

SBA Paycheck Protection Loan Forgiveness

Frequently Asked Questions (May 5, 2020)

Loan forgiveness is a key feature of the Paycheck Protection Program (PPP) administered by the Small Business Administration (SBA) as part of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). If PPP loan proceeds are spent in accordance with the forgiveness rules and guidelines, a substantial portion of the loan amount may be forgiven, effectively transforming the PPP loans into grants. It will be critical for PPP loan recipients to understand how much of their loan may be forgiven and how various actions can impact that figure. Planning now can help maximize loan forgiveness in the future.

Below are some of the most frequently asked questions related to loan forgiveness and our understanding as of the most current guidance. Please note that the guidance on the forgiveness piece is changing rapidly, and many questions remain unanswered at a time when employers need to make important decisions about their workforce and the use of the PPP funds to ensure maximum forgiveness.

- **How does a company calculate the expected forgiveness amount of its PPP loan?**

PPP loan recipients can apply for and receive forgiveness for all or portion of a PPP loan in an amount equal to the funds the borrower can **document** that it paid, and show that it cleared the bank, in qualifying expenses during the eight weeks following loan origination. Specifically, borrowers can seek forgiveness for amounts spent on "payroll costs," mortgage interest, rent, and utilities.

Notably, no amounts spent on these qualifying expenses outside of this eight-week period are forgivable, and no more than 25% of the loan forgiveness amount may be attributable to non-payroll costs.

- **When does the eight-week forgiveness window begin?**

The eight-week period for paying qualifying expenses subject to forgiveness begins on the date that the lender makes its first disbursement of PPP loan proceeds to the borrower.

- **How are "payroll costs" defined?**

Payroll costs for purposes of the forgiveness are defined in the same way that payroll costs are defined for the purposes of calculating the borrower's loan amount, i.e., the total amount of any compensation to employees in the form of a salary, wage, commission, cash tip, payment for leave, severance, group health care benefit, retirement benefit and state or local taxes assessed on employee compensation.

Importantly, the **exclusions** from payroll costs are the same as well. Payroll costs may not include:

- Compensation to an individual employee in excess of an annual salary of \$100,000 (not including the value of non-cash benefits)
- The employer's share of FICA taxes
- Compensation to employees whose principal place of residence is outside the US
- Qualified sick or family leave for which credit is allowed under the Families First Coronavirus Response Act
- Compensation to independent contractors or sole proprietors.

It is unclear from the guidance currently available as to whether payment of "bonuses" during the eight-week period to employees who make less than \$100,000 per year would be considered payroll costs eligible for forgiveness.

- **How are non-cash benefits treated for purposes of the \$100,000 annual salary cap?**

As noted above, non-cash benefits are excluded from the \$100,000 annual salary cap for employees (not for owners of a sole proprietorship or active partners in a partnership). Accordingly, for those employees whose annual salary would otherwise exceed the cap, the cap for each such individual employee will be increased on a dollar-for-dollar basis for (and payroll costs will include) the value of non-cash benefits received by the employee, including employer contributions to defined-benefit or defined contribution retirement plans; payment of group health care coverage, including insurance premiums; and payment of state and local taxes assessed on the compensation of employees.

- **What mortgage interest, rent payments, and utility payments qualify for forgiveness?**

Amounts paid in interest on a mortgage obligation on real or personal property that the company incurred in the ordinary course of business that existed before February 15, 2020, may be included in a forgiveness calculation, as is rent paid on a lease agreement that was in force prior to February 15, 2020. Utility payments include "payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020."

- **Does a borrower need a separate bank account to track the expenses?**

Using a separate bank account to hold and disburse PPP loan proceeds is not required, but it may be prudent to help track and document spending. Whichever way a borrower approaches tracking the funds, it is crucial to fully document the amounts spent in the eight-week period and the specific nature of those expenses. This documentation will form the basis for the forgiveness amount. Every lender will have their own documentation requirements, so it is essential for borrowers to speak with their bankers early in the eight-week period to determine what level of detail the bank will require for the forgiveness calculation. If a separate bank account is not set-up, GPP recommends setting up a separate account in your general ledger to segregate these funds from your standard operating account.

- **What if a fourth payroll date falls outside the eight-week period? Can the borrower accelerate it?**

The SBA has not specifically addressed whether this is permissible. Absent guidance, a company should ensure it does not deviate substantially from its "ordinary payroll practices" (such as paying unusual bonuses) for the purpose of increasing its forgiveness amount; however, taking relatively minor measures (like accelerating a payroll date that will otherwise occur and for which the amounts are validly earned) are less likely to be problematic.

- **What if the borrower has or will conduct layoffs or implement salary reductions?**

Conducting layoffs and reducing salaries or wages is contrary to the spirit of the PPP loan program, and loan forgiveness will be negatively impacted by such cuts. Specifically, the amount of PPP loan actually given by the SBA will be impacted by two calculations:

1. **Workforce Retention:**

- Loan forgiveness will be granted to the extent that you retain your employees. The amount of loan forgiveness may be reduced if there has been a reduction in full-time equivalent employees. This reduction in loan forgiveness (if any) is calculated by multiplying the amount of loan forgiveness by a fraction. The numerator of the fraction is the average number of full-time equivalent employees of the borrower during the eight-week covered period. The denominator of the fraction is either:
 - the average number of full-time equivalent employees of the borrower between Feb. 15, 2019 and June 20, 2019
 - OR (whichever is lower)**
 - the average number of full-time equivalent employees of the borrower between Jan. 1, 2020 and Feb. 29, 2020

2. **Maintaining Wages:**

- The amount of loan forgiveness can be further reduced if employees who made less than \$100,000 in annualized wages in 2019 receive a reduction in pay of more than 25% during the eight-week period. The SBA will be issuing additional guidance on this loan forgiveness element, and that guidance is warranted to determine how this dollar-for-dollar calculation will work in practice.

3. **The Act allows for relief if FTEE counts and wages are restored by June 30, 2020:**

- Restoring employees to work and raising salaries and wages following a pay cut can mitigate reductions in loan forgiveness. Where layoffs or salary reductions occurred between February 15, 2020 and April 26, 2020, the loan forgiveness amount will not be reduced if the cuts in personnel and salaries are undone prior to June 30, 2020. To accomplish this, the company must (by June 30, 2020):
 - Rehire employees such that its FTEE levels are at least where they were as of February 15, 2020, AND
 - Reinstatement all salaries and wages for employees making less than \$100,000 that were reduced by more than 25% back to the level of those salaries and wages as of February 15, 2020.

- **If a company has deferred the payment of the employer's share of Social Security tax under section 2302 of the CARES Act, is the borrower still eligible for PPP loan forgiveness?**

Yes. However, once an employer receives a decision from its lender that its PPP loan is forgiven, the employer may not utilize the deferral for the employer's share of Social Security tax due after that date. The amount of the deposit and payment of the employer's share of Social Security tax that the employer deferred through the date on which the loan is forgiven continues to be deferred and will be due on the applicable dates provided in section 2302 of the CARES Act (i.e., December 31, 2021, and December 31, 2022).

- **When should borrowers expect to begin the forgiveness process with its lender?**

We expect borrowers to be able to begin working with lenders on forgiveness applications no later than the end of the eight-week forgiveness period. The CARES Act requires lenders to make decisions on forgiveness within 60 days of the applicant's request.

- **What documentation will borrowers need to provide its lender?**

The CARES Act requires PPP loan recipients seeking forgiveness to submit an application to their lenders including (1) documentation verifying the number of full-time equivalent employees on payroll and pay rates during the applicable periods (i.e., the periods of time described in the question above regarding layoffs and salary reductions) (payroll tax filings, and state income, payroll and unemployment filings) and (2) documentation verifying payments on mortgage and rent obligations and utilities. The SBA may issue additional guidance on the form of this "application" and documentation required, and lenders may also require specific additional information and materials.

At a minimum, the following documents should be collected throughout the eight-week period:

- Documents verifying the number of full-time equivalent employees on payroll and their pay rates, for the periods used to authenticate you met the staffing and pay requirements:
 - Payroll reports from your payroll provider
 - Payroll tax filings (Form 941)
 - Income, payroll, and unemployment insurance filings from your state
 - Documents verifying any retirement and health insurance contributions
- Documents verifying your eligible interest, rent, and utility payments (canceled checks, payment receipts, account statements)

Good recordkeeping and bookkeeping will be critical for getting your loan forgiven —borrowers must keep track of eligible expenses and their accompanying documentation over the eight-week period. Your lender will likely require these documents in digital format, so take the time to scan any paper documents and keep backups of your digital records.

- **Can I prepay my rent, mortgage, or health insurance premiums?**

No, prepayment is not an allowed use of the PPP and is not eligible for forgiveness. Although the guidance is still fluid, it is clear that "playing games" or trying to "game the system" does not fall within the spirit of the program and won't be eligible for forgiveness. Examples of "gaming the system" that could be disallowed and result in scrutiny of a borrower's PPP loan eligibility include:

- Prepaying or accelerating future expenses
- Any transactions with Owners/Partners that may look like a preferential transaction
 - Repayment of note payable to Owner/Partner
 - Distributions other than for taxes or a recurring Owner's draw/compensation

Take care with paying out bonuses that were not declared prior to applying for the loan or are outside normal payroll processes as those could be deemed as not forgivable expenses.

- **How is forgiveness calculated for a sole-proprietor (Sch C) taxpayer?**

As an individual sole-proprietor, you are entitled to use PPP loan proceeds to replace lost compensation due to the impacts of COVID-19. However, you are not allowed to use the full amount to replace pay. An amount equal to eight weeks (or 8/52) of your 2019 net profit will be eligible for forgiveness.

If you have mortgage interest, rent, or utility expenses, you must have claimed or be entitled to claim a deduction for those expenses on your 2019 Form 1040 Schedule C in order to claim them for forgiveness.

- **What happens if there is a balance on the loan that is not forgiven?**

Unforgiven loan balances will be treated as a loan, fully-guaranteed by the SBA (thru December 31, 2022), and for which no personal guarantee or collateral is required. Payments of principal and interest will be deferred until December 31, 2020, though interest will accrue during this deferment period. PPP loans have a two-year maturity and a one percent (1%) interest rate.

- **How will the SBA review the borrowers' required good-faith certification concerning the necessity of their loan request?**

When submitting a PPP application, all borrowers must certify in good faith that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” SBA, in consultation with the Department of the Treasury, has determined that the following safe harbor will apply to SBA’s review of PPP loans with respect to this issue: 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 concerning the necessity of the loan request in good faith.

SBA has determined that this safe harbor is appropriate because borrowers with loans below this threshold are generally less likely to have had access to adequate sources of liquidity in the current economic environment than borrowers that obtained larger loans. This safe harbor will also promote economic certainty as PPP borrowers with more limited resources endeavor to retain and rehire employees. In addition, given the large volume of PPP loans, this approach will enable SBA to conserve its finite audit resources and focus its reviews on larger loans, where the compliance effort may yield higher returns.

Importantly, borrowers with loans greater than \$2 million that do not satisfy this safe harbor may still have an adequate basis for making the required good-faith certification, based on their individual circumstances in light of the language of the certification and SBA guidance. SBA has previously stated that all PPP loans in excess of \$2 million, and other PPP loans as appropriate, will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form. If SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request. SBA’s determination concerning the certification regarding the necessity of the loan request will not affect SBA’s loan guarantee.