PPP Loan Forgiveness Application: An In-Depth Analysis

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Like Alice's trip down the rabbit hole in Lewis Carroll's famous 1865 novel, the Paycheck Protection Program (PPP) has been filled with surprising, strange and sometimes frightful twists and turns. The latest of these is the PPP Loan Forgiveness Application (Application) that was released by the U.S. Small Business Administration (SBA) sometime after business hours on Friday night, May 15. The Application and the related instructions, which is long and surprisingly complex, is no exception. Those looking for answers to the many questions relating to loan forgiveness may be disappointed.

Perhaps the most pressing question is: Are expenses determined on a cash basis or an accrual basis? At first glance, the answer appears to be *both*. But a more thorough review of the Application and related instructions highlights numerous inconsistencies and ambiguities, typical of our understanding of much of the PPP guidance issued to date. Nonetheless, a few important questions have been answered and, applying common sense, we can make *some* reasonable assumptions about what future clarifying guidance might say.

Payroll Costs

The Application provides that "Borrowers are generally eligible for forgiveness for the payroll costs paid and payroll costs incurred during the eight-week (56-day) Covered Period[1] (or Alternative Payroll Covered Period [discussed below]) ("payroll costs"). 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. Payroll costs incurred but not paid during the Borrower's last pay period of the Covered Period (or Alternative Payroll 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 (or Alternative Payroll Covered Period)." This certainly sounds like both costs paid and costs incurred in the eight-week period are eligible for forgiveness. But hang on.

The Application instructions further provide that, "For administrative convenience, Borrowers with a biweekly (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 (the "Alternative Payroll Covered Period")." This Alternative Payroll Covered Period (APCP) may be used only for purposes of determining eligible payroll costs. What is not clear is whether the SBA's intent is to limit payroll costs to a 56-day period, or whether the payroll costs paid in the first few days of the APCP, which were incurred prior to the APCP, are also an eligible payroll cost.

Regardless of which period a Borrower uses to determine eligible payroll costs, it is possible – even likely – that the Borrower will have more than 56-days of payroll costs if they include both costs paid and costs incurred in the period. In fact, there could be as many as 72 days of eligible payroll costs. What's more, the number of days of eligible payroll costs will be different for different Borrowers depending on whether they pay weekly, bi-weekly or semi-monthly, and when their pay date falls relative to the PPP Loan Disbursement Date. Is this really what the SBA intends? Or, is the SBA's intention to limit payroll costs to 56-days despite the language in the Application instructions that infer otherwise? Absent further guidance, it appears that Borrowers are able to include more than 56-days of payroll in their forgivable costs. Do not be surprised, however, if this is limited by subsequent rulings.

Unfortunately, the ambiguity does not end there. The instructions for Lines 6, 7 and 8 of Schedule A of the Application, dealing with employee benefits and employer taxes, state that you should "enter the total

[1] The CARES Act defines the Covered Period as the eight-week (56-day) period that begins on the PPP Loan Disbursement Date.

amount paid by the Borrower for" employer contributions for employee health insurance, employee retirement plans, and the employer-level state and local taxes. So here they break from the concept of "payroll costs paid and payroll costs incurred" to simply payroll costs paid, leaving us with unanswered questions involving (a) retirement contributions and employer taxes relating to the Covered Period but remitted after the Covered Period, (b) accrued retirement costs from prior periods paid during the Covered Period, and (c) health insurance premiums paid prior to the Covered Period relating to coverage for the Covered Period. Again, further clarification, especially with regard to the timing of payments, is needed.

There are two additional points relating to payroll costs.

1. The Application instructions require the Borrower to certify that the requested forgiveness does not include more than "eight weeks' worth of 2019 compensation for any owner-employee or self-employed individual/general partner, capped at $15,385 per individual." Presumably, this limitation also extends to the immediate family members of owners. So for Borrowers considering adding spouses or children to payroll, or increasing their own or their family members' salaries to a level greater than actual 2019 salaries, pro-rated for the Covered Period, it appears this is not allowed.

2. While there is a prohibition against increasing the salaries of owners and their immediate family members, no such prohibition exists with regard to other employees. So, while we continue to caution against Borrowers taking actions outside of the ordinary course of business, giving salary increases, even temporary salary increases, to non-owner employees earning under $100,000 a year is not specifically prohibited. At least not yet.

Calculating Full-Time Equivalency Employees (FTEs)

For purposes of calculating full-time equivalency employees (FTEs), the SBA breaks from the 30-hour week used in the Affordable Care Act and have instead adopted a 40-hour week. This could be problematic if your standard work week is 35 or 37.5 hours. The practical solution here might be to count your full-time salaried employees as one FTE each, regardless of what your standard work week is. As per the Application instructions, however, you must use 40 hours in computing FTEs for your part-time employees and full-time hourly employees who work less than 40 hours a week. The Application instructions also provide a simplified method under which you count each part-time employee as one-half of an FTE. Regardless of the methodology used, as long as it is used consistently for both the base period and the forgiveness period, it should not make a meaningful difference in your FTE ratio.

FTEs are ***not*** reduced for:

- Any positions for which the Borrower made a good-faith, written offer to rehire an employee during the Covered Period or Alternative Payroll Covered Period which was rejected by the employee; and
- Any employees who were (a) fired for cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction of their hours.

The Application instructions confirm the *FTE Reduction Safe Harbor*, which provides that Borrowers are exempt from the reduction of loan forgiveness based on a reduction in FTEs if (a) the Borrower reduced its FTE employee levels in the period beginning February 15, 2020 and ending on April 26, 2020, and (b) the Borrower then restores its FTE levels by not later than June 30, 2020 to its FTE employee levels in the Borrower's pay period that included February 15, 2020. Unfortunately, the Application instructions do not indicate how long the restored FTE levels must be maintained in order to qualify as *restored*. As written, this is a "point in time" test and nothing more.

Nonpayroll Costs

The Application instructions provide that eligible nonpayroll costs – covered mortgage obligations, covered rent obligations and covered utility payments – "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." This is the same paid *and* accrued language used in defining eligible payroll costs. Prepayments of mortgage interest are explicitly disallowed. However, there is no such explicit prohibition against prepayments of rent or utilities.

Also, there is nothing in the instructions or in previous guidance that restricts the inclusion in your forgiveness Application of payments made during the Covered Period for costs incurred prior to the Covered Period. So paying deferred rent from prior months, and even pre-paying future rent, are not explicitly prohibited. Perhaps this is because nonpayroll costs are limited to 25% of total forgivable costs. However, including expenses not related to the Covered Period seems inconsistent with the overall intent of the PPP. So, if this is a strategy you intend to use, be wary of the possibility of future guidance prohibiting these costs.

The Application instructions confirm that:

- ***Covered mortgage obligations*** include interest (not principal) on loans existing prior to February 15, 2020 used to acquire both real and personal property, and which are secured by that property.
- ***Covered rent obligations*** include business rent or lease payments for real or personal property (such as business vehicles or equipment) pursuant to lease agreements in force before February 15, 2020.
- ***Covered utilities*** include payments for a service for the distributions of electricity, gas, water, transportation, telephone or internet access for which service began before February 15, 2020. This definition is quite explicit and does not include other services such as trash collection or security monitoring, as some have surmised it might.

Other Aspects of the Application

The Application instructions provide the methodology to be used in computing the excess *Salary/Wage Reduction* adjustment to the loan forgiveness amount, as well as the *Salary/Hourly Wage Reduction Safe Harbor* to eliminate the reduction. This is consistent with prior guidance, remains somewhat confusing and will not likely apply to *most* Borrowers.

The PPP Schedule A Worksheet, which is to be retained by the Borrower but not submitted with the request for forgiveness, requires that gross wages (cash compensation) for the Covered Period or Alternative Payroll Covered Period be entered separately for each employee. This is a tedious and time-consuming task if you have more than a few employees. Hopefully, your payroll provider will be able to assist.

The Application instructions also provide a detailed list of documents that must be submitted with the PPP Loan Forgiveness Application. This documentation is consistent with prior guidance and includes:

- Bank statements or third-party payroll service provider reports for periods that overlap with the Covered Period or Alternative Payroll Covered Period;
- Federal and state payroll tax forms or the equivalent third-party payroll service provider reports;
- Payment receipts, cancelled checks and account statements documenting employer contributions to employee health insurance and retirement
- Copies of mortgage loan amortization schedules or account statements;
- Copies of current lease agreements and cancelled checks or lessor account statements verifying payments of covered rent obligations; and
- Invoices, receipts, cancelled checks or account statements verifying business utility payments.

Key Takeaways and Recommended Actions

While the Application and related instructions clarify a few of the questions regarding the determination of costs eligible for forgiveness, many inconsistencies and ambiguities remain. Hopefully, these will be addressed in short order by the SBA. Ultimately, it is up to the lenders to process and approve forgiveness applications. Where guidance is unclear or lacking, lenders will likely have the final say. Undoubtedly, different lenders will have different interpretations, making planning even more difficult. ***Reaching out to your lender early in order to understand their interpretations will be helpful***; although it is doubtful that many lenders have yet focused on loan forgiveness. And if the forgiveness process is anything like the application process, changes will emerge over time.

While we wait for further guidance on forgiveness, there are a number of things Borrowers should do:

- Calculate your FTEs for the allowable base periods and estimate your FTEs for your Covered Period based on what you know today. Formulate a plan to maximize Covered Period FTEs by evaluating your need and ability to rehire or replace furloughed employees by June 30.
- Prior to completing your forgiveness Application, give careful consideration to which payroll period will work best for your circumstances based on payroll period, Loan Disbursement Date and other relevant matters.
- Pay your health benefits as they accrue during the Covered Period. Stand ready to pay the health insurance premium for the month after your Covered Period ends during the last few days of your Covered Period.
- Pay your retirement benefits as they accrue during the Covered Period. If you have a safe harbor plan that requires you to contribute a certain percentage of employee compensation, do not wait to make those payments.
- Stand ready to pay any unpaid retirement plan contributions from 2019 (but wait for further guidance before paying them).
- Pay your rent as it becomes due during your Covered Period. Stand ready to pay rent due for the month following your Covered Period prior to the end of your Covered Period.
- Stand ready to pay any deferred rent for periods prior to your Covered Period (but wait for further guidance before paying it).
- Be sure to pay invoices for all eligible costs on a timely basis, prior to the next billing date.
- Stand ready to pay reasonable bonuses if it makes sense for your business (but wait for further guidance before paying them).
- Keep good records and start accumulating and making copies of the documents you will need to submit with your forgiveness application. When saving as PDFs, use clear names and consider creating subfolders for each type of eligible cost.

As you approach the end of your Covered Period and it becomes time to complete your Application for Forgiveness, you will need to act based on the guidance available at that time. If that guidance remains that eligible costs paid and eligible costs incurred in your Covered Period qualify for forgiveness, then that is the position you should take, unless your lender advises otherwise.

PKFOD has a team of professionals ready to assist clients and others in preparing for forgiveness and completing the forgiveness Application properly and favorably. More information is available on our website, www.PKFOD.com.

Contact Us

As always, we are here to help. While the decision to keep or return any PPP loans received must be yours, we can guide you through the assessment process, helping you to identify and document key considerations and acting as a sounding board along the way. Please reach out to your PKFOD engagement team with questions or for assistance or contact Bruce L. Blasnik, CPA, CGMA, Partner at CLT-SBATechnical@pkfod.com.