



PPP Forgiveness Guidelines, Advisory #1 5-18-2020

Late Friday night (May 15th), the SBA released its long-awaited guidelines for businesses seeking forgiveness of their PPP loan advances.

The forgiveness of a borrower's PPP debt was a critical unique factor upon which millions of borrowers are betting the future of their enterprise. The alternative to debt forgiveness will be another debt owed by their businesses during the critical surviving and re-opening periods, which may doom some already tenuous enterprises.

The application document – Paycheck Protection Program Loan Forgiveness Application (SBA Form 3508) can be accessed at the agency's website www.sba.gov. It consists of 4 parts:

- the PPP Forgiveness Calculation Form;
- (2) PPP Schedule A;
- (3) the PPP Schedule A Worksheet; and
- (4) an optional form – PPP Borrower Demographic Information Form.

It should be noted that all borrowers must submit forms #1 and #2 to their PPP Lender. Per earlier guidance, these completed forms, along with all required supporting documentation, must be submitted to their lender within 90 days of the completion of the "covered period" (see below for additional details), and that the lender has up to 60 days after submission to determine the amount of forgiveness for which the borrower is eligible.

It is important to note in the reading of the Application Form and supporting schedules, whenever the SBA uses the terms "must" or "shall", this means that the party mentioned is required to provide the documentation/forms stated, but when the document states "may", then the affected party has the option of not providing the requested form or document.

Required Documentation:

Borrowers must submit forms #1 and #2 to their lender, and **must** provide the following forms –

- Documentation, including payroll tax filings reported to the IRS and state income, payroll, and unemployment insurance filings, verifying the number of full-time equivalent (FTE) employees on payroll and their respective pay rates for the following periods:
 - The 8-week covered period of the loan:
 - 2/15/2019 - 6/30/2019 or 1/11/2020 or 2/29/2020, depending on the dates used to measure any drop in the number of employees or salary reductions (required by Section 1106-d)
 - Seasonal employers can use the dates 2/15/2019 – 6/30/2019
 - The last full quarter prior to the covered period
 - 2/15/2020 – 4/27/2020

- Documentation, including cancelled checks, payment receipts, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments,
- A certification from, either the small business owner or a representative of the eligible recipient authorized to make such certifications, that the document presented is true and correct and the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered return obligation, or make covered utility payments and,
- Any other documentation the SBA or their lender determines necessary
- Borrowers may want to create a calendar to track how and when different categories of expenses were paid or incurred during the period for which forgiveness is being sought
- Borrowers should immediately organize documentation and implement procedures in accordance with the Loan Forgiveness Application.
- The business should compile records reflecting the salary and hourly wages paid and the number of hours worked per week for each employee during this time and for the period from 1/1/2020 through 3/31/2020.
- Documentation may also be required if the borrower wishes to seek a Safe Harbor by restoring the employee's average annual salary or hourly wage as of 6/30/2020
- Borrowers should also gather records dating from 2/2020 thru the end of the Covered Period of payments

Doing so now should ensure that when the borrower applies for forgiveness, they will have the documentation organized in a way that conforms with SBA and lender requirements

General Guidelines:

Most of the guidance provided in Form 3508 and related instructions is consistent with those provided to borrowers and lenders related to the application for the PPP loan, which was launched earlier this year. Additionally, some of the issues evidenced during the roll-out of the application process have been clarified, many of them to the benefit of the borrower (as outlined below), but some of the more onerous requirements (namely the 75%/25% split) and possible reduction in the amount forgiven (a/k/a "haircut") remain. Finally, there is considerable documentation required to support the amount being requested for forgiveness, which could place considerable burden on small business owners and managers of non-profit agencies that received PPP funds.

A word of caution for businesses (and their affiliates) that received over \$2 million in PPP loans: the SBA has stated that they will audit all such situations. One issue with this guidance is that borrowers will be required to obtain a clear understanding of the SBA's affiliate rules issued 4/15/2020. In these situations, it is highly recommended that borrowers seek legal advice before proceeding.

Another consideration is that the SBA has expanded its "safe harbor" concept introduced earlier regarding loans of \$2 million or less, to include:

- Reduced the number of employees
- Reduced the salary/wage paid employees

The SBA guidance provides for 4 categories of costs that are eligible for forgiveness:

- *Payroll Costs:*

- Borrowers can deduct payroll costs “paid” **or** “incurred” the *Covered Period* or *Alternative Payroll Covered Period*, (each of which is 8 weeks in duration). **Note: Borrowers are cautioned to be sure that they don’t double-count these costs**
- Borrowers can now deduct payroll that is paid after the 8-week post-funding period if employees are paid the next regular payroll date
- The concept of Alternative Payroll Covered Period has been introduced for borrowers that use a weekly or bi-weekly payroll schedule, which allows them to elect to calculate eligible payroll costs using the 8-week period that begins on the first day of their first pay period following the disbursement of PPP proceeds. However, if a borrower elects to use this payroll cycle, he/she are still required to use the standard Covered Period for other costs
- Eligible payroll costs have not changed; these include:
 - Gross salary
 - Gross wages
 - Gross tips
 - Gross commissions
 - Paid leave
 - Allowances for dismissal or separation paid
- Non-cash compensation includes:
 - The total amount paid for employer contributions for health insurance, including employer-sponsored group health plan, but excluding pre or post tax contributions by employees
 - The total amount paid for employer contributions to employee retirement plans, but excluding employee contributions
 - The total amount paid for employer state and local taxes assessed on employee compensation but not any taxes withheld from employee earnings
- Notes on owner compensation:
 - Amounts paid owners, including self-employed or general partners, is capped at the lesser of a pro-rata amount of \$15,385 (\$100,000/52X8) or the equivalent amount paid in 2019, whichever is lower
 - ***Partners, proprietors, or independent contractors do not appear to be able to deduct their own health insurance and retirement plan contributions***
- *Non-payroll costs include:*
 - Covered mortgage interest for debt incurred prior to 2/15/2020
 - Covered rent obligations and/or lease payments on real or personal property in force prior to 2/15/2020
 - Covered utility payments, which includes payments for electricity, gas, water, transportation, telephone, or internet access in force prior to 2/15/2020
 - Note: non-payroll costs must be paid 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
 - ***The 25% rule still applies***

Adjustments to Amount of Forgiveness:

The intent of the PPP is to retain employment levels at pre-crisis salary/wage levels. As a result, the forgiveness guidelines require borrowers to provide evidence that these key requirements have been met, and if not, the amount of the loan forgiven is subject to a downward adjustment. One adjustment

introduced is that the borrower may be exempt from a reduction in debt forgiveness if they meet the FTE Reduction Safe Harbor requirements.

FTE reduction **exceptions** include:

- Reduction in employee levels where borrower made a good-faith, written offer to rehire an employee during either the Covered Period or Alternative Payroll Covered Period that was rejected by the employee, and reductions related to an employee that was fired for cause, voluntarily resigned, or voluntarily requested and received a reduction of their hours
- A “Safe Harbor” has been created if the borrower if both of the following conditions are met –
 - The borrower reduced its FTE employee levels in the period beginning 2/15/2020 and ending 4/26/2020, and
 - The borrower, no later than 6/30/2020, restored its FTE level that existed during the borrower’s pay period that included 2/15/2020

Wage reduction exceptions include:

- Salary/wage reductions can also impact forgiveness if employee salary/wage levels were reduced during the Covered Period or the Alternative Payroll Covered Period compared to the period of 1/1/2020 to 3/31/2020. This reduction applies only for employees whose salaries or hourly wages were reduced by more than 25% during these periods
- A “safe Harbor” has been created if the borrower returns salary/wage rates to pre-crisis levels by 6/30/2020

Guidance for sole proprietors and independent contractors:

The guidelines for these types of entities differ from other legal forms in that there are no employees or related calculations involved in the forgiveness analysis. However, there are several important factors for these entities to consider, including:

- PPP loan disbursement date – which is the date the borrower received the loan funds. This is the date that the 8-week “Covered Period” commences
- EIDL advance amount – the amount received from the EIDL program, which will be deducted from the borrower’s PPP forgiveness amount
- Covered period – this is the 8-week period for the loan advances to be forgiven. The start date is the day loan proceeds are received, and the end date is 8-weeks (56 days) later
- PPP loans larger than \$2 million – if less, then an automatic audit by the SBA is protected by a safe harbor clause
- If employees are involved, the requirements noted above are required, which are more complicated
- Other eligible expenses can count towards forgiveness, including mortgage interest, business rent or lease payments, and business utility payments, which can be included if paid or incurred during the 8-week billing cycle. As with firms that include employees, it is important for borrowers not to double-count expenses, and the SBA will be comparing actual expenses claimed vs. your 2019 tax return
- These entities **will not** be able to include costs associated with their own health insurance and retirement plan contributions, for these can only be included for **employees**

Required Documentation:

These mirror entities with employees, and include:

- No payroll records are required, but a copy of a borrower's 2019 tax return will need to be provided
- For non-payroll related expenses, the following are deemed eligible:
 - Business mortgage interest payments – including a copy of lender amortization schedules and receipts or cancelled checks verifying eligible payments from the Covered Period, or lender account statements from 2/2020 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 – a copy of current lease agreements 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 payments – copies of invoices from 2/2020 and those paid during the Covered Period and receipts, cancelled checks, or account statements verifying those eligible payments

Tax Implications:

The Internal Revenue Service (IRS) ruled that any funds forgiven as part of the PPP are not subject to Federal income tax (but may be subject to state and local taxes). However, the IRS has also recently determined that any expenses forgiven cannot be deducted on their 2020 Federal income tax return which means that businesses may incur a higher estimated tax payment than from comparable periods. The rationale for this ruling is to prevent PPP borrowers from obtaining what the agency calls a “double-tax benefit”. However, members of Congress have found this ruling to be contrary to the spirit of the CARES Act and are writing legislation that would enable small businesses to deduct the covered costs. Until or unless this occurs, in short, the IRS giveth and taketh away.

Additional Considerations:

The Borrower Certification is important for all borrowers, for they are attesting to the veracity of the following:

- The amount for which forgiveness is requested is for eligible costs (payroll, business mortgage interest payments, business rent or lease payments, or business utility payments)
- If funds are used for unauthorized purposes, the federal government may pursue recovery of the loan amounts with penalties and/or civil or criminal fraud charges
- Making a false statement to obtain forgiveness is punishable by imprisonment and a fine

Unanswered Questions:

It is understood that these guidelines are the SBA's first effort at providing details about the forgiveness process, and as such, it is likely that the agency will provide follow-up information that will address issues raised by borrowers, lenders, and their advisers. However, based on this guidance, the following questions remain including:

- Are bonuses able to be counted as cash compensation
- Is there a deadline for submitting the PPP Loan Forgiveness Application

- What happens if a recipient business operates in a locale that was closed and therefore unable to pay employees during the Covered Period
- How does a borrower being acquired by another firm during the Covered Period
- What type of transportation, telephone or other utilities qualify for forgiveness
- What happens when the Safe Harbor expires (6/30/2020) in the middle of the Covered Period

Final Thoughts on Interim Guidance

These guidelines are the SBA's first effort at codifying their forgiveness guidelines for PPP borrowers. Although the document provides good information, there are still gaps in the instructions that may be addressed in follow-up guidance. However, borrowers are advised to consider the following:

- Start now to collect the required documentation, and organize the data into two main "buckets" of covered expenses, including:
 - Money spent on employees:
 - Payroll
 - Retirement and other benefits
 - Money spent on physical space:
 - Rent
 - Mortgage interest
 - Utilities
- Don't even think of lying, but there is a difference between making a false statement and making a mistake
- Examine the Safe Harbor provisions and determine if they are applicable and can be documented regarding the following:
 - An employee refused to return to work
 - An employee that was terminated for cause
- Borrower may get more credit for payroll than originally estimated because the SBA has clarified expenses paid or incurred rather than paid and incurred
- Businesses with seasonal fluctuations should choose their time periods wisely, for the guidelines allows for 3 different possible time periods to calculate the baseline FTE. The selection of a time period during which the baseline FTE is chosen will mostly affect businesses with heavy fluctuation in seasonal staffing, but every owner should calculate their FTE for each possible time period to see which should be selected based on which had the fewest FTEs. This will result in the lowest possible, but permissible, FTE threshold, and which should result in maximum debt forgiveness
- Prepare to keep everything for 6 years, including electronic and paper copies

As additional information is received our guidance to the SBDC network and clients will be adjusted accordingly. If after reviewing this document you have questions, contact your SBDC Advisor. Visit www.virginiasbdc.org/locations for a list of local SBDC offices to speak to an Advisor near you.

