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SBA releases PPP Loan Forgiveness Application - Key takeaways from Hinckley Allen

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On May 15th, the Small Business Administration (SBA) released the much-awaited Paycheck Protection Program (PPP) loan forgiveness application and instructions (SBA Form 3508). While the 11-page SBA Form 3508 provides answers to several key questions that were previously troubling borrowers, it also confirms that the calculation of loan forgiveness amounts and, in particular, if and how much of a reduction in forgiveness there will be as a result of reductions in headcount or compensation, will not be an easy task for borrowers.

Key components of SBA Form 3508 and takeaways for borrowers are summarized below.

Components of SBA Form 3508

SBA Form 3508 consists of four components: (1) the PPP Loan Forgiveness Calculation Form; (2) PPP Schedule A (for calculating the overall amounts to be entered in the PPP Loan Forgiveness Calculation Form); (3) the PPP Schedule A Worksheet (for the detailed calculations and information to be populated in PPP Schedule A); and (4) the (optional) PPP Borrower Demographic Information Form.

A borrower is only required to submit (1) and (2) to its lender, together with supporting documentation referenced below under “Supporting Documentation and Recordkeeping Requirements.”

Use of 75% of PPP Loan Proceeds on Payroll Costs

In addition to providing that not more than 25% of a PPP loan forgiveness amount can be attributable to non-payroll costs, prior SBA rules stated that borrowers must use at least 75% of PPP proceeds on payroll costs. For borrowers that could not satisfy this affirmative covenant (for example, because their current payroll costs were less than the amount determined based upon the SBA formula for determining their PPP loan amount), there has been an open question as to whether they will be eligible for forgiveness at all. SBA Form 3508 seems to indicate that the answer is “yes.” The SBA Form 3508 instructions do not include a test as to whether at least 75% of total PPP loan proceeds were actually expended on payroll costs; rather, they include a test to determine whether at least 75% of the forgiveness amount was used for payroll costs.

Mis-match Between Payroll and Billing Cycles vs. the 8-Week Covered Period

The CARES Act states that costs incurred and payments made during the 8-week period following PPP loan disbursement (the “Covered Period”) may be eligible for forgiveness. SBA Form 3508 provides borrowers greater clarity as to what this means, and more flexibility in computing these amounts, given that payment and billing cycles will rarely align with the 8-week forgiveness period prescribed by the CARES Act.

Payroll Costs

- SBA Form 3508 provides for a new “Alternative Covered Period” for administrative convenience. Borrowers with a bi-weekly or more frequent payroll schedule can elect to start their 8-week covered period on the first day of the first payroll period after disbursement of their PPP loan rather than the loan’s disbursement date. Borrowers who elect to use this Alternative Covered Period must apply the Alternative Covered Period wherever there is a reference to “the Covered Period or the Alternative Covered Period” in SBA Form 3508.
- Payroll costs that are incurred but not paid^[1] during the borrower’s last pay period of the Covered Period (or, if elected by the borrower, the Alternative Covered Period) are eligible for forgiveness if paid on or before the next regular payroll date.
- Consistent with the \$100,000 cap on annualized compensation for purposes of determining “payroll costs” under the CARES Act, SBA Form 3508 states that a single individual’s compensation during the applicable covered period cannot exceed \$15,385. The \$15,385 is a cap on the amount of an individual’s compensation eligible for forgiveness. The instructions do not require that this maximum amount be paid pro rata over the applicable covered period.
- The SBA Form 3508 instructions state that borrowers can include gross salary, gross wages, gross tips, gross commissions, paid leave (vacation, family, medical or sick leave, not including leave covered by the Families First Coronavirus Response Act), and allowances for dismissal or separation paid or incurred during the applicable covered period in calculating employee cash compensation. “Bonuses” are not listed, so it is still unclear whether bonuses constitute “payroll costs.” To assure that additional amounts paid to compensate employees for working under challenging conditions remain eligible for forgiveness, employers should consider designating such compensation as temporary “hazard pay,” rather than a “bonus.”

Non-Payroll Costs

- The Alternative Covered Period provided for payroll costs does not apply to other forgivable expenses (business mortgage interest payments, business rent or lease payments for real or personal property, or business utility payments).
- However, SBA Form 3508 provides that all eligible non-payroll costs must be paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date.

Reductions in Loan Forgiveness Amount

Pursuant to the SBA Form 3508 instructions, the amount of a PPP loan eligible for forgiveness will be reduced first, by reductions to employee compensation (a dollar for dollar reduction), and then, by reduction related to full time employee equivalent (FTE) headcount (a percentage reduction). Previously, it was unclear in what order these reductions would be applied.

Salary/Wage Reductions

- The CARES Act provided that when determining whether an employee's salary/wages have been reduced by more than 25%, the borrower must compare the employee's average annual salary/wages during the Covered Period to the employee's average annual salary during the most recent full quarter. SBA Form 3508 confirms that this time period is January 1, 2020 and March 31, 2020, but allows the borrower to use compensation levels during the Alternative Covered Period.
- Pursuant to the calculation methodology set forth in SBA Form 3508, only the reduction in compensation in excess of 25% is subtracted from a borrower's forgiveness amount (meaning the entire reduction does not count against the borrower).
- For example, if a salaried employee made \$52,000 (annualized) between January 1, 2020 and March 31, 2020, but was reduced to \$26,000 (annualized) during the applicable covered period (\$500 a week, for a total of \$4,000 over the 8-week period), the borrower's forgiveness amount will only be reduced by \$2,000. That reduction amount is calculated by multiplying \$52,000 by 0.75 (equaling \$39,000); subtracting \$26,000, which was the employee's average annual compensation over the 8-week period (equaling \$13,000); dividing by 52 (to reduce annual compensation to weekly compensation) (equaling \$250); then multiplying by 8 (to determine the total reduction over the applicable covered period). SBA Form 3508 also instructs borrowers how to calculate the loan reduction amount for hourly employees (given that their weekly hours and therefore their pay may have been inconsistent over Q1 2020).

Salary/Wage Reduction Safe Harbor

- The CARES Act provided a "safe harbor" provision related to reductions in loan forgiveness amounts for reductions in salary or wages that were made between February 15, 2020 and April 26, 2020, such that any reductions in pay in excess of 25% during the applicable covered period will not affect a borrower's forgiveness amount, if the reductions are eliminated by June 30, 2020.
- Pursuant to the calculation methodology set forth in SBA Form 3508, in order to qualify for this safe harbor, any employee's average annual salary or hourly wages that were reduced between February 15, 2020 and April 26, 2020, must be fully restored to their February 15, 2020 level (not 75% of such level) as of June 30, 2020.
- Note that this June 30, 2020 measurement date may fall after the borrower's applicable covered

period.

- Note also that SBA Form 3508 does not require a borrower to provide a “make-whole” payment to an employee.
- If any such employee is not returned to February 15, 2020 salary or wage levels, SBA Form 3508 provides instructions as to how to calculate the reduction to loan forgiveness, as set forth above.

FTE Headcount Reductions

- The CARES Act provides that a borrower’s forgiveness amount may be reduced if the borrower’s average FTE numbers during the applicable covered period are less than the average FTE numbers during the borrower’s selected baseline period (February 15, 2019 to June 30, 2019 or January 1, 2020 to February 29, 2020, per previous SBA rules).
- SBA Form 3508 instructs a borrower how to calculate its average FTE number for the applicable covered period: it must be done on an employee by employee basis.
- For each employee, during the applicable covered period and during the selected baseline period, a borrower must (1) enter the average number of hours paid per week, (2) divide by 40, and (3) round to the nearest tenth. Alternatively, a borrower may use 1.0 for employees working more than 40 hours a week (an employee’s FTE number cannot exceed 1.0) and 0.5 for employees working less than 40 hours. It is advantageous to the borrower to use whatever method results in a higher average FTE number for the applicable covered period; however, a borrower must use a consistent methodology in calculating average FTEs for both the baseline period and the applicable covered period.

FTE Reduction Exceptions and Safe Harbor

- The CARES Act provided a “safe harbor” provision related to reductions in loan forgiveness amounts for reductions in average FTEs that were made between February 15, 2020 and April 26, 2020, such that any such reductions will not affect a borrower’s forgiveness amount, if the reductions are eliminated by June 30, 2020.
- SBA Form 3508 confirms that in order to qualify for this safe harbor, the borrower must have (1) reduced its FTE employee levels in the period between February 15, 2020 and April 26, 2020 and (2) then restored its FTE employee levels, by not later than June 30, 2020, to its FTE employee levels in the borrower’s pay period that included February 15, 2020.
- Note that this June 30, 2020 measurement date may fall after the borrower’s applicable covered period.
- SBA Form 3508 provides that a borrower may include in its FTE calculation the FTE number for the following employees or former employees (meaning FTE reductions in these circumstances will

not affect the borrower's forgiveness amount), if the position was not filled by a new employee:

- Any positions for which the borrower made a good-faith, written offer to rehire an employee during the applicable covered period which was rejected by the employee (this exception was set forth in a prior SBA rule);
- Employees fired for cause;
- Employees who voluntarily resigned; and
- Employees who voluntarily requested and received a reduction in hours.

For example, if a borrower had two employees working 40 hours per week (making each employee's FTE number 1.0) during the covered period, but one voluntarily resigned (and was not replaced), the borrower's FTEs during the covered period would still equal 2.0.

Supporting Documentation and Recordkeeping Requirements

In addition to requiring a borrower to submit payroll tax filings, bank account statements, tax forms, payment receipts, canceled checks, and other documentation to verify the borrower's payroll and non-payroll costs, SBA Form 3508 requires that a borrower maintain (but not necessarily submit) the following documentation:

- Documentation supporting the listing of each individual employee in PPP Schedule A Worksheet Table 1, including the "Salary/Hourly Wage Reduction" calculation, if necessary.
- Documentation supporting the listing of each individual employee in PPP Schedule A Worksheet Table 2; specifically, that each listed employee received during any single pay period in 2019 compensation at an annualized rate of more than \$100,000.
- Documentation regarding any employee job offers and refusals, firings for cause, voluntary resignations, and written requests by any employee for reductions in work schedule.
- Documentation supporting the PPP Schedule A Worksheet "FTE Reduction Safe Harbor."

Other documentation related to the borrower's PPP loan, including documentation:

- Submitted with its PPP loan application;
- Supporting the borrower's certifications as to the necessity of the loan request and its eligibility for a PPP loan;
- Necessary to support the borrower's loan forgiveness application; and Demonstrating the borrower's material compliance with PPP requirements.

All such documentation must be maintained in a borrower's files for six years after the loan is forgiven or repaid. Further, the borrower must permit authorized representatives of the SBA, including those in its Office of Inspector General, to access such files and documentation upon request.

[1] SBA Form 3508 provides that payroll costs are considered paid on the day that paychecks are distributed or the borrower originates an ACH credit transaction. Payroll costs are considered incurred on the day the employee's pay is earned.

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