

## We Received Our PPP Funds, Now What? SBA Provides Additional Guidance Regarding Loan Forgiveness

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**UPDATE May 29:** This article has been updated to reflect the SBA's Interim Rules on Loan Forgiveness and [Loan Review Procedures and Related Borrower and Lender Responsibilities](#), both posted on May 22, 2020 (IFR).

On May 15, 2020, the Small Business Administration (SBA) released highly anticipated guidance regarding loan forgiveness under the Paycheck Protection Program (PPP) in the form of the [Paycheck Protection Program Loan Forgiveness Application](#) and related instructions. These documents provide a blueprint regarding how borrowers can obtain partial or even complete forgiveness of their PPP loans.

Borrowers will be required to submit the Loan Forgiveness Application along with the PPP Loan Forgiveness Calculation Form, PPP Schedule A and supporting documentation to their lenders. While additional guidance may be forthcoming, below are some of the key aspects of loan forgiveness and the Loan Forgiveness Application. **Please note that many questions regarding forgiveness still exist and certain guidance may still be unclear. We will continue to update this article as additional guidance or clarification is provided.**

**Timeframe (Covered Period):** Except for limited purposes as described below, loan proceeds must be used in the eight-week (56-day) period (Covered Period) immediately following the date the loan was disbursed by the lender (Disbursement Date).

- **Alternative Payroll Covered Period:** For administrative convenience, a borrower with a biweekly (or more frequent) payroll schedule may elect to calculate eligible payroll costs starting at the beginning of the first payroll period following the Disbursement Date and continuing for eight weeks (the Alternative Payroll Covered Period).

For example, if a borrower received its PPP loan proceeds on Monday, April 20, and the first day of its first pay period following its PPP loan disbursement is Sunday, April 26, the first day of the Alternative Payroll Covered Period is April 26 and the last day of the Alternative Payroll Covered

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Period (56 days later) is Saturday, June 20. The Alternative Payroll Covered Period does not apply to borrowers that pay payroll twice per month or monthly as such payment periods would be less frequent than biweekly.

Borrowers that elect to use the Alternative Payroll Covered Period are required to maintain consistency and use the Alternative Payroll Covered Period for other purposes, although several sections of the Loan Forgiveness Application specifically require use of the Covered Period (the eight-week period beginning on the Disbursement Date). For example, for payroll-related items, borrowers will be allowed to use the Alternative Payroll Covered Period while payments for other non-payroll eligible expenses must be calculated using the Covered Period.

**Use of Funds in the Covered Period:** A borrower may use the PPP loan proceeds only on the following expenses (Permitted Expenditures):

### **Payroll Costs**

- Payroll costs include 1) salaries, wages, commissions, tips or similar compensation, 2) vacation, parental, family, medical, or sick leave and severance pay, 3) group health care benefits, including insurance premiums (employer's share only), 4) retirement benefits (employer's share only), 5) state and local tax assessed on the compensation of employees, and 6) self-employment income paid to partners in a partnership and owner-members of a limited liability company (which is taxed as a partnership). The IFR has clarified that bonuses and hazard pay may be paid using PPP loan proceeds during the Covered Period, provided such bonus and hazard pay will be deemed compensation and is thus included in the \$15,385 cap described below.
- The PPP's definition of "payroll costs" excludes salaries and wages in excess of \$100,000 on an annualized basis for any individual prorated for the Covered Period. Therefore, borrowers must be aware that forgiveness for salaries and wages for any individual will be limited to \$15,385. This limitation includes any amounts paid as bonuses or for hazard pay.

Owner-employees, self-employed and general partners must not exceed 8/52 of 2019 compensation during the Covered Period (or the Alternative Payroll Covered Period) and this is similarly capped at \$15,385 per individual. No additional forgiveness is provided for retirement or health insurance contributions for self-employed individuals (including Schedule C filers and general partners) as such expenses are paid out of their net self-employment income.

- Payroll costs do not include 1) the employer portion of FICA, Medicare and FUTA, 2) amounts claimed for the Emergency Sick Leave Credit or the Emergency Family and Medical Leave Credit, 3) health insurance premiums and retirement benefits for sole proprietors and independent contractors, and 4) compensation of an employee whose principal place of residence is outside of the United States.

**Timing of Payment of Payroll Costs:** There has been significant confusion regarding whether a cost had to be both incurred and paid during the Covered Period. The Loan Forgiveness Application provides that Permitted Expenditures that are *paid or incurred* during the Covered Period are now eligible for forgiveness; provided that incurred Permitted Expenditures must still be paid no later than the regular payment dates following the Covered Period. Thus, the Loan Forgiveness Application

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provides some flexibility and allows payment and forgiveness for certain costs incurred prior to the Disbursement Date and paid during the Covered Period, as well as certain costs incurred during the Covered Period and paid after that 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 an employee's pay is earned.
- Payroll costs paid after the beginning of the Covered Period in the regular course that relate to an earlier payroll period may be included.
- Payroll costs incurred but not paid during the borrower's last pay period of the Covered Period (or Alternative Payroll Covered Period) are eligible for forgiveness if paid on or before the next regular payroll date.
- For employees who are not performing work but are still on borrower's payroll, payroll costs are incurred based upon the schedule established by the borrower (typically each day the employee would have performed the work).

**Non-Payroll Costs:** Non-payroll costs consist of the following permissible expenses:

- Interest (not principal) on any mortgage obligations for loans incurred prior to February 15, 2020 (not including any prepayment). This includes mortgages on real and personal property used in the borrower's business.
- Rent or leases in existence prior to February 15, 2020. This includes equipment leases, copier leases and vehicle leases used in the business. The guidance does not address whether the prepayment of rent is acceptable.
- Utilities for services begun prior to February 15, 2020. This includes electric, gas, water, telephone, internet and transportation (generally interpreted to mean expenses such as gas for business vehicles). The guidance does not address whether the prepayment of utilities is acceptable.

**Timing of Payment of Non-Payroll Costs:** Eligible non-payroll costs must either 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. In certain circumstances, borrowers may make payments of non-payroll costs in the Covered Period with respect to non-payroll costs that were incurred prior to the Covered Period. For example, if April rent was not paid on April 1, but later paid using PPP proceeds after such proceeds were received, then the April rent will be deemed paid in the Covered Period and thus eligible for forgiveness.

The Alternative Payroll Covered Period does not apply to payments for non-payroll costs.

**Forgiveness Limited to Principal Loan Amount:** Due to the cap of forgiveness at the principal amount of the loan, borrowers should expect to pay interest on their PPP loans even though a borrower may be entitled to full forgiveness of the principal amount.

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**75/25 Rule:** No more than 25 percent of the loan forgiveness amount (as opposed to the full loan amount) may be attributable to non-payroll costs (at least 75 percent of the forgiveness amount must be attributable to payroll costs).

**Reduction on Forgiveness:** While borrowers are eligible for loan forgiveness for expenditures on payroll costs for the Covered Period (or the Alternative Payroll Covered Period), the actual loan forgiveness amount a borrower receives may be less depending upon 1) whether a borrower's number of average weekly full-time equivalent employees (FTEs) employees during the Covered Period (or Alternative Payroll Covered Period) is fewer than certain previous periods, and 2) whether the average annual salary or average hourly wages of certain employees during the Covered Period (or the Alternative Payroll Covered Period) was less than the comparable average(s) during the period from January 1, 2020 to March 31, 2020.

Borrowers may however, be exempt from these reductions under certain circumstances and may be entitled to a safe harbor from reduction if the number of FTEs and salary and hourly wages are restored to certain levels on or before June 30. In determining the amount eligible for forgiveness, details relating to the hours and compensation of every employee must be listed.

Furthermore, the Loan Forgiveness Application first reduces the eligible amount to the extent of any compensation-related reductions and then further reduces the amount eligible for forgiveness for any reduction in FTEs. Importantly, these reductions are with respect to amounts expended for the Covered Period (or the Alternative Payroll Covered Period) and not to the entire amount of the loan disbursement. As a result, even though the expenditures for the Covered Period (or the Alternative Payroll Covered Period) are only made for payroll costs, for example, not all of those expenditures will necessarily be forgiven.

**FTE Count:** Loan forgiveness will be reduced based on the retention of FTEs. A borrower's loan forgiveness will be reduced by multiplying the amount of the loan used by the borrower in the Covered Period (or Alternative Payroll Covered Period) by the quotient of a) the average number of FTEs per month for the Covered Period, divided by b) the lower of the average number of FTEs per month from i) February 15, 2019 through June 30, 2019, and ii) January 1, 2020 through February 29, 2020.

By way of example, if during the Covered Period (or Alternative Payroll Reduction Period), a borrower's monthly average of FTEs is 90, and the average number of FTEs per month from January 1, 2020 through February 29, 2020 is 100, then the borrower's forgiveness will be limited to 90 percent of the loan proceeds spent on Permitted Expenditures.

- **How Do You Measure FTE?** An FTE would be an employee who works, on average, 40 hours per week or more per month. An FTE is determined by calculating the average number of hours paid per week, dividing by 40, and rounding the total to the nearest tenth. The maximum for each employee is capped at 1.0. The SBA has stated that borrowers may use 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.
- **FTE Reduction Exemptions:** Any reduction due to the following will not reduce the borrower's loan forgiveness: 1) a borrower that laid off an employee offered to rehire the same employee for the same salary/wages and same number of hours, but the employee declined the offer (the borrower must have made the offer in good faith and in writing and the employee's rejection of that offer must be documented by the borrower and the borrower must

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inform the applicable state unemployment office of such employee's rejected offer of employment within 30 days of such employee's rejection of the offer), 2) an employee was fired for cause or voluntarily resigned during the Covered Period (or Alternative Payroll Covered Period), or 3) an employee voluntarily requested and received a reduction in his or her hours.

- **FTE Reduction Safe Harbor:** A borrower that rehires or replaces workers who were previously laid off will be exempt from the reduction in loan forgiveness during the Covered Period (or Alternative Payroll Covered Period) provided that 1) such employee reduction occurred between February 15, 2020 and April 26, 2020, and 2) the borrower restored its FTE employee levels by no later than June 30, 2020 to its FTE employee levels in the borrower's pay period that included February 15, 2020.

**Reduction of Compensation:** Loan forgiveness will also be reduced if, during the Covered Period (or the Alternative Payroll Covered Period), a borrower decreases the annual average salary or hourly wage of any employee (on a per employee basis) by more than 25 percent of the base salary or wages received by that employee during the period of January 1, 2020 to March 31, 2020. This reduction will apply only to employees who have earned less than \$100,000 annualized. The reduction relating to reduction of compensation applies only to the portion of the decline in an employee's salary and wages that is not attributable to the FTE reduction (borrowers will not be penalized for both).

- **Salary/Hourly Wage Reduction Safe Harbor:** A borrower that restores the average annual salary or hourly wage for employees who were previously laid off or had their compensation reduced will be exempt from the reduction in loan forgiveness during the Covered Period (or Alternative Payroll Covered Period) provided that 1) such employee compensation reduction occurred between February 15, 2020 and April 26, 2020, and 2) the borrower restored each employee's average annual salary or hourly wage by no later than June 30, 2020 to the amount of such employee's average annual salary or hourly wage as it existed as of February 15, 2020.

## Amounts Not Forgiven

- Payments for anything other than Permitted Expenditures during the Covered Period or relating to payroll during the Alternative Payroll Covered Period. These excluded payments include:
  - For each individual employee, the total amount of cash compensation in excess of an annual salary of \$100,000, as prorated for the Covered Period (or Alternate Payroll Covered Period).
  - Payment used for interest on debt other than mortgage obligations that were incurred prior to February 15, 2020.
  - Payment made to refinance an Economic Injury Disaster Loan made between January 30, 2020 and April 3, 2020.
  - Any funds not expended during the Covered Period or the Alternative Payroll Covered

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Period (other than payments on the next regular billing/payment cycle for amounts incurred during the Covered Period).

**Application for Forgiveness:** Borrowers will be required to submit a [detailed application](#) and related documentation in support of loan forgiveness to their lenders. The lender will decide on the request for loan forgiveness within 60 days of receipt of the application, however, the SBA can undertake review of the PPP loan at any time. Borrowers should keep detailed accounting records in order to take advantage of the loan forgiveness provisions. Loan forgiveness is not automatic. If a borrower fails to submit its request for forgiveness and the required documentation, none of the loan will be forgiven.

**Documentation to Submit with PPP Loan Forgiveness Application:** PPP Schedule A outlines the documents required to be submitted to the lender to support the PPP Loan Forgiveness Application:

- **Payroll Documentation**

- Bank account statements (or third-party payroll service provider reports) documenting the amount of cash compensation paid to employees.
- Tax forms (or equivalent third-party payroll service provider reports), including payroll tax filings and state quarterly business and individual employee wage reporting and unemployment insurance tax filings.
- Payment receipts cancelled checks or account statements documenting the amount of any employer contributions to employee health insurance and retirement plans that the borrower included in the forgiveness amount.

- **FTE Documentation**

- The average number of FTE employees on payroll per month employed between February 15, 2019 and June 30, 2019;
- the average number of FTE employees on payroll per month employed between January 1, 2020 and February 29, 2020; or
- in the case of a seasonal employer, the average number of FTE employees on payroll per month employed between February 15, 2019 and June 30, 2019; between January 1, 2020 and February 29, 2020; or any consecutive 12-week period between May 1, 2019 and September 15, 2019.
- Documents may include payroll tax filings (typically Form 941) and state quarterly business and individual employee wage reporting and unemployment insurance tax filings. Documents may cover periods longer than the specific time period.

- **Non-Payroll Documentation**

- Business Mortgage Interest Payments: Copy of the lender amortization schedule and receipts or cancelled checks verifying eligible payments from the Covered Period; or lender account statements from February 2020 and the months of the Covered Period

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through one month after the end of the Covered Period verifying interest amounts and eligible payments.

- Business Rent or Lease payments: Copy of the current lease agreement 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: Copy of invoices from February 2020 and those paid during the Covered Period and receipts, cancelled checks or account statements verifying those eligible payments.

**Additional Record Keeping:** While not necessarily required to submit to the SBA with the Loan Forgiveness Application, all borrowers are required to retain, for a period of six years after the date the loan is forgiven or repaid in full, and permit the SBA and the Office of Inspector General to access the following files upon request: 1) All records relating to the borrower's PPP loan, including documentation submitted with its PPP loan application, 2) documentation supporting the borrower's certifications as to the necessity of the loan request and its eligibility for a PPP loan, and 3) documentation necessary to support the borrower's loan forgiveness application, and documentation demonstrating the borrower's material compliance with PPP requirements.

In addition, documents used to prepare the PPP Schedule A Worksheet should be retained, including:

- Documentation supporting the listing of each individual employee including any salary or hourly wage reduction calculation, if necessary.
- Documentation supporting the listing of each individual employee showing what each listed employee received during any single pay period in 2019 compensation at an annualized rate of more than \$100,000.
- Documentation regarding any employee job offers and refusals, firings for cause, voluntary resignations, and written requests by any employee for reductions in work schedule.
- Documentation supporting any FTE safe harbor reduction.

**What Can the SBA Review?** The SBA can review whether the borrower is eligible for the PPP loan; whether the information, certifications, and representations on both the borrower's application and loan forgiveness application are accurate; whether the borrower requested an improper loan amount and whether the borrower is eligible for loan forgiveness. Although the SBA has given guidance that all loans of \$2 million or more would be audited, the SBA's review is not limited by the principal amount of the loan (i.e., loans under \$2 million can also be audited by the SBA).

**Consequences for Ineligible Borrowers:** If it is determined that a borrower is ineligible for the PPP loan the loan will not be eligible for forgiveness.

**Consequences for Mistake of Loan Amount or Amount of Loan Forgiveness Requested:** If it is determined that the borrower is ineligible for the loan amount or loan forgiveness amount claimed by

the borrower, loan forgiveness may be denied in full or in part as appropriate. The SBA may seek repayment of the loan amount or pursue other remedies.

**Improper Use of Funds:** If loan proceeds are knowingly used for payments of any obligations that are not Permitted Expenditures, the officers and owners may be civilly and criminally liable for fraud.

**Cancellation of Indebtedness:** For federal tax purposes, amounts forgiven will not constitute taxable cancellation of indebtedness income.

**No Tax Deduction on Forgivable Portions of Loan:** No deduction is allowed under the IRS Code for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a PPP loan.

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