Forgive and forget? Receiving a PPP loan and seeking forgiveness

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While small businesses across the country are looking for much needed relief and assistance in the wake of COVID-19, they are focusing on pressing topics like payroll, keeping bills paid and the immediate needs of their employees, customers and owners.

The rush to access government funds, like the Paycheck Protection Program (PPP), Economic Injury Disaster Loans (EIDL) and other funds is often accompanied by a flurry of paperwork, the proverbial "fine print" and constantly changing agency guidance on process, eligibility requirements and disqualifiers. For most business owners, the threat of losing the business is a more pressing concern than some theoretical threat of enforcement due to an improperly completed application or a misunderstanding on how the proceeds may be used once received.

In the short term, this way of thinking is understandable. The government is cognizant of the needs of small business, and given the hundreds of thousands of applications banks are getting each day likely will not scrutinize the applications on the so-called "front end" before making the funds available. Consistent with the practices in prior emergency relief situations, the government will make the funds quickly available to get through the most difficult times.

However, when the dust settles, and the true price tag is revealed to Congress and the administration, the finger-pointing may start. Congress has built into the CARES Act extra oversight provisions, setting up administration officials to be challenged in public during an election season. This will pressure these officials to show they are taking steps to fight fraud, waste and abuse. What does this mean for the business owner? Why does this matter? In this and a follow-up article, we will discuss how the answer can be found in the old saying, "An ounce of prevention is worth a pound of cure."

Disbursement of PPP loans and the "eight-week period" thereafter

Many PPP applicants have already received loan proceeds or will be receiving them shortly, as lenders are required to make the first disbursement of a loan no later than 10 days from the date of the loan approval.

The disbursement date for your PPP loan is significant, as the amount of forgiveness for a PPP loan is based on the borrower's payroll cost over an eight-week period that begins on the date the lender makes the first disbursement to the borrower. Expenses in these categories during the subsequent eight weeks are subject to forgiveness under the PPP program:

- Payroll costs;
- Interest on mortgage obligations incurred before February 15, 2020;
- Rent payments on leases dated before February 15, 2020; and

- Utility payments under service agreements dated before February 15, 2020.

At least 75% of the proceeds must be used on payroll costs, and no more than 25% on non-payroll expenses.

Forgiveness of a PPP loan

PPP loan proceeds that were used by the borrower solely for the approved expenses detailed above will generally be fully forgiven by the lender if certain employee headcount and compensation requirements are met.

However, PPP loan forgiveness will be reduced for borrowers that have certain reductions in employee headcount or salary and wages, because the focus of PPP is to ensure that employees keep getting paid. Therefore, if these situations occur, less of the loan will be forgiven by the bank and SBA and the borrower will need to repay the amounts not forgiven at the required interest rate.

Loan forgiveness reduction based on decrease in employees

Loan forgiveness will be proportionally reduced for borrowers who have certain decreases in the average number of full-time equivalent employees per month. Specifically, to determine loan forgiveness on this basis the PPP requires borrowers to use a ratio to divide the average number of full-time equivalent employees per month during the eight-week period following PPP loan disbursement by, at the discretion of the borrower, either:

- The average number of full-time equivalent employees per month during the period beginning February 15, 2019 and ending on June 30, 2019; or
- The average number of full-time equivalent employees per month during the period beginning January 1, 2020 and ending on February 29, 2020.

However, seasonal employers cannot use the 2020 period for comparison, but instead must use only the period beginning on February 15, 2019 and ending on June 30, 2019.

After determining this ratio, the borrower's loan forgiveness will be reduced if the above calculation results in some number less than one, i.e., if it has less full-time equivalent employees during the eight-week period after loan disbursement than it did during the earlier period of comparison as described above. If that number is less than one, then the forgiveness will be reduced by a proportional amount.

Loan forgiveness reduction based on decrease of salary of more than 25% for those making less than an annualized amount of $100,000

Loan forgiveness also will be reduced for each employee whose salary or wages is decreased by more than 25% during the eight-week period after loan origination as compared to that employee's salary and wages for the full quarter before the eight-week period. However, this reduction only applies related to employees who did not receive, during any single pay period in

2019, wages or salary at an annualized rate of pay higher than $100,000 (i.e., $8,333.33 over 12 pay periods or $4,166.67 over 24 pay periods). Therefore, borrowers need to track any pay reductions to employees who made less than $100,000 in 2019, because a 25% or more decrease of salary and wages to those individuals during the eight-week period after loan origination as compared to the full quarter before it will cause a reduction in loan forgiveness.

Borrowers can avoid forgiveness penalties by restoring employee or salary reductions that already occurred between February 15, 2020 and April 26, 2020.

One key point is that borrowers can correct any reduction in employees or compensation that occurred between February 15, 2020 and April 26, 2020 to avoid penalties under the above forgiveness calculations. For reductions in employees or compensation that occurred during that period, borrowers will not have their loan forgiveness reduced if they restore those numbers in accordance with the PPP forgiveness provisions by June 30, 2020. This language was included in the CARES Act with an understanding that several employers needed to take adverse action before it was enacted. The forgiveness provisions allow those employers to amend those prior actions by June 30, 2020 to avoid suffering any reduction in forgiveness on that basis.

We anticipate substantial guidance from Treasury on how the above reductions and exclusions might work.

Although guidance on the application for forgiveness has not yet been promulgated, it will include:

- Documentation verifying the employee and wage thresholds are met, including payroll tax filings reported to the IRS and state income, payroll, and unemployment insurance filings;
- Documentation verifying other permissible expenses, including cancelled checks, payment receipts and account statements;
- Certification from an officer of the borrower that the documentation is true and correct, and that the proceeds were made for permissible uses; and
- Other documentation or certification the SBA or lenders determine may be appropriate.

The CARES Act specifies that lenders will make decisions on loan forgiveness within 60 days of receipt of the application. Any loans forgiven under this program will not be taxable to the borrower as income. Any loans not forgiven shall be due and payable in accordance with the terms of the loan (two-year term, 1.00% interest), but proceeds remain limited to permissible uses.

Note that although the CARES Act specifies only the principal of a PPP loan will be forgiven, Treasury Department rules indicate both principal and interest will be forgiven.

Risks of accepting a PPP loan or other government assistance

Following disbursement of loan proceeds and forgiveness, you may think that like a commercial loan, you can simply forget about a PPP loan. However, as an SBA loan program, PPP loans

have risks that borrowers need to keep in mind at all stages of borrowing (especially long after no loan obligation remains). What is really at stake? At some point in the future, internal agency auditors will likely start reviewing submissions from applicants and payments. They will be advised by statisticians, lawyers and financial analysts with experience and knowledge of common types of errors and fraud. They will focus on known "hot spots" where applicants may erroneously certify compliance. Audits will seek supporting documentation and interviews; those who don't comply may be visited by law enforcement agents from the Office of Inspector General with subpoenas. Books and computers may be seized, restitution forced, fines levied, and, in serious cases, claims made under the False Claims Act or criminal charges.

Of additional concern — these won't all originate from the government. Disgruntled employees who seek out or discover "whistleblower" attorneys or what is referred to as "relator" counsel can initiate these investigations by filing hot line complaints or qui tam lawsuits under the False Claims Act—virtually requiring the government to investigate. These could be motivated by anything from pure concern for the fiscal security of the United States, to personal greed, to a personal vendetta for a perceived slight. Attorneys all over the country will soon begin advertising to help these people bring these kinds of suits.

This will cause the government to be more proactive, attempting to bring these investigations in advance of these suits (for a myriad of reasons not addressed here), likely through the formation of a CARES Recovery Task Force or similar effort. In an upcoming article, we will discuss what businesses taking advantage of the PPP loan program and other forms of relief should consider to prepare themselves for these issues and ensure, first and foremost, that any money or relief taken from the government is received lawfully.

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