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# Approaching the Finish Line: PPP Forgiveness

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If, like most sensible people, you took a month or so off from thinking about PPP loans after the Paycheck Protection Program Flexibility Act was passed in June, and now you're waking up in the middle of the night worrying about loan forgiveness, you can relax. We're heading into the home stretch. And, except for a little math – actually, a lot of math – everything should work out, hopefully . . .

The nice thing about math, of course, is that its not supposed to change. One plus one is always supposed to equal two. However, introduce politics and you get pushed from the realm of pure mathematics into theoretical mathematics. There you have the Treasury Secretary, testifying on September 1st about another coronavirus relief package, saying that Congress should aim for a stand-alone bill to expand the Paycheck Protection Program because its something both sides can agree on.

What then follows are multiple bills defeated for a multiplicity of reasons that would, for example, have made such changes as the following:

- Allow smaller businesses to apply for a second PPP loan if they meet certain criteria, e.g., a 50% drop in year-over-year quarterly receipts in one bill or 35% in another.
- Provide a simplified forgiveness process for PPP borrowers receiving loans of \$150,000 or less.

It's unclear whether the results will change as the election gets nearer. But, for now, we'll put our stake in the ground and outline the rules as we presently know them.

## **The Basic Paradigm**

A PPP loan can be forgiven in whole or in part to the extent the loan proceeds are spent on “forgivable costs” during the applicable 24-week period (or 8-week period, if elected) following the loan funding date. Forgivable costs consist of a

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combination of payroll costs, interest on collateralized debt, lease or rent obligations, and utility costs. No more than 40% of the costs counting toward the forgiveness amount may be spent on non-payroll costs.

The payroll and non-payroll costs for the applicable 24-week (or 8-week) period represent a preliminary forgiveness amount that may be reduced if the employer reduced employee pay for individual employees by more than 25% or if the employer reduced the number of full-time equivalent employees (FTEs) during the applicable 24-week (or 8-week) period. Once the preliminary forgiveness amount is reduced for compensation reductions and/or FTE reductions, the resulting amount is tested to ensure that allowable payroll costs comprise at least 60% of the forgiveness amount. If they do not, the forgiveness amount is adjusted to ensure that payroll costs comprise at least 60% of the forgiveness amount.

There are two versions of the PPP loan forgiveness application. Form 3508 is the basic form. Form 3508EZ is an abbreviated form that can be used by borrowers that meet certain criteria noted in the instructions. Form 3508EZ is generally available for self-employed individuals, independent contractors and sole proprietors with no employees, and borrowers who are not subject to any reduction in their loan forgiveness amount.

### **You Mean There is Potentially More than One Covered Period?**

The loan proceeds must be spent during the period beginning on the date that the borrower received the PPP loan proceeds (the “Funding Date”) and ending on the date that is 24 weeks later or December 31, 2020, if earlier. This 24-week period is referred to as the “Covered Period.” Borrowers who obtained loans prior to June 5, 2020, may elect an 8-week period beginning on the Funding Date as their Covered Period. A borrower with payroll periods that are at least bi-weekly in frequency is permitted to elect an “Alternative Payroll Covered Period” that begins on the first day of the borrower’s first payroll period beginning after the Funding Date.

Borrowers who elect to use the Alternative Payroll Covered Period must apply the Alternative Payroll Covered Period wherever there is a reference in the application to “the Covered Period or the Alternative Payroll Covered Period.” However, borrowers must apply the Covered Period, and not the Alternative Payroll Covered Period, wherever there is a reference in the application only to “the Covered Period.” More on that later . . .

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## **Deciphering Payroll Costs**

The amount of payroll costs for the Covered Period or the Alternative Payroll Covered Period, whichever is applicable, is limited to employees whose principal place of residence is in the United States and includes the following:

- Cash compensation;
- Employer-paid group health care benefits;
- Employer-paid retirement benefits; and
- Employer-paid state and local taxes on employee compensation (e.g., unemployment taxes).

Payroll costs paid or incurred during the Covered Period or the Alternative Payroll Covered Period, whichever is applicable, count as forgivable costs. Payroll costs incurred but not paid during that period are also counted, as long as the amount incurred through the end of the period is paid by the next regular payroll date.

Employee health care and retirement plan costs paid by the borrower during the Covered Period or the Alternative Payroll Covered Period, whichever is applicable, appear to count as forgivable costs regardless of whether or not the payments relate to employee services provided during that period.

Cash compensation means gross wages before deducting employee deferrals such as 401(k) or 403(b) contributions, health insurance premiums, etc., but not more than \$46,154 per employee for the Covered Period or the Alternative Payroll Covered Period, whichever is applicable. The limit of \$46,154 represents the annual compensation limit of \$100,000 prorated for the 24-week period. The limit would be \$15,385 for borrowers who elect an 8-week Covered Period. Cash compensation does not include emergency sick leave or emergency family leave payments that qualify for a credit under the Families First Coronavirus Response Act.

Back in June, the SBA issued a rule which limited the forgiveness of owner compensation to either eight weeks' worth (8/52) of 2019 net profits (up to \$15,385) for an eight-week covered period or 2.5 months' worth (2.5/12) of 2019 net profit (up to \$20,833) for a 24-week covered period per owner in total across all businesses. Later on, the SBA created an exception indicating that owner-employees with less than a 5 percent ownership stake in a C- or S-Corporation are not subject to the owner-employee compensation rule.

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## **The “Other” Forgivable Costs**

The other forgivable costs include interest on collateralized debt, lease or rent obligations, and utility costs. These amounts may not be more than 40% of the total forgiveness amount. However, borrowers are not required to include costs in the forgiveness application that they do not wish to be considered in the forgiveness calculation.

Interest costs are limited to payments of interest (not principal) on business real estate mortgages and other collateralized business loans paid or incurred during the Covered Period. The Alternative Payroll Covered Period does not apply to these interest payments. The debts on which the interest payments are made must have been incurred before February 15, 2020, in order for the interest costs to be counted as forgivable costs. Prepayments of interest are not forgivable costs. Mortgage interest payments to a related party are also not eligible for forgiveness.

Business lease or rent payments on real or personal property are forgivable costs as long as the rent or lease obligations were incurred before February 15, 2020. The business lease or rent obligations must be paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date, even if the billing date is after the Covered Period. Again, the Alternative Payroll Covered Period does not apply to business lease or rent payments.

Rent payments made to a related party are eligible for forgiveness as long as:

- The amount of loan forgiveness requested for rent or lease payments to a related party is no more than the amount of mortgage interest owed on the property during the covered period that is attributable to the space being rented by the business, and
- The lease and the mortgage were entered into prior to February 15, 2020.

The related party itself, of course, is not eligible to request loan forgiveness for these same amounts. Any ownership in common between the business and the property owner is a related party for these purposes.

Utility costs include payments for the distribution of electricity, gas, water, telephone, or internet access that began before February 15, 2020. Utility costs must be paid during the Covered Period or incurred during the Covered Period

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and paid on or before the next regular billing date, even if the billing date is after the Covered Period. The Alternative Payroll Covered Period does not apply to utility costs.

The amount of loan forgiveness requested for nonpayroll costs may not include any amount attributable to the business operation of a tenant or subtenant of the PPP borrower or, for home-based businesses, household expenses.

**Example:** A borrower rents an office building for \$10,000 per month and subleases out a portion of the space to other businesses for \$2,500 per month. Only \$7,500 per month is eligible for loan forgiveness.

**Example:** A borrower has a mortgage on an office building it operates out of, and it leases out a portion of the space to other businesses. The portion of mortgage interest that is eligible for loan forgiveness is limited to the percent of the fair market value of the space that is not leased out to other businesses. If the leased space represents 25 percent of the fair market value of the office building, then the borrower may only claim forgiveness on 75 percent of the mortgage interest.

When determining the amount that is eligible for loan forgiveness, a borrower who shares a rented space with another business must prorate rent and utility payments in the same manner as on the borrower's 2019 tax filings, or if a new business, the borrower's expected 2020 tax filings.

## **Wage Reduction**

So much for the “good” news. Now the bad news. After going through all of the effort to calculate the amount of the loan that is forgivable, the result can be reduced due to either a reduction in wages or a reduction in full-time employees. The reduction for wages is intended to reduce the loan forgiveness amount by the amount that compensation for any employee is reduced by more than 25%. If an employer has not reduced the salary or hourly wage for any of its employees by more than 25% during the Covered Period or the Alternative Payroll Covered Period, whichever is applicable, as compared to the period from January 1, 2020, through March 31, 2020, the adjustment for a reduction in wages will not apply.

The first step of this analysis is to determine for each employee whether his/her average annual salary or hourly wage decreased by more than 25% during the Covered Period or the Alternative Payroll Covered Period, whichever is

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applicable, as compared to the period of January 1, 2020, through March 31, 2020. Any employee whose annual salary or hourly wage was not reduced by more than 25% is not included in the wage reduction calculation. You also don't include any employee whose employment terminated or whose work hours were reduced. This is because the FTE reduction element is intended to address the implications of reducing the workforce. Lastly, any employees who received compensation for any pay period in 2019 that, if annualized, would equal more than \$100,000 are not included.

The next step is the "Salary/Hourly Wage Reduction Safe Harbor." If an employee's average annual salary or hourly wage was reduced by more than 25% during the period beginning after February 15, 2020, and ending on or before April 26, 2020, as compared to his/her salary or hourly wage as of February 15, 2020, and if his/her salary or hourly wage as of December 31, 2020 (or the date of the forgiveness application, if earlier) is equal to or greater than his/her salary or hourly wage as of February 15, 2020, then the Salary/Hourly Wage Reduction Safe Harbor is met for that employee and that employee is not included in the wage reduction calculation.

The third step involves calculating the actual reduction in loan forgiveness on a per-employee basis for any employee whose annual salary or hourly wage was found in Step 1 to have been reduced by more than 25%, and for whom the Salary/Hourly Wage Reduction Safe Harbor in Step 2 is not met. In general, this calculation is done as follows:

- ` . Determine the employee's average hourly wage for the period January 1 through March 31, 2020.
- ` . Determine the employee's average hourly wage for the Covered Period or the Alternative Payroll Covered Period, whichever is applicable.
- ` . Take 25% of (a), and then subtract (b).
- ` . Multiply the result in (c) by the average number of hours per week that the employee worked during the period from January 1 through March 31, 2020.
- ` . Multiply the result in (d) by 24 (assuming a 24-week Covered Period).
- ` . Add together the result in (e) for all of the affected employees and that is the amount by which the borrower's loan forgiveness is reduced.

The calculation for a salaried employee is similar, except the amount in (d) has to be divided by 52 before multiplying it by 24 in (e) due to the fact that salaries are,

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of course, based on annual amounts.

## **FTE Reduction**

Well, if the wage reduction hasn't gotten you flummoxed, then it's on to the FTE reduction! The FTE reduction is intended to reduce the potential loan forgiveness amount for employers whose workforce was reduced during the Covered Period or the Alternative Payroll Covered Period, whichever is applicable. In short, if a borrower has not reduced the number of employees or the average paid hours of its employees during the period between January 1, 2020, and the end of the Alternative Payroll Covered Period, whichever is applicable, then the FTE reduction does not apply. Although it is not explicitly stated in the instructions, it seems implicit that if a borrower submits a forgiveness application prior to the end of its Covered Period, and at the time of the application, the borrower has not reduced its FTE count or the borrower has restored its FTE count, then any subsequent FTE reductions that the borrower may initiate prior to the end of its Covered Period are ignored.

There are two other exceptions to the FTE reduction:

- The reduction does not apply to Borrowers who document that they have an "inability" to return during the Covered Period to the same level of business activity at which they were operating before February 15, 2020, due to compliance with requirements established or guidance issued by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration during the period beginning on March 1, 2020, and ending December 31, 2020, related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19.
- The reduction does not apply if the borrower reduced its FTE count during the period beginning after February 15, 2020, and ending on or before April 26, 2020, to a count lower than its FTE count in the pay period that includes February 15, 2020, and the borrower then restored its FTE employee count as of December 31, 2020 (or its application date, if earlier), to its FTE employee count in the borrower's pay period that included February 15, 2020.

If you haven't passed "go" with any of these exceptions, then you start

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calculating the potential reduction by determining the average number of FTEs on the payroll for the Covered Period or the Alternative Payroll Covered Period, whichever is applicable. For each employee, the first step is to take the average number of hours paid per week during the aforesaid period, and divide the result by 40. The maximum for any employee is 1. A simplified method is permitted that assigns a 1 for employees who work 40 hours or more per week and 0.5 for employees who work fewer hours. If the simplified method is used, it must be applied to all employees for all periods.

The second step is to determine the average FTEs during the “Reference Period” using the same methodology as described above. All borrowers are permitted to choose as their Reference Period either February 15, 2019, through June 30, 2019, or January 1, 2020, through February 29, 2020. In lieu of either of the foregoing periods, seasonal employers are allowed to choose as a Reference Period any consecutive 12-week period from May 1, 2019, through September 15, 2019.

There are two situations where the FTE number for an employee in the first step is adjusted to match the FTE number for the employee in Reference Period:

- For any employee who was fired for cause, voluntarily resigned, or voluntarily requested and received a reduction in work hours, that employee’s FTE count for the Covered Period or the Alternative Payroll Covered Period, whichever is applicable, is adjusted to match that employee’s FTE count for the Reference Period unless the employee’s position was filled by a new employee. This basically means that reductions in FTE counts resulting from these events will not adversely affect a borrower’s loan forgiveness amount.
- For any employee whose employment terminated or whose work hours were reduced prior to the end of the Covered Period or the Alternative Payroll Covered Period, whichever is applicable, and to whom the borrower made a good-faith, written offer to rehire or restore work hours during that period (at the same level of pay), and where the employee rejected the offer, then that employee’s FTE count is adjusted to match that employee’s FTE count for the Reference Period unless the employee’s position was filled by a new employee. Once again, reductions in FTE counts resulting from these events will not adversely affect a borrower’s loan forgiveness amount. The employer is required to maintain records documenting the offer and its rejection, and to notify the applicable state



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unemployment insurance office of the employee's rejection of the offer within 30 days of the rejection.

Finally, the last step is to divide the average FTE number obtained in the first step outlined above by the average FTE number for the Reference Period determined in the second step. The result of this calculation is the FTE reduction percentage.

As you can see, the wage reduction is a dollar amount reduction of the potential loan forgiveness amount, whereas the FTE reduction is a percentage amount, i.e., the potential loan forgiveness amount is multiplied by a percentage representing the ratio (not more than 1.0) of average FTEs during the Covered Period or the Alternative Payroll Covered Period, whichever is applicable, to the average FTEs during the selected Reference Period. Once the preliminary forgiveness amount is reduced for wage reductions and/or FTE reductions, the resulting "potential" forgiveness amount is tested to ensure that payroll costs constitute at least 60% of the forgiveness amount. Whew!

### **Begging for Forgiveness**

Borrowers may apply for forgiveness at any time, even if it's before the end of their Covered Period or the Alternative Payroll Covered Period, whichever is applicable. However, Borrowers who have employee pay reductions in excess of 25% or FTE reductions as of the date of they file their application will not have the opportunity to use the safe harbor exemptions by restoring pay levels or FTE levels subsequent to filing their application. Moreover, if a borrower applies prior to the end of its Covered Period or the Alternative Payroll Covered Period, whichever is applicable, and the borrower has employee pay reductions in excess of 25% as of the date it files its application, then it must calculate the loan forgiveness amount by applying the excess salary reduction to the entire 24-week or 8-week covered period.

Once a forgiveness application is filed, the lender is required to make a decision within 60 days and communicate that decision to the SBA. The SBA generally has 90 days from the date it is notified to make payment to the lender for the forgiveness amount. The SBA can review any forgiveness application at any time for any reason. The lender and/or the SBA may ask the borrower for additional information in the review process. There is an appeal process for borrowers who disagree with the conclusions reached by their lender and/or the SBA.

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The borrower must retain all records relating to the borrower's PPP loan, including documentation submitted with its PPP loan application, documentation supporting the borrower's certifications as to the necessity of the loan request and its eligibility for a PPP loan, documentation necessary to support the borrower's loan forgiveness application, and documentation demonstrating the borrower's material compliance with PPP requirements in its files for six years after the date the loan is forgiven or repaid in full, and permit authorized representatives of the SBA, including representatives of its Office of Inspector General, to access those files upon request.

### **What? There's More!**

The SBA will review all forgiveness applications for loans in excess of \$2 million both for eligibility to obtain a PPP loan and for accuracy of the forgiveness application. Generally speaking, if the SBA determines that a borrower was not eligible to receive a PPP loan, the borrower will not qualify for forgiveness and will be required to repay the loan, with interest, by its maturity date.

The SBA it will deem borrowers of loan amounts less than \$2 million to have validly made their good-faith certifications that their loans were necessary due to the economic uncertainty that was current at the time of the application's submission. However, the SBA may still review the forgiveness applications for borrowers with loans of less than \$2 million for matters other than loan eligibility.

On September 1, 2020, the majority staff of the House Select Subcommittee on the Coronavirus Crisis issued a memorandum to the members of the subcommittee providing a "preliminary" analysis of the Paycheck Protection Program. According to the memorandum, "The analysis shows PPP helped millions of small businesses and non-profit organizations stay afloat during the coronavirus crisis, but a lack of oversight and accountability from the Treasury Department and Small Business Administration (SBA) may have led to billions of dollars being diverted to fraud, waste, and abuse, rather than reaching small businesses truly in need."

The memorandum identified the following specific problems:

- Over \$1 billion in loans went to companies that received multiple loans.
- More than 600 loans totaling over \$96 million went to companies excluded from doing business with the government.

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- More than 350 loans worth \$195 million went to government contractors with significant performance and integrity issues.
  - The federal government's System for Award Management (SAM) database raised red flags for \$2.98 billion in loans to more than 11,000 PPP borrowers.
  - SBA and Treasury approved hundreds of loan applications missing key identifying information about the borrower.

The concern, of course, is that these abuses by the few (if you can call it that . . . ) will poison the well for the many and make processing forgiveness applications that much harder. Time will tell . . .