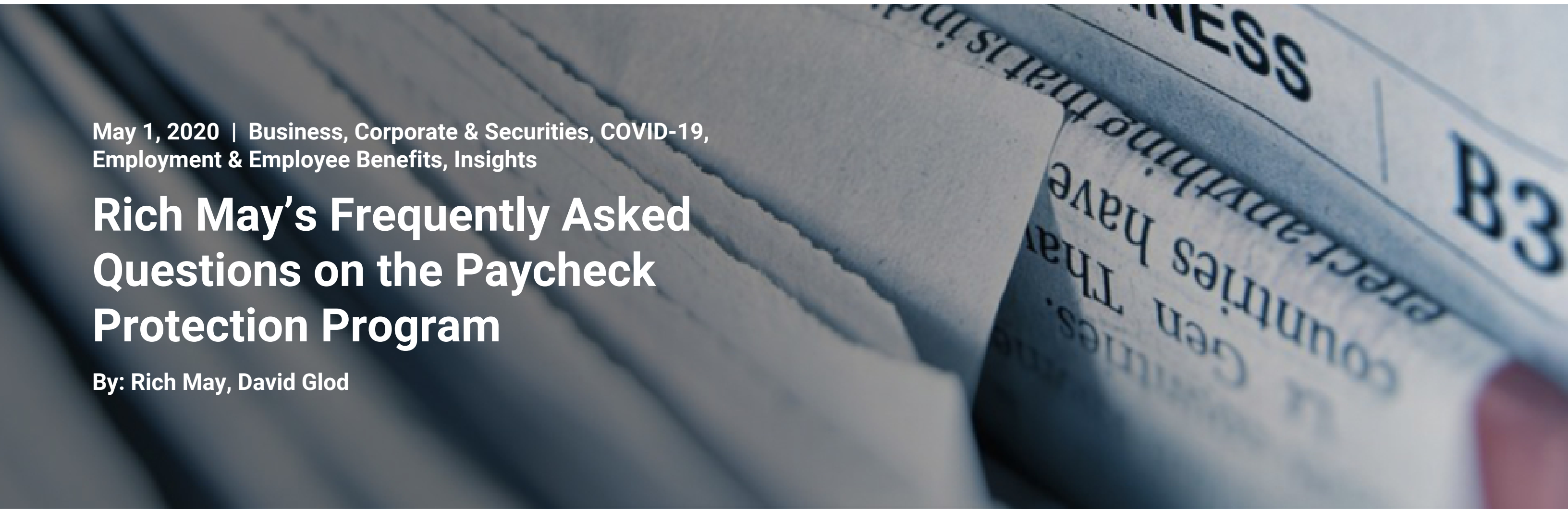

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Rich May's Frequently Asked Questions on the Paycheck Protection Program

By: Rich May, David Glod

In assisting clients with their applications for Paycheck Protection Program (PPP) loans under the CARES Act, and advising them on how to spend the loan funds to maximize their loan forgiveness, we have seen certain questions coming up repeatedly. Below are some of those common questions and our current thinking on them.

Note that these are merely our interpretations of the law and guidance as they exist today. However the official guidance has been frequently evolving, and further guidance will undoubtedly be released—particularly relating to permissible expenditures and loan forgiveness, which have thus far not been addressed in depth. Borrowers should consult with counsel for the most up-to-date guidance relating to their specific situation, as the resolution of many of these interpretive questions will be fact-specific.

My company processed payroll on Wednesday, received PPP money on Thursday, and distributed payroll funds on Friday. Does this payroll fall within the 8-week period during which amounts spent on payroll costs will be forgiven?
The CARES Act provides for forgiveness of payroll "costs incurred and payments made" during the covered 8-week period. It is not clear whether this means payroll "costs incurred and payments made [for those costs]" during the 8-week period, or payroll "costs incurred [during the 8-week period] and payments made [during the 8-week period]". It seems likely that the SBA will issue additional guidance on this point.

As a business owner who was not previously on the payroll, can I add myself to the payroll in order to increase payroll costs?
Because the SBA has determined that forgiveness of non-payroll costs will be limited to 25% of the forgiveness amount, many businesses are concerned about maximizing their payroll costs in order to maximize forgiveness. However depending on the circumstances, any such effort might be seen as an abuse of the program—particularly if there is no change in your services corresponding to the change in compensation structure. If it appears you are simply adding yourself to payroll in order to take advantage of forgiveness, and/or increase payroll costs up to the 75% threshold, it could be seen as not

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a bona fide payroll expense. With respect to self-employed individuals, owner's compensation during the 8-week period is being limited to their corresponding income in 2019, and it is possible that the SBA could come up with a similar way to limit increases in owner compensation for other businesses.

As a business owner on the payroll, can I increase my pay together with raising employee salaries in order to meet the 75% threshold?
Where it applies across the board, this raise seems more likely to be seen as bona fide than the previous scenario. However the raise should have a legitimate business purpose beyond meeting the 75% threshold for forgiveness.

What happens if during the covered 8-week period, I use more than 25% of the PPP funds for non-payroll costs?
Failing to use 75% for payroll does not disqualify a borrower from forgiveness. Rather, forgiveness will be reduced such that the forgiven amount comes to 75% payroll/25% non-payroll during the 8-week covered period. Additionally, even beyond the 8-week period and regardless of forgiveness, 75% of the total loan amount must still be used for payroll costs. (See the SBA's first Interim Final Rule setting forth this requirement and the rationale.)

Can I give my employees a bonus during the 8-week covered period, and have the amount paid forgiven?
It's not clear. Pre-payment of salary is clearly prohibited. The CARES Act does not explicitly address bonuses in its forgiveness provisions, and many employers are considering paying bonuses to incentivize employees to give up sometimes more lucrative unemployment compensation to return to work. Bonus payments are arguably "similar compensation" to salary and on that basis should be covered. However the opposite interpretation is also plausible. Other areas of the CARES Act specifically identify bonuses, so it could be argued that their omission from the forgiveness section was intentional.

If the bonus would have been payable in the ordinary course, that would support its inclusion as "similar compensation" to salary. If it is only being paid to increase the amount of payroll costs for forgiveness purposes, likely not. Between those extremes, there is a gray area.

At this point, an employer should have and document a sound reason as to why such payments are a needed part of "support[ing] the ongoing operations of the business" and "maintaining payroll," in line with the certification they made about their need for the funds when applying. And absent further guidance, employers should be prepared for bonuses to potentially not be included in the forgiveness calculation.

In order to avoid loan forgiveness being reduced based on a reduction in my workforce or their salaries, by when—and for how long—do I need to eliminate the reduction in workforce or salaries?
Forgiveness will be reduced by amounts corresponding to reductions in the business' full-time-equivalent headcount, or reductions in salary during the 8-week covered period, as compared with specified prior periods. That forgiveness reduction is nullified if, no later than June 30, the employer has eliminated the reduction in headcount or salaries and

restored the headcount and salaries that existed as of February 15, 2020. If employees are hired back and then terminated again within the covered period, that likely would not constitute the reduction being "eliminated." Even if the reduction is eliminated on June 30 and employees are terminated on July 2, the lender and SBA may make the same argument and claim that the borrower acted in bad faith.

How should a sole proprietor evidence payments to themselves for purposes of showing their payroll costs?

The SBA issued detailed instructions in an Interim Final Rule. In essence, replacement of owner compensation will be limited to 8 weeks' worth of 2019 net profits. The guidance provides that the lender and SBA will simply rely on your 2019 tax filing to determine the permissible amount of owner compensation.

What are the tax consequences of the PPP loan?

The CARES Act provides that loan amounts that are forgiven are not treated as gross income for tax purposes. However, on April 30, 2020, the IRS issued a notice determining that otherwise deductible business expenses—such as wages, mortgage payments and utility costs—will not be deductible to the extent that they are paid with forgiven PPP amounts. In the IRS' view, this prevents businesses from receiving a double tax benefit.

Disclaimer: This summary is provided for educational and informational purposes only and is not legal advice. Any specific questions about these topics should be directed to attorney David Glod.