

SBA Issues Interim Final Rule on PPP Loan Forgiveness

Hinshaw Alert | 10+ min read

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On May 22, 2020, the Small Business Administration (SBA) and the U.S. Department of the Treasury released an [Interim Final Rule](#) on Paycheck Protection Program (PPP) Loan Forgiveness (the “Loan Forgiveness Rule”). Although this rule clarifies further several issues already raised in previously issued guidance from the agencies, it still leaves others unanswered. The agencies have indicated that further guidance will be forthcoming.

The Loan Forgiveness Rule and the PPP Forgiveness Loan Application (the “Application”) highlight problems some borrowers have concerning the 75/25 split on permitted payroll and nonpayroll costs that may be forgiven, as well as the eight week period during which borrowers must spend the PPP loan proceeds on permitted costs.

A second Interim Final Rule was also issued by the SBA and Treasury on May 22, which addresses the SBA loan review process, and borrower and lender loan responsibilities. We will address this Interim Final Rule in a separate alert.

Here, we first consider the various issues that remain unresolved by the Loan Forgiveness Rule. We conclude with a review of the issues the guidance does address.

Loan Forgiveness Issues Unresolved by the Guidance

75/25 Split on Permitted Payroll and Nonpayroll Expenses

A significant concern for a number of businesses is the fact that 75% of the loan proceeds must be used for payroll costs. This severely impacts businesses with high rent and overhead expenses. These businesses believe they will not be able to meet this standard, because in many cases their payroll costs will not equal 75% of the PPP loan

amount. They are hopeful that this percentage will be reduced, and that the list of permitted non-payroll expenses will be expanded. The 75/25 split is not mandated by the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), it was included in the rules by the agencies.

Eight Week Covered Period

Similarly, businesses that have been closed during the crisis or have laid off a significant number of employees are concerned about the requirement that payroll costs have to be incurred and paid during the eight week period following the borrower’s receipt of the loan proceeds (the “Covered Period”). Many of these businesses do not feel they can restart or ramp up operations during such a short period of time, making it difficult—if not impossible—for them to maximize their ability to have some or all of the loan forgiven. They are hoping that the Covered Period will be extended. However, because the length of the Covered Period is set by the CARES Act, it would have to be changed by appropriate legislation.

Legislative Proposals

Legislation has been introduced in the Senate which would extend the eight week Covered Period to 16 weeks. Alternatively, legislation proposed in the House would extend the Covered Period to 24 weeks.

In addition, legislation has been proposed to eliminate the requirement that at least 75% of the loan proceeds must be spent on permitted payroll costs. If enacted, this legislation would prevent the SBA from limiting the percentage of a loan that can be used for permitted nonpayroll expenses, and are thus eligible to be forgiven.

Notably, there is also legislation being considered that would expand the list of permitted nonpayroll expenses.

For PPP borrowers facing one or both of the issues discussed above, we recommend that if at the end of the eight week Covered Period they cannot seek forgiveness of the entire loan, they should delay seeking forgiveness for a limited time to see if the Covered Period is extended or the limit on nonpayroll expenses is lifted.

The adoption of the extension proposal would allow such borrowers to increase the amount of permitted payroll and nonpayroll expenses paid during the expanded Covered Period. Alternatively, the adoption of the second or third proposals would allow borrowers to increase the amounts spent on permitted nonpayroll expenses.

Other Legislative Proposals

Two Year Loan Period

If a PPP loan is not totally forgiven, the unforgiven balance of the loan must be paid within two years.

Although the CARES Act provides that the term of a PPP loan can be up to ten years, the SBA and Treasury settled on a two-year term. Legislation has been proposed that would direct that a PPP loan have a maturity of at *least* five years, providing borrowers extra time to repay the unforgiven portion of the loan.

Delayed Payment of the Employers Portion of the Social Security Taxes

According to rules set forth by the IRS, starting on March 27, 2020, a PPP borrower could delay paying the employer's share of the social security taxes, but that deferment ends when the PPP loan is forgiven. For example, if a loan is forgiven on August 1, 2020, the borrower must pay the employer's current share of the social security taxes starting on August 1, 2020. The amount deferred until that point would be due as follow: 50% by the end of 2021 and 50% by the end of 2022.

For a borrower, the deferment ends when the PPP loan is forgiven. A borrower should consider the benefits obtained by continuing the deferment of the employer's shares of the social security taxes versus continuing to pay interest (1%) on the portion of the loan that will be forgiven. If it makes sense, a borrower may delay seeking forgiveness.

Legislation has been proposed that would allow a PPP borrower to delay payment of the employer's share of the social security taxes after the loan has been forgiven for the remainder of 2020.

Deductibility of Forgiven Expenses

The IRS has taken the position that expenses paid with PPP loan proceeds that are forgiven are not deductible. Legislation is being considered that would reverse its position on deductibility.

Loan Forgiveness Issues Clarified by the Guidance

Alternative Payroll Covered Period

In the Application, the agencies allowed one minor change to the Covered Period rule. Borrowers with a biweekly or more frequent payroll schedule will be allowed to calculate payroll costs with the eight week period beginning on the first day of the first payroll period following the date they received the PPP loan proceeds.

For example, if the loan proceeds were received on April 20 and the first day of a borrower's next payroll period is April 24, the first day of the Alternative Payroll Covered Period would be April 24 and the last day of the period would be June 19. This only applies to payroll costs; it does not apply to tracking the non-payroll costs.

The Loan Forgiveness Rule makes it clear that the Alternative Payroll Covered Period is only available to borrowers who have bi-weekly or more frequent payroll periods. It is not available for borrowers with semi-monthly payroll periods.

Bonuses, Hazard Pay, and Payment to Furloughed Employees

The Loan Forgiveness Rule states that bonuses, hazard pay, and payments to furloughed employees are eligible payroll costs. These payments may be included as long as the employee's annualized salary does not exceed \$100,000 (or \$15,385) during the relevant period (8/52 times \$100,000).

It is not clear if the bonus has to be pro-rated for the Covered Period (or the Alternative Payroll Covered Period). Payments to furloughed employees would be permitted payroll costs; such employees would also count as full-time equivalents (FTEs) for purposes of the PPP forgiveness rules.

Loan Forgiveness Rule

Loan Forgiveness Process

A borrower must complete and submit the Application—either the SBA form or a lender equivalent—to its lender, or the loan servicer. The lender must provide the SBA with the lender's decision within 60 days of the lender's receipt of a complete application.

The 60-day process starts upon the receipt of a complete application. If the application is deemed deficient by the lender, the 60-day period does not start until the borrower cures the application's deficiencies.

If the lender determines that the borrower is entitled to forgiveness of some or all of the amount applied for, the lender must request payment from the SBA at the time the lender provides its decision to the SBA. The SBA may review the loan or loan application upon the receipt of the lender's decision.

The SBA must remit to the lender the approved forgiveness amount—plus accrued interest, if any—within 90 days of the date the lender provides its decision to the SBA. If applicable, the SBA will deduct Economic Injury Disaster Loan (EIDL) advance amounts from the forgiveness amount remitted to the lender.

Additionally, the SBA may decide that a borrower is ineligible for the PPP loan based on (1) the provisions of the CARES Act, (2) the SBA rules or guidance available *at the time of the borrower's loan application* or (3) the terms of the borrower's PPP loan application (e.g. the borrower lacked an adequate basis for the certifications that it made in its PPP loan application). If it does so, the loan will not be eligible for loan forgiveness.

The lender will notify the borrower of the SBA's decision. If a forgiveness request is denied, or only a portion of the loan is to be forgiven, any remaining balance due on the loan must be repaid by the borrower on or before the two-year maturity of the loan.

If the amount remitted by SBA to the lender exceeds the remaining principal balance of the PPP loan—because the borrower made payments on the loan after the expiration of the initial six-month deferment period—the lender must remit the excess amount, including accrued interest, to the borrower.

Payroll Costs

Payroll costs consist of compensation to employees whose principal place of residence is the United States). This includes salary, wages, commissions, or similar compensation; cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips); payment for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums, and retirement; and payment of state and local taxes assessed on compensation of employees.

For an independent contractor or sole proprietor, payroll costs consist of wages, commissions, income, or net earnings from self-employment, or similar compensation (see [Owner-Employee, Self Employed Individuals, and General Partners](#) for a discussion on forgivable payroll costs).

Payroll Costs Eligible for Loan Forgiveness

Payroll costs paid or incurred during the eight consecutive week period are eligible for forgiveness. Borrowers may seek forgiveness for payroll costs for the eight weeks beginning on either:

- the date of disbursement of the borrower's PPP loan proceeds from the lender (at the start of the Covered Period); or
- the first day of the first payroll cycle in the Covered Period (the "Alternative Payroll Covered Period").

Payroll costs are considered paid on the day that paychecks are distributed or the borrower originates an ACH credit transaction.

Payroll costs incurred during the borrower's last pay period of the relevant covered period—either the Covered Period or the Alternative Covered Period—are eligible for forgiveness if paid on or before the next regular payroll

date. In all other circumstances, payroll costs must be paid during the relevant period to be eligible for forgiveness.

Generally, payroll costs are incurred on the day the employee worked. For employees who are not performing work but are still on the borrower's payroll (see [Furloughed Employees](#)), payroll costs are incurred based on the schedule established by the borrower (typically, each day that the employee would have performed work).

Example from the Loan Forgiveness Rule

A borrower has a bi-weekly payroll schedule (every other week). The borrower's eight-week covered period begins on June 1 and ends on July 26. The first day of the borrower's first payroll cycle that starts in the covered period is June 7. The borrower may elect an Alternative Payroll Covered Period for payroll cost purposes that starts on June 7 and ends 55 days later (for a total of 56 days) on August 1. Payroll costs paid during this period are eligible for forgiveness. In addition, payroll costs incurred during this period are eligible for forgiveness as long as they are paid on or before the first regular payroll date occurring after August 1. Payroll costs that were both paid and incurred during the Covered Period (or Alternative Payroll Covered Period) may only be counted once.

Bonuses, Hazard Pay, and Payment to Furloughed Employees

[See discussion above.](#)

Owner-Employees, Self Employed Individuals, and General Partners

The amount of loan forgiveness requested for owner-employees and self-employed individuals' payroll compensation can be no more than the lesser of 8/52 of 2019 compensation (i.e., approximately 15.38% of 2019 compensation) or \$15,385 per individual in total across all businesses.

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.

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.

Permitted Nonpayroll Expenses

A nonpayroll cost is eligible for forgiveness if it was:

- 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

Note, permitted nonpayroll expenses are measured during the Covered Period and not the Alternative Covered Period.

Example from the Loan Forgiveness Rule

A borrower's Covered Period begins on June 1 and ends on July 26. The borrower pays its May and June electric bill during this period and pays its July electric bill on August 10, which is the next regular billing date. The borrower may seek loan forgiveness for its May and June electric bills, because they were paid during this period. In addition, the borrower may seek loan forgiveness for the portion of its July electric bill through July 26 (the end of the Covered Period), because it was incurred during the Covered Period and paid on the next regular billing date.

Prepayment of Mortgage Interest Obligations and Payment of Mortgage Principal

Advance payments of interest on a covered mortgage obligation are not eligible for loan forgiveness.

Principal on mortgage obligations is not eligible for forgiveness.

Reductions to Loan Forgiveness Amount

A borrower's loan forgiveness amount can be reduced based on reductions in FTE employees (the "Employee Test") or in employee salary and wages (the "Wage Test") during the relevant period. This reduction can be eliminated for borrowers who have rehired employees and restored salary and wage levels by June 30, 2020, with limitations.

Treatment of Laid Off Employees and Employees with Reduced Hours

Employers are concerned that the elevated level of unemployment benefits could dissuade laid-off employees from returning to work. To address this, the rules provide that employees whom the borrower offered to rehire are generally exempt from the loan forgiveness reduction calculation. This exemption is also available to a borrower who previously reduced the hours of an employee and offered to restore the employee's hours at the same salary or wages.

In calculating the loan forgiveness amount, a borrower may exclude any reduction in FTE headcount that is attributable to an individual employee if:

- the borrower made a good faith, written offer to rehire such employee (or, if applicable, restored the reduced hours of such employee) during the Covered Period or the Alternative Payroll Covered Period;
- the offer was for the same salary or wages and same number of hours as earned by such employee in the last pay period prior to the separation or reduction in hours;
- the offer was rejected by such employee;
- the borrower has maintained records documenting the offer and its rejection; and
- the borrower notified the state unemployment office of such employee's rejected offer of reemployment within 30 days of the employee's rejection of the employer's offer.

Impact of Reduction in FTE Employees on Loan Forgiveness: The Employee Test

A reduction in FTE employees during the relevant period reduces the loan forgiveness amount by the same percentage as the percentage reduction in FTE employees. The borrower must first select a Reference Period: February 15, 2019 – June 30, 2019 or January 1, 2020 – February 29, 2020. A seasonal employer may select either of the two preceding periods or a consecutive 12-week period between May 1, 2019 and September 15, 2019.

If the average number of FTE employees during the relevant period (the Covered Period or the Alternative Payroll Covered Period) is less than during the selected Reference Period, the total eligible expenses available for forgiveness is reduced proportionally by the percentage reduction in FTE employees. For example, if a borrower had 10 FTE employees during the selected Reference Period and only 8 FTE employees during the relevant covered period, the percentage of FTE employees declined by 20%. As a consequence, only 80% of otherwise permitted expenses may be forgiven.

Calculation of FTEs

An FTE is defined as an employee who, on average, works 40 hours or more each week. As discussed below, the hours of employees who work less than 40 hours are calculated as proportions of a single FTE and aggregated, as discussed below.

Borrowers must document their average number of FTE employees during the Covered Period (or the Alternative Payroll Covered Period) and their selected Reference Period. Borrowers must divide the average number of hours paid for each employee per week by 40, capping this quotient at 1.0. For example, an employee who was paid 48 hours per week during the covered period would be considered an FTE employee of 1.0.

For employees who were paid for less than 40 hours per week, borrowers may choose to calculate the full-time equivalency in one of two ways. The borrower may calculate the average number of hours a part-time employee was paid per week during the relevant covered period.

An Example from the Loan Forgiveness Rule

If an employee was paid for 30 hours per week on average during the relevant covered period, the employee could be considered to be an FTE employee of 0.75. Similarly, if an employee was paid for ten hours per week on average during the covered period, the employee could be considered to be an FTE employee of 0.25.

Instead of the forgoing, a borrower may elect to use a full-time equivalency of 0.5 for each part-time employee.

Borrowers may select only one of these two methods. When it selects one, it must apply that method consistently to all their part-time employees for the Covered Period or the Alternative Payroll Covered Period and the selected Reference Period.

In either case, the borrower shall provide the aggregate total of FTE employees for both the selected Reference Period and the relevant covered period, by adding together all of the employee-level FTE employee calculations. The borrower must then divide the average FTE employees during the covered period or the alternative payroll covered period by the average FTE employees during the selected reference period, resulting in the reduction quotient.

Impact of Reduction in Wages/Salary on Loan Forgiveness: The Wage Test

Unless an exception applies, a 25% or greater reduction in an employee's salary or wages will generally result in a reduction in the loan forgiveness amount, this is known as the Wage Test. For each new employee in 2020 and each existing employee who was not paid more than the annualized equivalent of \$100,000 in any pay period in 2019, the borrower must reduce the total forgiveness amount by the total dollar amount of the salary or wage reductions that are in excess of 25% of base salary or wages paid between January 1, 2020 and March 31, 2020 (the "wage reference period"), subject to exceptions for borrowers who restore reduced wages or salaries (see [Avoiding the Impact of the Wage Test and the Employee Test of Loan Forgiveness](#)).

This reduction calculation is performed on a per employee basis, not in the aggregate.

Example from the Loan Forgiveness Rule

A borrower reduced an FTE's weekly salary from \$1,000 per week during the selected Reference Period to \$700 per week during the relevant covered period. The employee continued to work on a full-time basis during such period resulting in an FTE of 1.0. In this case, the first \$250 (25 percent of \$1,000) is exempted from the loan forgiveness reduction. A borrowers seeking forgiveness would list \$400 as the salary/hourly wage reduction for that employee (the extra \$50 weekly reduction multiplied by eight weeks).

Impact of the Wage Test on the Employee Test: Double Counting

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 an FTE reduction under the [Employee Test](#) discussed above.

Example from the Loan Forgiveness Rule

An hourly wage employee had been working 40 hours per week during the borrower selected Reference Period (an FTE employee of 1.0) and the borrower reduced the employee's hours to 20 hours per week during the selected covered period (an FTE employee of 0.5). There was no change to the employee's hourly wage during the selected 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.

Avoiding the Impact of the Employee Test and the Wage Test on Loan Forgiveness

If certain employee salaries and wages were reduced during a safe harbor period—between February 15, 2020 and April 26, 2020—but the borrower eliminates those reductions by June 30, 2020 or earlier, the borrower is exempt from any reduction in loan forgiveness amount that would otherwise be required under the [Wage Test](#). If a borrower eliminates any reductions in FTE employees occurring during the safe harbor period by June 30, 2020 or earlier, the borrower is exempt from any reduction in loan forgiveness amount that would otherwise be required under the [Employee Test](#).

Legislation has been proposed that would extend the cure period until December 31, 2020.

Firing Employees for Cause, Voluntarily Resignation of Employee, or Employee Request for a Reduced Schedule

When an employee of the borrower is fired for cause, voluntarily resigns, or voluntarily requests a reduced schedule during the Covered Period or the Alternative Payroll Covered Period (an “FTE Reduction Event”), the borrower may count such employee at the same full-time equivalency level before the FTE Reduction Event when calculating the employee reduction penalty required under the [Employee Test](#).

Borrowers who wish to rely on this exemption must maintain records demonstrating that each such employee was fired for cause, voluntarily resigned, or voluntarily requested a schedule reduction. The borrower shall provide such documentation upon request.

Documentation Requirements

The Application details the documentation that (1) must be provided by a borrower when submitting its Application (SBA Form 3508 or a lender equivalent), (2) a borrower is required to maintain and make available upon request, and (3) that a borrower may voluntarily submit with its Application.

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