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To: Businesses of Hawaii

From: Darin R. Leong, Esq.
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Re: Save Hawaii Jobs and Businesses – Paycheck Protection Program Forgiveness

This memo discusses the requirements for loan forgiveness under the Paycheck Protection Act (“PPP”). Because we are still waiting for guidance from the Small Business Administration (“SBA”) and U.S. Treasury (“Treasury”), we expect to update this memo as new guidance is published.

- Requirements for PPP Loan Forgiveness
 - RULE #1: FUNDS MUST BE USED FOR “ALLOWABLE USES” BY JUNE 30, 2020 (*see* additional 8-week limitation below)
 - In order to obtain loan forgiveness, the borrower must use the funds for “allowable uses”
 - Allowable uses are limited to a period ending June 30, 2020
 - Allowable uses include:
 - “Payroll costs”:
 - salary, wage, commission, or similar compensation
 - cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips)
 - vacation, parental, family, medical, or sick leave payments
 - separation allowance
 - “payment required for the provisions of group health care benefits, including insurance premiums”
 - Payment of any retirement benefit
 - State or local tax assessed on employee compensation

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- For sole proprietors or independent contractors, “payroll costs” includes wages, commissions, income, net earnings from self-employment, or similar compensation of \$100k or less in a year.
- “Payroll costs” excludes:
 - compensation of any employees in excess of \$100k annual salary (prorated for the applicable period; exclusive of employer retirement plan contributions, group health care costs, and state and local taxes assessed on employee compensation)
 - This means that for forgiveness, the maximum “payroll costs” per employee is 8-weeks of \$100k salary, which equals \$15,384.62 (exclusive of employer retirement plan contributions, group health care costs, and state and local taxes assessed on employee compensation)
 - employer’s share of federal payroll taxes
 - compensation of employees with a principal place of residence outside of the U.S.
 - payments to an independent contractor or sole proprietor
 - qualified paid sick leave or paid family leave where a tax credit is allowed
- Mortgage interest (for mortgage obligation incurred before February 15, 2020)
- Rent under a leasing agreement (in force before February 15, 2020)
 - Note: There appears to be an open question whether use of loan proceeds to pay mortgage interest or rent exposes borrower to added federal obligations applicable for receipt of federal funds lasting for the life of loan or lease.
- Utilities (*i.e.*, payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020)



- Note: Interest on any other debt obligation incurred prior to covered period is an “allowable use” but not eligible for forgiveness
- RULE #2: FORGIVENESS APPLIES TO THE FOLLOWING CATEGORIES IN THE EIGHT-WEEK PERIOD FOLLOWING DISBURSEMENT OF FUNDS
 - Payroll Costs (as defined above)
 - Non-Payroll Costs
 - Mortgage interest (for mortgage obligation incurred before February 15, 2020)
 - Rent under a leasing agreement (in force before February 15, 2020)
 - Utilities (*i.e.*, payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020)
 - Note: Interest on any other debt obligation incurred prior to covered period is not eligible for forgiveness
 - Note: The funds must be used for “costs incurred and payments made” within the eight weeks following disbursement of funds. SBA/Treasury has not specifically defined “costs incurred and payments made” yet.
- RULE #3: NO MORE THAN 25% OF THE FORGIVEN AMOUNT MAY BE USED FOR NON-PAYROLL COSTS
 - No more than 25% of the forgiven amount may be used for non-payroll costs
 - This presumably means that as the forgiven amount decreases, the amount that may be used for non-payroll costs decreases.
 - Note: In order to obtain full forgiveness of the entire loan amount and use 25% for non-payroll costs such as rent/utilities, the borrower will need to use 75% of the PPP funds for payroll costs. For most employers, this 75% of PPP funds will be roughly equivalent to bringing all employees back at 100% pay for eight weeks. If an employer follows this path, Rules #4 and #5 below will likely be satisfied.



- RULE #4: YOU MUST MAINTAIN THE AVERAGE NUMBER OF FULL-TIME EQUIVALENT EMPLOYEES IN THE 8-WEEK PERIOD FOLLOWING FUND DISBURSEMENT AS COMPARED TO A LOOK-BACK PERIOD
 - Maintain average monthly number of full-time equivalent (“FTE”) employees in 8-week period following loan origination equal or above the previous average monthly number of full-time equivalent employees.
 - The 8-week period begins on the date the lender makes the first disbursement of the PPP loan to the borrower.
 - FTE has not yet been defined by the SBA or Treasury. We expect a definition to be issued in the next few weeks.
 - Many employers will need to re-hire employees who have been laid-off to get back to the previous average number of employees.
 - The employer has two choices for the look-back period and should choose the time period with a lower average FTE headcount.
 - The amount of loan forgiveness will be reduced based on the proportion of employee headcount the employer has reduced from prior levels. This percentage is calculated by multiplying (1) the forgivable costs by (2) the quotient obtained by dividing (a) the average number of full-time equivalent employees per month during the covered period by (b) at the election of the borrower, (i) the average number of full-time equivalent employees per month from February 15, 2019 to June 20, 2019 or (ii) the average number of full-time equivalent employees per month from January 1, 2020 to February 29, 2020.
 - Seasonal employers are required to use the February 15, 2019 to June 30, 2019 look-back time period to determine average monthly FTE headcount.
 - This rule does not apply if the employer had a reduction in FTEs between February 15, 2020 and April 26, 2020, and eliminates the FTE reduction and goes back to the February 15, 2020 FTE level no later than June 30, 2020.
 - Note: In order to get forgiveness of the entire loan amount and comply with the rule that no more than 25% of the forgiven amount may be used for non-payroll



costs such as rent/utilities, the employer must expend 75% of the funds on payroll costs. This means that the employer will likely need to keep a full payroll at around 100% pay for the full eight weeks to use 75% of PPP funds. In this scenario, Rule #4 is unlikely to come into play.

- RULE #5: NO PAY REDUCTIONS MORE THAN 25% FOR EACH EMPLOYEE UNDER \$100K/YEAR COMPENSATION
 - The amount of loan forgiveness will be reduced by the amount of any reduction in total salary or wages of any employee during the 8-week period that is in excess of 25 percent of the total salary or wages during the most recent full quarter during which the employee was employed before the covered period.
 - This applies to each employee individually, not the aggregated total employee compensation
 - Exclusions
 - Employees who in any single pay period had prorated annualized pay over \$100k (e.g., \$4,200 in a pay period for employer that pays bi-monthly) are excluded from this rule.
 - This rule does not apply if the employee had his/her pay reduced more than 25% between February 15, 2020 and April 26, 2020, if the employer eliminates the reduction in pay by June 30, 2020.
 - Note: In order to get forgiveness of the entire loan amount and comply with the rule that no more than 25% of the forgiven amount may be used for non-payroll costs such as rent/utilities, the employer must expend 75% of the funds on payroll costs. This means that the employer will likely need to keep a full payroll at around 100% pay for the full eight weeks to use 75% of PPP funds. In this scenario, Rule #5 will not come into play.
- MISC.
 - If there is a remaining balance after forgiveness is calculated, that balance falls under the two (2) year, 1% interest loan. Payment is deferred for the first six months.
 - Cancelled indebtedness shall be excluded from gross income for tax purposes.



- Funds that are not used for “allowable uses” by June 30, 2020 will presumably need to be returned immediately.
- Funds used for “allowable uses” but not forgiven will remain subject to the 2-year loan term.
- If PPP funds are misused, SBA will direct repayment. Knowingly using funds for unauthorized purposes may be subject to serious penalties including fraud charges, up to thirty (30) years prison, up to \$1M fine.
- EXAMPLE:
 - Employer has 5 employees at \$48k/year (\$4k/month) salaries for each employee
 - Monthly payroll cost is \$20k
 - Maximum loan amount is \$20k x 2.5 = \$50k
 - Employer obtains PPP loan, keeps all employees at 100% pay for eight weeks following disbursement of PPP funds by the bank
 - Employer uses PPP funds to pay for eight weeks of payroll, \$36,923
 - Employer uses 25% of PPP funds for rent and utilities, \$12,500
 - The remaining \$577 should be paid out as eligible payroll costs during the eight-week period so that the \$12,500 of non-payroll costs is 25% of the forgiven amount

***This information is provided for informational purposes only and is not intended as legal or tax advice. Please consult your attorney or accountant to discuss your particular business situation.*