

As a follow-up to the May 26, 2020 "Back to Work in New York?" webinar presented by:

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IN-DEPTH DISCUSSION

Agencies Issue New Interim Final Rules on PPP Loan Forgiveness and Loan Review Process

By **Amberly Morgan and Sean Malley** on May 27, 2020

On May 22, 2020, the SBA and Department of the Treasury issued two Interim Final Rules implementing the Paycheck Protection Program (PPP) provisions of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The PPP provides low-interest, forgivable loans to small businesses affected by the COVID-19 pandemic. [One of these Rules](#) details the loan forgiveness process and requirements, while the [second Rule](#) details the process by which the SBA will review loans to ensure compliance.

Banks began disbursing PPP loans on April 3, 2020, but until Friday, May 22, 2020, none of the 13 prior SBA and Treasury Interim Final Rules or prior FAQs addressed loan forgiveness with any detail. As a result, borrowers have had little guidance beyond the statutory language and have been struggling to understand how to maximize loan forgiveness. Finally, on Friday, May 15, 2020, the SBA and Treasury released the loan forgiveness application and instructions for completing the application. This information began to clarify many questions, but left many others unanswered.

The Rules released on May 22, 2020, generally track the forgiveness application, albeit with significantly more detail. The Rules also contain a few surprises while emphasizing that the guidance is intended to further the purposes of CARES Act – keeping workers employed and paid.

PPP Loan Forgiveness Requirements and Process

The statutory language of the PPP provided a framework for borrowers to use PPP loan proceeds for specified purposes. Such loans could be fully forgiven if certain criteria were met, but that forgiveness would be reduced based on a reduction to employee headcount or wages. The loan application and instructions, released May 15, 2020, clarified for the first time how full-time equivalent (FTE) employees are calculated, that employees may be paid for not working, and how to calculate reductions to

forgiveness based on a reduction in FTEs or a reduction in salary or wages. The forgiveness application also clarified the operation of the PPP's safe harbor provisions. Under these safe harbor provisions, a borrower that experienced reductions in average FTE levels or wages between February 15, 2020 and April 26, 2020 can avoid reductions to loan forgiveness if they cure those FTE and salary/wage reductions by June 30, 2020.

The Interim Final Rule on loan forgiveness provides further clarification on these topics and explains the new *de minimis* exceptions.

Timing of payroll costs – The PPP provisions require expenses to be incurred and paid during the eight weeks following loan disbursement (Covered Period). The forgiveness application and the new Rule explain that payroll costs are generally incurred on the day the employee's pay is earned (i.e., on the day the employee worked). For employees who are not performing work but are still on the borrower's payroll, payroll costs are incurred based on the schedule established by the borrower (typically, each day that the employee would have performed work). However, to ease the administrative burden on borrowers, the new Rule now provides an alternative option for employers to commence the eight consecutive weeks of covered payroll costs on the first day of the first full payroll cycle following the disbursement of the loan proceeds.¹ For employees who are not performing work but are still on the borrower's payroll, payroll

costs are incurred based on the schedule established by the borrower (typically, each day that the employee would have performed work).

The new Rule also specifies that compensation is considered paid on the day that paychecks are distributed or an automated clearing house (ACH) payment to the employee is originated by the employer. Payroll costs incurred during the borrower's last pay cycle in the Covered Period or the Alternative Payroll Covered Period are also eligible for forgiveness if paid on or before the next regular payroll date.

Bonuses and Hazard Pay – The Rule finally gives official blessing to bonuses and hazard pay paid to employees during the covered period as long as the compensation does not exceed an annual rate of \$100,000. Payroll costs are defined in the CARES Act to include salary, wages, commissions, "or similar compensation." Hazard pay and bonuses are eligible for loan forgiveness because they constitute a supplement to salary or wages, and are thus a similar form of compensation.

Limits on Compensation for Owner Employees – Raises are permitted for employees, but are limited for owner-employees and self-employed individuals' compensation. In addition to the limitation capping payroll expenses at an annual rate of \$100,000 for any employee, owner-employees cannot obtain forgiveness for compensation in excess of 2019 cash compensation and

employer retirement and health care contributions made on their behalf. Owner-employees are limited to the lesser of 8/52 of 2019 compensation or \$15,385 (eight weeks of salary at an annual rate of \$100,000) per individual in total across all businesses. 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. No additional forgiveness is provided for retirement or health insurance contributions for self-employed individuals, including Schedule C filers and general partners, as such expenses are paid out of their net self-employment income.

Timing of Nonpayroll Costs – Borrowers are afforded greater flexibility regarding the timing of the payment for nonpayroll costs. Nonpayroll costs are eligible for forgiveness if they are 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.

Rents on Personal Property – In accordance with the forgiveness application, borrowers can apply for loan forgiveness on rent payments on personal property as well as rent on real property. This expands on earlier guidance indicating that interest payments for mortgages on personal property would be eligible for forgiveness. Prepayments of interest and principle payments remain ineligible for forgiveness.

Offers to Rehire/Restore Hours – Recognizing the difficulty some employers are having recalling workers who may be receiving more compensation elsewhere, earlier guidance provided that an employer that has made a good-faith written offer to re-hire an employee (for the same wage/salary and hours) would not face a reduction to forgiveness based on such an employee's rejection of the offer. The new Rule adds that an employee whose hours had been reduced prior to the Covered Period, but who declines an offer to restore hours, will also not result in a reduction to forgiveness. To take advantage of this exemption, the employer would be required to maintain records documenting the employee's rejection of the offer. The offer must be at the same salary or wages and same number of hours earned by the employee in the law's pay period prior to the separation. The employer is also now required to inform the applicable state unemployment office of the employee's rejection of the offer within 30 days. The SBA will provide further information on its website in the near future to explain how borrowers will report this information to state unemployment agencies.

Employee Terminations and Resignations – The exemption to the reduction in forgiveness also applies to employees who are fired for cause, voluntarily resign or voluntarily request reduced hours. Borrowers are required to retain records documenting any voluntary resignations, reduction in hours and terminations for cause and be prepared to provide such documentation upon request.

Calculating Forgiveness Based on FTEs – Borrowers that have a reduction to full-time equivalent levels during the Covered Period relative to the borrower's chosen reference period will experience a reduction to the amount of loan forgiveness they receive. The CARES Act provides that such reduction is calculated by multiplying covered expenses paid and incurred during the Covered Period by the average number of FTEs per month in the covered period divided by the average number of FTEs per month in the chosen reference period. The Rule clarifies, as an example, a borrower who had 10 FTEs during its chosen reference period, but 8 FTEs during the Covered Period, maintained 80% of its FTEs and therefore would be eligible to receive forgiveness of 80% of its covered expenses.

Consistent with the forgiveness application, the new Rule clarifies for the first time that borrowers must calculate FTE for each employee based on a 40-hour work week rather than a 30-hour work week. The new Rule also provides two methods for calculating FTE. Under the first method, borrowers divide the average number of hours paid for each employee per week by 40, capping this quotient at 1.0, and aggregate the result. To simplify this process for employers that may not have detailed hours-worked records, an alternative method may be used. Under the second method, an employee working at least 40 hours per week is counted as 1.0 FTE and each employee working fewer than 40

hours per week as 0.5 FTE. In no case can an employee be counted as greater than 1.0 FTE. The Rule requires borrowers to apply the chosen method consistently to all part-time employees.

Calculating Forgiveness Based on Wages/Salaries – Loan forgiveness is also reduced based on reductions in salary or wages during the Covered Period in excess of 25 percent relative to the first calendar quarter of 2020. This reduction applies only with respect to employees who did not receive wages in excess of an annual rate of \$100,000 during any pay period in 2019. Additionally, a borrower that restores salaries/wages to the prior levels by June 30, 2020, will avoid this reduction. For example, consider an employee whose salary was \$1,000 per week during the reference period that was later reduced by 30 percent to \$700 per week during the covered period. The employee continued to work on a full-time basis during the covered period with an FTE of 1.0. The first \$250 (25 percent of \$1,000) is exempted from the reduction. The total wage reduction for that employee is \$400 (\$50 per week multiplied by eight weeks) and the corresponding reduction to loan forgiveness is also \$400.

No Double Penalty – The Rule contains new language that will come as a pleasant surprise to borrowers. Under the CARES Act, a reduction to forgiveness is based on a decline in the average number of FTEs or on a reduction in salaries or wages. To ensure that borrowers are not doubly penalized, the salary/wage reduction applies only to the portion of the decline in employee

salary and wages that is not attributable to the FTE reduction. The CARES Act does not address this intersection and the Rule helps ensure uniformity across all borrowers in applying the FTE reduction provision and the salary/wage reduction provision, and will help ensure that borrowers are not doubly penalized for reductions. For example, an hourly wage employee had been working 40 hours per week during the borrower-selected reference period (FTE employee of 1.0) and the borrower reduced the employee's hours to 20 hours per week during the covered period (FTE employee of 0.5). There was no change to the employee's hourly wage during the covered period. Because the hourly wage did not change, the reduction in the employee's total wages is entirely attributable to the FTE employee reduction and the borrower is not required to conduct a salary/wage reduction calculation for that employee.

This provision also provides clarity as to how the wages of employees who resign or otherwise leave the employ of the borrower during the covered period. For example, if an employee resigned on week four of the Covered Period, the borrower does not need to include weeks five through eight in averaging the employee's compensation for purposes of calculating forgiveness.

Safe Harbor – The PPP provisions of the CARES Act include "second chance" language, deemed Safe Harbor provisions in the Rule. As noted, borrowers that experienced reductions in average FTE levels or wages between February 15, 2020 and April 26, 2020

must eliminate such reductions by June 30, 2020 to avoid reductions to loan forgiveness. The CARES Act language describes FTEs on an average basis during both the Covered Period and the reference period (the period chosen by the borrower for comparison of FTE levels). The CARES Act provisions also describe wages as “total wages.” This language suggests that the elimination of FTE or wage reductions over the course of the Covered Period could not mathematically take place in a single day. As a result, it would make sense that the process of eliminating any reduction in these average amounts would have to begin well before June 30, 2020.

The Rule does not clearly address the implementation of the Safe Harbor provisions. The forgiveness application instructions, however, demonstrate that a borrower need only make the restoration *as of* June 30, 2020. It is unclear whether an employer that experienced reductions in FTEs could simply re-hire employees with schedules sufficient to match earlier FTE levels, or if such an employer would need to re-hire employees far enough in advance of June 30, 2020 to calculate employees’ average weekly hours paid—perhaps one week or one pay period. Similarly, an employer that reduced wages more than 25% during the Covered Period relative to the first quarter of 2020 does not need to restore “total” average wages but can simply restore an employee’s rate of pay as of June 30, 2020 in order to avoid a reduction to forgiveness.

Loan Forgiveness Process – To receive loan forgiveness, a borrower must complete and submit the Loan Forgiveness Application to its lender. As a general matter, the lender will review the application and make a decision regarding loan forgiveness. The lender has 60 days to issue a decision to the SBA. For loans that are not reviewed by the SBA, the Agency will remit payment to the lender within 90 days. The lender is required to notify the borrower of the amount of loan forgiveness and any amount not forgiven must be repaid by the two-year maturity of the loan. As discussed in more detail below, if the SBA reviews the loan and determines the borrower was not eligible for the loan based on the CARES Act provisions or guidance available at the time of the loan application, the loan will not be eligible for forgiveness.

PPP Loan Review Process

Following public backlash after reports of large public companies taking PPP loans, the SBA issued guidance reminding borrowers of their obligation to certify in good faith that their PPP loan request is necessary. Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Borrowers must make this certification in good faith, taking into account their current business activity and their ability

to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.

Thereafter, the SBA issued guidance stating it would review all PPP loans in excess of \$2 million in addition to other loans as appropriate. In a reversal of course, the SBA then issued further guidance that any borrower receiving a loan with a principle amount of less than \$2 million will be deemed to have made the certification concerning the necessity of the loan request in good faith. Borrowers unable to certify need for the loan were given until May 14, 2020 to repay their PPP loans. The Interim Final Rule on loan review has reversed again and states the SBA will review any PPP loan as deemed appropriate. For a PPP loan of any size, the SBA may undertake a review at any time in SBA's discretion. For example, the SBA may review a loan if the loan documentation submitted to the SBA by the lender or any other information indicates that the borrower may be ineligible for a PPP loan, or may be ineligible to receive the loan amount or loan forgiveness amount claimed by the borrower. Borrowers must retain PPP documentation in their files for six years after the date the loan is forgiven or repaid in full, and permit authorized SBA representatives access to such files upon request.

The Rule states the SBA may review PPP loans for compliance. Specifically the SBA may review:

- whether a borrower is eligible for the PPP loan based on the provisions of the CARES Act, the rules and guidance available at the time of the borrower's PPP loan application, and the terms of the borrower's loan application;
- whether a borrower calculated the loan amount correctly and used loan proceeds for the allowable uses specified in the CARES Act; and
- review whether a borrower is entitled to loan forgiveness in the amount claimed on the borrower's Loan Forgiveness Application (SBA Form 3508 or lender's equivalent form).

If loan documentation submitted to the SBA by the lender or any other information indicates that the borrower may be ineligible for a PPP loan or may be ineligible to receive the loan amount or loan forgiveness amount claimed by the borrower, the SBA will require the lender to contact the borrower in writing to request additional information or may contact the borrower directly. If the borrower does not respond to the SBA's questions, the SBA may determine the borrower was ineligible to receive the loan or the specific loan amount, or was ineligible for loan forgiveness in whole or in part.

If the SBA determines that a borrower is ineligible for the PPP loan, the SBA will direct the lender to deny the loan forgiveness application. Further, if the SBA determines that the borrower is ineligible for the loan amount or loan forgiveness amount claimed by the borrower, it will direct the lender to deny the loan

forgiveness application in whole or in part, as appropriate. The SBA may also seek repayment of the outstanding PPP loan balance or pursue other unspecified remedies. Borrowers will have the opportunity to appeal an adverse decision by the SBA. The process for doing so will be outlined in a forthcoming Interim Final Rule.

Next Steps

While these latest Rules provide significantly more direction on loan forgiveness than any guidance to date, past policy reversals dictate that borrowers should continue to monitor additional developments.

¹ The latter option is referred to as the Alternative Payroll Covered Period and is only available to borrowers with biweekly or more frequent pay cycles.

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