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BANKING & FINANCE LAW ALERT

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Paycheck Protection Program Forgiveness Application

On May 15, 2020, the Small Business Administration (SBA) released the much-anticipated Paycheck Protection Program (PPP) Forgiveness Application. In a press release from the U.S. Department of Treasury regarding the application, the Treasury stated that the form and instructions for the application "include several measures to reduce compliance burdens and simplify the process for borrowers." We will highlight some of those measures in this law alert.

Flexibility regarding covered period for payroll costs

The new SBA Forgiveness Application allows PPP borrowers with a biweekly or more frequent payroll schedule to elect to calculate eligible payroll costs using the eight-week period beginning on the first day of their first pay period following their PPP loan disbursement date (the "Alternative Payroll Covered Period"). Prior to this guidance, borrowers were expected to calculate eligible payroll costs using the eight-week period beginning immediately after the loan disbursement date (the "Covered Period"). The SBA believes this will create administrative convenience for the borrower. This new change is more flexible and favorable to borrowers because the "Alternative Payroll Covered Period" should now more easily conform to an employer's normal pay period schedule.

Note that if you choose this alternative method, it only applies to payroll costs; non-payroll costs still must have been paid or incurred in the original Covered Period (the eight-week period after the disbursement of the PPP loan). Borrowers who choose the Alternative Payroll Covered Period should be prepared to monitor their eligible costs for two different periods for payroll costs and non-payroll costs.

Eligible Costs

Eligible payroll costs may be forgiven if **paid or incurred** during the chosen Covered Period. Payroll costs are **paid** on the day that paychecks are distributed or the borrower originates an ACH credit transaction to its payroll service. Payroll costs are **incurred** on the day that the employee's pay is earned. Payroll costs incurred but not paid during the last pay period of the chosen Covered Period can still be forgiven if paid on or before the next regular payroll date (even though that might fall outside the selected eight-week period). Otherwise, payroll costs must be paid—meaning the borrower must have distributed paychecks or originated an ACH credit transaction to its payroll service—during the borrower's chosen Covered Period. Remember, cash compensation eligible for forgiveness may not exceed an annualized salary of $100,000, as prorated for the Covered Period. This means that no employee's salary during the Covered Period may exceed $15,385 to be eligible for forgiveness.

The application defines eligible non-payroll costs as:

a. Covered mortgage obligations: payments of interest (not including any prepayment or payment of principal) on any business mortgage obligation on real or personal property incurred before Feb. 15, 2020 ("business mortgage interest payments");

b. Covered rent obligations: business rent or lease payments pursuant to lease agreements for real or personal property in force before Feb. 15, 2020 ("business rent or lease payments"); and

c. Covered utility payments: business payments for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before Feb. 15, 2020 ("business utility payments").

Notably, for covered mortgage obligations and covered rent obligations, both real and personal property are included. Any loan secured by machinery, equipment, furniture, fixtures, computers, or other personal property (and any lease of those items) is eligible for inclusion in the calculation of forgivable costs. For all of the eligible non-payroll costs, the obligation or service must have been in effect as of Feb. 15, 2020.

An eligible non-payroll cost must be paid during the eight-week Covered Period after the loan disbursement date, or incurred during such period and paid on or before the next regular billing date, even if the billing date is after the eight-week period.

Note that under the current SBA interim rule, eligible non-payroll costs cannot exceed 25% of the total forgiveness amount, so borrowers should not spend too much on non-payroll costs if they want full forgiveness.

Self-reporting loan size

The Forgiveness Application contains a box that a borrower must check if the borrower, together with its affiliates, if applicable, received PPP loans with an original principal amount in excess of $2 million. This check box will help the SBA sort which loans will be automatically audited.

Certifications

Like the original PPP Loan Application, the Forgiveness Application requires the borrower to make a number of certifications. Most of these involve the borrower certifying that all the information provided to the lender for its forgiveness calculation is accurate and that the PPP money was spent on eligible expenses. One notable certification requires the borrower to certify that it agrees the SBA may later request additional information for the purpose of evaluating the borrower's eligibility for the loan and for forgiveness. Failure to provide that information may result in a later determination by the SBA that the borrower was ineligible or denial of the borrower's loan forgiveness. Based on this certification, borrowers should be prepared to have documentation and other evidence demonstrating their eligibility for the PPP loan in the first place, in addition to the documentation required for forgiveness.

Definition of Full Time Employees (FTE)

For purposes of calculating a forgiveness reduction for employing fewer employees during the Covered Period, **the SBA has defined full-time equivalency as an employee who works 40 hours per week**.

Borrowers may use one of two calculations to compute their total FTEs:

- More preceise and complex:
    - For each employee, the Borrower should take the average number of hours paid per week, divide by 40, and round to the nearest tenth (but the number cannot exceed 1.0)
    - Example: An employee who works 30 hours per week would be counted as 0.8 (30/40 = 0.75, rounded to 0.8)
- Simple:
    - Any employee who works 40 or more hours per week = 1.0.
    - Any employee who works less than 40 hours per week = 0.5.

Safe harbor/ FTE exception

The Coronavirus Aid, Relief, and Economic Security (CARES) Act provides that borrowers will be penalized for reducing their workforce during the chosen Covered Period or reducing employee salary or hourly wages by more than 25% during the chosen Covered Period. The Forgiveness Application gives step-by-step instructions on how to determine whether these reductions to the forgiveness amount apply. Notably, a borrower will determine reductions to the forgiveness amount based on any employee salary or wage reduction first, and then the FTE reduction would apply, if any. The salary reduction penalty does not apply to employees who made over $100,000 on an annualized rate in 2019.

A borrower may avoid these aforementioned reductions to its forgiveness amount if, by June 30 2020, a borrower rehires FTEs to eliminate any reduction in FTEs during the chosen Covered Period or restores average annual salary or hourly wages of any employee to an amount equal or greater than that as of Feb. 15, 2020. This is described as a "safe harbor," which incentivizes borrowers to rehire employees or restore average annual salary or hourly wages of employees in order to maximize forgiveness. Borrowers should be aware of the June 30, 2020 safe harbor, and if either the salary reduction or FTE reduction applies, borrowers should consider applying for forgiveness after June 30, 2020 if they can prove that they meet the safe harbor.

Additionally, in calculating whether there is a FTE reduction, there are a number of exceptions. If an exception applies, any FTE reductions during the Covered Period compared with the prior year will not reduce the forgiveness amount. One such circumstance is when the borrower made a good-faith, written offer to rehire an employee during the chosen Covered Period which was rejected by the employee. Additionally, forgiveness will not be reduced by any employees who, during the chosen Covered Period, (a) were fired for cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction of their hours. Note that a borrower should only include these FTE exceptions on its application if the position was not filled by a new employee.

Last line

The last line of the application is important:

> 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.

The SBA may release future regulations or guidance before a borrower applies for forgiveness. Borrowers should be aware of all regulations and guidance at the time of their forgiveness application. Additionally, the last line provides that the SBA may direct a lender to disapprove a borrower's loan forgiveness application if the SBA determines that the borrower was ineligible for the PPP loan. Lenders will generally be in charge of monitoring compliance with the Paycheck Protection Program and approving forgiveness, but the SBA may disapprove if a borrower was ineligible in the first place.

Documentation

The forgiveness application requires borrowers to keep and submit the documents described below.

In order to prove payroll costs, borrowers must keep documentation verifying the eligible cash compensation and non-cash benefit payments from the chosen 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 chosen Covered Period:
   a. Payroll tax filings reported to the IRS (typically, Form 941); and
   b. State quarterly business and individual employee wage reporting and unemployment insurance tax filings 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)).

In order to prove FTE employees, borrowers must submit documentation showing (at the election of the Borrower):

1. The average number of FTE employees on payroll per month employed by the borrower between Feb. 15, 2019 and June 30, 2019;
2. The average number of FTE employees on payroll per month employed by the borrower between Jan. 1, 2020 and Feb. 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 Feb. 15, 2019 and June 30, 2019; between Jan. 1, 2020 and Feb. 29, 2020; or any consecutive twelve-week period between May 1, 2019 and Sept. 15, 2019.

The selected time period must be the same time period used for purposes of completing PPP Schedule A, line 11 to determine whether forgiveness should be reduced for FTE reduction, but the documentation may cover periods longer than the chosen time period. Documentation proving FTEs may include payroll tax filings reported to the IRS (typically, Form 941) and state quarterly business and individual employee wage reporting and unemployment insurance tax filings reported to the relevant state.

For non-payroll costs, borrowers must keep and submit documentation verifying the obligations/services prior to Feb. 15, 2020 and eligible payments during the Covered Period. In order to prove mortgage interest payments, borrowers must submit copies of a 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. In order to prove business rent or lease payments, borrowers must submit copies of their 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. In order to prove business utility payments, borrowers must submit copies of invoices from February 2020 and those paid during the Covered Period and receipts, cancelled checks, or account statements verifying those eligible payments.

The SBA will require borrowers to keep in their files the following documentation to determine whether loan forgiveness will be reduced for laying off employees or decreasing employee salaries by more than 25%. This documentation will not need to be submitted with the Forgiveness Application.

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."

Importantly, each borrower must keep all documents related to its PPP loan for six years after the date the loan is forgiven or repaid in full, 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." Borrowers must also permit authorized SBA representatives, including representatives of its Office of Inspector General, to access those files upon request. This effectively creates a six-year "statute of limitations" for any PPP-related actions.

For more information please contact Jack Beeler, Jack Meadows, Cassandra Rice or any member of Porter Wright's Banking & Finance practice group.