A Guide to the Paycheck Protection Program: Eligibility, Application, and Loan Forgiveness Modeling

Taylor A. Gast
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AUTHORS/ CONTRIBUTORS
Taylor A. Gast

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The CARES Act's Paycheck Protection Program is an extremely attractive program designed to provide loans that are generally forgivable to small businesses. Despite technical glitches and other issues, more than 1.5 million applicants were approved for PPP loans, depleting the Program's entire $350 billion budget in less than two weeks. In Michigan alone, there were over 43,000 approved PPP loan applications, totaling over $10 billion. **There is now general consensus that the Program will receive significant additional funding this week, although it is unclear how long the additional funding will last.**

Whether your organization is considering applying for a PPP loan in the next round of funding, or it has already received a PPP loan, we recommend that you carefully consider your next steps. Many organizations have incorrectly assumed that they are not eligible or will not benefit from a PPP loan. Organizations that have already received PPP funds should closely review the Program's forgiveness rules to build a forward-looking forgiveness model to ensure that there are no surprises when the organization applies for loan forgiveness.

Pre-Application Considerations

- Is the organization eligible to apply?
- Do the Program's benefits make it advisable for the organization to apply?
- What if my business is closed, or operating at a reduced capacity?

PPP loan eligibility is based on the applicant's employee count, and whether it can make required certifications. Many potential applicants have heard of a 500 employee limit, but may not be aware of industry-based exceptions for larger employers. For example, businesses in several critical industries can apply with up to 1,500 employees. Sole proprietors, independent contractors, self-employed individuals, tribal businesses, and 501(c)(3) nonprofits and 501(c)(19) veterans organizations are generally eligible to apply as long as they meet the SBA's size standards.

It is also important to confirm whether the SBA's affiliation rules require the organization to include the employee count of "affiliated" organizations when determining eligibility. For example, two organizations that are wholly owned by the same entity will be required to count both entities' employees to determine eligibility. The affiliation rules can be complicated to apply to more complex ownership and management situations. The organization must also make several certifications to apply, including that current uncertainty requires the PPP loan.

The Program's benefits usually make applying advisable for eligible organizations. In most cases, an eligible business will expect most or all of its PPP loan to be forgiven. Loan forgiveness will be reduced to the extent that the organization has fewer employees or payroll reductions in excess of 25% compared to pre-COVID-19 levels. Unforgiven portions of PPP loans carry a favorable 1% interest rate. Although the application process will involve time and effort, the organization may be able to recuperate costs for time spent or professional fees by designating an agent who assisted it in preparing its application.

Importantly, even businesses that cannot operate, or that are operating at a significantly-reduced capacity can benefit from a PPP loan. However, the loan forgiveness calculations incentivize those businesses to rehire any laid off employees and pay them at pre-COVID-19 levels.

Application Considerations

- How should an applicant properly calculate its loan amount?
- The importance of accurately completing the loan application.

Applicants should carefully complete the loan application in coordination with legal counsel to avoid delays in processing the loan application and problems that could arise when applying for loan forgiveness.

In general, the maximum loan amount is the applicant's average monthly payroll costs multiplied by 2.5. Borrowers may have options when it comes to calculating the loan amount. For example, the U.S. Department of Treasury has clarified that most applicants can aggregate payroll costs from either the previous 12 completed months, or from calendar year 2019. There are additional rules that apply to seasonal applicants and those that were not operational in 2019.

Payroll costs should generally include: (1) salaries, wages, and other compensation up to $100,000, (2) cash tips and equivalent payments, (3) vacation, parental, family, medical, and sick leave (except for qualified sick and family leave wages permitted under the Families First Coronavirus Response Act), (4) allowance for dismissal or separation, (5) payment for group health care and retirement benefits, and (6) state and local income tax payments. However, payroll costs must exclude some expenses, like certain payroll taxes, and any compensation paid to non-U.S. employees. Several includable payroll costs are subject to their own unique definitions in the CARES Act. Others have been clarified by the U.S. Department of Treasury in recent weeks.

Each applicant should confirm that the application is completed fully and accurately. In our experience, Question 3 of the application is a common source of confusion. Question 3 asks whether the applicant or its owner is an owner of any other business or has common management with any other businesses. If the answer is yes, the applicant must include a list of those businesses.

Forgiveness Modeling and Permitted Expenses

- How does loan forgiveness work?
- How can a borrower maximize the likelihood that their PPP loan will be forgiven?

A PPP loan will generally be forgivable if (1) loan proceeds are spent on forgivable expenses, with at least 75% spent on payroll costs, during the 8 weeks after loan origination, (2) the borrower's average number of full time equivalent employees during the 8 weeks after loan origination is not lower than its pre-COVID-19 average employment, and (3) the borrower has not reduced wages of any employee by more than 25% compared to pre-COVID-19 wages. Forgivable expenses generally include payroll costs, mortgage interest, rent, and certain utilities. Additionally, borrowers may use loan proceeds to pay the interest on other debt obligations incurred before loan origination, but such payments would not be forgivable unless future Treasury guidance clarifies this point.

There are many details, definitions, and ambiguities in the PPP loan forgiveness provisions of the CARES Act. We expect that the U.S. Department of Treasury will issue additional guidance regarding loan forgiveness, but there is no telling when that additional guidance will come. In the meantime, many businesses are already spending loan proceeds with the expectation that their PPP loan will be forgivable. It is possible that many borrowers will have already spent their loan proceeds before the Treasury publishes its loan forgiveness guidance.

Given the importance and fact-specific nature of the borrower's loan forgiveness calculations, we strongly recommend that each borrower coordinate with legal counsel to build a model that forecasts loan forgiveness at the end of the 8 week period after the PPP loan is originated. Running this calculation as early as possible will give the business the most flexibility in determining how to spend the loan proceeds, whether to rehire laid-off employees, and other strategic decisions that could significantly affect loan forgiveness. Loan forgiveness modeling will also minimize the amount of time spent compiling information to apply for loan forgiveness later this year.

While beneficial, the Paycheck Protection Program involves complicated and fact-specific issues. Please contact us if you have any questions.

Taylor Gast is a business attorney with Foster, Swift, Collins & Smith who has helped numerous businesses apply for PPP loans and weather the effects of COVID-19. He can be reached at tgast@fosterswift.com.