SBA Issues PPP Loan Forgiveness Guidance, A Few New Rules: What You Need To Know Now

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The SBA just issued much-awaited guidance, allowing borrowers to claim forgiveness of their Paycheck Protection Program ("PPP") loans. The new guidance implements the single most enticing aspect of the CARES Act's marquee borrowing initiative for small businesses and self-employed individuals—loan forgiveness. The SBA's Loan Forgiveness Application provides detailed instructions for borrowers and the calculation of PPP loan forgiveness. It comes as a welcome development for small businesses, many of which have

already begun spending their PPP funds and have been following private and informal guidance and resources while they awaited official SBA directives.

Under the new procedures, a borrower must request the forgiveness of PPP loan proceeds by filing SBA Form 3508, *Paycheck Protection Program Loan Forgiveness Application*. The application has four components: (1) the PPP Loan Forgiveness Calculation Form; (2) PPP Schedule A; (3) the PPP Schedule A Worksheet; and (4) an (optional) PPP Borrower Demographic Information Form. Borrowers are required to submit items (1) and (2) to their lender.

Borrowers with PPP loans over $2 million. The SBA Form 3508 requires that a borrower who, along with its affiliates, received aggregate PPP funds over $2 million, check a box alerting the SBA to the size of the aggregate loan. This provision flags PPP loans that the Treasury Department has already warned it will audit. Notably, however, the form's instructions specifically limit the obligation to check this flag-raising box to loans aggregated with affiliates "to the extent required under SBA's interim final rule on affiliates issued April 15, 2020." That means that borrowers will still have to interpret the meaning of those affiliation rules to determine whether to check the box. Many borrowers will—and almost all should—seek legal guidance with respect to the affiliation rules where they are potentially applicable.

Forgivable Costs. The SBA's guidance provides for four broad categories of costs that are eligible for forgiveness: (1) payroll costs; (2) business mortgage interest payments; (3) business rent or lease payments; and (4) business utility payments. Subject to some exceptions, forgiveness is generally available for costs incurred with respect to these items during the borrower's "Covered Period," which is the eight-week period that begins on the date the PPP loan was disbursed. As with prior guidance, the SBA requires that at least

75% of the forgiven amount be attributable to payroll costs. This article covers each category in depth below.

Payroll Costs. The SBA's guidance allows a PPP borrower to deduct payroll costs "paid" or "incurred" during the borrower's eight-week Covered Period (or an Alternative Payroll Covered Period). Under the guidance, payroll costs are considered paid on the day that paychecks are distributed or that the borrower originates an ACH credit transaction. Payroll costs are considered incurred on the day that the employee earned the pay. This distinction allows employers some flexibility in timing their use of PPP funds.

Payroll costs incurred but not paid during the borrower's last pay period of the Covered Period (or Alternative Payroll Covered Period) are eligible for forgiveness if the borrower pays them by its next regular payroll date. Otherwise, the SBA's guidance requires that payroll costs must be paid during the Covered Period (or Alternative Payroll Covered Period) to qualify.

The SBA provides for an Alternative Payroll Covered Period that caters to borrowers with a biweekly (or more frequent) payroll schedule, allowing them to elect to calculate eligible payroll costs using the eight-week period that begins on the first day of their first pay period following the disbursement of PPP proceeds. Borrowers who opt for the Alternative Payroll Covered Period are still required to use the standard Covered Period for other costs.

Cash Compensation. Under the SBA's guidance, the total amount of cash compensation that is eligible for forgiveness for each individual employee cannot exceed an annual salary of $100,000, as prorated for the Covered Period; that is, it cannot exceed $15,385. For these purposes, "cash compensation" includes the sum of 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.

Non-Cash Compensation Payroll Costs. The SBA's guidance distinguishes between cash compensation payroll costs and non-cash compensation payroll costs. The former is

subject to the prorated limit discussed above. The latter (non-cash compensation) is not. Non-cash compensation payroll costs include the following items:

- The total amount paid by the borrower for employer contributions for employee health insurance, including employer contributions to a self-insured, employer-sponsored group health plan, but excluding any pre-tax or after-tax contributions by employees.
- The total amount paid by the borrower for employer contributions to employee retirement plans, but excluding any pre-tax or after-tax contributions by employees.
- The total amount paid by the borrower for employer state and local taxes assessed on employee compensation (e.g., state unemployment insurance tax), but not including any taxes withheld from employee earnings.

Compensation to Owners. The SBA's guidance allows for the forgiveness of amounts paid to owners (e.g., owner-employees, a self-employed individual, or general partner). The amount eligible for forgiveness is capped at the lower of (1) $15,385 (the eight-week equivalent of $100,000 per year) for each individual or (2) the eight-week equivalent of the owner's applicable compensation in 2019, whichever is lower.

Eligible Nonpayroll Costs. Nonpayroll costs eligible for forgiveness consist of the following categories:

- Covered Mortgage Obligations. The amount of business mortgage interest payments during the Covered Period for any business mortgage obligation on real or personal property incurred before February 15, 2020. The guidance defines "business mortgage interest payments" as payments of interest (not including any prepayment or payment of principal) on any business mortgage obligation on real or personal property that was incurred before February 15, 2020.
- Covered Rent Obligations. The amount of business rent or lease payments for real or personal property during the Covered Period pursuant to lease agreements that were in force before February 15, 2020.

- Covered Utility Payments. The amount of business utility payments during the Covered Period for business utilities for which service began before February 15, 2020. The guidance defines "business utility payments" as business payments for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020.

The SBA's guidance further provides that an eligible nonpayroll cost must either be (1) "paid" or (2) "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. Moreover, the SBA provides that eligible nonpayroll costs cannot be more than 25% of the total forgiveness amount.

Limitations. The guidance also implements the forgiveness limitations that are set out in the CARES Act.

Reductions in Average Full-Time Equivalency. The CARES Act provided that a borrower's forgiveness relief is limited where there is a reduction in the average number of full-time equivalent employees during the Covered Period as compared to a past reference period. In other words, Congress wanted to see that the employer was maintaining its workforce before it would allow forgiveness of the full PPP proceeds. The new guidance, however, provides that a borrower is exempt from this reduction if a new FTE Reduction Safe Harbor applies.

The SBA's guidance provides rules for calculating the average full-time equivalency (FTE). The borrower enters the average number of hours paid per week for each employee during the Covered Period or the Alternative Payroll Covered Period, divides by 40, and rounds the total to the nearest tenth. The maximum for each employee, however, is capped at 1.0. The guidance also provides that a simplified method that assigns a 1.0 for employees who work 40 hours or more per week and 0.5 for employees who work fewer hours may be used at the borrower's election.

FTE Reduction Exceptions. The SBA's guidance provides several exceptions to the forgiveness-limitation rules. One exception provides that a borrower is not penalized for FTE reductions that result from the following circumstances: (1) reductions related to any

positions for which the borrower made a good-faith, written offer to rehire an employee during the Covered Period or the Alternative Payroll Covered Period that was rejected by the employee; and (2) reductions related to any employees who during the Covered Period or the Alternative Payroll Covered Period (a) were fired for cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction of their hours.

FTE Reduction Safe Harbor. The SBA's guidance also recognizes a safe harbor that exempts some borrowers from losing loan forgiveness based on reduced FTE employee levels. Under this safe harbor, a borrower is exempt from the reduction in loan forgiveness based on FTE employees if both of the following conditions are met: (1) the borrower reduced its FTE employee levels in the period beginning February 15, 2020, and ending April 26, 2020; and (2) the borrower, by no later than June 30, 2020, restored its FTE employee level to the FTE employee level that existed during the borrower's pay period that included February 15, 2020.

Salary/Hourly Wage Reduction. The CARES Act reduces a borrower's loan forgiveness amount where the employer reduces certain employee salary and wages. Under this rule, the actual amount of loan forgiveness may be reduced if the salary or hourly wages of certain employees were less during the Covered Period or the Alternative Payroll Covered Period compared to the period from January 1, 2020 to March 31, 2020. This reduction applies only for employees whose salaries or hourly wages were reduced by more than 25% during the Covered Period or the Alternative Payroll Covered Period as compared to the period of January 1, 2020 through March 31, 2020. While not referenced in the new guidance, this reduction generally does not apply to employees with compensation in excess of $100,000.

Small businesses may find comprehensive PPP and CARES Actguidance here.