



PPP and Loan Forgiveness: Latest Guidance and Changes Under the PPP Flexibility Act

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Since the Paycheck Protection Program (“PPP”) was implemented under the Coronavirus Aid, Relief and Economic Security Act (“CARES Act”), borrowers have sought clarity from the Small Business Administration (“SBA”) about the PPP and its loan forgiveness component. This allows borrowers forgiveness for up to the full principal amount of the PPP loan plus accrued interest. Because loan forgiveness hinges on borrowers satisfying very specific requirements, and the first of the PPP loans were disbursed after April 3, 2020, time is of the essence for borrowers to receive additional guidance. The SBA finally answered the call and recently issued additional guidance on the PPP and loan forgiveness. Additionally, Congress has stepped in to provide borrowers with more flexibility to make it easier to achieve full (or almost full) loan forgiveness by enacting the Paycheck Protection Program Flexibility Act of 2020 (“PPPFA”), which became law on June 5, 2020.

This eAlert provides a brief summary of what borrowers need to know about (1) the latest regulations, rules and guidance relating to the PPP and loan forgiveness, including changes under the PPPFA and (2) the loan forgiveness application and process. Because the rules and guidance relating to the PPP and loan forgiveness are constantly in flux, readers should visit the websites of the SBA and U.S. Department of the Treasury for more complete and up to date information.

Additional Guidance Regarding Loan Forgiveness

On May 22, 2020, the SBA issued additional guidance on the requirements for PPP loan forgiveness (see SBA’s Interim Final Rules published at 85 FR 33004 on June 1, 2020). Below is an overview of this additional guidance and clarifications that were introduced in the loan forgiveness application form and instructions. **However, as further discussed below, the newly enacted PPPFA makes several changes to the PPP and its loan forgiveness component, including to the eight-week “covered period” referenced in the sections below.**

(1) Payroll Costs Eligible for Loan Forgiveness

(a) **Time Period for Paying or Incurring Payroll Costs.** In general, payroll costs paid or incurred during an eight consecutive week (56-day) period are eligible for forgiveness (but if incurred during the last pay cycle of the eight-week period, must be paid by the next payroll date to be eligible for forgiveness). Under prior rules and guidance, the eight-week “covered period” begins on the date the loan is awarded. Recognizing the need to accommodate businesses whose eight-week covered period may not always align with their regular payroll cycles, the new guidance allows borrowers with a bi-weekly (or more frequent) payroll cycle to select an “alternative payroll covered period,” which is the first day of the first payroll cycle after the borrower received the PPP loan proceeds.

(b) **Payroll Costs — Paid vs. Incurred.** In its new guidance, the SBA provides definitions for when payroll costs are paid and incurred. Payroll costs are paid on the day the paychecks are distributed or an ACH credit transaction is initiated. Payroll costs are incurred when the pay is earned, i.e. on the day the employee worked, or would have worked if they are still on payroll but not performing work.

(c) **Payments to Furloughed Employees; Bonus and Hazard Pay.** Payroll costs paid to furloughed employees, as well as bonus and “hazard pay” during the covered period, are eligible for loan forgiveness so long as they do not exceed an annual salary of \$100,000 per employee as prorated for the covered period. The SBA explained that this is consistent with the intent of the PPP to enable businesses to continue to pay their employees, even those who are furloughed due to the COVID-19 pandemic.

(d) **Caps on Loan Forgiveness for Owner-Employees and Self-Employed Individuals.** In addition to its prior rules on loan forgiveness requested for business owners,^[1] the latest guidance provides for different loan forgiveness treatment for compensation paid to owners of businesses based on three categories — owner-employees, Schedule C filers and general partners.^[2] The SBA further stated for self-employed individuals, including Schedule C filers and general partners, that no additional forgiveness is provided for retirement or health insurance contributions because these are paid out of their net self-employment income.

(2) Non-Payroll Costs Eligible for Loan Forgiveness

Non-payroll costs such as utilities, business rent and mortgage interest payments paid or (if paid before the next regular billing date -- even if the billing date is after the covered period) incurred during the covered period are eligible for forgiveness. This more flexible approach opens the door for more forgiveness than originally contemplated. The SBA clarified that advance payments of interest on a covered mortgage obligation are considered prepayments and, therefore, are not eligible for loan forgiveness under the CARES Act.

(3) Reductions to Loan Forgiveness Amount

Under the CARES Act, the amount of loan forgiveness is reduced based on decreases in full-time employees or in employee compensation unless an exemption applies (see “Exemptions to Loan Forgiveness Reductions” below).

(a) **Reduction in Full-Time Employees (FTE).** The amount of loan forgiveness reduction is based on the level of reduction in the average number of FTE employees during the covered period or the alternative payroll covered period as compared to a “reference period.”^[3] So, a 25% decline in the average number of FTE employees would result in a 25% reduction in the loan forgiveness amount.

While a “full-time employee” is not defined under the CARES Act, the SBA determined this to mean an employee who works 40 or more hours on average each week. This is a departure from the 30 hours per week standard that borrowers and advisors were expecting,^[4] so some borrowers will need to do a recalculation of their loan forgiveness. Borrowers must calculate the hours of all part-time employees as a proportion of a single full-time equivalent employee and aggregated by either (1) calculating the average number of hours a part-time employee worked per week (e.g., 30 hours per week is a 0.75 FTE), or (2) using a full-time equivalency of 0.5 for each part-time employee, which is better for borrowers who do not maintain hours-worked data. Borrowers must use the same method for all of their part-time employees for the covered period or alternative covered period and the selected reference period.

Borrowers seeking loan forgiveness should keep written records of their average number of FTE employees during the applicable eight-week period and reference period.

(b) Reduction in Employee Compensation. The amount of loan forgiveness reduction is also based on a reduction in an employee’s compensation by more than 25% during the covered period or the alternative payroll covered period, as compared to a “reference period” (January 1, 2020 and March 31, 2020). Borrowers must do this calculation on a per employee basis (not in the aggregate) for each new employee in 2020 and each existing employee who received an annualized salary of \$100,000 or less in 2019.

For example, for an FTE employee who earned less than \$100,000 in 2019 and whose compensation was reduced from \$1,000 per week during the reference period to \$500 per week during the covered period or alternative payroll covered period (i.e., a \$500 per week reduction), the borrower would do the following calculation:

- The first 25% reduction in compensation for the employee, or \$250 (25% of \$1,000), is exempt from loan forgiveness reduction.
- The additional \$250 weekly reduction in compensation for the employee counts toward loan forgiveness reduction, so the borrower should list \$2,000 as the compensation reduction for that employee (\$250 weekly reduction multiplied by eight weeks).

(c) Interplay Between Reductions in Full-Time Employees and Employee Compensation. Unfortunately, the CARES Act does not address the interplay between FTE employee reduction and compensation reduction. To ensure borrowers are not subject to a double penalty when calculating a reduction in loan forgiveness, the updated guidance provides that the compensation reduction apply only to the portion of the decline in compensation that is not attributable to the FTE reduction. For example, if a borrower reduces the hours of a full-time employee from 40 to 20 hours per week, *but maintains the same hourly wage*, the borrower does not need to calculate a compensation reduction for that employee because the reduction in the employee’s wages is solely attributable to the reduction in hours.

(d) Exemptions to Loan Forgiveness Reductions. In addition to the statutory exemption under the CARES Act,^[5] the SBA’s latest guidance added the following new regulatory exemptions to reductions in loan forgiveness amounts based on reductions in FTE employee headcount or employee compensation.

(i) A borrower who makes a good faith written offer to rehire or restore the reduced hours of an employee during the covered period or alternative payroll covered period for the same compensation and same number of hours, but the employee rejects the offer. To be eligible for this exemption, borrowers must maintain records documenting the offer and its rejection, and also must inform the applicable state unemployment insurance office of the employee’s rejection of the offer within 30 days of the rejection. Thus,

employees should be careful in rejecting an employer's rehire offer because this will likely impact any unemployment benefits the employee is receiving.

(ii) If the employee is fired for cause, voluntarily resigns or voluntarily requests and receives a reduction in hours during the covered period or the alternative covered period. This is an appropriate and welcome update for borrowers because it would be unfair to penalize them where the reduction in FTE is due to the employee's actions and requests. To be eligible for this exemption, borrowers must maintain records demonstrating that the employee was fired for cause, voluntarily resigned or voluntarily requested a schedule reduction.

Paycheck Protection Program Flexibility Act

On May 28, 2020, the U.S. House of Representatives approved a bill (H.R. 7010) known as the Paycheck Protection Program Flexibility Act of 2020 ("PPPFA"), which unanimously passed in the U.S. Senate on June 3, 2020 and was signed into law by President Trump on June 5, 2020. The measure included the \$3 trillion Health and Economic Recovery Omnibus Emergency Solutions ("HEROES") Act that the House passed on May 15, 2020, but is stalled in the Senate and may not become law [see Nossaman's *eAlert* regarding the HEROES Act]. The PPPFA amends certain PPP provisions in the CARES Act and takes effect retroactively as if they were included in the initial PPP signed into law on March 27, 2020. Key highlights of the PPPFA include:

(1) Extending the eight-week "covered period" for loan forgiveness from eight to 24 weeks or December 31, 2020, whichever comes sooner.^[6] The PPPFA did not address the "alternative payroll covered period" introduced by the SBA (see above), so presumably the SBA will modify the "alternative payroll covered period" to 24 weeks. What remains open is (i) whether a borrower is required to (or should) wait the full 24 weeks to apply for loan forgiveness if it spends all of its PPP loan funds sometime between eight and 24 weeks and (ii) whether the applicable reference periods by which to compare terminations of FTE employees or employee compensation reductions for purposes of reductions in loan forgiveness will be also be extended.

(2) Lowering the threshold on the requirement to use PPP loan funds for payroll costs from 75% to 60%, which provides more flexibility to businesses to pay for other overhead expenses. However, one unintended consequence is that the new language is viewed as a "cliff" requirement, meaning that a borrower is not eligible for loan forgiveness if it fails to meet the 60% threshold. The prior language allowed for loan forgiveness even if the 75% threshold was not met, but required borrowers to proportionately reduce the amount of loan forgiveness claimed. There is talk of a possible correction to this that would restore the prior "sliding scale" concept.

(3) Extending the deadline to rehire workers from June 30, 2020 to December 31, 2020. However, what is unclear is whether a borrower can still rely on the June 30, 2020 date for rehiring workers to seek full loan forgiveness if they subsequently terminate FTE headcount before December 31, 2020.

(4) Extending the two-year repayment schedule to a **minimum** of five years for new borrowers (existing borrowers and lenders could agree to extend the maturity date of current loans).

(5) Ensuring that PPP recipients benefit from a special payroll tax deferral even if all or a portion of the PPP loan is forgiven.

(6) Providing an additional exemption from loan forgiveness reduction for borrowers that document their inability to (a) rehire workers employed as of February 15, 2020, and their inability to hire similarly qualified workers by December 31, 2020^[7] or (b) return to the same level of pre-February 15, 2020 business activity due to compliance with federal requirements or guidance relating to COVID-19 (e.g., follow requirements for sanitization or social distancing).

(7) Extending the covered period to apply for a PPP loan from June 30, 2020 to December 31, 2020. However, it appears that this was not the intent and, accordingly, the SBA will continue to impose the June 30, 2020 deadline for accepting and approving PPP loan applications.^[8]

(8) Allowing borrowers to defer principal and interest payments on PPP loans until the date the SBA compensates lenders for forgiven amounts, instead of the current six-month deferral period (borrowers that don't apply for loan forgiveness can defer payments for at least 10 months after the last day of the "covered period").

As noted above, we should expect to receive further guidance from the SBA and Department of Treasury on implementing the PPPFA. In addition, it is likely that we'll see modifications to the PPPFA to clarify (or fix) certain provisions.^[9]

Loan Forgiveness Application and Process

On May 15, 2020, the SBA, in consultation with the Department of the Treasury, released the PPP loan forgiveness application along with detailed instructions to guide borrowers and lenders on the loan forgiveness process. The application includes: (1) PPP Loan Forgiveness Calculation Form; (2) PPP Schedule A; (3) PPP Schedule A Worksheet; and (4) PPP Borrower Demographic Information Form (optional). In order to receive loan forgiveness, borrowers must submit items (1) and (2) to their SBA approved lenders, together with certain documents (e.g., relating to payroll, tax forms, business mortgage interest, rent and utility payments). Borrowers are also required to maintain certain PPP-related documentation in their files for **six years** after the date the loan is forgiven or repaid in full (e.g., PPP Schedule A worksheet, documents supporting borrower certifications, etc.).

The lender is charged with reviewing its borrower's loan forgiveness application, and must provide the SBA with its decision on loan forgiveness within 60 days of receipt of the completed application. The lender must also notify the borrower of its decision. If the borrower's loan forgiveness application is denied, or if only a portion of the loan is forgiven, the borrower must repay the non-forgivable portion of the loan by the maturity date of the loan. Borrowers have 30 days to appeal a denial of loan forgiveness, and the SBA has indicated that it will issue additional guidance on this process.

Because the application form itself is complicated, borrowers should seek assistance from advisors such as accountants and attorneys to ensure that the application is completed properly so that they receive full (or close to full) loan forgiveness and also in the case of a review or audit by the SBA. (See our *eAlert* regarding the latest guidance on SBA review of PPP loans.) There has been discussion about creating a simpler loan forgiveness application for smaller loans (e.g., \$150,000-\$300,000 range). Regardless, the application form will need to be changed, likely with additional clarification, based on the recent changes to the PPP implemented under the PPPFA.

[1] See 85 FR 21747, 21750.

[2] Owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement and health care contributions made on their behalf. Schedule C filers are capped by the amount of their owner compensation replacement calculated based on 2019 net profit. General partners are capped by the amount of their 2019 net earnings from self-employment (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235.

[3] The borrower must select a reference period to measure against the FTE employee count (same method must be followed for each employee), which is either (i) February 15, 2019 through June 30, 2019, (ii) January 1, 2020 through February 29, 2020, or (iii) for seasonal employers either of the above two methods or a consecutive 12 week period between May 1, 2019 and September 15, 2019.

[4] Previous SBA guidance on the interpretation of the term “FTE” in the context of the Employer Shared Responsibility Program introduced by the Affordable Care Act in 2014 was that an employee would be an FTE if he/she worked at least 30 hours per week, or who in combination with others work at least 30 hours per week. Thirty hours per week is also the approach taken by the IRS.

[5] If a borrower reduces employee compensation by more than 25% and/or reduces FTE employees during the reference period (between February 15, 2020 and April 26, 2020), but restores employee compensation or FTE headcount (as applicable) to the February 15, 2020 level by June 30, 2020, the borrower is exempt from any loan forgiveness reduction. See discussion below regarding changes to this deadline imposed by the PPPFA.

[6] Businesses that received a loan before the enactment of the PPPFA may elect to keep the current eight-week period, which may be advantageous to certain borrowers. For example, a borrower who used all of its PPP loan proceeds during the eight-week covered period to maintain FTE employee headcount and employee compensation may not be able to continue doing so for a full 24 week period.

[7] Of note, the SBA’s newly added exemptions for not penalizing borrowers for terminations of FTE employees due to the employee’s actions (see “Exemptions to Loan Forgiveness Reductions” above) does not require the employer to demonstrate an inability to rehire similarly qualified workers.

[8] This is based on a letter entered into the congressional record by the Senate prior to adopting the PPPFA.

[9] One additional note on the regulatory front is that the Small Business Truth Act, which would have required disclosure of all PPP loans over \$2 million in an effort to bolster transparency, did not pass.