) during the forgiveness period, which appears to apply even to bonus or one-time amounts.
- Compensation of non-US employees;
- Leave covered by FFCRA credits; and
- Payments to “1099” independent contractors

## PAYROLL COSTS – CASH VS ACCRUAL

- “Eligible payroll costs”:
  - **incurred** during the forgiveness period (incurrence date = “the day that the employee’s pay is earned”) **and**
  - **paid** during the forgiveness period **or on or before the borrower’s FIRST regularly-scheduled payroll date AFTER** such forgiveness period.
- But ... Other provisions say “paid or incurred”

# PAYROLL COSTS – CASH VS ACCRUAL

1. **Eligible payroll costs.** Borrowers are generally eligible for forgiveness for the payroll costs paid **and** payroll costs incurred during the eight-week (56-day) Covered Period (or Alternative Payroll Covered Period) (“payroll costs”). Payroll costs are considered paid on the day that paychecks are distributed or the Borrower originates an ACH credit transaction. Payroll costs are considered incurred on the day that the employee’s pay is earned. Payroll costs incurred but not paid during the Borrower’s last pay period of the Covered Period (or Alternative Payroll Covered Period) are eligible for forgiveness if **paid on or before the next regular payroll date**. Otherwise, **payroll costs must be paid during the Covered Period** (or Alternative

**Cash Compensation:** Enter the sum of gross salary, gross wages, gross tips, gross commissions, paid leave (vacation, family, medical or sick leave, not including leave covered by the Families First Coronavirus Response Act), and allowances for dismissal or separation paid **or** incurred during the Covered Period or the Alternative Payroll Covered Period. For each individual employee, the

**Forgiveness Amount Calculation (see Summary of Costs Eligible for Forgiveness below):**

**Line 1:** Enter total eligible payroll costs incurred **or** paid during the Covered Period or the Alternative Payroll Covered Period.

## PAYROLL COSTS – CASH VS ACCRUAL

- Reconciling paid “**and**” vs “**or**” incurred
  - **AND:** Requires all costs incurred during forgiveness period to be paid:
    - **during** the forgiveness period **or**
    - **on or before first payroll date** thereafter
  - **OR:**
    - Allows costs incurred during forgiveness period to be paid **on or before first payroll date** thereafter; and
    - **\*MAY\*** allow costs incurred **prior** to forgiveness period to be paid during forgiveness period



# Reductions to Forgiveness Amount

## FTE REDUCTION

- Pro rata fractional reduction in forgiveness amount
  - Numerator: Average FTE during forgiveness period
  - Denominator: Average FTE during “reference period”
  
- Reference period is, at Borrower’s election:
  - i. Feb. 15, 2019 to June 30, 2019;
  - ii. Jan. 1, 2020 to Feb. 29, 2020; or
  - iii. For seasonal employers, either of above or any **12-week period** between May 1, 2019 and Sept. 15, 2019.

## FTE REDUCTION

- FTE Calculations: Based on 40-hour week
  - Cannot exceed 1.0 (e.g., *employees working 50 hours / week = 1.0 FTE*)
  - “Simplified method”
    - *Employees working 40+ hours / week = 1.0 FTE*
    - *Employees working <40 hours / week = 0.5 FTE*
  - (*Borrowers should run the math both ways to see which is more beneficial*).
- Borrowers can exclude **unfilled positions** for employees who **during the forgiveness period**:
  - Were offered jobs back in writing on the same terms and who rejected such offer;
  - Were fired for cause;
  - Voluntarily resigned; or
  - Voluntarily requested and received a reduction in hours.

# FTE REDUCTION – CALCULATION

Actual Average FTE Method				
Employee	Base Period		Covered Period	
	Hours	FTE	Hours	FTE
A	45	1.00	40	1.00
B	40	1.00	40	1.00
C	39	0.98	25	0.63
D	30	0.75	12	0.30
E	20	0.50	10	0.25
Total		4.23		3.18
FTE Reduction Fraction				<b>0.75</b>

“Simplified” Method				
Employee	Base Period		Covered Period	
	Hours	FTE	Hours	FTE
A	45	1.00	40	1.00
B	40	1.00	40	1.00
C	39	0.50	25	0.50
D	30	0.50	12	0.50
E	20	0.50	10	0.50
Total		3.50		3.50
FTE Reduction Fraction				<b>1.00</b>

# SALARY/HOURLY WAGE REDUCTION

- CARES Act:
  - “Any reduction in **total salary or wages** ... during the covered period that is in excess of 25 percent of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the covered period”
  - Excludes employees making >\$100k / year
- Forgiveness Application:
  - Complete the Salary/Hour Wage Reduction column only for employees whose salaries or hourly wages were reduced by more than 25% during the Covered Period or the Alternative Payroll Covered Period as compared to the period of January 1, 2020 through March 31, 2020. For each employee listed in Table 1, complete the following (using salary for salaried employees and **hourly wage** for hourly employees)
  - Excludes employees making >\$100K because they are not listed in “Table 1”

## SALARY/HOURLY WAGE REDUCTION

- Hourly Employee Ambiguity: Is base amount:
  - Total hourly wages during reference period
    - Probably more consistent with CARES Act
    - Reduction in hours “double dips” on reduction
      - Reduces FTE in numerator **AND**
      - Impacts “Salary/Hourly Wage Reduction”
  - “Hourly wage” during reference period (w/o regard to hours worked)
    - Probably the more consistent reading of the Application form
    - Avoids double dip; **BUT**
    - Creates (or exacerbates) loophole”

# SALARY/HOURLY WAGE REDUCTION

## Step 1. Determine if pay was reduced more than 25%.

- a. Enter average annual salary or hourly wage during Covered Period or Alternative Payroll Covered Period: \_\_\_\_\_.
- b. Enter average annual salary or hourly wage between January 1, 2020 and March 31, 2020: \_\_\_\_\_.
- c. Divide the value entered in 1.a. by 1.b.: \_\_\_\_\_.  
If 1.c. is 0.75 or more, enter zero in the column above box 3 for that employee; otherwise proceed to Step 2.

## Step 2. Determine if the Salary/Hourly Wage Reduction Safe Harbor is met.

- a. Enter the annual salary or hourly wage as of February 15, 2020: \_\_\_\_\_.
- b. Enter the average annual salary or hourly wage between February 15, 2020 and April 26, 2020: \_\_\_\_\_.  
If 2.b. is equal to or greater than 2.a., skip to Step 3. Otherwise, proceed to 2.c.
- c. Enter the average annual salary or hourly wage as of June 30, 2020: \_\_\_\_\_.  
If 2.c. is equal to or greater than 2.a., the Salary/Hourly Wage Reduction Safe Harbor has been met – enter zero in the column above box 3 for that employee. Otherwise proceed to Step 3.

## Step 3. Determine the Salary/Hourly Wage Reduction.

- a. Multiply the amount entered in 1.b. by 0.75: \_\_\_\_\_.
- b. Subtract the amount entered in 1.a. from 3.a.: \_\_\_\_\_.

If the employee is an hourly worker, compute the total dollar amount of the reduction that exceeds 25% as follows:

- c. Enter the average number of hours worked per week between January 1, 2020 and March 31, 2020: \_\_\_\_\_.
- d. Multiply the amount entered in 3.b. by the amount entered in 3.c. \_\_\_\_\_ Multiply this amount by 8: \_\_\_\_\_ Enter this value in the column above box 3 for that employee.

If the employee is a salaried worker, compute the total dollar amount of the reduction that exceeds 25% as follows:

- e. Multiply the amount entered in 3.b. by 8: \_\_\_\_\_ Divide this amount by 52: \_\_\_\_\_ Enter this value in the column above box 3 for that employee.

## POTENTIAL LOOPHOLE?

- As Drafted, Can Borrowers Combine
  - + Simplified FTE Method
  - + Reduction in Hours for All <1.0 FTEs
  - + 25% Reduction in Hourly Wages
  - = **NO Forgiveness Reduction?**

*(Stay tuned on this, as we may get corrective guidance.)*



# SALARY/HOURLY WAGE REDUCTION - EXAMPLE

Comparison of Salary/Hourly Wage Reduction Methodologies										
EE	Base Period			Covered Period						
	Avg. Hours	Hourly Wage	Total Comp	Avg. Hours	Hourly Wage	Total Comp	Reduction in Actual Compensation		Reduction in Hourly Wage	
							Reduction %	Over 25%	Reduction %	Over 25%
A	45	36.00	\$ 1,620	40	27.00	\$ 1,080	-33.33%	\$ -	-25.00%	\$ -
B	40	30.00	\$ 1,200	40	22.50	\$ 900	-25.00%	\$ -	-25.00%	\$ -
C	39	24.00	\$ 936	25	18.00	\$ 450	-51.92%	\$ 252.00	-25.00%	\$ -
D	30	20.00	\$ 600	12	15.00	\$ 180	-70.00%	\$ 270.00	-25.00%	\$ -
E	20	12.00	\$ 240	10	9.00	\$ 90	-62.50%	\$ 90.00	-25.00%	\$ -
Total			\$ 4,596			\$ 2,700	-41.25%	\$ 612.00		0.00
<b>Salary/Hourly Wage Reduction</b>								<b>\$ 612.00</b>		<b>0.00</b>

## FTE REDUCTION – SAFE HARBOR

- FTE reduction does not apply if:
  - 1) Borrower reduced FTE levels in the period beginning February 15, 2020, and ending April 26, 2020; and
  - 2) Borrower then restored FTE levels:
    - 1) **By not later than June 30, 2020**
    - 2) **to its FTE levels for its pay period that included February 15, 2020.**

## SALARY/HOURLY WAGE REDUCTION – SAFE HARBOR

- Salary/Hourly Wage Reduction does not apply for any individual employee if:
  - 1) Borrower reduced such employee’s “salary or hourly wage” between Feb. 15, 2020, and April 26, 2020; **and**
  - 2) Borrower then restored such employee’s “salary or hourly wage” as of June 30, 2020.

***Open Question:*** Can borrowers fire and/or reduce comp for employees as of July 1?

# Non-Payroll Costs

## NON-PAYROLL COSTS – WHAT IS INCLUDED

- Mortgage Interest: “real or personal property”
- Rent: Real or personal property” leases
- Utilities
  - distribution of electricity, gas, water,
  - transportation (WTF: What is Transportation Forgiveness?),
  - telephone, or
  - internet access
- Must have existed before February 15, 2020
- **Subject to 25% cap: forgiveness & use**

## NON-PAYROLL COSTS – TIMING

- Non-payroll costs must be:
  - **paid during** the Covered Period **or**
  - incurred during the Covered Period and
    - paid on before the next regular billing date for such costs,
    - **even if the billing date is after the Covered Period.**
- Mortgage interest: **NOT** prepayable
- Rent & utilities: **seem prepayable**
- *But ... there may be future guidance on this.*
- **Alternate** Covered Period is **N/A** to non-payroll costs

## TAX TREATMENT

- CARES ACT: Forgiveness amount is not CODI
- BUT: IRS: expenses paid with forgiven loan are not deductible on tax return

## NON-FORGIVABLE USE OF PROCEEDS

- Payments made after forgiveness period –
  - Payroll costs
  - Non-payroll costs (still capped at 25% of loan)
- Employee compensation >\$100k annualized
- Interest on non-mortgage debt
  - Existing before February 15, 2020
  - NOT principal
- Refinancing a prior EIDL



## APPLICATION PROCESS

- Borrowers must apply for forgiveness
- Application & documents submitted to **lender**
- Lenders must respond within 60 days
  - CARES Act: “Lender shall issue a decision”
  - SBA review?
- CARES Act: prefunding of “Expected Forgiveness Amount”

## TREATMENT OF INTEREST ON PPP LOAN

- 1.0%, deferred for 6 months
- Forgivable?
  - CARES Act: “The amount of loan forgiveness under this section **shall not exceed the principal amount** of” the loan..
  - IFR 1: “The amount of loan forgiveness can be up to the full principal amount of the loan ***and any accrued interest.***”
  - Application (Line 11): Forgiveness is the **least of**:
    - Line 8: Forgivable payments x FTE Reduction Fraction
    - **Line 9: Original Principal Amount**
    - Line 10: Forgivable Payroll Costs / 0.75% (i.e., multiplied by 1.33)
  - BUT, CARES Act: SBA purchases loan for par + interest



## REPAYMENT TERMS

- Maturity: two years
- All payments deferred for 6 months
- Payment of unforgiven amounts:
  - Principal amortization schedule depends on lender
  - Unforgiven interest generally payable monthly
- Unsecured, no personal guaranty
  - **BUT! Recourse to owners if funds used improperly**

Reviews;  
Recordkeeping Requirements;  
Risks

## SBA REVIEW OF LOANS

- SBA will review all loans >\$2M of **original** principal
  - “And other loans as appropriate”
  - Borrowers **self report** if they **& affiliates** received loans > \$2M of **original principal** amount
  - Original principal: can’t prepay to \$1.99M to avoid review
- Borrowers acknowledge and agree to provide any additional info that SBA may request re:
  - Forgiveness and
  - “**Borrower’s eligibility for the PPP loan**”.

*(All borrowers must agree to this, not just those >\$2M)*

## DOCUMENTATION REQUIREMENTS

- Borrowers must submit w/ forgiveness app.:
  - PPP Schedule A
  - Payroll records, records for non-cash compensation
  - Bank statements or copied checks
  - Copies of statements for non-payroll expenses:
    - From February 2020 (to prove pre-COVID origin) and
    - During the covered period
    - Lease and loan agreements
    - Payment statements for obligations

## RECORDKEEPING REQUIREMENTS

- Must retain records re PPP loan for **six years**.
- Certify that the records submitted re loan forgiveness are “consistent with”:
  - Tax returns (Federal & state)
  - Other state workforce reporting (*unemployment ins.*)
- Not just regulatory
  - Regulatory audits
  - FCA & third party claims
  - Due diligence in future sale or financing

## FOIA & CONFIDENTIALITY

### ■ Confidential Treatment

- Information submitted to lender and/or SBA is subject to disclosure to third parties under FOIA.
- Exception: confidential commercial information
- Borrowers should consider:
  - Requesting confidential treatment for all materials submitted in connection with a PPP loan forgiveness application and
  - Marking such materials as confidential.



## RISKS – BEYOND LACK OF FORGIVENESS

- **Congressional Investigations & Oversight**
  - “Naming and Shaming” & “Headline Risk”
  - Referral to SIGPR, DOJ, SEC...
- **Civil**
  - FCA
    - Treble damages (3x the loan amount)
    - Maximum \$22k per claim statutory penalty
    - Attorney’s fees & costs
  - FIRREA
    - Civil penalties in amount of loss to government from the fraud;
    - Multi-million dollar statutory penalties
- **Criminal**
  - Title 18 criminal statutes
    - Imprisonment, multi-million dollar statutory penalties

## BEST PRACTICES

- Designate a Point Person / Document Custodian
- Review Document Retention Policy
- Board Approval / Ongoing Oversight
  - Memorandum Memorializing Decisionmaking Process
  - Contemporaneous Rationale for Necessity Certification
- **Segregated Bank Account**
- Meticulous Record Keeping

## QUESTIONS?

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Questions?