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Business Alert

PPP Loan Forgiveness Guidance

Written by Jennifer V. Audeh, Thomas Draper, Malcolm G. Henderson

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On August 4, 2020, the U.S. Small Business Administration (SBA) issued New PPP Loan Forgiveness FAQs. These FAQs, together with previously released guidance and forgiveness applications and instructions, provide an outline for borrowers preparing to seek full or partial forgiveness of their Paycheck Protection Program (PPP) loans under the CARES Act (as modified by the Paycheck Protection Flexibility Act). Some key aspects of loan forgiveness eligibility and calculations are summarized below.

Calculating Forgivable Amount of Loan

Under the PPP, a loan may be forgiven if the borrower has used the loan proceeds for the specific uses permitted under the CARES Act. To determine how much of the loan is eligible for forgiveness, the borrower must analyze its expenditures of the PPP loan proceeds during the applicable covered period and the amount by which forgiveness may be reduced due to a reduction in headcount or a reduction of salaries and wages, as summarized below. In addition, in order to qualify for loan forgiveness a borrower must have used at least 60% of the loan proceeds for payroll costs.

Expenses Qualifying for Loan Forgiveness

A borrower can seek forgiveness for certain payroll expenses, mortgage interest payments, rent payments, and utilities payments incurred or paid by the borrower during the Covered Period applicable to the PPP loan. The "Covered Period" is the 24-week period beginning on the day the PPP loan proceeds were disbursed [1]. A borrower with a bi-weekly payroll schedule may instead choose to use the 24-week period beginning on the first day of the first pay period following the PPP loan disbursement as the Covered Period. In no event may the Covered Period for any borrower extend beyond December 31, 2020.

Payroll expenses that are eligible for forgiveness include (i) compensation (limited to $100,000 per employee on an annualized basis) in the form of (A) salary, wages, commission, tips, bonuses and hazard pay, (B) vacation, parental, family, medical or sick leave [2], and (C) payments in connection with separation or dismissal, (ii) employer contributions for employee group health care [3], (iii) employer contribution for employee retirement plans, and (iv) payments of state and local taxes assessed on compensation of employees. Expenses related to mortgage interest, rent payments, and utility expenses are eligible for reimbursement only if those obligations or services began before February 15, 2020.

The SBA has placed a cap on the amount of compensation paid to an "owner-employee" that can be included in payroll expenses eligible for forgiveness. For borrowers using a 24-week Covered Period, this amount is capped at $20,833 (the 2.5 month equivalent of $100,000 per year) for each individual or the 2.5-month equivalent of their applicable compensation in 2019, whichever is lower. For borrowers using an 8-week Covered Period, this amount is capped at $15,385 (the 8-week equivalent of $100,000 per year) for each individual or the 8-week equivalent of their applicable compensation in 2019, whichever is lower. Unfortunately, the SBA has not defined "owner-employee" for the purposes of this cap, nor has SBA provided any ownership threshold for applying this cap. Without additional guidance, it remains unclear whether employees with a de minimis amount of equity ownership or unexercised options will be treated as an "owner-employee" for the purpose of this limitation.

Reduction of Loan Forgiveness Amount

The amount of PPP loan proceeds eligible for forgiveness may be reduced if the borrower has reduced salaries or headcount during the Covered Period.

The loan forgiveness amount will be reduced for each employee whose average pay is reduced by more than 25% during the Covered Period by the amount of the reduction that exceeds 25%. However, a borrower can avoid a reduction in forgiveness based on salary or wage reductions if such salaries or wages are restored by December 31, 2020 to the salary or hour wage level that was in place on February 15, 2020.

In addition, the loan forgiveness amount may be further reduced if the borrower reduces the average number of full-time equivalent employees (FTEs) has decreased during the Covered Period. However, two separate safe harbors exempt borrowers from any forgiveness reduction in respect of FTEs:

- If a borrower reduced its FTEs during the period beginning February 15 and ending on April 26, 2020 but then, no later than December 31, 2020, restores its FTEs to the level that was in place on February 15, the forgivable loan amount will not be reduced.
- If a borrower provides documentation demonstrating that the business was not able to return to its February 15, 2020 level of business activity due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020 by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration related to the maintenance of standards of sanitation, social distancing, or any other work or customer safety requirements related to COVID-19.

If neither safe harbor is applicable, a borrower will need to determine the amount by which the loan forgiveness amount will be reduced by comparing the average number of weekly FTEs during the Covered Period to the average number of FTEs during one of the following periods at the choice of the borrower: (i) February 15 to June 30, 2019, (ii) January1 to February 29, 2020, or (iii) in the case of seasonable businesses, a consecutive 12-week period between May 1 and September 15, 2019.

In calculating any reduction to the loan forgiveness amount, a borrower may exclude any reduction in FTEs related to (i) any positions for which the borrower made a good-faith, written offer to rehire an individual who was an employee on February 15, 2020 and the borrower was unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020, (ii) any positions for which the borrower made a good-faith, written offer to restore any reduction in hours, at the same salary or wages, during the Covered Period and the employee rejected the offer, and (iii) any employee who during the Covered Period (A) was fired for cause, (B) voluntarily resigned, or (C) voluntarily requested and received a reduction of their hours. In each case the borrower must document compliance with these requirements, including written offers to rehire, written records of any rejection of an offer of employment, written records of any request for reduced hours, and written records of any efforts to hire a similarly qualified individual.

A borrower's maximum loan amount may also be reduced if the borrower's non-payroll expenses exceed 40% of total eligible expenses.

Loans Not Forgiven

For any PPP loans not forgiven (in whole or in part), the original loan terms will apply, and loan amounts not eligible for forgiveness will incur interest of 1% per annum and will be payable on the loan's maturity date [4]. Payments of principal and interest with respect to any unforgiven loan amounts will be deferred until the date on which the amount of forgiveness, if any, is remitted to the lender by SBA. Any amounts not forgiven will accrue interest from the date of the disbursement of the loan proceeds.

How to Apply for Forgiveness

Which Application to Use

The SBA has issued two different application forms for borrowers to apply for forgiveness, SBA Form 3508 and SBA Form 3508EZ. Sole proprietors, independent contractors, and self-employed individuals who did not include any employee salaries in the computation of average month payroll automatically may use the shorter SBA Form 3508EZ. A borrower that did not reduce annual salary or hourly wages of any employee [5] by more than 25% during the Covered Period compared to the period between January 1, 2020 and March 31, 2020 and can satisfy at least one of the following two conditions is also permitted to use SBA Form 3508EZ:

- The borrower did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the Covered Period [6]; or
- The borrower was unable to operate during the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020 by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration related to the maintenance of standards of sanitation, social distancing, or any other work or

customer safety requirements related to COVID-19.

All other borrowers must use SBA Form 3508 to apply for forgiveness.

Submission Process and Review

A borrower may submit a loan forgiveness application before the end of its Covered Period, provided that the borrower has used all of the loan proceeds for which the borrower is requesting forgiveness and the borrower's loan forgiveness application accounts for any salary reductions in excess of 25% for the full Covered Period. The deadline for completing a loan forgiveness application is 10 months from the date of the completion of the Covered Period. As long as the application is submitted within that time period, the borrower is not required to make any payment until the forgiveness amount, if any, is remitted to the lender by SBA. Any amounts not forgiven will accrue interest from the date of the disbursement of the loan proceeds.

Once the application is submitted to the borrower's lender, the lender is required to complete the review of the application and issue a decision on forgiveness eligibility to the SBA within 60 days. If the lender determines that the borrower is entitled to forgiveness, in whole or in part, SBA will, subject to its right to review the loan or the loan application, remit the appropriate forgiveness amount to the lender, plus any interest accrued through the date of payment, no later than 90 days after the lender issues its decision to SBA.

The SBA may review any PPP loan of any size at any time at its discretion. If SBA initiates a review of a PPP loan, it will notify the lender and the lender must notify the borrower in writing. In the event the SBA determines that a borrower is not eligible for a PPP loan or loan forgiveness, the borrower may appeal that decision. The SBA has indicated it will be releasing additional guidance on the appeal process separately.

Submitting and Retaining Records

Borrowers are required to include the following documentation with respect to any forgiveness application:

- bank account statements or third-party payroll service provider reports documenting compensation paid to employees;
- tax forms or payroll provider reports for the Covered Period including payroll tax filings and state wage reporting and unemployment insurance tax filings;
- payment receipts, cancelled checks, or account statements documenting payment of employer contribution to employee health insurance and retirement plans;
- documentation showing the number of FTEs for the Covered Period and the relevant reference period;
- lender account statement or cancelled checks for mortgage interest payments from February 2020 through the Covered Period;
- lease Agreement and receipts or canceled checks or account statements for rent or lease payments from February 2020 through the Covered Period; and
- copies of invoices for utility payments from February 2020 through the Covered Period and related receipts, cancelled checks or account statements.

Though not required to be submitted, Borrowers will also be required to retain the following records in connection with requesting forgiveness:

- documentation supporting the listing of each employee and their cash compensation for which the borrower is seeking to include an eligible payroll expense, including any documentation related to salary or wage reductions during the covered period and any restorations prior to December 31, 2020;
- documentation regarding any employee job offers and refusals, firings for cause, voluntary resignation, requests for reduction of hours, and inability to hire similarly qualified employees for unfilled positions;
- documentation supporting any certification that the borrower was unable to return to their February 15, 2020 level of business activity due to compliance with social distancing or other customer safety requirements; and
- documentation related to the restoration of its FTEs employee levels prior to December 31, 2020.

All documentation in connection with a borrower's application for a PPP loan, the PPP loan documentation, and the application for forgiveness must be retained by the borrower for six years after the date the loan is forgiven or repaid in pull. The borrower must permit authorized representatives of the SBA, including representatives of its Office of Inspector General, to access such files upon request.

For more information on these topics, please contact Jennifer Audeh, Thomas Draper, or Malcolm Henderson.

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[1] For loans received prior to June 5, 2020, borrowers have the option to use either the 8-week period or the 24-week period beginning on the day the PPP loan proceeds were disbursed.

[2] Leave for which the borrower was reimbursed under the Families First Coronavirus Response Act should not be included.

[3] Employer health insurance contributions made on behalf of a self-employed individual, general partners, or owner-employees of an S-Corporation must be excluded because such payments are already included in their compensation.

[4] For loans made before June 4, 2020, the term of the loan is 2 years. For loans made after June 4, 2020, the term of the loan is 5 years.

[5] For the purposes of this test, "employees" means only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount of more than $100,000.

[6] Reductions related to an inability to rehire individuals who were employees on February 15, 2020 if the borrower was unable to hire similarly qualified employees for unfilled positions on or before December 31,2020 or related to reductions in an employee's hours that the borrower offered to restore and the employee refused are not applicable for the purposes of this test.

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