**Fine, Boggs & Perkins llp**

Coronavirus Disease 2019 (COVID-19)

PPP Loan Repayment Instructions and Example

Many dealerships have asked about how the PPP Loan Forgiveness principles will be applied in practice. Initial guidance was based on the statutory language and early guidance from the Treasury Department. On May 18, 2020, the Treasury Department released the PPP Loan Forgiveness Application Form, together with Instructions. While these materials do not address every question that may come up, the Form and Instructions do provide some practical guidance on how borrowers can maximize their loan forgiveness.

Additional guidance from the Treasury Department is expected, so we encourage all borrowers to continue to review updates as they are released.

1. PPP Loan Basics

Paycheck Protection Program (PPP) Loans were designed to encourage employers to maintain both headcount and payroll levels during an eight-week period where most nonessential business operations were suspended or broadly curtailed in response to the Coronavirus pandemic. Employers were eligible to borrow up to 250% of their average monthly expenses in key expense categories (payroll, mortgage interests, rent, and utilities) to help sustain business operations. To encourage employers to use the loan proceeds to maximize continued employment during the economic disruption, the loans were made forgivable, eliminating the need to pay back loan disbursements at all, subject to key limitations.

The initial appropriation of $349 billion in federal funds for the loan program was snapped up in a matter of days. It was followed by an additional allocation of $310 billion for a second round, most of which was similarly claimed quickly. Because of the rapid deployment of this relief program, there was little opportunity for development of detailed eligibility rules and guidance, sowing substantial confusion for employers nationwide.

By now, more than halfway through May, some loans have been disbursed for more than a month. Thus, the focus of this analysis is primarily on the forgiveness process and not on whether and how much funding businesses should borrow under this program.

As of May 23, there remained some $138 billion in allocated funds available for lending under the program. So if you have not yet made a PPP loan, there may still be funds available.

1. The Covered Period

The statutory language creating the PPP loan opportunity defined the Covered Period for the loan as the eight-week period beginning on the day the employer receives the first disbursement of loan funds under the program. This seemingly arbitrary time period engendered confusion and frustration among employers whose loan disbursement dates did not match the beginning of an established payroll period. Fortunately, the forgiveness application form and instructions expressly permit employers to measure payroll costs based on an “Alternative Payroll Covered Period,” which is the eight-week period that starts on the first day of the next regular payroll period beginning after the loan disbursement. By way of example, if the established pay periods run weekly from Sunday to Saturday and the loan funds were received on Tuesday, April 28, 2020, the Alternative Payroll Covered Period would begin on Sunday, May 3, and conclude on Saturday, June 27, 2020.

Note: The guidance states that this Alternative Payroll Covered Period is available to employers with a “biweekly (or more frequent) payroll schedule,” which would seem to exclude employers with valid semi-monthly payroll periods.

In addition, the Covered Period for purpose of paying mortgage interest, rent, and utilities remains the 56-day period starting with the day on which the loan proceeds were first disbursed.

1. Costs Paid and Costs Incurred in the Covered Period

The significance of the “Covered Period” and “Alternative Payroll Covered Period” is that only loan proceeds that were spent on qualifying expenses incurred and paid during the period are eligible for forgiveness. Specifically, payroll costs paid and payroll costs incurred during the Covered Period or Alternative Payroll Covered Period may be eligible for forgiveness. Payroll costs paid are considered paid on the day that checks are distributed or ACH transactions are initiated. Payroll costs are incurred, however, on the day that the employee’s pay is earned. Payroll costs incurred but not paid by the end of the Covered Period or Alternative Payroll Covered Period will be eligible for forgiveness if they are paid on or before the next regular payroll date following the applicable period. This interpretation of the rule prevents employers from having to adjust payroll periods to maximize PPP loan forgiveness.

Nonpayroll costs must be paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date, even if the billing date is after the Covered Period. The Interim Final Regulations offer an example:

Covered period begins on June 1 and ends on July 26. Electrical utility bills are due on the 10th of each month. Payments for May and June were paid during the covered period, on June 10 and July 10 respectively. July electrical bill is paid August 10. Not only may the borrower include the May and June electrical bills within the forgiveness application (as “payments made”), but the borrower may also include that portion of its July electrical bill that was incurred during the Covered Period (*e.g.,* July 1–26) even though payment was not made until the regular scheduled payment date (as “costs incurred” during the Covered Period).

And the regulations note with some candor that the potential for abuse of this standard is tempered by the limitation on forgiveness for non-payroll expenses to 25% of the potential forgiveness.

1. Three Loan Forgiveness Reduction Factors
* FTE Ratio Adjustment

First,a reduction in the number of Full-Time Equivalent Employees (FTE Employees) will reduce the amount of PPP loan forgiveness available to the borrower. This is done by comparing the average number of FTE Employees during the Covered Period (or Alternative Payroll Covered Period) against the average number of FTE Employees on the payroll during the reference period.

The reference period is, at the election of each individual borrower, either the period (a) from February 15, 2019, through June 30, 2019; or (b) from January 1, 2020, to February 29, 2020. (Seasonal employers may adopt either option, or use any period of 12 consecutive weeks between May 1, 2019, and September 15, 2019.)

Computation of FTE Employees is based on a 40-hour week. This calculation takes, for each employee, the average number of hours paid per week and divides it by 40, with the total rounded to the nearest tenth. Thus, ten employees each paid 38 hours per week would aggregate to 10 FTE Employees, but ten employees each paid 37 hours per week would each count as 0.9 FTE, for a total of only 9 FTE Employees. The same process is used for computing both the FTE Employee count for the reference period and for the Covered Period (or Alternative Payroll Covered Period).

The adoption of the 40-hours-per-week standard for FTE calculation (rather than the 30-hours-per-week standard used in other federal contexts, such as the Affordable Care Act) was intention, with the Treasury Department regulations confirming that a 30-hour week was considered but rejected because “40 hours or more of work each week better reflects what constitutes full-time employment for the vast majority of American workers.” The regulations do offer an alternative simplified approach: Rather than calculate FTE headcount numbers based on actual hours less than 40 per week, employers may assign 0.5 FTE to each employee working less than 40 hours, even if the employee worked a 39.5-hour week. For employers whose part-time employees generally work more than 20 hours per week, this will result in a lower aggregate FTE count than using actual hours. But the same method must be used for calculating both the reference period and the applicable Covered Period. Because employers should generally have available timekeeping data sufficient to run both the hours-based and the simplified calculations, most employers should run the numbers both ways and pick the option with the most favorable outcome (*e.g.,* the choice that minimizes any headcount reductions between the measuring period and the Covered Period.

The FTE Reduction Quotient is calculated by dividing the number of FTE during the Covered Period (or Alternative Payroll Covered Period) by the corresponding FTE figure for the reference period.

By way of example, a hypothetical Dealership averaged 150 employees during the selected base period of January–February 2020, each of whom were paid for 40-hour weeks. (This calculates to an FTE Employee tally of 150 during the Reference Period.) Unfortunately, during March 2020, only 50 employees continued to work 40 hours per week: 50 were laid off entirely, and 50 more were reduced to 20-hour weeks. During the Covered Period of the loan, the Dealership restored half of the 100 reduced employees to full-time roles, but 20 were brought back to 20-hour weeks, 15 were brought back to 30-hour weeks, and 15 were not recalled. The FTE Calculation for the Covered Period is 122 FTE Employees, counted as follows:

|  |  |  |
| --- | --- | --- |
|  | 50 | FTE from the 50 Unchanged Employees |
|  | 50 | FTE from the 50 restored to full-time work |
|  | 10 | FTE from the 20 Employees averaging 20-hour weeks[[1]](#footnote-2) |
| + | 12 | FTE from the 15 Employees averaging 30-hour weeks[[2]](#footnote-3) |
|  | 122 | FTE for the Covered Period |

Thus, the FTE Reduction Quotient will reduce the loan forgiveness to 81.33% (122 ÷ 150) of its potential, a reduction of 18.67%.

* + Exceptions to the FTE Reductions:

Recent guidance from the Treasury Department explained that employers could ignore FTE reductions caused by employees who refused good-faith offers to return to work. This exception was amplified in the instructions, by confirming that FTE reductions could similarly be ignored for employees who voluntarily resigned, were discharged for cause, or who voluntarily requested and received a reduction in hours. The subsequent Interim Final Regulations confirmed this, but added the requirement that the borrower inform the applicable state unemployment insurance office of the rejected offer of employment with 30 days of the rejection.

Returning to our FTE Calculation example above, if we assume that (a) 10 of the 20 employees brought back to only 20 hours per week had requested reduced hours (*e.g.,* to share homeschooling responsibilities, etc.), and 10 of the 15 not recalled were offered but rejected offers to return to full-time employment. The revised FTE Calculation for the Covered Period is augmented by the exceptions, as follows:

|  |  |  |
| --- | --- | --- |
|  | 5 | FTE Exceptions from the 10 Employees requesting 20-hour weeks |
|  | 10 | FTE Exceptions from the 10 Employees rejecting Recall |
| + | 122 | FTE for the Covered Period |
|  | 137 | FTE for the Covered Period, as Adjusted |

The revised FTE Reduction Quotient now reduces the loan forgiveness to 91.33% of its potential (based on [122 FTEs + 15 Exceptions] ÷ 150 original FTEs) or a reduction of only 8.67%.

* + The FTE Reduction Safe Harbor:

In addition to taking FTE credit for employees who do not (fully) return as a result of their own choice (or as a consequence of discharge for cause), the employer can entirely eliminate the FTE Reduction by eliminating any reduction in average FTE Employees by restoring the same total FTEs as of June 30, 2020, as were employed during the pay period that included February 15, 2020. If the employer brings the total number of FTE Employees back to the level of February 15, 2020, by hiring or rehiring sufficient employees and scheduling them for sufficient hours such that the number of FTE Employees on June 30, 2020, matches the pre-Covered Period FTE count, then no reduction in forgiveness based of FTE headcount will apply.

Returning to our revised example, if the employer were restore all 135 employees who remained or returned to work during the Covered Period to full-time employment—and replace those who refused recall or may have been terminated for cause—by June 30, 2020, then there would be no reduction in forgiveness based on the FTE Employee count. Note: this savings clause does not compare FTE Employees against the pre-Covered Period used for the potential reductions, but rather compares June 30, 2020 FTE level against that from the pre-pandemic target of February 15, 2020. And the application of this clause is binary: if the June 30 FTE number were even slightly short of the February 15 benchmark, the “safe harbor” would not apply and the other calculations would govern the forgiveness analysis.

* The Wage Ratio Adjustment

The second potential Adjustment to the Potential Forgiveness amount will be an adjustment measured by the amount of any reduction in wages in excess of 25% when comparing Covered-Period wages to Base Period Wages. This element is complicated for a couple of reasons. First, the calculations must be done on an individual basis, not aggregated as a whole. Second, while the Covered Period (or Alternative Payroll Covered Period) is the same as for the FTE headcount evaluation, the Base Period is different. According to the statute, the Base Period for the wage level comparison is the “most recent full quarter during which the employee was employed before the Covered Period.” The forgiveness application and instructions clarify that the measuring period is January through March 2020.

The instructions for the forgiveness application lay out a step-by-step analysis that should be done for each employee.

* + Step 1: Determine which employees are included and excluded from comparison because they earned over $100,000 per year

In determining whether there has been reduction in wages, you should exclude from the analysis any employee that earned over $100,000 per year ($8,333.33 per month, or $4,166.67 per semi-monthly period) for any pay period during 2019, as those employees do not have to be considered as part of the Wage Ration Adjustment calculation. Only included employees (those earning less than $4,166.67 during each semi-monthly period in 2019) should be considered for the remaining steps.

* + Step 2: Determine whether the pay was reduced by more than 25%

This step begins with a comparison of the average annual salary or hourly wage during the Covered Period or Alternative Payroll Covered period with that of the measuring period from January–March 2020. For employees paid only a regular salary or hourly wage, this computation is relatively simple. However, where a variable-rate employee (such as piece-rate production bonuses for technicians and commissioned salespersons), the answer is not so clear and the federal guidance is not complete at this time. That is because the language used is not clear as to whether the employer should use only the “hourly” portion of the wages or whether to use the total wages (including variable wages like piece-rate or commissions) to calculate an average hourly rate (sometimes referred to as the “regular rate of pay”). Both interpretations are reasonable and there isn’t a clear answer. NADA has taken the position that dealers may choose (in good faith) to use just the straight hourly pay for the comparison without having to reduce total compensation to the “regularly rate of pay” calculation common to wage-and-hour calculations for overtime computations (*e.g.,* all non-discretionary income *divided by* all hours worked). This means that dealers will have to make a decision on which approach they use, although the NADA’s interpretation and guidance is clearly the most dealer-friendly interpretation. You should seek legal advice depending upon your circumstances on which approach to use. Regardless of which interpretation you use, if the Covered Period rate is at least 75% of the measuring period rate, then there is no reduction in forgiveness for this employee.

Note that the Interim Final Regulations state that borrowers should not be doubly penalized for both headcount and salary/wage reductions. Thus, employers should only apply the wage reduction analysis to compensation declines that were not attributable to the FTE reduction, or the reduction in hours. The example from the regulations is where a 40-hour employee (1.0 FTE) becomes a 20-hour employee (0.5 FTE), albeit without change to the rate of compensation. In this case, there would be no reduction based on lower compensation because the entire reduction in compensation was attributable to the change for 40-hour weeks to 20-hour weeks.

* + Step 3: Determine if the Wage Reduction Safe Harbor is met

This step allows an employer to make up for any reduction in wages during the period between February 15 and April 26 by restoring such reductions by June 30. It begins with a comparison between (a) the average rate of pay as of February 15, 2020; (b) the average rate of pay between February 15, 2020, and April 26, 2020; and (c) the average rate of pay as of June 30, 2020. If there was no reduction of wages between (a) and (b), then the safe harbor is not applicable, and analysis continues with Step 3. But if (b) is lower than (a), but (c) is greater than (a), then there is no reduction in forgiveness based on the wages paid to this employee, and the remaining steps can be omitted for this individual.

**Note:** The instructions do not eliminate all potential uncertainty, particularly for variable-rate employees whose “Regular Rate” must be determined not on a specific date (such as February 15 or June 30), but as an average rate of pay over a representative period (*e.g.,* a workweek, or pay period). Because the instructions describe the February 15 FTE headcount as the average in the “pay period inclusive of February 15, 2020,” it may be reasonable to adopt the same pay-period averaging under this analysis as well, although further guidance may adopt a different interpretation.

* + Step 4: Calculate the Forgiveness Deduction

If the compensation rate has been reduced by more than 25% and the Safe Harbor does not apply, then Step 3 requires the employer to calculate the amount by which the difference in average compensation between the measuring period and the Covered Period exceeds 25%. First, the average compensation for the measuring period (Jan–March 2020) is multiplied by 75%, reflecting the minimum compensation rate that avoids any reduction. From this the average rate from the Covered Period (or Alternative Payroll Covered Period) is subtracted, reflecting the rate for the reduction in forgiveness. For hourly employees, this rate is then applied to (multiplied against) the average number of hours worked per week during the measuring period and applied to (multiplied against) the eight weeks in the applicable covered period to calculate the amount by which the forgiveness must be reduced. For salaried workers, the annualized salary amount is divided into 52 weeks and applied to the 8-week covered period, resulting in the amount of forgiveness reduction for the employee.

Once each individual has been evaluated, the individual forgiveness reductions are aggregated and entered into the forgiveness calculation form from the worksheet.

* The 25%/75% Ratio Limitation:

While the Statute does not include this restriction, the SBA Administrator’s regulations include a further limitation on forgiveness: liming forgiveness for non-payroll costs to 25% of the total forgiveness amount.

1. Calculating the Adjustments/Reductions
in Potential Forgiveness

The forgiveness application and the instructions clarify how the various reductions in potential forgiveness are combined:

* First, the total amount of Payroll and Nonpayroll costs paid and incurred during the Covered Period (or Alternative Payroll Covered Period) are inserted into Lines 1 through 4 of the calculation form, reflecting the entire amount of the loan that was paid out for covered expenses.
* Second, the individual reductions based on salary reductions (Part 2 of the forgiveness reductions detailed in the previous section) are aggregate and entered into Line 5 of the calculation form. Line 6 is calculated as the total eligible expenditures (Lines 1–4) less the aggregate of individual forgiveness reductions.
* Third, the remaining expenditures eligible for forgiveness are multiplied by the FTE Reduction Quotient (*See* Part 1 of the reductions described above), resulting in the modified forgivable amount.
* Finally, because the actual forgivable amount cannot exceed the original loan amount and because at least 75% of the loan forgiveness must have been spent in payroll costs, the final forgiveness amount is the smaller of (a) the modified forgivable amount from the Third step in final calculation; (b) the original amount of the PPP loan; and (c) the total amount of payroll expenditures divided by 75%.

To summarize, an illustration is useful. For this we will assume an initial PPP loan amount of $1,000,000, of which $700,000 was spent on eligible payroll for the 150 FTE Employees illustrated in the FTE headcount analysis above. Salary Reduction calculations resulted in an aggregate of $75,000 in non-forgivable loan proceeds. (Calculations rounded down to nearest whole dollar.)

|  |  |  |  |
| --- | --- | --- | --- |
| **Line(s)** | **Description** | **Amount** | **Comments** |
| 1 | Payroll Expenditures | $   700,000   |  |
| 2–4 | NonPayroll Expenditures | $   300,000  |  |
| 5 | Aggregate Wage-reduction Adjustment | ($     75,000) |  |
| 6 | Expenditures less Wage-reduction Adjustment | $   925,000  | *Lines 1–4, minus Line 5* |
| 7 | FTE Reduction Quotient | 91.33%  | *This assumes that the Safe Harbor was not met, but the exceptions are applied* |
| 8 | Modified Forgivable Amount | $   844,802  | *Line 6 × Line 7* |
| 9 | Original Loan Amount | $1,000,000  |  |
| 10 | Max. Amount based on Payroll Expenses | $   933,333  | *Line 1 ÷ 75%* |
| **11** | **Forgiveness Amount** | **$   844,802** | ***Smallest of Lines 8–10*** |

1. Documenting the PPP Forgiveness Criteria

The Forgiveness Application includes instructions on the documentation that borrowers must maintain and submit in support of their application for forgiveness. Some of the documentation must be submitted with the application, while other documentation must be maintained but not immediately submitted.

* Submit with the Forgiveness Application and Schedule A
	+ Payroll Expenses

Borrowers must submit documentation to demonstrate that the claimed payroll payments were actually made when and to whom the borrower claims they were made. This includes each of the following:

Bank Account Statements or payroll provider reports showing amounts of cash compensation to employees;

Tax Forms (or payroll provider reports) for the periods that overlap with the Covered Period or Alternative Payroll Covered Period, including payroll tax filings reported (IRS Form 941) and State business and individual employee wage reporting and unemployment insurance tax filings reported (or that will be reported) to the relevant State(s); and

Payment receipts, cancelled checks, or account statements documenting the amount of health insurance or retirement plan contributions included in the forgiveness amount as non-cash payroll expenses.

* + Nonpayroll Expenses

Documentation must include both evidence of the payments actually made and evidence verifying the existence of the obligations/services prior to February 15, 2020.

For mortgage interest payments, Borrowers should submit a copy of the lender amortization schedule and receipts or cancelled checks verifying payments made, or copies of account statements from February 2020 and the months through the month following the end of the Covered Period verifying interest amounts and payment thereof.

For rent and lease payments, Borrowers should submit copies of receipts or cancelled checks verifying payments made, or lessor statements from February 2020 and the months through the month following the end of the Covered Period verifying eligible payments.

For utility payments, Borrowers should submit copies of invoices from February 2020 and the months through the Covered Period, together with receipts, cancelled checks, or account statements showing payments actually made.

* + FTE Measuring Period

***Employers must submit documentation showing the number of FTE Employees on the payroll per month*** during the selected FTE Measuring Period. For most employers, this will be either (a) February 15, 2019, through June 30, 2019; or (b) January 1, 2020, through February 29, 2020. (Seasonal employers have other options.) These documents may include payroll tax filings (*e.g.,* IRS Form 941) and State tax filings. (The submission may cover longer periods than the specific measuring period, but that does not expand the size of the measuring period.)

**Records to Keep but Not Submit**

The Forgiveness Application includes the “PPP Schedule A Worksheet” which was developed to assist employers in organizing and aggregating the number of FTE employees during the Covered Period (or Alternative Payroll Covered Period) and the amount by which their compensation may have been reduced by more than 25% so as to affect forgiveness amounts. Neither this worksheet nor the documentation used to complete it need be turned in with the application, but it should be retained in Borrower files (and available for SBA inspection) for six years after the loan is forgiven or repaid in full.

This documentation should include:

Documentation supporting the listing of each employee in the tables of employees both above and below the annualized cash compensation threshold of $100,000 per year;

Documentation regarding any job offers and refusals, discharges for cause, voluntary resignations, and written requests by employees for reductions in work schedules; and

Documentation supporting the analysis behind the FTE Reduction Safe Harbor, such as documents showing FTE counts for the period including February 15, 2020, and for June 30, 2020.

1. 20 hours worked ÷ 40 hours threshold = 0.5 FTE × 20 Employees = 10 FTE Employees. [↑](#footnote-ref-2)
2. 30 hours worked ÷ 40 hours threshold = 0.75, which rounds to 0.8 FTE × 15 Employees = 12 FTE Employees. [↑](#footnote-ref-3)