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## **Ensuring PPP Loan Compliance and Avoiding Potential Penalties**

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The Small Business Administration's (SBA) Paycheck Protection Program (PPP) was launched on April 3, 2020, and the initial round of funding was exhausted on April 16, with more than 1.6 million small businesses receiving approval for loans totaling over \$342 billion. According to the SBA, the average loan size is \$206,000. Although the vast majority of loans were under \$150,000, over 25,000 borrowers received loans in excess of \$2 million, accounting for greater than 25% of the loaned funds. Now that Congress has approved an additional \$310 billion in funding for additional PPP loans, many more small businesses will surely take advantage of this program.

With so much money being expended, it seems likely that the government will strictly enforce the PPP loan eligibility and forgiveness requirements, and seek to punish those business that are perceived to have abused the program. If you have already applied for or plan to seek a PPP loan for your small business, it is imperative to consider the potential pitfalls and ramifications of failing to comply with the program's requirements. As such, please give consideration to the issues discussed below, and keep in mind that (as of the date of this alert) the SBA has yet to release detailed guidance on many topics.

### *Ensure Your Loan is Forgiven*

Of course, the most attractive feature of the PPP loans is that they are potentially fully forgivable, if the borrower meets certain requirements. Specifically, the amount of the loan that will be forgiven is equal to the amount the borrower incurs and actually expends on certain qualified expenses during the covered period (defined as the 8 week period beginning on the date loan proceeds are received by the borrower). These qualified expenses are:

1. Certain Payroll Costs
  - Including (but not limited to):
    - Salary, wages and other compensation paid to employees;
    - State and local payroll taxes; and
    - Employee benefits.
  - But Excluding:
    - Compensation to employees in excess of \$100,000, on an annual basis;
    - The employer's share of federal payroll taxes; and
    - Qualified sick and family leave for which the employer is allowed a credit under the Families First Coronavirus Response Act.
2. Interest payments on mortgages in existence as of February 15, 2020;
3. Rent payments under lease agreements in existence as of February 15, 2020; and
4. Utility payments for which service was in existence as of February 15, 2020.

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There are also a number of limitations that can reduce the amount of the PPP loan that will be forgiven. First, at least 75 percent of the loan forgiveness amount must be attributable to payroll costs; a maximum of 25 percent can be attributable to mortgage interest, rent, and utility payments.

Second, the amount of loan forgiveness will be reduced if the borrower reduces its number of full-time employees, or reduces salary or wages. The formulas for determining the reduction in loan forgiveness are complex and the SBA has yet to issue additional guidance on how to calculate the amount of loan forgiveness. Still, borrowers need to pay careful attention to these limitations on loan forgiveness.

In order to stay compliant with the PPP and ensure that your loan is forgiven, all small business borrowers must keep detailed records of how the loaned funds were expended. When seeking loan forgiveness, the borrower will have to submit to the lender an application that includes, among other things, documentation verifying the number of full-time equivalent employees on payroll, pay rates, payroll tax filings, as well as receipts, cancelled checks, and other documents verifying payments of mortgage interest, utilities, and rent. Borrowers may want to consider opening a new bank account to deposit the loaned funds to assist in clear recordkeeping.

#### *Automatic Audit of all Loans in Excess of \$2 Million*

Recently, much attention has been given to companies who received PPP loans and then quickly returned the funds following criticism that the funds should have gone to needier companies. This scrutiny stems from the certification each borrower must make when applying for a PPP loan. Each borrower must certify in good faith that, among other things, the loan requested is necessary to support the ongoing operations of the borrower in light of uncertain economic conditions caused by COVID-19.

Based on additional guidance published by the SBA in the FAQs on April 23, 2020, borrowers must 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 when making this certification. Businesses with substantial market value and access to capital markets will likely not be able to make the required certification in good faith. Accordingly, all borrowers should document their basis for requesting the loan and be prepared to demonstrate to the SBA its basis for this certification.

Furthermore, on April 29, 2020, the SBA, in conjunction with the Treasury Department, announced that it will audit and review all loans in excess of \$2 million upon the borrower's submission of a forgiveness application. In addition, smaller loans will be reviewed on a case-by-case basis. Borrowers who the SBA determines failed to certify in good faith the need for a loan, face potential penalties including denial of loan forgiveness, criminal prosecution, and harsh civil fines. This holds true for the owners of the business as well.

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*“Grace Period” to Return Loaned Funds*

Fortunately, the SBA has established a grace period for any borrowers who wish to return their PPP loan for fear of failing to meet the good faith certification. Any borrower that applied for a PPP loan **before April 23, 2020**, and repays the loan in full **on or before May 7, 2020**, will be deemed to have made the certification in good faith. In other words, if a borrower requested and received a PPP loan that it actually did not need to support its operations in light of COVID-19, it can return the funds “no questions asked” during this safe harbor period and avoid a finding of bad faith and associated consequences.

*Conclusion*

The purpose of the PPP loan forgiveness program was and is to encourage employers, both essential and non-essential, to retain employees and continue payroll during a period of extreme economic uncertainty caused by the COVID-19 pandemic. The qualification standard to be met – necessary to support ongoing operations – is vague and one most small businesses could represent in good faith based on the crisis they were confronting at the time their applications were submitted. We feel most small employers should not be overly concerned about requesting forgiveness, but instead should focus on making sure the amount of forgiveness they request is based on eligible costs incurred in the ordinary course of business, correct in amount, and well-documented.

*Carruthers & Roth is here to help if you have questions or concerns regarding your PPP loan or the impact of the COVID-19 pandemic on your business. Please feel free to contact **Chris Genheimer** (336-478-1156, [cwg@crlaw.com](mailto:cwg@crlaw.com)); **Brandon Jones** (336-478-1160, [bkj@crlaw.com](mailto:bkj@crlaw.com)); or any member of our [Business, Tax and Estate Planning Team](#).*