

PPP Loan Forgiveness – A Summary of Available Guidance

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By
Mike Batts, CPA
Michele Wales, CPA

Updated May 20, 2020 to clarify applicability of the safe harbor described in Step 2 of Section 5.a.

Updated May 29, 2020 to reflect clarifications from new SBA Interim Final Rule on loan forgiveness published May 22, 2020.

Late on Friday, May 15, the Small Business Administration (SBA) issued the long-awaited forgiveness application for Paycheck Protection Program (PPP) loans along with a related schedule, a related worksheet, and instructions. A copy of all of the documents is available [here](#).

The loan forgiveness application, together with its related schedule, worksheet, rules, safe harbors, calculations, and options, rivals a federal income tax return in its complexity.

Some PPP borrowers are already several weeks into the eight-week period during which the PPP loan funds must be spent (under current guidance) in order to qualify for forgiveness. Borrowers have been anxiously awaiting official guidance to clarify numerous unanswered questions about how the forgiveness process will work and how the forgiveness amount will be calculated. The SBA issued additional guidance in the form of an “[Interim Final Rule](#)” on May 22. It is possible that the SBA could issue more guidance further clarifying technical questions, and Congress could still act to modify fundamental elements of the forgiveness process.

Based on a combination of provisions in the CARES Act, SBA guidance, and information published in connection with the new forgiveness application, we have provided below a summary of our understanding of core elements of the forgiveness process.

Note that our analysis below does not necessarily track with the sequence of items in the application and related forms. Our analysis is intended to describe the logic trail of the forgiveness calculations.

The information provided herein represents our understanding of the subject matter covered. Due to the lack of abundant guidance and clarity with respect to the topics addressed herein, the information provided in this document may be inaccurate and/or incomplete. Additionally, further official guidance may be issued by the SBA which could impact the accuracy of the information provided herein.

1. The forgiveness application is to be submitted to the PPP lender that made the PPP loan to the borrower or (if different) the lender that is servicing the loan.

- a. The SBA has announced that it 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.
 - i. It remains unclear what standards the SBA will use to assess loan eligibility when performing such reviews.
 - ii. The nature and extent of eligibility reviews (e.g., the types of information and documents the SBA will require from borrowers) also remain unclear.
 - b. The SBA has announced that it will deem borrowers of loan amounts less than \$2 million to have validly made their good-faith certifications regarding economic uncertainty making their loans necessary.
 - i. The SBA may still review the forgiveness applications for borrowers with loans less than \$2 million for matters other than loan eligibility.
 - c. It is possible that the forgiveness application and its instructions will change prior to the date that borrowers are required to submit their applications to their lenders.
2. In order to qualify for forgiveness, the loan proceeds must be spent during the eight-week period beginning on the date that the borrower received the PPP loan funds (the “**Funding Date**”). This eight-week (56-day) period is referred to as the “**Covered Period**.”
- a. If a borrower received PPP loan funds in more than one transaction, the first date on which it received PPP loan funds is considered the Funding Date.
 - b. A borrower with payroll periods that are at least bi-weekly in frequency is permitted to elect and apply an “**Alternative Payroll Covered Period**” that begins on the first day of the borrower’s first payroll period beginning after the Funding Date.
 - i. For example, if the borrower received its PPP loan proceeds on Monday, April 20, and the first day of its first pay period following its PPP loan disbursement is Sunday, April 26, the first day of the Alternative Payroll Covered Period is April 26 and the last day of the Alternative Payroll Covered Period is Saturday, June 20 (i.e., 56 days from April 26).
 - ii. 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 (not the Alternative Payroll Covered Period) wherever there is a reference in the application to “the Covered Period” only.
 - iii. Hereinafter in this document, our reference to the “applicable Covered Period” means whichever of the Covered Period or the Alternative Payroll Covered Period applies to the borrower.

3. The types of costs that count toward the forgiveness amount (our term for such costs is “**forgivable costs**”) include the following:
- a. **Payroll costs** for the applicable Covered Period, which include (only as applicable to employees whose principal place of residence is in the United States):
 - i. Cash compensation...including gross wages (before deducting employee deferrals such as 401(k) or 403(b) contributions, health insurance premiums, etc.), but not more than \$15,385 per employee for the applicable Covered Period. (The limit of \$15,385 represents the annual compensation limit of \$100,000 prorated for the eight-week period.)
 - 1. Clergy housing allowances are considered cash compensation for this purpose.
 - 2. Do not include in cash compensation any emergency sick leave or emergency family leave payments that qualify for a credit under the Families First Coronavirus Response Act.
 - ii. Employer-paid group health care benefits
 - iii. Employer-paid retirement benefits
 - iv. Employer-paid state and local taxes assessed on employee compensation (e.g., unemployment taxes)
 - v. SBA guidance in the forgiveness application and instructions provides that payroll cost **amounts paid or incurred** during the applicable Covered Period count as forgivable costs. Payroll costs incurred but not paid during the applicable Covered Period are counted, so long as the amount incurred through the end of the applicable Covered Period is paid by the next regular payroll date.
 - 1. **Example** – assume that the borrower’s Funding Date was April 29, and the borrower had a semimonthly payroll on April 30, which covered employee compensation for the period from April 16 through April 30. The full amount of eligible payroll costs paid in the April 30 payroll count as forgivable costs (i.e., the payroll amount does not have to be prorated for the fact that the PPP loan Funding Date was only one day prior to the payroll date).
 - 2. **Example** – Assume that the last day of a borrower’s applicable Covered Period is June 23. The borrower’s payrolls are semimonthly – on the 15th and the last day of each month. The payroll costs incurred by the borrower from June 16 through June 23 count as forgivable costs, so long as the borrower pays the amount incurred on its next regular payroll date of June 30.
 - 3. It appears that employee health care and retirement plan costs paid by the borrower during the applicable Covered Period count as forgivable costs

regardless of whether or not the payments relate to employee services provided during the applicable Covered Period.

- b. **Interest** (but not principal) on business real estate mortgages (or their equivalent) or interest on other collateralized business loans paid or incurred during the Covered Period
 - i. Debts on which interest payments are made must have been incurred before February 15, 2020 for the interest costs to be counted as forgivable costs.
 - ii. Prepayments of interest are not forgivable costs.
 - iii. The Alternative Payroll Covered Period does not apply to interest payments.
- c. **Business lease or rent payments** on real or personal property where such rent or lease obligations were incurred before February 15, 2020
 - i. Guidance in the instructions indicates that 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.
 - ii. The form instructions and guidance are silent as to prepayments of rent or lease obligations. While prepayments of rent or lease obligations made during the Covered Period may be allowable as forgivable costs, we do not recommend counting on such treatment until and unless additional guidance clearly allows it.
 - iii. The Alternative Payroll Covered Period does not apply to business lease or rent payments.
- d. **Utility costs** for utility services that began before February 15, 2020
 - i. Utility costs include payments for the distribution of electricity, gas, water, telephone, or internet access.
 - 1. The examples of utility costs described in the CARES Act and in the forgiveness application instructions also include “transportation.” We are not sure what type of “transportation” would constitute utility costs, so we are disregarding that element until and unless further guidance clarifies.
 - 2. Until and unless further guidance clarifies, we believe it is reasonable to consider cell phone charges as allowable utility costs – as cell phone service constitutes a combination of telephone service and internet access.
 - 3. Where a vendor’s charges include some elements that are allowable (e.g., internet access) and some elements that are not allowable (e.g., cable television), we believe the costs for the services should be broken out in a reasonable manner – even if they are bundled as part of a packaged price.

4. It is BMWL's position that it is not prudent to attempt to include in utility costs charges for services not included in the specific examples in official SBA guidance.
 - ii. Guidance in the instructions indicates that utility costs 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.
 - iii. The form instructions and guidance are silent as to prepayments of utility costs. While prepayments of utility costs made during the Covered Period may be allowable as forgivable costs, we do not recommend counting on such treatment until and unless additional guidance clearly allows it.
 - iv. The Alternative Payroll Covered Period does not apply to utility costs.
4. **Under current guidance, the forgiveness amount for items 3 b – d above may not be more than 25% of the total forgiveness amount.** (This requirement was not part of the CARES Act, but rather was added by the SBA in regulatory guidance. The SBA is under pressure to change this requirement and Congress is considering a legislative mandate to change this requirement.)
 - a. Borrowers are informed that they are not required to include costs in the forgiveness application that they do not wish to be considered in the forgiveness calculation.
5. **Reduction of the potential forgiveness amount** applies based on two separate elements – the wage reduction element and the FTE reduction element.
 - a. **The wage reduction element**

The wage reduction element is intended to reduce the loan forgiveness amount by the amount an employer reduces compensation for employees – to the extent that compensation for any employees 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 applicable Covered Period as compared to the period from January 1, 2020 through March 31, 2020, the wage reduction element will not apply.

Following is a description of applying the wage reduction element

- i. **Step 1** – Determine for each employee whether his/her annual salary (for salaried employees) or hourly wage (for hourly workers) decreased by more than 25% during the applicable Covered Period (either the **Covered Period** or the **Alternative Payroll Covered Period** described above) as compared to the period of January 1, 2020 through March 31, 2020. For any employee whose annual salary or hourly wage was reduced by more than 25%, continue to Step 2. Otherwise, do not include the employee in the wage reduction forgiveness amount calculation.

1. As provided in the CARES Act, the instructions do not require analysis of wage reductions for any employees who received compensation for any pay period in 2019 that, if annualized, would equal more than \$100,000.
 2. SBA guidance addresses the handling of an employee in the wage reduction element whose employment terminated or whose work hours were reduced during the applicable Covered Period. The guidance states that reductions in total salary or wages paid to an employee during the applicable Covered Period which are solely attributable to an FTE reduction (i.e., termination or reduction of work hours) are not to be considered in the wage reduction element of forgiveness reduction. This is based on the fact that the FTE reduction element is intended to address the implications of reducing the workforce.
- ii. **Step 2** – Determine if the Salary/Hourly Wage Reduction Safe Harbor is met.

The Salary/Hourly Wage Reduction Safe Harbor exists for employees whose salary/wage was reduced between February 15, 2020 and April 26, 2020 but whose wage or salary was restored to the February 15, 2020 salary/wage on or before June 30, 2020 (and continued to be at the restored level on June 30, 2020).

1. If an employee's average annual salary or hourly wage was not reduced 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, the Salary/Hourly Wage Reduction Safe Harbor is not available for that employee. Go to Step 3.
 2. If an employee's average annual salary or hourly wage was reduced 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 June 30, 2020 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 would not be included in the wage reduction element of the forgiveness amount calculation. Otherwise, go to Step 3.
- iii. **Step 3** – 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, determine the amount of the reduction in salary or wages for the applicable Covered Period as follows:

1. For **hourly workers**:

- a. Take the average hourly wage for the period January 1 through March 31, 2020 and reduce it by 25%.
- b. Subtract from the result in a. the average hourly wage determined in Step 1 for the applicable Covered Period.

- c. Multiply the result in b. by the average number of hours worked per week during the period January 1, 2020 through March 31, 2020.
- d. Multiply the result in c. by 8 (representing 8 weeks' worth of pay reduction in excess of 25% for that worker).
- e. The result in d. is accumulated with that from other hourly workers whose pay was reduced by more than 25% to arrive at the hourly wage reduction amount.
- f. **Example** – Assume employee Earl Goodman was paid an average hourly rate of \$40 for the period January 1 through March 31, 2020 during which he worked an average of 35 hours per week. Assume that his average hourly rate for the applicable Covered Period was \$25. Assume that we have determined in Step 2 that the Salary/Hourly Wage Reduction Safe Harbor does not apply to Earl. First, we reduce the \$40 average hourly rate Earl was paid during the period January 1 through March 31, 2020 by 25%, giving us a result of \$30. We then subtract from that the average hourly rate of \$25 that Earl was paid during the applicable Covered Period, giving us a result of \$5. We take the \$5 and multiply it by 35, which is Earl's average weekly work hours during the period January 1 through March 31, 2020, giving us a result of \$175. We then multiply the \$175 by 8, giving us a result of \$1,400. The \$1,400 represents the amount by which Earl's pay is deemed to have been reduced in excess of 25% for the relevant period. This amount, \$1,400, is accumulated with that from other employees whose pay was reduced by more than 25% to arrive at the wage reduction amount – the amount by which the loan forgiveness amount is reduced due to employee wage reductions.

2. For **salaried workers**:

- a. Take the average annual salary for the period January 1 through March 31, 2020 and reduce it by 25%.
- b. Subtract from the result in a. the average annual salary determined in Step 1 for the applicable Covered Period.
- c. Divide the result in b. by 52 to arrive at a weekly amount.
- d. Multiply the result in c. by 8 (representing 8 weeks' worth of pay reduction in excess of 25% for that worker).
- e. The result in d. is accumulated with that from other salaried workers whose pay was reduced by more than 25% to arrive at the salaried wage reduction amount.

- f. **Example** – Assume employee Paul Goodman was paid an average annual salary of \$80,000 during the period January 1 through March 31, 2020. Assume that his average annual salary during the applicable Covered Period was \$50,000. Assume that we have determined in Step 2 that the Salary/Hourly Wage Reduction Safe Harbor does not apply to Paul. First, we reduce the \$80,000 annual salary Paul was paid during the period January 1 through March 31, 2020 by 25%, giving us a result of \$60,000. We then subtract from that the \$50,000 average annual salary that Paul was paid during the applicable Covered Period, giving us a result of \$10,000. We take the \$10,000 and divide it by 52, giving us a result of \$192. We then multiply the \$192 by 8, giving us a result of \$1,536. The \$1,536 represents the amount by which Paul's pay is deemed to have been reduced in excess of 25% for the relevant period. This amount, \$1,536, is accumulated with that from other employees whose pay was reduced by more than 25% to arrive at the wage reduction amount – the amount by which the loan forgiveness amount is reduced due to employee wage reductions.
- iv. **Step 4** – Aggregate the amounts from Step 3 in items 1.e. for hourly workers and 2.e. for salaried workers above to arrive at the total wage reduction amount. This amount reduces the potential loan forgiveness amount.

b. The FTE reduction element

The FTE reduction element is intended to reduce the potential loan forgiveness amount for employers whose workforce was reduced during the applicable Covered Period as compared to certain prior periods.

A **safe harbor exemption** from the FTE reduction in loan forgiveness is described in the instructions and applies if both of the following conditions are met:

1. the borrower reduced its FTE employee 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
2. the borrower then restored its FTE employee count as of June 30, 2020, to its FTE employee count in the borrower's pay period that included February 15, 2020.

If the FTE Reduction Safe Harbor applies, the FTE reduction in the potential PPP loan forgiveness amount does not apply.

An **additional de facto safe harbor exemption** from the FTE reduction appears in the actual forms (Schedule A) without instructional support. Between Lines 10 and 11 on Schedule A, the form states:

If you have not reduced the number of employees or the average paid hours of your employees between January 1, 2020 and the end of the Covered Period, check here , skip Lines 11 and 12 and enter 1.0 on Line 13.

The effect of skipping Lines 11 and 12 and entering 1.0 on Line 13 is a complete exemption from the FTE reduction element. While the specific intended meaning of this de facto safe harbor isn't abundantly clear, we believe the following to be a reasonable and safe interpretation:

If your organization did not terminate any employees or mandate any reduction in work hours for any of your employees from January 1, 2020 through the end of your applicable Covered Period, the FTE reduction element does not apply to your organization.

Whether our interpretation as described above is accurate remains to be seen as future guidance hopefully adds clarity to this de facto safe harbor exemption.

For an organization to which neither the regular safe harbor exemption nor the de facto safe harbor exemption described above applies, following is a description of applying the FTE reduction element:

- i. **Step 1** – Determine average FTEs on payroll for the applicable Covered Period (either the **Covered Period** or the **Alternative Payroll Covered Period** described above).
 1. Instructions state that for each employee, the borrower should enter the average number of hours paid per week during the applicable Covered Period, divide the result by 40, and round the total to the nearest tenth¹. The maximum FTE count for any employee is 1. The instructions and guidance permit a simplified method that assigns a 1 for employees who work 40 hours or more per week and 0.5 for employees who work fewer hours.
 2. For any employee who was fired for cause, voluntarily resigned, or voluntarily requested and received a reduction in work hours, such employee's FTE count for the applicable Covered Period should be adjusted to match that employee's FTE count for the applicable Reference Period (see below) unless the employee's position was filled by a new employee.
 3. For any employee whose employment terminated or whose work hours were reduced prior to the end of the applicable Covered Period and to whom the borrower made a good-faith, written offer to rehire or restore work hours during the applicable Covered Period (at the same level of pay), and where such employee rejected the offer, such employee's FTE count for the applicable Covered Period should be adjusted to match that employee's FTE count for the

¹ We note, however, that in the Interim Final Rule (IFR) published by the SBA, amounts are calculated to hundredths. For example, an employee working an average of 30 hours per week would be counted as 0.8 per the form instructions and 0.75 per the IFR. We believe either approach is acceptable, so long as it is applied consistently.

applicable Reference Period (see below) unless the employee's position was filled by a new employee.

- a. In such cases, the employer is required to maintain records documenting the offer and its rejection, and to notify the applicable state unemployment insurance office of the employee's rejection of the offer within 30 days of the rejection.²

ii. **Step 2** – Determine the average FTEs during the borrower's chosen **Reference Period** (using the same method described in Step 1).

1. All borrowers are allowed to choose one of the two following Reference Periods: February 15, 2019 through June 30, 2019 or January 1, 2020 through February 29, 2020.
2. Seasonal employers are allowed to choose a Reference Period, as an alternate to the two options above, of any consecutive 12-week period from May 1, 2019 through September 15, 2019.

- a. Neither the law nor SBA guidance describes the criteria for being considered a "seasonal employer" for this purpose.
- b. We recommend that organizations whose employment levels vary somewhat predictably throughout the year apply reasonable judgment in determining if they are a seasonal employer, documenting the basis for their position if they believe they are...subject to further guidance.

iii. **Step 3** – Divide the average FTE number obtained in Step 1 by the average FTE number determined in Step 2. The result of this calculation is the FTE reduction percentage. (Maximum is 1.0)

6. In **determining the actual loan forgiveness amount**, the form and instructions are structured so as to apply the wage reduction amount (if any) first and then to apply the FTE reduction percentage (if applicable) to the amount determined after the wage reduction amount is applied.

- a. The wage reduction amount (if applicable) is a dollar amount reduction of the potential loan forgiveness amount.
- b. The FTE reduction percentage (if applicable) is a percentage amount – the potential loan amount is multiplied by a percentage representing the ratio (not more than 1.0) of average FTEs during the applicable Covered Period to the average FTEs during the selected Reference Period.

² SBA guidance states that information will be provided on the SBA website regarding how borrowers will make such reports to state unemployment insurance offices.

Once the preliminary forgiveness amount is reduced for compensation reductions and/or FTE reductions (if applicable), the resulting possible forgiveness amount is tested to ensure that payroll costs constitute at least 75% of the forgiveness amount.

7. Page 10 of the form and instructions document linked at the beginning of this article describes the nature of the **documents that each borrower must submit** to its lender with its PPP loan forgiveness application.
8. The instructions also describe **documents that borrowers must maintain** but that they are not required to submit with the loan forgiveness application. In addition to listing specific types of records to be maintained, the instructions state that borrowers must maintain:

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.

The instructions further state that:

The **Borrower must retain all such documentation in its files for six years after the date the loan is forgiven or repaid in full**, and permit authorized representatives of SBA, including representatives of its Office of Inspector General, to access such files upon request.

A Brief Recap of the Forgiveness Calculation Process

The PPP loan amount can be partially or totally forgiven. PPP loan funds spent (as defined above) during the applicable 8-week period following the loan funding date can be spent on a combination of payroll costs, interest on collateralized debt, lease or rent obligations, and utility costs – all of which are defined and/or described above. No more than 25% of the costs counting toward the forgiveness amount may be non-payroll costs. The sum of allowable payroll and non-payroll costs for the applicable 8-week period represents a preliminary forgiveness amount that may be reduced if the employer cut employee pay for individual employees by more than 25% or if the employer reduced the number of FTEs during the applicable 8-week period. Some exceptions and safe harbors apply to these potential reductions in the forgiveness amount. Once the preliminary forgiveness amount is reduced for compensation reductions and/or FTE reductions (if applicable), the resulting possible forgiveness amount is tested to ensure that allowable payroll costs constitute at least 75% of the forgiveness amount.

Planning for Maximum Loan Forgiveness

Based on current guidance, PPP borrowers wishing to maximize the forgiveness amount for their PPP loans would do well to take the following actions:

- Maximize cash compensation to employees (as defined above) as much as is reasonable and possible during the applicable 8-week Covered Period, noting that cash compensation of up to \$15,385 per employee during the applicable Covered period is a fully forgivable cost.

- Bonuses paid during the applicable Covered Period constitute an allowable payroll cost, keeping in mind the \$15,385 limit on cash compensation for the period.
- Maximize other payroll costs (as defined above) as much as is reasonable and possible during the applicable 8-week Covered Period.
- Ensure that total allowable payroll costs, together with forgivable non-payroll costs, equal or exceed the PPP loan amount if possible...and if not...that the total is as close to the PPP loan amount as possible, remembering that non-payroll costs may be no more than 25% of the forgiveness amount.
- If pay was reduced by more than 25% for any employees during the period from February 15, 2020 through April 26, 2020, try to restore pay levels for those employees by June 30, 2020.
- If employees were terminated or their work hours reduced after February 15, 2020, try to restore FTE levels as much as possible by June 30, 2020...noting that, generally, if FTE levels as of June 30, 2020 at least equal that as of February 15, 2020, the forgiveness amount will not be reduced due to an FTE reduction.

BMWL Can Help

BMWL's COVID-19 Task Force is ready, willing, and able to help our clients navigate the forgiveness process. Nonprofit organizations that would like the assistance of our Task Force in addressing the forgiveness application should contact us at C19TaskForce@nonprofitcpa.com.

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