Steptoe

Small Business Relief under the CARES Act

Overview of the SBA Paycheck Protection Program

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Paycheck Protection Program

Below are answers to commonly asked questions about the Paycheck Protection Program (PPP) established under the CARES Act. The program is designed to encourage employers to maintain payroll and to help small businesses cover their expenses (e.g., payroll, mortgage, rent, utilities, etc.) during the COVID-19 crisis.

The Paycheck Protection Program Flexibility Act of 2020, enacted on June 5, 2020 in response to wide-spread criticism and challenges related to the program's original design, made significant changes to the PPP and is effective retroactively "as if included in the CARES Act." As reflected in the discussion below, the Act:

- Extends the program from June 30, 2020 to December 31, 2020;
- Expands the "forgiveness period" during which forgivable expenses must be incurred and paid from eight weeks to 24 weeks (with the option for pre-Act loan recipients to keep the original eight-week period);
- Requires borrowers to spend at least 60% of loan dollars on payroll costs to be eligible for forgiveness (down from 75% under SBA regulations);
- Provides a statutory safe harbor from forgiveness amount reductions for employers who make good faith efforts to restore payroll to pre-crisis levels but are unable to get employees back to work or to resume full business operations by the end of the year due to COVID-19-related restrictions;
- Extends the deadline by which employers can maximize forgiveness amounts by rehiring employees and/or restoring employee wages to the end of the year;
- Gives borrowers longer to pay back unforgiven loan amounts by setting a minimum loan maturity of five years;
- Extends deferral of all principal, interest, and fee payments on loans to the date on which forgiveness amounts are remitted to the lender or until 10 months after the end of the 24-week forgiveness period if the borrower has not applied for forgiveness by then; and
- Allows borrowers who receive loan forgiveness to participate in employer payroll tax deferral relief provided in section 2302 of the CARES Act.

The Small Business Administration (SBA) has issued final loan and forgiveness applications, multiple interim final rules, and FAQ guidance to implement the PPP (collectively, the "rules"). Those rules supersede any conflicting SBA loan program requirements contained in SBA Business Loan regulations (13 CFR 120.10, et seq.) until this program expires on December 31, 2020.

Because SBA is issuing new rules and guidance on a rolling basis, borrowers may rely on the rules and guidance in place at the time of application and do not need to take any further action based on subsequent

SBA releases. Borrowers whose applications have not yet been processed may, however, amend those applications based on new rules/guidance.

How long will these loans be available?

Loans are made to eligible borrowers on a first-come basis. They will be available until program funding is exhausted or until the program itself expires on December 31, 2020, whichever is sooner.

What are some of the main benefits of a paycheck protection loan (PPL)?

- Loan amounts up to $10 million per eligible entity;
- Principal, interest, and fee payments are automatically deferred until loan forgiveness amounts are remitted or until 10 months after the forgiveness period expires for borrowers who do not apply for forgiveness by then;
- Full loan amount forgiveness for employers that maintain or restore pre-crisis payroll;
- 100% federally guaranteed;
- No recourse against individuals, shareholders, members, or partners of loan recipients for non-payment, unless s/he uses loan dollars for impermissible purposes;
- No collateral or personal guarantee requirements, or SBA fees;
- Loans have a minimum maturity of five years, but there is no penalty for prepayment; and
- Fixed interest rate of 1%.

Who is eligible?

Any "small business concern" –

- As defined in current SBA rules based on employee-based or revenue-based size standards for the entity's primary industry (see www.sba.gov/size); or
- That meets both tests in the SBA's alternative size standard as of March 27, 2020:
  - Maximum tangible net worth of the business is not more than $15 million, and
  - Average net income after federal income taxes (excluding any carry-over losses) of the business for the two fiscal years before the date of PPL application is not more than $5 million.

Additionally, entities (including sole proprietors, independent contractors, and self-employed individuals) that were operating and paying workers on February 15, 2020 (or, for seasonal businesses, operated for any eight-week period between May 1, 2019 and September 15, 2019), and:

- Have 500 or fewer employees; or
- Satisfy the "small" SBA employee-based size standard for the entity's primary industry, if applicable.

Eligible entities currently include for-profit businesses, 501(c)(3) nonprofits, 501(c)(12) electric cooperatives, 501(c)(19) veterans organizations, Tribal business concerns described in section 31(b)(2)(C) of the Small Business Act, and agricultural enterprises described in section 18(b) of the Small Business Act.

Special Rules for Applicants with Self-Employment Income

Regarding individuals with self-employment income (e.g., independent contractors and sole proprietors), the rules clarify that you are eligible to apply for your own PPL if:

- You were in operation on February 15, 2020;
- Your principal place of residence is the US; and
- You filed or will file a Form 1040 Schedule C for 2019.

Notably, partners in partnerships may not submit separate PPL applications as self-employed individuals. Instead, self-employment income of general active partners may be reported as payroll costs (up to the $100,000 limit discussed below) on the partnership's application.

Special Rules for Faith-Based Organizations

The rules also contain special eligibility provisions for faith-based organizations. Such entities are eligible if they:

- Have not more than 500 employees; and
- Pay federal payroll taxes using their own IRS employer identification number (EIN) or are eligible for the federal tax deduction for gross income derived from any unrelated trade or business regularly carried out by a parish, church, etc. (see 26 U.S.C. 512(b)(12)).

Ineligible Entities

The rules explicitly exclude "household employers" of nannies, housekeepers, etc. from eligibility. The rules also exclude from this program entities that are ineligible for SBA Business Loans under 13 CFR 120.110, except 501(c)(3)s, faith-based organizations, legal gaming businesses, and hospitals that receive less than 50% of their funding, excluding Medicaid, from state and local governments. We encourage you to check the full list, but examples of ineligible entities include:

- Financial businesses primarily engaged in the business of lending;
- Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved by the loan proceeds;
- Life insurance companies;
- Businesses located in a foreign country;
- Private membership clubs and businesses;
- Speculative businesses (e.g., hedge funds and private equity firms, per SBA guidance); and
- Businesses primarily engaged in political or lobbying activities.

Moreover, as we read it, FAQ guidance creates a presumption of sorts that publicly-traded companies with access to capital markets and "businesses owned by private companies with adequate sources of liquidity to support the business's ongoing operations" are not eligible for PPLs of $2 million or more because they likely cannot satisfy the good-faith "need certification" required under the CARES Act (see discussion below on certifications and safe harbor for loans under $2 million). SBA has not provided details on how it will evaluate the "adequacy" of liquidity available to these potential borrowers.

How do I count my employees to figure out if I'm eligible?

General Rules

Borrowers should use average employment numbers over the same period used for calculating monthly average payroll costs (discussed below) or they may use the average number of employees per pay period in the last 12 calendar months (or for the months the business has been operating, if fewer than 12 months).

All entities count full-time, part-time, and "other basis" employees (e.g., employees from temp agencies or professional employer organizations) **of the entity and of all of the entity's domestic and foreign affiliates**, unless an affiliation rule exception applies to your business or organization. The SBA has clarified that it is the borrower's responsibility to determine which, if any, entities are its affiliates. Lenders may rely on the borrowers' certifications regarding overall headcount of employees.

Due to some borrower confusion based on early SBA guidance, SBA is using its enforcement discretion to not find any borrower that applied for a PPL before May 5, 2020 ineligible because the borrower failed to include non-US employees in its employee headcount.

Affiliation Rules

The SBA has issued special guidance on affiliation rules applicable to the PPL program. Generally, entities are affiliates when one controls or has the power to control the other, or a third party or parties has the power to control both.

The guidance sets forth four tests/circumstances that will establish affiliations for PPL applicants:

- **Equity Ownership** – if an individual, concern, or entity owns or has the power to control more than 50% of the applicant's voting equity; absent such over 50% ownership, SBA will consider the CEO, Board of Directors, or similar body in "control" of the applicant; it also will consider a minority shareholder that has the authority to block Board or other shareholder action to be in "control."
- **Common Management –** when the CEO or President (or similar manager) of the applicant also controls the management of one or more other concern; or where an individual, concern or entity controls the Board/management of the applicant and the Board/management of one or more other concerns; or when a single individual, concern, or entity controls the applicant through a management agreement.
- **Identity of Interest –** when close relatives (spouse, parent, child, or sibling – or the spouse of any such person) have identical or substantially identical business or economic interests (e.g., they operate concerns in the same or similar industry in the same geographic area; but note, applicants may rebut a finding of affiliation under this test and show the businesses are separate.

- **Stock options, convertible securities, and agreements to merge –** generally will be considered to have present effect on the power to control a concern and are treated as though rights granted have been exercised. But no present effect will be given for:
  - Agreements to open or continue negotiations toward a possible merger or sale at a future date (don't count as agreements in principal);
  - Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect; or
  - Individuals', concerns', or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation.

Special Counting Rules and Affiliation Waivers for Certain Businesses

Under the CARES Act, there are special employee counting rules for "business concerns" with NAICS industry codes starting with 72 (generally, "accommodations and food services"). Specifically:

- You are eligible for a PPL if you have 500 or fewer employees per location; and
- SBA affiliation rules are waived for these applicants (meaning only the employee count of the applicant entity, not the entity's affiliates, is considered).

SBA affiliation rules also are waived for "business concerns" that:

- Operate as a franchise under an SBA franchise identifier code (list available on the SBA website); or
- Receive financial assistance from Small Business Investment Act licensees.

To allow more businesses to take advantage of the franchise waiver, SBA has indicated that it will allow franchisors to apply for identifier codes for purposes of PPLs under a more relaxed process than would normally apply (but those codes will not extend beyond the PPL program).

There also is an affiliation rule waiver for faith-based organizations. Under SBA guidance, the normal affiliation rules do not apply to "the relationship of any church, convention or association of churches, or other faith-based organization or entity to any other person, group, organization, or entity that is based on a sincere religious teaching or belief or otherwise constitutes a part of the exercise of religion." SBA will permit these applicants to make a good-faith determination about whether and to what extent the affiliation rule waiver applies to them and will not require lenders to assess the reasonableness of the applicant's determination.

Finally, there are general exceptions to the SBA's affiliation rules (*see* 13 CFR 121.103(b)) that still apply for purposes of the PPL program.

A Few More Things to Consider on Counting

It is worth evaluating PPL eligibility from the perspective of each separately organized business concern. "Business concerns" under the SBA are for-profit business entities with US locations that have primary operations in the US or make a significant economic contribution in the US (e.g., by paying taxes). Business

concerns may be organized as sole proprietorships, partnerships, LLCs, corporations, associations, trusts, cooperatives, or joint ventures with under 50% foreign business participation.

If a business concern operates under multiple NAICS industry codes (perhaps one of which begins with 72), the SBA will look at the code of your "primary industry" based on average receipts, employees, costs of doing business, etc.

How do I apply for a loan?

The rules clarify that entities may not apply for or receive more than one PPL in 2020.

PPLs are available through private banks and credit unions that are authorized to participate in the program. The Treasury Department has posted a link on its website to help you locate an eligible participating lender.

What is Required for the Loan Application?

There is a standard PPL loan application (SBA Form 2483), which is significantly streamlined compared to normal SBA Business Loan applications. By design, banks' underwriting obligations for PPLs are very limited (essentially, verifying that documentation is submitted, payroll averages are substantiated, etc.) and they may rely on borrowers' documentation and certifications to determine eligibility and loan amounts.

The application generally requires:

- Basic business identification information;
- A list of all owners of the applicant with 20% or greater ownership stake;
- A list of any businesses under common ownership or management with the applicant;
- Details on any EIDL loan received by the business between January 1, 2020 and April 3, 2020;
- Information about individual applicants' and 20%-plus owners' criminal history; and
- The good-faith certifications described below.

The only blanket "borrower requirements" imposed by the CARES Act for PPLs are certain good-faith certifications. An authorized business representative must certify, among other things, that:

- The entity is eligible for a PPL.
- "Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant" (the "need certification").
- Funds will be used to retain workers and maintain payroll or make mortgage, lease, and utility payments.
- You will provide your lender with documentation necessary to establish your forgiveness amount (e.g., payroll numbers, proof of dollars spent on forgiveness-eligible expenses, etc.).
- Loan forgiveness will be based on the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities, but not more than 25% of the forgiven amount may be for non-payroll costs (discussed further below).

- The applicant has not and will not receive another PPL in 2020.
- Everything you submit to the lender is true and accurate. Knowingly making a false statement to get a loan under this program is punishable by law.
- You acknowledge that the lender will calculate your loan amount using the tax documents you submitted.

The rules clarify that e-signatures and e-consents are permitted.

Note that you will not be approved for a loan if you are presently involved in a bankruptcy or if the business or any owner has defaulted on a federal government loan in the last seven years, among other circumstances.

Additional Notes on the "Need Certification" and Related Safe Harbors

Multiple pieces of SBA guidance on the need certification released in late April and May have created confusion and concern for PPL recipients, particularly those who received their loans early in the program. The SBA has therefore created multiple safe harbors related to this certification.

First, any borrower who received a PPL and repaid the loan in full by May 18, 2020 will be deemed by SBA to have made the need certification in good faith.

Second, SBA guidance issued on May 13, 2020 creates a bright-line safe harbor going forward:

"Any borrower that, together with its affiliates, received a [PPL] with an original principal amount of less than $2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith."

The guidance does not specify whether affiliates' loan amounts will be considered for purposes of this safe harbor for businesses that have an affiliation rule waiver (e.g., restaurants, churches, etc.).

SBA has made clear that it will specially review compliance with the PPL program rules and requirements, including the good-faith need certification, for borrowers with loans above $2 million. While SBA acknowledges that these borrowers may be able to show, based on their individual circumstances, that the need certification was made in good faith, it has – as noted above – suggested that publicly-traded companies with access to capital markets and some PE-backed or privately-owned businesses are unlikely to be able to make this showing.

If SBA determines that a borrower lacked a good-faith basis for making the need certification, it will seek repayment of the balance of the loan and will inform the borrower's lender that the borrower is not eligible for forgiveness. Notably, such a finding by SBA will not impact SBA's guarantee of the loan. If the borrower repays the loan (required timing of repayment is unclear), SBA will not pursue further penalties against the borrower based on its finding of an improper need certification.

What Other Documentation Do I Need to Submit with My Application?

Ultimately, for applicants not applying as individuals with self-employment income, this will be up to your lender and we understand that there are some significant variations between banks. At a minimum, however, all applicants will need to supply some payroll documentation along with Form 2483.

SBA FAQs provide examples of what may suffice for payroll documentation, including: payroll reports from recognized third-party processors; an employer's quarterly federal tax returns; or, for employers who contract

with payroll providers or PEOs for payroll, relevant information from Schedule R (Form 941), Allocation Schedules for Aggregate Form 941 filers, and the like.

SBA has clarified that most borrowers may calculate average monthly payroll costs based on data from the previous 12 months or from calendar year 2019 (seasonal businesses may use data from February 15, 2019 or March 1, 2019 until June 30, 2019, or any consecutive 12-week period between May 1, 2019 and September 15, 2019; and new businesses not operating between February 15, 2019 and June 30, 2019 may use data from January 1, 2020 through February 29, 2020).

SBA guidance further clarifies that it is the borrower's obligation to accurately calculate payroll costs and lenders need only do a "good faith review in a reasonable time" – but ultimately, the lender may rely on the borrower's certification that the "payroll cost" numbers submitted are correct.

For individual applicants earning self-employment income, the rules are more prescriptive about the documentation you must submit with your application. Specifically, you must provide:

- 2019 Form 1040 Schedule C to substantiate your loan amount (whether or not you have filed 2019 tax returns with the IRS); and
- 2019 Form 1099-MISC detailing non-employee compensation received, invoice, bank statement, or book of record that establishes you are self-employed; and
- 2020 invoice, bank statement, or book of record to establish that you were in operation on or around February 15, 2020; and
- If you have employees, Form 941 (or other tax forms or equivalent payroll records); and
- If you have employees, 2019 state quarterly wage unemployment insurance tax reporting forms (or equivalent payroll records); and
- If you have employees, evidence of any retirement or health insurance contributions.

Borrowers Beware!

A general caution on the application and documentation process – borrowers beware. It is the borrower's obligation to verify eligibility and loan amounts, and to make the certifications above on some good-faith basis. Lenders are held harmless if they rely on borrower representations and documentation.

There will be increased SBA audit and oversight activity when borrowers seek forgiveness of loan amounts (discussed below), and loans in excess of $2 million will receive additional scrutiny. The Justice Department already is investigating some PPL borrowers for possible fraudulent activity and the SEC has started questioning borrowers within its purview.

Borrowers who improperly claim eligibility, make misrepresentations, or certify without a good-faith basis to any of the items above, could face: loan default (per some lender contracts under the program), SBA audits, federal civil and/or criminal penalties, and Congressional oversight actions.

What if I already got an SBA loan for economic injury due to the COVID-19 emergency?

Under the CARES Act, SBA economic injury disaster loans (EIDLs) made under the SBA's Disaster Loan Program between January 31, 2020 and April 3, 2020 may be refinanced as PPLs. The implementing rules further state that if your EIDL loan was used for payroll costs, your PPL loan must be used to refinance your EIDL loan. But, according to the rules, if your EIDL loan was not used for payroll costs, it does not impact your eligibility for a PPL.

Additionally, the CARES Act clarifies that you may have a post-January 31, 2020 EIDL and a PPL if the EIDL is for a purpose other than paying payroll costs and other obligations that may be paid with PPLs (see full list below).

What is my maximum loan amount and how can I spend it?

Calculating Maximum Laon Amounts

Under the rules, loan amounts are, up to $10 million:

- 250% of average monthly "payroll costs" (defined below) paid by the applicant during the last 12 months (or one of the alternate look-back periods noted above), plus
- Any outstanding amount of an EIDL made between January 31, 2020 and April 3, 2020 that you seek to refinance as a PPL, less any amounts you took as an advance on such EIDL.

Pursuant to SBA guidance, for any loans not fully disbursed by April 30, 2020, a single corporate group may not receive more than $20 million in PPLs (this applies to groups that have affiliation rule waivers). Businesses are considered part of a single group if they are majority-owned, directly or indirectly, by a common parent. Borrowers are obligated to notify their lenders if they have applied for loans above this amount and must withdraw or cancel their applications accordingly.

There are special calculation rules for individual applicants with self-employment income. If you are such an individual and you have no other employees, your maximum loan amount is (again, up to $10 million):

- 250% of your net profit amount from Form 1040 Schedule C line 31 (capped at $100,000 annualized) divided by 12; plus
- Any outstanding amounts from an EIDL made between January 31, 2020 and April 3, 2020 that you seek to refinance as a PPL, less any amounts you took as an advance on such EIDL.

Note that if your net profit amount is zero or negative, you do not qualify for a PPL.

If you are an individual applicant and you do have other employees, your maximum loan amount is the outstanding amount on any refinanced EIDL (less any advances taken on the EIDL), plus 250% of the monthly average of:

- Net profit amount from Form 1040 Schedule C line 31 capped at $100,000 annualized;
- 2019 gross wages and tips paid to employees whose principal place of residence is in the US (capped at $100,000 annualized for any individual employee) computed using 2019 Form 941 Taxable Medicare wages

& tips (line 5c-column 1) from each quarter, plus any pre-tax employee contributions for health insurance or other fringe benefits excluded from Taxable Medicare wages & tips; plus

- 2019 employer health insurance contributions (from Form 1040 Schedule C line 14), retirement contributions (Form 1040 Schedule C line 19), and state and local payroll taxes.

Allowable Uses for Loan Proceeds

By rule (not the CARES Act), **at least 75% of PPL proceeds "shall" be used for "payroll costs**." It is not clear whether the SBA will relax this requirement following the PPP Flexibility Act of 2020, which reduces the payroll cost spend requirement to 60% specifically for forgiveness purposes (discussed more below).

Payroll costs, as defined in the rules:

Include (on a gross basis):

- individual employee compensation (salary, wages, commissions, cash tips, or similar) up to annualized compensation of $100,000 (this cap applies only to cash compensation, not the other items below);
- paid leave;
- severance payments;
- payment for group health benefits, including insurance premiums;
- retirement benefits (e.g., employer contributions to retirement or pension plans);
- state and local payroll taxes; and
- "owner compensation replacement" for self-employed, independent contractor and sole proprietor applicants only: based on net profits on 2019 Form 1040 Schedule C up to annualized compensation of $100,000 (note: other employers may not include these individuals in their "payroll cost" calculation);

Exclude:

- excess individual compensation above the $100,000 threshold;
- federal employer-side taxes (e.g., employer's share of federal payroll taxes);
- compensation to employees whose principal place of residence is not the US; and
- sick and family leave wages for which credit is allowed under the Families First Coronavirus Relief Act (for both employees and owners);

The rules clarify that independent contractors and sole proprietors do not count as "employees" for purposes of calculating "payroll costs" because they may apply for their own loans under the program.

Other allowable uses for PPL dollars – which, again, may only account for 25% of overall loan dollars spent, per SBA rules – include:

- Group health care benefits during periods of paid sick, medical, or family leave;
- Insurance premiums;

- Payments of interest on mortgage obligations;
- Rent (including rent under a lease agreement);
- Utilities;
- Interest on any other debt obligations incurred before February 15, 2020;
- Any uses already permitted for SBA Business Loans (e.g., inventory, supplies, building or land purchases, construction, site improvements, etc.); and/or
- Refinancing an SBA EIDL loan made between January 1, 2020 and April 3, 2020.

Note that these expenditures are all permitted under the PPL program, but not all of them are eligible for loan forgiveness (see discussion below). So, for example, you could use the loan dollars to pay inventory expenses, but that portion of the loan will not be forgiven.

A word of caution – we have seen a variety of "use" requirements in loan documents from different banks, not all of which comport with the CARES Act or SBA rules. We therefore advise borrowers to carefully review their loan documents for any contractual limits/requirements on how and/or when loan dollars must be spent to avoid default or other penalties.

Additional Clarifications & Limitations for Individual Borrowers with Self-Employment Income

The "allowable uses" rules described above generally apply to individual borrowers with self-employment income, but SBA rules make some additional and notable clarifications for these borrowers:

- You may use loan dollars for owner compensation replacement (as calculated above based on 2019 net profits and capped at $100,000 annualized);
- "Payroll costs" follow the definition above for any employees you have (but you do not count owner benefits in "payroll costs");
- Mortgage interest, rent, and utility payments must be business obligations/expenses, and you must have claimed or be entitled to claim a deduction for these expenses on your 2019 Form 1040 Schedule C for them to be permissible uses during the eight-week period following disbursement of your loan (this is to ensure loans are used for maintaining existing operations and not for business expansion); and
- The general "allowable use" categories for group health benefits and insurance premiums do not apply for these borrowers (but note employer payments for employees' health benefits, including health premiums, are includable/allowable under "payroll costs").

How much of my loan will be forgiven?

Your full loan amount may be forgiven, subject to the rules and penalties discussed below. Per IRS Notice 2020-32 issued on April 30, 2020, however, no federal tax deduction is allowed for expense payments (i.e., payroll, rent, utilities, mortgage interest amounts) that ultimately are forgiven. The Notice purports to avoid a double tax benefit because under the CARES Act, forgiven amounts are excluded from gross income for purposes of the Internal Revenue Code.

On May 17, 2020, SBA issued a standard PPL forgiveness application (SBA Form 3508) and related instructions. SBA intends to publish additional rules and guidance to implement the forgiveness provisions in the program, and indeed, some previous SBA rules will have to be revised to comport with changes in the PPP Flexibility Act of 2020. Notably, eligibility for loan forgiveness will be assessed based on rules/guidance in place on the date of your forgiveness application, so it is important to stay apprised of any regulatory developments.

Determining Your Maximum Possible Forgiveness Amount

The maximum possible forgiveness amount (capped under the CARES Act at the principal amount of the loan) is the sum of the following **incurred and paid within the forgiveness period**:

- Payroll costs for employees (as defined above, including owner compensation replacement for individual borrowers with self-employment income);
- Interest on mortgage obligations that were in place before February 15, 2020;
- Rent obligations under leases that were in place before February 15, 2020; and
- Certain utility payments for services that began before February 15, 2020.

The PPP Flexibility Act of 2020 extended the forgiveness period from eight weeks to 24 weeks after loan disbursement. Borrowers who received PPLs prior to June 5, 2020 (date of enactment of the Act), however, may elect to keep the original 8-week forgiveness period.

To receive loan forgiveness, borrowers must spend at least 60% of PPL dollars on payroll costs. Moreover, any amounts spent outside of the forgiveness period, even for forgiveness-eligible expenses, will not be included in your forgiveness amount. The SBA's forgiveness rules clarify that salary, wages, commissions, or similar compensation paid to furloughed employees (i.e., those not actually providing services to the business) are forgivable expenses (capped at the $100,000 annualized rate for compensation to any individual employee). Additionally, hazard pay and bonuses are eligible for forgiveness (again, up to the $100,000 cap).

The forgiveness application provides some clarification around the "incurred and paid" requirement. Payroll costs are incurred on the day the employee's pay is earned and they are paid on the date paychecks are distributed or ACH credit transactions are originated. The application permits borrowers to pay payroll costs incurred during the last pay period within the forgiveness period on or before the next regular payroll date and still receive forgiveness. For non-payroll expenses (mortgage interest, rent, and utilities), those may be forgiven if they are incurred during the forgiveness period and paid during the forgiveness period or by the next regular billing date.

More on the Forgiveness Period

The SBA's forgiveness application instructions provide some limited flexibility in the original eight-week forgiveness period only for purposes of evaluating eligible payroll expenses, full-time equivalent employee calculations, and salary reduction determinations. Specifically, borrowers that pay employees biweekly or more frequently may elect to calculate these items using the eight-week period beginning on the first day of the first pay period following the loan disbursement date (the "Alternative Payroll Covered Period"). It is unclear

whether SBA will extend this flexibility to the longer 24-week forgiveness period for borrowers who do not elect to stick with the original eight-week period.

SBA rules clarify that borrowers may not delay the start of the forgiveness period by putting off loan disbursements. Absent borrower documentation delays, lenders must make one-time, full disbursements within 10 calendar days of loan approval. Relatedly, loans will be cancelled for borrowers who do not submit required loan documentation within 20 calendar days of loan approval.

Special Forgiveness Amount Calculations for Individuals with Self-Employment Income

Per the forgiveness application and related instructions, the following compensation rules apply for determining "payroll costs" for these individuals, all capped at $15,385 total for the eight-week period –

- Owner-employees" = 8/52 of 2019 compensation per individual in total across all businesses (may include 2019 employee cash compensation and employer retirement and healthcare contributions made on their behalf);
- Schedule C filers (e.g., independent contractors) = 8/52 of 2019 net profits (the "owner compensation replacement" discussed above);
- General partners = amount of 2019 net earnings from self-employment (reduced by claimed 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235.

"Owner-employee" is not defined in the application or forgiveness rules. That term generally refers, however, to sole proprietors and some partners.

Note that retirement and health contributions for self-employed individuals, including Schedule C filers and general partners, are not forgivable payroll costs. These individuals are limited to the amounts described above for forgiveness eligibility.

Also, as noted above, you must have claimed or be entitled to claim a deduction for the business's mortgage interest, rent, and utility expenses on your 2019 Form 1040 Schedule C for those to be forgivable expenses.

Penalties That Will Reduce Your Forgiveness Amount

Because the policy goal of the PPL program is to encourage employers to keep employees on payroll at something at least close to their normal base pay, the maximum forgiveness amount will be reduced as follows:

- Full-time equivalent employee (FTEEs) reductions = proportionately for reductions in average FTEEs between the forgiveness period and pre-crisis levels (borrower may elect February 15, 2019 to June 30, 2019, or January 1, 2020 to February 29, 2020 as the look-back period);
- Certain salary reductions = via a straight reduction for drops in any individual employee's salary/wages over 25% (compared to the last completed pre-PPL quarter of employment by that employee) for workers who did not make $100,000 on an annualized basis in any pay period in 2019; and
- For any advances taken on SBA EIDLs.

Borrowers may use the Alternative Payroll Covered Period referenced above to make the FTEE and salary reductions calculations if the borrower opts to use that period for calculating forgivable payroll costs.

"Full-time equivalent employee" under the rules and forgiveness application means an employee who works 40 hours or more, on average, each week. Hours for employees who work fewer than 40 hours are recorded as proportions of a single FTEE and aggregated. There are two permissible methods for calculating FTEEs (borrowers may use either one, but it must be applied consistently across all employees and relevant timeframes):

- For each employee, the average number of hours paid per week during the relevant period divided by 40 (round to nearest tenth) with a maximum of "1" for each employee; or
- Using a simplified method, assign a "1" for any employee who works 40 hours or more per week and "0.5" for employees who work fewer than 40 hours (i.e., for any part-time employee, regardless of how many hours they actually work or were paid during the relevant periods).

The PPP Flexibility Act of 2020 includes a safe harbor from the FTEE reduction for employers who can document either:

- An inability to rehire employees who were employed on February 15 and inability to hire similarly qualified employees for unfilled positions on or before December 31, 2020; or
- An inability to return to the "same level of business activity as such business was operating [] before February 15, 2020," due to compliance with COVID-19-related safety guidance or requirements (e.g., sanitation standards, social distancing, worker safety requirements, etc.).

SBA had previously provided some regulatory exceptions to the FTEE penalty. Under those rules, which may still be consistent with the PPP Flexibility Act, would not be penalized for reductions in average FTEEs during the forgiveness period for employees who receive and decline offers of employment/rehire if:

- The borrower makes a good faith written offer during the Covered Period or Alternative Payroll Covered Period;
- The offer is for the same salary/wages and number of hours earned by the employee in the last pay period prior to the separation or hours reduction;
- The offer is rejected by the employee;
- The borrower maintains documentation of the offer and rejection; and
- The borrower informs the applicable state unemployment insurance office of the employee's rejection within 30 days of receiving it.

The SBA forgiveness application and rules also exclude from the FTEE reduction penalty employees who, during the Covered Period or Alternative Payroll Covered Period, were fired for cause, voluntarily resigned, or voluntarily requested a reduction in hours (if those positions were not filled by new employees). Employers must maintain records for such employees and events.

Interplay between FTEE and Salary Reduction Penalties

The SBA's forgiveness rules clarify that the salary reduction penalty applies only to the portion of salary/wage reduction not attributable to a FTEE reduction. SBA provides a couple of examples of how this rule operates –

- An employer reduces an applicable full-time employee's weekly salary from $1000 to $700 between the relevant comparison periods. The first $250 reduction is exempted from the reduction, so the forgiveness penalty would be $400 ($50 of non-exempt reduction times the eight weeks of the Covered Period or Alternative Payroll Covered Period).
- An hourly employee worked 40 hours per week during the pre-crisis look back period, but is reduced to 20 hours during the Covered Period. There is no change in the employee's hourly wage, so the entire salary reduction is attributable to a reduction in FTEEs and there is no separate salary/wage reduction penalty amount.

Opportunities to Negate Forgiveness Amount Penalties by December 31, 2020

There is relief from forgiveness amount penalties in certain circumstances for businesses that restore payroll to pre-crisis levels by December 31, 2020. Specifically, the FTEE and salary reduction penalties described above will not apply (i.e., eligibility for your maximum forgiveness amount is restored) if the employer eliminates by December 31, 2020 reductions (compared to February 15, 2020) in the number of FTEEs and/or reductions in individuals' salaries, as applicable, made between February 15, 2020 and April 26, 2020.

The "safe harbor period" from February 15 to April 26 is specified in the CARES Act and was not amended in the PPP Flexibility Act, so SBA has no room to alter it via regulations. It therefore appears that FTEE lay-offs and/or penalty-triggering salary reductions that happen outside of this period are not eligible for the law's "rehire" relief.

How do I get my loan forgiven and what if I have unforgiven amounts left over?

The Application Process

To receive loan forgiveness, you must submit the forgiveness application to the lender servicing your loan along with documentation (described in more detail in the application instructions):

- Verifying FTEEs on payroll and their pay rates (IRS payroll tax filings and state income, payroll, and unemployment filings);
- On covered costs/payments (e.g., canceled checks, receipts, or other documents verifying mortgage, rent, and utility payments); and
- Certifying (by an authorized business representative), among other things, that the documentation is true and correct and that forgiveness amounts requested were used to retain employees and make other forgiveness-eligible payments.

For individual borrowers with self-employment income, you will have to submit Form 941 and state payroll tax records for any employees, evidence of eligible business rent, utility, and/or mortgage interest payments, and 2019 Form 1040 Schedule C to determine net profits for purposes of calculating the maximum forgivable owner compensation replacement amount.

Lenders have 60 days following submission of a completed application to make a forgiveness determination. As with the original loan application, lenders may rely – after a good-faith review in a reasonable time – on borrowers' certifications and documentation when making forgiveness decisions. It is the borrower's obligation to properly calculate forgiveness amounts.

Lenders may approve forgiveness applications in whole or in part, deny applications, or (if instructed by the SBA) deny an application without prejudice due to a pending SBA review. Borrowers have 30 days after the lender's determination to request that the SBA review the decision. The SBA may also review the lender's decision in its sole discretion.

SBA Discretionary Reviews of PPL and/or Forgiveness Eligibility

SBA may review a PPP loan of any size prior to or after a lender's forgiveness determination. SBA is authorized to review, among other things:

- A borrower's initial PPL eligibility, including compliance with SBA's affiliation rules, certifications and representations made on the loan application, etc.;
- Proper calculation of loan amounts and uses of loan proceeds; and
- Loan forgiveness amounts to which the borrower is entitled.

If SBA opts to review a PPP loan or forgiveness application, it will notify the lender and the lender must then notify the borrower within five business days. While the SBA review is ongoing, the lender may not approve any forgiveness application.

If questions arise about a borrower's loan or forgiveness eligibility, the borrower will have an opportunity to respond. The lender or SBA will request additional information from the borrower. Failure to provide additional requested information will result in a determination of ineligibility for the loan and/or forgiveness.

If SBA determines that the borrower was ineligible for a PPP loan in the first place, it will notify the lender that the borrower is ineligible for forgiveness. If SBA concludes that the borrower is not eligible for the forgiveness amount claimed on the forgiveness application, it will direct the lender to deny the forgiveness application in whole or in part, as appropriate. SBA may also seek repayment of the outstanding balance of the loan, but the rules do not specify the timing for such repayment.

Borrowers may appeal an SBA finding of ineligibility for a PPL and/or forgiveness amounts. SBA intends to issue rules on this process in the future.

The forgiveness application requires borrowers to maintain PPL documentation for six years after forgiveness or payment of the loan in full and allow SBA to access those files, which suggests that SBA may conduct oversight activities around PPLs for an extended period after the program expires.

Unforgiven Amounts

Regarding loan amounts remaining after the forgiveness determination, it appears that the intent of the CARES Act is for the same loan terms to continue applying (e.g., 1% interest rate, federally-guaranteed, etc.). Due to changes made by the PPP Flexibility Act of 2020 to minimum loan maturity (now five years) and payment deferral periods, SBA will have to revise its previous guidance on those topics.

Are there other considerations I should evaluate before I apply for a PPL?

Although the PPP Flexibility Act extended employer payroll tax deferral relief to PPL forgiveness recipients, there still are trade-offs for businesses that receive PPL loans with respect to other tax benefits in the CARES Act. Specifically, an employer that receives a PPL is not eligible for the employee retention tax credit (ERTC) in

section 2301 of the CARES Act, which provides eligible employers a refundable credit against payroll tax (Social Security and Railroad Retirement) liability equal to 50% of the first $10,000 in wages per employee (including value of health plan benefits). Eligible employers must have carried on a trade or business during 2020 and be experiencing either: at least a partial suspension of operations due to government orders (e.g., limiting commerce, travel, group meetings, etc.); or a year-over-year gross receipts reduction of at least 50%.

Businesses will have to compare the benefits of PPLs and the ERTC to determine which path provides the greater financial benefit (e.g., compare immediate liquidity needs with longer-term time value of money calculations).

For additional guidance, please refer to Steptoe's COVID-19 Resource Center.

Last modified: June 5, 2020