Paycheck Protection Program – How to Obtain Forgiveness

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PPP Loan Forgiveness: Key Rules & Regulations

- **CARES Act §1106**
  - §1106(b): "An eligible recipient shall be **eligible for forgiveness** of indebtedness on a covered loan in an amount equal to the sum of the following costs incurred and payments made during the covered period: (1) payroll costs; (2) any payment of interest on any covered mortgage obligation (which shall not include any prepayment of or payment of principal on a covered mortgage obligation); (3) any payment on any covered rent obligation; [and] (4) any covered utility payment."
- **Paycheck Protection Program Flexibility Act (PPPFA)** (signed June 5, 2020)
  - Amended various aspects of the CARES Act regarding PPP loan forgiveness, payroll tax deferral, and loan maturity dates.
  - Key Changes: (1) 24-week covered period, (2) 60% payroll cost requirement, and (3) full-time equivalent (FTE) reduction safe harbors.
  - PPPFA amendments are reflected in Interim Final Rules published on June 11, 12, 17, 22, and 24.
- **Interim Final Rules on Loan Forgiveness** (published on May 22, 2020 and June 22, 2020)
- **Loan Forgiveness Applications** (revised on June 16 to reflect changes from PPPFA)
  - **SBA Form 3508** (and related instructions) (general PPP loan forgiveness application)
  - **SBA Form 3508EZ** (and related instructions) (simplified forgiveness application that can be used by borrowers that fall into one of three categories)
    - 1) Borrower is self-employed, independent contractor, or sole proprietor with no employees at the time of the PPP loan application and did not include any employee salaries in computing average monthly payroll in its PPP loan application form.
    - 2) Borrower (A) did not reduce annual salary or hourly wages of any qualified employee by more than 25% during the covered period (or alternative payroll covered period) compared to the period between 1/1/20 and 3/31/20; **and** (B) did not reduce the number of employees or the average paid hours of employees between 1/1/20 and the end of the covered period.
    - 3) Borrower (A) did not reduce annual salary or hourly wages of any qualified employee by more than 25% during the covered period (or alternative payroll covered period) compared to the period between 1/1/20 and 3/31/20, **and** borrower was unable to operate during the covered period at the same level of business activity as before 2/15/20, due to compliance with requirements established or guidance issued between 3/1/20 and 12/31/20 by certain specified federal agencies (or state/local government shutdown orders issued in accordance with such federal guidance) related to the maintenance of standards of sanitation, social distancing, or any other work or customer safety requirement related to COVID-19. (**Categories 2 and 3 require the borrower to provide certifying documentation**).

Loan Forgiveness Amount

- Loan forgiveness amount equals the lesser of:
  1. The full PPP loan amount;
  2. The sum of all forgiveness-eligible costs as reduced for employee compensation and FTE headcount reductions; and
  3. Payroll costs during the covered period divided by 0.60 (60% payroll requirement).

Forgiveness-Eligible Costs

- Up to the entire principal amount of the PPP loan *plus any accrued interest* is eligible for forgiveness if applied toward **forgiveness-eligible uses**.
- **Forgiveness-eligible uses** (in each case incurred or paid during a 24-week (or 8-week) covered period):
  - "**Payroll costs**" (discussed in following slides)
  - Interest payments on mortgages existing before 2/15/20
  - Rent under leases in place before 2/15/20
  - Payments for utilities for which service began before 2/15/20
- **Borrower must use at least 60% of the PPP loan amount for payroll costs**.
  - This is a proportional limitation on the loan forgiveness amount (i.e., if payroll costs represent less than 60% of the total loan forgiveness amount requested by a borrower, then the forgiveness amount is proportionally reduced until payroll costs constitute 60% of the total forgiveness amount).
- All eligible *non-payroll costs* must be **incurred or paid** during the covered period and paid on or before the next regular billing date, even if the billing date is after the covered period.

Forgiveness-Eligible Costs: What Are "Payroll Costs"?

- **"Payroll costs" differ based on the applicant**:
  1. Non-Self-Employed Applicants: The following compensation for U.S. employees (not independent contractors): (i) salary, wages, commissions, or similar compensation; (ii) cash tips or equivalents; (iii) payment for vacation, parental, family, medical, or sick leave; (iv) allowance for dismissal or separation; (v) payment required for the provision of group health care benefits, including insurance premiums; (vi) payment of any retirement benefit; and (vii) payment of state or local taxes assessed on employee compensation.
  2. Self-Employed Applicants (with no employees): The sum of payments of any compensation that is a wage, commission, income, net earnings from self-employment, or similar compensation up to a maximum annualized amount of $100K.
  3. Self-Employed Applicants (with employees): Payroll costs for employees of self-employed individuals are calculated based on: (i) 2019 gross wages and tips paid to such U.S. employees *plus* any pre-tax employee contributions for health insurance or other fringe benefits excluded from taxable Medicare wages & tips (net of any amounts paid to any individual employee in excess of $100K); and (ii) 2019 employer health insurance contributions and retirement contributions listed on the 2019 Form 1040 Schedule C, and state and local taxes assessed on employee compensation.
  4. Partnerships with General Operating Partners: Partners in a partnership may not submit a separate PPP loan application as a self-employed individual. Self-employment income of general active partners may be reported as a payroll cost on a PPP loan application filed by or on behalf of the partnership.
- **Cap on Payroll Costs for Owner Employees/Self-Employed Individuals/General Partners**: Payroll costs for owner-employees, self-employed individuals, and general partners is capped at $20,833 for a 24-week covered period and $15,385 for an 8-week covered period per individual across all businesses.
- **Increased Compensation/Bonuses**: An employee's hazard pay and bonuses are eligible for loan forgiveness (as a supplement to salary or wages) so long as the employee's total compensation does not exceed $100K on an annualized basis.
- **Payroll Costs Do NOT Include**: (i) cash compensation (i.e., exclusive of non-cash benefits) of any individual employee in excess of an annual salary of $100K, as prorated for the covered period; (ii) federal income taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code of 1986 during the covered period; and (iii) qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act.
- **Period for Calculating Payroll Costs**: Borrowers (other than self-employed applicants) can calculate their aggregate payroll costs using data ***either*** from the trailing 12 months or calendar year 2019. Seasonal businesses may use average monthly payroll for the period between 2/16 – 6/30/19 ***or*** 3/1 – 6/30/19.

Forgiveness-Eligible Costs: What Are "Payroll Costs"? (cont.)

- **When Are Eligible Payroll Costs Paid/Incurred?**
  - Payroll costs are considered paid on the day that paychecks are distributed or the borrower ***originates*** an ACH credit transaction.
  - Payroll costs are considered incurred on the day that the employee's pay is earned.
  - Payroll costs incurred but not paid during the borrower's last pay period of the covered period are eligible for forgiveness if paid on or before the next regular payroll date. Otherwise, payroll costs must be paid during the covered period.
  - Payroll costs for employees not performing work but still on the borrower's payroll are incurred based on the schedule established by the borrower (typically, each day that the employee would have worked).

Forgiveness-Eligible Costs: What is the “Covered Period”?

- **Covered Period**:
  - The “covered period” begins on the date the PPP loan was originated and ends on the earlier of: (i) 24 weeks after the date of loan origination, or (ii) December 31, 2020.
    - However, a borrower who received a PPP loan before the enactment of the PPPFA may elect an 8-week covered period that begins on the loan origination date (i.e., the construct under the CARES Act prior to the enactment of the PPPFA).
- **Alternative Payroll Covered Period**:
  - The loan forgiveness applications (Form 3508 and Form 3508EZ) permit a borrower in calculating forgiveness-eligible payroll costs (and compensation-based or FTE-based forgiveness amount reductions) to use an “Alternative Payroll Covered Period” (whether 24-week or 8-week).
  - Only borrowers with a biweekly (or more frequent) payroll schedule may elect to use the Alternative Payroll Covered Period.
  - The Alternative Payroll Covered Period **begins on the first day of the borrower’s first pay period following their PPP loan disbursement date**.
  - If the Alternative Payroll Covered Period is selected, a borrower must use it consistently in their forgiveness application wherever the option is given.
    - If no option is given, then the standard Covered Period (beginning on the loan origination date) applies, and only the standard Covered Period applies to the calculation of eligible non-payroll costs.
  - The Alternative Payroll Covered Period cannot cover any period beyond December 31, 2020.

Reduction in Loan Forgiveness Amount

- The amount of a PPP loan eligible for forgiveness will be reduced:
  - **First**, dollar-for-dollar by the amount of any **salary cut** for any employee employed by the borrower during the covered period that is in excess of 25% of such employee's total salary or wages for the period between January 1, 2020 and March 31, 2020 that either (A) did not receive annualized compensation of $100K or more in any pay period in 2019, or (B) was not employed by the borrower in 2019; and
  - **Second**, proportionally for reductions in the average number of FTE employees during the (24- or 8-week) covered period compared to the average number of FTE employees per month during a reference period selected by the borrower.
    - The borrower can select one of the following reference periods: (A) 2/15/19 – 6/30/19, (B) 1/1/20 – 2/29/20, or, (C) in the case of seasonal employers, the average number of FTE employees per month between 2/15/19 – 6/30/19.

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Reduction in Forgiveness Amount: FTE Reduction Exception

- No reductions in the loan forgiveness amount are required for the following categories of employees (and the borrower can include the FTE of such employees in its calculation of **average FTE** for the covered period (as if such employee were still employed)):
  - **(1)** Any positions for which the borrower made a good-faith, written offer to rehire an individual who was an employee on 2/15/20 and the borrower was unable to hire similarly qualified employees for un-filled positions on or before 12/31/20;
  - **(2)** Any positions for which the borrower made a good-faith, written offer to restore any reduction in hours, at the same salary or wages, during the covered period and the employee rejected the offer; and
  - **(3)** Any employee who during the covered period (A) was fired for cause, (B) voluntarily resigned, or (C) voluntarily requested and received a reduction of hours.
- **No Double Counting**: A borrower <u>cannot</u> include the FTE for such employees if the position was filled by a new employee (i.e., the borrower cannot double count such former and replacement employee for the same position).
- **No Double Penalty for Salary Decline Due to FTE Reduction**: To ensure that borrowers are not doubly penalized, the salary/wage reduction applies only to the portion of the decline in employee salary and wages that is not attributable to the FTE reduction (i.e., if employee's hours are reduced, but hourly wage stays the same, the borrower is not required to conduct a salary/wage reduction calculation for that employee).

Reduction in Forgiveness Amount: Calculating "Average" FTE

- Average FTE during the covered period is determined using the average number of hours paid per week, divided by 40, and rounded to the nearest tenth.
  - Example: If the average number of hours paid per week for an employee is 45, that employee counts as 1 FTE. If the average number of hours paid per week for an employee is 30, that employee would count as 0.75 FTE.
- This calculation is done on an employee-by-employee basis and the maximum FTE for each employee is **capped at 1.0**.
- New employees not employed during the reference period can be included in the calculation of average FTE for the covered period.
- Borrowers can use a simplified method that assigns a 1.0 for employees who work 40 hours or more per week and 0.5 for those who work fewer than 40 hours per week.

Loan Forgiveness Reduction: Safe Harbors

- **Safe Harbor 1: COVID-19 Safe Harbor**
  - Protects a borrower broadly from any reductions in FTE employee levels between 2/15 and the end of the covered period due to compliance with requirements established or guidance issued by the Secretary of Health and Human Services, the director of the CDC or OSHA (or any state or local government shutdown orders issued pursuant to such guidance) during the period beginning on 3/31/20 and ending on 12/31/20, related to the maintenance of standards for sanitation, social distancing or any other worker or customer safety requirements related to COVID-19.
  - Borrower must be able to document and certify in good-faith as to the applicability of this safe harbor.
- **Safe Harbor 2: FTE Employee Reduction/Restoration Safe Harbor**
  - Borrower is exempt from the reduction in loan forgiveness for reduction of the number of FTE employees if both of the following conditions are met:
    - **(1)** The borrower <u>reduced</u> its average FTE employee levels in the period beginning 2/15/20 and ending 4/26/20; and
    - **(2)** the borrower <u>restored</u> by ***the earlier of*** 12/31/20 and the end of the covered period, its total FTE employee levels to its total FTE employee levels for the pay period inclusive of 2/15/20.
  - Borrower is instructed to calculate FTE for each relevant period (2/15—4/26/20, the pay period inclusive of 2/15/20, and total FTE as of the earlier of 12/31/20 and the end of the covered period) using the same calculation methods required for determining Average FTE during the covered period.

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Loan Forgiveness Reduction: Safe Harbors (cont.)

- **Safe Harbor 3: Salary/Hourly Wage Reduction Safe Harbor**
  - Borrower is exempt from a reduction in its loan forgiveness amount with respect to a qualified employee (i.e., under $100K annualized salary) if:
    - (1) The borrower reduced that employee's compensation by more than 25% in the period beginning 2/15/20 and ending 4/26/20; **<u>and</u>**
    - (2) the ***average*** annual salary or hourly wages of that employee as of 12/31/20 is equal to or greater than that employee's annual salary or hourly wages as of 2/15/20.
  - This safe harbor applies if the reduction is restored as of the ***earlier of*** 12/31/20 and the date that the forgiveness application is submitted.
  - Assessed on an employee-by-employee basis.
  - **What does "average" mean?**
    - The implication of "average" in this context is unclear. Is it sufficient for compensation to be restored by the earlier of 12/31/20 and the end of the covered period to the same annualized salary amount or hourly wages that an employee was receiving on 2/15/20 (e.g., if an employee was making $5K per month ($60K annualized salary) as of 2/15 and is reduced to $3K per month on 3/1, does that employee simply need to be restored to $5K per month going-forward as of 12/31 (or earlier date))? Or does "average" imply that an employee needs to be "caught up" so the average salary or hourly wages for year-to-date as of 12/31/20 (or earlier date) is equal to or greater than annual salary or hourly wages as of 2/15/20 (e.g., would the employee need to receive $8K to make up for $2K less in monthly compensation for March – June, so that the employee's average annualized salary as of 12/31 (or earlier date) is the same as on 2/15 ($60K))?

Loan Forgiveness Application: Certifications

- **Certifications**
  - Borrower must certify (among other certifications) that:
    - The forgiveness amount was used only for eligible expenses;
    - The forgiveness amount has been appropriately reduced (for compensation or average FTE reductions);
    - The forgiveness amount does not include non-payroll costs in excess of 40%; and
    - The forgiveness amount does not exceed 24 weeks' worth of 2019 compensation for any owner-employee or self-employed individual/general partner (capped at $46,155 per individual).
  - Consequences of a False Filing:
    - **Criminal Charges**: The loan forgiveness application reinforces that there are potential criminal charges for false claims in connection with the information provided in the application or supporting documents or if funds were knowingly used for unauthorized purposes.
    - **Civil Penalties**: In addition to criminal penalties, the government can pursue civil fraud remedies under the civil False Claims Act or the Program Fraud Civil Remedies Act.
- **>$2 Million PPP Loan**: Borrowers that, together with their affiliates, received PPP loans in excess of $2 million are required to check a box on Form 3508 indicating as much. This will be used to flag applications required to be reviewed by the SBA.

Loan Forgiveness Application: Required Documentation

- **Required Documentation**:
  - Payroll Costs: Documentation verifying the eligible cash compensation and non-cash benefit payments from the 24-week covered period.
    - E.g., bank statements, tax forms, payment receipts, cancelled checks, or account statements documenting the amount of any employer contributions to employee health insurance and retirement plans that the borrower included in the forgiveness amount.
  - Non-Payroll Costs: Documentation verifying existence of the obligations/services prior to February 15, 2020 and eligible payments from the covered period.
    - **Business Mortgage Interest Payments**: Copy of lender amortization schedule and receipts or cancelled checks verifying eligible payments from the covered period, or lender account statements from February 2020 and the months of the covered period through one month after the end of the covered period verifying interest amounts and eligible payments.
    - **Business Rent or Lease Payments**: Copy of current lease agreement and receipts or cancelled checks verifying eligible payments from the covered period, or lessor account statements from February 2020 and from the covered period through one month after the end of the covered period verifying eligible payments.
    - **Business Utility Payment**: Copy of invoices from February 2020 and those paid during the covered period and receipts, cancelled checks, or account statements verifying those eligible payments.
  - FTE Reference Period Documentation: Documentation showing the average number of FTE employees on payroll per week employed by the borrower during the selected reference period.
- **Retention Requirement**: Borrower must retain the required documentation (as well as the PPP Schedule A Worksheet included in Form 3508 and supporting documentation) for **6 years** after the loan is forgiven or repaid in full.

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Loan Forgiveness Application: Timeline for Applying for Forgiveness

- **When Can Borrowers Submit a Loan Forgiveness Application?**
  - A borrower may submit a loan forgiveness application **any time on or before the maturity date of the loan, including before the end of the covered period**, if the borrower has used all of the loan proceeds for which the borrower is requesting forgiveness.
- **Payment Deferral**:
  - All principal, interest, and fees on the PPP loan may be deferred until the date on which the determined forgiveness amount is remitted to the lender so long as the borrower submits a loan forgiveness application **within 10 months of the end of its forgiveness covered period**.
  - If borrower fails to apply for forgiveness of a covered loan within 10 months after the last day of the covered period, such borrower must make payments of principal, interest, and fee beginning no earlier than 10 months after expiration of the covered period.

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Tax Treatment of Forgiven PPP Loans

- **Not Taxable Income**: Amounts forgiven are not taxable income to the borrower.
  - However, the IRS has held that a borrower whose PPP loan is forgiven may not deduct the expenses that relate to the forgiven amount (i.e., the 24 weeks of wages, employee benefits, interest, rent, and utilities that determined the forgiven amount).
- **Deferral of Payroll Tax**: The PPPFA allows employers and self-employed individuals that receive PPP loan forgiveness to continue deferring payment of the employer share of the Social Security tax under CARES Act (Section 2302) through December 31, 2020.
- **Employee Retention Tax Credit**: Borrowers under the PPP are ineligible for the Employee Retention Tax Credit made available under the CARES Act.

Sick and Family Leave Tax Credits

- Refundable payroll tax credits through 2020 to employers to cover wages paid to employees while they take time off under the sick leave (for up to 10 days) and family leave (for up to $10,000) provisions.
- Sick leave credit is for wages up to $511/day or $200/day if the sick leave is to care for a family member or child following the child's school closing.
- Family leave credit is for wages up to $200/day ($10,000 maximum) while the employee is receiving paid family leave.
- The credit is not available for employers receiving a credit for paid family and medical leave under the Tax Cut and Jobs Act.

50% Employee Retention Credit for Employers Closed Due to Covid-19.

- Refundable payroll tax credit equal to 50% of certain "qualified wages" (including certain health plan expenses) paid to its employees beginning March 13, 2020 through December 31, 2020 if the employer is engaged in an active trade or business in 2020 and the wages are paid:
  - (i) while operation of that trade or business is fully or partially suspended due to a governmental order related to COVID-19 or
  - (ii) during the period beginning in the first quarter in which gross receipts for that trade or business are less than 50% of gross receipts for the same calendar quarter of 2019 and ending at the end of the first subsequent quarter in which gross receipts are more than 80% for the same calendar quarter of 2019.
- For employers with more than 100 employees, the credit is available only with respect to wages paid to an employee that is not providing services due to the circumstances described in (i) or (ii) above.
  - The IRS has specified that if an employee is unable to fully (tele) work due to the circumstances described in (i) or (ii), the credit is available for the portion of the employee's time that the employee is not working.
- The credit is capped at $5,000 (50% of $10,000 qualified wages) per employee for all calendar quarters.
- Companies receiving PPP loans under the CARES Act are not eligible for the credit.

Filing and Payment Extensions

- The CARES Act permits employers to delay payment of the 6.2% employer share of the Social Security tax (but not the 1.45% employer share of the Medicare tax) from the date of enactment through the end of 2020. The tax would be payable over the following two years with half paid by December 31, 2021 and the other half by December 31, 2022.
  - Prior to the enactment of the PPP Flexibility Act, taxpayers who had indebtedness forgiven under the CARES Act were not eligible to defer taxes due after they received a notice of debt forgiveness.

Loan Forgiveness: Lender Review Process

- **Good Faith Review of Required Documents**: The lender is required to confirm receipt of all required documentation and to use such materials to confirm the borrower's calculations as part of a "good-faith review."
  - The lender may rely on the borrower's representations/certifications and the burden remains on the borrower to provide an accurate calculation of the loan forgiveness amount and to supply accurate information and calculations in its forgiveness application.
  - If lenders identify errors in a borrower's calculation or material lack of substantiation in the supporting documents, lenders are directed to work with the borrower to remedy the issue (i.e., as opposed to denying forgiveness without an opportunity to ameliorate such deficiencies).
- **Loan Forgiveness Determination Required Within 60 Days**: Lenders must make a determination as to loan forgiveness in no less than 60 days from receipt of a "complete application" and will report its decision to the borrower and the SBA.

Loan Forgiveness: Lender Review Process (cont.)

- **Approval of Loan Forgiveness**: Within 90 days after the lender approves the loan forgiveness application, the SBA will remit the forgiveness amount to the lender, plus any interest accrued through the date of payment, less any EIDL advance amounts.
  - This 90-day timeframe is subject to any SBA review of the loan/loan application, during which time a loan may not be forgiven.
  - The forgiveness process may take as many as **150 days** assuming no issues that create delays.
  - If the amount remitted by the SBA exceeds the remaining principal balance because the borrower made scheduled payments on the loan after the payment deferral date, the lender must pay the excess amount (including accrued interest) to the borrower.
- **Denial of Loan Forgiveness**: If a lender issues its decision to the SBA that all or a portion of the requested forgiveness amount is to be denied, the lender must provide the SBA a reason for such denial and notify the borrower of the lender's decision.
  - Within 30 days of notice from the lender, a borrower may request that the SBA review the lender's decision. The SBA also has the right to review the lender's determination in its sole discretion.
  - If only a portion of the loan is forgiven or if the forgiveness request is denied, the balance must be repaid by the borrower on or before the 2-year maturity of the loan.

SBA Review Process

- **Scope of Review**: The SBA may review: (i) borrower eligibility, (ii) loan amount calculation and use of proceeds, and (iii) **loan forgiveness amount claimed by the borrower**.
  - If the SBA undertakes a review of a PPP loan, it will notify the lender and the lender must notify the borrower in writing **within 5 business days**.
- **SBA Requests**: If loan documentation submitted to the SBA or any other information indicates that a borrower may be ineligible for a PPP loan or may be ineligible to receive the loan amount or loan forgiveness amount claimed by the borrower, the SBA will (directly or via the lender) request additional information from the borrower. Failure to respond may result in a finding of ineligibility or that a borrower is ineligible for loan amount/forgiveness amount claim.
- **SBA Determinations**: If the SBA determines that a borrower was ineligible for the PPP loan (e.g., because the borrower lacked an adequate basis for the certifications made in its PPP loan application) the loan will not be eligible for loan forgiveness and the SBA will direct the lender to deny the forgiveness application. If the SBA determines that the borrower is ineligible for the loan amount or forgiveness amount claimed, the SBA will direct the lender to deny the loan forgiveness application in whole or in part, as applicable. Such denial may be in addition to the SBA's exercise of other remedies (e.g., repayment of the PPP loan) and may expose the borrower to penalties.

PPP Loan Forgiveness: Open Questions

- **How long do restored compensation/FTE levels need to be preserved?**
  - If a borrower restores employee compensation or FTE employee levels prior to December 31, 2020 or the end of the covered period and submits a forgiveness application availing itself of the applicable safe harbor, how long does such restored compensation/FTE level need to be preserved?
- **How are fully-furloughed employees (not receiving compensation, but continuing to receive benefits from the borrower) treated for purposes of calculating (and reducing) the forgiveness amount?**
  - While the loan forgiveness rules indicate that a reduction in an employee's wages/salary that is the result of a reduction in hours does not create a "double penalty" for purposes of reducing the forgiveness amount (such that only the FTE-based reduction applies), what about a fully-furloughed employee who has had their hours eliminated (and as a result their compensation reduced to $0)? Is it the case that if a borrower was forced to fully-furlough 50% of its workforce, in part to ensure sufficient funds to continue to pay for the healthcare benefits for such employees, that the borrower may suffer a 50% reduction in its forgiveness amount?

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