Follow these PPP Loan Spending Rules to Qualify for Loan Forgiveness

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How Can I Spend My PPP Loan?

Congratulations, you managed to secure a forgivable PPP loan for your business! Now, how do you stay within federal guidelines to maximize your forgiveness?

The U.S. Small Business Administration ("SBA") released the application and instructions for loan forgiveness under the Paycheck Protection Program ("PPP") on May 15. The SBA and U.S. Treasury issued an Interim Final Rule on Loan Forgiveness and Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities on May 22. Along with these new PPP loan spending rules, the application and instructions provide additional clarity to borrowers regarding PPP loan forgiveness. Below are a few highlights.

Payroll

Applicable Measurement Period

For forgiveness purposes, eligible borrowers have the option of selecting between the two options: a "Covered Period," or an "Alternative Payroll Covered Period."

The Covered Period consists of the eight-week (or 56-day) period beginning on the disbursement date of the PPP loan.

For example, if a borrower's PPP loan was funded on April 20, 2020, the first day of its Covered Period is April 20, 2020, and the last day of its Covered Period is June 14, 2020.

For administrative convenience, the SBA allows borrowers with a biweekly (or more frequent) payroll schedule to calculate eligible payroll costs using an “Alternative Payroll Covered Period,” defined as the eight week (or 56-day) period beginning on the first day of the borrower’s first pay period following its loan disbursement date.

For example, if a borrower’s PPP loan was funded on April 20, 2020, but the first day of its first payroll period following the disbursement date is April 26, the first day of the Borrower’s Alternative Payroll Covered Period would be April 26, 2020, and the last day of the Alternative Payroll Covered Period would be June 20, 2020.

Borrowers are required to be consistent in their use of a Covered Period versus an Alternative Payroll Covered Period wherever the application references “the Covered Period” or the “Alternative Payroll Covered Period.”

Note that, if selected, the Alternative Payroll Covered Period is only used with respect to payroll calculations. Borrowers electing to use an Alternative Payroll Covered Period must still use their relevant Covered Period for all other calculations under the forgiveness application.

“Paid or Incurred”

Borrowers are eligible for loan forgiveness for the amount of payroll costs they “paid or incurred” during the Covered Period or the Alternative Payroll Covered Period. These costs are considered paid on (I) the day paychecks are distributed; or (ii) the date on which the borrower originates an ACH credit transaction. Payroll costs are considered incurred on the date an employee’s pay is earned.

Payroll costs that are incurred but not paid during the borrower’s last pay period of its Covered Period or Alternative Payroll Covered Period are eligible for loan forgiveness if paid on or before the next regular payroll date. As such, there is no need to run a special payroll on the last day of the Covered Period to maximize forgiveness amounts.

Substance and Limits

Under the interim final rule governing loan forgiveness, PPP loan spending rules allow the following costs under payroll compensation to employees whose principal place of residence is the United States:

- Salary, wages, commissions or similar compensation
- Cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips)
- Payment for vacation, parental, family, medical or sick leave
- Allowance for separation or dismissal
- Payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums, and retirement
- Payment of state and local taxes assessed on compensation of employees

For an independent contractor or sole proprietor, payroll costs can include:

- Wages
- Commissions
- Income or net earnings from self-employment or other similar compensation

For non-owner employees, the forgiveness application allows payments of cash compensation up to a $15,385 limit (the eight week equivalent of a $100,000 annual salary), plus the other payroll expenses outlined above, including health insurance and retirement benefits. The application, however, separates amounts paid to owners (owner-employees, self-employed individuals and general partners) from employees, and places a cap of $15,385 on all payroll costs for owners, inclusive of health insurance, retirement plan benefits, and other non-cash compensation.

For borrowers seeking forgiveness for amounts paid to owner-employees or self-employed individuals, forgiveness amounts are further limited to an amount equal to the lesser of (I) 8/52 of 2019 compensation (approximately 15.38% of 2019 compensation) or (ii) $15,385 per individual in total across all businesses. Depending on a borrower's entity type, additional nuanced rules come into play in connection with this last limitation, but those provisions are beyond the scope of this article.

PPP Loan Spending Rules for Non-Payroll Costs

To qualify for forgiveness, eligible non-payroll costs must be paid or incurred during the Covered Period (even if the borrower is using an Alternative Payroll Covered Period). For expenses that are incurred, such items must be paid on or before the next regular billing date, even if the billing date is after the Covered Period. Eligible non-payroll costs cannot exceed 25% of the total loan forgiveness amount sought. Eligible expenses include:

Business Mortgage Interest Payments

Payment of interest (but not including any payment or prepayment of principal) on any business mortgage obligation on real or personal property so long as the mortgage was in place on Feb. 15, 2020. (Note: the phrase "mortgage" is a bit misleading as a mortgage is only obtained on real but not personal property. Presumably in the case of personal property they mean security interest.)

Business Rent or Lease Payments

Business rent or lease payments pursuant to lease agreements for real or personal property so long as the lease agreement was in place on Feb. 15, 2020.

Business Utility Payments

Business payments for services for electricity, gas, water, transportation, telephone or internet access so long as the service was in place on Feb. 15, 2020.

Forgiveness Mechanics

Calculating of a Full-Time Equivalent Employee

The forgiveness application includes a worksheet (referred to in the application as "Schedule A") which requires that a borrower calculate average Full Time Equivalency ("FTE") for all employees. To do so, a borrower must, for each employee, enter the average number of hours paid per week to each employee, divide that average number by 40 and round the resulting total to the nearest tenth.

No one may be counted as more than one FTE (i.e., 40 hours maximum per person). If it elects to, however, a borrower seeking loan forgiveness may use a simplified method for calculating FTE. The borrower can simply ascribe an FTE of "1.0" for each employee who works 40 hours a week or more, and an FTE of "0.5" for each employee who works less than 40 hours a week. A borrower must apply its method consistently across all employees.

FTE Reduction Exceptions: Notwithstanding the above, the number of FTE will not be reduced by (1) any positions for which a borrower made a good-faith, written offer to rehire an employee during the Covered Period or 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, such individuals shall be included as FTEs as long as their position was not filled by a new employee. Stated another way, any FTE reductions in the above-described cases do not reduce a borrower's loan forgiveness amount.

FTE Reduction Safe Harbor: A safe harbor under applicable law and regulation exempts certain borrowers from the loan forgiveness reduction based on FTE employee levels where both of the following conditions are met: (1) the borrower reduced its FTE employee levels in the period beginning February 15, 2020 through April 26, 2020; and (2) the Borrower then restored its FTE employee levels by no later than June 30, 2020 to its FTE employee levels in the borrower's pay period that included February 15, 2020.

Salary Reductions

To calculate salary reductions from PPP loan forgiveness amounts, borrowers must compare average annual salaries or hourly wages from January 1, 2020 to March 31, 2020 to average annual salaries or hourly wages during the eight week period.

A reduction in an employee's salary or wages in excess of 25% will generally result in a reduction in the loan forgiveness amount unless an exception applies. Specifically, the borrower must reduce the total forgiveness amount by the total dollar amount of the salary or wage reductions that are in excess of 25% of base salary or wages, subject to exceptions for borrowers who restore reduced wages or salaries. This reduction calculation is performed on a per-employee basis, not in the aggregate.

Notwithstanding the above, to ensure that borrowers are not doubly penalized, the salary/wage reduction applies only to the portion of the decline in employee salary and wages that is not attributable to the FTE reduction. So, to the extent that a borrower's forgiveness amount has already been reduced on account of a reduction in hours, it will not be additionally penalized because an employee's total compensation was correspondingly reduced.

For example, a $20 an hour employee who had their hours reduced from 40 to 20, but continued to earn $20 an hour would be included as a FTE reduction, but not a salary reduction. If that same employee also had their pay cut to $14 an hour, then because their salary was reduced by an amount greater than 25%, the excess would be a further reduction to the forgiveness amount [here $1/hour (i.e., the amount in excess of a 25% reduction in salary) * 20 hours * 8 weeks=$160].

Salary Reduction Safe Harbor: Just like with the FTE calculation, a safe harbor under applicable law and regulation exempts certain borrowers from loan forgiveness reduction based on compensation levels where both of the following conditions are met: (1) the borrower reduced its employee salary and wages during the period beginning February 15, 2020, through April 26, 2020; and (2) the borrower eliminates those reductions by no later than June 30, 2020.

75% Payroll Threshold

One key area that was previously unclear was the PPP loan requirement that borrowers spend at least 75% of their PPP loan amount on payroll to be eligible for forgiveness. The application and implementing rules make it clear that total forgiveness just needs to include at least 75% payroll costs. The actual formula does this by limiting forgiveness to the amount calculated as your total payroll costs divided by .75.

For example, suppose the bank gave you $28,000 instead of $21,000 because of the lack of guidance when initially receiving the loan. Further assume that your payroll costs for the Covered Period are only $16,000. But $16,000 only equals 57.14% of $28,000. The new rules clarify that with $16,000 of payroll costs, that means up to $21,333.33 of forgiveness, because $16,000/.75 equals $21,333.33. In this case, it does not destroy forgiveness if you incorrectly received $28,000.

You will get forgiveness of $21,333.33 if you spend at least $16,000 on payroll and $5,333.33 on eligible rent, interest, and utilities. You will be allowed to keep the remaining $6,666.67 as a loan to be repaid at 1% interest over two years from the date received.

Certain Additional Items of Note

By following PPP loan spending rules, you'll have an easier time with the forgiveness application process—but the process doesn't stop there. Your documentation can still be audited in the future.

Below are some additional notes to keep in mind:

- If applicable, the SBA will deduct EIDL Advance Amounts from the forgiveness amount remitted to the Lender.
- The SBA may review a borrower's eligibility, loan amount and use of proceeds, and loan forgiveness amounts for any size loan at any time.
- The loan forgiveness application form details the documentation requirements; specifically, the documentation each borrower must submit with its application, documentation each borrower is required to maintain

and make available upon request, and documentation each borrower may voluntarily submit with its loan forgiveness application.

- All documents must be saved for six years after the loan is forgiven or repaid in full.
- SBA may request additional documentation at any time.
- A borrower may appeal the SBA's determinations. Additional guidance on appeal procedures are expected to be issued at a later date.
- The AICPA has a free spreadsheet that is very useful in performing the calculations outlined in this article. AICPA appears to be updating this spreadsheet regularly as additional guidance is released.

About Jeremy Waitzman

Jeremy chairs the Corporate Group at the Sugar Law Firm (Sugar Felsenthal), a national boutique serving the affluent and the companies they own or otherwise control. He advises his clients on significant transactions and operational issues in their businesses. Described by clients as "an essential business advisor" and "a partner in the success of my business," Jeremy has substantial experience representing businesses of all types and sizes from inception, guiding them through significant growth, and often through ownership's exit. His clients include privately-held middle market and emerging growth companies, family offices/funds, investors, C-level executives, boards of directors, family-owned businesses and entrepreneurs. Jeremy counsels clients in the areas of corporate law, mergers & acquisitions, private placements, and general contract law. He represents individuals, closely held businesses, start-up companies and serves as outside counsel to several large corporations. His work with companies often includes strategies for the creation of enterprise value.

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