THE MATH BEHIND PPP LOAN FORGIVENESS

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We are in a short lull period in the Paycheck Protection Program (PPP) loan process. Those eligible businesses that have SBA loan numbers have been funded or will be funded soon. Those who have applied but did not get in on the first SBA tranche will be funded shortly assuming Congress adopts proposals for additional funding. We have written about the PPP loans in depth here: *Update:* Congress Passes CARES Act to Stimulate Business Efforts and SBA Issues Guidance on Paycheck Protection Program.

So this seems like a good opportunity to take a closer look at the loan forgiveness provisions of the Program. Unless forgiven, PPP loans are repayable, with interest at 1% per annum, over a 2-year term with an initial 6-month moratorium on payments. A good deal, especially when you consider the loans are non-collateralized and non-recourse.

That said, by following the CARES Act debt forgiveness rules, the PPP loans can be wholly or partially forgiven. What follows is a summary of the loan forgiveness provisions of the program based in part on SBA's guidance as of April 17, 2020 (it is worth noting that the most definitive SBA guidance to date is in the form of "Temporary Final Rules" (emphasis added)). Also note that computation methods used in this article are based on the language of the CARES Act and are the current conventional wisdom on point. There will undoubtedly be further government guidance to come which may revise these computation methods.

1. First and foremost, make sure that at least 75% of loan proceeds are used for "allowable payroll expenses" during the 8-week period beginning on the day you get the loan proceeds (the "8-week period"). Allowable payroll expenses include employee wages and salaries (capped for any employee at $100,000 annualized) plus the employer's contribution for PTO/vacation/sick pay, healthcare and retirement benefits, and state tax withholdings. We have written about the importance of planning in advance of when to take the PPP loan here:

Careful Planning Can Help You Ensure that Your PPP Loan is Forgiven

2. Second, make sure that any loan proceeds not used for payroll are spent only on rent, mortgage interest, and utilities payments related to facilities occupied as of 2/15/2020. If you follow points 1 and 2, you start with 100% forgiveness subject to reductions in forgiveness based on points 3-5.
3. Subject to the "safe harbor" described in point 5 below, your loan forgiveness will be reduced by an amount equal to your percentage reduction in Full-Time Employees (FTEs) during the 8-week period. The math to calculate reductions in FTEs for this purpose is described below. For most employers who have furloughed employees or cut hours, the safe harbor (point 5) will be the most likely way to avoid some loan repayment by virtue of the FTE maintenance requirement.
4. Also subject to the "safe harbor" described in point 5 below, your loan forgiveness will be reduced dollar for dollar by pay reductions in excess of 25% during the 8-week period. Again, the math to calculate a reduction in pay for this purpose is described below.
5. Any reduction in FTEs and resulting reduction in loan forgiveness can be "cured" by restoring the number of employed FTEs as of June 30, 2020 to the number of FTEs you had on February 15, 2020. Likewise, any reduction in pay and resulting reduction in loan forgiveness can be "cured" if every employee making less than $100,000/year who worked for you both during the 8-week period and at any time during 2019 has their pay restored to their February 15, 2020 pay level by June 30, 2020.

The methods for calculating the reductions in loan forgiveness under points 3 and 4 have not yet been included in SBA guidance. Based on the CARES Act language, however, the conventional wisdom on how the computations work is as follows:

- **FTE Maintenance Requirement:** To calculate your potential exposure to loan repayment because of reduced FTEs, here's the procedure:
  - First add up all hours worked by all employees during the 8-week period, divide that total by 8, and then divide the quotient so determined by 40 to get the "8-week FTE average."
  - Then pick one of two options to determine your "baseline FTE average," whichever option works best for you, utilizing the same computation method as described in the preceding bullet. For option 1, calculate your average FTEs for the period 2/15/2019 to 6/30/2019. For option 2, calculate your average FTEs for the period 1/1/2020 to 2/29/2020. The number so determined is the "baseline FTE average."
  - The 8-week FTE average is then divided by the baseline FTE average and expressed as a percentage. If the percentage so computed is less than 100%, you will be obligated to repay a portion of the PPP loan equal to the difference between the percentage so computed and 100%. So, for example, if the computed percentage is 80%, you will have to repay 20% of the loan unless you get your FTEs back up to the baseline FTE average by June 30, 2020.

- **Wage Maintenance Requirement:** To calculate your potential exposure to loan repayment because of reduced wages/salary, here's the procedure:
  - First identify each employee employed at any time during the 8-week period who (i) was also employed at any time during 2019 and who (ii) was not paid at an annualized rate over $100,000 for any pay period in 2019. We'll refer to these employees as the "target employees."

- Then, for each target employee, compute their average weekly pay during the period 1/1/2020 to 3/31/2020 to get the "base average pay."
- Then, for each target employee, compute the average weekly pay during the 8-week period to get the "current average pay." If the current average pay is more than 25% below the base average pay, you will have to repay a portion of the PPP loan equal to the amount of the wage reduction over 25%.