KTA COVID-19 ALERT

Next Steps After Receiving a PPP Loan

On April 24, 2020, another $310 billion dollars was appropriated for the Paycheck Protection Program ("PPP"). For many businesses shut out from the first round of loans, these new funds offer a second chance for to obtain one of these potentially forgivable loans. Regardless of whether a business is still applying or has already received its PPP loan, businesses need to be aware of potential mistakes that may reduce the forgivable amount of the loan and create additional liability for businesses and owners. Below are five actions all PPP applicants and recipients should take immediately.

1. Review the Promissory Note

All PPP funds are issued as a loan which is eligible for potential forgiveness after eight weeks. Like most loans, borrowers are required to sign promissory notes containing the terms under which the money will be required to be paid back. These terms include important details such as the expected monthly payment amount, the due date of the first payment, and the conditions triggering a default. However, many of the notes are missing important terms or contain terms that contradict the CARES Act, such as personal guarantees for owners. Moreover, some banks have buried the promissory note in their application package, resulting in some businesses overlooking this key document. It is advised that all businesses obtain a copy and review this important document with counsel prior to signing.

2. Retain All Documentation to Support the Certifications Made on the Application

Every PPP loan application is a sworn statement made subject to the penalties of perjury. Included in that application are certifications regarding the business's payroll and the business's need for the loan. Businesses should retain copies of the loan application and all documentation submitted to the bank. In addition, businesses must certify that current economic uncertainty makes the loan necessary to support ongoing operations. Businesses with easy access to capital and not anticipating reductions to income should be prepared to substantiate this certification with supporting documentation. Misstatements or false certifications may result in additional liability for businesses, including potential charges under the False Claims Act, which carries treble damages.

In addition, all businesses are required to apply for forgiveness with their lender. No loan forgiveness will be available without documentation showing how and when the loan funds were spent. For payroll costs, businesses will likely need to provide the IRS Form 941 (quarterly tax return) and payroll reports. For other expenses, businesses may be required to produce both bills and cancelled checks to substantiate any amounts spent. Businesses are advised to keep the funds segregated from general operating funds to allow for easy tracing when applying for forgiveness. All PPP recipients should contact their lenders for additional information regarding applying for loan forgiveness.

3. Plan How to Use the Funds To Earn Forgiveness

For the PPP loans to be forgiven, the funds must be used within the 8 weeks after the loan was disbursed and used for forgivable expenses incurred and spent within those 8 weeks. Forgivable expenses are (1) payroll costs, including health insurance benefits; (2) mortgage interest on mortgages incurred before February 15, 2020; (3) rent on a lease in force before February 15, 2020; and (4) utility payments, including electricity, gas, water, transportation, telephone or internet access for which service began before February 15, 2020. Only 25% of the forgivable amount may be non-payroll costs.

The 8-week period begins on the date the lender makes the first disbursement of the PPP loan to the borrower, which must be within 10 days of loan approval. That period may not be delayed. It is important for all businesses to have a plan on how to spend the money. For businesses that have recently experienced a reduction in force, current payroll costs may not allow for the business to spend the entirety of their loan in a way to qualify for complete forgiveness. Funds not spent within the 8 weeks following the loan may still be spent on payroll, rent, mortgage interest, and utilities in the future. However, these amounts will need to be repaid subject to the terms in the promissory note. Nevertheless, it may be advantageous for some businesses to forgo loan forgiveness in exchange for access to the funds for longer than 8 weeks. Developing a plan early will allow firms to use the money most strategically and effectively for them.

4. Begin Rehiring Employees or Raising Salaries Where Required

Even where PPP loan funds are spent entirely on forgivable expenses, businesses may have their forgivable amount reduced based upon two tests. First, the forgivable amount may be reduced if the business's the average number of full-time equivalent employees per month during the 8 weeks following the loan is less than that during both February 15, 2019 – June 30, 2019 and January 1, 2020 – February 29, 2020. Because this calculation uses the average number of full-time equivalent employees, waiting too long to rehire employees may result in a lower amount of loan forgiveness. In addition, the amount of loan forgiveness will be reduced by any salary reductions during the 8-week period that is in excess of 25% of the employee's salary during the most recent full quarter. However, reductions in either workforce or salary occurring after February 15, 2020, may not count against a business if that reduction is eliminated by June 30, 2020. Loan forgiveness under the PPP can be full of traps for the small business owner attempting to navigate it alone. Our team is available to answer any questions regarding the specifics of your business.

5. Calculate the Portion of the Funds That May Be Used for Owner Compensation

The Treasury has issued new guidance for independent contractors and sole proprietors. These individuals may apply for their own PPP loan separate from their business entity. However, for partnerships, the Treasury has limited the partnership and its partners to one loan. The self-employment income of general active partners may be reported as a payroll cost, based upon a 2019 net profit and up to $100,000 annualized. As a payroll cost, owner compensation replacement payments are a forgivable use of the PPP loan. Business owners are advised to calculate the amount the loan that may be used for owner compensation replacement as soon as possible to ensure they remain within the program's limits.