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The KBG Payroll Protection Plan Payback Playbook (PPPPP)
Loan Forgiveness under the PPP of the CARES Act and the PPPFA as of June 12, 2020

Overview

The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted on March 27, 2020, in response to COVID-19. Among its many provisions, the CARES Act establishes The Keeping American Workers Paid and Employed Act, which creates the Paycheck Protection Program ("PPP"). The PPP is overseen by the Small Business Administration ("SBA") and the Treasury.[1]

The idea of the PPP is to incentivize small business owners to bring their workers back on payroll – and get them off unemployment – during the pandemic by providing forgivable loans. The real draw for these loans was that they could be forgiven if used as intended – meaning free money for the "borrowers." The program launched on April 4, 2020 with $349 billion in funding, which was rapidly exhausted, and a second tranche of $310 billion was added on April 27, 2020.[2] On June 5, the Paycheck Protection Program Flexibility Act (PPPFA) was enacted. The PPPFA aims to address some issues that borrowers and industry groups had raised regarding the PPP as originally passed on March 27, including giving businesses more time to use the funds and rehire employees. As of June 1, 2020, according to a report published by the Treasury, just under $90 billion in PPP loan funds remained available. There continues to be talk of a third tranche of money (as part of Phase IV). Our guess is that the playbook will continue to change, so this version of it may well be outdated by the time you submit your forgiveness application.

Because of the virtually universally held belief that the loan funds would be exhausted within days, there was a frenzy to apply, and many millions did,[3] long before (a) businesses, particularly those in the hospitality sector, had any need to rehire staff, and (b) anyone had any concrete guidance on how the loans would be handled. In fact, as of this writing, many questions remain unanswered. To compound matters, the entire rulebook may change if and when Phase IV of the federal government's response to COVID-19 becomes law.

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[1] The PPP provisions of the CARES Act have been interpreted by the SBA in sixteen rulings so far, on April 2, 2020 (the first of many curiously named Interim Final Rules or "IFR"), April 3, 2020 (an "Affiliation Rule"), April 14, 2020 IFR, April 24, 2020 IFR, April 27, 2020 IFR, April 28, 2020 IFR, April 30, 2020 IFR, May 5, 2020 IFR, May 8, 2020 IFR, May 13, 2020 IFR, May 14, 2020 IFR, May 18, 2020 IFR, May 20, 2020 IFR, two May 22, 2020 IFRs, June 6, 2020 IFR and June 10, 2020 IFR. In addition, Frequently Asked Questions ("FAQs") started to be released on April 6, 2020 and they have been updated with a series of additional FAQs, with the most current FAQ issued on May 27, 2020. In addition, in conjunction with the issuance of the Affiliation Rule, the SBA issued a two-page explanation of the affiliation principles applicable to the PPP (the "Affiliation Guidance"). The Affiliation Rule and Affiliation Guidance clarified the affiliation principles that apply to applicants. Relatedly, on May 15, 2020, the SBA released its Loan Forgiveness Application with corresponding guidance, available at https://home.treasury.gov/system/files/136/3245-0407-SBA-Form-3508-PPP-Forgiveness-Application.pdf. This lattermost document will surely be revised.

[2] Federal Register Vol. 85, No. 73, Pg. 20816.

[3] Within the PPP's first six weeks, lenders processed 4.3 million loans, totaling $513 billion. Information available at: https://home.treasury.gov/system/files/136/SBA-Paycheck-Protection-Program-Loan-Report-Round2.pdf.

A quick step back: You applied for a loan by calculating your average monthly payroll, multiplied that by 2.5, and, if appropriate, made adjustments for other disaster relief. You also had to indicate your average employee headcount and certify your application.[4] Loan forgivability required expenditure of loan proceeds during an 8-week "Covered Period." Under the PPPFA, enacted today, virtually everything changed, and the "Covered Period" now runs until the earlier of (i) 24 weeks after a borrower first receives funds or (ii) December 31, 2020. This change is in response to the fact that many businesses shut down by the COVID-19 pandemic simply could not use PPP funds within 8-weeks of receiving the money, unless they paid employees to stay home. The maximum loan amount has not yet been increased, but the funds can now be spread out over the new 24-week Covered Period. Still, any borrower who received a PPP loan before the PPPFA was enacted may opt to remain with an 8-week covered period and use their funds and measure employee headcount for purposes of forgiveness during the shorter period. The PPPFA only modifies, but does not replace, certain provisions of the CARES Act and the SBA Act related to loan forgiveness under the PPP and the deferral of payroll taxes. Generally, in addition to the 24-week period, the other major change to the PPP program, brought about by today's PPPFA are that you must use at least 60% of the loan for payroll (decreased by the PPPFA from 75%), maintain your headcount and use the remaining funds for rent, mortgage payments and utilities. To the extent the loan is not forgiven, you will have to pay it back (after the deferral period, discussed below) at 1% simple interest over 2 or 5 years (depending, in part, on when your loan was originated).

Sounds straightforward enough, but these "rules" raise more questions than they answer. As has been the case with the PPP, there are and will be various questions and ambiguities in the PPPFA and potential conflicts with previous guidance, so all borrowers should be prepared for continuing changes to the guidance and potential ongoing uncertainties. That being said, we expect additional guidance in the form of further IFRs and FAQs.

Why is it essential that you know the rules? Because you could be looking at a lot more than easy money at 1%. Lenders have been handsomely incentivized to quickly process as many loans as possible, not only with origination fees but also by being assured that borrowers, and not lenders, will be held accountable for improperly funded or improperly used loans. The Treasury has already started using the $6 billion in its budget to investigate PPP loans and several criminal complaints already have been filed. The SBA has promised to audit all loans in excess of $2 million, including loans among affiliates that exceed $2 million in the aggregate. Specifically, the SBA may select forgiveness applications, wherein it will review borrower eligibility, loan amounts and use of proceeds, loan forgiveness amounts. Borrowers need to ensure they are properly applying and using the funds, as misuse can result in the denial of their forgiveness requests and convert an asset (free money) into a liability (a loan).This PPPPP is what we know so far.

[4] On April 24, 2020 (after millions had already applied), the SBA issued guidance on how to calculate maximum loan amounts for each type of applicant. The FAQs, which are still being issued, provide some additional clarification regarding the application of the affiliation rules and interpretation of the CARES Act and have been updated numerous times with additional questions and answers. The FAQs provide that borrowers and lenders may rely on the SBA's guidance in the FAQs and the IFRs available at the time of application. Specifically, FAQ 17 provides that borrowers may rely on the "laws, rules and guidance available at the time of the application." However, the same answer notes that "borrowers whose previously submitted loan applications have not yet been processed may revise their applications based on clarifications reflected in these FAQs."

****Note, until we have further guidance from the SBA or Treasury, we are assuming that if a borrower opts to stay with the 8-week Covered Period, any calculation previously that required the use of an 8-week period, will still be based on that same 8-week period.**

<u>How may PPP funds be used?</u>

- <u>Payroll Costs and Employee Benefits</u>. To be eligible for <u>full</u> forgiveness of the loan, regardless of whether the borrower has opted to stay with 8 weeks or switch to the 24 week period, at least 60% of the PPP loan funds must be used for "Payroll Costs," including employee benefits incurred and paid during the selected Covered Period (changes to the Covered Period are discussed in detail below).
    - <u>What are "payroll costs"?</u> The following are permitted payroll costs:
        - salary, wages, commissions, or similar compensation (including housing stipends) (FAQ 32-36);
            - ✓ Commission payments to furloughed employees, bonuses or hazard pay are also permitted payroll costs. (IFR May 22, 2020.) Be aware that using such compensation instead of increasing an employee's hours worked or pay during the covered period, may be a lost opportunity for forgiveness.
        - cash tips or equivalents;
        - payments for vacation, parental, family, medical or sick leave;
        - allowance for dismissal or separation;
        - employer payments for group health care benefits, including insurance premiums;
        - employer payments of retirement benefits (*e.g.*, contributions to defined retirement plans);
        - payments of state or local taxes assessed on the compensation of the employee; and
        - draws or distributions to partners in a partnership.[5]
            - ✓ PPP Compensation as to owners cannot exceed 8-weeks' worth of 2019 compensation,[6] and is subject to the annualized $100,000 maximum. This does not include 1099 income.
    - <u>What is excluded from Payroll Costs</u>: PPP funds may not be used for the following:

[5] Owner-employees, sole proprietors, independent contractors, or the self-employed who either file a Schedule C or receive a K-1, can use net profits to calculate their eligibility, subject to the lesser of an annualized $100,000 maximum ort 2019's reported income. No additional forgiveness is provided for retirement or health insurance contributions for self-employed individuals and general partners because such expenses are paid out of their net self-employment income. (IFR May 22, 2020.)

[6] We await further guidance as to whether this changes with the new 24-week Covered Period.

- Cash compensation of an individual employee in excess of an annual salary of $100,000 as prorated for the period.[7]
  - ✓ Bonuses, hazard pay and payments to furloughed employees are included within the $100,000 cap (IFR May 22, 2020);
  - ✓ Paid leave disbursements from employer are included within the $100,000 cap;
  - ✓ Employer contributions to healthcare and retirement benefits are not part of amount deemed in excess of $100,000 annual salary (FAQ 7).
- Employer's portion of federal payroll taxes – taxes imposed or withheld (includes FICA taxes);
  - ✓ Under the PPPFA borrowers are now eligible to defer employer payroll taxes (FICA) for wages paid after March 27, 2020, and before January 1, 2021, paying half of the deferred balance on December 31, 2021, and the other half on December 31, 2022.
- The compensation of any employee whose principal place of residence is outside of the United States (FAQ 33); and
- Qualified sick leave wages for which a credit is allowed under section 7001 of the Families First Coronavirus Response Act or qualified family leave wages for which a credit is allowed under section 7003 of the same act.

o What Payroll Period is covered?

- Payroll costs paid or incurred during the Covered Period (costs may only be counted once).
  - ✓ Payroll costs are considered paid when the paycheck is distributed or there is an ACH originated transaction.
  - ✓ Payroll costs are considered incurred when the employee's pay is earned (on the day worked), if employee is not working but is on the payroll, then the cost is incurred on the schedule established by the borrower. These costs are eligible for forgiveness if paid on or before the next regular payroll date following the end of the Covered Period.
- Covered Period: If not opting to keep the 8-week Covered Period, the PPPFA provides that the Covered Period now begins on the date the loan is issued and ends on the earlier of (i) 24 weeks from the loan's issuance date or (ii) December 31, 2020.
- Alternative Payroll Covered Period: For those who choose to use the 8-week formula, borrowers with a bi-weekly or weekly payroll cycle may elect the 8-week period[8] starting on the first full payment cycle following the date of the disbursement of PPP funds. Although the existing loan forgiveness application

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[7] Prior to the PPPFA, the prorated limit of the $100,000 salary for 8 weeks was $15,385 per employee. The PPPFA did not clarify whether the prorated limit of the $100,000 salary would be increased to match the 24-week Covered Period – amounting to approximately $46,153. We anticipate clarification on this item.

[8] We await further guidance as to whether this changes with the new 24-week Covered Period.

does not reflect the new 24-week period, we assume a similar Alternative Payroll Covered Period option will be provided when it is updated, or a new application is issued.

- ✓ These costs, when incurred in the Alternative Payroll Covered Period, will be forgivable if paid by the first regular payroll following the end of the Alternative Payroll Covered Period.

- Other Costs. Up to 40% of PPP loan funds may be used to cover specific non-payroll expenses.
  - What non-payroll expenses may the PPP funds be used for?
    - Mortgage interest obligations (any indebtedness or debt instrument incurred in the ordinary course of business that (i) is a liability of the borrower, (ii) is a mortgage on real or personal property, and (iii) was incurred prior to February 15, 2020; this cannot include payments of principal nor advance payments of interest (IFR May 22, 2020));
    - Rent obligations or lease payments, for real or personal property (paid pursuant to a lease agreement in effect prior to February 15, 2020);
      - ✓ "Lease payments" imply that related expenses may be forgivable to the extent they are included in the applicable lease, so BID and CAM charges are probably OK to include.
      - ✓ We interpret leases on "personal property" to include leases on vehicles leased by the borrower entity and even things like icemaker and espresso machine leases.
    - Utilities (electric, gas, internet access, phone, water, or transportation);[9]
      - ✓ We believe this should include items like music services that are essential to a borrower's business.
    - Refinancing an SBA Economic Injury Disaster Loan made between January 31, 2020 and April 3, 2020.[10]
    - Although not yet permitted, we believe that costs associated with personal protective equipment and COVID-19-related operational expenses (like dividers) will be included through future guidance or in Phase IV.
  - The PPP funds will cover non-payroll expenses during the following time frames:
    - PPPFA Covered Period: If not opting to keep the 8-week Covered Period, the PPPFA provides that the Covered Period now begins on the date the loan is issued and ends on the earlier of (i) 24 weeks from the loan's issuance date or (ii) December 31, 2020.

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[9] SBA Press Release, available at https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/sbas-paycheck-protection-program-small-businesses-affected-coronavirus-pandemic-launches.

[10] 13 CFR Part 120.

- ✓ To be clear: The Alternative Payroll Covered Period does not apply to non-payroll costs, but it will apply to payroll-related costs during the PPPFA covered period if a borrower elects it.
- ✓ Again, borrowers who received their loan before June 4, 2020, may elect to keep their Covered Period at 8 weeks rather than expand to the 24-week period. We assume that borrowers who elect to keep the 8-week Covered Period for payroll expenses will be required to keep the 8-week Covered Period for non-payroll expenses as well. We expect the SBA or Treasury to clarify and provide further guidance.

- ▪ Non-payroll costs can include, under Option 1, all eligible costs paid during the Covered Period and, under Option 2, all eligible costs incurred during the Covered Period so long as they are paid by the next standard payment date defined for each cost type (even if after the Covered Period).

Example: *The Covered Period is April 30 to October 15 and the electricity billing cycle begins on the first of the month and ends on the last of the month, being billed on the 16thth day of the subsequent month.*

We believe that Borrower can pay the March electricity invoice, billed on April 16, if paid during the Covered Period, as well as the monthly invoices for the electricity used from April to October, so long as paid by October 15. If not paid by October 15, the September bill may still be fully covered if paid before October 16, and the October bill will be covered for the electricity used from October 1 to October 15 if paid by November 16.[11]

- o To receive full forgiveness, the PPPFA requires that borrowers use a minimum of 60% of PPP funds on payroll expenses and a maximum of 40% on non-payroll expenses. Otherwise a borrower may only request forgiveness of an amount which is in compliance with the above rule – requiring that 60% of the loan be used to cover payroll expenses.

Example: *If Borrower had a loan of $100,000, and it only used $54,000 on payroll expenses, then Borrower would not be eligible for full forgiveness of its loan. However, Borrower may still receive partial forgiveness on the loan if it requests forgiveness on $90,000 of the total $100,000 loan. 60% of $90,000 is $54,000 – which Borrower satisfies since it used $54,000 on payroll expenses.*

Will the PPP loan be forgiven?

- 100% of the Loan May Be Forgiven. A loan is eligible for complete forgiveness, for costs incurred and payments made during the covered period (8 or 24 weeks) after the lender makes the first disbursement of the PPP loan to the borrower, subject to proper documentation for verification and if the funds have been used only for permitted purposes. Amounts forgiven are

[11] Unless provided otherwise, assume in all examples that the borrower has not opted to maintain an 8-week Covered Period.

not taxable income to the borrower, but the expenses paid with loan proceeds can't be deducted from income.[12] Additional requirements for forgiveness are:

- Payroll costs must make up at least 60% of the amount forgiven.
- Non-payroll costs can make up no more than 40% of the amount forgiven and are defined as the last three categories under permitted uses.
- To receive full forgiveness, an employer must retain or rehire by December 31, 2020 (or June 30, 2020 if opting for the 8-week Covered Period) all full-time equivalent employees (FTEs) to the average FTE count maintained during the selected reference period (discussed below), except for any fully documented instances in which an employee declines the rehire offer and the borrower is unable to hire a similarly qualified employee on or before December 31, 2020,[13] or borrower "documents an inability to return to previous levels of business activity,"[14] or borrower satisfies the Reduction Safe Harbor.[15]

<u>How could forgiveness be reduced?</u>

The amount of loan forgiveness may be reduced if there is a reduction in the number of FTEs and/or a reduction of greater than 25% in wages or salary is paid to any particular employee. The two specific reduction penalties are:

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[12] The CARES Act expressly provides that forgiven amounts of PPP loans used for payroll costs are excluded from gross income. However, on April 30, 2020, IRS released guidance (Notice 2020-32) that seemingly nullified this benefit under the CARES Act. Specifically, the IRS states in the guidance that expenses that result in forgiveness of a PPP loan are not tax deductible in order to prevent a "double tax benefit." The disallowance of a deduction for permitted expenses under the PPP potentially reduces the tax benefit available to PPP loan recipients. In some cases, a prospective loan recipient may be in a better financial position if it does not obtain a PPP loan. In effect, the IRS guidance produces a result that seems contrary to the purpose of the CARES Act. This point is not settled, and bills are currently being considered in both houses of Congress that would clarify if businesses can deduct items such as wages and rent that were paid with PPP loan funds and invalidate the IRS notice regarding "double dipping" for tax deduction purposes.

[13] If borrower opts for the 8-week period, it is unclear whether this date will be changed to June 30, 2020.

[14] Guidance on how to demonstrate "an inability to return to the same level of business activity as such business was operating at before February 15, 2020, due to compliance with requirements established or guidance issued by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration during the period beginning on March 1, 2020, and ending December 31, 2020, related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID–19" is yet to be fully explained. We expect further guidance.

[15] Self-employed applicants who filed a Form 1040 Schedule C in 2019 are only eligible for forgiveness for loan proceeds used for: (i) owner compensation equal to 8 weeks of 2019 net profit up to a maximum annualized amount of $100,000; (ii) payroll costs to employees (if any) with a principal place of residence in the US; and (iii) mortgage interest, rent or utility payments that the applicant claimed or was entitled to claim as a business expense deduction on its 2019 Form 1040 Schedule C. The 40% limitation on forgiveness of non-payroll costs also applies.

- Employee Reduction Penalty. The loan amount eligible for forgiveness will be reduced proportionally for reductions in the average number of FTE employees during the covered period compared to the average number of FTE employees per month during the borrower's reference period.
  - Calculating FTE counts.[16]
    - An employee who works in excess of 40 hours a week is one full-time-equivalent employee (1 FTE). For all others, the PPP provides two methods to calculate an FTE.
      - ✓ Under the first method, an employee that works less than 40 hours will be deemed a .5 FTE.
      - ✓ Under the second calculation method, the borrower may divide the average hours worked in a week by 40, rounding to the nearest tenth. For example, an employee who worked for 25 hours out of the 40 hours necessary, can be counted as .6 (.63, rounded to the nearest tenth) of an FTE employee.
    - The borrower should select one of the two calculation methods and keep it uniform throughout the application – including calculation of the Safe Harbor.
      - ✓ In a nutshell, if you want to reduce your headcount for the "reference period" and your part-timers average more than 20 hours a week, the .5 FTE will give you a lower total headcount, but you have to be careful of your part-timer headcount as of the end of the Covered Period since you will likely have to use the same methodology for both periods.
  - The periods used to measure the reduction:
    - The borrower must use the Covered Period, which begins on the day the loan is issued, or if applicable, the Alternative Payroll Covered Period, which begins on the first day of the first full pay period following the issuance of the loan.
    - For the "reference period," the borrower must select one of the following three: (1) Feb. 15, 2019 to June 30, 2019, (2) Jan. 1, 2020 to Feb. 29, 2020, or (3) in the case of seasonal employers, average number of FTE employees per month between Feb. 15, 2019 to June 30, 2019.
      - ✓ It is now evident that the headcount figure the borrower used when it filed its loan application is no longer relevant, and that's good, because that number included part-time employees, and now the application is looking only at FTEs (and counting part-timers as fractional FTEs).

Example: *Borrower takes a $100,000 loan and selects Feb. 15, 2019 to June 30, 2019 as its "reference period," where it had an average FTE count of 10. Borrower then reduces its average FTE employee count to 9 employees during the selected*

[16] Note that owners do not count toward the FTE number.

Covered Period. Because Borrower reduced its employee number by 10%, then only $90,000 of the $100,000 would be forgiven.

Example: *Borrower takes a $100,000 loan. From Feb. 15, 2019 to June 30, 2019, Borrower had an average FTE count of 12. From Jan. 1, 2020 to Feb. 29, 2020, Borrower's average FTE employee count was 10. Borrower should use Jan. 1, 2020 to Feb. 29, 2020 as its "reference period," because borrower need only keep its average FTE count at 10 during the Covered Period to avoid the forgiveness reduction penalty.*

- "Good Faith" Effort to Rehire/Hire and Unable to Restore Business Activity Exemptions. The PPPFA provides that a reduction in FTE employees will not be counted to the extent a borrower can show in good faith, and is able to document, that it was:

  (1) unable to rehire persons who were employees before February 15, 2020, and

  (2) that the borrower could not hire a similarly qualified employees for the unfilled positions on or before December 31, 2020.[17]

  Additionally, a borrower will not be penalized for a reduced FTE count if it can document an inability to return to the same level of business activity it was operating at before February 15, 2020, due to compliance with COVID-19 requirements imposed by government agencies.[18]

  When counting average FTE for the Covered Period, add an FTE for (1) any positions for which the borrower made a good-faith, written offer to rehire an employee during the Covered Period or the Alternative Payroll Covered Period which was rejected by the employee; and (2) any employees who during the Covered Period or the Alternative Payroll Covered Period (a) were fired for cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction of their hours. In all of these cases, include these FTEs only if the position was not filled by a new employee.[19]

  The borrower must demonstrate, in writing, the offer to rehire (to the same salary or wages and same number of hours as in the last pay period prior to the separation or reduction in hours) and must have "documentation" of refusal. To the extent possible, send the offer by Certified Mail, first class mail or e-mail. Phone calls are not "written offers to rehire." If you receive no response, document that fact.[20] The borrower must, within 30 days of rejection, notify the applicable state unemployment insurance officer. (IFR May 22, 2020.)

  - ✓ Be careful with Certified Mail, though. If your letter is returned to sender, you have no proof of a written offer. Email may be used, but

[17] See FN 13 above.

[18] See FN 14 above.

[19] This information is derived from the existing loan forgiveness application. However, we expect the Treasury and SBA to issue a new loan application with further guidance.

[20] Further information regarding how borrowers are to report rejected rehire offers to state unemployment insurance offices has not been provided by the SBA.

as with a letter, ask that the employee respond to the email with an answer within a set number of days, or you will assume they have declined the offer.

- Any such absent employees under this provision will likely be counted at the equivalent of that employee's FTE count during the "reference period."
- Regardless of the lack of guidance at this time, the borrower is advised to (1) keep records of inability to hire similarly qualified employees, (2) keep records of the COVID-19 related government measures that affected it and any additional proof of its impact on its business.

<u>Example</u>: *Borrower's FTE count during the reference period was 15. A part-time employee of the Borrower is fired for cause during the loan's Covered Period. That employee had been working 20 hours per week during Borrower's "reference period," meaning his contribution to the Borrower's "reference period" FTE count had been .5. Because the part-time employee was fired for cause, then Borrower only needs to satisfy an FTE count of 14.5, rather than 15, to avoid the employment reduction penalty.*

- <u>FTE Reduction Safe Harbor</u>:
  - The above reduction penalty to the loan forgiveness amount will not apply if both (1) the borrower reduced its FTE numbers for the period from February 15, 2020 to April 26, 2020 *as compared to* the average FTE number during the pay period that includes February 15, 2020 and if (2) by December 31, 2020, the borrower rehires the terminated employees or hires other employees to the count equal to or greater than the FTEs during the pay period that includes February 15, 2020.
  - Note: This safe harbor applies regardless of the borrower's selected "reference period."

<u>Example</u>: *Borrower selects a "reference period" of Jan. 1, 2020, to Feb. 29, 2020, with an average FTE of 10. Borrower reduces its FTE count to 9 for the pay period on which Feb. 15, 2020 falls. Then Borrower further reduces its average FTE count to 7 for the period from Feb. 15, 2020 to April 26, 2020, Borrower will not be penalized so long as by Dec. 31, 2020, the FTE count is restored to 9.*

<u>Example</u>: *If Borrower did not reduce its average FTE count from Feb. 15, 2020 to April 26, 2020, then Borrower is not eligible for the Safe Harbor. The Borrower will have to restore its total average FTE count for the entire 24-week Covered Period to match the average in the selected "reference period."*

To the extent the Safe Harbor is not triggered, the penalty will be measured by looking at the average during the Covered Period against the average during the "reference period" – while accounting for good faith efforts to rehire and reduced business operations due to pandemic related government measures.

✓ Your accountant, together with your payroll company, should prepare the following FTE calculations, using both the .5 FTE and fractional FTE calculations for employees with fewer than 40 hours per week:

For the period 2/15/20 to 4/26/20;

For the period 2/15/2019 to 6/30/2019;
For the period 1/1/2020 to 2/29/2020;
For the pay period that includes 2/15/2020;
For the Covered Period or Alternative Payroll Covered Period; and
For the count as of June 30, 2020 or December 31, 2020, 2020 (how to calculate this is not yet clear).

- Salary Reduction Penalty. The loan amount eligible for forgiveness will be reduced dollar-for-dollar by the amount of any salary cut in excess of 25% of an employee's total salary or wages throughout the Covered Period (or Alternative Payroll Covered Period) *as measured against* the employee's salary in the most recent full quarter of employment. This reduction will not apply to employees who receive annualized compensation of $100,000 or more in any pay period in 2019. This reduction will apply only to employees who remain employed during the Covered Period.

    - Salary Reduction Safe Harbor:

        - The penalty will be restored (1) if an employee's salary/wages were reduced between February 15, 2020 and April 26, 2020, and (2) if by June 30, 2020 or December 31, 2020 (depending on selection of 8 or 24 week period), the borrower raises the employee's salary/wages to the annualized amount received immediately as of her February 15, 2020 pay.

Example: *Employee was paid at an annualized rate of $99,999 in Q1 of 2020, but his pay was reduced to an annualized rate of $80,000 by February 15, 2020, then further reduced to $65,000 during the Covered Period. Thus, Borrower will not be subject to the salary reduction penalty if, as of December 31, Borrower restores employee's pay to an annualized rate of $80,000.*

Again, if the Safe Harbor is not triggered, then the penalty will be measured as the dollar-for-dollar reduction (in excess of 25%) during the Covered Period as measured against the Q1 of 2020.

- Salary Reduction Penalty Interplay with FTE Reduction Penalty: The salary reduction penalty will apply only to that portion of the salary reduction that is not attributable to the FTE reduction.

Example: *Employee, working 40 hours a week at $1,000 a week, has his hours reduced to 20 a week. This would result in a .5 reduction in Borrower's FTE count, and a 50% reduction in the wages received by Employee. Because the wage reduction arises from the same event as the FTE reduction, then only the FTE reduction will count against forgiveness.*

✓ Your accountant, with the assistance of your payroll company, should prepare the following weekly payroll calculations for each employee:

During the Covered Period or Alternative Payroll Covered Period;
During the pay period including February 15, 2020;
During Q1 of 2020; and
Payroll as of June 30, 2020 or December 31, 2020 (how to calculate this is not yet clear).

<u>What should be done to ensure maximum forgiveness?</u>

- <u>Keep Abreast.</u> Keep up to date on SBA and Treasury rules and guidance regarding the PPP and forgiveness. Things are in a constant state of flux and what is law today may not be so tomorrow.

- <u>Properly use the funds.</u> Ensure that the PPP funds are used only for allowable purposes with at least 60% of the funds used for payroll costs during the selected Covered Period following the loan.. The CARES Act requires that PPP borrowers certify that the funds will be used for purposes that are authorized under the Act. Work closely with financial, tax, and legal advisers to maximize your loan forgiveness.

- <u>Rehire employees or similarly qualified employees.</u> Rehire employees or hire new similarly qualified employees if needed to restore the payroll headcount as of either June 30 or December 31 to the "reference period" headcount. Any offers to rehire or offers to prospective hires must be in writing and you must keep a record of all rejected and ignored offers. Keep detailed records of employees who have voluntarily resigned, voluntarily requested a reduction in work schedule, or were fired for cause during the Covered Period.

- <u>Keep detailed records.</u> Direct your payroll provider or bookkeeper to track and prepare reports showing the funds were used for payroll during the Covered Period. Keep track of and carefully document the PPP funds used for permitted operating expenses, keep such records for six years after the loan is forgiven or repaid in full. The following documentation will need to be provided to the lender:

    - Documentation verifying the number of FTEs on payroll and their pay rates for the relevant time periods (as chosen by the borrower) including payroll tax filings reported to the IRS and state income, payroll and unemployment insurance filings;

    - Payment verification for covered mortgage obligations, lease obligations and utility payments (*e.g.*, paid receipts, canceled checks, or bank transfers with billing statements, or QuickBooks records);

    - Document compliance with COVID-19 requirements established or guidance imposed by government agencies that interrupted business activity. Be prepared to provide certification by an authorized representative of the borrower that the documentation presented is true and correct, and that the amount for which forgiveness is requested was used for permitted costs and expenses; and

    - Compile and submit any other related paperwork the lender requests and any documentation borrower deems important for lender to consider in reviewing its application for forgiveness.

- <u>Prepare to submit the application.</u> We fully expect an updated application to reflect PPPFA changes. Keep in touch with your lender and ask to be updated on the forgiveness timing and what documentation the lender will require. The borrower is required to contact its lender to apply for forgiveness of the PPP loan and should be substantially prepared to do so (tracking of use of funds and supporting documentation in order) by the week before the end of borrower's selected Covered Period (7th or 23rd week).[21] It should apply promptly with its

[21] We anticipate further guidance on whether a borrower can apply for forgiveness before the 24 week period, to the extent that it has expended all PPP funds.

lender or as soon as the lender advises that it is accepting applications for forgiveness. The lender must advise the borrower within 60 days of the date of application for forgiveness.

- ✓ As a practical matter, if you are going to need a safe harbor, borrower cannot file until after either June 30 or December 31.
- ✓ If you fail to submit your forgiveness application within ten months of the end of your selected Covered Period, then it will be assumed that none of your loan is eligible for forgiveness.

- <u>Be prepared if the entire loan is not forgiven.</u> It is possible that the full loan amount may not be forgiven, and that the remaining funds must be paid back through a loan with a 2 or 5 year maturity (*see* Loan Maturity, below) and a fixed interest rate of 1%. Payments are deferred until the date on which the amount of forgiveness determined is remitted to the lender (up to a maximum of ten months from the end of the Covered Period), but interest accrues during the deferral period.

<u>What if the loan or a portion of the loan is not forgiven?</u>

- <u>Conversion to a loan</u>. Any portion of the PPP loan that is not forgiven will be converted to a loan on the following terms:
  - o *<u>Fixed Interest Rate</u>*: 1.00%.
  - o *<u>Loan Maturity</u>*: If the loan was issued before June 5, 2020, then the loan maturity is 2 years, unless the borrower reaches an agreement with the lender to extend the loan maturity to 5 years. We expect all lenders to agree to the 5 year term on the 24 week Covered Period loans. If the loan was issued on or after June 5, 2020 the loan maturity is 5 years. Either way, there is no prepayment penalty.
  - o *<u>Payment Deferral Period</u>*: For all borrowers applying for forgiveness within 10 months after the loan's covered period ends, interest and principal payments are deferred until the date on which the amount of forgiveness determined is remitted to the lender by the SBA (during which time interest accrues). The lends must notify the borrower of the date when the SBA remits the loan forgiveness amount or the date on which the SBA determines that no forgiveness is allowed. Lender must also notify the borrower of the date that the first payment is due. If borrower is not applying for forgiveness, then the first payment is due 10 months after the loan's covered period ends.
  - o *<u>Collateral/Personal Guarantees</u>*: No collateral or personal guarantee is required.

<u>What happens if PPP funds are misused?</u> It is vital that borrowers use PPP funds for permitted purposes and be able to accurately and adequately document and substantiate the use of funds in order to obtain forgiveness of the loan and avoid fines or liability.

- <u>Loan Application Certifications</u>. Under the PPP Rules, the applicant/borrower bears the burden of confirming eligibility for the loan, including calculating payroll costs, determining headcount and assessing affiliation, and the accuracy of the information it submits to the lender. Lenders also required borrowers to make "good faith" certifications, including that:

  - the uncertainty of current economic conditions makes the loan request necessary to support ongoing operations;[22]
  - the borrower will use the loan proceeds to retain workers and maintain payroll or make mortgage, lease, and utility payments; and
  - the borrower understands that knowingly making a false statement in order to obtain an SBA-guaranteed loan is punishable by law (including by imprisonment and significant monetary fines) (Form 2483).
    - ✓ If your loans total less than $2mio, the economic hardship prongs are automatically met. There are also affiliate exemptions for hotels and restaurants, so you might be able to avail yourself of them to keep your affiliated loan total under $2mio.

- <u>Forgiveness Certifications</u>: In the forgiveness application, a representative of the eligible recipient authorized to make such certification must ensure that:
  - the documentation presented is true and correct;
  - the amount sought to be forgiven was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered lease obligation, or make covered utility payments;
  - the borrower understands that if the funds were knowingly used for unauthorized purposes, the federal government may pursue recovery of the entire loan amount and/or civil or criminal fraud charges; and
  - the borrower is aware that knowingly making false statements to obtain forgiveness is punishable under several federal statutes, some of which are individually punishable by up to 30 years and $1mio in fines.[23]

- <u>Repayment; Additional Liability.</u> If PPP funds are used for unauthorized purposes, the borrower will have to repay those amounts in accordance with the SBA loan terms. If a borrower knowingly uses the funds for unauthorized purposes, it will be subject to additional liability such as fines or charges for fraud.

- <u>Audits.</u> Recipients of PPP loans in excess of $2 million, including loans among affiliates that exceed $2 million in principal in the aggregate, will be audited by the SBA for compliance with the program's requirements, including with respect to the borrower's analysis and certification of eligibility to participate in the PPP. The SBA has clarified that loans that are less than $2 million in original principal, including among affiliates in aggregate, will be deemed to be in compliance with the "good faith" certification regarding the necessity of the loan request. To the extent that a borrower is audited by the SBA and found not eligible for the PPP program, then the outstanding balance of the loan will not be forgiven and will need to be repaid. If the

[22] When certifying that "the uncertainty of current economic conditions makes the loan request necessary to support ongoing operations," a borrower must consider its ability to access other sources of liquidity in a manner that is not detrimental to the business. (FAQs 31 and 37.)

[23] Specifically, such false statements are punishable under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to $250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than $5,000; and, if submitted to a Federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than $1,000,000.

borrower repays the loan after notification from the SBA, the SBA will not pursue administrative enforcement or refer the matter to other agencies for enforcement. (FAQ 46)

DISCLAIMER:

This PPPPP will be updated to reflect any further changes in the key terms of the PPP resulting from any new legislation, rules, and guidance issued by the SBA, Treasury, or other agency of the Federal government. While this summary addresses the principal criteria of the program and we will endeavor to update it regularly, it is not possible to cover all of the evolving and changing rules and guidance published by the SBA and Treasury. THIS PPPPP, UPDATED AS OF JUNE 12, 2020, IS INTENDED FOR INFORMATIONAL PURPOSES ONLY AND IS PROVIDED AS A HELPFUL RESOURCE, BUT SHOULD NOT BE VIEWED AS LEGAL ADVICE FOR ANY SPECIFIC CIRCUMSTANCES. FOR GUIDANCE ON YOUR SPECIFIC CIRCUMSTRANCES, PLEASE CALL, WE ARE HAPPY TO HELP.

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