

PPP Loan Forgiveness Application: A Discussion of Recent Developments and Implications for Lenders

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Due to economic uncertainty caused by COVID-19, Congress created the Paycheck Protection Program (the “PPP”) under sections 1102 and 1106 of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). The PPP is administered by the Small Business Administration (the “SBA”) and provides that loans guaranteed by the SBA may be fully forgiven if borrowers use the proceeds to maintain their payrolls and pay certain specified eligible non-payroll expenses.

A significant amount of guidance has been provided by the SBA in respect of the PPP generally and on May 15, 2020, the SBA released the long-awaited Paycheck Protection Program Forgiveness Application, accompanied by detailed instructions (collectively, the “Application”). Though the Application provides guidance to PPP loan borrowers on the details of loan forgiveness, the SBA indicates that it will continue to issue additional regulations and guidance to further assist borrowers as they complete their Applications, and provide lenders with guidance on their responsibilities in connection with the same.

The following highlight some of the common questions and complexities regarding the forgiveness process that are answered by the Application and recent rules, together with a discussion of the implications and practical considerations for PPP lenders.

Time Period for Forgiveness

PPP loan borrowers may be eligible to have loans forgiven if the proceeds are used for eligible expenses over the eight-week period commencing when the loan was first disbursed (the “Covered Period”). For administrative convenience, the Application also provides an option for borrowers to calculate payroll costs using an “Alternative Payroll Covered Period” that aligns with a borrower’s regular payroll cycles in lieu of using the Covered Period. The Alternative Payroll Covered Period is the eight-week period starting on the first day of the pay period immediately following loan disbursement.

When are Payroll and Non-Payroll Costs “Paid and Incurred”?

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Under the CARES Act, PPP loan borrowers are generally eligible for forgiveness of payroll costs “paid and incurred during” the Covered Period (or Alternative Payroll Covered Period). The Application addresses the ambiguity under the CARES Act regarding the timing of payroll payments and incurrences. Specifically, payroll costs are considered paid on the day that paychecks are distributed or funds are deposited into an employee’s account. Payroll costs are considered “incurred” on the day that an employee’s pay is earned. Payroll costs incurred but not paid during a borrower’s last pay period of the Covered Period (or Alternative Payroll Covered Period) are eligible for forgiveness if paid on or before the next regular payroll date. Eligible non-payroll costs must 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 Covered Period. Note that eligible non-payroll costs must be tied to the Covered Period and not the Alternative Payroll Covered Period. Finally, both payroll and non-payroll costs that are both paid and incurred can be counted only once.

Costs Eligible for Forgiveness

Eligible payroll costs are the key factor to maximizing PPP loan forgiveness. No less than 75% of all eligible costs for forgiveness spent during the Covered Period/Alternative Payroll Covered Period must be eligible payroll costs. For purposes of calculating forgiveness, compensation under “payroll costs” 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 paid or incurred during the Covered Period (or the Alternative Payroll Covered Period).”

The SBA has determined that the CARES Act’s definition of the term “payroll costs” should be interpreted broadly to include compensation in the form of salary, wages, commission payments to furloughed employees, bonuses, hazard pay or similar compensation. If a borrower pays furloughed employees their salary, wages, or commissions during the Covered Period/Alternative Payroll Covered Period (even if those employees are not able to perform their day-to-day duties), then those payments are eligible for forgiveness. Importantly, for purposes of calculating compensation for each individual employee, the total amount of cash compensation eligible for forgiveness may not exceed an annual salary of \$100,000, as prorated for the selected Covered Period or Alternative Payroll Covered Period.

Eligible non-payroll costs, per the Application consist of the following:

- (a) Business mortgage interest payments (not including payment of principal and not including any advance payment of interest) during the Covered Period for any business mortgage obligation on real or personal property incurred before February 15, 2020;
- (b) Business rent or lease payments during the Covered Period pursuant to lease agreements for real or personal property in force before February 15, 2020; and
- (c) Business utility payments during the Covered Period for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access, which service began before February 15, 2020.

Loan Forgiveness Reductions and Safe Harbors

A PPP loan borrower's forgiveness amount can be reduced if: (i) the borrower has on average fewer "full-time-equivalent" ("FTE") employees during the Covered Period/Alternative Payroll Covered Period as compared to the borrower's chosen reference period (either (a) February 15, 2019 to June 30, 2019 or (b) January 1, 2020 to February 29, 2020) (the "FTE Reduction"); or (ii) any salary or hourly reductions (the "Salary/Hourly Reduction") for specified employees (employees making less than \$100,000 at an annualized rate during 2019) during the Covered Period/Alternative Payroll Covered Period by more than 25% compared to the calendar quarter ending March 31, 2020.

- FTE Reduction and Exemptions and Exceptions

The FTE Reduction is calculated by dividing the Average FTE employees during the Covered Period/Alternative Payroll Covered Period by the Average FTE employees during the borrower's chosen reference period (either: (i) February 15, 2019 to June 30, 2019; or (ii) January 1, 2020 to February 29, 2020). Once the FTE Reduction is determined (which cannot be greater than 1), the borrower must then multiply that ratio by the total of all eligible costs paid/incurred during the Covered Period (or Alternative Payroll Covered Period). However, a borrower is exempt from application of the FTE Reduction if both of the following conditions are met: (a) the borrower reduced its average FTE employee levels in the period beginning February 15, 2020, and ending April 26, 2020; and (b) the borrower then restored its FTE employee levels by not later than June 30, 2020 to its FTE employee levels in the borrower's pay period that included February 15, 2020.

For purposes of calculating the FTE Reduction, a borrower will not be required to include any employees in two circumstances. The first is the situation in which: (a) the borrower made a good-faith, written offer to rehire an employee during the Covered Period (or the Alternative Payroll Covered Period) which was rejected by the employee; (b) 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; (c) the borrower has maintained records documenting the offer and its rejection; and (d) 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.

The second situation is that instance in which any employee who during the Covered Period (or the Alternative Payroll Covered Period): (a) was fired for cause; (b) voluntarily resigned; or (c) voluntarily requested and received a reduction of their hours. If a borrower wishes not to include employees in the preceding sentence for purposes of calculating the FTE Reduction, then records must be maintained demonstrating that each such employee was fired for cause, voluntarily resigned, or voluntarily requested a schedule reduction.

"Average FTE" during the Covered Period or Alternative Payroll Covered Period is

calculated by taking the average number of hours worked per week divided by 40 (rounded to the nearest tenth). The maximum for each employee is capped at 1.0 and the Application allows for a borrower to use a simplified method that assigns a “1.0” for employees who work 40 hours or more per week and a “0.5” for employees who work fewer than 40 hours per week. Note that this is not the same formulation used by the IRS, which is a 30-hour week standard.)

- **Salary/Hourly Reduction**

In addition to the FTE Reduction criteria described above, the Application includes a salary and hourly component pursuant to which the amount of loan forgiveness will be reduced, dollar for dollar, in an amount equal to the reduction of the salary or hourly wages of certain employees during the Covered Period (or the Alternative Payroll Covered Period) as compared to the calendar quarter ending March 31, 2020. The Salary/Hourly Reduction calculation is performed on a per employee basis, not in the aggregate. Nonetheless, the Salary/Hourly Reduction will not apply if: (i) the annual salary or hourly wage of an employee as of February 15, 2020 is greater than the average annual salary or hourly wage between February 15, 2020 and April 26, 2020; and (ii) the average annual salary or hourly wage of such employee as of June 30, 2020 is equal to or greater than the annual salary or hourly wage as of February 15, 2020. In addition, the SBA has determined that, in order to ensure that a PPP borrower is not doubly penalized under the Salary/Hourly Reduction and the FTE Reduction, the Salary/Hourly Reduction applies only to the portion of the decline in employee salary and wages that is not attributable to the FTE Reduction. In other words, if a borrower merely reduces the hours of a full-time employee to below 40 hours per week, but does not reduce the hourly wage, then the reduction in the employee's total wages is entirely attributable to the FTE Reduction. Therefore, the borrower is not required to conduct a Salary/Hourly Reduction calculation for such employee.

Documentation and Review Process

- **Documentation**

The Application states that certain documentation must be submitted and retained by borrower. Specifically, with its Application a borrower must submit documentation supporting payroll and FTE employee and non-payroll calculations. Furthermore, a borrower must maintain for a period of not less than six years after the date the loan is forgiven or repaid in full, the following:

a. PPP Schedule A Worksheet or its equivalent and the following:

- i) Documentation supporting the listing of each individual employee in PPP Schedule A Worksheet Table 1, including the “Salary/Hourly Wage Reduction” calculation, if necessary.
- ii) 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.

- iii) Documentation regarding any employee job offers and refusals, firings for cause, voluntary resignations, and written requests by any employee for reductions in work schedule.
- iv) Documentation supporting the PPP Schedule A Worksheet “FTE Reduction Safe Harbor”.

b. All records relating to a borrower’s PPP loan, including documentation submitted with its PPP loan application, documentation supporting such 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 loan forgiveness application, and documentation demonstrating a Borrower’s material compliance with PPP requirements.

PPP borrowers are required to make certain representations and certifications in the Application as to the information provided in the Application and supporting documentations. For example, a borrower is required to attest that information provided in the Application and the information provided in all supporting documents is true and correct in all material respects, and a certification that 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. Lenders administering Applications are allowed to rely on a borrower’s certifications. Providing an accurate calculation of the loan forgiveness amount is the responsibility of the borrower. *Nonetheless, lenders are expected to perform a good-faith review, in a reasonable time, of a borrower’s calculations and supporting documents concerning amounts eligible for loan forgiveness, which may create legal risk to the PPP lender if deemed unacceptable to the SBA (discussed further below).*

Lenders must also comply with applicable SBA requirements for records retention, which for federally regulated lenders means compliance with the requirements of their federal financial institution regulator.

- Application Review

If loan documentation submitted to the SBA by the lender or any other information indicates that the PPP borrower may be ineligible for a PPP loan or may be ineligible to receive loan forgiveness, the SBA will require the lender to contact the borrower in writing to request additional information. The SBA may also request information directly from the borrower, and the lender must provide to the SBA any additional information it receives from the borrower. The SBA will consider all information provided by the borrower in response to an inquiry. Failure to respond to the SBA’s inquiry may result in a determination that the borrower was ineligible for a PPP loan or loan forgiveness. If the SBA determines that a borrower is ineligible for the PPP loan or loan forgiveness, the SBA may (i) direct the lender to deny the loan forgiveness application in whole or in part, as appropriate or (ii) seek repayment of the outstanding PPP loan balance or pursue other available remedies. The SBA intends to issue a separate interim final rule addressing a borrower’s right to appeal a determination that borrower was ineligible for a PPP loan or loan forgiveness.

Implications for PPP Lenders

- Review of Loan Forgiveness Applications

For the meantime, PPP lenders need to be prepared to review and make decisions regarding loan forgiveness and therefore should implement appropriate policies and procedures. First, upon receipt of an Application, a lender will have 60 days to issue a decision to the SBA. That decision may take the form of an approval (in whole or in part), denial or (if directed by the SBA) a denial without prejudice due to a pending SBA review of the loan for which forgiveness is sought. Unless the SBA determines that the borrower was ineligible for a PPP loan and in the case of a denial without prejudice, the borrower may subsequently request that the lender reconsider its Application for loan forgiveness.

If a PPP lender determines that a borrower is entitled to forgiveness, then the lender must request payment from the SBA at the time the lender issues its decision to the SBA. When the lender issues its decision to the SBA approving an Application (in whole or in part), it must include the calculation form, PPP Schedule A to the Application and the (optional) PPP Borrower Demographic Information Form (if submitted to lender). The SBA, not later than 90 days after the lender issues its decision to SBA and subject to any SBA review of the loan or loan application, will remit the appropriate forgiveness amount to the PPP lender, plus any interest accrued through the date of payment, but deducting any EIDL advance (if applicable) [Note: the SBA has stated that it will issue additional procedures on the process for advance purchases of PPP loans].

If a PPP lender determines that a borrower is not entitled to forgiveness, then the lender must provide the SBA with the reason for its denial along with the calculation form, PPP Schedule A to the Application and the (optional) PPP Borrower Demographic Information Form (if submitted to lender). The lender must also notify the borrower in writing that the lender has issued a decision to the SBA denying the loan forgiveness application. The SBA reserves the right to review the lender's decision in its sole discretion. Within 30 days of notice from the lender, a borrower may request that the SBA review the lender's decision.

In connection with the review of each Application, a lender must confirm:

- (i) Receipt of the borrower certifications contained in the Application;
- (ii) Receipt of the documentation the borrower must submit to aid in verifying payroll and nonpayroll costs, as specified in the instructions to the Application;
- (iii) The borrower's calculations on the Application, including the dollar amount of the cash compensation, non-cash compensation, and compensation to owners claimed on Lines 1, 4, 6, 7, 8, and 9 on PPP Schedule A of the Application and business mortgage interest payments, business rent or lease payments, and business utility payments claimed on Lines 2, 3, and 4 on the calculation form submitted with the Application; and
- (iv) That the borrower made the calculations on Line 10 of such calculation form correctly, by dividing the borrower's eligible payroll costs claimed on Line 1 by 0.75.

As noted above, lenders are expected to perform a good-faith review, in a reasonable time, of a borrower's supporting documents. While the SBA has indicated that a lender does not need to independently verify a borrower's reported information if the borrower submits documentation supporting its request for loan forgiveness and attests that it accurately verified the payments for eligible costs, if the lender identifies errors in the borrower's calculations or material lack of substantiation in the borrower's supporting documents, then the lender should work with the borrower to remedy the issue.

If the SBA determines that a borrower was ineligible for the PPP loan, then the loan will not be eligible for loan forgiveness. If only a portion of the loan is forgiven, or if the forgiveness request is denied, then any remaining balance due on the loan must be repaid by the borrower on or before the two-year maturity of the loan. If the amount remitted by the SBA to the lender exceeds the remaining principal balance of the PPP loan (because the borrower made scheduled payments on the loan after the initial deferment period), then the lender must remit the excess amount, including accrued interest, to the borrower. Importantly, the general loan forgiveness process described above applies only to loan forgiveness Applications that are not reviewed by the SBA prior to the lender's decision on the forgiveness application. In other words, the above is inapplicable to independent reviews of PPP loans by the SBA, which it may undertake at any time in its sole discretion.

- Notice of Review by SBA

If a lender receives notice that the SBA is reviewing a loan, then the lender must notify the PPP borrower in writing within five business days of receipt and, within such time period, transmit to the SBA electronic copies of the following:

- (a) The Borrower Application Form (SBA Form 2483 or lender's equivalent form) and all supporting documentation provided by the borrower;
- (b) The Application (SBA Form 3508 or lender's equivalent form), and all supporting documentation provided by the borrower (if the lender has received such Application);
- (c) Schedule A Worksheet to the Application;
- (d) A signed and certified transcript of account;
- (e) A copy of the executed note evidencing the PPP loan; and
- (f) Any other documents related to the loan requested by the SBA.

If the SBA has notified the lender that the SBA has commenced a loan review, then the lender shall not approve any Application for loan forgiveness for that loan until the SBA notifies the lender in writing that the SBA has completed its review.

- Lender Fees

If the SBA conducts a loan review and determines that the borrower was ineligible for a PPP loan, then the lender is not eligible for a processing fee and any such fee that has been paid is subject to the SBA's claimed clawback right. Specifically, if within one year after a PPP loan was disbursed the SBA determines that a borrower was ineligible for a PPP loan, then the SBA will seek repayment of the lender processing fee from the

lender.

Importantly, however, the SBA's determination of borrower eligibility will have no effect on the SBA's guaranty of a loan if the lender has complied with its obligations and the document collection and retention requirements described in the lender application form (SBA Form 2484). Furthermore, if a PPP lender fails to satisfy the requirements applicable to lenders or the document collection and retention requirements described in the lender application form (SBA Form 2484), the SBA will seek repayment of the lender processing fee and may determine that the loan is not eligible for a guaranty.

In light of the above, lenders participating in the PPP and administering the review and processing of Applications should be sure to implement safeguards. Specifically, lenders should revisit their respective quality control guidelines to determine whether those guidelines should be updated or revised to encompass training for staff, procedures for spotting and handling clear errors or obvious misstatement of facts, a unique escalation process specific to PPP loan forgiveness related matters and a PPP loan forgiveness application checklist.