

## So You've Successfully Applied For A PPP Loan, Now What ? What You Need To Know About The PPP Forgiveness Process

April 17, 2020

**(Last updated April 17, 2020)**

Information provided by media outlets indicates that the entire \$349B in funding authority allocated to the Paycheck Protection Program (PPP) was lent through the issuance of 1,661,397 loans by 4,975 lenders, all in less than 13 days. That is an average loan amount of just over \$210,000, an indication that many businesses with smaller payrolls have received the short term assistance that they so desperately needed.

If you are among the lucky ones who have received an SBA loan approval number (or better yet, the funds), then congratulations! If not, then don't abandon all hope just yet. Clearly there is some political wrangling currently going on between the White House (which wants \$250B in additional PPP funding authority approved now) and certain elements of Congress (which are seeking to promote additional funding for state and local governments first), but the likelihood is that additional funding authority for PPP loans for small businesses will be forthcoming at some point in the coming weeks.

Regardless of whether your funding has been approved or not at this point, it makes sense to start making plans now for how those funds will be used once received, how you can simplify the process for proving appropriate use of funds, and how you will apply for forgiveness of your PPP loan.

Section 1106 of the CARES Act (the Act) sets forth the loan forgiveness process for PPP loans (referred to in the statute as "covered loans" or – in legalese – loans guaranteed under paragraph (36) of section 7(a) of the Small Business Act (15 U.S.C. 636(a)), as added by Section 1102). The "covered period" for forgiveness is the 8 week period beginning on the date of the origination of your PPP loan. This means that you need to spend your PPP loan proceeds during the 8 week period directly following the funding of your loan. Any portions of your PPP loan which are not spent for authorized purposes during that 8 week period will not be subject to being forgiven and must be repaid at 1% interest over a 2 year period after the 6-month deferral for the loan.

### **USES OF THE PPP LOAN FUNDS THAT QUALIFY FOR FORGIVENESS**

Section 1106 further provides that the following costs are approved for forgiveness to the extent that they are **incurred and paid** during the 8 week period:

Payroll Costs – Section 1106 relies on the definition set forth in Section 1102(a) of the CARES Act for “payroll costs.” This is a relatively broad definition and is the same definition that you relied in calculating your PPP loan amount. With respect to W-2 employees, payroll costs include (a) salary, wages, commissions and cash tips, (b) vacation, parental, family, medical and sick leave, (c) allowance for dismissal or separation, (d) payment for provision of group health benefits, including premiums, (e) payment of retirement benefits, and (f) payment of state or local tax assessed on the compensation of employees. For sole proprietors or independent contractors, the definition includes wages, commissions, income, net earnings from self-employment, or similar compensation. In all cases, wages or salary in excess of \$100k annualized are excluded, but sums paid up to that amount count. For more specific details on what is included or excluded, please refer directly to the referenced provision of the CARES Act and to the FAQs updated by the U.S. Department of Treasury from time to time (which can be [found here](#)).

Interest Payments on Covered Mortgage Obligations – Interest paid on a covered mortgage obligation (any prepayment of or payment of principal on that covered mortgage obligation is expressly excluded). A “covered mortgage obligation” is a mortgage incurred before February 15, 2020 that is a liability of the borrower and secured by real or personal property.

Payments on Covered Rent Obligations – Rent that is an obligation under a leasing agreement in force before February 15, 2020.

Covered Utility Payments – Defined as payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began prior to February 15, 2020.

It is important to note that regulations released in response to the Act have made it clear that **at least 75%** of the amount to be forgiven must be for payroll costs and that the above-referenced interest payments, covered rent payments and covered utility payments cannot amount to more than 25% of the PPP loan proceeds forgiven. The Act provides that “an eligible recipient shall be eligible for forgiveness of indebtedness on a covered loan in an amount equal to the sum of the [above-referenced] costs incurred and payments made during the covered period.” So, the key is to be able to show your lender that you have properly and timely spent your PPP loan funds.

## **APPLICATION FOR LOAN FORGIVENESS**

Upon the completion of your 8 week “covered period,” you will need to submit another application to your lender – this time for loan forgiveness. Between now and then, your lender will certainly have an application form available to you for that purpose. We do know that your application will need to include the following:

(i) Documentation verifying the number of full-time equivalent (FTE) employees on payroll and pay rates for the applicable periods, including payroll tax filings reported to the IRS, and state income, payroll, and unemployment insurance filings;

(ii) Documentation including cancelled checks, payment receipts, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, covered lease obligations, and covered utility payments;

(iii) A certification (from a representative authorized to make the same) that the documentation is true and correct and that the amount for which forgiveness was requested was used to retain employees or to make payments on a covered mortgage, covered rent obligation or covered utility payments; and

(iv) Any other documentation the SBA determines necessary.

The Act makes it clear that no forgiveness will be given if the necessary documentation is not provided. Your lender must issue a decision on your application for forgiveness not later than 60 days after the date that your lender receives your application for forgiveness. Your lender's decision will control how much of your loan is forgiven, although we don't expect that lenders will be unduly tough on you in this process, rather they will be just taking reasonable steps to confirm that you have submitted necessary confirming documentation.

### **REDUCTION IN LOAN FORGIVENESS**

In addition to simply not spending your PPP loan funds for the proper purposes in the referenced 8 week period, there are two additional bases for a reduction in your loan forgiveness amount.

Reduction in Number of Employees: If the average number of full-time equivalent (FTE) employees that you employed during your 8 week covered period is lower than the average number of FTE employees that you had during (at your election) either: (i) the period from February 15, 2019 to June 30, 2019; or (ii) the period from January 1, 2020 to February 29, 2020, then your loan forgiveness **will be proportionately reduced**. To calculate FTEs for a given period, we expect that the forthcoming guidance will be to calculate the average number of FTE employees based on a 40-hour workweek. For example, if you have 15 employees (combination of full and part-time) and, for the 8 week covered period, you paid your employees for a combined total of 3,600 hours, then your calculation of average FTE employees would be 3,600 total hours divided by 40 hours in a full-time workweek divided by 8 weeks (the length of the period), for a result of 11.25 FTE employees during that period – even if your actual employee headcount is actually 15. We expect that further specific guidance will be provided on the exact calculation method that your lender expects you to use. One important note, there is no requirement that we have seen that requires that your employees are actually busy working during this period. Indeed, many businesses that qualify for PPP loans may be forced by operation of law to be closed during the subject period. We think that the key consideration is that you are paying your employees during the covered period, whether you are open for business or not.

Reduction in Compensation: The amount of your PPP loan forgiveness will also be reduced to the extent that you reduce the wages of any one or more employees by more than 25% when compared to the most recent full quarter during which the employee was employed (please note that highly compensated employees (those making over

\$100k per year) are expressly excluded from this provision). The Act implies that this will be an employee-by-employee analysis. We expect that further guidance will be provided as to how to treat special situations, for example, if you have an employee who elects to quit and to not return to work. Guidance on this front will be especially important for employers in high turnover industries.

### **TAX TREATMENT OF AMOUNT FORGIVEN**

Forgiven debt is usually taxable as income to the borrower. As a welcome relief, the CARES Act is clear that PPP loan amounts forgiven will not be included in gross income of the borrower for income tax purposes. Section 1106(i) of the CARES Act provides that “(f)or purposes of the Internal Revenue Code of 1986, any amount which (but for this subsection) would be includable in gross income of the eligible recipient by reason of forgiveness . . . shall be excluded from gross income.”

### **RECOMMENDED BEST PRACTICES**

We have a few recommendations to help ensure that your forgiveness process is as smooth as possible.

**1. Use a Separate Account.** To the extent that you can, set up a new account with your lender that is separate from your usual business accounts and have the funding from your PPP loan and all payments from those funds flow through that separate account. This should make the process of proving appropriate and timely uses of your PPP funds quite a bit simpler in that you won't have to track and explain commingling of funds and debits unrelated to qualified PPP expenditures from the account.

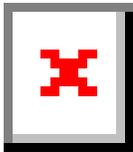
**2. Keep in Close Communication with your Lender.** It goes without saying that keeping in close contact with your lender and keeping up to date on additional information and guidance that they provide is a great idea.

**3. Keep Good Documentation.** Be sure to maintain very accurate and detailed documentation on all uses of your PPP loan funds. Following the recommendation in subsection (1) above will dramatically help you in this process. If you keep track of cancelled checks, receipts and other supporting documentation substantiating your expenditures, this will go a long way towards simplifying the document submission process that you already know is coming.

**4. Prepare your Loan Forgiveness Application in Advance.** Start preparing your loan forgiveness application well in advance of the completion of your 8 week period so that you are in a position to file your forgiveness application with your lender immediately upon the completion of that period. Just as lenders were inundated with applications at the outset of this process, they will undoubtedly be inundated with forgiveness applications on the back end.

**5. Pay Attention to your FTE and Compensation Numbers.** Carefully watch your FTE employee counts and your compensation amounts to ensure that your forgiveness amount is not reduced unnecessarily.

**6. Watch for Future CCSB Client Alerts.** Together with you, we will continue to watch developments and additional regulations and guidance that are provided and will prepare and distribute future CCSB Client Alerts to assist you in navigating the PPP process.



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