Small Business Relief under the CARES Act
Overview of the SBA Paycheck Protection Program
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. Absent further action by Congress, the last day for submitting PPP applications was August 8, 2020.

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 full forgiveness (down from 75% under previous 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 December 31, 2020;
- Gives borrowers approved for loans on or after June 5, 2020 longer to pay back unforgiven loan amounts by setting a minimum loan maturity of five years and also allows borrowers and lenders to mutually extend the maturity date of earlier PPP loans;
- Extends deferral of all principal, interest, and fee payments on loans to the date on which forgiveness amounts are remitted to the lender (or the lender is notified that forgiveness is not allowed) 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 federal 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 the loan and/or forgiveness application and do not need to take any further action based on subsequent SBA releases.

**How long will these loans be available?**

Loans are made to eligible borrowers on a first-come basis until program funds are exhausted. Loan applications will be accepted until August 8, 2020.

**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;
- Loan maturities of two years (pre-June 5 loans) and five years (loans approved June 5 or later, and pre-June 5 loans that are renegotiated by the borrower and bank), 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 and telephone 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 basically creates a presumption 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 because they likely cannot satisfy the good-faith "need certification" required under the CARES Act (but see discussion below on need certification 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.

Change in Ownership of Entities With PPLs

Effective October 2, 2020, SBA issued rules for changes in ownership of PPP borrowers. Notably, certain changes in ownership must be approved by the SBA. Further, the original PPP borrower remains responsible for performance of all loan obligations and all PPP certifications and requirements. No restrictions on changes in ownership apply, however, if prior to the closing date of the sale/transfer, the borrower has already repaid the PPL in full or has completed the forgiveness process and either received full forgiveness or repaid any unforgiven balance. More details on these rules and processes can be found here: https://www.sba.gov/sites/default/files/2020-10/5000-20057-508.pdf.

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 borrowers’ certifications regarding overall headcount of employees.

Due to some confusion arising out of 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 and elect 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 7(a) 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 40% 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 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 rules do 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.), but forgiveness application instructions suggest that affiliates’ loan amounts will not be counted if a borrower has such a waiver.

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.

To help facilitate this additional oversight policy, SBA has released “Loan Necessity Questionnaires” for for-profit borrowers and non-profit borrowers who, together with their affiliates, received PPL loans with an original principal amount of $2 million or more.

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 – indicated 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. The for-profit Lender Necessity Questionnaire requests information on, among other things: 2020 gross revenue compared to 2019, government-ordered and/or voluntary changes in business operations, non-COVID related capital improvement projects, dividend or other capital distributions, prepayment of any debt, employee compensation above $250,000 (annualized), securities listings on national exchanges, and ownership by private equity firms, venture capital firms or hedge funds.

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
Steptoe

- 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.

As noted above, loans in excess of $2 million will receive additional scrutiny from the SBA. Additionally, 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 we have reviewed), 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. Implementing guidance from the SBA clarifies:

PPLs **must** be used to refinance the full amount of an EIDL when the PPL borrower –
- Received EIDL funds from January 31, 2020 through April 3, 2020; and
- Used the EIDL funds to pay payroll costs.

PPLs **may** be refinanced – but are not required to be – when the PPL borrower –
- Received EIDL funds from January 31, 2020 through April 3, 2020; and
- Used the EIDL funds for purposes other than payroll costs.

The amount to be refinanced does not include any EIDL advance taken by the borrower.

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

**Calculating Maximum Loan 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; plus

- 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, **at least 60% of PPL proceeds must be used for “payroll costs”** (this requirement is separate from and in addition to the forgiveness eligibility requirements discussed below).

Payroll costs, as defined in the rules:

**Include** (paid by the employer on a gross basis):

- individual employee cash 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 vision and dental benefits), including insurance premiums and contributions to self-insured plans;

- 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 cash 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 40% 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

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 June 17, 2020, SBA issued an updated standard PPL forgiveness application (Form 3508) and related instructions that reflect changes in the law made by the PPP Flexibility Act of 2020. SBA also released a two-page streamlined forgiveness application (Form 3508EZ) requiring fewer calculations and accompanying documents for certain borrowers who can, for instance, make certifications regarding maintaining employees and salaries over a prescribed period and/or having business activity decline due to COVID-19-related federal requirements. Details about eligibility for the streamlined forgiveness application can be found here: https://home.treasury.gov/system/files/136/PPP-Loan-Forgiveness-Application-Form-EZ-Instructions.pdf. SBA also put out a final rule referencing “lender equivalent” forgiveness applications, suggesting that some lenders may develop their own documents and requirements (no further detail has been provided by SBA).

More recently, on October 8, 2020, SBA released an even simpler, more streamlined application (Form 3508S) for borrowers who received $50,000 or less (as long as the borrower did not, together with affiliates, receive $2 million or more). Eligibility details and application instructions can be accessed here: https://home.treasury.gov/system/files/136/PPP-Loan-Forgiveness-Application-Form-3508S-Instructions.pdf. Notably, pursuant to an interim final rule published on October 19, 2020, borrowers who use Form 3508S are exempt from penalties on forgiveness amounts for reductions in full-time equivalent employees or in salaries/wages (discussed in more detail below). These borrowers also are not required to show the calculations they use to determine their forgiveness amount, but the SBA may request further information or documents as part of its loan review process.

SBA intends to continue publishing additional rules and guidance to implement the forgiveness provisions in the program. Notably, loan forgiveness assessments will be based on rules/guidance in place on the date of your forgiveness application, so it is important to stay apprised of any regulatory developments.
Finally, as noted above, the Paycheck Protection Program Flexibility Act extended deferral of all principal, interest, and fee payments on loans to the date on which forgiveness amounts are remitted by SBA to the lender (or the lender is notified by SBA that forgiveness is not allowed) or until 10 months after the end of the 24-week forgiveness period if the borrower has not applied for forgiveness by then. This statutory change overrides any loan document terms that may reference the older/original deferral period of six months.

**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, however, may elect to keep the original eight-week forgiveness period.

**Under the PPP Flexibility Act, to receive loan forgiveness, borrowers must spend at least 60% of PPL dollars on payroll costs.** The SBA has interpreted that requirement as a proportional limit on non-payroll costs’ share of the borrower’s forgiveness amount, so borrowers who do not spend at least 60% on payroll still will be eligible for some forgiveness. The SBA provides the following example on how the proportional calculation will be made:

> [I]f a borrower receives a $100,000 PPP loan, and during the [forgiveness] period the borrower spends $54,000 (or 54%) of its loan on payroll costs, then because the borrower used less than 60% of its loan on payroll costs, the maximum amount of loan forgiveness the borrower may receive is $90,000 (with $54,000 in payroll costs constituting 60% of the forgiveness amount and $36,000 in nonpayroll costs constituting 40% of the forgiveness amount).

**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 annualized rate cap).

Additionally, “interest on mortgage obligations” includes interest on business mortgages on real or personal property (e.g., an auto loan). Although a permissible use of PPL dollars, interest on unsecured credit is not eligible for loan forgiveness.

The forgiveness applications and SBA rules provide some clarification on 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. For payroll costs incurred during the last pay period within the forgiveness period, borrowers are permitted to pay them on or before the next regular payroll date (even if that is outside of the forgiveness period) and still receive forgiveness. For non-payroll expenses (mortgage interest, rent, and utilities), those may be forgiven if they are (1) paid during the forgiveness period; or (2) incurred during the forgiveness period and paid on or before the next regular billing date, even if that is outside of the forgiveness period.

**More on the Forgiveness Period**

The forgiveness applications provide some limited flexibility in the eight-week and 24-week forgiveness periods only for purposes of evaluating eligible payroll expenses, full-time equivalent employee calculations, and salary reduction determinations. Specifically, borrowers who pay employees **biweekly or more frequently** may elect to calculate these items using the eight-week or 24-week period beginning on the first day of the first pay period following the loan disbursement date (the “Alternative Payroll Covered 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 Owners & Self-Employed Individuals**

The following rules apply for determining forgivable “payroll costs” for owner-employees/sole proprietors, self-employed individuals, and general partners:

- For an eight-week forgiveness period, cash compensation is capped at 8/52 of 2019 compensation up to $15,385; and
- For a 24-week forgiveness period, cash compensation is capped at 2.5 months of 2019 compensation up to $20,833.

Note that these rules do **not** apply to owner-employees in a C- or S-Corporation who have less than a 5% ownership stake (these individuals are treated like other employees of the business).

SBA rules provide the following detail on what “compensation” should be counted for different types of individuals:

- C-corporation owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement and health insurance contributions made on their behalf.
- S-corporation owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement contributions made on their behalf, but employer health insurance contributions made on their behalf cannot be separately added because those payments are already included in their employee cash compensation.
- Schedule C or F filers are capped by the amount of their owner compensation replacement, calculated based on 2019 net profit (as described above), and do not include retirement or health contributions.
General partners are capped by the amount of their 2019 net earnings from self-employment (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235, and do not include retirement or health contributions.

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

**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.

As noted above, these penalties do not apply to borrowers who use Form 3508S. Borrowers who are subject to these penalties 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).

**Safe Harbors/Exemptions from Forgiveness Amount Penalties**

There are some exemptions under which borrowers’ forgiveness amounts will not be reduced, even if employee counts or salaries/wages decline during the forgiveness period. 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 certain federal COVID-19-related safety guidance or requirements (e.g., sanitation standards, social distancing, worker safety requirements, etc.).
SBA has interpreted these statutory safe harbors and related documentation requirements as follows:

- **Inability to rehire by December 31, 2020** – Borrowers should maintain documentation showing the written offer to rehire, a written record of the offer’s rejection, and a written record of efforts to hire a similarly qualified individual.

- **Inability to return to the same level of business** – The exemption is interpreted to include both direct and indirect compliance with federal COVID Requirements or Guidance, and because a significant amount of the reduction in business activity stemming from COVID Requirements or Guidance is the result of state and local government shutdown orders that are based in part on guidance from the three federal agencies, reductions in business levels due to state/local orders will count for purposes of this exemption; documentation must include copies of applicable COVID Requirements or Guidance for each business location and relevant borrower financial records.

Under SBA rules, to take advantage of either Flexibility Act safe harbor above, borrowers must inform the applicable state unemployment office of the employee’s rejection of the rehire offer.

Additionally, by rule, SBA will *not* reduce a borrower’s forgiveness amount if the borrower reduces the hours of an employee, offers to restore the reduction in hours, but the employee declines the offer. This exemption applies if:

- The borrower made a good faith, written offer to restore the reduced hours of such employee;
- The offer was for the same salary or wages and same number of hours as earned by such employee in the last pay period prior to the reduction in hours;
- The offer was rejected by such employee; and
- The borrower has maintained records documenting the offer and its rejection.

The SBA forgiveness application and rules also exclude from the FTEE reduction penalty employees who, during the forgiveness 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.

In all of these safe harbor/exemption cases, you exclude the employee from the FTEE reduction headcount, so under the pre-crisis and forgiveness period comparison calculation, the borrower does not trigger a penalty for that particular employee.

### 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 in an eight-week forgiveness period context –

- 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 forgiveness 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 forgiveness period. There is no change in the employee’s hourly wage, so the entire salary
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”).

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 extended “rehire” relief.

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

The Forgiveness Application Process

To receive loan forgiveness, you must submit either the simplified or regular forgiveness application (or “lender equivalent”) to the lender servicing your loan along with documentation. With both applications, borrowers must submit documents substantiating forgivable payroll, mortgage interest, rent, and utility costs incurred and paid during the forgiveness period. Non-streamlined forgiveness applicants must submit additional documentation on FTEE numbers. Both applications also require borrower certifications and substantial recordkeeping and document retention requirements. These requirements are described in detail in the application instructions.

The proper timing to apply for forgiveness is an open question, we think, particularly for borrowers who elect the longer 24-week forgiveness period but exhaust their loan dollars well before the forgiveness period ends. SBA FAQs say that borrowers may submit a forgiveness application any time before the maturity date of the loan (two or five years from loan origination) and another SBA rule states in passing that borrowers may submit forgiveness applications before the end of the forgiveness period if the borrower has used all of the loan proceeds for which it seeks forgiveness. But certain statutory provisions (and requirements within the SBA’s own rules and applications) require reductions in forgiveness amounts for decreases in FTEEs and salaries/wages during the forgiveness period (not, for instance, until loan dollars are spent), and related documentation requirements also cover the entire forgiveness period.

SBA rules suggest that, even if a borrower applies for forgiveness before the end of the forgiveness period, forgiveness amount penalties will still apply for the duration of the forgiveness period. SBA provides the following examples:

- A borrower is using a 24-week covered period. This borrower reduced a full-time employee’s weekly salary from $1,000 per week during the reference period to $700 per week during the covered period. The employee continued to work on a full-time basis during the covered period, with an FTE of 1.0. In this case, the first $250 (25% of $1,000) is exempted from the loan forgiveness reduction. The borrower seeking forgiveness would list $1,200 as the salary/hourly wage reduction for that employee (the extra $50 weekly
reduction multiplied by 24 weeks). If the borrower applies for forgiveness before the end of the covered period, it must account for the salary reduction for the full 24-week covered period (totaling $1,200).

- A borrower that received a PPP loan before June 5, 2020 has elected to use an eight-week covered period. This borrower reduced a full-time employee’s weekly salary from $1,000 per week during the reference period to $700 per week during the covered period. The employee continued to work on a full-time basis during the covered period, with an FTE of 1.0. In this case, the first $250 (25% of $1,000) is exempted from the loan forgiveness reduction. The borrower seeking forgiveness would list $400 as the salary/hourly wage reduction for that employee (the extra $50 weekly reduction multiplied by eight weeks).

SBA rules are silent, so far, on FTEE reductions and documentation requirements for borrowers who seek forgiveness before the forgiveness period expires.

**Lender Forgiveness Determinations**
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 receipt of a complete application and required documentation, and 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.

**SBA Discretionary Reviews of PPL and/or Forgiveness Eligibility**
By law, SBA has 90 days after a lender’s forgiveness determination to review the decision and to remit any forgiveness amount due to the lender. But SBA has broadly reserved the right to review any PPP loan of any size before or after a lender’s determination. SBA will 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. A lender may not approve any forgiveness application while an SBA review is ongoing.

If questions arise about a borrower’s loan or forgiveness eligibility, the borrower will have an opportunity to respond and 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 to the SBA Office of Hearings and Appeals (OHA). Such an appeal does not extend the deferral period for payment of unforgiven amounts on a PPL. Only certain “final SBA review decisions” are appealable:

- Ineligible for a PPP loan;
- Ineligible for the PPP loan amount received or used the PPP loan proceeds for unauthorized uses;
- Ineligible for PPP loan forgiveness in the amount determined by the lender in its full approval or partial approval decision issued to SBA (except for the deduction of any Economic Injury Disaster Loan advance in accordance with section 1110(e)(6) of the CARES Act); and/or
- Ineligible for PPP loan forgiveness in any amount when the lender has issued a full denial decision to SBA.

Note that if SBA remits a forgiveness amount that matches the lender’s forgiveness determination, the borrower may not appeal to OHA.

OHA appeals must be filed with 30 calendar days of the earlier of: borrower receipt of the final SBA loan review decision or notification by the lender of the SBA’s decision. Other formal rules and processes for OHA appeals, including requirements for the appeal petition, are set forth in 13 CFR 134.1202 – 134.1217.

Both forgiveness applications require 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.

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

Although the PPP Flexibility Act extended federal 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: November 9, 2020**