

Drum Roll, Please ...

The PPP Loan Forgiveness Application!

Late Friday, May 15, 2020, the Small Business Administration released a Loan Forgiveness Application (Application) for Paycheck Protection Program (PPP) loans. After testimony by Treasury Secretary Steven Mnuchin at a Tuesday, May 19, 2020, hearing of the Senate Banking, Housing, and Urban Affairs Committee, the Application may be the final word on forgiveness. In response to questions from Sen. Kyrsten Sinema, D-Ariz., Mnuchin said, "I thought the guidance we put out dealt with all the issues." As a result, borrowers need to make the most of guidance they can glean from the Application.

This article focuses on the partial resolution by the Application of four unrelenting questions borrowers have faced.

1. What does "costs incurred and payments made during the covered period" mean?
2. How is a full-time equivalent (FTE) employee calculated?
3. Is it true if a business restores salaries and wages and FTEs as of June 30, there will be no decrease in forgiveness related to a reduction of these amounts?
4. To what amount does the 75/25% limitation apply?

Remaining are two of the most frequently asked questions—whether forgivable costs include employee bonuses or rent paid to a related party.

PPP loans through the lens of the Application.

In early April 2020, businesses could apply for a PPP loan in an amount equal to 2.5 times of their historical monthly average "payroll costs." Self-employed individuals, such as independent contractors and sole proprietors, could qualify for a loan in an amount of 2.5 times their average monthly net profit. This is calculated by dividing line 31 on 2019 Form 1040 Schedule C by 12 and then multiplying the result by 2.5, with line 31 being capped at \$100,000. What made these loans so attractive is that they can potentially be partially or wholly forgivable.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, of which the PPP loans are a part, states that eligible costs must be "incurred and payments made" during an eight-week covered period for the costs to be forgivable. As described below, the Application modifies the definition of "Covered Period" (CP) and creates a new Alternative Payroll Covered Period (APCP). Eligible forgivable costs include payroll costs, interest on indebtedness secured by real or personal property, rent, and utilities. Ultimately, we learned that "payroll costs" means gross wages, plus employer contributions for employee health insurance and retirement plans, and state unemployment taxes. Excluded from "payroll costs" are wages of persons living outside the United States, the pro-rated share of compensation over \$100,000 per year, and sick leave or family leave wages covered by the [Families First Coronavirus Response Act](#).

There are three limitations on forgiveness after spending the loan proceeds on forgivable costs. First, absent qualifying for the "Exemption for Re-Hires," commonly described as a "safe harbor," a decrease in the forgiveness amount is required for certain reductions in FTEs. Second, in the absence of qualification for a safe harbor, a decrease is required if the salary or wages of certain employees are reduced by more than 25%. Third, in an April 15, 2020, [Interim Final Rule](#), the SBA imposed a threshold requiring 75% of the loan proceeds or forgivable costs to be spent on eligible payroll costs.

So, what about those FTEs? A borrower's forgiveness amount will be decreased if there is a reduction in FTEs, unless the borrower qualifies for the safe harbor. The safe harbor applies if the following two requirements are met: (1) there is a reduction in FTEs when comparing total average FTEs between February 15 through April 26, 2020, to total FTEs in the pay period inclusive of February 15, 2020; and (2) that reduction is eliminated as of June 30, 2020. If the safe harbor is met, there is no reduction in the borrower's forgiveness amount. If the borrower does not qualify for the safe harbor, the amount of forgiveness is decreased by the application of an FTE reduction quotient.

The quotient is calculated by dividing the average FTEs during the CP or APCP to a borrower's selected reference period. A borrower whose business is not seasonal may choose between February 15 through June 30, 2019, and January 1 through February 29, 2020. A borrower whose business is seasonal may choose either of those periods or any consecutive twelve-week period between May 1 and September 15, 2019. The FTE reduction quotient is applied to total forgivable costs after any decrease for a reduction in salary or wages, but before application of the 75/25% rule.

Regarding the salary and wage reductions, absent qualifying for the safe harbor, a borrower's forgiveness amount will be reduced if the salary or wages of certain employees during the CP or APCP is less than 75% of the respective salary or wages for those employees during the period from January 1 through March 31, 2020. Providing additional information on this reduction and the safe harbor risks both your attentiveness and sanity. Instead, we will move on with this promise. Shortly, we will post a separate article to our [website](#) that walks through the salary and wage reduction calculation and safe harbor.

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Finally, a few answers.

We have an answer to, arguably, the most important of the open questions: what is meant by the CARES Act language “costs incurred and payments made during the covered period.” Does this language refer to costs accrued or costs paid during the CP? The answer—both.

1. It is costs incurred and costs paid.

The Application modifies the definition of CP and, *for payroll costs only*, creates a new period called the Alternative Payroll Covered Period. The CP is expanded so that eligible costs incurred during the CP are treated as forgivable, even if the costs are paid after the CP, provided that payment of the costs is made on or before the next regular payroll or billing date. Payroll costs are considered “paid” on the day that paychecks are distributed, or the borrower originates an ACH credit transaction, and are “incurred” on the day that the employee’s pay is earned.

Concerning payroll costs, companies no longer have to worry about fitting their payroll into an artificially chosen eight weeks. Instead, borrowers with a bi-weekly, or more frequent, payroll schedule may elect the APCP, an eight-week (56-day) period that begins on the first day of the first pay period following the borrower’s PPP loan disbursement date. For example, if the borrower received its PPP loan proceeds on Monday, April 20, and the first day of its first pay period following its PPP loan disbursement is Sunday, April 26, the first day of the APCP is Sunday, April 26 and the last day of the APCP is Saturday, June 20. As with the CP, costs incurred but not paid during the APCP are eligible for forgiveness if paid on or before the next regular payroll date. Again, the APCP applies only to payroll costs. For borrowers that elect the APCP, the CP continues to apply to non-payroll costs.

Therefore, costs **paid during** the CP or APCP are forgivable, even if incurred before those periods. And, costs **incurred during and paid after** the CP or APCP are forgivable provided that payment of the costs is made on or before the next regular payroll date or billing date. Costs that are both paid and incurred may only be counted once.

2. FTEs are calculated using 40 hours per week or a simplified method.

The educated guesses that the SBA would use 30 hours per week were just that—guesses. To compute its FTEs, a borrower must take the number of hours paid per week, divide by 40, and round the total to the nearest tenth. However, an employee working over 40 hours per week can only count as a maximum of 1.0. Borrowers may elect a simplified method in which an FTE of 1.0 is assigned to an employee that works 40 hours or more per week, and an FTE of 0.5 is assigned to an employee that works fewer than 40 hours per week. The most advantageous method will depend on each borrower’s facts. The Application also provides that a borrower will not have its loan forgiveness reduced if FTEs cannot be restored because an employee rejects a good-faith, written offer of rehire, is fired for cause, voluntarily resigns, or voluntarily requests and receives a reduction of their hours.

3. ON June 30, really?

The answer appears to be yes, really. The FTE safe harbor provides that if FTEs between February 15 and April 26, 2020, decreased, a reduction in forgiveness is avoided provided that “**as of**” or “**not later than**” June 30, 2020, the borrower restores the FTEs to the FTE level for the pay period including February 15, 2020. A similar safe harbor exists for certain salary and wage reductions. There is no reduction in forgiveness amount if the salary and wage reductions are eliminated as of June 30, 2020.

4. 75/25% of what?

The 75/25% rule requires at least 75% be spent on payroll costs. Previous guidance was inconsistent as to what amount the 75% was to be applied. Is 75% of the loan amount to be spent on payroll costs, or is it 75% of the amount of requested forgiveness? Per the Application, the forgiveness amount is the lesser of (i) total eligible payroll and nonpayroll costs less adjustments for FTE and salary/wage reductions (referred to as the modified total potential forgiveness amount), (ii) the PPP loan amount, or (iii) total payroll costs divided by .75. If that makes your head spin, it’s okay. The bottom line is the 75% is not applied to loan proceeds, but instead to something akin to the requested forgiveness amount.

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That's it.

The questions of whether forgivable costs include employee bonuses and rent paid to a related party remain. As we have told many of you, there is nothing in the statute or existing guidance that prohibits these costs from being forgivable, nor is there anything that describes them as forgivable.

Anything else?

Two additional areas of the Application deserve mention—certifications and documentation. The Application requires the borrower to certify several things, including:

- The dollar amount for which forgiveness is requested was used to pay costs that are eligible for forgiveness; includes all applicable reductions due to decreases in the number of FTEs and salary/hourly wage reductions; does not include non-payroll costs over 25% of the amount requested; and compensation for any owner-employee or self-employed individual/general partner does not exceed eight weeks' worth of 2019 net earnings, capped at \$15,385 per individual.
- If the funds were knowingly used for unauthorized purposes, the federal government might pursue recovery of loan amounts and/or civil or criminal fraud charges.
- The SBA may request additional information to evaluate the borrower's eligibility for the PPP loan and loan forgiveness, and that the borrower's failure to provide the information requested by the SBA may result in a determination that the borrower was ineligible for the PPP loan or a denial of the borrower's loan forgiveness application.
- The SBA may direct a lender to disapprove the borrower's loan forgiveness application if the SBA determines that the borrower was ineligible for the PPP loan.

In light of the SBA's heavy, after-the-fact reliance on the necessity certification in loan applications, borrowers should carefully read and consider what they are certifying.

The Application devotes a full page to the documentation required to be submitted with it. The Application consists of four parts: (1) the PPP Loan Forgiveness Calculation Form (Calculation Form); (2) PPP schedule A; (3) PPP schedule a worksheet; and (4) Documents that each borrower must submit with its PPP Loan Forgiveness Application.

The Calculation Form and the PPP Schedule A must be submitted to the lender. The PPP Schedule A Worksheet, or its equivalent, is not required to be submitted but is required to be maintained by the borrower. The documentation of payroll costs, FTEs, and nonpayroll costs to be submitted are described in detail, as is the documentation to support the PPP Schedule A Worksheet. The borrower must retain all documentation in its files for six years after the date the loan is forgiven or repaid in full, and permit authorized representatives of the SBA, including representatives of its Office of Inspector General, to access the files upon request.

Dean Dorton is committed to continuing to provide support to individuals and businesses during these complex times. Reach out with questions to your Dean Dorton advisor, another professional advisor, or email us at info@deandorton.com.

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