



## Computational Framework for Determining Number of Employees for Eligibility, Qualifying Loan Amount and Forgiveness for a PPP Loan

### Introduction

The Paycheck Protection Program (“PPP”), as enacted under the [Coronavirus Aid, Relief, and Economic Security \(CARES\) Act](#), provides federally-guaranteed loans up to a maximum amount of \$10 million to qualified businesses, which can be fully forgivable, to encourage businesses to retain employees through the COVID-19 crisis by assisting in the payment of certain operational costs.

The below Computational Framework equips PPP applicants with detailed guidance on calculating (i) the total number of employees for eligibility, (ii) the maximum loan amount available and (iii) the eligible forgiveness amount.

The Computational Framework was prepared in accordance with our analysis of the (i) [CARES Act](#), (ii) [First Interim Final Rule](#) issued by the U.S. Small Business Administration (“SBA”) on April 2, 2020, (iii) [Second Interim Final Rule](#) issued by the SBA on April 4, 2020, (iv) [Applicable Affiliation Rules](#) fact sheet that was issued by the U.S. Department of Treasury (“Treasury”) on April 4, 2020, (v) [Third Interim Final Rule](#) issued by the SBA on April 14, 2020, and (vi) the [Frequently Asked Questions fact sheet](#) (“FAQ”) issued by the Treasury, which was last updated on April 17, 2020 at the time of this publication.

### Number of Employees for Eligibility

Applicant may use any of the following periods for computing the average number of employees for determining eligibility:<sup>1</sup>

1. January 1, 2019 through December 31, 2019;
2. 12-month period before the date of the application;
3. 12 completed calendar months before the date of the application;
4. If the applicant has not been operational for 12 months, then the period over which the applicant has been operational;
5. If the applicant was not in business from February 15, 2019 to June 30, 2019, the period from January 1, 2020 through February 29, 2020; or
6. If the applicant is a seasonal employer, the period beginning on February 15, 2019, or March 1,

<sup>1</sup> See [FAQ](#), Question 14.

2019, through June 30, 2019.

The computation prescribed by existing SBA regulations for #3 is performed by taking the average of the number of employees for each of the pay periods during such 12-month period (SBA's usual calculation). We believe a similar computation should be used for the other options, though no official guidance has been provided to date.

The [FAQ](#) suggests that the time period used for determining eligibility and the time period used for determining payroll costs do not have to be the same, although no clear guidance has been provided to date.

## Loan Amount

### Computation of Maximum Loan Amount

During the period from February 15, 2020 through June 30, 2020 (the “covered period”), the maximum loan amount available to an applicant is the lesser of:

- (1) 2.5x the average total monthly “payroll costs” incurred during a specified period before the loan is made;<sup>2</sup> <sup>3</sup> PLUS, if applicable, the outstanding amount of a loan made to a borrower under the SBA’s Disaster Loan Program between January 31, 2020 and the date on which such loan may be refinanced as permitted under the Paycheck Protection Program;
- (2) Upon request, for businesses that were not in existence during the period from February 15, 2019 to June 30, 2019: 2.5x the average total monthly payroll payments from January 1, 2020 to February 29, 2020, PLUS, if applicable, the outstanding amount of a loan made to a borrower under the SBA’s Disaster Loan Program between January 31, 2020 and the date on which such loan may be refinanced as permitted under the Paycheck Protection Program; and
- (3) \$10,000,000.

### Computation of Payroll Costs

Calculate the aggregate “payroll costs” over one of the following periods (chosen at the applicant’s election), and DIVIDE BY 12: (i) January 1, 2019 through December 31, 2019; (ii) the 12-month period before the date of the application; or (iii) if the applicant is a seasonal employer, the period beginning on February 15, 2019, or March 1, 2019, through June 30, 2019.

#### “payroll costs” INCLUDES:

- a) salary, wage, commission, or similar compensation;
- b) payment of cash tip or equivalent;
- c) payment for vacation, parental, family, medical, or sick leave;
- d) allowance for dismissal or separation;
- e) payment required for the provisions of group health care benefits, including insurance premiums;
- f) payment of any retirement benefit;
- g) payment of state or local tax assessed on the compensation of employees; and
- h) for a sole proprietor or independent contractor, the sum of payments of any compensation that is a wage, commission, income, net earnings from self-employment, or similar compensation and that is in an amount that is not more than \$100,000 in 1 year, as prorated for the covered period;

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<sup>2</sup> See [FAQ](#), Question 14.

<sup>3</sup> Note: Example calculations are provided on pages 8 through 10 of the SBA’s [First Interim Final Rule](#).

**BUT EXCLUDES:**

- v) employee/owner compensation above the prorated amount (over the covered period) of \$100,000 per annum;
- w) taxes imposed or withheld under chapters 21, 22, or 24 19 of the tax code during the covered period;<sup>4</sup>
- x) compensation of an employee whose principal place of residence is outside of the United States;
- y) qualified sick leave wages for which a credit is allowed under section 7001 of the Families First Coronavirus Response Act; and
- z) qualified family leave wages for which a credit is allowed under section 7003 of the Families First Coronavirus Response Act.

Note: Except in limited circumstances (*i.e.*, persons providing services to the applicant through a PEO, temp agency or leasing concern), payments made to independent contractors are not included in the computation of payroll costs. Independent contractors will typically be independently eligible to apply for PPP loans.

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<sup>4</sup> See [FAQ](#), Question 16 (“Under the Act, payroll costs are calculated on a gross basis without regard to (*i.e.*, not including subtractions or additions based on) federal taxes imposed or withheld”).

## Forgiveness<sup>5</sup>

### Total Eligible Forgiveness Amount

Pursuant to the CARES Act, a borrower is eligible for forgiveness and cancellation of indebtedness for up to the full principal amount of a PPP loan. Additional SBA guidance, however, suggests that interest can also be forgiven.<sup>6</sup>

The amount eligible for forgiveness (the “Total Eligible Forgiveness Amount”) is equal to the total costs incurred and payments made during the 8-week period beginning on the date a PPP loan is funded (the “Forgiveness Period”) for (1) payroll costs, (2) mortgage interest, (3) rent and (4) utilities; provided, that of all PPP loan proceeds spent by a borrower, at least 75% of such amount is required to be used on payroll costs.<sup>7</sup>

### Reduction in Total Eligible Forgiveness Amount due to Employee Terminations during Forgiveness Period (the “Employee Reduction”)

Unless the borrower qualifies for the safe harbor described below, the amount that may be forgiven (the “Forgiveness Amount”) is initially computed by the following formula if the borrower terminates employees during the Forgiveness Period:

$$FA = TEFA \times \frac{x}{y}, \text{ where}$$

FA is the Forgiveness Amount,

TEFA is the Total Eligible Forgiveness Amount,

x is the average number of full-time equivalent employees (FTEEs) per month<sup>8</sup> during the Forgiveness Period, and

y is either of the following (at the election of the borrower):

- i) the average number of FTEEs per month during the period beginning on February 15, 2019 and ending on June 30, 2019; or
- ii) the average number of FTEEs per month during the period beginning on January 1, 2020 and ending on February 29, 2020; or
- iii) for seasonal employers only (as determined by SBA), the average number of FTEEs per month employed during the period beginning on February 15, 2019 and ending on June 30, 2019.

<sup>5</sup> Note: At this time, SBA has not provided example calculations. The calculations provided here, while consistent with the CARES Act, require some interpretation and assumptions (particularly with respect to order of operations) that could lead to different results.

<sup>6</sup> Note: Section 1106(d)(1) of the CARES Act provides that the amount forgiven “cannot exceed the principal amount” of the PPP loan. The SBA’s [Third Interim Final Rule](#), however, states that the “the full principal amount of the loans and any accrued interest may qualify for forgiveness.” See page 4 of the SBA’s [Third Interim Final Rule](#). It is therefore unclear if the PPP provides for forgiveness of interest.

<sup>7</sup> Note: If less than 75% of the amount of PPP loan proceeds that are spent are used on payroll costs, a borrower’s Forgiveness Amount will be proportionately reduced and, additionally, a borrower may be subject to penalties imposed by the SBA, which can include a demand for repayment of loan proceeds spent for unauthorized uses and, if done intentionally, charges of fraud. Furthermore, the SBA’s guidance can be interpreted to require that a borrower spend at least 75% of such borrower’s total PPP loan proceeds on payroll costs (see pages 15 through 17 of the SBA’s [First Interim Final Rule](#)), but it is unclear how such a requirement, if intended, would be enforceable in practice, particularly with respect to any borrower that fails to achieve such spending by no fault of its own and that repays its PPP loan in accordance with its terms.

<sup>8</sup> Note: The average number of FTEEs is determined by calculating the average number of FTEEs for each pay period falling within a month.

Employee Reduction Safe Harbor: If both (i) during the period beginning on February 15, 2020 and ending on April 26, 2020, a borrower reduced its FTEEs (as compared to February 15, 2020) and (ii) not later than June 30, 2020, such borrower has eliminated such reduction in the number of its FTEEs, then the Employee Reduction will not be applied to reduce such borrower's Forgiveness Amount.<sup>9</sup>

Reduction in Total Eligible Forgiveness Amount due to Employee Salary and Wage Reductions during Forgiveness Period (the "Salary Reduction")

Unless the borrower qualifies for the safe harbor described below, the Forgiveness Amount will be reduced, dollar-for-dollar, by the amount of any reduction in total salary or wages of any employee during the Forgiveness Period that is in excess of 25% of the employee's salary/wages during the employee's most recent full quarter of employment before the Forgiveness Period. For purposes of this paragraph only, an "employee" is any person who did not receive wages or salary at an annualized rate of pay over \$100,000 *during any single pay period* in 2019.

Salary Reduction Safe Harbor: If both (i) during the period beginning on February 15, 2020 and ending on April 26, 2020, a borrower reduced the salary or wages of 1 or more of its employees (as compared to February 15, 2020) and (ii) not later than June 30, 2020, such borrower has eliminated such reduction in salary or wages, then the Salary Reduction will not be applied to reduce such borrower's Forgiveness Amount.<sup>10</sup>

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<sup>9</sup> See Footnote 10 below.

<sup>10</sup> Note: There is an open question among practitioners as to whether the Salary Reduction Safe Harbor eliminates only the Salary Reduction (and not the Employee Reduction as well) and whether the Employee Reduction Safe Harbor eliminates only the Employee Reduction (and not the Salary Reduction as well). The CARES Act is ambiguous on this point and the SBA has not yet issued any clarifying guidance. In context, however, it seems more likely than not that each safe harbor was intended to apply only to its corresponding reduction provision, and we expect the SBA will ultimately take that position.