This article presents general guidelines for Georgia nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.

Loan Forgiveness under Paycheck Protection Program

Small nonprofits that have received money under the CARES Act Paycheck Protection Program ("PPP") will want to take advantage of the loan forgiveness provisions. This article attempts to outline the factors a small nonprofit should consider to maximize its loan forgiveness under PPP based on guidance provided by Treasury and the Small Business Administration ("SBA") on loan forgiveness, mostly through FAQs.
For more information on loan forgiveness, in an article which supplements this alert, see SBA Releases PPP Loan Forgiveness Application – Major Changes in Loan Forgiveness!

Before diving into the details about how to spend the PPP loan to maximize forgiveness, note that if you also received an Economic Injury Disaster Loan (EIDL) advance after submitting your PPP application, the amount of PPP forgiveness is reduced by the amount of that advance. For instance, if you received an EIDL advance of $4,000 and a PPP loan of $35,500, your total PPP loan forgiveness amount is $31,500. You will have to repay the $4,000 at 1% interest within two years. If your nonprofit received an EIDL advance prior to submitting its PPP application, the PPP amount was likely reduced.

In order to be eligible for loan forgiveness, the borrower must meet certain expenditure thresholds (#1 and 4 below) during an eight-week covered period. Even if a nonprofit meets the requirements for loan forgiveness, the amount of loan forgiveness may be reduced if certain thresholds (#2 and 3 below) are not maintained. Overall, there are four main considerations when thinking about loan forgiveness and three of them (#1-3) intersect with one another: 1) 75% of the PPP loan must be used for payroll costs, 2) reductions in FTEEs will affect forgiveness, 3) salary reductions may affect forgiveness, and 4) any funds not used to pay payroll costs (up to 25%) can only be used to pay mortgage interest, rent, utilities and other debt interest.

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1) 75% or More of the Loan Must be Used for Payroll Costs

For forgiveness of the loan, at least 75% of the loan must be spent on payroll costs. These costs include:

- Salary, wage, commission, or similar compensation for U.S. residents (does NOT include independent contractors or non-U.S. residents),
- Payment for vacation, parental, family, medical, or sick leave (but not if covered by the Families First Coronavirus Response Act or FFCRA),
- Allowance for dismissal or separation,
- Payment for the provisions of group health care benefits, including insurance premiums,
- Payment of any retirement benefit, and
- Payment of state or local tax assessed on the compensation of the employee.

However, for employees who normally are paid over $100,000 a year in cash salary/wages, PPP funds may only be used for salary/wages for such employees up to an annualized salary or compensation of $100,000. This limit does not include the non-cash benefits the employees receive.

Note that PPP funds cannot be used to cover the employer's share of payroll taxes on wages paid during the eight-week period. The SBA provided the following example:

> ***SBA Example***: If employee earned $4,000 per month in gross wages, from which $500 in federal taxes was withheld, then employer could count $4,000 in payroll costs. The employee would receive $3,500, and $500 would be paid to the federal government. However, the employer-side federal payroll taxes imposed on the $4,000 in wages would be excluded from payroll costs under the statute.

Stepping back a moment and looking at the big picture, your nonprofit received two and a half months' worth of payroll costs as the amount of your PPP loan. You have eight weeks to spend your PPP loan which equals roughly two months. If you pay out the PPP funds for the payroll costs you calculated to get your loan, your nonprofit should meet the 75% test. However, what you submitted as your payroll costs was calculated based upon either the average of your 2019 payroll costs or payroll costs for the past 12 months. If you have reduced head count or reduced salaries since 2019, then 75% of the amount you received might be more than eight weeks' worth of your current payroll costs. (If you haven't had any head count or salary reductions then you should easily meet the 75% test by paying the eight weeks of payroll costs.)

2) Reductions in FTEEs Will Affect Forgiveness

The goal of the PPP is to keep people employed and earning the same wages as before the COVID-19 crisis. As a result, loan forgiveness will be reduced if full-time employee equivalent ("FTEE") count is reduced. This is a specific calculation.

a) X = your average number of FTEES during the eight-week period
b) Y = your average number of FTEEs from EITHER:
    i. February 15, 2019 – June 30, 2019 OR
    ii. January 1, 2020 – February 29, 2020
c) Your fraction is X/Y. Multiply your PPP loan amount by that fraction to determine your loan forgiveness reduction. (for example, if X = 8, Y = 10, and PPP loan amount is $60,000; then 8/10 x $60,000 = 48,000 and $48,000 may be forgiven)

There are also two qualifiers to this FTEE reduction calculation.

First, the CARES Act included a special provision to address the immediate needs of employers until they receive the PPP loan. If your nonprofit furloughed or laid off employees between February 15 and April 26, 2020 (presumably due to COVID-19), as long as you bring the employees back or rehire them no later than June 30, 2020, your loan forgiveness will not be affected. However, don't forget the 75% rule described above! If you don't bring the FTEE levels up almost immediately upon receiving your PPP loan by reinstating and rehiring employees, you will likely not meet the 75% payroll costs test described above. Factors 1-3 of forgiveness go hand in hand. The key is to consider your FTEEs based on the date range you chose in 2(b) above and get back to that count immediately.

Second, SBA/Treasury FAQ #40 says that if your nonprofit offers a position to someone it had to lay off, and that person declines the offer, the resulting lowered FTEE count will not reduce your nonprofit's forgiveness. However, your nonprofit must make a good faith, written offer of rehire (for the same salary/wages and same number of hours) and must clearly document the employee's rejection of that offer. In addition, under the May 22, 2020 Interim Final Loan Forgiveness Regulations, your nonprofit must also inform your unemployment insurance office of the rejection of the offer for reemployment within 30 days of the rejection.

Excluding the specific FAQ guidance above, it does not appear that your nonprofit must employ the same people or the same number of full-time and part-time positions. You just need to meet the FTEE number and pay them the same or similar wages. (Wages are discussed below.) If your facilities are still closed and employees cannot telework, you can use PPP money to pay these employees even if they are not working. Stepping back again, if you don't have at least the same number of FTEEs and don't pay them similar wages, then you probably won't meet the 75% requirement for loan forgiveness anyway. The two go hand in hand, as does the wages piece described below.

3) Salary Reductions May Affect Forgiveness

If employees' wage levels are reduced during the eight-week covered period by more than 25% of the employees' wage levels paid in the first quarter of 2020, the amount of the PPP loan that can be forgiven is reduced by the amount of the wage level reduction.

The CARES Act includes another special provision to address the immediate needs of employers until they receive the PPP loan. If your nonprofit reduced wage/salary levels between February 15 and April 26, 2020 (presumably due to COVID-19), as long as your nonprofit returns the salary/wage levels back to what they were prior to the reduction by no later than June 30, 2020, then your nonprofit's loan forgiveness will not be affected. However, don't forget the 75% rule described above! If you don't bring the salary/wage levels up almost immediately upon receiving your PPP loan, you will likely not meet the 75% payroll costs test described above. Factors 1-3 of forgiveness go hand in hand.

Other questions involving wages to consider include whether you can pay extra wages and/or bonuses and whether to adjust payroll to pay out the amount within the eight-week covered period.

Will your PPP loan be forgiven if you pay employees more money in the form of wages or bonuses? You can, of course, pay employees higher wages during the eight-week period especially if the employees would have normally received tips and are not receiving them due to closure. Further, if your nonprofit normally provides bonuses during this time of the year, such bonuses can be paid. It's not clear whether a special one-time bonus or a bonus paid earlier than usual (such as paid during eight-week covered period rather than at the usual year-end) would qualify for forgiveness.

However, also keep in mind the $100,000 annual cash wages cap when paying employees higher wages or bonuses using PPP funds. Finally, if your nonprofit paid out annual bonuses in the first quarter of 2020, it will be necessary to carefully look at the cash salary/wages comparison between first quarter 2020 and the eight-week covered period to make certain cash wages/salaries are not more than 25% lower due to that paid bonus.

4) Amount of Loan Not Used for Payroll (Up To 25%) Can Only Be Used for Mortgage Interest, Rent, Utilities and Other Debt Obligation Interest

The fourth consideration regarding use of the PPP loan funds in a manner that will obtain full forgiveness is the requirement that any funds not used to pay payroll costs (up to 25%) can only be used to pay mortgage interest, rent, utilities and interest on other debt obligations. *All of these obligations must have been in existence as of February 15, 2020*. The goal of the PPP loan is to keep employees employed and paid and to help the nonprofit pay some of the specific expenses it already had in place. For example, your nonprofit cannot obtain additional or different internet service in May, 2020 and use PPP loan funds to cover that cost. What if your nonprofit refinanced its mortgage or renegotiated its lease after February 15, 2020? Then, it is likely a new mortgage or a new lease and therefore payment of rent or mortgage interest will not be forgivable.

While funds may be used to pay interest on mortgage obligations, funds may <u>not</u> be used for any prepayment or payment of principal on mortgage obligations. And while funds may be used to pay rent payments, "rent" is not clearly defined in the CARES Act, rules or FAQs.

Utility payments that may be included are limited to payments on electric, gas, water, transportation, telephone and internet access, and again, service had to begin before February 15, 2020.

Other Considerations

Importance of Documentation

Nonprofits seeking loan forgiveness should keep careful and meticulous documentation. First, be sure to document the reasons for applying for the PPP loan. This approach supports and clarifies the certification in the PPP loan application that "current economic uncertainty makes this loan request necessary to support ongoing operations of the Applicant." You should create a file and store all information about how your nonprofit made the decision to apply for a PPP loan including, for instance, board resolutions, summary of calls and discussions, pre-loan financial statements and projections, any need to lay off or furlough workers or cut salaries, any discussions about strength of cash reserves, etc.

The SBA will review all loans of $2 million or more to determine if the borrower "lacked an adequate basis for the required certification concerning the necessity of the loan request." With the uproar over large businesses that had plenty of money and reserves applying for and receiving funds, SBA/Treasury added FAQs ##31, 37 and 39 addressing the requirement that a nonprofit must lack liquidity in order to receive PPP funds. Specifically, businesses must "tak[e] 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." If the SBA determines that a borrower "lack[s] an adequate basis for the required certification concerning the necessity of the loan request," then the loan will be required to be repaid and no forgiveness will be provided.

On the other hand, borrowers that received PPP loans of less than $2 million fall under the safe harbor that the Treasury and the SBA announced on May 13, 2020 in FAQ #46. This latest FAQ states, "Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than $2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith." Since there are no other apparent requirements to qualify for the safe harbor, this effectively takes the certification issue off the table for loans under $2 million.

It is important to keep the PPP loan separate from the rest of the nonprofit's funds. It can be in a separate, segregated account or it can be treated like a restricted fund. All expenditures must be clearly documented in your financial accounting software (such as QuickBooks) clearly showing what expenses the funds covered. The more documentation the organization has, the better. This documentation must be submitted to your lender and the SBA in order for the loan to be forgiven.

At the end of the eight-week covered period, your nonprofit should be ready to provide your lender the following detailed documentation:

1) The number of FTEEs on payroll and their pay rates, wages/salaries paid, and other associated payroll costs paid during the eight-week covered period;
2) Any evidence of employees not willing to accept a rehire offer;
3) Any evidence of salary reductions, furloughs or layoffs during the February 15- April 26, 2020 time period and reinstatement of salaries/wages and employees by June 30th;
4) Payments of other covered costs including mortgage interest, rent, specific utilities, and interest on other debt obligations along with evidence that such arrangements existed before February 15, 2020;
5) Certification from an officer of the nonprofit that the documentation is true and correct and that forgiveness amounts requested were used to retain employees and make other forgiveness-eligible payments; and
6) Any other documentation the SBA may require.

Portion of Loan Not Forgiven

Should a portion of your nonprofit's PPP loan not be forgiven, that portion is a loan at a

1% interest rate that must be paid back within two years of receipt. A six-month deferral of any loan principal repayments is permitted under the CARES Act. Presumably, your nonprofit should know within six months of receipt of the PPP loan whether any portion of the loan is not forgiven.

If you have additional questions about loan forgiveness, contact your attorney or accountant.