

CARES Act: Paycheck Protection Program Loan Forgiveness Application Released

On May 15, 2020, the Small Business Administration (the “SBA”) released the [Paycheck Protection Program Loan Forgiveness Application](#) (the “Application”) for borrowers of Paycheck Protection Program (the “PPP”) loans to apply to have their PPP loan forgiven. Totalling 11 pages in length, including instructions and worksheets, the Application specifies in detail how PPP loan borrowers are to calculate the amounts of their PPP loans eligible to be forgiven, information previously spread across the PPP statute and subsequent regulatory guidance. While the Application clarifies several points about PPP loan forgiveness, it also raises new questions and leaves some old questions unanswered. In addition, the Application introduces new rules not previously reflected in the PPP statute and guidance.

Background

The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) was signed into law on March 27, 2020. The CARES Act authorizes up to \$349 billion in forgivable loans to small businesses through the PPP administered by the SBA. On April 24, 2020, \$484 billion of additional coronavirus relief was approved, which includes an additional \$310 billion in funding for the PPP.

The preeminent feature of the PPP is that PPP loans are forgivable. The CARES Act provides that PPP loan principal is forgivable up to the amount of certain payroll, mortgage interest, rent and utilities costs incurred and payments made during the 8-week period beginning on the origination date of a PPP loan (the “Covered Period”). See the discussion below on how the Application measures the Covered Period and such costs incurred and payments made.

Subsequent guidance provided details about the types of costs to be included in calculating the forgivable amount of PPP loans, most notably, the requirement that certain payroll costs account for 75% of the calculated forgiveness amount. See the discussion below on how this limitation interacts with other limitations on the forgiveness amount.

Clarifications Provided by the Application

Measurement of the Covered Period

The CARES Act defines the Covered Period as the 8-week period beginning on the origination date of the PPP loan. The Application clarifies that the Covered Period begins on the first date PPP loan proceeds are actually received from the lender. As noted in a [previous alert](#), certain partnership and seasonal employer borrowers may have received multiple disbursements of their PPP loans. Such borrowers would need to measure the Covered Period by reference to their first PPP loan disbursement date.

Determination of Costs and Payments for Calculation of Forgiveness Amount

The CARES Act provides that the amount of forgiveness for a PPP loan is the sum of certain enumerated “costs incurred and payments made” during the Covered Period. The Application clarifies that the forgiveness amount is calculated by summing eligible payments made during the Covered Period with certain eligible costs incurred during the Covered Period and subsequently paid on the next regular payment date. With respect to payroll costs, costs incurred but not paid during the Covered Period may be included in the forgiveness amount if incurred during the last pay period of the Covered Period and subsequently paid on or before the next regular payroll date. With respect to non-payroll costs (i.e., mortgage interest, rent and utility costs), costs incurred but not paid during the Covered

Period may be included in the forgiveness amount if subsequently paid on or before the borrower's next regular billing date. PPP loan borrowers should be especially diligent in making timely payments following the Covered Period as late payments of costs incurred but not paid during the Covered Period may not be counted towards the forgiveness amount.

Application of Forgiveness Amount Reductions and Limitations

The CARES Act provides that the forgiveness amount is reduced by the dollar amount of certain reductions in compensation and by a fraction based on full-time equivalent ("FTE") employee headcount reductions, and is also limited to the principal amount of the PPP loan. Subsequent guidance limits the forgiveness amount such that no less than 75% of the costs counted towards the forgiveness amount comprise payroll costs (as opposed to non-payroll mortgage interest, rent and utilities costs). The order in which such reductions and limitations are applied could affect the calculation. The Application clarifies that, in applying these reductions and limitations, a borrower must first reduce the forgiveness amount by certain reductions in compensation, then multiply the result by a fraction based on FTE reductions and lastly compare such reduced amount to the overall limitations on forgiveness, i.e., that forgiveness cannot exceed the PPP loan principal or 133% (i.e., the reciprocal of 75%) of the payroll costs incurred or paid during the Covered Period.

Forgiveness does not Include PPP Loan Interest

Despite the clear language in Section 1106(d) of the CARES Act that the "amount of forgiveness under this section shall not exceed the principal amount of the financing made available," some commentators saw ambiguity in subsequent guidance as to whether interest on PPP loans might also be forgivable. Consistent with the language of the CARES Act, the Application makes clear that forgiveness cannot exceed the principal amount of the PPP loan disbursed.

New Developments

Alternative Payroll Covered Period

The Application allows borrowers to elect to calculate the Covered Period for payroll costs as the 8-week period beginning on the first day of the borrower's first full pay period following the date PPP loan proceeds are first received from the lender. Such "Alternative Payroll Covered Period," as the Application calls it, may not be used for calculation of non-payroll costs (i.e., mortgage interest, rent and utility costs) included in the PPP loan forgiveness amount.

\$2 million Threshold Check-Box

The Application requires the borrower to check a box if it, together with its affiliates, received PPP loans in excess of \$2 million. The Application does not say what this information will be used for, but it may relate to one or more of the safe harbors discussed in the [Frequently Asked Questions](#) (the "FAQs") posted by the U.S. Department of the Treasury. FAQ 39 provides that the SBA will review all PPP loans in excess of \$2 million, following the lender's submission of the borrower's Application. FAQ 46 provides that any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification as to the necessity of its PPP loan in good faith. That the aforementioned check-box refers to PPP loans "in excess of \$2 million" suggests that it may relate to FAQ 39 (the FAQ 46 safe harbor applies to loans "less than \$2 million," so presumably, if the check-box related to such safe harbor, it would require borrowers to check the box if they had loans equal to or in excess of \$2 million). However, the aforementioned check-box requires a determination of loan amounts for the borrower together with its affiliates, suggesting it may relate to the FAQ 46 safe harbor which, unlike the review threshold in FAQ 39, is determined by including PPP loans to a borrower's affiliates. To the extent this check-box relates to FAQ 39, it expands the number of PPP loans that will be reviewed by including borrowers'

affiliates in measuring the \$2 million threshold. To the extent this check-box relates to FAQ 46, it expands the safe harbor by specifying that, for purposes of the \$2 million threshold, borrowers need not include PPP loans for affiliates as to which the CARES Act waives affiliation rules. FAQ 46 and the aforementioned check-box both provide that the threshold for a borrower is measured by including all the borrower's affiliates determined under [the interim final rule on affiliates](#), but unlike FAQ 46, the Application's check-box excludes from the threshold affiliates as to which the CARES Act waives affiliation rules in determining a borrower's eligibility to receive a PPP loan. In determining eligibility to receive a PPP loan, the CARES Act waives affiliation rules for certain applicants in the accommodations and food services industry, certain franchises and businesses that receive financial assistance from a Small Business Investment Company. See our [previous alert](#) for a discussion of FAQ 39 and FAQ 46.

Certain Employee Terminations do not Reduce Forgiveness Amount

In general, the PPP loan forgiveness amount is reduced for certain reductions in FTE headcount. FAQ 40 provides that a laid-off employee would be excluded from the forgiveness reduction calculation to the extent the borrower offers to rehire the employee and the offer is rejected. The Application implements this exception by allowing the borrower to include such laid-off employee in its calculation of FTE employees during the Covered Period as if the employee had not been laid-off. In addition, the Application provides a similar exception allowing the Covered Period FTE calculation to include employees who were fired for cause or who voluntarily resigned as if such employees had not been terminated, and to include employees who voluntarily requested and received a reduction of their hours as if such hours had not been reduced. Inclusion of the FTE associated with such employees is permitted only if the position was not filled by a new employee (i.e., no double counting if the termination or hours reduction was already reversed by hiring a new employee).

Compensation of Owner-Employees, Self-Employed Individuals and General Partners

The Application restricts the amount of compensation to owner-employees, self-employed individuals, or general partners ("Owners") that may be included in payroll costs in calculating the PPP loan forgiveness amount. In addition to the \$100,000 per employee annualized compensation limit applicable to all employees, compensation of any Owner included in the forgiveness amount cannot exceed the 8-week equivalent of such Owner's 2019 compensation. Thus, Owners do not get any additional forgiveness for increasing their compensation relative to 2019. Further, as discussed below, the Application may restrict borrowers from including non-cash compensation to Owners (such as health insurance contributions, retirement plan contributions and state and local employer taxes) in the forgiveness calculation.

Owners are excluded in calculating any reduction of the forgiveness amount based on compensation or FTE headcount reductions.

Documentation Required to be Submitted with the Application

The CARES Act provides that the Application must include documentation verifying FTE headcount and payrates for the applicable periods, including payroll tax filings, state wage, payroll and unemployment insurance filings, and documentation verifying payments of non-payroll costs included in the forgiveness amount, including cancelled checks, receipts, account transcripts or other payment verifications. The Application additionally requires bank account statements or third-party payroll service provider reports to verify cash compensation paid to employees. The Application also requires documentation verifying the existence of non-payroll obligations and services prior to February 15, 2020 (i.e., verifying that mortgage interest, rent and utility payments relate to mortgages, leases and services predating February 15, 2020, as required by the CARES Act). It also provides that third-party payroll service provider reports may be provided in lieu of tax forms to verify certain payments.

6-Year Borrower Recordkeeping Requirement

The Application imposes a 6-year recordkeeping requirement on borrowers with respect to all records relating to the borrower's PPP loan. Such records include documentation submitted with the PPP loan application, documentation supporting the borrower's eligibility for a PPP loan, including its certification as to the necessity of its PPP loan request, documentation supporting the borrower's Application and documentation demonstrating the borrower's material compliance with PPP requirements. Such 6-year retention period begins on the date a borrower's PPP loan is forgiven or repaid in full. Borrowers must grant SBA representatives access to such records upon request.

Remaining Questions

Exclusion of Non-Cash Compensation of Owners

The Application may restrict borrowers from including non-cash compensation for Owners. The instructions for PPP Schedule A to the Application refer to contributions for "employee health insurance" and "employee retirement plans," and employer taxes on "employee compensation," while referring only to "amounts paid to owners." Some have interpreted the Application as making a distinction between employees and Owners, and thus, the aforementioned references to employee health insurance, employee retirement plans and taxes on employee compensation exclude inclusion of such contributions and taxes paid with respect to Owners. This would make the calculation of payroll costs consistent across various business types (the CARES Act already provides that payroll costs for sole proprietors and independent contractors includes only wages, commission, income, net earnings from self-employment or similar compensation, so it would be consistent for other types of business owners, such as owners of corporations that are also employed by the corporation, to be similarly limited in the amounts included in payroll costs). It is not clear who would be considered an "owner-employee" for these purposes. For instance, it is unclear how employees with stock options or similar but limited ownership through equity compensation would be treated.

Application Timing

It is not clear whether borrowers may submit the Application before June 30, 2020. The Covered Period for many PPP loan borrowers may end before June 30, 2020. However, in calculating the forgiveness amount reductions due to reductions in compensation and FTE headcount, the Application requires borrowers to report certain compensation items and FTE counts as of June 30, 2020, which would not be possible if the Application is submitted before such date. These items of the Application relate to safe harbors in the CARES Act, which eliminate the forgiveness amount reduction if applicable reductions in compensation or headcount are restored no later than June 30, 2020. Thus, it should be possible to take advantage of these safe harbors before June 30, 2020, but the Application does not contemplate reporting information about the safe harbors as of such an earlier date.

Going Forward

The release of the Application is an important milestone for borrowers and the practitioners who assist them. For some, the Application provides much-needed clarification, and allows borrowers to begin collecting documentation and running calculations required for their Applications. For many, however, the Application has caused frustration and confusion. Some practitioners who have followed the PPP guidance closely hoped the Application would resolve all of the issues and questions presented by the CARES Act and subsequent PPP guidance, and were disappointed that the Application did not do so, and in some cases, added additional complexity and uncertainty. We expect further guidance will continue to be released between the date of this article and the time borrowers must submit their Applications, but such guidance may not be timely enough for borrowers who must make operating decisions now without understanding the full impact such decisions may have on their eligibility for PPP loan forgiveness. In light of this, industry groups are pushing for easing of forgiveness conditions, including extension of the Covered Period,

allowing borrowers to elect a later Covered Period and altering the requirement that payroll costs incurred or paid during the Covered Period constitute at least 75% of the forgiveness amount. There appears to be some bipartisan support for these potential changes, some of which may require an act of Congress rather than updated regulatory guidance.

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<u>Peter J. Schaeffer</u>	212.336.2313	<u>pjschaeffer@pbwt.com</u>
<u>Tara S. Knapp</u>	212.336.2068	<u>tknapp@pbwt.com</u>
<u>Jonah Rizzo-Bleichman</u>	212.336.2863	<u>jrizzo@pbwt.com</u>
<u>Zuo (Zoey) Yi</u>	212.336.2974	<u>zyi@pbwt.com</u>

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