



CLIENT ALERT

PAYCHECK PROTECTION PROGRAM LOAN FORGIVENESS

ELIGIBILITY AND PROCEDURES

Clients that have borrowed Paycheck Protection Program (“PPP”) loans are now considering the steps that they must take to obtain loan forgiveness in a timely manner. Over the past two weeks, the Small Business Administration (the “SBA”) has issued additional guidance regarding loan forgiveness eligibility and procedures, and the Association of International Certified Professional Accountants, or AICPA, has issued some guidance on accounting for forgiveness.

PPP Loan Forgiveness Applications

The SBA has issued two different loan forgiveness application forms, the SBA Form 3508EZ, and the SBA Form 3508 (revised 6/16/2020). The SBA Form 3508 EZ may be submitted by any one of the following three categories of PPP loan borrowers:

Category 1: Borrower has no employees. The borrower is a self-employed individual, independent contractor, or sole proprietor, with no employees when the PPP loan application was submitted, and no employee salaries were included in monthly payroll costs in its PPP loan application.

Category 2: Borrower meets both the “Salary/Wage Test” and the “Employee/FTE Test.”

- a. *The Salary/Wage Test* – The borrower meets the Salary/Wage Test if it did not reduce the annual salary or hourly wages of any employee by more than 25% during the “covered period” or “alternative covered period” (as each of these terms are defined below) as compared to the January 1, 2020 – March 31, 2020 period, looking at employees who did not earn more than \$100,000 on an annualized basis during any period in 2019; and
- b. *The Employee/FTE Test* – The borrower meets the Employee/FTE Test if the borrower did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the “covered period.” The borrower may ignore (i) persons employed on February 15, 2020, if the borrower was unable to hire similarly qualified employees for unfilled positions on or

before December 31, 2020, and (ii) reductions in hours if the borrower offered to restore these, and the employee refused.

Category 3: Borrower meets both the Salary Wage Test and the “Business Activity Test.”

- a. *The Salary/Wage Test* – This is the same test the borrower must meet to qualify for Category 2; and
- b. *The Business Activity Test* – The borrower meets this test if it was unable to operate during the “covered period” or the “alternative covered period” at the same level of business activity as before February 15, 2020, due to compliance with requirements or guidance issued between March 1, 2020 and December 31, 2020 by the Secretary of Health and Human Services (HHS), the Director of the Centers for Disease Control and Prevention (CDC), or the Occupational Safety and Health Administration (OSHA), relating to the maintenance of standards for sanitation, social distancing, or any other work or customer safety requirement related to COVID-19

The “covered period” is either the 24-week period beginning on the PPP loan disbursement date, or, if the borrower received its PPP loan proceeds before June 5, 2020 and so elects, the 8-week period beginning on the PPP loan disbursement date. In each case, a borrower with a biweekly or more frequent payroll schedule may use an “alternative covered period” that begins on the first day of the first pay period following the PPP loan disbursement period. In all cases, the “covered period” or “alternative covered period” may not extend to a date later than December 31, 2020.

Any PPP loan borrower that does not meet the requirements of at least one of Categories 1, 2 or 3 above must file SBA Form 3508 to obtain loan forgiveness. The primary difference between SBA Form 3508EZ and SBA Form 3508 is that SBA Form 3508 elicits information necessary to determine the extent to which failure to meet the Salary/Wage Test or the Employee/FTE Test requires a reduction in loan forgiveness.

Timetable for Submitting PPP Loan Forgiveness Application

Early applications

In its Revisions to Loan Forgiveness Interim Final Rule and SBA Loan Review Procedures Interim Final Rule (the “SBA Revisions”), the SBA states that a borrower may submit a loan forgiveness application at any time, including before the end of the covered period, provided that the borrower has used all of the loan proceeds for which the borrower is requesting forgiveness.

There may be practical considerations, however, that require the borrower to wait until the end of the covered period to apply for forgiveness. For example, the SBA Revisions state that if the borrower applies for forgiveness before the end of the covered period, and has reduced

any employee's salary or wages in excess of 25%, the borrower must account for the excess salary reduction for the full 8-week or 24-week covered period, as applicable. Given that the future is necessarily uncertain, it might be prudent for borrowers to wait until the end of the applicable covered period, when they can calculate employee salaries and wages during the covered period with certainty. Similarly, because the Employee/FTE Test described above takes into account the rehiring of employees on or before December 31, 2020, a borrower might need to wait until the end of the year to know whether it has satisfied this Test. Lastly, the SBA Form 3508EZ requires the borrower to make certifications regarding the salaries and wages paid to employees and the number of employees during the applicable covered period, in order to demonstrate that the Salary/Wage Test and the Employee/FTE Test have been met during the entirety of that period. It is not clear how such certifications can be made with certainty before the end of the applicable covered period.

Future guidance might assist borrowers in determining the circumstances in which it might be reasonable for a PPP borrower to submit a loan forgiveness application before the end of the covered period.

Late applications

If the borrower does not apply for loan forgiveness within 10 months after the last day of the covered period, the PPP loan will no longer be deferred, and the borrower must begin paying principal and interest.

Accounting Treatment

General Rule

The Association of International Certified Professional Accountants (AICPA) has issued some guidance on accounting for PPP loans. According to AICPA, a nongovernmental entity should account for a PPP loan as a financial liability, which accrues interest at the PPP loan rate. The loan proceeds would remain recorded as a liability until all or any portion of the loan is (1) forgiven, to the extent of forgiveness, and/or (2) repaid, to the extent of repayment.

Not-for-profits

According to AICPA, not-for-profits may treat the loan proceeds as conditional government assistance, initially as a deferred income liability. Once the not-for-profit borrower has reasonable assurance that the conditions for forgiveness will be met, it would recognize the PPP loan proceeds on a systematic basis over the period in which it recognizes as expenses the related costs for which the PPP loan proceeds are intended to compensate, offsetting the deferred income liability.

AICPA notes that a not-for-profit that expects to meet the PPP's loan forgiveness eligibility criteria might instead treat the PPP loan proceeds as a grant expected to be forgiven. If

the PPP loan is a conditional grant, it would be recorded as a refundable advance. Once all conditions for forgiveness are met or explicitly waived, the refundable advance would be reduced, and the contribution recognized. Alternatively, using a model for gain contingency recognition, the PPP loan would initially be recorded as a liability, until all contingencies related to receipt of the grant are met, and the gain is realized or realizable. At that point, the PPP loan proceeds would be treated as earnings.

If you have any questions about PPP loan forgiveness, please contact Attorneys Elka Sachs, esachs@kb-law.com, or Anthony L. Leccese, aleccese@kb-law.com.