

PUBLICATION

Forgive and Forget? Important Practical Advice for Borrowers Receiving a PPP Loan and Seeking Forgiveness

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UPDATED: April 29, 2020: The guidance related to additional limitations on forgiveness is evolving. For example, on April 28, 2020, Treasury announced there will be increased scrutiny on companies with PPP loans in excess of \$2 million. Please see our April 29th alert and contact your Baker Donelson attorneys.

Introduction

While small businesses across the country are looking for much needed relief and assistance in the wake of COVID-19, they are focusing on pressing topics like payroll, keeping bills paid, and the immediate needs of their employees, customers and owners. The rush to access government funds, like the Paycheck Protection Program (PPP), Economic Injury Disaster Loans (EIDL), and other funds is often accompanied by a flurry of paperwork, the proverbial "fine print" and constantly changing agency guidance on process, eligibility requirements, and disqualifiers. For most business owners, the threat of losing the business is a more pressing concern than some theoretical threat of enforcement due to an improperly completed application or a misunderstanding on how the proceeds may be used once received.

In the short term, this way of thinking is understandable. The government is cognizant of the needs of small business and given the hundreds of thousands of applications banks are getting each day, likely will not scrutinize the applications on the so-called "front end" before making the funds available. Consistent with the practices in prior emergency relief situations, the government will make the funds quickly available to get through the most difficult times. However, when the dust settles, and the true price tag is revealed to Congress and the administration, the finger pointing may start. Congress has built into the CARES Act extra oversight provisions, setting up administration officials to be challenged in public during an election season. This will pressure these officials to show they are taking steps to fight fraud, waste, and abuse. What does this mean for the business owner? Why does this matter? The answer can be found in the old saying, "an ounce of prevention is worth a pound of cure."

Disbursement of PPP Loans and the "Eight-Week Period" Thereafter

Many PPP applicants have already received loan proceeds or will be receiving them shortly, as lenders are required to make the first disbursement of a loan no later than ten days from the date of the loan approval.

The disbursement date for your PPP loan is significant, as the amount of forgiveness for a PPP loan is based on the borrower's payroll cost over an eight-week period that begins on the date the lender makes the first disbursement to the borrower. Expenses in these categories during the subsequent eight weeks are subject to forgiveness under the PPP program:

- Payroll costs;
- Interest on mortgage obligations incurred before February 15, 2020;

- Rent payments on leases dated before February 15, 2020; and
- Utility payments under service agreements dated before February 15, 2020.

At least 75 percent of the proceeds must be used on payroll costs, and no more than 25 percent on non-payroll expenses.

Forgiveness of a PPP Loan

PPP loan proceeds that were used by the borrower solely for the approved expenses detailed above will generally be fully forgiven by the lender if certain employee headcount and compensation requirements are met.

However, PPP loan forgiveness will be reduced for borrowers that have certain reductions in employee headcount or salary and wages because the focus of PPP is to ensure that employees keep getting paid. Therefore, if these situations, which are discussed in more detail below, occur, less of the loan will be forgiven by the bank and SBA, and the borrower will need to repay the amounts not forgiven at the required interest rate.

Loan Forgiveness Reduction Based on Decrease in Employees

Loan forgiveness will be proportionally reduced for borrowers who have certain decreases in the average number of full-time equivalent employees per month. Specifically, to determine loan forgiveness on this basis, the PPP requires borrowers to use a ratio to divide the average number of full-time equivalent employees per month during the eight-week period following PPP loan disbursement by, at the discretion of the borrower, either:

- The average number of full-time equivalent employees per month during the period beginning February 15, 2019 and ending on June 30, 2019; or
- The average number of full-time equivalent employees per month during the period beginning January 1, 2020 and ending on February 29, 2020.

However, seasonal employers cannot use the 2020 period for comparison, but instead must use only the period beginning on February 15, 2019 and ending on June 30, 2019.

After determining this ratio, the borrower's loan forgiveness will be reduced if the above calculation results in some number less than one, i.e., if it has less full-time equivalent employees during the eight-week period after loan disbursement than it did during the earlier period of comparison as described above. If that number is less than one, then the forgiveness will be reduced by a proportional amount.

Loan Forgiveness Reduction Based on Decrease of Salary of More than 25 Percent for Those Making Less Than an Annualized Amount of \$100,000

Loan forgiveness also will be reduced for each employee whose salary or wages is decreased by more than 25 percent during the eight-week period after loan origination as compared to that employee's salary and wages for the full quarter before the eight-week period. However, this reduction only applies related to employees who did not receive, during any single pay period in 2019, wages or salary at an annualized rate of pay higher than \$100,000 (i.e., \$8,333.33 over 12 pay periods or \$4,166.67 over 24 pay periods). Therefore, borrowers need to track any pay reductions to employees who made less than \$100,000 in 2019 because a 25 percent or more

decrease of salary and wages to those individuals during the eight-week period after loan origination as compared to the full quarter before it will cause a reduction in loan forgiveness.

Borrowers Can Avoid Forgiveness Penalties By Restoring Employee or Salary Reductions That Already Occurred Between February 15, 2020 and April 26, 2020.

One key point is that borrowers can correct any reduction in employees or compensation that occurred between February 15, 2020 and April 26, 2020 to avoid penalties under the above forgiveness calculations. For reductions in employees or compensation that occurred during that period, borrowers will not have their loan forgiveness reduced if they restore those numbers in accordance with the PPP forgiveness provisions by June 30, 2020. This language was included in the CARES Act with an understanding that several employers needed to take adverse action before it was enacted. The forgiveness provisions allow those employers to amend those prior actions by June 30, 2020 to avoid suffering any reduction in forgiveness on that basis.

We anticipate substantial guidance from Treasury on how the above reductions and exclusions might work.

Although guidance on the application for forgiveness has not yet been promulgated, it will include:

- Documentation verifying the employee and wage thresholds are met, including payroll tax filings reported to the IRS and state income, payroll, and unemployment insurance filings;
- Documentation verifying other permissible expenses, including cancelled checks, payment receipts and account statements;
- Certification from an officer of the borrower that the documentation is true and correct, and that the proceeds were made for permissible uses; and
- Other documentation or certification the SBA or lenders determine may be appropriate.

The CARES Act specifies that lenders will make decisions on loan forgiveness within 60 days of receipt of the application. Any loans forgiven under this program will not be taxable to the borrower as income. Any loans not forgiven shall be due and payable in accordance with the terms of the loan (two-year term, 1.00 percent interest), but proceeds remain limited to permissible uses.

Note that although the CARES Act specifies only the principal of a PPP loan will be forgiven, Treasury Department rules indicate both principal and interest will be forgiven.

Risks of Accepting a PPP Loan or Other Government Assistance

Following disbursement of loan proceeds and forgiveness, you may think that like a commercial loan, you can simply forget about a PPP loan. However, as an SBA loan program, PPP loans have risks that borrowers need to keep in mind at all stages of borrowing (especially long after no loan obligation remains). What is really at stake? At some point in the future, internal agency auditors will likely start reviewing submissions from applicants and payments. They will be advised by statisticians, lawyers, and financial analysts with experience and knowledge of common types of errors and fraud. They will focus on known "hot-spots" where applicants may erroneously certify compliance. Audits will seek supporting documentation and interviews; those who don't comply may be visited by law enforcement agents from the Office of Inspector General with subpoenas. Books and computers may be seized, restitution forced, fines levied, and, in serious cases, claims made under the False Claims Act or criminal charges.

Of additional concern—these won't all originate from the government. Disgruntled employees who seek out or discover "whistleblower" attorneys or what is referred to as "relator" counsel can initiate these investigations by filing hot line complaints or qui tam lawsuits under the False Claims Act—virtually requiring the government to investigate. These could be motivated by anything from pure concern for the fiscal security of the United States, to personal greed, to a personal vendetta for a perceived slight. Attorneys all over the country will soon begin advertising to help these people bring these kinds of suits. This will cause the government to be more proactive, attempting to bring these investigations in advance of these suits (for a myriad of reasons not addressed here), likely through the formation of a CARES Recovery Task Force or similar effort.

So, What Can You Do?

Below are some practical tips and answers to questions which businesses taking advantage of the PPP loan program and other forms of relief can consider to help prepare themselves for these issues and ensure, first and foremost, that any money or relief taken from the government is received lawfully. **It all starts with the application.**

Overarching Guidance

Any time you apply for a government benefit, there is some type of application and supporting documentation. Applicants need to make sure they understand the questions on the application before answering them. This can be through their own experience; or they can do one of several things: Seek advice from a consultant in the industry; seek advice from a fellow business person; seek advice from counsel; or seek advice from the government agency. As mentioned above, questions concerning the appropriateness of submissions and applications may come months or even years after the fact. A business may be asked to explain its actions when the people involved in the decision are no longer even with the company. To best prepare for this situation, it's a good practice to remember the "R's": **Record** advice; **Record** keeping; **Rationale**.

Recording advice: When completing the forms and working to understand the requirements of these programs, you should seek advice from others. You should write down this advice, including who you talked to, when you talked to them, what you told them and asked them, and what they said. If they provide a written reference or email, you should both save it and attach a hard copy to your own notes. This does not mean make an audio or visual recording, but simply a note or memo to your own files can be critical. How can this help? Guidance from a government agent, or from an attorney, can often be a defense to various allegations the government may bring.

Record keeping: Organizing and keeping all relevant records relating to claims for government benefits is one of the most important steps a business or individual can take. A claimant should assume the worst—that the government will be unable to locate copies of documents you or your business have submitted. For loans that are withdrawn, cancelled or do not close, the SBA instructs lenders to retain those files for two years and for loans that do close, the SBA generally requires the lender to retain all key records for up to ten years from payment or other disposition. Borrowers should also follow these general guidelines.

Rationale: A year or two after a business files for a particular program or benefit, the government may ask it to explain its rationale for why it thought it was eligible and what it knew at the time. A completely logical decision at the time may not appear as sound in hindsight absent a full picture of the factors and knowledge at the time. To avoid sounding like Dierks Bentley in his song "What Was I Thinking," a memo that summarizes the thoughts and understanding, the advice received, and the facts known, and the guidance given by the government, which is kept in the ordinary course of business, and made at or near the time of the decision, may qualify as a business record and be admissible in court without "hearsay" objections. If you have counsel, you should not include what counsel said in this memo, only a note that you consulted with counsel, to avoid any waiver of privilege in the future. The correspondence or guidance from counsel should be kept in a

separate document that is clearly marked "privileged," and never shared with the government unless and until you have consulted with counsel and have a complete understanding of the potential impacts of waiver.

What if there is a lack of specific guidance?

Despite your best efforts, you simply may not be able to find guidance or reach someone from the government to get clarification on requirements before filing your request. In those instances, here are our best practices for dealing with this situation:

Over-Disclose. If a program or benefit requires you to make certifications or to answer specific questions about eligibility, you should usually err in favor of over-disclosure to protect from False Claims Act and fraud allegations. Government knowledge of all material facts can be a defense to these claims. If you are not sure whether to answer "yes" or "no" as to whether you satisfy a particular requirement, but believe you do, consider checking yes, but then noting all relevant information relating to that question. Often applications will have a remarks section where this information can be disclosed. Be sure to include language that directs the government review to "see attachment" or "see remarks" and identify the block.

Additionally, a "signing statement" can be a good practice. In other words, when you sign a certification or application, consider including an attachment or statement that lists what you believe are the relevant facts or circumstances, especially where there was not space on the application or certification to provide supplemental information. A signing statement would be a good place to list key assumptions and facts about your understanding of the various program requirements that support your decision to submit your application. The best practice is to get assistance from counsel in deciding whether to prepare and submit a signing statement or supplemental disclosure.

However, disclosing all the facts or including a signing statement likely will not be sufficient in those areas where the guidance is clear. For example, you should not rely on a signing statement to explain your rationale for answering "yes" to a question that clearly should have been marked "no" under the application's instructions and existing regulations. The documents described here are primarily helpful in confusing areas of the law. They should not be used to list facts clearly showing ineligibility for a program while separately certifying on the application that you are eligible.

And of course – go back and remember the three **R's**, and keep a clear, organized record of relevant information, communication and guidance.

What if the guidance changes after an application is submitted?

One of the most difficult situations arises where a claimant's understanding of the guidance changes due to supplemental guidance, changes in the rules, or informal agency decisions, after the application and certification have been submitted. In the ever-changing environment post-CARES Act and the negotiations between large entities like banks and government agencies, this is a very real and serious scenario. The best practices in these circumstances require a slightly more cautious approach.

First, this is one of the situations where a business or individual should seek legal counsel. Calling the government directly, drafting correspondence or stepping into this situation without counsel can have a higher risk of negative outcome. For instance, statements made directly by a claimant acknowledging error, and not through counsel, could be used against an individual or entity in court as a "party admission." It is critical to consider the nature and style of the communication, availability of "voluntary disclosure" mechanisms, and other program specific guidance before making this communication.

Second, even if a submission was accurate and truthful at the time of its submission, if the claimant learns subsequent information, or realizes that there is something that might cause the government to deny the application, and does not provide that information, the failure to supplement the record or withdraw the application may create liability under the False Claims Act. Accordingly, a party should not assume that, just because a claim appeared right at the time it was filed does not mean the obligations do not continue to run. This can be a complicated question, and should be considered with advice of counsel.

Lastly, where the claimed money has already been received, and new information is learned or new guidance is issued, the government likely will want that money back. After consulting with counsel, a claimant can consider a number of options including supplementing the application; withdrawing the application; setting aside the money until clarification is reached; returning the money; or a meeting with counsel and the government. Given the circumstances, even if the decision is to return the money, using counsel may help delay that repayment or spread it out over time, as well as avoid any potential interest or penalties.

Department of Treasury FAQs acknowledge the complexity of these issues and government's understanding that the evolving PPP rules may put at risk an applicant who was eligible at the time of application but became ineligible at the time of disbursement or forgiveness, and permit applicants to rely on the rules and guidance in effect at the time, further underscoring the necessity of good recordkeeping.

What are some other general tips?

Full disclosure, and clear, documented understanding is critical. The old adage of "Better to ask forgiveness than permission" is not a good one to follow when seeking assistance from the government.

Closely review the application questions and seriously consider your answers before making certifications for any government program or benefit, including SBA loans. There are multiple examples of the government enforcing claims against parties receiving or applying for benefits for which they were not qualified. Caution should be used when applying for any government programs.

Make sure your compliance program is documented, comprehensive, up-to-date and enforced. Do you have a clear whistleblower non-retaliation policy? What kinds of training are you doing? These programs should be created and in place before you apply for or receive any kind of government funding. Conduct periodic checks to make sure the system is being followed and document these efforts.

Prepare your employees for likely interaction with the government. Make them aware that the government will someday want to review the records, and that they should keep all records and communication with that in mind. Get advice from counsel on preparing your employees for being contacted directly by agents or auditors, and how to notify counsel.

Review your document and email preservation policy. Ensure it not only complies with the requirements of any government in which you are participating, but also will be sufficient to show and defend your actions if they are ever questioned in the future.

The application for and forgiveness of loans under the PPP or other forms of government assistance may create risk for borrowers. For specific guidance on this issue, please contact any of the authors. For more information and general guidance on how to address other legal issues related to COVID-19, please visit the [Coronavirus \(COVID-19\): What You Need to Know information page](#) on our website.