PPP Forgivable Loans Will be Unforgiving for Many

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Many small business owners who have been approved for Paycheck Protection Program loans ("PPP") are realizing that the loan isn't as forgivable as they'd hoped.

The amount a small business can qualify to have forgiven must primarily be payroll costs. The SBA's rulemaking has stated that at least 75% of the forgiveness request must be payroll costs but can also contain up to 25% of other approved expenses under the law such as rent, mortgage interest and utilities. That rule seems to be widely understood and so long as small business owners are spending 75% of their PPP funds on payroll this rule won't frustrate small business owners when it comes time to forgiveness.

For details on the PPP loan program in general, please refer to my prior article here.

Unfortunately, there is an additional restriction on loan forgiveness requests which penalizes a small business if they do not bring back the same number of workers they had before the pandemic. For example, if you were a small business who had 10 employees prior to the pandemic, and now, after receiving your PPP loan funds you only have 6 employees, then your loan forgiveness request will be reduced to 60% of the total amount of eligible expenses. If the small business brought back 10 or more employees, then there is no reduction in the forgivable loan amount. In other words, small

businesses who have kept or who re-hire their entire workforce are rewarded while those who can’t are punished. The fact of the matter is, that many who can’t bring back their workforce are those who have been hurt the most.

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The pre-pandemic time period used to determine the number of full-time equivalent employees is either January 1, 2020 to February 29, 2020, or February 15, 2019 to June 30, 2019. The business owner can choose either time period and a smart one will choose the period when they had a lower number of full-time equivalent employees.

Using the example of a small business that received a PPP loan of $60,000 that prior to the pandemic had 10 full-time equivalent employees but has only retained or brought back 6 employees over the eight weeks following their loan funding, let’s go through both the 75% Payroll Cost Rule and the Full-time Equivalent Employee Rule to see what amounts a small business borrower would be eligible to have forgiven.

Total PPP Loan = $60,000

75% Payroll Cost Rule (applies from PPP loan funding for 8 weeks)

Amount spent on payroll costs = $30,000

Amount spent on rent = $4,000

Amount spent on utilities = $2,000

Total Amount Spent = $36,000

Payroll costs of $30,000 represent 83% of the total qualifying expenses ($36,000) to be requested and as a result, there is no need to reduce the forgiveness request based on the 75% payroll cost rule.

Side note: If non-payroll costs exceeded 25%, then the forgiveness request is reduced until no more than 25% of the amount to be forgiven is qualifying non-payroll costs. The payroll costs are always 100% eligible for forgiveness but the non-payroll costs will need to be reduced until they are no more than 25% of the total amount requested to be forgiven.

Full-time Equivalent Employee Rule

Even though the small business had a PPP loan of $60,000, they only spent $36,000 on qualifying expenses. They met the 75% payroll cost rule and the entire $36,000 is eligible for forgiveness but only after applying the full-time equivalent employee rule.

Full-time equivalent employees after PPP funding (8-week period) = 6

Full-time equivalent employees pre-pandemic = 10

Ratio of Employees Retained (amount eligible for forgiveness) = 60%

The amount eligible for forgiveness of $36,000 is then multiplied by 60% to get the final amount eligible for forgiveness of $21,600.

In the end, the small business who received a $60,000 PPP loan, spent $36,000 on payroll and other qualifying expenses (within the 75% rule), but then had their forgivable amount reduced down to $21,600 as they were only able to bring back 60% of their pre-pandemic workforce. At the end of the 8 weeks, they will be eligible for loan forgiveness of $21,600 and will need to re-pay the remaining $38,400 to the bank where they received the PPP loan. This amount is subject to 1% interest and must be repaid within two years from the date they obtained the loan.

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the U.S. Small Business Administration?

Side note: There is an additional reduction calculation if you bring back workers but reduce their pay from the pre-pandemic time-period by more than 25%.

The reality is that small business owners are penalized harshly if they can't bring back employees. In advising business owners in my law firm, we've already seen this to be a major concern and have heard of small business owners who are unable to bring back their workers as those workers' unemployment benefits are more generous than the pay they received when working in the small business. Other business owners are struggling with shelter in place orders being extended, are still unable to open, and are reluctant to simply re-hire workers when there's uncertainty about whether the PPP loan will just be more debt or whether it will actually function like true stimulus for the small business owner and be forgiven.

Robert Scott, a Regional SBA Administrator who was part of the SBA team that launched the PPP program, said the SBA is aware of the harshness of the rule and how it hurts many small businesses who can't bring back all of their workers. Unfortunately, this restriction was built into the CARES Act itself so there's not much the SBA can do to assist or provide regulatory relief as it will literally take an act of Congress to change.

Small business owners should be very cautious with the PPP dollars they spend and need to make sure that they understand what amounts will be forgiven and what amounts will be nothing more than additional debt on their business. Don't assume that just because you were given a certain loan amount that you can use all of those funds for business expenses. Keep in mind, this isn't the Small Business Protection program, it's the Paycheck Protection Program. Consequently, small businesses who are counting on loan forgiveness should ensure that at

least 75% of the loan funds are being spent on payroll costs. They must also realize that if they are unable to bring back the same number of employees from the pre-pandemic time that the amount eligible for forgiveness will be reduced.

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