

****The following article is an update of our PPP Forgiveness Update issued on May 22, 2020.****

PPP FORGIVENESS GUIDE v2.0

On May 22, 2020, the Small Business Administration (“SBA”) published long awaited guidance on [loan forgiveness](#) for Paycheck Protection Program (“PPP”) loans and certain related [borrower and lender responsibilities](#) (collectively, the “New Guidance”). Along with the SBA’s PPP Loan Forgiveness Application (“Application”), the New Guidance sets an official framework for what is required of borrowers and how forgiveness is calculated and, in doing so, answers a number of open questions. Nevertheless, borrowers must proceed with caution. Questions remain and additional guidance is forthcoming.

A 1-page quick reference guide on PPP Loan Forgiveness is also available [here](#).

I. APPLYING FOR FORGIVENESS:

Navigating the Application: Reading and understanding the 11-page [Application](#) requires borrowers to switch back and forth between multiple sections. Similar to IRS forms, borrowers will work their way from the back of the Application forward, filling out worksheets and schedules to derive figures that are necessary for the main loan forgiveness calculation. There are six components to the Application, however, only the main loan forgiveness calculation form, a supporting schedule (Schedule A) and supporting documentation are required for submission. The six components are:

- 1) Schedule A Worksheet (pages 7-9): This should be step 1. It calculates the Salary/Hourly Wage Reduction Penalty and the FTE Reduction Quotient, if any.
- 2) Schedule A (page 5-6): This should be step 2. It calculates the components of forgiveness.
- 3) Loan Forgiveness Calculation Form (page 3): This should be step 3. It calculates forgiveness.
- 4) Borrower Certifications (page 4): Borrowers are required to make several certifications. Note that knowingly-made false statements are subject to criminal penalty.
- 5) Documents required (page 10): The documentation that borrowers must submit¹ and others that they must maintain (presumably for audits) are listed on page 10 of the Application.

¹ This includes documentation verifying cash compensation and non-cash benefits (including bank statements or 3rd party payroll reports, specific tax forms, receipts documenting employer contributions to health insurance and

- 6) Borrower Demographic Information Form (page 11): This is an optional form that is designed to provide the SBA with information regarding the demographics of PPP borrowers.

Application Timeline: Certain questions in the Application require information from June 30, 2020 payroll. Borrowers will therefore submit Applications to their lenders no sooner than the date such information becomes available or the end of the 8-week forgiveness period and no later than October 31, 2020. Lender review of Applications is primarily limited to checking that the document is fully completed, the calculations are accurate and all required documentation is submitted and supports the calculations. Lenders have 60 days to issue a decision on a submitted Application and then, if applicable, request payment from the SBA. Lenders will issue one of the following decisions: (a) approval in whole, (b) approval in part, (c) denial, or (d) if directed by the SBA, denial without prejudice pending SBA review. If a lender approves an Application in whole or in part, the SBA will, subject to its review of the Application and loan, remit the forgiven amount, plus interest through the date of payment within 90 days of the date the lender submits its decision to the SBA. A longer timeframe may apply for loans audited/reviewed by the SBA (see section VII below). Borrower may request the SBA review any adverse decision within 30 days of notice of the decisions from the lender.

Note 2: Given the 60-day (for lender processing) plus 90-day (for SBA processing) timeline and the number of PPP loans (over 4 million loans as of May 23, 2020), it is increasingly likely that loan forgiveness may not occur before the current 6 month deferment on loan payments expires. The CARES Act authorized up to 12 months of deferment (but the SBA implemented only 6 months) and so it is possible that the SBA may further extend the deferment period or authorize lenders to do so on a case-by-case basis. Nevertheless, unless changes are made to the PPP loan program, borrowers should prepare for a potentially large payment (including six months of accrued interest plus amortized principal) to become due on the 7th month of their loans.

Certifications: Page 4 of the Application contains a list of required borrower certifications. It warns that knowingly-made false statements and use of loan proceeds for unauthorized purposes give rise to potential criminal penalty. The Application also advises that if the SBA determines that a borrower is ineligible for a PPP loan, it will direct the lender to disapprove the borrower's loan forgiveness Application.

Compensation Limits: In addition to limitations imposed under prior guidance, the Application and New Guidance caps forgiveness for owner compensation (including employment income) at the lesser of eight weeks' worth of 2019 compensation and \$15,385 in total across all businesses.² Forthcoming guidance may address or elaborate on these limitations.

In summary, the caps on forgiveness for compensation are:

Employees: \$100,000 as annualized (\$15,385 max).

retirement plans), FTE documentation showing the average number of FTEs, and Non-Payroll expenses (verifying the existence of obligation/service as of 2/15/2020 and the amount of eligible payments).

² The New Guidance uses the phrase "across all businesses," presumably meaning that an owner of multiple business cannot seek forgiveness in excess of \$15,385 in the aggregate.

Owner-Employees Receiving Cash Compensation: The lesser of \$100,000 annualized (\$15,385 max) and 8/52nds of 2019 income (including employment compensation plus retirement and health care contributions made on the owner's behalf).

Self-Employment – 1040 Schedule C filers: The lesser of \$100,000 annualized (\$15,385 max) and 8/52nds of 2019 net earnings (the loan must have been made to the sole proprietor).

Self-Employment – Partners (multi-partner/member companies): The lesser of \$100,000 annualized (\$15,385 max) and 8/52nds of 2019 net earnings as reported on a 2019 schedule K-1 (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235.

II. GENERAL FORGIVENESS CALCULATION:

General Summary: Forgiveness is determined in four steps.

- Step 1:** Determine the amount eligibly spent during the applicable 8-week forgiveness period(s);
- Step 2:** Reduce the amount determined in Step 1 by the amount of any Salary/Hourly Wage Reduction Penalty (see below for calculation), unless a safe harbor applies;
- Step 3:** Multiply the amount determined in Step 2 by the FTE Reduction Quotient (see below for calculation), unless a safe harbor applies; and
- Step 4:** Divide the total payroll cost during the 8-week forgiveness period by 75%. If this result is less than the amount determined in Step 3, then use this result as the amount of forgiveness; otherwise use the amount determined in Step 3. (The use of funds is subject to a limitation requiring that at least 75% be used for eligible payroll purposes and no more than 25% be used for eligible non-payroll purposes).

Note: The ordering of steps 2 through 4 has mathematic consequence and was previously unknown. Also, the amount of any Economic Injury Disaster Loan Advance will be deducted separately by the SBA from the final number derived in Step 4 (or Step 3, if Step 4 is inapplicable).

III. DETERMINING THE AMOUNT ELIGIBLY SPENT

Start of the 8-week Forgiveness Period: The amount eligible for forgiveness depends in part on the amount incurred and/or expended on eligible expenses over an 8-week period. Prior SBA guidance stated that the 8-week period begins on the date loan proceeds are first received. Per the Application and New Guidance, solely with respect to payroll expenses, borrowers with a biweekly or more frequent payroll schedule may elect to begin their 8-week period on the first day of their first pay period following receipt of funds. The 8-week period for non-payroll expenses still begins on receipt of funds, regardless of whether a borrower opts to use an alternate date for payroll.

Note: Changes to the length and start date of the forgiveness period are the subject of well-supported lobbying efforts and pending legislation, but until and unless addressed by enacted legislation or regulation, borrowers should plan on following the framework in the New Guidance.

End of the Forgiveness Period: The instructions to the Application and examples used in the New Guidance contemplate that all borrowers will have a full 8-week (56-day) forgiveness period, which appears to resolve an open question to whether June 30, 2020 is a hard cut-off date.³

Incurring and Paying Eligible Expenses: The text of the CARES Act discusses forgiveness for “costs incurred and payments made” during the 8-week period, leaving open a number of questions, including whether eligible expenses must be both incurred and paid during such period and how to determine when expenses are incurred and paid. The Application and New Guidance create the following framework:

1) *Payroll Costs:*

- (a) Forgivable payroll costs⁴ must be both paid and incurred during the applicable 8-week period, except payroll costs incurred in the final pay period of the 8 weeks may be paid on their regularly scheduled payment date (even if that date is after the end of the 8-week period).
- (b) Payroll costs are considered paid on the day that paychecks are distributed or the borrower originates an ACH credit transaction.
- (c) Payroll costs are considered incurred on the day that the employee’s pay is earned.
- (d) The New Guidance clarifies that borrowers can eligibly utilize PPP funds to pay idled (non-working) employees and to pay bonuses and hazard pay (subject to caps on forgivable compensation).

Note 1: Ambiguities and inconsistencies in the relevant authorities leave open the possibility that compensation earned prior to the start of the 8-week period and paid during the 8-week period may be eligible for forgiveness.

Note 2: Borrowers should exercise caution in awarding bonus and hazard pay and consult with an employment law or human resources professional. For instance, hazard pay carries employment law implications, including connotations of risk and hazard. Further, the SBA has demonstrated a pattern of initially issuing permissive guidance and later limiting it to address perceived abuses. Unnecessary or unjustifiable pay increases (just to use up PPP funds) might easily be characterized as a wasteful use of taxpayer funds or an attempt to skirt caps on owner compensation and may be ripe for such limitation.

2) *Non-Payroll Costs:*

- (a) Forgivable non-payroll costs must be either (i) paid during the 8-week period (beginning on the receipt of funds), or (ii) incurred during the 8-week period and paid

³ In mandating what types of expenses are eligible, the CARES Act provides that its list of acceptable expenses are eligible uses “during the covered period.” In that instance, the “covered period” means the period beginning on February 15, 2020 and ending on June 30, 2020. Based on the Application, it does not appear that June 30, 2020 is a limitation on use of funds or forgiveness.

⁴ Essentially, compensation (subject to the caps discussed above), group healthcare and retirement, vacation/parental/medical/sick leave (except to the extent a tax credit is taken under FFCRA), state and local payroll taxes and separation pay for employees principally residing the U.S.

on or before the next regular billing date, even if the billing date is after the 8-week period.

Note: Prior incurred, yet unpaid, non-payroll expenses can be paid with PPP proceeds.

- (b) Eligible non-payroll costs are (a) payments of interest (not prepayment) under real or personal property mortgages that were in place as of February 15, 2020; (b) rent or lease payments under lease agreements for real or personal property⁵ that were in place as of February 15, 2020; (c) payments for electricity, gas, water, transportation, telephone, or internet utilities for which service began before February 15, 2020.
- (c) Consistent with prior guidance, no more than 25% of the amount of forgiveness sought can be attributable to non-payroll costs.

IV. DETERMINING THE SALARY/HOURLY WAGE REDUCTION PENALTY:

Formula: Per the CARES Act, forgiveness is reduced by certain salary/hourly wage reductions (the “Salary/Hourly Wage Reduction Penalty”), unless a safe harbor applies. The Application and New Guidance clarify that borrowers should compare:

- (a) The average annual salary or hourly wage level of each applicable employee during the 1st quarter of 2020, to
- (b) The employee’s average annual salary or hourly wage level during the 8-week forgiveness period.

If the average salary/wage level is reduced by more than 25%, then there is a penalty (equal to the amount the reduction exceeds 25%), unless the safe harbor applies.

Only Applies for Certain Employees: According to the Application and New Guidance, the Salary/Hourly Wage Reduction Penalty only applies to employees that were employed during the 8-week forgiveness period and either (a) in every single 2019 pay period, earned an amount that, if annualized, is \$100,000 or less; or (b) were not employed by the borrower in 2019.

Note: The inclusion of newly hired employees is a new development. The CARES Act did not specifically address such employees. Also, the New Guidance clarifies that a wage reduction that is attributable to an FTE reduction (described below) is not also subject to the Salary/Hourly Wage Reduction Penalty (borrowers are not doubly penalized).

Safe Harbor: Borrowers may avoid the Salary/Hourly Wage Reduction Penalty if, for each applicable employee (see above), any salary/wage reduction that occurred between February 15, 2020 and April 26, 2020 is eliminated by June 30, 2020. Per the Application, the safe harbor applies if, effective as of June 30, 2020, the average annual salary or hourly wage level of each applicable employee is equal to or greater than the employee’s annual salary or hourly wage level on February 15, 2020.

⁵ Due to ambiguities in the CARES Act, it was previously unclear if rent and mortgage interest expenses related to personal property were eligible for forgiveness.

New Questions: Further guidance may be required for the following issues:

- (a) The Application and New Guidance suggests that the Salary/Hourly Wage Reduction Penalty applies to all newly hired employees (employees that did not work in 2019). Should it apply if such an employee earns an average salary greater than \$100,000 per year? If so, must that person be included when evaluating the safe harbor (PPP funds cannot compensate an employee at a rate exceeding \$100,000 per year)?
- (b) Does the Salary/Hourly Wage Reduction Penalty apply to commission employees?

V. DETERMINING THE FTE REDUCTION QUOTIENT:

In General: The FTE Reduction Quotient is essentially a reduction of forgiveness in proportion to the decrease in the number of the borrower’s full time equivalent employees (“FTEs”). It applies unless the reduction is eliminated by June 30, 2020.

Formula:
$$\frac{\text{Average number of FTEs during the applicable 8-week forgiveness period}}{\text{Average number of FTEs during the applicable comparison period}}$$

The applicable comparison period is either February 15, 2019 through June 30, 2019 or January 1, 2020 through February 29, 2020, at the borrower’s election. Additional options exist for seasonal employers.

FTE Count: FTEs are measured based on the average number of hours of each employee per week divided by 40 hours per week (but an employee averaging over 40 hours cannot count as more than one employee). Borrowers may select a simplified method of counting 0.5 for each employee working less than 40 hours and 1.0 for each employee working 40 or more hours.

Exceptions: The following instances do not constitute an FTE reduction: (1) documented rejections by employees of written offers to come back to work (for the same salary/wages and same number of hours) for which the borrower has notified applicable state unemployment authorities within 30 days of the rejection; and (2) employees who, during the 8-week period, are fired for cause, voluntarily resign or voluntarily request a reduction of their hours. Borrowers must internally maintain records supporting each such instance.

Safe Harbor: The FTE Reduction Quotient does not apply if the FTE reduction occurred between February 15, 2020 and April 26, 2020 and is eliminated by June 30, 2020. Per the Application, the safe harbor applies if the number of FTEs at June 30, 2020 is greater than or equal to the number of FTEs for the pay period that includes February 15, 2020.

VI. Non-Forgiven Amounts

In General: Any unforgiven amounts will continue to be due under the loan, with interest at 1%. The CARES Act provides that all payments are deferred for six (6) months from the date of initial disbursement. Unforgiven amounts must be repaid over the eighteen (18) months following the deferral period. In addition, there is no prepayment penalty; so, if desired, borrowers may repay unused funds at the end of the 8-week forgiveness period to mitigate the accrual of additional interest.

VII. SBA Review

The New Guidance reiterates that the SBA will review/audit loan applications and forgiveness applications as it deems appropriate (of any size), in addition to a guaranteed review of loans over \$2 million. Among other things, this may include a review of eligibility (including size testing and need⁶), calculation of loan amounts, use of proceeds and loan forgiveness amounts. Per the New Guidance, borrowers must retain PPP-related documentation for 6 years and permit SBA access to such files.

The New Guidance provides the following general framework:

- The SBA will notify lenders of reviews, and the lender must then notify the applicable borrower within 5 days.
- Borrowers will have an opportunity to respond to SBA questions in a review.
- Failure to respond to an SBA inquiry (which may come from the SBA or a lender) may result in an adverse decision.
- If the SBA determines that a borrower is ineligible, the loan cannot be forgiven. If a borrower is ineligible for an amount, the SBA will direct the lender to deny forgiveness in whole or in part, as appropriate. Also, the “SBA may ... seek repayment of the outstanding PPP loan balance or pursue other available remedies.”
- Borrowers will have an opportunity to appeal SBA determinations and further guidance will be issued on this topic.

VIII. A Note of Caution

Caution: Given the still-evolving nature of PPP regulation, borrowers should continue to monitor and follow new guidance as released. In this regard, the Application provides that forgiveness will be evaluated based on the rules existing as of the date the borrower signs its Application.

We are closely monitoring the guidance and related developments and remain ready to assist you and your business in navigating these unprecedented times. Please feel free to consult with us for any questions or assistance. For SBA and government-backed lending specific questions, please reach out to a member of our SBA team:

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⁶ Per prior guidance, borrowers with loan amounts less than \$2million (in the aggregate among affiliates) are deemed to have made the need certification in good faith.