

PPP Loan Forgiveness

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05.26.2020

The Small Business Administration has released much-anticipated guidance regarding forgiveness of Paycheck Protection Program (PPP) loans. This client alert is provided on May 26, 2020 and, as all participants in this loan program have come to understand by now, is subject to change as additional guidance is issued.

LOAN FORGIVENESS IN GENERAL

To receive loan forgiveness, a borrower must complete and submit the Loan Forgiveness Application (SBA Form 3508 or lender equivalent) to its lender (or the lender servicing its loan). As a general matter, the lender will review the application and make a decision regarding loan forgiveness. The lender has 60 days from receipt of a complete application to issue a decision to SBA. If the lender determines that the borrower is entitled to forgiveness of some or all of the amount applied for under the statute and applicable regulations, the lender must request payment from SBA at the time the lender issues its decision to SBA. SBA will, subject to any SBA review of the loan or loan application, remit the appropriate forgiveness amount to the lender, plus any interest accrued through the date of payment, not later than 90 days after the lender issues its decision to SBA.

If applicable, SBA will deduct EIDL Advance Amounts from the forgiveness amount remitted to the Lender as required by section 1110(e) (6) of the CARES Act.

If SBA determines in the course of its review that the borrower was ineligible for the PPP loan based on the provisions of the CARES Act, SBA rules or guidance available at the time of the borrower's loan application, or the terms of the borrower's PPP loan application (for example, because the borrower lacked an adequate basis for the certifications that it made in its PPP loan application), the loan will not be eligible for loan forgiveness. The lender is responsible for notifying the borrower of the forgiveness amount. If only a portion of the loan is forgiven, or if the forgiveness request is denied, any remaining balance

due on the loan must be repaid by the borrower on or before the two-year maturity of the loan.

PAYROLL COSTS FORGIVEN

New “Paid or Incurred” Standard. In general, payroll costs paid or incurred during the eight consecutive week (56 days) covered period are eligible for forgiveness. Borrowers may seek forgiveness for payroll costs for the eight weeks beginning on either:

1. the date of disbursement of the borrower’s PPP loan proceeds from the Lender (i.e., the start of the covered period); or
2. the first day of the first payroll cycle in the covered period (the “alternative payroll covered period”).

Payroll costs are considered paid on the day that paychecks are distributed or the borrower originates an ACH credit transaction. Payroll costs incurred during the borrower’s last pay period of the covered period or the alternative payroll covered period are eligible for forgiveness if paid on or before the next regular payroll date; otherwise, payroll costs must be paid during the covered period (or alternative payroll covered period) to be eligible for forgiveness.

Alternative Payroll Covered Period. A borrower with a bi-weekly (or more frequent) payroll cycle may elect to use an alternative payroll covered period that begins on the first day of the first payroll cycle in the covered period and continues for the following eight weeks. If payroll costs are incurred during this eight-week alternative payroll covered period, but paid after the end of the alternative payroll covered period, such payroll costs will be eligible for forgiveness if they are paid no later than the first regular payroll date thereafter.

Example: A borrower has a bi-weekly payroll schedule (every other week). The borrower’s eight-week covered period begins on June 1 and ends on July 26. The first day of the borrower’s first payroll cycle that starts in the covered period is June 7. The borrower may elect an alternative payroll covered period for payroll cost purposes that starts on June 7 and ends 55 days later (for a total of 56 days) on August 1. Payroll costs paid during this alternative payroll covered period are eligible for forgiveness. In addition, payroll costs incurred during this alternative payroll covered period are eligible for forgiveness as long as they are paid on or before the first regular payroll date occurring after August 1. Payroll costs that were both paid and incurred during the covered period (or alternative payroll covered period) may only be counted once.

Definition of Payroll Costs. The CARES Act defines the term “payroll costs” broadly to include compensation in the form of salary, wages, commissions, or similar compensation. If a borrower pays furloughed employees their salary, wages, or commissions during the covered period, those payments are eligible for forgiveness as long as they do not exceed an annual salary of \$100,000, as prorated for the covered period. Also, if an employee’s total compensation does not exceed \$100,000 on an annualized basis, the employee’s hazard pay and bonuses are eligible for loan forgiveness because they constitute a supplement to salary or wages, and are thus a similar form of compensation.

Caps on Loan Forgiveness for Owner-Employees and Self-Employed Individuals. The amount of loan forgiveness requested for owner-employees and self-employed individuals' payroll compensation can be no more than the lesser of 8/52 of 2019 compensation (i.e., approximately 15.38 percent of 2019 compensation) or \$15,385 per individual in total across all businesses

Additional Owner-Employee Guidance. Owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement and health care contributions made on their behalf. Schedule C filers are capped by the amount of their owner compensation replacement, calculated based on 2019 net profit. General partners are capped by the amount of their 2019 net earnings from self-employment (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235. No additional forgiveness is provided for retirement or health insurance contributions for self-employed individuals, including Schedule C filers and general partners, as such expenses are paid out of their net self-employment income.

NON-PAYROLL COSTS FORGIVEN

New "Paid or Incurred" Standard. A non-payroll cost is eligible for forgiveness if it was:

1. paid during the covered period; or
2. incurred during the covered period and paid on or before the next regular billing date, even if the billing date is after the covered period.

REDUCTIONS TO LOAN FORGIVENESS AMOUNTS

In General. Section 1106 of the CARES Act specifically requires certain reductions in a borrower's loan forgiveness amount based on reductions in full-time equivalent employees or in employee salary and wages during the covered period, subject to an important statutory exemption for borrowers who have rehired employees and restored salary and wage levels by June 30, 2020 (with limitations).

Employee Headcount

Re-hires and Restoration of Hours – Offers Rejected. Employees whom the borrower offered to rehire are generally exempt from the CARES Act's loan forgiveness reduction calculation. This exemption is also available if a borrower previously reduced the hours of an employee and offered to restore the employee's hours at the same salary or wages. Specifically, in calculating the loan forgiveness amount, a borrower may exclude any reduction in full-time equivalent employee headcount that is attributable to an individual employee if:

1. the borrower made a good faith, written offer to rehire such employee (or, if applicable, restore the reduced hours of such employee) during the covered period or the alternative payroll covered period;
2. the offer was for the same salary or wages and same number of hours as earned by such employee in the last pay period prior to the separation or reduction in hours;

3. the offer was rejected by such employee;
4. the borrower has maintained records documenting the offer and its rejection; and
5. the borrower informed the applicable state unemployment insurance office of such employee's rejected offer of reemployment within 30 days of the employee's rejection of the offer.

FTE Calculations. In general, a reduction in FTE employees during the covered period or the alternative payroll covered period reduces the loan forgiveness amount by the same percentage as the percentage reduction in FTE employees.

The borrower must first select a reference period:

1. February 15, 2019 through June 30, 2019;
2. January 1, 2020 through February 29, 2020; or
3. in the case of a seasonal employer, either of the two preceding methods or a consecutive 12-week period between May 1, 2019 and September 15, 2019.

If the average number of FTE employees during the covered period or the alternative payroll covered period is less than during the reference period, the total eligible expenses available for forgiveness is reduced proportionally by the percentage reduction in FTE employees.

Example: if a borrower had 10.0 FTE employees during the reference period and this declined to 8.0 FTE employees during the covered period, the percentage of FTE employees declined by 20 percent and thus only 80 percent of otherwise eligible expenses are available for forgiveness.

Definition of FTE. Full-time equivalent employee means an employee who works 40 hours or more, on average, each week. The hours of employees who work less than 40 hours are calculated as proportions of a single full-time equivalent employee and aggregated.

Borrowers seeking forgiveness must document their average number of FTE employees during the covered period (or the alternative payroll covered period) and their selected reference period. For purposes of this calculation, borrowers must divide the average number of hours paid for each employee per week by 40, capping this quotient at 1.0. For example, an employee who was paid 48 hours per week during the covered period would be considered to be an FTE employee of 1.0.

Borrower Election Regarding FTE Calculations. For employees who were paid for less than 40 hours per week, borrowers may choose to calculate the full-time equivalency in one of two ways. First, the borrower may calculate the average number of hours a part-time employee was paid per week during the covered period. For example, if an employee was paid for 30 hours per week on average during the covered period, the employee could be considered to be an FTE employee of 0.75. Similarly, if an employee was paid for ten hours per week on average during the covered period, the employee could be considered to be an FTE employee of 0.25. Second, for administrative convenience, borrowers may elect to use a full-time equivalency of 0.5 for 18 each part-time employee.

Borrowers may select only one of these two methods, and must apply that method consistently to all of their part-time employees for the covered period or the alternative payroll covered period and the selected reference period. In either case, the borrower shall provide the aggregate total of FTE employees for both the selected reference period and the covered period or the alternative payroll covered period, by adding together all of the employee-level FTE employee calculations. The borrower must then divide the average FTE employees during the covered period or the alternative payroll covered period by the average FTE employees during the selected reference period, resulting in the reduction quotient.

Reduction in Wages

Under section 1106(d)(3) of the CARES Act, a reduction in an employee's salary or wages in excess of 25 percent will generally result in a reduction in the loan forgiveness amount, unless an exception applies. Specifically, for each new employee in 2020 and each existing employee who was not paid more than the annualized equivalent of \$100,000 in any pay period in 2019, the borrower must reduce the total forgiveness amount by the total dollar amount of the salary or wage reductions that are in excess of 25 percent of base salary or wages between January 1, 2020 and March 31, 2020 (the reference period), subject to exceptions for borrowers who restore reduced wages or salaries (see g. below). This reduction calculation is performed on a per employee basis, not in the aggregate.

Example: A borrower reduced a full-time employee's weekly salary from \$1,000 per week during the reference period to \$700 per week during the covered period. The employee continued to work on a full-time basis during the covered period with an FTE of 1.0. In this case, the first \$250 (25 percent of \$1,000) is exempted from the reduction. Borrowers seeking forgiveness would list \$400 as the salary/hourly wage reduction for that employee (the extra \$50 weekly reduction multiplied by eight weeks).

No Double Penalty. To ensure that borrowers are not doubly penalized, the salary/wage reduction applies only to the portion of the decline in employee salary and wages that is not attributable to the FTE reduction.

Example: An hourly wage employee had been working 40 hours per week during the borrower selected reference period (FTE employee of 1.0) and the borrower reduced the employee's hours to 20 hours per week during the covered period (FTE employee of 0.5). There was no change to the employee's hourly wage during the covered period. Because the hourly wage did not change, the reduction in the employee's total wages is entirely attributable to the FTE employee reduction and the borrower is not required to conduct a salary/wage reduction calculation for that employee.

Restoration of Reductions by June 30, 2020. Section 1106(d)(5) of the CARES Act provides that if certain employee salaries and wages were reduced between February 15, 2020 and April 26, 2020 (the safe harbor period) but the borrower eliminates those reductions by June 30, 2020 or earlier, the borrower is exempt from any reduction in loan forgiveness amount that would otherwise be required due to reductions in salaries and wages under section 1106(d)(3) of the CARES Act. Similarly, if a borrower eliminates any reductions in FTE employees occurring during the safe harbor period by June 30, 2020 or earlier, the borrower is exempt from any reduction in loan forgiveness amount that would otherwise be required due to reductions in FTE employees.

Terminations for Cause, Voluntary Resignations and Schedule Reductions. When an employee of the borrower is fired for cause, voluntarily resigns, or voluntarily requests a reduced schedule during the covered period or the alternative payroll covered period (FTE reduction event), the borrower may count such employee at the same full-time equivalency level before the FTE reduction event when calculating the section 1106(d)(2) FTE employee reduction penalty.

DOCUMENTATION REQUIREMENTS

The SBA has also released its PPP Forgiveness Application, available at:

<https://home.treasury.gov/system/files/136/3245-0407-SBA-Form-3508-PPP-Forgiveness-Application.pdf>

The Forgiveness Application must include:

PPP Loan Forgiveness Calculation Form

PPP Schedule A

Payroll: Documentation verifying the eligible cash compensation and non-cash benefit payments from the Covered Period or the Alternative Payroll Covered Period consisting of each of the following:

1. Bank account statements or third-party payroll service provider reports documenting the amount of cash compensation paid to employees.
2. Tax forms (or equivalent third-party payroll service provider reports) for the periods that overlap with the Covered Period or the Alternative Payroll Covered Period: i. Payroll tax filings reported, or that will be reported, to the IRS (typically, Form 941); and ii. State quarterly business and individual employee wage reporting and unemployment insurance tax filings reported, or that will be reported, to the relevant state.
3. Payment receipts, cancelled checks, or account statements documenting the amount of any employer contributions to employee health insurance and retirement plans that the Borrower included in the forgiveness amount (PPP Schedule A, lines (6) and (7)).

FTE: Documentation showing (at the election of the Borrower):

1. the average number of FTE employees on payroll per month employed by the Borrower between February 15, 2019 and June 30, 2019;
2. the average number of FTE employees on payroll per month employed by the Borrower between January 1, 2020 and February 29, 2020; or
3. in the case of a seasonal employer, the average number of FTE employees on payroll per month employed by the Borrower between February 15, 2019 and June 30, 2019; between January 1, 2020 and February 29, 2020; or any consecutive twelve week period between May 1, 2019 and September 15, 2019.

The selected time period must be the same time period selected for purposes of completing PPP Schedule A, line 11. Documents may include payroll tax filings reported, or that will be reported, to the IRS (typically, Form 941) and state quarterly business and individual employee wage reporting and unemployment insurance tax filings reported, or that will be reported, to the relevant state. Documents submitted may cover periods longer than the specific time period.

Nonpayroll: Documentation verifying existence of the obligations/services prior to February 15, 2020 and eligible payments from the Covered Period.

1. Business mortgage interest payments: Copy of lender amortization schedule and receipts or cancelled checks verifying eligible payments from the Covered Period; or lender account statements from February 2020 and the months of the Covered Period through one month after the end of the Covered Period verifying interest amounts and eligible payments.
2. Business rent or lease payments: Copy of current lease agreement and receipts or cancelled checks verifying eligible payments from the Covered Period; or lessor account statements from February 2020 and from the Covered Period through one month after the end of the Covered Period verifying eligible payments.
3. Business utility payments: Copy of invoices from February 2020 and those paid during the Covered Period and receipts, cancelled checks, or account statements verifying those eligible payments.

Documents that Each Borrower Must Maintain but is Not Required to Submit

PPP Schedule A Worksheet or its equivalent and the following:

1. Documentation supporting the listing of each individual employee in PPP Schedule A Worksheet Table 1, including the "Salary/Hourly Wage Reduction" calculation, if necessary.
2. Documentation supporting the listing of each individual employee in PPP Schedule A Worksheet Table 2; specifically, that each listed employee received during any single pay period in 2019 compensation at an annualized rate of more than \$100,000.
3. Documentation regarding any employee job offers and refusals, firings for cause, voluntary resignations, and written requests by any employee for reductions in work schedule.
4. Documentation supporting the PPP Schedule A Worksheet "FTE Reduction Safe Harbor."

All records relating to the Borrower's PPP loan, including documentation submitted with its PPP loan application, documentation supporting the Borrower's certifications as to the necessity of the loan request and its eligibility for a PPP loan, documentation necessary to support the Borrower's loan forgiveness application, and documentation demonstrating the Borrower's material compliance with PPP requirements. The Borrower must retain all such documentation in its files for six years after the date the loan is forgiven or repaid in full, and permit authorized representatives of SBA, including representatives of its Office of Inspector General, to access such files upon request.



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