

SBA'S Long-Awaited PPP Loan Forgiveness Guidance

The SBA has published its long-awaited guidance on forgiveness of Paycheck Protection Program (PPP) loans — SBA Form 3508, the Loan Forgiveness Application. This guidance implements what many consider to be the key provisions in the CARES Act that allow small businesses and self-employed individuals to seek full forgiveness of their PPP loans that are being used to pay employee wages and other critical expenses during the COVID-19 pandemic. The guidance comes as a welcome relief to many companies that have already begun spending their PPP loans while awaiting SBA instructions on how the forgiveness rules will work. Indeed, many borrowers that received PPP funds in the first round of loans are already half way through their eight-week covered period.

The 10-page form (plus one page of optional borrower demographic information) is the document to be completed and submitted to the lender, together with specified supporting documentation, to start the forgiveness process. As expected, the lender will ultimately be responsible for assessing forgiveness. The form consists of the application, Schedule A, and a Schedule A worksheet, with instructions for each. No narrative rules or other interpretations were issued with the form, but it is always possible that the SBA releases additional guidance on outstanding forgiveness issues in the form of either an interim rule or Frequently Asked Questions (FAQs), which it has been doing on other aspects of the PPP program since it began.

The form does not specify when to file, but presumably borrowers will want to do so as soon as possible. Some borrowers will want to wait until after June 30 to take advantage of safe harbors in the forgiveness formulas. Under the CARES Act, the lender has 60 days in which to process the application.

Many key points are addressed in the form, including the answers to questions many have asked about how forgiveness would work. Some are as expected based on the CARES Act, but some are not.

“Need” Safe Harbor and Loan Eligibility

Over the past several weeks, a major topic of discussion has been the SBA's reinterpretation of the need certification contained in the PPP loan application: “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” In previous guidance, SBA created a safe harbor, by which (as amended) borrowers that returned funds in full by May 18, 2020, are deemed to have made this certification in good faith.

On May 13, SBA issued FAQ 46, which explained for the first time how the SBA would review these certifications. All loans in an original principal amount of less than \$2 million are deemed to have made this certification in good faith. For loans of \$2 million or more, the SBA will review the basis for the borrower's certification. If SBA determines that the certification is not made in good faith, SBA stated that it will not take any further administrative action or make any referrals if the borrower returns the funds in full.

In determining whether the \$2 million threshold is met, SBA considers the aggregate principal amount of all PPP loans to the borrower and its affiliates, as determined under the SBA's interim final affiliation rule, while exempting from such aggregation any entity that has a statutory affiliation waiver (NAICS Sector 72 entities, certain franchises, and entities receiving SBIC federal assistance). To allow SBA to make this determination, the form requires the borrower to certify whether the borrower and its affiliates received PPP loans in excess of \$2 million. This means that borrowers will have one last chance to consider how those rules apply before deciding whether to check this box. Many borrowers have already sought legal guidance on the affiliation rules either at



Steven J. Dickinson

**Co-Chair,
International
Practice**

sdickinson@cozen.com
Phone: (612) 260-9051
Fax: (612) 260-9080



James F. Van Orden

Member

jvanorden@cozen.com
Phone: (215) 665-4625
Fax: (215) 665-2013



Robert K. Magovern

**Co-Vice Chair,
Transportation
& Trade**

rmagovern@cozen.com
Phone: (202) 463-2539
Fax: (202) 912-4830

Related Practice Areas

- Corporate

the time the PPP application was filed or after the SBA asked borrowers to recertify their need. Those borrowers that have not yet reviewed potential affiliation issues, or those whose eligibility may be in question due to the SBA's often conflicting guidance in the FAQs, are encouraged to do so before answering this certification question.

The borrower's eligibility for the program, apart from need (e.g., 500 employees or less, or otherwise meeting the SBA small business size requirement), is also a key issue. Eligibility other than need is not addressed by the need safe harbor. Thus, some have wondered what would happen if SBA determines during the need review process that the borrower was not otherwise eligible for a loan. The form does not give clear guidance on this. The certifications in the form, however, do contain a statement that SBA may direct a lender to disapprove the borrower's loan forgiveness application if SBA determines that the borrower was ineligible for the PPP loan. Hopefully, this signals that SBA intends to take a similar approach for disagreements over good faith determinations of eligibility as it is taking for disagreements about need under the safe harbor, and repayment of the loan without forgiveness will generally be sufficient to resolve such disagreements. As noted below, this would not prevent the government from pursuing a claim against any borrower for knowingly making a false statement in an effort to obtain a PPP loan or forgiveness for that loan.

Use of Loan Proceeds

The CARES Act and the form permit four types of payments to be made with PPP loan proceeds: payroll costs, mortgage interest, rent, and utilities.

Payroll Costs

Payroll costs include (i) cash compensation to employees, (ii) certain employer (but not employee) benefits, and (iii) employer state and local taxes assessed on employee compensation (e.g., state unemployment insurance tax).

Cash compensation includes gross salary, gross wages, gross tips, gross commissions, paid leave (vacation, family, medical, or sick leave, not including leave covered by the Families First Coronavirus Response Act), and allowances for dismissal or separation, to be calculated according to the *Interim Final Rule* posted on April 2, 2020. For each individual employee, the total amount of cash compensation eligible for forgiveness may not exceed an annual salary of \$100,000, prorated for the covered period (\$15,385).

The form does not directly address whether bonuses are includible in cash compensation. However, the instructions for calculating payroll costs in the Schedule A worksheet require the borrower to provide bank statements or third-party payroll service provider reports and IRS payroll forms (typically Form 941) to document such payments, which would be consistent with including bonuses in the allowable compensation. This is further supported by the limited restriction in the form that owner-employees must certify that the amount for which forgiveness is sought does not "exceed eight weeks' worth of 2019 compensation for any owner-employee or self-employed individual/general partner, capped at \$15,385 per individual." Since this would be based on those employees' W-2s, this effectively limits the ability of a corporation to pay a bonus to an owner-employee who had less than \$100,000 in 2019 cash compensation to get up to the \$15,385 maximum. No such restricting language appears for other types of employees, suggesting that a bonus is acceptable to be paid to those other employees.

The benefit payments allowed by the form are employer (but not employee) contributions for employee health insurance, including employer contributions to a self-insured, employer-sponsored group health plan, and to employee retirement plans. No other benefit payment is includible under the form.

Employer taxes allowed by the form are amounts paid by the borrower for employer state and local taxes assessed on employee compensation (e.g., state unemployment insurance tax), but not amounts withheld on behalf of the employee.

The form does not specifically address prepayments of compensation or benefits. However, both the CARES Act and the form only include (with limited exceptions described in the following section) costs incurred and paid during the covered period, which seems inconsistent with

allowing prepayments. In addition, prepayment of mortgages is specifically prohibited, which suggests that the same approach might be appropriate for other items.

Mortgage Interest

The borrower may include payments of interest (not including any prepayment or payment of principal) on any business mortgage obligation on real or personal property incurred before February 15, 2020. Since personal property mortgages, by that name, have not existed since article 9 of the Uniform Commercial Code was adopted in the United States, presumably this concept includes debt secured by security interests in personal property. However, only the term “mortgage” is used in the CARES Act and the form. The instructions require the borrower to provide a copy of the 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 plus one month verifying interest amounts and eligible payments.

Rent

The borrower may include business rent or lease payments made during the covered period pursuant to lease agreements for real or personal property in force before February 15, 2020. Thus, the SBA has now expressly stated that rent or lease payments for business personal property (such as, for example, copiers or leased company cars) may be included both as a permissible PPP funds use and for purposes of forgiveness. The instructions provide that borrowers shall provide a copy of the current lease agreement and receipts or cancelled checks verifying eligible payments from the covered period or, in the alternative, lessor account statements from February 2020 and from the covered period through one month after the end of the covered period verifying eligible payments. It would appear that the second form of documentation would allow any entity to include good faith rental payments under a lease agreement that is extended or renewed post-February 2020 to include those costs.

Utilities

The borrower may include business payments during the covered period for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020. The instructions provide that borrowers shall provide their banks with copies of invoices from February 2020 and those paid during the covered period and receipts, cancelled checks, or account statements verifying those eligible payments.

Additional Information Concerning Nonpayroll Costs

The borrower is required to provide information about nonpayroll costs only to the extent the borrower seeks loan forgiveness relating to those costs. Nonpayroll costs may not exceed 25 percent of the total costs for which forgiveness is requested. This appears to suggest that the 25 percent limitation created by SBA rule applies only to forgiveness amounts rather than the entire loan amount although the SBA has not stated that expressly. The form requires the borrower to document that the loan, lease, or utility service to which the claimed payment relates existed at February 15, 2020.

Unspent Proceeds

Some borrowers will be unable to spend all of the loan proceeds within the covered period because, for example, they are subject to mandatory closure orders or are operating on a limited basis. The form may indirectly provide some degree of comfort to those borrowers. The maximum amount of forgiveness is based on the amounts spent for eligible costs during the covered period, so such borrowers will have limited opportunities for forgiveness. However, the form does not call for immediate repayment of unspent amounts. The unspent and unforgiven amounts will be included in the PPP loan and repaid over the two-year loan term at 1 percent interest, with an initial six-month payment grace period. The form is silent on whether unspent proceeds must only be used for the four eligible purposes or whether the 75 percent payroll use requirement applies to the unspent proceeds.

Eligible Costs “Incurred and Paid”

The CARES Act only allows forgiveness for eligible costs that are “incurred and paid” during the eight-week “covered period” that begins on the day the borrower first receives the loan proceeds. Payroll costs are considered paid on the day paychecks are distributed or the borrower originates the credit transaction. This caused concerns because that covered eight-week period would not necessarily coincide with the borrower’s payroll periods or with the billing period for interest, rent, or utilities. For example, would the borrower be required to do a “short” payroll period ending on the last day of the eight-week covered period?

In an attempt to address these issues, the SBA is giving borrowers some latitude for costs that incurred **before** the covered period but paid **during** the period, and costs incurred **during** the covered period but paid **after** the period. Specifically, the form makes two accommodations. First, a borrower with biweekly or more frequent payroll periods may calculate payroll costs (but not interest, rent, or utilities) using either the covered period or an “alternative payroll covered period” of eight weeks beginning on the first day of the pay period following receipt of loan proceeds. No explanation is given for not making a similar accommodation for bimonthly or monthly payroll periods. Second, to qualify for forgiveness, interest, rent, and utilities must either be paid during the covered period or incurred during the covered period and paid on or before the next regular billing date, even if the billing date is after the end of the covered period. While this is perhaps an open question, it appears that this means borrowers can seek forgiveness of mortgage interest, rent, and utilities payments that were incurred prior to the covered eight-week period, as long as they were paid during that period or paid in the normal course thereafter. Also, the form makes clear that the alternative payroll covered period only applies to payroll items. Payments on other nonpayroll expenses will continue to apply to the eight-week covered period beginning on the date the loan funds are received.

Maximum Forgiveness Amount

The amount of payroll costs incurred and paid during the covered period or alternative payroll covered period, plus the amount of business mortgage interest, business rent, and business utilities incurred and paid during the covered period, all as described above, is the maximum amount eligible for loan forgiveness. The FTE and compensation adjustments described below are then applied to that amount to determine the forgiveness amount.

Adjustments for Reductions in FTEs or Compensation

The CARES Act provides adjustments in the forgiveness amount based on a reduction in FTEs compared to one of two reference periods and for decreases in compensation of more than 25 percent. As a critical policy under the CARES Act, Congress wanted to ensure that employers were maintaining and/or reinstating their workforces before it would allow forgiveness of the full loan proceeds. Many commentators believed the FTE adjustment was applied first, and then the compensation adjustment. However, the form takes the opposite approach — the compensation deficit amount is subtracted from the eligible costs, and that amount is then multiplied by the FTE adjustment ratio.

Compensation Adjustment

The downward adjustment for decreases in employee compensation applies only to employees who were employed during the covered period or alternative payroll covered period and who did not have compensation at an annualized rate over \$100,000 during any pay period in 2019. The reference period is the first three months of 2020. It is determined on an employee-by-employee basis, not in the aggregate. If average annual employee compensation (capped at \$15,385 for the calculation period) for each listed employee during the covered period or alternative payroll covered period was at least 75 percent of the average annual amount that employees made between January 1 and March 31, 2020, then there is no downward forgiveness adjustment due to salary reductions for that employee. To the extent that an employee was newly hired during the covered period/alternative payroll covered period, it appears they and their compensation must be listed in Table 1, but that they should have no salary/hourly wage reduction since they have no baseline salary/hourly wage against which to calculate such a reduction. This is consistent with the approach of calculating reductions in salary against historic levels on an employee-by-employee basis, rather than collectively.

If the compensation decrease for an employee exceeded 25 percent, then the borrower determines if the employee's annual compensation as of June 30, 2020, is equal to or greater than the annual compensation as of February 15, 2020. If so, then there is no downward forgiveness adjustment for that employee. This effectuates the statutory safe harbor for restoring compensation decreases by June 30.

Any downward adjustment due to compensation decreases is subtracted from the eligible costs, and then the following FTE adjustment is applied.

FTE Adjustment

Under the CARES Act, forgiveness is based on the ratio of average monthly full time equivalent employees (FTEs) during the covered period to the average monthly FTEs during one of two reference periods — February 15 through June 30, 2019, or January 1 through February 29, 2020. In addition, the application permits seasonal employers to also elect to choose any consecutive 12-week period between May 1, 2019, and September 15, 2019. This is referred to in the form as the FTE reduction quotient.

One significant development is a new safe harbor from the FTE reduction calculation for borrowers whose average number of FTEs was not reduced between January 1, 2020, and the end of the covered period. Borrowers that meet this criterion may simply check a box, skip the rest of the calculation and enter 1.0 on the line for the FTE reduction quotient. This at least in part delivers on previous statements by SBA that an employer that did not lay off workers during the covered period would have its loan forgiven in full.

In calculating FTEs for forgiveness purposes, one FTE equals 40 hours per week, rounded to the nearest tenth and capped at 1.0. In the alternative, a borrower may use a simplified method that assigns 1.0 to workers with 40 or more hours per week and 0.5 for all other employees. FTEs are not reduced by employees who were terminated for cause, voluntarily quit, voluntarily requested and received reduced hours, or declined a good faith written offer of reemployment. Previous guidance had only addressed employees who declined reemployment.

The CARES Act contains a rehire provision that avoids the downward forgiveness adjustment for FTEs for employees who are rehired by June 30, 2020, although the CARES Act was unclear as to the mechanics. The form implements the rehire provision through a second safe harbor. The safe harbor will apply if (i) total FTEs in the borrower's pay period including February 15, 2020, is greater than its total average FTEs between February 15 and April 26, 2020, and (ii) the borrower's total FTEs as of June 30, 2020, is greater than or equal to the total FTEs in the borrower's pay period including February 15, 2020. If the safe harbor is satisfied, no FTE reduction is made — the borrower enters 1.0 as the FTE reduction quotient.

The total eligible costs, minus the compensation reduction, is multiplied by the FTE reduction quotient. This is referred to as the modified total. The total forgiveness amount is the smallest of (i) the modified total, (ii) the PPP loan amount, or (iii) 75 percent of the payroll costs paid with PPP loan proceeds. Thus, the 75 percent limitation referred to in *SBA rules* only applies to the forgiveness amount, not to the entire loan amount.

EIDL Deduction

The form requires the borrower to indicate if it received an Economic Impact Disaster Loan (EIDL) and, if so, the loan number. Under the CARES Act, the EIDL loan advance amount (which may be up to \$10,000) is deducted from the amount of loan forgiveness.

Documentation Requirements

To document the payroll and FTE calculations, the form contains a Schedule A Worksheet, in which for each employee must be listed the name, employee identifier, cash compensation during the covered period or alternative payroll covered period, average FTE and (for employees who did not earn prorated cash compensation of \$100,000 in any payroll period during 2019) amount of compensation reduction. Borrowers are required to submit certain supporting documentation for these calculations with the application, including amounts paid in cash compensation and non-cash benefits, FTE numbers, and the existence and payment amounts for interest, rent, and

utilities. Other supporting documentation is not submitted, but must be retained for six years. Detailed information is found on page 10 of the form.

Borrower Certifications

As noted above, the form requires borrowers to certify whether they and their affiliates received PPP loans in excess of \$2 million dollars.

In addition, the signer must initial several individual certifications before signing the form:

1. The dollar amount for which forgiveness is requested:
 - a. was used to pay costs that are eligible for forgiveness (payroll costs to retain employees; business mortgage interest payments; business rent or lease payments; or business utility payments);
 - b. includes all applicable reductions due to decreases in the number of full-time equivalent employees and salary/hourly wage reductions;
 - c. does not include nonpayroll costs in excess of 25 percent of the amount requested; and
 - d. does not exceed eight weeks' worth of 2019 compensation for any owner-employee or self-employed individual/general partner, capped at \$15,385 per individual.
2. The signer understands that if the funds were knowingly used for unauthorized purposes, the federal government may pursue recovery of loan amounts and/or civil or criminal fraud charges.
3. The borrower has accurately verified the payments for the eligible payroll and nonpayroll costs for which the borrower is requesting forgiveness.
4. The signer has submitted to the lender the required documentation verifying payroll costs, the existence of obligations and service (as applicable) prior to February 15, 2020, and eligible business mortgage interest payments, business rent or lease payments, and business utility payments.
5. The information provided in the application and the information provided in all supporting documents and forms is true and correct in all material respects.
6. The tax documents submitted to the lender are consistent with those the borrower has submitted/will submit to the IRS and/or state tax or workforce agency. The signer also understands, acknowledges, and agrees that the lender can share the tax information with SBA's authorized representatives, including authorized representatives of the SBA Office of Inspector General, for the purpose of ensuring compliance with PPP requirements and all SBA reviews.
7. The signer understands, acknowledges, and agrees that SBA may request additional information for the purposes of evaluating the borrower's eligibility for the PPP loan and for loan forgiveness, and that the borrower's failure to provide information requested by SBA may result in a determination that the borrower was ineligible for the PPP loan or a denial of the borrower's loan forgiveness application.

As in the PPP loan application, the applicant also certifies its understanding that knowingly making a false statement to obtain forgiveness of an SBA-guaranteed loan is 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 30 years and/or a fine of not more than \$1,000,000.

The applicant also acknowledges that the borrower's eligibility for loan forgiveness will be evaluated in accordance with the PPP regulations and guidance issued by SBA through the date of this application, and that SBA may direct a lender to disapprove the borrower's loan forgiveness application if SBA determines that the borrower was ineligible for the PPP loan.

Number of Employees

Although not directly relevant to the loan forgiveness calculation, the form requires the borrower to state the number of employees at the time of the PPP loan application and at the time of the forgiveness application. The purpose of collecting this information is not stated in the form or instructions.
