

# Client Alert

May 2020

## Worth the Wait? The Paycheck Protection Program Forgiveness Application Finally Arrives

After hours on Friday, May 15th, the Small Business Administration (the “SBA”), in consultation with the Department of the Treasury, released the long awaited Paycheck Protection Program (the “PPP”) forgiveness application and the related detailed instructions (collectively, the “Forgiveness Application”). In recognition that the Forgiveness Application does not address all outstanding forgiveness questions, the SBA stated that it will issue additional regulations and guidance to further assist borrowers as they complete their applications. The SBA has also indicated that it will provide lenders with additional guidance on borrowers’ responsibilities during the forgiveness process—which are proving to be substantial.

In fact, the shift of the PPP burden on to borrowers alone is now almost complete. Lenders most significant obligation is to obtain the documentation supporting the calculation components. While such obligation is considerable (especially because of the significant documentation added by the Forgiveness Application), the SBA has made it clear it is the borrower’s responsibility for ensuring accuracy, completeness and legitimacy.

### Overview

The Forgiveness Application is composed of four sections: (1) the PPP Loan Forgiveness Calculation Form; (2) PPP Schedule A; (3) the PPP Schedule A Worksheet; and (4) the (optional) PPP Borrower Demographic Information Form. All Borrowers are required to submit the Loan Forgiveness Calculation Form and Schedule A to their Lender (as well as supporting documentation).

In the press release announcing the Forgiveness Application, the SBA states that the application includes “several measures to reduce compliance burdens and simplify the process for borrowers.” However, the application’s instructions are in prose that even an IRS form W-2 author would find hard to follow. While we were hopeful that the SBA would distribute simplified forgiveness guidance, it is clear that this phase of the PPP will be incredibly burdensome on borrowers and lenders alike.

### Changes to Definitions

The SBA has expanded on some of the definitions that have been used in interim final rules and frequently asked questions (“FAQs”) since the PPP began.

Employees: The form does not provide much clarity on the term “employees” used in determining the number of employees later in the calculation portion of the form. However, the SBA states that the forgiveness reduction calculation uses Full Time Equivalents (“FTE’s”) set at 40 hours a week later in the forgiveness calculation portion of the form. The form is silent on how Borrower’s should count employees when they do not use the traditional 40 hour week.

Covered Period: The forgiveness period is listed as eight weeks. This period is determined as 56 days from the date of the PPP loan distribution date. We saw earlier this week that the HEROES Act wishes to extend this period to 24 weeks. There is no mention of any potential extension of the Covered Period.

This form now gives borrowers an option to calculate payroll costs using an “alternative payroll covered period”, if that alternative method better aligns with borrowers’ regular payroll cycles. 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 Covered Period”)

Rent and Mortgage expenses: The SBA clarifies that rent and mortgage expenses include both real and personal property. This allows borrowers to include payment besides leases for real property. The original definition was ambiguous as to whether or not it only covered real property leases.

Interest: Covered expense includes both real estate and personal property mortgage interest payments.

Utilities: The utilities definition is now “payments for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access.” This definition is more expansive for borrowers and lenders on what can be included under utilities. Borrowers are required to submit documentation verifying the existence of such obligations prior to February 15, 2020. What documentation is required to prove transportation expense obligations, for example, remains unclear.

## **New Certifications**

The authorized representative of the borrower must sign additional certifications. These certifications include confirming the accuracy of the Forgiveness Application, accuracy of the supporting documents and proper use of PPP funds. The borrower must acknowledge potential government enforcement if funds were misused or for falsehoods in the application or supporting documents. The form asks the borrower to check a box if the borrower, together with its affiliates, received PPP loans with a principal amount in excess of \$2 million. The borrower does not need to include affiliates that were not otherwise waived (15 U.S.C. 636(a)(36)(D)(iv)).

Formalizing question 17 from the SBA’s FAQs, the Forgiveness Application provides that “[t]he Borrower’s eligibility for loan forgiveness will be evaluated in accordance with the PPP regulations and guidance issued by SBA through the date of this application.” (emphasis added) Considering the constant flow of new guidance and rules on top of the strict certifications, borrowers might hurry to complete their Forgiveness Applications.

The SBA has not provided guidance on how these certifications will affect lenders and their duties in regard to the forgiveness process. Presumably, the SBA believes the potential loss of the 100% SBA guaranty is sufficient lender incentive to exercise good faith in seeing that there is documentation to support each number on the Forgiveness Application.

## **Timing of Eligible Expenses, Best of Both Worlds**

Eligible payroll costs includes either payroll costs incurred or payroll costs paid during the forgiveness period. Payroll costs incurred but not paid during the Borrower’s last pay period of the Covered Period (or “Alternative Covered Period” described below) are eligible for forgiveness if paid on or before the next regular payroll date. The borrower must be sure not to count any payroll cost twice using these methods.

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, which can be outside the Covered Period.

## **Calculating Forgiveness**

The form includes a step by step worksheet for calculating the forgiveness amount. Please refer to the form for the steps. It is possible that the forgiveness amount will not be in line with what borrowers were anticipating based on SBA guidance to date. Borrowers are expected to use Schedule A and the Schedule A Worksheet to complete the Forgiveness Application. The SBA states that, in lieu of the Schedule A worksheet, borrowers can obtain an equivalent report from their payroll system or payroll

processor—but borrowers would still need to use the worksheet to determine if they meet the FTE Reduction Safe Harbor described below.

## **FTE Reduction Safe Harbor**

The Forgiveness Application formalizes a safe harbor for borrowers whose number of FTEs as of June 30, 2020 equal the number of FTEs as of February 15, 2020. Specifically, the Borrower is exempt from the reduction in loan forgiveness based on FTE employees described above if both of the following conditions are met: (1) the borrower reduced its FTE employee levels in the period beginning February 15, 2020, and ending April 26, 2020; and (2) the Borrower then restored its FTE employee levels by not later than June 30, 2020 to its FTE employee levels during the pay period that included February 15, 2020.

The safe harbor is separate from the FTE reduction exception when (i) the borrower has made a good-faith, written offer to rehire an employee that was rejected by such employee, or (ii) employees were fired “for cause”, voluntarily resigned, or voluntarily requested a reduction in hours and were replaced. These FTE reductions do not reduce the borrower’s loan forgiveness.

## **Requirements for Schedule A Worksheet**

As mentioned above, the Schedule A Worksheet should be completed by borrowers or a borrower may use an equivalent report from their payroll processor or system. In either event, the SBA will require:

- A list of each employee, not including independent contractors, owner-employees, self-employed individuals or partners,
- The last four digits of each employees Social Security Number,
- The cash compensation for the sum of all employees and
- The average FTEs during the Covered Period or the Alternative Payroll Covered Period. The FTE is set at 40 hours, and each employee is capped at 1.0 FTE. The Borrower may also state each employee that works 40 hours or more at 1.0 and any that work fewer hours as .5 as a simple alternative—but some forgiveness may be sacrificed for taking this option.

It is worth noting that the instructions for the Schedule A Worksheet are longer than the instructions for the actual application.

## **Questions for Lenders**

The Forgiveness Application raises a number of questions for lenders. Notably, the form provides that the “SBA may direct a lender to disapprove the Borrower’s loan forgiveness application if SBA determines that the Borrower was ineligible for the PPP loan.” Accordingly, the onus may be on the lender to communicate approval of the Forgiveness Applications. The language does appear to remove the lender from making the decision.

It is not clear if the SBA will require the lenders to certify that it verified all information in borrowers’ forgiveness applications. We anticipate that the SBA will need to provide additional clarity on the lender’s obligation as the gatekeepers of forgiveness. With lenders being aligned with borrowers in terms of wanting maximum forgiveness, this could lead to tensions between the lender’s financial goals and the responsibilities set by the SBA.

In addition to the actual Forgiveness Application, borrowers are required to provide lenders with documentation verifying payroll costs, the existence of obligations and service prior to February 15, 2020, and other eligible non-payroll expenses. What types of documentation lenders may accept remains unclear.

Lenders may feel compelled to fact check borrowers on a much larger scale than anticipated. The Forgiveness Application expects individual salary amounts for each employee, as opposed to asking for an average. The SBA will need to reinforce the lender's role in reviewing these applications, as lenders quickly approved large quantities of these loans during the initial rush. From this application, the borrower will need to determine the salary/wage reduction for each individual employee.

## Optional Demographic Information Form

The last page of the Forgiveness Application consists of an optional demographic information form. It is unclear why borrowers would want to provide this additional information. This form itself may be quite burdensome. Requested information includes demographic information for "Principals," which includes the 20% or more equity owners, trustors, key employees of the borrower as well as officers and directors if the borrower is a nonprofit. This form also asks for the veteran status, gender, race and ethnicity of each Principal.

## Next Steps

We expect that the SBA will supplement the Forgiveness Application with new rules and FAQs. If the application process seemed difficult for borrowers and lenders, the forgiveness process appears to be at an entirely other level. We encourage lenders to communicate with borrowers to explain the heavy documentation burden that is required to obtain forgiveness of their PPP loans.

As mentioned in a previous [client alert](#), some lenders are considering technology solutions to support their PPP activities.<sup>1</sup> It will be difficult to avoid at least a partially manual process to meet the documentation requirements call for by the Forgiveness Application. Technology solutions may become even more appealing now that we know how burdensome the forgiveness process is going to be. Technology solution providers are going to promise a lot more than they can actually offer at this time, largely due to the uncertain and changing nature of the PPP. While it is certainly advised to leverage technology to minimize the burden on operations, please evaluate the providers carefully before signing any new agreement—this includes any new services offered by any existing technology or core vendors.

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<sup>1</sup> [Client Alert: Leveraging Technology for the SBA's Paycheck Protection Program](#), April 2020.