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Analysis of the Paycheck Protection Program Loan Forgiveness Application

On May 15, 2020, the Small Business Administration (the “SBA”) published a Loan Forgiveness Application (the “Forgiveness Application”),¹ which provides long awaited information regarding loan forgiveness under the Paycheck Protection Program (the “PPP”). The PPP generally provides that borrowers are eligible for forgiveness of their PPP loans based upon certain qualifying expenses that arise during the eight-week period commencing on the date the loan was funded (the “Covered Period”). Expanding on the rules and other guidance previously issued by the SBA, the Forgiveness Application provides important clarity on several features of forgiveness on PPP loans. Below is a detailed analysis of the new guidance provided by the Forgiveness Application.

TIMING ISSUES RELATED TO ELIGIBLE EXPENSES

One of the most significant details provided by the Forgiveness Application is that particular costs are not required to be both incurred **and** paid during the Covered Period to be eligible for forgiveness. This clarification eliminates previous uncertainty regarding the intent of certain statutory language in the PPP.

Payroll Costs

Covered payroll costs can be included in a borrower’s forgiveness calculation so long as the payroll costs are:

- paid during the Covered Period (or Alternative Payroll Covered Period, as described below, as applicable); or

- incurred during the Covered Period (or Alternative Payroll Covered Period, as applicable) and paid on or before the borrower’s next regular payroll date.

For this purpose, payroll costs are considered incurred on the day that the employee’s pay is earned and are considered paid on the day paychecks are distributed or the day the borrower originates an ACH credit transaction.

The Forgiveness Application also permits borrowers with biweekly (every other week) or more frequent payroll schedules to adjust the start date of their Covered Period to begin on the first day of the first pay period after their receipt of the PPP loan (an “Alternative Payroll Covered Period”). This adjustment may help some borrowers calculate and document their forgivable payroll expenses by avoiding pay periods that straddle the first day and the last day of the Covered Period and may be particularly useful because many borrowers have had little or no control over when their PPP loans were funded.

Non-Payroll Costs

Similarly, covered mortgage, rent, and utility expenses can be included in a borrower’s forgiveness calculation so long as those non-payroll costs are:

- paid during the Covered Period; or
- incurred during the Covered Period and paid on or before the next regular billing date.

Also, while this new guidance provides a certain level of flexibility regarding the timing of forgivable costs, borrowers should ensure that relevant expenses paid during the Covered Period (or Alternative Payroll Covered Period, as applicable) are supported by a bona fide business purpose. The PPP expressly states that prepayment of mortgage interest is not eligible for forgiveness. Similarly, although not expressly stated in the PPP, the Interim Final Rules or FAQs issued under the PPP, or the Forgiveness Application, we anticipate that accelerating certain payroll costs (e.g., employee bonuses and 401(k) matching payments) or other non-payroll costs solely to increase the forgiven amount of a PPP may be denied forgiveness and could attract negative attention from the SBA or other relevant regulators.

REDUCTIONS TO THE FORGIVEN AMOUNT BASED ON FTE REDUCTIONS

FTE Reduction Calculations

The PPP provides that loan forgiveness is subject to reduction based on employee terminations or furloughs. The Forgiveness Application provides clarity that full-time equivalent employees (“FTEs”) will be calculated on the basis of 40-hour work week. In particular, if a borrower has reduced the number of its employees during the Covered Period (or Alternative Payroll Covered Period, as applicable) compared to the Reference Period (defined below), then the PPP states that forgiveness will be reduced by multiplying the eligible forgiveness amount by the quotient of:

- the average number of FTEs per month employed during the Covered Period (or Alternative Payroll Covered Period, as applicable), *divided by*
- the average number of FTEs per month employed during one of the following periods (as elected by the borrower, the “Reference Period”): (i) February 15, 2019 through June 30, 2019 or (ii) January 1, 2020 through February 29, 2020.²

Adding significant clarity to this calculation, the Forgiveness Application provides the formula borrowers must use to determine the average number of FTEs in each applicable period.

- The average FTE for each employee is calculated as: (i) the average number of hours worked per week during the applicable period, *divided by* (ii) 40. This result is then rounded to the nearest tenth, subject to a cap for each employee of 1.0.
- As an alternative, the Forgiveness Application allows borrowers to use an average FTE of 1.0 for any employee who works 40 or more hours per week and 0.5 for any employee who works less than 40 hours per week.

- The average FTE for all employees are added together—the result is the average number of FTEs for the applicable period.

FTE Reduction Exceptions

The Forgiveness Application also provides additional detail regarding circumstances in which certain former employees are nevertheless included in calculating average FTEs during the Covered Period (or Alternative Payroll Covered Period, as applicable). Specifically, the FTE calculation will include former employees when:

- a borrower made a good-faith, written offer to rehire an employee during the Covered Period (or Alternative Payroll Covered Period, as applicable) that was rejected by the employee; or
- an employee was fired for cause, voluntarily resigned, or voluntarily requested and received a reduction of hours.

The average FTE calculation will include these limited classes of former employees in calculating the average number of FTEs during the Covered Period (or Alternative Payroll Covered Period, as applicable) unless that employee’s position was filled by a new employee. In order to ensure that borrowers can take advantage of these exceptions, those borrowers should retain documentation relating to those offers or terminations.

FTE Reduction Safe Harbor

The Forgiveness Application also provides clarity on determining the calculations for restored employees. The PPP provides that FTE reductions that are *fully* restored will eliminate any reduction arising under the forgiveness calculations. A borrower will not be subject to a reduction in forgiveness for FTE reductions if the borrower:

- reduced its FTEs in the period beginning February 15, 2020 and ending April 26, 2020; and
- restored its FTEs by not later than June 30, 2020 to the FTE level for the pay period that included February 15, 2020.

The language of the PPP and the Forgiveness Application make clear that the safe harbor is all or none. A partial restoration of FTEs will not impact the reduction calculation, but a full restoration will result in no reduction to forgiveness.

While the PPP and the commentary in the Forgiveness Application each states that the restoration should occur “by not later than June 30, 2020,” the worksheet for the safe harbor provides for the calculation only as of June 30, 2020. This approach indicates that the FTE adjustments must be effective

as of June 30, 2020. As this has a potentially significant impact on forgiveness, borrowers should be cautious to ensure that any FTE adjustments remain in effect at least through June 30, 2020.

REDUCTION TO THE FORGIVEN AMOUNT BASED ON SALARY OR WAGE REDUCTIONS

The PPP also provides for a reduction in forgiveness to the extent salaries or wages of employees are reduced by 25% or more. This calculation in the Forgiveness Application operates largely as anticipated based on the plain language of the PPP, but the Forgiveness Application uses a base period for comparison of January 1, 2020 through March 31, 2020. The PPP Schedule A Worksheet, included in the Forgiveness Application, excludes any employee who received compensation at an annualized rate of more than \$100,000 for any pay periods in 2019. Accordingly, any reduction of salary or wages to any such employee would not impact the amount of forgiveness regardless of the amount of reduction. Alternatively, any newly hired employee (after the end of 2019) would be included regardless of whether the compensation for that employee exceeded \$100,000 on an annualized basis (and in which case a reduction in compensation in excess of 25% would reduce forgiveness). This is an anomalous result in the treatment of highly compensated employees, but appears to be the result based on a plain reading of the Forgiveness Application and is consistent with statutory language in the PPP.

TREATMENT OF ACCRUED INTEREST

The Forgiveness Application does not expressly contemplate forgiveness of interest accrued on a borrower's PPP loan. Specifically, the maximum amount of forgiveness on the application is limited to the initial principal amount of the loan. This limitation is inconsistent with both the PPP, which states that upon approval of a forgiveness application the SBA will remit to the PPP lender "the amount of forgiveness, *plus any interest accrued through the date of payment*,"³ and SBA rules, which state that "the amount of loan forgiveness can be up to the full principal amount of the loan *and any accrued interest*."⁴ The SBA should provide further guidance and clarification on this apparent omission in the Forgiveness Application.

BORROWER REPRESENTATIONS AND CERTIFICATIONS

The Forgiveness Application requires borrowers to make certifications, including that the requested forgiveness amount:

- was used to pay costs that are eligible for forgiveness;
- includes all applicable reductions due to decreases in the number of FTEs and salary/wage reductions;

- does not include non-payroll costs in excess of 25% of the total amount requested; and
- does not exceed eight weeks' compensation for any owner-employee or self-employed individual/general partner.

Borrowers also are required to acknowledge that *knowingly* using PPP funds for unauthorized purposes may result in civil or criminal fraud charges and that making false statements on the Forgiveness Application could result in fines or imprisonment.

Finally, the Forgiveness Application requires borrowers to self-report whether the amount of their PPP loan, together with PPP loans made to all of their affiliates (as determined under SBA rules, including waivers of certain affiliation rules under the PPP), exceeds \$2,000,000. The inclusion of this item on the Forgiveness Application highlights the SBA's stated intent to review all PPP loans in excess of \$2,000,000 in the aggregate as part of the forgiveness determination.

SUPPORTING DOCUMENTATION

The Forgiveness Application provides a detailed list of supporting documentation that borrowers must deliver with their application.

For payroll costs, borrowers must submit the following:

- bank account statements or third-party payroll service provider reports evidencing cash compensation paid to employees;
- certain tax forms, including forms provided to the IRS and state taxing authorities; and
- payment receipts, cancelled checks, or account statements documenting health insurance and retirement plan contributions.

To support FTE calculations, borrowers must submit documentation showing the average number of FTE employees during the relevant periods used in calculating whether any forgiveness reductions are required to be made based on employee terminations. This documentation may include payroll tax filings reported to the IRS and relevant state taxing authorities.

To support nonpayroll costs, borrowers must submit detailed information regarding eligible costs. For mortgage interest payments, borrowers must provide either:

- a lender amortization schedule and receipts or cancelled checks verifying payments; or

- lender account statements from February 2020 and from the Covered Period (or Alternative Payroll Covered Period, as applicable) through one month after the end of the Covered Period (or Alternative Payroll Covered Period, as applicable) verifying eligible payments.

To evidence rent or lease payments, borrowers must provide either:

- a copy of the current lease agreement and receipts or cancelled checks verifying payments; or
- lessor account statements from February 2020 and from the Covered Period (or Alternative Payroll Covered Period, as applicable) through one month after the end of the Covered Period (or Alternative Payroll Covered Period, as applicable) verifying eligible payments.

For utility payments, borrowers must provide each of the following:

- copies of invoices from February 2020 and those paid during the Covered Period (or Alternative Payroll Covered Period, as applicable); and
- receipts, cancelled checks or account statements verifying eligible payments.

In addition, Borrowers are required to maintain (but not file with their application) certain additional documentation for a period of *six years* after the date the loan is forgiven *or* fully repaid. The list of documents includes the detailed calculation worksheet used to prepare the Forgiveness Application, along with documentation supporting the information used on the worksheet. It further requires borrowers to maintain all records relating their PPP loan, including loan application information, and documentation supporting borrower's certification as to necessity of the loan request and eligibility for a PPP loan.

While the Forgiveness Application does not provide answers to all of the myriad questions that borrowers have raised about the mechanics and details of loan forgiveness, it does provide clarity around several important issues. Borrowers applying for forgiveness should carefully review and consider these updates to help ensure they maximize and properly support the amount of loan forgiveness that they seek from their lender.

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1. The Loan Forgiveness Application is available on the SBA's website [here](#).
 2. Seasonal employers have the option to elect any consecutive 12-week period between May 1, 2019 and September 15, 2019.
 3. Cares Act, Section 1106(c)(3).
 4. Interim Final Rule, dated April 2, 2020, Docket Number SBA-2020-0021, 13 CFR Parts 120 and 121, RIN 3245-AH37.