

All You Need to Know About the PPP Loan Forgiveness Application

The U.S. Small Business Administration (SBA) recently issued the Paycheck Protection Program (PPP) Loan Forgiveness Application (the Application) along with an Interim Final Rule on Loan Forgiveness (the Forgiveness Final Rule) and an Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities (the Loan Procedures Final Rule). Available [here](#), the highly anticipated Application provides important guidance, including detailed forgiveness calculation instructions and answers to other substantive questions. To apply for forgiveness of eligible costs during the 8-week period starting from the PPP loan disbursement date (the Covered Period), the borrower must complete this Application and submit it to its lender along with certain supporting documentation.

Below are the key takeaways from the Application, the Forgiveness Final Rule, and the Loan Procedures Final Rule:

Cap of \$15,385 Compensation Per Individual

The Application places a cap of \$15,385 for each employee's gross salary, gross wages, gross tips, gross commissions, paid leave (vacation, family, medical or sick leave, not including leave covered by the Families First Coronavirus Response Act), and allowances for dismissal or separation paid or incurred during the Covered Period. This amount is consistent with the requirement to limit an employee's compensation at an annualized rate of \$100,000.

The Forgiveness Final Rule also clarifies that the amount of loan forgiveness available for owner-employees and self-employed individuals' own payroll compensation is the lesser of 8/52 of 2019 compensation (approximately 15.38% of 2019 compensation) or the \$15,385 per individual in total across all businesses.

Bonuses and Hazard Pay Are Considered Eligible Payroll Costs

The Forgiveness Final Rule settles the uncertainty related to the payment of bonuses and hazard pay to employees during the Covered Period. Hazard pay and bonuses paid to employees are eligible for loan forgiveness, however, provided that such bonuses and hazard pay do not cause the employee's total compensation to exceed \$100,000 on an annualized basis.

Retirement and Health Insurance Contributions Are Not Eligible Payroll Costs for Self-Employed Individuals

The Forgiveness Final Rule asserts that retirement and health insurance contributions made by self-employed individuals, including Schedule C filers and general partners, are not eligible for forgiveness.

However, for employees, the SBA has yet to issue guidance on what costs and benefits are included in the employee retirement plan definition. The Application and Forgiveness Final Rule both fail to clarify or address this outstanding question.

Eligible Non-Payroll Costs Must Be 25% Or Less of the Forgiveness Amount

Prior to the release of the Application, ambiguity existed as to whether eligible non-payroll costs (mortgage interest, rent, lease payments and utilities all existing prior to February 15, 2020) must not exceed 25% of the forgiveness amount, or rather, if non-payroll costs must not exceed 25% of the entire PPP loan proceeds. The Application clarifies this 25% eligible non-payroll costs requirement only pertains to the forgiveness amount and calculation. As such, it is permissible

for borrowers to use more than 25% of the PPP loan proceeds on eligible non-payroll costs (although the monies eligible for forgiveness will be reduced such that the payroll costs are at least 75% of the amounts requested for forgiveness).

Eligible Payroll and Non-Payroll Costs May Be Paid or Incurred During the Covered Period (Except for Employee Benefits, Withholding Taxes, and Payments to Owners)

It was unclear under the CARES Act and subsequent SBA guidance whether costs *incurred or paid* during the Covered Period would be eligible for forgiveness. The Application provides clarity in terms of this issue and indicates that certain eligible costs do not have to be both paid and incurred during the Covered Period.

Pertaining to certain payroll costs, the Application clarifies that borrowers are generally eligible for forgiveness for both the payroll costs *paid* and the payroll costs *incurred* during the Covered Period. 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 (or Alternative Payroll Covered Period, explained below) are eligible for forgiveness if paid on or before the next regular payroll date.

However, the Application indicates that only certain employee benefits, employee taxes and amounts to owners that are paid (not incurred) are eligible for forgiveness. This includes: 1) total amount paid by the borrower for employer contributions for employee health insurance (including employer contributions to a self-insured, employer-sponsored group health plan, but excluding any pre-tax or after-tax contributions by employees; 2) total amount paid by the borrower for contributions to employee retirement plans, excluding any pre-tax or after-tax contributions by employees; 3) total amount paid by the borrower for employer state and local taxes assessed on employee compensation (e.g., state unemployment insurance tax), not including any taxes withheld from employee earnings; and 4) amounts paid to owners (owner-employees, a self-employed individual, or general partners) capped at \$15,385 per individual.

Pertaining to non-payroll costs, the Application clarifies that such costs “must be paid during the Covered Period or *incurred* during the Covered Period and paid on or before the next regular billing date, even if the billing date is after the Covered Period.” As such, for borrowers that have incurred such expenses and pay them after the conclusion of the Covered Period, such pro-rated costs remain eligible for forgiveness. The Forgiveness Final Rule expands on this by providing the following example: If a borrower's Covered Period begins on June 1 and ends on July 26 and the borrower pays its May and June electricity bill during the Covered Period and pays its July electricity bill on August 10 (the next regular billing date), then the borrower may seek loan forgiveness for its May and June electricity bills and for the portion of the July electricity bill through the end of the Covered Period (July 26).

However, the Application and the Forgiveness Final Rule do not definitively address if past-due payments incurred before the Covered Period and paid during the Covered Period are eligible for forgiveness.

The Alternative Payroll Covered Period

For administrative convenience, and to calculate payroll costs when they are incurred, borrowers have the option to select an Alternative Payroll Covered Period for purposes of the Loan forgiveness calculation. Borrowers with a biweekly (or more frequent) payroll schedule may elect to calculate eligible payroll costs using the eight-week (56-day) period that begins on the first day of their first pay period following their PPP loan disbursement date. If borrowers elect the Alternative Payroll Covered Period, the eight-week period will begin on the first day of the first pay period following the loan disbursement date.

Full-Time Equivalent Employee Reduction

The Application clarifies that the average full-time equivalency (FTE) for employees is calculated as follows: “For each employee, enter the average number of hours paid per week, divide by 40, and round the total to the nearest tenth. The

maximum for each employee is capped at 1.0. A simplified method that assigns a 1.0 for employees who work 40 hours or more per week and 0.5 for employees who work fewer hours may be used at the election of the Borrower.” This will require employers to determine if they will count employees based on a 40-hour work week, or if they will utilize the simplified method. The Forgiveness Final Rule emphasizes that borrowers may select only one of these two methods and must apply that method consistently to all of their part-time employees for the covered period or the alternative payroll covered period and the selected reference period.

Detailed in our previous [information memo](#), the PPP loan forgiveness amount may be reduced if borrowers reduce their FTE workforce headcount. The Application specifies that the average number of hours worked per week for an FTE is 40 hours.

The SBA has since established a “de minimis” exception for headcount reductions when employees are not rehired through no fault of the borrower (such as if the employee is offered to return to work but declines). The Application and Forgiveness Final Rule together further expand this exception, providing that the following employee reductions will not reduce the forgiveness amount:

1. Any positions for which the borrower (a) made a good-faith, written offer to rehire (or restore the previously reduced hours of) an employee during the Covered Period or the Alternative Payroll Covered Period at the same salary or wages and same number of hours as previously earned by such employee in the last pay period prior to the furlough or reduction in hours and (b) such offer was rejected by the employee; and
2. Any employees who during the Covered Period or the Alternative Payroll Covered Period (a) were fired for cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction of their hours.

The Forgiveness Final Rule imposes an additional obligation on borrowers claiming that employee rejected its offer to return to work. Borrowers claiming this exception must demonstrate that it notified the applicable state unemployment insurance office of the employee’s rejection of the offer to return to work within 30 days of the employee’s rejection of the offer. The SBA further indicated in the Forgiveness Final Rule that additional information regarding this reporting requirement will be forthcoming.

All of these exceptions should be documented and maintained by the employer.

Employee Salary Reduction

The Application provides a step-by-step analysis of whether to reduce the forgiveness amount due to salary/hourly wage reductions; and if so, by how much. Note that the employee salary reduction is calculated for each individual employee. Note that this reduction (and the corresponding safe harbor) does not apply to employees with an annualized salary of \$100,000 or more.

Step 1 determines whether the pay was reduced by more than 25% in the Covered Period as compared to January 1, 2020 through March 31, 2020. If the average annual salary during the Covered Period, when divided by the average annual salary between January 1, 2020 and March 31, 2020 is more than 0.75, then forgiveness is not affected. If the result is less than 0.75, then we move to Step 2.

Step 2 establishes the Salary/Hourly Wage Reduction Safe Harbor for forgiveness reductions based on salary reductions. If the average salary was decreased between February 15, 2020 and April 26, 2020 as compared to the salaries on February 15, 2020, but the average salary was fully restored by June 30, 2020 to the February 15, 2020 level, the Salary/Hourly Wage Reduction Safe Harbor has been met. If salaries have not been fully restored by June 30, 2020, then we move to Step 3.

Step 3 determines the amount of the forgiveness reduction based on the reduction of employee salaries. The determinations for hourly employees and salaried employees are completed separately.

For hourly employees, the average hourly wage between January 1, 2020 and March 31, 2020 is multiplied by 0.75 and then the average annual hourly wage during Covered Period or Alternative Payroll Covered Period is subtracted from that product. That difference is then multiplied by the average number of hours worked per week between January 1, 2020 and March 31, 2020. That product is then multiplied by 8 and the product is the hourly wage reduction amount to be entered in the column above box 3 of the Schedule A Worksheet to the Application.

For salaried employees, the average annual salary between January 1, 2020 and March 31, 2020 is multiplied by 0.75 and then the average annual salary during Covered Period or Alternative Payroll Covered Period is subtracted from that product. That difference is then multiplied by 8. That product is then divided by 52 and the quotient is the salary reduction amount to be entered in the column above box 3 of the Schedule A Worksheet to the Application.

Example 1: assume the following for a single salaried employee:

- Average annual salary during the Covered Period or Alternative Payroll Covered Period = **\$35,000**;
- Average annual salary between January 1, 2020 and March 31, 2020 = **\$50,000**;
- Annual salary as of February 15, 2020 = **\$55,000**;
- Average annual salary between February 15, 2020 and April 26, 2020 = **\$40,000**; and
- Average annual salary as of June 30, 2020: **\$45,000**.

Pursuant to Step 1, we must divide \$35,000 by \$50,000 = 0.7. Since it is less than 0.75, we move to Step 2. Pursuant to Step 2, since \$40,000 is less than \$55,000, we must determine whether the Safe Harbor applies. Because the wages were only \$45,000 on June 30, 2020 and not fully restored to \$55,000, the Safe Harbor does not apply and we must move to Step 3. Pursuant to Step 3, we multiply \$50,000 by 0.75 = \$37,500; and then subtract \$35,000 = \$2,500. For a salaried employee, we multiply \$2,500 by 8 = \$20,000, and then divide by 52 = **\$384.66**. This is the amount of the reduction required.

Example 2: assume the following for a single hourly employee:

- Average annual hourly wage during the Covered Period or Alternative Payroll Covered Period = **\$24/hr.**;
- Average annual hourly wage between January 1, 2020 and March 31, 2020 = **\$33/hr.**;
- Annual hourly wage as of February 15, 2020 = **\$35/hr.**;
- Average annual hourly wage between February 15, 2020 and April 26, 2020 = **\$30/hr.**; and
- Average annual hourly wage as of June 30, 2020: **\$27/hr.**
- Average number of hours worked per week between January 1, 2020 and March 31, 2020: **40**

Pursuant to Step 1, we must divide \$24 by \$33 = 0.72. Since it is less than 0.75, we move to Step 2. Pursuant to Step 2, since \$30 is less than \$35, we must determine whether the Safe Harbor applies. Because the wages were only \$27/hr. on June 30, 2020 and not fully restored to \$35/hr., the Safe Harbor does not apply and we must move to Step 3. Pursuant to Step 3, we multiply \$33 by 0.75 = \$24.75; and then subtract \$24 = \$0.75. We then multiply \$0.75 by 40 = \$30, and then multiply by 8 = **\$240**. This is the amount of the reduction required.

Forgiveness Will Not Be Impacted Twice for Reductions in Hours that Also Result in a Reduction of Wages

As discussed above, a borrower's PPP loan forgiveness amount could be reduced based on employee salary/wage reductions and reductions in FTE's. These two reduction tests created uncertainty in the situation where an employee's total compensation was reduced directly as a result of a reduction in his or her hours. The Forgiveness Final Rule clarifies that the salary/wage reduction does not apply reductions in an employee's salary/wages that are attributable to a reduction in that's employee's hours. For example, if an employee's hourly wage remains unchanged during the Covered Period but his or her hours were reduced from 40 hours to 20 hours, then only the FTE reduction test would apply.

No Prepayment or Advances on Mortgage Interest

The Application clearly states that prepayments on mortgage interests are not eligible for forgiveness. The Forgiveness Final Rule also states that advance payments of interest on mortgage interest are not eligible for forgiveness. The Forgiveness Final Rule further states that principal on mortgage obligations is not eligible for forgiveness under any circumstances.

Rent and Mortgage Interest Payments Include Personal Property

The Application confirms that business rent and lease payments include rent and lease agreements for personal property (i.e., a business car payment). Additionally, business mortgage interest payments also include mortgage obligations on personal property.

Detailed Documentation

The Application provides a detailed list of documents that each borrower must submit in conjunction with its Application for forgiveness and also a list of documents that should be maintained by the borrower. This list may be found [here](#). Note that the borrower must retain all documentation in its files for 6 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 such files upon request.

No Re-Certifications of Necessity; But SBA May Review Original Eligibility

We previously detailed in our [information memo](#) that when applying for the PPP loan, applicants must make a good-faith certification as to the necessity of the loan.

The Application does not include a re-certification pertaining to the necessity of the loan; the certifications included pertain primarily to the borrower's use of the PPP money for its intended purposes. However, the Application does require the borrower to acknowledge and agree that the "SBA may request additional information for the purposes of evaluating the Borrower's eligibility for the PPP loan and for loan forgiveness, and that the Borrower's failure to provide 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." Therefore, if a borrower that received a PPP loan is determined during the forgiveness process to have been ineligible, then forgiveness will not be granted and the full loan will need to be repaid.

What Else May the SBA Review During the Forgiveness Process?

The Loan Procedures Final Rule asserts that the SBA is authorized to review the following representations and statements of the borrower: (1) the borrower's eligibility for the loan (as discussed further above), (2) the borrower's calculations for the loan amount (3) the borrower's use of the loan funds, and (4) whether the borrower is entitled to forgiveness in the amount claimed in the Application.

SBA Review of PPP Loans in Excess of \$2 Million Is Not Going Away But Borrowers Still May Face Reviews for Loans Under \$2 Million

The Application requires borrowers to indicate whether they received PPP loans in excess of \$2 million. Accordingly, such borrowers should prepare to have their loan eligibility and necessity certifications reviewed by the SBA.

Further, the Loan Procedures Final Rule asserts that the SBA may undertake a review of any loan of any size at any time. This is important because this guidance clarifies that borrowers of loans under \$2 million are not immune from SBA review of their loans and still may face review if, for example, they did not meet eligibility requirements for the PPP or were not eligible for the amount of the loan that they received.

Borrowers Will Have The Opportunity to Respond to the SBA's Requests During the Review Process

The Loan Procedures Final Rule clarifies that in the event that the SBA receives information that the borrower was either ineligible for the PPP or ineligible for the loan amount or the forgiveness amount that the borrower is requesting, then the SBA (or the lender as directed by the SBA) will contact the borrower in writing to request additional information. The SBA will consider all information provided by the borrower in response to such an inquiry prior to making a determination regarding the borrower's eligibility for the PPP or the loan or forgiveness amounts.

What if the Application for Forgiveness is Denied?

The Forgiveness Final Rule clarifies that if the PPP loan is only partially forgiven or if the request for forgiveness is denied, any remaining balance due on the PPP loan must be repaid by the borrower on or before the two year repayment term of the PPP loan. However, it is still unclear what a borrower's obligations are with respect to PPP funds that the borrower did not ultimately use during the Covered Period. It is unclear if those unused funds will need to be promptly returned to the lender at the end of the Covered Period or if such unused funds will instead also be subject to the two year repayment term of the PPP loan. It is also unclear based on the language contained in the Loan Procedures Final Rule if forgiveness is denied on the basis of eligibility, if the PPP loan repayment will be accelerated as part of the SBA's authorization to "pursue other available remedies."

The Loan Procedures Final Rule indicates that a borrower will have the opportunity to appeal the SBA's determination that it was ineligible for a PPP loan, ineligible for the loan amount, or ineligible for the requested forgiveness amount. The SBA intends to issue additional guidance on this appeal process.

The attorneys at Bond, Schoeneck & King can help by answering your questions regarding the Application and determining your maximum forgiveness amount under the PPP. Please contact [Jeffrey B. Scheer](#), any of the [attorneys](#) in the [Business and Transactions practice](#), or the attorney at the firm with whom you are regularly in contact.



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