



CARES Act Paycheck Protection Program Updates, Best Practices, and Clarifications

On April 23, 2020, Congress passed the Paycheck Protection Program and Health Care Enhancement Act (the “Enhancement Act”), which was signed into law by President Trump the following day. Among other things, the Enhancement Act provides an additional \$310 billion for the Paycheck Protection Program (“PPP”) established under the CARES Act and administered by the Small Business Administration (“SBA”). Separately, on April 24, 2020 the SBA issued its [Fourth Interim Final Rule](#), which creates a “safe harbor” for certain borrowers (the “Fourth Interim Final Rule”) and, on April 26, updated its [Frequently Asked Questions](#) (the “FAQs”).

We provided an overview of the CARES ACT on [March 27](#), and published updates on [April 3](#) and [April 17](#). In this fourth update, we provide a summary of the Enhancement Act and its impact on the PPP, discuss the SBA's new "safe harbor" rule, offer best practices for applicants that have received or will receive a PPP loan, and clarify certain specific PPP requirements.

The Enhancement Act and its Impact on the PPP

On April 16, the SBA [announced](#) that the initial \$350 billion funding for the PPP had been exhausted, though some banks continued to take applications with the expectation that Congress would authorize additional funds. The Enhancement Act replenishes PPP funding with an additional \$310 billion, of which \$60 billion will be set aside for PPP loans to be made by smaller lenders, such as insured depository institutions, credit unions and community financial institutions. The Enhancement Act also appropriates another \$10 billion for SBA's Economic Injury Disaster Loan ("EIDL") grant program, also established under the CARES Act, which provides eligible small businesses with an advance of up to \$10,000 on their EIDL loan which does not have to be repaid.

The Enhancement Act does not alter PPP loan eligibility or loan forgiveness requirements. Accordingly, applicants who submitted a PPP application, but did not get approved or receive funds before the previous funding was exhausted, remain eligible to receive a loan. These applicants should consult their lender to determine the status of their application and when the lender expects the processing and funding of applications to resume. Eligible businesses that have not yet applied should be ready to do so as soon as possible, because the new PPP funding will likely run out again very soon.

SBA's "Safe Harbor" Rule

The CARES Act requires applicants for PPP loans to make a good faith

certification that “current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Since the PPP program began, many public companies have faced public backlash for receiving loans under the program, notwithstanding their size and financial well-being and questionable eligibility. In the Fourth Interim Final Rule, the SBA stated that “[a]ny borrower that applied for a PPP loan prior to the issuance of this regulation and repays the loan in full by May 7, 2020 will be deemed by the SBA to have made the required certification in good faith.” The FAQs add context to this statement, by re-stating the known requirement that applicants must make this certification in good faith, but also explaining that in making the certification, applicants are to take “into account their current business activity, and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.” While this measure is aimed at loans awarded to major and publicly-owned institutions and those with adequate sources of liquidity to encourage them to return their loan money, each applicant should consider and confirm (internally) that alternative funding sources are not available or would be significantly detrimental.

As a further caution for all applicants, on April 28, 2020, in an interview with CNBC, Treasury Secretary Steven Mnuchin said the government will audit any company taking out more than \$2 million from the PPP loan program, and will perform a “full review of that loan before there is loan forgiveness.” While there is no assurance that every borrower of \$2 million will in fact be audited (and banks may flag lesser loans for audits on their own), applicants should follow the best practices discussed below in case of any such audits.

Best Practices for Eligible Applicants

As discussed in our prior alerts, an eligible applicant can use a PPP loan to cover payroll costs. It can also devote the loan proceeds to other enumerated expenses, provided that at least 75% of the loan is used for payroll costs. Eligible applicants

will receive loan forgiveness under the program for payroll costs, mortgage interest, rent, and utilities incurred and paid during the 8-week period from the date of the first disbursement of the loan, so long as at least 75% of the total loan forgiveness amount is used for payroll costs. The amount of loan forgiveness can be reduced if the borrower has reduced its number of full-time equivalent employees (“FTEEs”) or reduced salaries.

The rules require an accurate accounting of the use of the PPP loan proceeds, employee headcount, and salary and wage rates. To ensure maximum loan forgiveness, business that receive a PPP loan should follow these best practices to meet the program’s requirements:

- Consider keeping PPP loan proceeds in a separate account
 - Applicants that received a PPP loan should consider depositing all loan proceeds in a separate bank account to help ensure that PPP loan proceeds are used only for allowable expenditures under the program. This will require coordination with your payroll company.
 - Employee compensation in excess of \$100,000 annually on a pro rata basis is not eligible for loan forgiveness. Accordingly, payroll for these employees should ideally be made in two separate amounts, with the amount under \$100,000 annually to be made from the separate PPP loan proceeds account.
 - On a similar note, the employer’s share of federal payroll taxes is not eligible for loan forgiveness, so payroll taxes should be paid from a different bank account than the PPP loan proceeds account.
- Accurate and Complete Recordkeeping
 - Borrowers should keep track of all expenses paid with the PPP loan proceeds and their associated supporting documentation over the 8-week period to ensure maximum loan forgiveness. This includes:
 - Payroll registers or ledgers;

- Health insurance invoices and payments;
 - Payments for employer-sponsored retirement plans (we recommend making pro rata payments during the 8-week period);
 - Supporting documentation for rent expense (lease and cancelled checks/Automatic Clearing House or wire transfer evidence);
 - Supporting documentation for interest paid on existing debt obligations;
 - Evidence of utilities paid, including invoices and receipts; and
 - State and local payroll tax payments, supported by tax returns, vouchers, or other documentary evidence.
- Borrowers should also scan in all paper documents and store all supporting documents electronically in a separately-identified folder for ease of access and completeness of records.
- Maintain Accurate Employee Data
 - Borrowers should maintain an accurate headcount of all full-time and part-time employees on payroll. In many cases your payroll company will be able to provide this information. You will need to account for the average number of FTEs per month during the following periods:
 - The 8-week period beginning with the date of the first disbursement of the PPP loan proceeds;
 - The period from February 15, 2019 to June 30, 2019; and
 - The period from January 1, 2020 to February 29, 2020.
 - Borrowers also need to track payroll during both the 8-week period and the first quarter of 2020 for all employees who earn \$100,000 or less annually.
 - If a borrower intends to rehire laid off or furloughed employees or reinstate their salary or wage rates by June 30, 2020 in order to avoid

a reduction in loan forgiveness, it should carefully track and keep accurate records of headcount and payroll to ensure that the number of FTEEs and/or salary and wage rates are restored to their respective levels as of February 15, 2020.

We expect the SBA will provide detailed guidance on the loan forgiveness application process, including required forms and supporting documentation and procedures. Hopefully, this guidance will provide additional direction about how the Treasury Department will compute loan forgiveness reductions for failure to maintain employee headcount and pay rates, and shed further light on appropriate documentation procedures.

Clarifications on the PPP Requirements

Since the enactment of the CARES Act, the SBA has provided guidance in its Interim Final Rules and FAQs on many of the open questions and ambiguities of the PPP program. However, we continue to receive questions about the program that have not been answered by Treasury. This section will provide some additional input on these questions, based on our interpretation of the laws as currently in effect.

1. As noted above, the SBA has required that at least 75% of PPP loan proceeds be used for payroll costs and at least 75% of the total loan forgiveness amount be used for payroll costs. Will failure to adhere to these requirements reduce loan forgiveness on a pro rata basis only, or will it render the PPP loan repayable? In other words, if, during the 8-week period, an applicant spent more than 25% of the PPP loan proceeds on costs other than payroll costs, does this mean the entire PPP loan is invalid and no longer eligible for loan forgiveness?

Based on the wording of the First Interim Final Rule, it appears that a failure to use at least 75% of the loan proceeds on payroll costs during the 8-week period will reduce loan forgiveness on a pro rata basis, rather than entirely. This means that if

an applicant spent more than 25% on costs other than payroll costs, the loan forgiveness amount will simply be reduced to where payroll costs are equal to at least 75% of the total; any amount exceeding the 25% limit on non-payroll costs will not be forgiven. The following are illustrative examples:

- Example 1: What if a business borrows \$1 million and spends \$750,000 on payroll costs and \$250,000 on rent, utilities and mortgage interest payments (“Allowed Costs”) within the 8-week period?
 - Answer: The entire \$1 million amount was used for allowable purposes; and since 75% is used for payroll costs, the entire \$1 million is eligible for loan forgiveness
- Example 2: What if a business borrows \$1 million and spends \$700,000 on payroll costs and \$300,000 on Allowed Costs within the 8-week period?
 - Answer: The \$700,000 of payroll costs can be forgiven entirely, but only \$233,333 of the Allowed Costs can be forgiven to meet the 75% requirement (i.e., \$700,000 is 75% of \$933,333). While the remaining \$66,667 of the PPP loan proceeds was used for allowable purposes, it exceeded the 25% limit, and therefore, will accrue 1% interest and can be repaid during months 7-24 of the loan.

2. What if less than 100% of the PPP loan proceeds is spent in the 8-week period?

We believe that it is acceptable under the program to spend the remaining PPP loan proceeds after the 8-week period, so long as 75% of the full loan is spent on payroll costs. For example:

- Example 3: What if a business borrows \$1 million and spends \$750,000 on payroll costs and \$150,000 on other Allowed Costs (or a total of \$900,000 of the PPP loan) within the 8-week period?

- Answer: The \$750,000 on payroll costs and \$150,000 on other Allowed Costs are eligible for loan forgiveness. The remaining \$100,000 will accrue 1% interest and can be repaid during months 7-24 of the loan, provided that it is spent on Allowed Costs, including 75% on payroll costs.

3. The CARES Act is explicit as to the allowable uses of PPP loans. The First Interim Rule also clearly states that if PPP funds are used for unauthorized purposes, the SBA will direct the borrower to repay those amounts. However, it does not state what happens when only a portion of the PPP loan proceeds is used for unauthorized purposes, nor how quickly the applicant must repay.

- Example 4: What if a business borrows \$1 million, spends \$750,000 on payroll costs and \$150,000 on Allowed Costs within the 8-week period, and subsequently spends \$100,000 on unauthorized purposes?
 - Answer: The \$750,000 on payroll costs and \$150,000 on Allowed Costs can both be forgiven. The remaining \$100,000 spent on unauthorized purposes will likely be required to be repaid immediately. If the borrower knowingly used the funds for unauthorized purposes, it can be subject to criminal liability such as charges for fraud. If its shareholders, members, or partners used the funds for unauthorized purposes, the SBA will also have recourse against such persons for the unauthorized use.

The information provided here does not constitute legal advice and the answers to these questions are not a substitute for reading the specific provisions of the law. The CARES Act and the requirements pertaining to the PPP program will continue to be updated by the SBA and our team of attorneys will do our best to keep you updated.

Eligible applicants interested in applying for the program should reach out the authors of this Alert: Bob Maloney (rmaloney@princelobel.com; 617-456-8008); John Bradley (jbradley@princelobel.com; 617-456-8076); John Chu (jchu@princelobel.com; 617-456-8007); and Junshi Lu (jlu@princelobel.com; 617-456-8056) or any other attorney in Prince Lobel's Corporate Practice Group.

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