Payroll Protection Program Update: Forgiveness Application and Guidelines

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The CARES Act created the Paycheck Protection Program ("PPP"), which amended the Small Business Act ("SBA") to provide short term loans to companies with fewer than 500 employees and other companies (such as those in the restaurant and hospitality industry). Such loans may be eligible for full forgiveness if used for payroll and other business expenses and all other statutory requirements are met. The SBA continues to issue guidance on a rolling basis, which can impact a company's eligibility for the loan, use of the loan, and the level of forgiveness.

Forgiveness Application and Guidelines

On May 15, 2020, the SBA issued its loan forgiveness application, which was the first significant piece of guidance by the SBA on the subject. On May 22, 2020, the SBA then issued its interim final rule on loan forgiveness, which expanded on and clarified some items in the loan forgiveness application. This update provides a non-exhaustive overview of the guidance contained in the loan forgiveness application and interim final rule on loan forgiveness.

1. ***Loan Forgiveness Process***

   To receive loan forgiveness, a borrower must complete and submit the Loan Forgiveness Application (SBA Form 3508 or lender equivalent) to its lender (or the lender servicing its loan). The lender must render a decision on loan forgiveness (and amount) within 60 days of receipt of the application. SBA must then make a decision on approving and funding the forgiveness within 90 days after the lender issues its decision to SBA. Any amount of the loan principal not forgiven must be paid back on or before the two-year maturity of the loan.

2. ***Payroll Costs Eligible for Loan Forgiveness***

   Cash Compensation

   Cash compensation payroll costs include, among other things, gross salary, gross wages, gross tips, gross commissions, paid leave (excluding Family First Act leave), and allowances for

dismissal or separation. The total for each individual employee may not exceed $15,385 for the 8-week period ($100,000 pro-rated). However, the loan forgiveness application and interim final rule on loan forgiveness provide that cash compensation to owner-employees ***is*** capped at the lesser of the $100k/cap ($15,385 total) *or* 8/52 of their cash compensation in 2019.

Notably, the interim final rule on loan forgiveness includes *bonuses* and *hazard pay* as forgivable cash compensation. The rule further clarified that payments to furloughed employees are included in payroll costs, which allows borrowers to pay employees even if the employees are not able to perform their day-to-day duties, due to lack of economic demand or public health considerations.

Other Payroll Costs

Other forgivable payroll costs include employer contributions for employee health insurance, including employer contributions to a self-insured, employer-sponsored group health plan; employer contributions to employee retirement plans; and employer state and local taxes assessed on employee compensation (e.g., state unemployment insurance tax).

Covered Period or Alternative Covered Period

Borrowers who make payroll biweekly (or more frequently) have the option of choosing from the following two consecutive 8-week periods to determine what payroll costs are forgivable: (1) “covered period” which starts on the day the loan is disbursed; or (2) “alternative covered period” which starts on the first day of the first payroll cycle following the day the loan is disbursed.

Payroll costs paid *or* incurred during the 8-week period the borrower chooses are forgivable. This means payroll costs incurred before the chosen 8-week period but paid during the chosen 8-week period are forgivable. Further, payroll costs incurred during but paid after the chosen 8-week period are forgivable, as long as they are paid on or before next regularly scheduled payroll date.

3. ***Non-Payroll Costs Eligible for Forgiveness***

Eligible Non-Payroll Costs

Non-payroll costs eligible for forgiveness include:

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 February 15, 2020;

B. *Covered rent obligations*: business rent or lease payments pursuant to lease agreements for real or personal property in force before February 15, 2020; and

C. *Covered utility payments*: business payments for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for service that began before February 15, 2020.

Paid or Incurred during the Covered Period

Any non-payroll costs paid during the covered period are forgivable (even if those payments were for non-payroll costs incurred prior to the covered period). Further, non-payroll costs incurred during the covered period but then paid outside the covered period are forgivable if paid on or before the next regular billing date.

4. ***Reductions to Loan Forgiveness***

Full-Time Equivalency (FTE) Calculation

To calculate the average FTEs during the covered period or alternative payroll covered period, a borrower can use two methods: (1) take the average number of hours paid per week during the chosen 8-week period, divide by 40, and round to the nearest tenth; or (2) assign a 1.0 for each employee who was paid for 40 hours or more on average per week and a .5 for employees who were paid for fewer than 40 hours on average per week during the chosen period.

Reduction in FTEs

In general, a reduction in FTE employees during the covered period or the alternative covered period reduces the loan forgiveness amount by the same percentage as the percentage of reduction in FTE employees. The borrower must select a reference period: (i) February 15, 2019 through June 30, 2019; (ii) January 1, 2020 through February 29, 2020; or (iii) in the case of a seasonal employer, either of the two preceding methods or a consecutive 12-week period between May 1, 2019 and September 15, 2019. If the average number of FTE employees during the covered period or the alternative covered period is less than the reference period, the total eligible amount of loan available for forgiveness is reduced proportionally by the percentage reduction in FTE employees.

Exceptions to Reduction in FTEs

The SBA has created an exception for borrowers that suffer a decrease in FTEs through no fault of their own. Employees who, during the selected loan period, were fired for cause, voluntarily resigned or voluntarily requested and received a reduction of their hours will be treated as FTEs during the selected loan period. Further, a borrower may exclude any reduction in FTEs that is attributable to an individual employee if: (1) the borrower made a good faith, written offer to rehire such employee (or, if applicable, restore the reduced hours of such employee) during the covered period or the alternative covered period; (2) 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; (3) the offer was rejected by such employee; (4) the borrower has maintained records documenting the offer and its rejection; and (5) 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.

Reduction in an Individual Employee's Salary or Wages

A reduction in an individual employee's salary or hourly wages in excess of 25 percent will generally result in a reduction in the loan forgiveness amount, unless an exception applies. For each new employee who was not paid more than the annualized equivalent of $100,000 in any pay period in 2019, the borrower must reduce the total forgiveness amount by the total dollar amount of the salary or hourly wage reductions that are in excess of 25 percent of base salary or hourly wages between January 1, 2020 and March 31, 2020, subject to exceptions for borrowers who restore reduced wages or salaries under the safe harbor exemption.

Safe Harbor for Restoring FTEs and/or Salary or Hourly Wages

If certain employee salaries and hourly wages were reduced between February 15, 2020 and April 26, 2020 (the safe harbor period) but the borrower eliminates those reductions by June 30, 2020 or earlier, the borrower is exempt from any reduction in loan forgiveness amount that would otherwise be required due to reductions in salaries and hourly wages. Similarly, if a borrower eliminates any reductions in FTE employees occurring during the safe harbor period by June 30, 2020 or earlier, the borrower is exempt from any reduction in loan forgiveness amount that would otherwise be required due to reductions in FTE employees.

75 Percent on Payroll Costs Requirement

At least 75 percent of the amount forgiven must be attributable to payroll costs. Otherwise, the borrower will suffer a reduction in forgiveness amount. An example of how the reduction is calculated is as follows: (1) borrower obtains $1 million loan; (2) borrower uses $500,000 for payroll costs and $200,000 for non-payroll costs; (c) the 75 percent requirement only allows the borrower to apply for forgiveness on $666,666.66 ($500,000/.75).

On the application, the borrower will have the lesser of the following forgiven: (1) the amount of payroll and non-payroll costs after the FTE and salary/wage reductions are assessed; (2) the total amount of the loan; or (3) the amount based on the 75 percent requirement.

FordHarrison's PPP team will continue to monitor the release of new guidance and provide such updates on a regular basis as guidance continues to roll out. The following attorneys are members of our PPP team:

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