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Economic Effect of COVID-19 Shutdowns and Paycheck Protection Program Relief

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Closing in on five months after the initial COVID-19 shutdown, it is apparent that most, if not all, industries have been affected by shutdowns, restrictions, and quickly changing guidelines and best practices. Physician practices and other healthcare providers were among the hardest hit, effectively closing in most states for seven weeks (or more), coupled with elective procedures at a virtual standstill. As restrictions have lifted and companies have made appropriate health and safety-related changes to policies and procedures, many people are back to work, but most would probably agree that things look and feel different, and the financial impact of the crisis still remains.

Once the impact of COVID-19 became apparent, the federal government implemented several relief programs, and loans made under the new Paycheck Protection Program ("PPP") became one of the most publicized relief efforts put in place, largely due to the forgiveness aspect of these loans. A part of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") passed in late March, these loans were so popular that the original amount reserved had to be increased. According to the U.S. Small Business Administration ("SBA"), through July 10, 2020, businesses in the health care and social assistance fields received 12.91% of all PPP loan funds (based on total dollars loaned), which is the highest among the industries reported.

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In the first several months after the passage of the CARES Act, the regulations and guidance surrounding PPP loans seemed to change as frequently as information about COVID-19, but that has been leveling out to some extent since late June. PPP loans are only available to businesses that have 500 or less employees or are otherwise considered small businesses under applicable SBA regulations (where, in some cases, a business can have more than 500 employees and be considered a small business), with some exceptions for businesses in the restaurant and hospitality industries that were permitted to count employees by location under the CARES Act.

A nuance in the eligibility requirements came in the form of economic necessity, such that in applying for a PPP loan, each applicant is required to certify in good faith that the "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." This became a focus of media attention, particularly after it became known that several very large, publicly traded companies received PPP loans. After several weeks of uncertainty, the SBA released guidance providing a safe harbor for borrowers who (along with affiliates) received loans less than $2,000,000, providing that those borrowers were deemed to have made the certification in good faith. This means that those who received loans greater than $2,000,000 will need to be prepared to demonstrate the circumstances facing their respective businesses created a good faith basis for applying for and receiving the PPP funds. The SBA has not provided specific guidance on this point, but borrowers should collect and maintain documentation showing the negative financial impact of COVID-19 on their business, such as comparative sales/revenue reports for comparable periods prior to COVID-19, evidence of government mandated shut-downs and other similar documentation.

Originally, only PPP funds that were used in the 8 weeks following the loan qualified for forgiveness, but the Paycheck Protection Program Flexibility Act of 2020 (the "Flexibility Act") provides borrowers the opportunity to elect to extend the covered period to 24 weeks (but no later than December 31, 2020). The CARES Act places restrictions on the use of PPP loan funds, and only the following uses are eligible for forgiveness: (1) payroll costs, (2) utilities, (3) qualified rent (meaning rent under a real property or personal property lease entered into prior to February 15, 2020 with an unaffiliated entity), and (4) mortgage interest on a mortgage in place prior to February 15, 2020 (also must relate to real or personal property). Payroll costs includes more than just salary costs, but include salary caps and further restrictions on the types and amounts of payroll costs that can be included for employee-owners (which may vary depending on the type of entity and whether the borrower chooses an 8-week or 24-week covered period). Additionally, where only 25% of the forgiven loan amount could be used for non-payroll purposes under the CARES Act, the Flexibility Act increased this to 40%, meaning that 60% of the forgiven amount has to be used for payroll purposes, but 40% can be used for utilities, rent or mortgage interest. Expenses that are eligible for forgiveness must be paid during the covered period or incurred during the covered period; provided, however, that in order for incurred expenses to be eligible for forgiveness, they must be paid on the next regular payroll date (for payroll costs) or on or before the next regular billing date (for non-payroll costs).

A borrower's PPP loan forgiveness amount may be decreased to the extent its average number of "full-time equivalent employees" during the applicable period is less than the average number of such employees per month during one of the applicable measuring periods. Note that various non-PPP-related rules require determination of full-time equivalent employees, and a borrower should take care that the determination of its full-time equivalent employees for purposes of PPP loan forgiveness follows the method described in the forgiveness application. There is a safe harbor if any reduction is corrected by December 31, 2020, and also a safe harbor if the borrower can show that it was unable to re-hire individuals or hire similarly qualified individuals, or was otherwise unable to return to the same level of business activity due to compliance with COVID-19 related safety standards. A borrower's forgiveness amount may also be reduced in the event an employee's wages have been subjected to a greater than 25% cut compared to that employee's wages in the first quarter of 2020, and such cut is not corrected by December 31, 2020. The application provides a step-by-step worksheet to help borrowers determine whether this forgiveness amount reduction could apply to it.

PPP borrowers will apply for forgiveness with their respective lenders, and the applicable lender will make the forgiveness determination (subject to automatic SBA review if the loan is over $2,000,000). As part of its forgiveness application, a PPP borrower must submit a loan forgiveness calculation form and a correlating schedule (known as PPP Schedule A), as well as a host of other supporting documentation verifying payroll costs, showing employee numbers and non-payroll costs that are eligible for forgiveness. Each borrower should be careful to include support for any expense claimed for forgiveness with its application. In addition to the foregoing, borrowers must maintain other documentation, as specified in the Loan Forgiveness Form, and maintain all such records for at least 6 years after the date of PPP loan forgiveness. The application explicitly contemplates that borrowers should permit the SBA access to such documentation upon request. It is important for PPP borrowers to carefully review the required documentation with their respective advisors to fully understand the documentation and retention requirements. Forgiveness decisions on PPP loans over $2,000,000 will automatically be audited by the SBA, but this does not mean that loans under $2,000,000 will not be audited. Similar to the need to be prepared in the event of an audit by the IRS, all PPP borrowers should keep appropriate documentation and be prepared in the event of an audit of its PPP loan.

Undoubtedly, PPP loans have provided a valuable lifeline for many businesses that have struggled and continue to struggle in the midst of these very uncertain times, including physician practices and other healthcare providers. As PPP borrowers continue to operate and enter into the forgiveness phase of their loans, it is important that they keep meticulous and detailed records supporting the use of PPP funds and the forgiveness application, and also maintain open communication channels with lenders and advisors in order to ensure compliance.

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