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Paycheck Protection Program Key Questions – RE-UPDATED With the Details From the April 3 Rule

The Coronavirus Aid, Relief and Economic Security Act ("CARES Act") created a new category of forgivable small business loan known as the Paycheck Protection Program ("PPP"). The PPP loans are intended to provide a massive influx of federal funding allowing businesses to keep employees employed and paid.

NEW: An interim final rule is available as of April 3, 2020 from the U.S. Department of the Treasury with additional details for potential borrowers.

Is My Business Eligible?

Small employers, including sole proprietors and independent contractors, are eligible. The dividing line is generally 500 employees based on head count (not FTEs). Some employers with more than 500 employees will be eligible if defined as a "small business concern" by the Small Business Administration ("SBA"). Businesses that are affiliated with larger enterprises will be combined in accordance with SBA affiliation rules – except for individual franchises, food service locations and places of accommodation (primarily hotels and motels). Most private nonprofit entities are eligible.

Businesses that do not have payroll costs are not eligible unless operating as a sole proprietor or independent contractor, in which case such persons will need to verify a loss of "net earnings from self-employment."

Eligible small businesses must have been in existence and incurring payroll costs by February 15, 2020.

When Can I Apply?

Most small businesses can apply on April 3, 2020. **NEW: Each participating financial institution is determining when it will accept applications. Some have determined not to take applications on April 3.** This date includes sole proprietors who have employees. Businesses reporting only "net earnings from self-employment" can apply starting April 10, 2020.

Where Do I Apply?

Banks and other financial institutions authorized as lenders by the SBA are authorized to take applications on the first day. The Treasury is also authorizing additional lenders to participate. Check with your current financial institution to see if it is participating or check the SBA website for a full list. Treasury has made available a sample application form here, but **each financial institution can determine what application form it will require**.

Can I Obtain Both a "Disaster Loan" (EIDL) and a PPP Loan?

Yes, but you cannot finance the same expenses twice. **NEW: Businesses that obtain a PPP loan will not be eligible for an EIDL loan for payroll after April 3, 2020.**

NEW: Businesses that obtained an EIDL loan for payroll between January 31, 2020 and April 3, 2020 and the EIDL loan was used for payroll costs, you MUST refinance your EIDL loan with your PPP loan. If the EIDL was used for both payroll and other costs, it is not immediately clear if the entire EIDL must be refinanced by the PPP loan or only the portion used for payroll costs.

Is There Any Advantage to Waiting to Apply?

There may be some advantage for client-facing businesses to attempt to line up the end of the eight-week PPP period with a date at which the business may be able to fully re-open or fully re-engage with customers. **Treasury is urging applicants to apply early** "because there is a funding cap and lenders need time to process your loan." Accordingly, any advantage to waiting may be outweighed by the possibility that funds may run out.

What is the Maximum Loan Amount?

The maximum amount is 2.5 times your average monthly "payroll costs" for the trailing 12 months, which includes health and retirement benefits, except that each person is capped at $100,000 per year of "payroll costs." There are certain other exclusions, such as payroll for persons outside the U.S. and FICA taxes. Costs reimbursed from tax credits under the Families First Coronavirus Response Act are also excluded. You will need to calculate "payroll costs" based on the statutory definition.

NEW: Although the model application distributed by Treasury states that "average payroll costs" are based on "2019" costs, the final rule conforms with the statute and states that average payroll costs are based on the "last 12 months" prior to the application.

NEW: You MUST add principal amounts of any EIDL "disaster loan" that was obtained between January 31, 2020 and April 3, 2020 and used for payroll. You do not need to refinance any portion obtained as an emergency grant since such amount does not need to be repaid.

Under the interim final rule, 75 percent of the PPP must be used for payroll costs. Therefore, you should calculate your anticipated "payroll costs" for eight weeks. You should borrow that amount plus one-third of that amount for other forgivable expenses (see example below).

If you will have additional forgivable expenses and you have already applied for the EIDL loan for expenses other than payroll, you may wish to refinance an amount of the EIDL principal in order to make such amounts forgivable (EIDL loans are not forgivable). This latter option will only apply if other forgivable expenses are greater than 25% of your anticipated eight weeks of payroll, so it is not likely to apply to most businesses.

Example: Your total payroll for the prior 12 months is $1,250,000 but your CEO makes $150,000 -- so that compensation is capped at $100,000. Thus, your "payroll costs" under the definition is $1,200,000. The average monthly "payroll costs" is thus $100,000.

Initial maximum loan amount: $100,000 x 2.5 = **$250,000**

You must add principal from an EIDL used for payroll to refinance it in the PPP. You may add principal from an EIDL used for expenses other than payroll, but that is likely to be a rare case.

Do Payments to Independent Contractors Reported on a Form 1099 Count as "Payroll Costs"?

NEW: Although there is statutory language indicating that payments to independent contractors reportable on a Form 1099 would qualify as "payroll costs," the interim final rule states conclusively that such payments are NOT to be included in "payroll costs" for purposes of the loan amount or loan forgiveness. The rule states that independent contractors are expected to apply for a PPP on their own.

How Will the Loan be Forgiven?

The forgiveness calculation has three steps.

Stage 1 -- Expected Amount: An initial "expected forgiveness amount" will be calculated based on the amounts of loan proceeds used in these four categories: (1) "payroll costs" [**must be 75 percent of total**]; (2) mortgage interest; (3) rent; and (4) covered utilities.

Stage 2 – FTE Ratio Adjustment: The "expected amount" will be adjusted by a ratio determined from your:

Average FTEs during the 8 weeks of the PPP program

compared to

Average FTEs during a "base period"

Your ratio will be 1.0 if all of your FTEs have been maintained or restored to equal the number of FTEs employed during the base period. A ratio of 1.0 means all of your forgivable expenses will be forgiven. As your ratio gets closer to 0.0 then smaller amounts will be forgiven.

Stage 3 – Compensation Reduction Adjustment: If any employee (making less than $100,000 annually) is reduced in salary or wages by more than 25% during the eight-week PPP period, then that reduction (dollar amount) will be reduced from the forgiveness amount. The reduction is taken after the reduction resulting from the FTE ratio.

Example: Continuing from above, if you maintain payroll or restore payroll in full by April 27, then your payroll costs will be $200,000 for the eight-week period, and your ratio will be 1.0.

Thus, you can pay other forgivable expenses (rent, covered utilities and mortgage interest) up to $50,000. Assuming you have $50,000 of eligible forgivable expenses, your total forgivable expenses will be **$250,000**. Therefore, your forgivable amount will equal your principal amount.

How Will Retention and Restoration of Employees Affect Forgiveness?

Retention and restoration of employees will determine the "ratio" – the percentage of the "expected forgiveness" that will be actually forgiven.

The first key date is April 27. If all FTEs that have been laid off or furloughed are restored by April 27 then the time during which they were laid off will not count against your ratio and your ratio is likely to be 1.0.

The second key date is June 30. If some or all FTEs are restored after April 27 but before June 30 then only the time from April 27 through the date of reinstatement will count against your ratio and your ratio will be closer to 1.0.

If none of your FTEs are restored by June 30 then all of their lost time will count against the ratio and the ratio could be close to 0.0.

> **Example 1**: You do not lay off any employees and maintain your usual payroll through the 8-week period.
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> > Ratio: 8.0 (for 8-week period) / 8.0 (base period) = 1.0
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> **Example 2**: You laid off four of your eight employees due to the economic disruption and restore the four laid off on April 27. Since they were restored by April 27, you will be eligible for the full-restoration exception.
>
> > Ratio: 8.0 (for 8-week period) / 8.0 (base period) = 1.0
>
> **Example 3**: You laid off four of your eight employees due to the economic disruption and restore the four laid off on June 22. Since the restoration is before June 30, you will be allowed to treat as restored the payroll for the four restored employees from the date of the loan through April 27 (we assume for this example a loan date of April 6, thus three weeks), but not for the remaining weeks (in this example, five weeks).
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> > Ratio: 5.5 (for 8-week period) / 8.0 (base period) = 0.6875
> >
> > FTEs for the 8-week period in this example are determined based on three weeks of 8.0 FTEs (fully restored pursuant to the exception) and five weeks of 4.0 FTEs (not restored), for an average of 5.5 FTEs for the eight-week period.
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> **Example 4**: You laid off four of your eight employees due to the economic disruption and are unable to restore the four laid off by June 30. You will not be allowed to treat any payroll as restored.
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> > Ratio: 4.0 (for 8-week period) / 8.0 (base period) = 0.5

In each case, the ratio is multiplied by the expected forgiveness amount.

Example 5: You laid off four of your eight employees due to the economic disruption and restore the four laid off on April 27. Since they were restored by April 27, you will be eligible for the full-restoration exception. One of the employees, however, who had been earning $60,000 is reduced to $40,000.

Ratio: 8.0 (for 8-week period) / 8.0 (base period) = 1.0

Since the reduced-pay employee is making under $100,000 and is reduced by more than 25 percent, then the amount of the reduction will not be forgivable.

In this case, the ratio will still be 1.0, but the forgiveness amount will be reduced by $20,000, which is the dollar amount of the reduction.

What Happens to the PPP Principal that is Not Forgiven?

Non-forgiven PPP principal must be paid back within two years at an interest rate of 1.0 percent. **NEW: The interest rate of 0.5 percent originally set by Treasury was amended to 1.0 percent in the final interim rule.**

There is no prepayment penalty.

There will be a six-month deferral period in principal, although interest will continue to accrue.

Can I Use the PPP for Expenses Not Eligible to be Forgiven?

Although the CARES Act permits certain expenses to be payable from a PPP loan that would not be eligible for forgiveness (i.e., interest on non-mortgage debt), the Treasury guidance on March 31 indicated that due to "likely high subscription" the loan proceeds should be limited to expenses classified as forgivable. **NEW: The interim final rule does not adopt this limitation beyond the 75-percent payroll costs requirement. Therefore, if there are loan proceeds available, it appears that non-forgivable uses are permitted if allowed by the statute. This would include interest on non-mortgage debt and payroll costs over $100,000 per person.**

What are the Advantages of an EIDL Loan?

The disaster loan (EIDL) provides access to the $10,000 emergency advance, which is not available from the PPP loan. It also has a broader range of operating expenses that can be permissibly financed.

It will make sense for businesses who (a) need the immediate $10,000, (b) have significant operating expenses beyond payroll, rent, mortgage interest and utilities, (c) anticipate a longer "bridge" period than eight weeks or (d) anticipate non-forgivable principal that could not be repaid in two years.

NEW: Pursuant to the interim final rule, EIDL loans not used for payroll will not affect eligibility for PPP loans. EIDL loans used for payroll must be refinanced in PPP loans.

How Do I Solve This for My Business?

Request a flat-fee consultation with business attorneys at Vandenack Weaver LLC. Just click [here].