

PAYCHECK PROTECTION ACT LOAN FORGIVENESS

As most employers know, a key feature of the CARES Act of 2020 is its Paycheck Protection Act ("PPA") that allows employers to obtain loans that may be "forgiven" if used for specified costs. The amount of the PPA's forgiveness is tied to additional requirements – employee retention and maintaining compensation levels. Unfortunately, the application of these forgiveness provisions is less than clear, and the federal regulatory agencies charged with administration have not published sufficient guidance to assist employers. We will summarize the key forgiveness provisions, the forgiveness provisions that are clear, identify the questions that have not been answered to date.

A. FORGIVEABLE USE OF LOAN

To obtain forgiveness of a PPA loan, it must be used for the following:

1. "Payroll costs"
 - a. Cost of employee benefits
 - Health, dental, vision, STD/LTD, life insurance premiums
 - Cafeteria plan
 - Retirement benefits
 - Paid time off
 - (Does not include payments under Emergency Paid Sick Leave and Emergency Family Medical Leave Expansion Act – these expenses are recouped through tax credits)
 - Severance benefits
 - b. State and local income taxes paid by employer
 - (Does not include payroll taxes paid by employer)
2. Mortgage interest (not principle payments or pre-payment fees)
3. Rent
4. Utilities (service that began before 2/15/20)
5. Interest on debt obligations (obligation incurred before 2/15/20)

THE EMPLOYER MUST USE 75% OF LOAN TOWARD "PAYROLL COSTS."

B. REDUCTIONS IN FORGIVENESS

Apart from using loan proceeds properly, there are two hurdles to 100% forgiveness of the loan – Employee Retention and Compensation Retention.

Although there is no clear guidance from federal regulatory agencies, the general assumption is that the reductions from failing to meet Employee Retention and Compensation Retention requirements are applied against the amount the employer uses to cover payroll costs.

Example: Total PPA loan of \$500,000
At least \$375,000 (75%) must be used toward Payroll Costs.
The other \$175,000 (25%) may be used for any combination of the other qualifying costs

If this is interpretation that will be applied, assuming a 10% Employee Retention "penalty" against loan forgiveness, the reduction would be applied against the \$375,000 as opposed to the full \$500,000 amount of the loan.

1. Employee Retention

The amount of loan forgiveness may be reduced based on the percentage reduction of the number of "full time equivalent employees" the employer has at times specified in the Act.

a. Counting employees

(1) The average of full-time equivalent employees for each month is derived from averaging the number of full-time equivalent employees for each pay period during a month.

(2) Employees on payroll, not whether employee worked during the payroll period

(3) "Full-time equivalent employee:" The CARES Act of 2020 does not define "full-time equivalent employee" but the concept is used in the Affordable Care Act). It is logical to expect that the Affordable Care Act definition will transfer to the CARES Act.

Full-time employees - All employees working 30 hours or more per workweek on a regular basis

+

Number reached by dividing all hours worked by part-time employees during a month by 120

Example:

40 employees regularly working more than 30 hours per workweek

20 part-time employees work a combined 1,600 hours in a month.

$$[40 + (1,600 \div 120)] = 53 \text{ FTE}$$

b. Reduction by Headcount Loss

Mathematical equation

Employer is allowed to select from two options

OPTION 1: Assumes loan proceeds received on 4/14/20

Avg. number of FTE's per month for the 8 week period from the date the loan proceeds are available

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Avg. number of FTE's per month between 2/15/19 and 6/30/19

80.6 ÷ 72.5 = 90% Employee Retention.
Loan forgiveness reduced by 10%.

Payroll Period		FTE	Avg.
4/16/20	4/30/20	60	
5/1/20	5/15/20	70	
5/16/20	5/31/20	80	
6/1/20	6/15/20	80	
		280	

Payroll Period		FTE	Avg.	
2/16/19	2/29/19	80		
3/1/19	3/15/19	85		
3/16/19	3/31/19	80		
4/1/19	4/15/19	82		
4/16/19	4/30/19	78		
5/1/19	5/15/19	80		
5/16/19	5/31/19	75		
6/1/19	6/15/19	80		
6/16/19	6/30/19	85		
		725		80.6

OPTION 2:

Assumes loan proceeds on 4/14/20

Payroll Period		FTE	Avg.
4/16/20	4/30/20	60	
5/1/20	5/15/20	70	
5/16/20	5/31/20	80	
6/1/20	6/15/20	80	
		280	72.5

Avg. number of FTE's per month for the 8 week period from the date the loan proceeds are available

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Avg. number of FTE's per month between 1/1/20 and 2/29/20

Payroll Period		FTE	Avg.
1/1/20	1/15/20	80	
1/16/20	1/31/20	82	
2/1/20	2/15/20	75	
2/16/20	2/29/20	70	
		307	76.8

76.8 ÷ 72.5 = 94% Employee Retention
6% reduction in loan forgiveness

c. Safe Harbor

If an employer separates employees between February 15, 2020 and April 26, 2020, there will be no reduction in loan forgiveness **IF** by June 30, 2020, the employer recalls, un-furloughs, re-hires or hires a sufficient number of employees to return to the number it had on 2/15/20.

Example: Employee count set as of 2/15/20

- Five FTE lay-off on 2/20/20
- Ten FTE lay-off on 3/15/20
- Five FTE lay-off on 4/15/20
- Ten FTE re-hire on 6/1/20
- Ten FTE re-hire 6/29/20

Date	FTE
2/15/20	75
2/20/20	70
3/15/20	60
4/15/20	55
6/1/20	65
6/29/20	75

No reduction in loan forgiveness.



2. Compensation Retention

As a *separate* reduction, loan forgiveness can be reduced due to reductions in the compensation of an employee.

a. General

The reduction is based on a comparison of the compensation paid to an employee making less than \$100,000 on an annualized basis.

\$3,846.15 gross for a bi-weekly payroll = \$100,000 annualized

\$4,166.66 for a semi-monthly payroll = \$100,000 annualized

For the employees falling under the \$100,000 exclusion, the reduction is based on an examination of *each individual employee's compensation*.

The CARES Act provides:

The amount of loan forgiveness ... shall be reduced by the amount of any reduction in total salary or wages of any employee ... during the covered period that is in excess of 25% the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the covered period.

Read literally, the equation is:

Total compensation received by the employee in the
8 week period after loan proceeds are available for use

Total compensation received by employee between
1/1/20 and 3/31/20

The strict application of this formula looks as follows;

Example 1: Employee employed entire period 1/1/20 - 3/31/20
and makes \$1,250 per week.

Employee's weekly compensation is reduced 1% from \$1,250
to \$1,237.50

Employee is paid total \$9,900 during 8 week period \$1,237.50.
Employee was paid total \$15,000 (\$1,250 x 12 wks) from
1/1/20 - 3/31/20

$$\$9,900 \div \$15,000 = .66$$

Employer would lose 9% of forgiveness for the 1% pay reduction

$$.75 - .66 = .09$$

$$\$9,900 \times .09 = \$891 \text{ not forgiven for that employee.}$$

This calculation would have to be run for every employee.

Such a result would be absurd. However, to date, there are no regulations that instruct employers how the Compensation Retention provision will be interpreted. This may soon change, but at present employers are left with no clear guidance.

b. Safe Harbor

The Compensation Retention provision has a clear safe harbor:

If an employer reduces the compensation of an employee between February 15, 2020 and April 26, 2020, there will be no reduction in loan forgiveness **IF** by June 30, 2020, the employee's compensation returns to its previous level.

Until guidance is issued, the Compensation Retention safe harbor is the only option through an employer knows without a doubt there will be no reduction based on reducing employees' compensation.

The CARES Act of 2020 and the Families First Coronavirus Response Act have thrown a great amount of statutory and regulatory interpretation at employers. The Department of Labor has stepped forward with its temporary regulations and Questions and Answers for the Families First Coronavirus Response Act. The Treasury Department has issued several publications of its own, but none address the ambiguities identified above. When the Treasury Department does issue guidance, we will provide you additional information regarding the avenues available to employers to ensure maximum forgiveness of an PPA loan.

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