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SBA Releases Application Form for PPP Loan Forgiveness

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On Friday, May 15, the Small Business Administration released its application and instructions for forgiveness of Paycheck Protection Program ("PPP") loans. Loan forgiveness is the next big question facing small businesses as many businesses applied for PPP loans assuming they would be fully forgiven. In broad strokes, PPP loans will be entirely forgiven if (i) the entire loan amount is used for qualified costs (payroll, mortgage interest payments, rent or lease payments and utility payments); (ii) of the qualified costs, 75 percent of that amount is payroll costs; (iii) the average number of full-time equivalent ("FTE") employees during the eight-week covered period following receipt of the loan is not less than the average number of FTE employees during the applicable prior reference period; and (iv) the employer did not reduce the compensation of employees making less than $100,000 by more than 25 percent. If any of these four requirements are not met then there will be a reduction in the amount of the loan that is forgiven.

The application form is complicated and will be a challenge to complete for many small business owners. By and large, the application form and instructions are consistent with guidance previously provided in the FAQs published by the SBA and the Treasury Department, but the instructions and form provide additional details that will help guide borrowers so that they qualify for the maximum amount of loan forgiveness.

The form and instructions contain a few points worth noting:

Calculation of Qualified Costs Paid and Incurred During the Covered Period

In most cases, the amount of a PPP loan is determined by taking 2.5 times the borrower's average monthly payroll costs during the prior year. The amount of the loan must be spent on qualifying costs over a "Covered Period" (or an "Alternative Payroll Covered Period") of only eight weeks. Moreover, the CARES Act refers to costs that are "paid and incurred" over this period. It was not clear what expenses would be considered "paid and incurred" during the applicable eight-week period. The SBA has interpreted this language in a manner that is very favorable to borrowers.

The instructions to the application form provide that qualifying payroll costs are to be counted towards forgiveness as long as they are either (i) actually paid during the applicable eight-week period or (ii) incurred during the eight-week period but not paid, as long as such incurred costs are paid at the next regular payroll date after the conclusion of the eight-week period. The same expense may not be counted twice, of course. Similar rules are provided for rent, interest and utility payments. This means that in most cases a borrower will be able to include more than eight weeks of expenses in the forgiveness calculation. For example, payroll costs paid at the beginning of the eight-week period for services performed prior to the eight-week period can count as qualifying payroll costs, and payroll costs incurred but not paid at the end of the eight-week period can also count as qualifying payroll costs.

Covered Period

Generally, the calculations required to be performed for the forgiveness application are for a "Covered Period" that is the eight-week period from the date of loan disbursement. The instructions to the forgiveness application create an "Alternative Payroll Covered Period" for employers with a biweekly (or more frequent) payroll period. The alternative period begins on the first day of the first pay period after the PPP loan was disbursed. The alternative period can be used in some, but not all, of the calculations. The flexibility in choosing the applicable eight-week period may enable some businesses to qualify for a larger forgiveness amount.

FTE Safe Harbor

The instructions describe how the SBA will determine whether, and to what extent, there has been a reduction in the number of FTE employees during the applicable eight-week period, and also contain a number of safe harbor rules and elections for borrowers. Under one safe harbor rule, an employer that reduced its workforce between February 15, 2020 and April 26, 2020 but subsequently increased its workforce back to the FTE amount as of February 15, 2020 by June 30, 2020 can avoid a reduction in loan forgiveness. As previously outlined in the FAQs, the FTE amount will not be reduced for employees that declined to return to work, employees that were fired for cause or employees who voluntarily resigned. Finally, the instructions provide that the FTE amount must be rounded to the nearest tenth and a simplified assumption can be made that an employee that works fewer than 40 hours per week is equal to 0.5.

Employees at Time of Forgiveness Application

The Application form asks the borrower to disclose the number of employees at the time of loan application and the number of employees at the time of the forgiveness application. This information has no bearing on the calculation of the forgiveness amount, and it is unclear why the SBA is asking for this information. Some have expressed concern that reporting a reduction in workforce at the time of the application might adversely affect how the SBA treats the application for forgiveness.

Payroll Costs – Treatment of Bonuses

Many businesses are having difficulty paying sufficient payroll costs to qualify for full forgiveness of the PPP loan, due to the fact that payroll costs must account for 75 percent of the amount forgiven, the Covered Period is only eight weeks in duration and many employees are not willing to return to work (often because they make more money on unemployment). Many borrowers have asked whether they can pay bonuses to employees to increase their qualifying payroll costs. The instructions do not address this issue directly, but it appears that bonuses ought to qualify as good payroll costs, subject to a per-employee cap of $15,385 in cash compensation for the eight-week Covered Period. Additional limits on bonuses apply to owner-employees and partners (they generally cannot exceed their pro-rated 2019 compensation).

Payroll Costs - Non-Cash Compensation

Certain non-cash compensation amounts can also be included in payroll costs. These are amounts paid by the employer for (i) contributions to employee health insurance, excluding any pre-tax or after-tax contributions by employees; (ii) amounts paid by employer to employee retirement plans, excluding any pre-tax or after-tax contributions; and (iii) amounts paid by the employer for state and local taxes assessed on employee compensation, not including taxes withheld from employees.

The instructions do not give additional guidance on whether payments to a retirement plan must be prorated for the covered period. For example, if an employer makes a payment towards its 2019 obligation for an employee retirement fund, it is not clear whether that payment is a qualified cost. Additionally, if an employer generally makes a single yearly payment to an employee retirement plan, it is unclear whether a portion of that amount can be considered a payroll costs as there is no concept of “incurred” when determining the non-cash consideration amount.

Information to Be Provided by the Borrower

The instructions provide a list of documentation that must be provided by the borrower with the application to substantiate the calculations.

Payroll Costs – **Each of the following** must be provided: (i) bank statements or reports from a third-party payroll service provider documenting the amount of cash payments; (ii) federal payroll tax filing and equivalent state wage reporting and unemployment insurance filings; and (iii) payment receipts, cancelled checks or account statements documenting employer contributions to employee health insurance and retirement plans.

Full-Time Equivalency – Documentation (which can be the federal and state payroll reports mentioned above) showing either of the following can be provided, depending on reference period chosen: (i) average number of FTE employees employed per month between February 15, 2019 and June, 30, 2019 or (ii) average number of FTE employees employed per month between January 1, 2020 and February 29, 2020. Special rules apply for seasonal employers.

Nonpayroll Costs – Documentation must also be provided to prove the existence of the business obligation or services prior to February 15, 2020, as well as the payments made during the covered period.

- Mortgage interest payments: A copy of the lender's amortization schedule along with receipts or cancelled checks showing payments during the Covered Period or statements from the lender showing payments from February 2020 until one month after the end of the Covered Period.
- Rent or lease payments - A copy of the current lease agreements and receipts or cancelled checks showing payments during the Covered Period or statements from the lessor showing payments from February 2020 until one month after the end of the Covered Period.
- Utility payments – A copy of invoices from February 2020 and during the Covered Period along with receipts, cancelled checks or account statements showing payments made.

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