

SBA and Treasury Issue PPP Loan Forgiveness Application – Many Technical Questions are Resolved but Additional Guidance is Needed

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Under the Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act), Congress created the Paycheck Protection Program (PPP) to provide forgivable loans to eligible small businesses to keep American workers on the payroll during the COVID-19 pandemic. On May 15, 2020, the Small Business Administration (SBA), in consultation with the Department of the Treasury, released the [PPP Loan Forgiveness Application \(Forgiveness Application\)](#) with detailed instructions (SBA Form 3508).

Under the new procedures and guidelines, a borrower must request the forgiveness of PPP loan proceeds by filing the Forgiveness Application. The application has four components: (1) a PPP Loan Forgiveness Calculation Form; (2) a PPP Schedule A; (3) a PPP Schedule A Worksheet; and (4) an (optional) PPP Borrower Demographic Information Form. Notably, the Forgiveness Application and its instructions direct borrowers to work with their lenders to complete the Forgiveness Application. Once completed, borrowers are required to submit to their lender items (1) the PPP Loan Forgiveness Calculation Form, and (2) the PPP Schedule A.

Interestingly, the Forgiveness Application simply asks a borrower to report how much payroll, rent, and other eligible expenses that the borrower has paid or incurred and does not ask for any documentation to show that the borrower actually used the PPP loan proceeds for those or other permissible purposes. However, the Forgiveness Application does require that the borrower (or its representative) certify that “the dollar amount for which forgiveness is requested” was, among other things, used to pay costs eligible for forgiveness, and ultimately places the responsibility for making the forgiveness determination with the lender. The fact that the lender is ultimately responsible for making the forgiveness determination underscores the need for close collaboration between the borrower applying for forgiveness of its PPP loan and its lender.

For borrowers who, along with their affiliates, received aggregate PPP funds in excess of US\$2 million, the Forgiveness Application requires that the borrower check a box alerting the SBA to the size of the aggregate loan. This provision flags PPP loans that the Treasury Department has already warned it will audit. Notably, however, the form’s instructions specifically limit the obligation to check this flag-raising box to loans aggregated with affiliates “to the extent required under SBA’s interim final rule on affiliates issued April 15, 2020.” That means that borrowers will still have to interpret the meaning of the affiliation rules to determine whether to check the box.

The Forgiveness Application and the accompanying step-by-step instructions on how to perform the calculations required by the CARES Act to confirm eligibility for loan forgiveness, appear to resolve or clarify a number of longstanding questions and issues including the following.

1. With respect to payroll costs, the Forgiveness Application includes options for borrowers to calculate payroll costs using the Alternative Payroll Covered Period (Covered Period) referenced in the application that aligns with borrowers’ regular payroll cycles. Specifically, borrowers with a bi-weekly (or more frequent) payroll schedule may elect to calculate eligible payroll costs using the eight-week (56-day) period that begins on the first day of their first pay period following their PPP loan disbursement date.
2. Also with respect to payroll costs, the Forgiveness Application effectively resolves the CARES Act requirement that only “costs incurred and payments made” within the eight-week period may be forgiven. Specifically, borrowers are generally eligible for forgiveness for the payroll costs paid and payroll costs incurred during the eight-week (56-day) Covered Period. Payroll costs are considered paid on the day that paychecks are distributed or the borrower initiates an ACH credit transaction. Payroll costs are considered incurred on the day that the employee’s pay is earned. Payroll costs incurred but not paid during the borrower’s last pay period of the Covered Period are eligible for forgiveness if paid on or before the next regular payroll date. Otherwise, payroll costs must be paid during the Covered Period.
3. The Forgiveness Application clarifies how full-time equivalents (FTEs), a term not defined in the CARES Act, are to be calculated for forgiveness purposes. While the typical calculation of an FTE is an employee’s scheduled paid hours divided by the employer’s hours for a full-time workweek, the application allows the borrower to calculate FTE by dividing hours worked by 40, or use a simplified calculation under the SBA rules that treat all employees (full time, part-time, temporary or employed on any other basis) equally – a person over 40 hours counts as 1 FTE, and person under 40 hours counts as 0.5 FTE.
4. The Forgiveness Application clarifies how the “proportionate” reduction requirement works for aggregate forgiveness reduced by individual salary reductions – specifically, if a borrower reduces an employee’s salary by more than 25%, whether the forgiveness reduction is proportional to the total reduction, or only to the reduction below the 75% threshold. Under the instructions, the borrower would calculate the “pre-crisis” average wage for the given employee and multiply that figure by 75%. Then, it would calculate the “covered period” average wage for that person. If that figure is less than the “75% of pre-crisis” average, the difference – the amount the borrower reduced below the 75% level, extrapolated to eight weeks – gets subtracted from forgiveness.

5. Also relative to salary reductions, the application and instructions also resolve confusion arising under the CARES Act requirement to compare salary totals over the covered period to the total for Q1, which is a period of a different length. The application form directs that averages, instead of the total, be used.
6. Finally, the Forgiveness Application includes a borrower-friendly implementation of statutory exemptions from loan forgiveness reduction, based on rehiring by June 30, and adds a new exemption from the loan forgiveness reduction for borrowers who have made a good-faith, written offer to re-hire workers that was declined.

Unsurprisingly, there remain issues of uncertainty for which guidance is necessary. These issues include the following.

Are Payments Made with Forgiven Funds Deductible?

Section 1106 of the CARES Act states that amounts forgiven on a PPP loan “shall be excluded from gross income.” But, Section 265 of the Internal Revenue Code provides that expenses “allocable to” tax-exempt income are not deductible; this prevents a “double dipping” of sorts, whereby a taxpayer would otherwise get both a deduction and tax-exempt income related to the same transaction or investment. Historically, Section 265 has applied to items such as interest expense incurred to generate tax-exempt interest income. On April 23, 2020, the IRS released guidance stating that since the CARES Act does not specifically provide otherwise, expenses related to forgivable loans through the PPP will not be recognized as tax-deductible. As things stand, the IRS’ position is clear and will prevail without further congressional action (notwithstanding that IRS’ position seems to be inconsistent with congressional intent).

Do Bonuses or Increases in Compensation Count as Payroll Costs?

Both the amount of a PPP loan and the loan forgiveness provisions are based in principal part upon the employer’s “payroll costs.” As defined in the CARES Act, “payroll costs” include “the sum of payments of any compensation with respect to employees that is salary, wage, commission, or similar compensation.” Many employers have been considering paying furloughed employees a bonus, or increasing salary levels to incentivize them to forgo their unemployment benefits, and return to employment during the period between the start of the Covered Period and the time the employer’s business becomes operational again. Bonuses are usually considered wages, and the bonuses that companies pay employees in these circumstances would probably count as wages for tax purposes.

But, there is a clause in Section 4116 of the CARES Act (unrelated to the PPP) that refers to “salaries” and “bonuses” separately, while the PPP provisions do not mention bonuses. Perhaps this difference in language suggests that bonuses are not considered “payroll costs” for PPP purposes. SBA has aggressively asserted its authority to interpret the PPP provisions thus far, but how it will interpret “payroll costs” with respect to bonuses remains unclear.

As these and other areas of forgiveness under the PPP remain unresolved, we expect that the SBA will soon issue regulations and guidance to further help borrowers complete their Forgiveness Applications and lenders on their responsibilities, and will monitor and provide analysis on any pertinent developments. Please contact us with any questions.

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