Effect of Employee Salary and Headcount Reductions When Calculating PPP Loan Forgiveness

As discussed in our prior memo, the Paycheck Protection Program (PPP) loan is now available to eligible small businesses, nonprofits, veterans' organizations, tribal concerns, eligible self-employed individuals, independent contractors and sole proprietors that are within the SBA size standards requirements. Private lenders are beginning to approve and roll out these loans.

Equally important to receiving these funds is the plan to ensure the maximum amount of the PPP loan is forgiven. Businesses should be aware that reductions in either employee salaries and/or workforce headcount can have a large impact on the amount eligible for forgiveness. This information memo serves as a comprehensive review of the PPP loan forgiveness program and illustrates how businesses can strategize accordingly.

The Basics

The amount of PPP loan forgiveness is limited to the lesser of:

1. the principal amount of the PPP loan; <u>or</u>
2. the total "Eligible Costs" incurred for the eight-week period starting from the PPP loan origination/first disbursement date (the Covered Period).

Eligible Costs include:

1. payroll costs;
2. payment of interest on a covered mortgage obligation, which existed before February 15, 2020;
3. rent obligations, which existed before February 15, 2020; and
4. utility payments related to electricity, gas, water, transportation, telephone or internet access, which were in effect before February 15, 2020.

Eligible Costs in items 2, 3 and 4 above cannot exceed 25 percent of the total eligible costs.

Proof and documentation of such expenses must be maintained in order to obtain loan forgiveness. Applicants that do not have such documentation may be denied forgiveness.

Reductions in PPP Loan Forgiveness Amounts

The PPP loan forgiveness amount may be reduced if businesses reduce either their employees' salaries or reduce its workforce headcount. However, as explained below, the forgiveness reduction may be waived for businesses that reinstate their employees' pay and rehire their entire workforce.

1. Effect of Reductions of Employee Salaries

The effect of reducing employee salaries is two-part.

First, for employees whose salaries or wages have been reduced between February 15, 2020 and April 26, 2020, the reduced wages must be restored <u>in full</u> by June 30, 2020 for the loan to be forgiven with respect to such wages. If the wages are not restored in full, there is a dollar-for-dollar reduction in the forgiveness amount.

Second, for employees whose salaries or wages have been reduced during the eight-week Covered Period, any reduction in salary in excess of 25 percent will result in a dollar-for-dollar reduction in the forgiveness amount.

2. Effect of Reductions in Number of Employees

The effect of reducing the workforce headcount is based on a formula rather than the dollar-for-dollar method. However, for businesses that have reduced their workforce between February 15, 2020 and April 26, 2020, the employee-reduction forgiveness calculation is waived for businesses that rehire their entire workforce by June 30, 2020.

The reduction of number of employees is based on the average number of full-time equivalent (FTE) employees employed before and during the COVID-19 pandemic. The number of FTE employees is determined by the average number of FTE employees for each pay period falling within a month.

The formula for testing workforce reduction is as follows:

Lesser of: (1) PPP loan principal; or
(2) Eight weeks of Eligible Costs

MULTIPLIED BY

average number of FTE employees per month during Covered Period

DIVIDED BY

(1) average number of FTE employees per month 2/15/19-6/30/19; or
(2) average number of FTE employees per month 1/1/20-2/29/20

By way of example: Assume that the PPP loan principal = $1 million; eight weeks of Eligible Costs = $750,000; the business has 75 employees during the Covered Period but had 100 employees during period (1) and 150 employees during period (2). The business must determine which period is most advantageous for applying the reduction calculation. Since the business had fewer employees during period (1), the business should select period (1) because the difference will be lower and will result in a more favorable outcome. Applying the formula above, the business should be entitled to a forgiveness amount of up to $562,500 ($750,000 x (75/100)).

For the portion of the PPP loan that is not forgiven, interest accrues at 1 percent from the date of disbursement of the loan proceeds, and the loan must be repaid in two years. There is a six-month deferral before any payment must be made (although interest continues to accrue during that period). There are no prepayment penalties or fees.

Businesses who have laid off, furloughed, or reduced their employees' salaries should consider the effects it may have on their PPP loan forgiveness amount and whether it is feasible to return to full workforce and/or salary by June 30, 2020.

The attorneys at Bond, Schoeneck & King can help you determine your business plan. Please contact Jeffrey B. Scheer or the attorney at the firm with whom you are regularly in contact.

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