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Insights from the New PPP Loan Forgiveness Application and Best Practices for Borrowers Seeking to Maximize Loan Forgiveness

Alert
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Maximizing Paycheck Protection Plan (PPP) loan forgiveness has been a priority for many borrowers. On May 15, 2020, the Small Business Administration (SBA) and U.S. Department of Treasury released their much anticipated PPP loan forgiveness application, which included instructions for borrowers on how to apply for PPP loan forgiveness, clarification on payroll and non-payroll expenses, and the methodology for determining loan forgiveness reduction due to full-time equivalent (FTE) and pay decreases.

In particular, the forgiveness application addresses the following areas:

- Procedural requirements and timing for applying for PPP loan forgiveness
- Documentation that must accompany a forgiveness application
- Expenses that will be treated as payroll and non-payroll expenses
- Introduction of a new covered period that may be elected by borrowers
- Calculation of full time equivalent employees and application of the safe harbor exemption
- Certification requirements for PPP loan forgiveness applicants

Borrowers who are still within their covered period should closely review the forgiveness application and modify their practices, if necessary, to ensure maximum loan forgiveness. Understanding the application requirements will also enable borrowers to create processes during the covered period to streamline the process for completing their loan forgiveness applications.

Insights from the New PPP Loan Forgiveness Application and Best Practices for Borrowers Seeking to Maximize Loan Forgiveness

The following guide provides analysis of different sections of the loan application and our recommendations for best practices.

THE FORGIVENESS APPLICATION PROCESS AND DOCUMENTATION REQUIREMENTS

The forgiveness application is comprised of four parts:

1. The PPP Loan Forgiveness Calculation Form, including the standard borrower information, basic calculations and borrower representations and certifications
2. The PPP Schedule A, providing for more specific calculations
3. The PPP Schedule A Worksheet, pertaining to the borrower's FTE employees
4. The (optional) PPP Borrower Demographic Information

Every borrower seeking loan forgiveness must submit parts (1) and (2) of the application to their lender; and, as an alternative to submitting part (3), the borrower may submit a substantially similar report from its payroll system or processor.

The borrower will need to have certain standard information on hand to complete the application, including its SBA and lender PPP loan numbers and the number of employees at the time of the loan application, as well as the number of employees at the time of the loan forgiveness application. The forgiveness application also requires the borrower to indicate whether the borrower received PPP loan funds in excess of $2 million. This is consistent with the SBA's recent guidance that it will scrutinize loans in excess of $2 million to determine compliance with the necessity certification.

In addition to the forgiveness application, the borrower must submit supporting documentation evidencing:

- Its payroll expenses, i.e., cash compensation and non-cash benefit payments made during the Covered Period or Alternative Covered Period (defined below)
- The existence of non-payroll obligations prior to February 15, 2020 and the eligible non-payroll payments made during the Covered Period
- The average number of FTE employees during the time period on which the borrower's eligibility is based, such as the average number of FTE employees between February 15, 2019 and June 30, 2019

The application advises that the borrower must maintain, though is not required to submit, all records relating to a borrower's PPP loan, including:

- Documentation submitted with its PPP loan application
- Documentation supporting a borrower's certifications as to the necessity of the loan request and its eligibility for a PPP loan
- Documentation necessary to support a borrower's forgiveness application
- Documentation demonstrating a borrower's material compliance with PPP requirements

Such documents must be retained by the borrower for at least six years after the date the loan is forgiven or repaid in full, as the SBA reserves the right to inspect such files upon request. Recent SBA guidance states that borrowers must apply for loan forgiveness within 90 days after the covered period ends.

PAYROLL AND NON-PAYROLL COSTS ELIGIBLE FOR FORGIVENESS

Under the CARES Act, borrowers are eligible for loan forgiveness for amounts spent on payroll costs, covered mortgage obligations, covered rent obligations and covered utility payments. The Forgiveness Application provides additional guidance on the expenses that may be included in these categories, as well as guidance on when costs must be paid or incurred to qualify for forgiveness.

What Costs Are Included?

Payroll Costs:

Cash Compensation: Cash compensation includes salary, wages, tips, and commissions. Cash compensation also includes vacation pay, and family, medical or sick leave payments, as well as allowances for dismissal or separation. Some borrowers may have previously interpreted the $100,000 cash compensation cap to apply only to the salary, wages, tips and commissions. *For each individual employee, the total amount of cash compensation eligible for forgiveness may not exceed $15,385* (the prorated portion of an annual salary of $100,000), which may limit the ability to pay a bonus to certain employees using PPP funds and may limit the ability to use PPP funds for both compensation paid and compensation incurred for some employees. Cash compensation *does not* include family, medical or sick leave covered by the Families First Coronavirus Response Act.

Non-Cash Compensation: Non-cash payroll costs include:

(a) Amounts paid for employee health insurance (including contributions to a self-insured, employer-sponsored group health plan), but contributions by employees using their own funds are not included

(b) Amounts paid for contributions to employee retirement plans, but excluding contributions by employees from their own funds

(c) Amounts paid for state and local taxes assessed on employee compensation, but excluding any taxes withheld from employee earnings (i.e., amounts for which the employees are liable).

Owner Payment Limitations: Amounts paid to owners of the business (whether owner-employees of a corporation or limited liability company, self-employed individuals, or general partners) may be included in payroll costs, *but for each such owner of the business, this amount is capped at the lesser of (i) $15,385 (the eight-week equivalent of $100,000 per year) or (ii) the eight-week equivalent of their applicable compensation in 2019*.

Non-Payroll Costs:

Covered Mortgage Obligations. Covered mortgage obligations include payments of interest on any business mortgage obligation secured by real or personal property incurred before February 15, 2020. No payments of principal, whether part of the monthly payment or a prepayment, may be included.

Covered Rent Obligations. Covered rent obligations include rent or lease payments made by the business under lease agreements for real or personal property in force before February 15, 2020. For the first time, this guidance specifically identifies leases of personal property as costs that may be included.

Covered Utility Payments. Covered utility payments include payments made by the business for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020. Note that this list is limited and includes only those items expressly identified in the CARES Act as covered utility payments. It is still unclear what the term "transportation" means in this context.

When may payments of eligible expenses be paid?

For payroll costs, both the payroll costs paid (by check to the employee or by ACH) during the covered period and the payroll costs incurred (earned by the employee) during the covered period may be forgiven, subject to the following:

- Costs incurred for payroll must be paid on or before the next regular payroll date to be eligible
- No employee may receive cash compensation from PPP funds of more than $15,385
- The amount that can be paid to an owner of the business from PPP funds is limited to <u>the lesser of</u> (A) $15,385 or (ii) the eight-week equivalent of their applicable compensation in 2019

For non-payroll costs, the expense must be paid during the covered period or incurred during the covered period and paid on or before the next regular billing date (which may be after the end of the covered period), but you may count non-payroll costs that were both paid and incurred only once.

Note that costs may be counted only once. Whether payroll or other costs, if the borrower is receiving compensation for the costs through payments invoiced for or made under a government program or contract, the borrower cannot seek forgiveness of PPP funds for these costs as that would be duplicative.

APPLICATION OF THE COVERED PERIOD AND THE ALTERNATIVE PAYROLL COVERED PERIOD

The CARES Act states that a PPP borrower is eligible for forgiveness of indebtedness on a covered loan in an amount equal to the total of eligible "costs incurred and payments made during the covered period." Meanwhile, the CARES Act defined the "covered period" for forgiveness purposes to be the eight-week period beginning on the date of "origination of a covered loan." Many questions have been raised surrounding these concepts, including how the date of origination is determined and whether an eligible cost must be both incurred and paid within the covered period in order to be forgivable. The Forgiveness Application provides some answers to these questions and also introduces some welcome flexibility for borrowers.

The standard covered period begins on the date loan proceeds were first received by a borrower and ends 56 days later. Wherever the Forgiveness Application refers to the "Covered Period" this is what it means. However, the Forgiveness Application also introduces an "Alternative Payroll Covered Period" as an alternative that can be used by borrowers for administrative convenience in calculating forgivable payroll costs. The Alternative Payroll Covered Period consists of the 56-day period beginning on the first day of the borrower's first pay period beginning after the first disbursement of PPP loan proceeds to the borrower. In other words, if PPP loan proceeds were first disbursed to a borrower in the middle of a pay period, the borrower can elect to start measuring forgivable payroll costs on the first day of the next pay period. The Alternative Payroll Covered Period is not available to all borrowers. The Forgiveness Application states that the Alternative Payroll Covered Period is only available for use by borrowers with a biweekly or more frequent payroll schedule. This leaves open questions relating to borrowers that pay some employees on a biweekly or more frequent basis and other employees on a less frequent, monthly basis.

With respect to the treatment of payroll costs "incurred" during the covered period or "paid" during the covered period, the Forgiveness Application clarifies that payroll costs are considered paid on the day checks are distributed to employees or ACH payments to employees are originated by the borrower. Payroll costs are incurred on the date they are earned by employees. According to the Forgiveness Application, the forgivable amount of payroll costs will consist of (i) payroll costs paid during the Covered Period or Alternative Payroll Covered Period, plus (ii) payroll costs that were incurred during the Covered Period or Alternative Covered Period and were not *paid* during such period, but were paid "on or before the next regular payroll date." This methodology is beneficial to borrowers, as it allows forgiveness for payroll costs paid early in the applicable covered period that were incurred prior to the beginning of such period, as well as for payroll costs paid after the applicable covered period but incurred during such period. As noted in the preceding section, payroll costs can be counted only once in the forgivable amount (whether incurred or paid). Note that a similar concept applies with regard to non-payroll costs, as the Forgiveness Application includes in the forgivable amount costs incurred but not paid during the Covered Period if such costs are paid on or before the next regular billing date after expiration of the Covered Period.

If the Alternative Payroll Covered Period is selected by a borrower, then the Alternative Payroll Covered Period will also be utilized for the calculation of whether the forgivable amount must be reduced due to either (i) reductions in average FTEs from the reference period, or (ii) reductions in employee compensation as compared to the reference period.

METHODOLOGY FOR CALCULATING FULL-TIME EQUIVALENT AND SALARY/ HOURLY WAGE REDUCTIONS

The methodology for calculating FTE employees has been unclear and is not defined within the CARES Act or the subsequent guidance issued by the SBA. The Forgiveness Application now defines this process and provides additional insight on accounting for pay reduction and the safe harbor rehiring exemption.

Calculating Average Monthly FTE

- Average FTE is calculated by determining the average number of hours paid each week, divided by 40, and rounding the total to the nearest tenth.
- The maximum FTE amount for each employee is capped at 1.0, regardless of the number of hours worked or paid for.
- Employers may choose to use a simplified method that assigns a 1.0 for employees who work an average of 40 hours or more each week and .5 for employees who work fewer hours. Employers should look at which method is more effective at maximizing the FTE ratio and loan forgiveness.
- The Forgiveness Application also provides the following scenarios where an employee may not impact loan forgiveness reduction:
  - Employees who reject a good-faith, written offer to rehire
  - Employees fired for cause
  - Employees who voluntarily resigned
  - Employees who voluntarily requested and received a reduction of their hours

Salary/Hourly Wage Reduction

- The amount of loan forgiveness will be reduced if a borrower reduced an employee's salary or hourly wages by more than 25% during the covered period or the Alternative Payroll Covered Period, as compared to the period of January 1, 2020 to March 31, 2020.
- For each employee, employers must provide information on their pay and calculate whether a pay reduction of more than 25% occurred.

FTE Reduction Safe Harbor

- The CARES Act provides a safe harbor from the loan forgiveness reduction based upon FTE employee levels.
- There are two conditions for the FTE reduction safe harbor:
  - The employer reduced its FTE employee levels in the period beginning February 15, 2020 and ending April 26, 2020; and
  - The employer then restored its FTE employee levels by not later than June 30, 2020 to its FTE employee levels in the pay period that included February 20, 2020.
- The safe harbor portion of the Forgiveness Application requires employers to provide the FTE count as of June 30, 2020. Accordingly, unless there is additional clarity from rules or FAQs, this FAQ would appear to allow a borrower to increase their FTE headcount the week before June 30, 2020 and still qualify for the FTE reduction safe harbor.

There is no indication in the forgiveness application that this safe harbor applies to loan forgiveness reductions due to a reduction in salary, despite the CARES Act expressly stating this in Section 1106(d)(5)(A).

BORROWER CERTIFICATION REQUIREMENTS FOR PPP LOAN FORGIVENESS

The Forgiveness Application contains express and implied certification requirements. Specifically, the application includes places for a borrower to insert its calculations of the costs incurred and for which it is seeking forgiveness. In addition, it includes an express set of "Representations and Certifications on Behalf of the Borrower," which require the authorized representative of a borrower, to certify "to all of the below." This Forgiveness Application's certification includes the express certifications that a borrower:

- Incurred the proper type and dollar amounts of costs for which forgiveness is being sought
- Took appropriate reductions from those amounts where it (a) decreased full-time equivalent employees and/or (b) there were applicable salary/hourly wage reductions
- Includes no more than 25% of the requested amount for forgiveness for non-payroll costs

- Did not "knowingly ... [use loan funds] for unauthorized purposes"
- "Accurately verified" its payments for which forgiveness is being sought
- Has and will submit to the lender information consistent with what it has and will submit to the IRS, state and workforce agencies
- Agrees to provide additional information where requested by the SBA for purposes of evaluating its eligibility for the loan and loan forgiveness or risk being found ineligible for the loan and denied loan forgiveness

Significantly, the form requires a borrower's authorized representative to certify that the borrower and representative have provided accurate and complete information and done so in good faith, without any intent to mislead, and that they are aware of the significant penalties they may be subject to in the event it is determined they have failed to comply with these requirements, including the fact that violations are:

> Punishable under the law, including 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to $250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than $5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than $1,000,000.

Whether and to what extent a borrower may be eligible for and receive forgiveness for its PPP loan clearly depends on the information provided in the Forgiveness Application *and* the initial loan application. This information must be accurate and complete or the borrower and its representative risks being found to have committed a knowing or willful violation of these applicable laws.

Accordingly, borrowers and their representatives executing the form must exercise diligence in verifying the accuracy and completeness of their submissions. Given that these applications and the underlying loans may be subjected to audit and further investigation, borrowers should engage in efforts to assemble and document the basis for their submissions in both the initial loan application and the forgiveness application to preserve evidence of contemporaneous good faith efforts and deliberations.

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