

# Client Alert

June 2020

## SBA Releases Streamlined Forgiveness Application and New Interim Final Rule: Anything But EZ

The Small Business Administration (“SBA”) has finally released a “simplified” Paycheck Protection Program (“PPP”) loan forgiveness application for borrowers who meet certain requirements. This is a welcome development as lenders, borrowers, and lawmakers have urged the SBA and the Treasury to simplify the forgiveness process. At the same time, the SBA also released a new interim final rule (the “New IFR”) and revised the standard forgiveness application to account for changes from the PPP Flexibility Act (the “Flexibility Act”).<sup>1</sup> Despite the request of a majority of senators and many others, the new application form does not provide for a dollar threshold below which loans would be deemed forgiven.

### Form 3508EZ Forgiveness Application

#### *Eligibility to Use Application*

The instructions for the new PPP Loan Forgiveness Application Form 3508EZ (the “EZ Forgiveness Application”)<sup>2</sup> provide that borrowers can apply for forgiveness of PPP loans if they meet at least one of three tests.

#### *Test One:*

The first test is exclusively for self-employed individuals, independent contractors, or sole proprietors who had no employees at the time of their initial PPP loan application and did not include any employee salaries in the computation of average monthly payroll in the Borrower Application Form (SBA Form 2483). Unlike the first test, the other two are a bit more nuanced and involve a two-part analysis.

#### *Test Two:*

The second eligibility test has the threshold requirement that: “The Borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period compared to the period between January 1, 2020 and March 31, 2020 (for purposes of this statement, “employees” means [sic] only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount of more than \$100,000).”<sup>3</sup> The instructions do not provide information on how to calculate whether this initial requirement is met, but the reference to “any employee” shows that the potential for disqualification based on this point is significant.

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<sup>1</sup> The [Paycheck Protection Program Flexibility Act of 2020](#) was signed into law on June 5, 2020.

<sup>2</sup> [Loan Forgiveness Application Form EZ Instructions](#) and [Loan Forgiveness Application Form EZ](#).

<sup>3</sup> Whenever we use the term “Covered Period”, it includes the “Alternative Covered Period” that can be used by borrowers with a biweekly or more frequent payroll schedule that begins on the first day of their first pay period following the PPP loan disbursement date.

The additional prong of the second test requires the borrower to certify that it 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.<sup>4</sup> This second part appears to be the most burdensome of the three tests, particularly for borrowers that are not electing to use the original 8-week forgiveness period as the Covered Period. Borrowers using the 24-week Covered Period would essentially have to maintain overall employment levels and “average paid hours” for the entirety of 2020.<sup>5</sup> Neither the instructions nor the EZ Forgiveness Application provides a formula for the “average paid hours” calculation.

Borrowers that elect to qualify under the second test must submit documentation of the average number of full-time equivalent (“FTE”) employees employed on January 1, 2020 and at the end of the Covered Period. The EZ Forgiveness Application instructions state that the borrower should not submit the checklist. The EZ Forgiveness Application also does not include any field asking the borrower to indicate which test is selected—this information is captured in the borrower certifications of the EZ Forgiveness Application.

### *Test Three:*

The third test is by far the broadest category for determining borrower eligibility to use the EZ Forgiveness Application. The third test has the same initial requirement as the second test, *i.e.*, no reduction of employee salary or hours by more than twenty-five percent. The second part of the third test provides that the borrower “was unable to operate during the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020, and December 31, 2020 by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration, related to the maintenance of standards of sanitation, social distancing, or any other work or customer safety requirement related to COVID-19.” (Emphasis and Underlining Added).

By referencing COVID-19 safety guidance, borrowers have broad discretion for determining whether they qualify based on this prong of the third test of eligibility. A borrower can submit the EZ Forgiveness Application provided it can, in good faith, certify that it could not operate at the same level of business activity during the Covered Period as before February 15, 2020.

The instructions clarify that the EZ Forgiveness Application can be completed and submitted electronically, which presumably includes the required supporting documentation.

One thing that is certainly not “EZ” about the EZ Forgiveness Application is the amount of documentation that borrowers must submit to lenders and the lender’s burden of review. The only documentation that borrowers submitting the EZ Forgiveness Application do not have to provide compared to the original Forgiveness Application is documentation showing the average number of FTE employees. Borrowers are still required to submit significant documentation verifying eligible payroll and non-payroll expenses.

The documentation requirements are detailed on page four of the instructions and also outline the substantial amount of documentation that borrowers must maintain, but are not required to submit. As has been the case with the previous forgiveness application requirements, borrowers must retain all documentation related to the PPP loan and the borrower certifications for a period of six years after the date the loan is forgiven or repaid in full and permit authorized representatives of the SBA to access such files upon request. The application did not reduce the burden on lenders, and lenders must still review all supporting documentation in good faith.

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<sup>4</sup> The “Covered Period” is either: (1) the 24-week (168-day) period beginning on the PPP loan disbursement date, or (2) if the borrower received its PPP loan before June 5, 2020, the borrower may elect to use an 8-week (56-day) Covered Period.

<sup>5</sup> Maintaining the safe harbors from the June 2, 2020, interim final rule on forgiveness, borrowers can ignore reductions that arose from an inability to rehire individuals if the borrower was unable to hire similarly qualified individuals for unfilled positions on or before December 31, 2020, and can also ignore reductions in an employee’s hours that the borrower offered to restore and the employee refused.

### *Major Components of the EZ Forgiveness Application*

The EZ Forgiveness Application itself contains only one page on which the borrower has to enter any specific information. The second page consists of the borrower certifications and the third page is the optional borrower demographic information form. As we have discussed previously, the certificate should be enhanced to reduce lender exposure.

Borrowers have to include the number of employees at the time of loan application as well as the number of employees at the time of the forgiveness application and are required to submit supporting documentation along with the application. The EZ Forgiveness Application also asks borrowers to enter any EIDL Advance Amounts received as well as the EIDL Application Number, which can be left blank if not applicable.

If the borrower, together with its affiliates, received PPP loans in excess of \$2 million, they must check the box above the forgiveness amount calculation. This will presumably filter certain applications into a separate category for the SBA to audit. Borrowers should take steps designed to ensure that they are aware of the complex affiliation rules that apply even though the SBA has provided very little guidance on the affiliation rules in an easy to understand format.

Borrowers must enter the total eligible payroll costs incurred or paid during the Covered Period as well as employee benefits and owner compensation. Borrowers will also enter the total amount of eligible business mortgage interest paid or incurred for any business mortgage obligation on real or personal property, rent or lease payments paid or incurred for real or personal property, and the amount of business utility payments paid or incurred during the Covered Period—all of which must have been for obligations that existed before February 15, 2020. The instructions clarify that a borrower does not have to report any non-payroll expenses that the borrower does not want to include in the forgiveness amount.

As established by the PPP Flexibility Act and clarified by the SBA in the interim final rule last week, borrowers are expected to spend 60% of the PPP loan amount on eligible payroll costs and will receive reduced forgiveness for falling below the 60% threshold. The ultimate forgiveness amount is the smaller of: (1) eligible payroll expenses, mortgage interest expenses, business rent or lease payments, and business utility payments; (2) the PPP loan amount; or (3) payroll costs divided by 60%.

The second page of the EZ Forgiveness Application contains a long list of borrower representations and certifications. Borrowers are required to certify that they have provided accurate information, the funds were used for authorized purposes, they did not reduce salaries or hourly wages by more than 25% during the covered period, they have accurately verified the payment information, they have submitted all required documentation to the lender, all information is true and correct in all material respects, and that they understand the SBA may request additional information (among various additional certifications that include acknowledging the significant penalties for knowingly making false statements). Ultimately, the failure to provide the SBA with additional requested information may result in a determination that the borrower was ineligible for the PPP loan or a denial of the forgiveness request.

Borrowers have to certify that they *either* 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 (subject to the safe harbors) *or* were unable to operate between February 15, 2020 and the end of the Covered Period due to compliance with federal requirements or guidance related to COVID-19 in order to be eligible to use the EZ Forgiveness Application.

The third page of the EZ Forgiveness Application is the optional demographic information form that asks for information of the “Principal” with respect to veteran status, gender, race, and ethnicity. This

information could be leveraged by lenders for CRA purposes or to show the SBA that they are complying with guidance encouraging lending to underserved businesses.<sup>6</sup>

## Standard Form 3508 Forgiveness Application

The SBA also released a revised standard forgiveness application with updated instructions (the “Standard Forgiveness Application”).<sup>7</sup> As with the new EZ Forgiveness Application, the instructions for the Standard Forgiveness Application have been separated from the application itself. The Standard Forgiveness Application instructions provide that the borrowers must complete the application in accordance with the instructions and submit the application to the lender or loan servicer.

Other than changing the Covered Period from 8 to 24 weeks and lowering the required payroll expense amount from 75% to 60% to conform to the changes made in the Flexibility Act, not much has changed in the Standard Forgiveness Application. One notable difference from the EZ Forgiveness Application is that the Standard Forgiveness Application instructions contain steps to determine the salary/hourly wage reduction; even though borrowers using the EZ Forgiveness Application are also required to make a certification that they meet the salary/hourly wage reduction in order to be eligible under the second or third tests.

The revised Standard Forgiveness Application provides information for borrowers that elect to use the 8-week period for loan forgiveness for Borrowers whose loans were made before June 5, 2020. This is a positive development considering many borrowers who obtained loans during the first round of funding will be reaching the end of the 8-week period and may not be able to maintain payroll levels for an additional 16 weeks.

The Standard Forgiveness Application also reflects a significant fix to an issue with respect to the FTE safe harbor. Initially, the FTE safe harbor required a borrower to use June 30, 2020, as the reference period to determine whether the safe harbor was met. The Flexibility Act changed the June date to the year-end 2020. The Standard Forgiveness Application instructions now provides two separate safe harbors exempting borrowers from any reduction of loan forgiveness based on a reduction in FTE employee levels:

1. The borrower is exempt from the loan forgiveness based on a reduction in FTE employees if the borrower, in good faith, is able to document that it was unable to operate between February 15, 2020, and the end of the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with certain federal requirements or guidance related to COVID-19.<sup>8</sup>
2. The borrower is exempt from the reduction in loan forgiveness based on a reduction in FTE employees if both of the following conditions are met: (a) the borrower reduced its FTE employee levels in the period beginning February 15, 2020, and ending April 26, 2020; and (b) the borrower then restored its FTE employee levels by not later than December 31, 2020 to its FTE employee levels in the borrower’s pay period that included February 15, 2020.

The Schedule A Worksheet of the Standard Forgiveness Application has been revised to account for the updated safe harbor so that the reference date for calculating FTE employees to meet the safe harbor is the date the application is submitted. If the borrower’s total FTE employees as of the earlier of December 31, 2020, and the date the application is submitted is equal to or greater than the total FTE employees

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<sup>6</sup> SBA Administrator Carranza sent a message on Monday, June 15<sup>th</sup>, to lenders participating in the PPP encouraging them ‘to redouble efforts to assist eligible borrowers in underserved and disadvantaged communities.’

<sup>7</sup> [Loan Forgiveness Application](#) and [Loan Forgiveness Application Instructions](#).

<sup>8</sup> These are the same federal requirements or guidance in the third eligibility test to use the EZ Forgiveness Application described above.

are in the borrower's pay period inclusive of February 15, 2020, the FTE reduction safe harbor has been satisfied.

Otherwise, the Standard Forgiveness Application retains all of the burdensome requirements of the original forgiveness application. Borrowers are required to complete extensive complex calculations and provide significant supporting documentation when the application is submitted to the lender. The documentation that borrowers must maintain but are not required submit arguably consists of nearly every business financial record that could conceivably relate to the PPP loan application including documentation related to the borrower's certifications as to the necessity of the loan request, documentation necessary to support the loan forgiveness application, and documentation demonstrating the borrower's material compliance with all PPP requirements. As has been the case, borrowers must retain such documentation for a period of six years after the loan is forgiven or repaid in full and must permit authorized representatives of the SBA to access such files upon request.

### **Interim Final Rule Revising Third and Sixth Interim Final Rules**

The SBA released the New IFR which amended the IFRs issued on April 14 and April 28, 2020, in light of the Flexibility Act. The April 14<sup>th</sup> IFR provided additional eligibility criteria for PPP loans as well as requirements for certain pledges of PPP loans. Changes to the April 14<sup>th</sup> IFR involve revising any references to the previous two-year maturity to the five-year maturity for loans made after June 5, 2020. The revisions include language accounting for the ability of borrowers and lenders to mutually agree to extend the maturity date of PPP loans made prior to June 5, 2020.

Other changes to the April 14 IFR involve extending the period for loan forgiveness calculations from 8 to 24 weeks and reducing the required payroll expense portion from 75% down to 60%. The New IFR also clarifies that borrowers with loans made prior to June 5, 2020, may elect to have the covered period be the 8-week period beginning on the date the PPP loan was disbursed.

The New IFR also seeks to close a windfall that the SBA and Secretary of Treasury determined Congress did not intend. Specifically, the New IFR limits forgiveness of owner compensation replacement for individuals with self-employment income who file a Schedule C or F to either eight weeks' worth of 2019 net profit for an eight-week covered period or 2.5 months' worth of 2019 net profits for a 24-week covered period in total across all businesses. This limitation avoids a potential loophole for borrowers that only have one other employee who could receive a maximum loan amount equal to five months of payroll (2.5 months of payroll for the owner plus 2.5 months of payroll for the employee). If the owner in that situation laid off the employee and availed itself of the safe harbor in the PPP Flexibility Act from reductions in loan forgiveness, the owner could treat the entire amount of the PPP loan as payroll, with the whole loan being forgiven. The SBA determined that this would provide a windfall for the owner by providing the owner with five months of payroll instead of 2.5 months and would also defeat the purpose of the CARES Act of protecting the paycheck of the fired employee.

The New IFR made only a minor change to the April 28<sup>th</sup> IFR on disbursements by striking references to the "eight-week covered period" and replacing the references with "covered period." This change serves to ensure that the rule is applicable to either an 8-week or 24-week covered period, as elected by the borrower. The provisions of the New IFR relating to loan forgiveness are effective March 27, 2020 (the date the CARES Act<sup>9</sup> was signed into law) and the provision relating to the maturity date of PPP loans is effective June 5, 2020 (the date of the Flexibility Act was signed into law).

### **Other Notable Items**

As referenced above, one meaningful piece of relief that the EZ Forgiveness Application fails to provide is related to documentation. Regardless of the forgiveness application borrowers submit, they are still

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<sup>9</sup> Formally titled the [Coronavirus Aid, Relief and Economic Security Act](#) – the CARES Act was signed into law on March 27, 2020.

required to submit significant supporting documentation verifying the eligible payroll and non-payroll expenses. This will not only be burdensome on borrowers but also on the lenders that have to review this information in good faith and submit this information electronically to the SBA.

The Federal Reserve updated the FAQs for the PPP Liquidity Facility in light of the Flexibility Act to clarify that PPPLF advances will be 5 years when secured by a pledge of PPP loans with a 5-year maturity, i.e., any loan originated on or after June 5, 2020. However, the Federal Reserve has not yet released guidance on what lenders should do when the lender and borrower mutually agree to extend the maturity of a PPP loan with a 2-year term to a 5-year term.<sup>10</sup>

Lawmakers, industry trade groups, lenders and borrowers are still urging the SBA and the Treasury to issue blanket forgiveness for loans under a certain dollar amount. So far, the SBA and Treasury have not hinted that this is a viable possibility, but it should be noted that such an action is within their authority without the need for additional Congressional action.

At this time, there remains approximately \$130 billion in unallocated PPP funds with less than two weeks until the PPP ends on June 30, 2020.<sup>11</sup> With less than a billion dollars in new loans having been processed since May 23<sup>rd</sup>, it looks like there will be a lot of money left in the PPP coffers. Extending the duration of the PPP past June 30<sup>th</sup> would require an act of Congress as would allowing certain borrowers to take a second dip in the PPP pool, both of which have been raised as rumored possibilities.

As a final note, we expect the SBA to release additional Frequently Asked Questions (“FAQs”) soon (perhaps by the time this is released). After two months of almost daily updates to the FAQs, the SBA has left the current FAQs unchanged since May 27<sup>th</sup>—all the while lenders and borrowers have been left with significant statutory updates and new program rules. It is understandable that the SBA and Treasury faced a significant task of updating rules and processes based on changes created by the PPP Flexibility Act, but it is less understandable how they left borrowers and lenders in the dark for so long.

## Contacts

### **Peter G. Weinstock**

pweinstock@HuntonAK.com

### **Dean Elazab**

delazab@HuntonAK.com

### **Patrick J. Boot**

pboot@HuntonAK.com

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<sup>10</sup> The Federal Reserve PPP Liquidity Facility FAQs provide that additional information will be available on its [Discount Window](#) page when ready.

<sup>11</sup> [SBA PPP Loan Report Round 2](#) (6/14/2020).