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Proposed Legislation May Extend Period for PPP Loan Forgiveness—Meanwhile, SBA Releases Yet More Guidance

The U.S. House of Representatives, on May 28, 2020, passed with bipartisan support H.R. 7010, referred to as the Paycheck Protection Program Flexibility Act of 2020. If signed into law, H.R. 7010 would extend the so-called "covered period" for borrowers to spend Paycheck Protection Program (PPP) loan proceeds and qualify for forgiveness from eight weeks to the earlier of December 31, 2020, or 24 weeks after the borrower received their loan. Legislation in the Senate was proposed that is reported to extend the "covered period" from 8 weeks to 16 weeks. The timing of this legislation is critical since some borrowers are already at the end of their original eight-week period. Meanwhile, on May 22, 2020, the Small Business Administration (SBA) released two interim final rules ([interim final rule #14](#) and [interim final rule #15](#)) providing long-awaited formal guidance regarding PPP loan forgiveness. This included detailed guidance on loan forgiveness (primarily addressed in interim final rule #14) and guidance regarding borrower and lender responsibilities and review procedures with respect to PPP loans (primarily addressed in interim final rule #15). The guidance regarding loan forgiveness largely restates information that could be inferred from the loan forgiveness application that the SBA released on May 15, 2020. A copy of the loan forgiveness application can be found [here](#), and our earlier update summarizing the loan forgiveness application and key takeaways can be found [here](#). Among other things, this additional guidance from the SBA formalizes and reaffirms the SBA's "paid or incurred" approach with respect to expenses eligible for forgiveness in a way that will provide borrowers greater certainty in completing their loan forgiveness applications, and it also clarifies the treatment of bonuses, hazard pay, and other payments made to employees during the "covered period" or "alternative payroll covered period."

Key Takeaways on Forgiveness Guidance

Forgiveness Period and the 75% Rule

- As noted above, Congress has discussed extending the eight-week period specified under the CARES Act for borrowers to use loan proceeds to qualify for loan forgiveness. H.R. 7010 would extend this period to end upon the earlier of the date that is 24 weeks after the loan is originated or December 31, 2020. A competing Senate proposal is reported to extend the 8-week period to 16 weeks. The latest interim final rules retain the current eight-week period since that is the period specified under the CARES Act.
- Similarly, H.R. 7010 would modify the so-called 75% rule, which requires that 75% of the PPP loan forgiveness be tied to eligible payroll costs. A proposed modification in H.R. 7010 would require that only 60% of loan proceeds be spent on payroll costs for a borrower to qualify for forgiveness of the full principal amount of their loan. However, for now at least 75% of the loan forgiveness amount must be based on payroll costs, and no more than 25% of the loan forgiveness can be based on other eligible expenses. As long as this rule remains in effect, borrowers must maximize the amount of payroll costs eligible for forgiveness to maximize their total loan forgiveness.

Payroll Cost Calculations

- The new guidance confirms that payroll costs eligible for forgiveness include payroll costs *paid and incurred*, in each case during an eight-consecutive-week (56 day) covered period. Amounts *paid* during this eight-week period, even if relating to earlier periods, will qualify for forgiveness. In addition, amounts *incurred* during the eight-week period but paid *after* the eight-week period will qualify for forgiveness as long as they are paid on or prior to the borrower's next regular payroll date. For some

- borrowers, this means that they will be able to include more than eight weeks' worth of payroll costs in their application for loan forgiveness, depending on when their payroll costs were paid or incurred.
- The new guidance also clarifies how borrowers can determine when amounts were paid or incurred:
 - Payroll costs are considered paid on the date that paychecks are distributed or on the date the borrower originates an ACH credit transaction. This distinction may be important for employers that have some employees who receive paper paychecks and others who receive pay via ACH.
 - Payroll costs are considered incurred on the date the employee's pay is earned (i.e., the date the employee worked). For employees who are not performing work but are still on the employer's payroll, payroll costs are incurred based on the schedule established by the borrower (i.e., the date the employee would have worked).
 - The new guidance provides that the eight week period for payroll costs that are eligible for forgiveness can begin on either (1) the date of disbursement of the borrower's PPP loan proceeds from the lender, or (2) for borrowers with a payroll cycle that is bi-weekly or more frequent, the first day of the first payroll cycle after the PPP loan proceeds are disbursed from the lender (the "alternative payroll covered period"). For some borrowers, this could be beneficial because it allows them to use a "covered period" that starts after their PPP loan was first disbursed, giving them more time to ramp up with respect to employees who had been laid off or furloughed. Notably, the "alternative payroll covered period" cannot be used for other expenses eligible for forgiveness, such as mortgage interest, rent, or utilities.
 - The payment of salary, wages, or commissions to furloughed employees, payment of bonuses, and payment of hazard pay during the covered period (or alternative payroll covered period) are expressly eligible for forgiveness, as long as the aggregate amount does not exceed \$100,000 per employee on an annualized basis (or \$15,385 during the eight-week period, as specified in the SBA's loan forgiveness application). The loan forgiveness application listed items of cash compensation as being eligible for forgiveness but did not specifically reference the treatment for furloughed employees, bonuses, or hazard pay. Accordingly, the new guidance provides helpful clarification for employers who seek to make such payments and qualify for the maximum amount of available loan forgiveness.

Payments to Owner-Employees

- Loan forgiveness with respect to owner-employees is capped at 8/52 of their 2019 compensation (approximately 15.38% of 2019 compensation) or \$15,385 per individual in total across all businesses, whichever is lower. This primarily affects general partners and self-employed individuals, but some have speculated that it may also affect stockholders of an S corporation.
- Although businesses may generally seek forgiveness with respect to retirement and health insurance contributions for employees, no forgiveness is provided for retirement or health insurance contributions for self-employed individuals, as such expenses are paid out of their net self-employment income.

Non-Payroll Cost Calculations

- Loan forgiveness with respect to non-payroll costs, including eligible mortgage interest, eligible rent, and eligible utilities payments, includes amounts *paid* during the covered period and amounts *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. Examples provided in interim final rule #14 make clear that a borrower that pays such eligible expenses during the covered period based on a bill received before the covered period would be eligible for forgiveness, and that the borrower may also seek forgiveness for the non-payroll costs incurred up until the end of the covered period.
- Advance payments of interest on covered mortgage obligations are not eligible for forgiveness since they would constitute "prepayments" that are not eligible under the CARES Act. Similarly, payments of principal on mortgage obligations are not eligible for forgiveness. The SBA did not provide any clarification on what constitutes "mortgage obligations" for this purpose, but the CARES Act uses a

somewhat expansive definition, referring to "any indebtedness or debt instrument incurred in the ordinary course of business that (1) is a liability of the borrower; (2) is a mortgage on real or personal property; and (3) was incurred before February 15, 2020." Accordingly, interest on all secured obligations appears to be eligible for forgiveness.

- The new guidance specifies that rent payments that may qualify for forgiveness include not only rent on real estate obligations that were in force before February 15, 2020, but also rent obligations on *personal property* (e.g., equipment) under a lease agreement in force before February 15, 2020. Although loan forgiveness is still subject to the 75% rule noted above, this could allow borrowers to expand the operating expenses included in their loan forgiveness application. The rent obligation is required to have been in existence before February 15, 2020, but the real or personal property is not required to have been in service or in use before February 15, 2020.

Reductions to the Loan Forgiveness Amount

- The CARES Act and loan forgiveness application contemplate reductions to loan forgiveness based on (1) reductions in a borrower's average full-time equivalent employees (FTEs) or (2) reductions to salary or hourly wages for a borrower's employees. As summarized in our earlier update regarding the loan forgiveness application form (which can be found [here](#)), these calculations require comparisons of average FTE counts during the covered period (or alternative payroll covered period) to a prior historic reference period (borrowers have the ability to select between two or three alternative reference periods) and comparisons of salary and hourly wages on a per-employee basis during the covered period (or alternative payroll covered period) to salary and hourly wages in the period from January 1, 2020, through March 31, 2020. The new guidance is generally consistent with the language of the loan forgiveness application and formally adopts some of the definitions, calculations, and "safe harbors" for FTE reductions and salary and hourly wage reductions that are referenced in the loan forgiveness application form. This includes formalizing an expanded alternative historic reference period for seasonal employers, which allows them to select any consecutive 12-week period between May 1, 2019, and September 15, 2019, as their reference period for FTE reductions.
- Reductions to loan forgiveness based on a reduction in FTEs is based on a 40-hour per week full-time equivalent employee standard. Under this standard, borrowers are required to calculate FTEs on an employee-by-employee basis using the average number of hours paid per week for each employee, and then divide by 40 hours. Each employee is capped as 1.0 FTE. However, the SBA allows borrowers to use a simplified calculation that treats all employees who work at least 40 hours per week as 1.0 FTEs and employees who work less than 40 hours per week as 0.5 FTEs. Borrowers may select only one of these two methods and must then apply the method consistently to all their part-time employees for the covered period or the alternative payroll covered period. In addition, this method must be used for the historic reference period for comparison purposes. The SBA notes that some borrowers do not maintain this kind of hours worked data for their employees, which justifies providing borrowers the option of using the simplified method of calculating FTEs.
- Reductions to loan forgiveness based on a reduction in salary or wages apply only with respect to reductions in excess of 25% and only with respect to employees who were not paid more than the annualized equivalent of \$100,000 in any pay period in 2019. This means that salary or wage reductions for new employees hired in 2020 could trigger this reduction to forgiveness, even if that employee earns more than \$100,000 on an annualized basis. In addition, the reference to employees who are paid more than the annualized equivalent of \$100,000 "in any pay period" in 2019 leaves open a question of whether an employee that received a significant bonus or commission in a pay period in 2019, but otherwise made less than \$100,000, would be covered by this rule.
- Restoring FTEs or salary or hourly wages by June 30, 2020, can allow a borrower to avoid a reduction in loan forgiveness. The SBA has not clarified whether this "restoration" would need to be for the full pay period including June 30, 2020, or would need to be maintained after June 30, 2020; however, rehiring

employees or restoring salaries and wages for a short period to take advantage of these "safe harbors" will likely be viewed negatively.

- The new guidance provides that loan forgiveness will not be reduced with respect to employees who are fired for cause, voluntarily resign, or voluntarily request a schedule reduction. These events are to be excluded for purposes of calculating the reduction to loan forgiveness based on a reduction in FTEs. The SBA has not defined "cause" in this context or provided any additional detail on how borrowers can demonstrate that an employee voluntarily resigned or voluntarily requested a schedule reduction.
- Similarly, the new guidance confirms that forgiveness will not be reduced based on an FTE reduction with respect to employees who refuse a written offer of reemployment. However, interim final rule #14 adds new conditions to this guidance, providing that (1) the offer of reemployment must be 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, and (2) if the employee rejects the offer, the employer must inform the applicable state unemployment insurance office of the employee's rejection of the offer within 30 days after such rejection. The new guidance states that further information regarding how borrowers are to report information concerning rejected rehire offers to state unemployment insurance offices on the SBA's website.
- The new guidance also restates that, if applicable, the SBA will deduct from the forgiveness amount it remits to the lender the amount the borrower received as an Economic Insurance Disaster Loan (EIDL) emergency advance. Since EIDL emergency advances (as distinguished from economic injury disaster loans themselves) do not require repayment, this should not have a substantive effect on borrowers.

Key Takeaways Regarding the Loan Forgiveness Application Process

- To apply for forgiveness, each borrower must complete a loan forgiveness application and submit it to the lender that is servicing their loan (not the SBA). This loan forgiveness application may be on the previously released form (SBA Form 3508) or a lender equivalent form. As many borrowers experienced in the PPP loan application process, procedures may vary by lender, so it will be important to understand what your specific lender will be requiring.
- Interim final rule #15 provides that lenders may rely on borrower representations but should work with borrowers to remedy any identified errors in the borrower's calculation or material lack of substantiation in the borrower's supporting documents. Lenders need not independently verify the borrower's reported information as long as the borrower submits documentation supporting its request for loan forgiveness and attests that it accurately verified the payments for eligible costs.
- Lenders have 60 days from the date the borrower submits a complete application for loan forgiveness to decide whether part, all, or none of a PPP loan will be forgiven. When the lender makes this determination, they must request payment from the SBA and issue their decision to the SBA. The SBA could then apply further review.
- Subject to any further SBA review of the request for loan forgiveness, the SBA is to remit the appropriate forgiveness amount to the lender no later than 90 days after the lender issues its decision to the SBA. Taken together, this means that it could be up to 150 days after the borrower submits its complete loan forgiveness application before the SBA remits payment to the lender and the loan is officially forgiven.
- If the SBA determines that the borrower was ineligible for the PPP loan, including based on the borrower lacking an adequate basis for the certifications that it made in its PPP loan application, then the loan will not be eligible for forgiveness.
- SBA determinations regarding eligibility for a PPP loan, eligibility as to the loan amount, and eligibility for loan forgiveness may be subject to an appeal process; however, the new guidance indicates that the appeal process will be outlined in a future interim final rule.

- Any portion of the loan that is not forgiven must be repaid by the borrower on or before the two-year maturity of the loan.
- Although prior FAQs suggested that the SBA would focus its review efforts on PPP loans in amounts in excess of \$2 million, the new guidance states that the SBA may review *any* PPP loan. This includes the potential for a review as to (1) the borrower's eligibility for the loan based on the provisions of the CARES Act, the rules and guidance available at the time of the borrower's PPP loan application, the terms of the borrower's loan application, and the borrower's loan forgiveness application form; (2) the borrower's calculation of the loan amount and use of loan proceeds for allowable uses; and (3) whether the borrower is entitled to loan forgiveness in the amount claimed. This review could occur at any time in the SBA's discretion, even after the loan forgiveness amount is determined and the SBA has remitted payment to the lender.
- Borrowers are required to retain PPP documentation in their files for six years after the date the loan is forgiven or repaid in full and permit authorized representatives of the SBA, including representatives of the Office of Inspector General, to access such files upon request.
- The lender, and not the SBA, is responsible for notifying the borrower of the forgiveness amount. Similarly, if the SBA determines that the borrower may be ineligible for a PPP loan or ineligible for forgiveness, the SBA will require the lender to contact the borrower in writing to request additional information, but the SBA may also request this information from the borrower directly.
- Failing to respond to an SBA inquiry may result in a determination that the borrower was ineligible for a PPP loan or ineligible to receive the loan amount or loan forgiveness amount claimed.
- Interim final rule #15 also includes language saying, "[Allowing forgiveness only for a borrower that is an "eligible recipient"] is consistent with the CARES Act's nonrecourse provision, 15 U.S.C. § 636(a)(36)(F)(v), which limits SBA's recourse against individual shareholders, members, or partners of a PPP borrower for nonpayment of a PPP loan only if the borrower is an eligible recipient of the loan." This is a reminder that borrowers that are found not to meet the PPP eligibility criteria (including the "necessity" certification) will be required to repay their loan and that their shareholders, members, or partners could be subject to liability.
- For lenders, the new guidance also provides that they will not be paid their lender processing fees for any PPP loan that the SBA deems ineligible, and that the SBA will be able to clawback these lender processing fees at any time within a year after the loan was disbursed.

Interim final rule #14 and interim final rule #15 provide some helpful clarifications with respect to the loan forgiveness application form and solidify some of the guidance implicit in the form, but there remain several questions that were not answered in this guidance. These include the following:

- Why does the application form ask about the borrower's number of employees as of the loan forgiveness application date when the formulaic reductions use differing measurement periods?
- Will accrued interest on PPP loans be eligible for forgiveness? The SBA's [interim final rule #1](#) suggested that interest is eligible for forgiveness, but the language of Section 1106 of the CARES Act and the SBA's loan forgiveness application form suggest that only principal on PPP loans is eligible for forgiveness. The new guidance does not specifically address this topic, but included language confusing the matter further. Specifically, interim final rule #14 provides that, when the lender determines that the borrower is eligible for forgiveness, then "SBA will, subject to any SBA review of the loan or loan application, remit the appropriate forgiveness amount to the lender, plus any interest accrued through the date of payment, not later than 90 days after the lender issues its decision to SBA." It does not say that the interest amount will be forgiven, nor does the loan forgiveness application form provide a mechanism for including interest in the forgiveness amount.
- If more than eight weeks' pay can be forgiven under the *paid* or *incurred* approach to calculating payroll costs, why is forgiveness for cash compensation limited to \$15,385 ($\$100,000 \div 52 \times 8$)?

- How does a borrower calculate an employee's "average" salary or hourly wage as of June 30, 2020, for purposes of determining whether the safe harbor for salary and hourly wage reductions applies?
- If an employee received a bonus or commission in a pay period in 2019 that would cause their annualized compensation based on that pay period to exceed \$100,000, does that mean that they're treated as receiving over \$100,000 in 2019 for purposes of the reduction to loan forgiveness based on reductions in salary or hourly wages?
- How does a borrower indicate reliance on the FTE reduction exemption in Table 2 to the PPP Schedule A Worksheet with respect to an employee who exceeded the \$100,000 limit in 2019? Why is there no line to indicate FTE reduction exemptions in Table 2 on the PPP Schedule A Worksheet?
- Loan forgiveness is limited to an annualized amount of \$100,000 in cash compensation per employee. Is the use of loan proceeds for payroll costs after the eight-week forgiveness period also subject to a limit of \$100,000 in cash compensation per employee on an annualized basis?
- What constitutes an employee's voluntary request for a reduction in hours? Would that include electing to take an unpaid sabbatical or unpaid family leave?
- Is prepayment of rent or utilities eligible for forgiveness?
- What is "transportation" as a utility?

As borrowers begin preparing their loan forgiveness applications, hopefully the SBA will provide additional guidance to help answer these and other questions. Congressional action to extend the eight-week period and/or change the so-called 75% rule could require new rulemaking but would also provide borrowers needed relief as they work to understand and comply with the SBA's latest round of rulemaking.

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