

Current State of Loan Forgiveness Under the Paycheck Protection Program

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Certain provisions of the Coronavirus/Covid-19 economic stimulus legislation are subject to the issuance of government regulations and other government action, thus certain details regarding the legislation may be clarified or added.

Now that many clients have received (or are about to receive) the proceeds of Paycheck Protection Program (PPP) loans, we have been fielding many questions about how loan forgiveness is calculated. As of this writing, unfortunately, there are more questions than answers.

Let's review the basics first:

- PPP loan proceeds (plus accrued interest on the loan itself) are forgivable to the extent they are expended on the following expenses incurred and paid during the eight-week period immediately following the date on which the lender makes the disbursement of the PPP funds to the applicant (the Covered Period): (i) payroll costs, (ii) utilities, (iii) rent, and (iv) mortgage interest (more on each of these below).
- Forgiveness is subject to an absolute maximum amount equal to the principal amount of (plus accrued interest on) the PPP loan.
- At least 75 percent of the loan proceeds must be spent on payroll costs. We have heard rumors that this percentage may be relaxed, but that hasn't occurred yet.
- Forgiveness is reduced, however, based on a headcount reduction formula and a

salary reduction formula. Each formula is complicated and fraught with unknowns; both are discussed at the end of this Client Alert.

- As of yet, we have not seen a form of application for forgiveness. Applications will be submitted to the lender that provided the PPP loan, and as lenders' requirements differed in connection with the initial loans themselves, they will probably differ as to applications for forgiveness. The application should include (i) documentation evidencing monies spent on qualified expenses during the Covered Period, (ii) documentation verifying the number of full-time-equivalent employees on payroll, and (iii) a certification from an authorized representative stating that the documentation provided is true and correct and the amount of forgiveness requested was used for qualified expenses.

I. The Four Categories of Qualified Expenses – Knowns and Unknowns

1. Payroll Costs

a. Payroll costs include salary, wages, and tips, up to \$100,000 of annualized pay per employee (for eight weeks, a maximum of \$15,385 per individual either full time or part time), plus benefits for employees (but not owners), including health care expenses, retirement contributions, and state taxes imposed on employee payroll paid by the employer (such as unemployment insurance premiums).

b. Benefits are not subject to the \$100,000 per employee cap, but there is an unanswered question as to how they are included in forgiveness. For example, if an entire year's health insurance premium is paid by the employer during the Covered Period, how much of the premium counts toward forgiveness? We believe the rational approach is to prorate it over the period it covers (here, a year) and to allocate 8/52 of the premium toward forgiveness.

c. A vexing question involves the interplay between payroll periods and the Covered Period. Normally, a payroll period will end before paychecks for that period are issued. The CARES Act requires that qualifying expenses be both "incurred" and "paid" during the Covered Period. What happens with respect to (i) the first paychecks issued after the PPP loan proceeds are received (which relate to payroll expenses "paid" during the Covered Period but probably "incurred" in whole or in part before the Covered Period began) and (ii) the first paychecks issued after the expiration of the Covered Period (which relate to payroll costs "incurred" in whole or in part during the Covered Period but paid after the Covered Period ends)? There is no guidance on this, so we suggest the following: Include any portion of the first paychecks issued during the Covered Period that relate to any portion of the Covered Period, and include as well any portion of the paychecks issued immediately after the close of the Covered Period that relate to payroll costs also incurred during the Covered Period.

d. We have been asked whether it is okay to pay bonuses outside the ordinary course of business. We would caution doing so without further guidance from the Small Business Association (SBA)/ Department of the Treasury, as that could raise a red flag to someone reviewing the file (either from an audit perspective or from a federal investigation perspective), and you also may run the risk of those payments not being deemed forgivable by a lender. Again, the CARES Act doesn't currently prohibit front-loading bonus payments (up to the per employee cap outlined above), but you may be subject to the other risks we outlined above.

e. Most important: Check with your PPP lender periodically as to whether it has published an application for forgiveness, and monitor the Department of the Treasury's website to confirm that additional guidance has not been issued in the form of an Interim Final Rule or in updates to the [FAQs](#) (most recently updated on April 23, 2020).

2. Utilities

a. Utilities include electricity, gas, telephone, and internet, and probably also include heating oil and propane.

b. Utilities must have been in service as of February 15, 2020.

c. The "incurred and paid" requirement probably bars counting toward forgiveness prepayments of utility costs and payments of overdue utility costs to the extent allocable to periods outside the Covered Period.

3. Rent and Mortgage Interest

a. The lease or mortgage, as the case may be, must be in effect as of February 15, 2020.

b. With respect to leases, there is no guidance as to whether payments outside of basic rent (such as payments for taxes or insurance) may be applied toward forgiveness. We hold the view that inclusion of those "additional rent" payments may be permitted.

c. We suspect that modifications of leases and mortgages that increase amounts payable during the Covered Period or any termination payments paid during the Covered Period will not be permitted to increase forgiveness and, with respect to a termination payment, may be deemed an ineligible use of proceeds, which would subject you to liability.

II. The Adjustments to Forgiveness – Even More Unknowns

Two separate adjustments may reduce (but never increase) the amount of forgiveness otherwise available: the Headcount Reduction

Adjustment and the Salary Reduction Adjustment. Both may be mitigated (i.e., forgiveness restored) to the extent they are reversed before June 30, 2020.

1. The Headcount Reduction Adjustment

a. The Headcount Reduction Adjustment multiplies the amount of forgiveness by a fraction, the numerator of which is the average number of full-time-equivalent employees (FTEs) per month during the Covered Period and the denominator of which is the average number of FTEs per month during either of the following periods (each a Base Period): (i) February 15, 2019-June 30, 2019; or (ii) January 1, 2020-February 29, 2020. The employer elects which Base Period to use; the larger the denominator of that fraction, the smaller the resulting forgiveness, so an employer that shrank in headcount between the two periods would elect (ii).

b. The average number of FTEs per month is determined by calculating the average number of FTEs "for each pay period falling within a month for both the Covered Period and the Base Period. There is no guidance as to (i) whether a "month" means a calendar month and (ii) what to do about pay periods straddling months. In general, regulatory guidance has departed from statutory language when conundrums arise. One approach might be to calculate the average number of FTEs during the Covered Period based on the number of full payroll periods occurring in whole or in part during the Covered Period (prorated for partial payroll periods), doing the same for the Base Period selected, and ignoring the "per month" requirement.

c. To the extent forgiveness is reduced because of a headcount reduction that occurred during the period February 15, 2020, through April 26, 2020, the "hit" to forgiveness can be reversed by rehiring prior to June 30, 2020. Issues abound: Do the employees rehired have to be the same employees who were furloughed during the period February 15, 2020, through April 26, 2020? What if one FTE is replaced by two part-time workers? How long do rehired employees have to remain on the payroll after being rehired? What

if a furloughed employee or an employee who was let go (and subsequently offered reemployment) chooses not to return, and is replaced? What if an employer dismissed an employee during the period February 15, 2020, through April 26, 2020, for good cause? What about employees who left of their own volition? We don't have answers to any of these questions.

2. The Salary Reduction Adjustment

a. The Salary Reduction Adjustment is computed on an employee-by-employee basis and applies only to employees compensated on an annualized basis of \$100,000 or less in 2019. With respect to each such employee, forgiveness is reduced dollar-for-dollar by the amount such employee's salary/wages is reduced by more than 25 percent.

b. Currently, calculation of the reduction amount requires comparing the employee's salary/wages during the Covered Period with that employee's salary/wages "during the most recent full quarter during which the employee was employed" before the Covered Period.

c. The statute simply can't mean what it says; it compares an eight-week period with a three-month period. Assuming that the periods should be normalized, i.e., prorated to equal length, there is no indication when that "full quarter" ends. (Is it the day before the Covered Period? The end of the calendar month next preceding the Covered Period? The end of the calendar quarter next preceding the Covered Period?) There is also no guidance on what happens if salary/wages varies during either of those periods.

d. As in the case of the Headcount Reduction Adjustment, the effect of the Salary Reduction Adjustment can be eliminated to the extent the reduction occurred during the period February 15, 2020, through April 26, 2020, and is cured by restoring salaries/wages on or before June 30, 2020. Again, there are unanswered questions: (i) if a 50 percent salary reduction is reduced to a 20 percent reduction, does that fully count, partially count, or not count at all toward

mitigating the “hit” to forgiveness?
What if an employee whose salary is cut from \$60,000 per year to \$30,000 per year is replaced by a new employee at a probationary wage of \$30,000 per year, i.e., someone who earned significantly less “during the most recent full quarter next preceding the Covered Period” than that employee earns during the Covered Period? What if an employee's salary is restored by June 30, 2020, but then the employee is let go (or the salary reduction is made again) immediately after June 30, 2020?

To see our other material related to the pandemic, please visit the Coronavirus/ COVID-19: Facts, Insights & Resources page of our website by clicking [here](#).

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