Loan Forgiveness Under The PPP And SBA EIDL Programs: 10 Things Small Businesses Need To Know

By Neil Hare (May 11, 2020)

If you were one of the lucky businesses to receive a Paycheck Protection Program (PPP) loan as provided under the CARES (Coronavirus Aid, Relief, and Economic Security) Act, you currently have eight weeks to use the funds appropriately to meet the criteria for loan forgiveness or face repayment.

There is still some PPP money available from Round 2 of Congressional relief, so if you haven't yet applied and still need the money, do so immediately. There was approximately $90 billion remaining as of May 6, largely because most loans in this second round have been much smaller than in Round 1 and many larger companies have returned their loans. You will likely have better luck receiving a loan by applying through a smaller community bank as opposed to a large national bank.

In addition, the regulations around both the PPP loan program and the Economic Injury Disaster Loan (EIDL) program have been changing constantly since the CARES Act was passed and will likely continue to do so. It is important to track these regulations closely. Already, leading trade associations including the American Bankers Association, the Consumer Bankers Association, and the Independent Community Bankers Association have written to Treasury Secretary Steven Mnuchin asking for changes to the PPP, mainly around the criteria for forgiveness.

The intent of Congress and the Trump Administration when passing the PPP loans was twofold: First, give small business the funding necessary to survive the Coronavirus shutdown, which the federal government estimated would last two months. That is why the loan amount was based on your average 2019 monthly payroll multiplied by 2.5%, and forgiveness is largely based on two months of payroll. Second, to keep workers employed and on payrolls instead of sending them to the unemployment line.

While these two reasons behind the loans were well meaning, they were misguided from the start and are now causing heartache for many small business owners. From day one, it was clear that forcing small business owners to keep workers on the payroll when they were effectively shut down with little or no revenue put them in the position of the unemployment office. The unemployment benefits program was also enhanced in the CARES Act to cover workers, and while no business ever wants to lay off good employees, there simply are times when that is necessary for survival.

While every American hoped the shutdown would be short-lived, there is a well-known saying in business that “Hope is not a strategy.” Clearly, now we know that even with some states relaxing business shutdown restrictions, it is not sufficient to make up for lost revenue, to generate enough revenue with social distancing restrictions, or to rule out a second shutdown if we see a spike in new Coronavirus cases.

Many small business owners still have questions about both obtaining the PPP and EIDL loans as well as how the forgiveness works. A good start in answering your questions is to look at the Treasury guidance issued May 5 and then talk to your banker.

The following are the top 10 most frequently asked questions about loan forgiveness starting with the most pressing one about borrower liability:

1. What is my liability exposure around the loans and forgiveness?

As you likely saw reported in the media, some major brands applied for and received PPP loans. These brands included the LA Lakers, Shake Shack, Sweetgreen, and even Harvard University. While all the companies and organizations met the criteria for the PPP loan, the Trump Administration and the court of public opinion determined they did not meet the “spirit of the law,” and many returned the funds. The CARES Act offered loopholes for borrowers who have more than 500 employees and waived the “Credit Elsewhere” test (with typical SBA 7(a) loans, borrowers must document they can’t access capital from other sources). The PPP loans did not require this documentation but put the onus on the borrower to show “good faith” that they needed the loans despite access to other sources of capital.

The answer to Question 31 in the May 5 Treasury guidelines stated the following:

Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Borrowers must make this certification in good faith, taking 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.

This somewhat ambiguous standard has made many small businesses nervous that they will not meet this “good faith” test, and will have to repay the loan or worse, suffer penalties—perhaps even criminal penalties. So, what should you be worried about with the “good faith” standard?

First, the stern warning from Secretary Mnuchin about audits and liability were aimed at large companies, many of whom are public, that do have other sources of capital; it was not directed at small, independently owned companies. The guidance further explains that companies that have received over $2 million in loans will be automatically audited by the SBA and Treasury to determine if this standard was met.

If your business obtained under $500,000 or perhaps even under $1,000,000 in PPP loans, it is highly unlikely this audit will occur and you will face any liability. It is important to remember, it is your lender who will review documentation after 8 weeks to determine forgiveness based on use of funds; 75% for payroll and 25% for rent, utilities, and interest payments. Lenders are working towards an easy mechanism to approve forgiveness of most loans “at the push of button” and forsake lengthy reviews.

Furthermore, while this “good faith” standard does need further clarification, the fact remains that the government instituted the shutdown that every American business had to abide by. This forced closure of our economy made the future uncertain and, as we are now seeing, that remains so. Therefore, even if your business had other sources of capital like a line of credit, it will be extremely difficult for your bank or the government to determine under those circumstances that the average business was not acting in “good faith” when showing the need for a PPP loan.

This being said, it is probably a good idea to document the state of your business and your need on or around the date you applied for the PPP loan. If you are a retailer or restaurant, the simple fact of being shut down should suffice, and for any business, the reality of lost future sales, canceled orders, and uncertainty about the length of the shutdown should suffice to show “good faith.” Just remember, the government and the banks want these loans forgiven, so presuming you used the funds appropriately, that should be the case.

2. When do I have to start tracking the use of the PPP funds?

At this point, the use of funds must begin upon receipt and extend out eight weeks in order for the loan to be forgiven. You cannot sit on the money. It is a common complaint about the program that businesses don’t want to use the funds to pay their employees to do nothing and want to wait until they reopen or have further certainty about the shutdown. This is a valid concern that makes sense, but this requirement can only change with an act of Congress, which is unlikely to occur. Use the money upon receipt.

3. Do I have to use at least 75% of the PPP loan on payroll?

Yes. As outlined above, for better or for worse, the intent of the PPP program was to keep workers on the payroll and off unemployment. Business owners should have the freedom to use the funds as they see fit on other major expenses like rent, but Congress opted for payroll. While business groups and associations are lobbying to reduce the percentage used on payroll to 50%, you can’t count on that and should assume the status quo. For complete forgiveness, ensure you are using at least 75% of the funds on payroll.

4. If I laid off workers, do I need to rehire the same employees to meet the payroll requirement?

No. Your bank will not check to see if you hired the same employee back, but simply that your payroll amount is the same or greater than the 2019 average upon which the loan amount was based. If you do extend an offer to an employee who rejects it, you may want to ensure the correspondence is in writing for future reference. But, even if that employee rejects your offer for reemployment, your obligation to use the PPP funds on payroll remains based on the 2019 numbers.

5. Do I need to hire the same position or keep employees in the same jobs?

No. Again, your lender will be looking at the amount you spent on payroll, not who fills what job. This is a good way to make use of the funds in a positive way. For example, instead of rehiring that sales rep, you could hire a web developer to revamp your website. Or you could shift roles and responsibilities of existing employees to meet the needs of your changing business model. Just note that the position must be a full-time employee and not a contractor in order to count towards forgiveness.

6. What if I'm still nervous and want to give my loan back?

The recent Treasury guidelines extended the date to return the funds with no questions asked until May 14.

7. What if I don't use the funds for payroll or rent, utilities, or interest payments?

While many groups are lobbying to change the allocations for how the funds should be used, it is best to assume those rules will not change. The rules allow for some variance between the approved and non-approved expenses due to miscalculations or an unforeseen issue, such as an employee quitting. That variance will be converted into the two-year note at 1% interest with a six-month deferral of the first payment. But, the borrower is certifying on the PPP loan application that they will use at least 75% on payroll and the other 25% on rent, utilities, and interest payments. So, if you do not use the funds accordingly, it will raise questions from your lender and potentially from the SBA and Treasury as well, something that you do want to avoid.

8. What documentation should I use with my lender to show the money was spent according to the regulations?

The easiest solution would be to reach out to your payroll provider, such as ADP, to prepare reports showing the funds were used for payroll. It should be as simple as that. In addition, provide bills and canceled checks for your rent, mortgage, utilities, or interest payments if you used the funds for those purposes. If you don't use a payroll company, then follow the outline of a Schedule C form with backup documentation to show how the money was spent. This can include canceled checks, bank transfers, and the payment of acceptable expenses. You should reach out to your payroll provider now and start documenting these expenses. If possible, it is also advisable to keep PPP funds in a separate bank account and make all forgivable expenses out of this dedicated account.

9. When can I apply for forgiveness?

Most lenders will begin processing forgiveness applications at seven weeks from fund disbursement. It is advisable to reach out to your banker now to confirm this and to double-check on what documentation your particular lender will want to see. Again, the lender will make the decision on forgiveness.

10. What is the status of the EIDL loan program?

The EIDL program is still processing applications already received. However, they are not accepting any new applications except from agricultural companies. The EIDL grant program was reduced from $10,000 per company to $1,000 per employee up to 10 employees. This grant is an advance on any potential loan and does not have to be repaid. It has been reported in the media that the maximum loan amount was reduced from $2 million to $150,000 per applicant, but the SBA has yet to publicly confirm that. The EIDL loan must be repaid over up to a 30-year term at 3.75% interest for businesses and 2.75% for nonprofits, with a one-year deferment on the first payment.