

## [Updates](#)

June 18, 2020

### SBA Releases New PPP Loan Forgiveness Application Forms Paycheck Protection Program Flexibility Act Guidance

The Small Business Administration (SBA), on June 16, 2020, released new loan forgiveness application forms and corresponding instructions for borrowers seeking forgiveness of their Paycheck Protection Program (PPP) loans. On June 17, 2020, the SBA also released a new interim final rule ([interim final rule #19](#)) providing updated guidance on the use of PPP loan proceeds and loan forgiveness. These materials implement and clarify aspects of the recently enacted Paycheck Protection Program Flexibility Act (PPPFA), which changed several aspects of PPP loans and the calculation of loan forgiveness. For those familiar with the PPP loan forgiveness documentation, key takeaways from the updated loan forgiveness forms and interim final rule #19 are provided below.

#### Key Takeaways

- Guidance regarding forgiveness of interest on PPP loans continues to be inconsistent. Although interim final rule #19 refers to forgiveness of interest, the new loan forgiveness application forms use a calculation that would exclude interest from the calculation of the loan amount to be forgiven.
- The "Alternative Payroll Covered Period" previously rolled out by the SBA for the administrative convenience of borrowers has been preserved, and the concept has been extended to apply to borrowers who use the new 24-week covered period. However, this alternative remains available only for borrowers whose regular payroll cycle is bi-weekly or more frequent.
- Eligible amounts *paid* during the "covered period" but *incurred* earlier can be included in the loan forgiveness amount, and language in the loan forgiveness application that created uncertainty on this point has been revised accordingly.
- The per-employee limit for cash compensation eligible for loan forgiveness is adjusted for borrowers using the new 24-week covered period, from \$15,385 (for borrowers using the 8-week covered period) to \$46,154 (for borrowers using the 24-week covered period); however, compensation for certain *business owners*[1] that use the 24-week covered period are subject to a lower limit of \$20,833 across all of their businesses.
- Borrowers eligible for the newly-released EZ form of PPP loan application do not need to provide detailed information regarding every employee and their cash compensation and hours worked, but this level of detail will be required for borrowers who do not qualify to use the EZ form.
- The EZ form is limited to borrowers in one of the following categories:
  - Self-employed individuals, independent contractors, or sole proprietors who had no employees at the time of their PPP loan application and did not include any employee salaries in the calculation of their PPP loan amount.
  - Borrowers who (1) *did not* reduce annual salary or hourly wages of certain employees[2] by more than 25% during the applicable covered period, compared to the period between January 1, 2020, and March 31, 2020, *and* (2) did not reduce the number of employees or the average paid hours of employees between January 1, 2020, and the end of the applicable covered period (ignoring certain reductions).
  - Borrowers who (1) *did not* reduce annual salary or hourly wages of certain employees by more than 25% during the applicable covered period, compared to the period between January 1, 2020, and

March 31, 2020, and (2) were unable to operate during the applicable covered period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020, and December 31, 2020, by the Secretary of the U.S. Department of Health and Human Services (HHS), the Director of the U.S. Centers for Disease Control and Prevention (CDC), or the U.S. Occupational Safety and Health Administration (OSHA) related to the maintenance of standards of sanitation, social distancing, or any other work or customer safety requirement related to COVID-19.

- The PPPFA safe harbor for employers who were unable to operate their businesses at the same level of activity as before February 15, 2020, refers only to requirements or guidance from HHS, CDC, or OSHA. It does not include restrictions or guidance issued by state, county, city, or other local authorities.

## Overview

As discussed in our June 4, 2020, post, the PPPFA allowed borrowers that obtained PPP loans prior to June 5, 2020, to elect a 24-week "covered period" instead of the original 8-week "covered period" for PPP loan forgiveness, but electing this extended period has other consequences, like extending the period in which certain use restrictions apply to the PPP loan and extending the measurement period for headcount, salary, and wage reductions. Borrowers that obtained PPP loans on or after June 5, 2020, must use a 24-week "covered period." These changes were partially implemented by the SBA's interim final rule #17, but the latest guidance provides additional clarifications.

The new forgiveness application forms reflect changes to PPP loans mandated by the PPPFA, including the reduction in the percentage of PPP loan proceeds that must be used for payroll costs from 75% to 60% and the new safe harbors for PPP borrowers who are unable to rehire or restore the salary or wages of employees or resume their pre-February 15, 2020, level of business activity. An updated [full-length form](#) and the corresponding [instructions](#) incorporate the extended 24-week "covered period" into the loan forgiveness application form and make other clarifying changes. In releasing the new forms, the SBA also included the new ["EZ" form](#) and corresponding instructions that simplify and streamline the process of applying for loan forgiveness for certain borrowers that qualify to use the EZ form.

## Changes to the Calculation of the Maximum Forgiveness Amount

### Eligible Expenses

The CARES Act indicated that PPP loan proceeds had to be spent on specific eligible expenses to qualify for forgiveness. This included payroll costs,[3] payments of interest on covered mortgage obligations (which include loans secured by personal property),[4] payments of covered rent obligations (which include rent paid for personal property), and covered utility payments. The new loan forgiveness application forms and interim final rule #19 provide the following updates or changes with respect to the calculation of these amounts:

- Amounts *paid or incurred* during the covered period (or Alternative Payroll Covered Period) are eligible to be included. This is in line with prior guidance, but language in the updated loan forgiveness application

reaffirms this point.

- Expenses eligible for forgiveness must be spent or incurred within the "covered period" (or Alternative Payroll Covered Period). The covered period was originally an 8-week period (56 days, including the date loan proceeds were first received). Under the PPPFA, this is extended to a 24-week period (168 days, including the date loan proceeds were first received). Borrowers who received their loans before June 5, 2020, can choose between the original 8-week covered period or the new 24-week covered period.
- The long-form loan forgiveness application continues to require borrowers to detail payroll costs on an employee-by-employee basis. The new EZ form eliminates this requirement from the forgiveness application, but still requires that the borrower provide to their lender copies of bank account statements or third-party payroll service provider reports documenting the amount of cash compensation paid to employees, as well as tax forms and other documentation supporting the claimed payroll costs.
- Eligible payroll costs for any employee are capped at a pro-rated portion of \$100,000 (on an annualized basis), which applies only with respect to cash compensation and not benefits or other non-cash compensation. Accordingly, for an 8-week period, the cash compensation limit would be \$15,385, but that would not limit other payroll costs, including health insurance premiums, employer contributions to retirement plans, and the employer's share of state and local taxes assessed on the employee's compensation. Under interim final rule #19 and the new loan forgiveness applications, the \$100,000 limitation translates to a limit of \$46,154 per employee for borrowers subject to the 24-month covered period; however, this guidance also imposed a new limit of \$20,833 for business owners with self-employment income who file a Schedule C or F with their federal tax returns. The stated rationale for the limit for business owners is that allowing them to use the \$46,154 limit for payments to themselves could result in a windfall if they (1) calculated their loan amount based on amounts that included employee payroll costs, (2) conducted a reduction in FTEs during their covered period, and (3) qualified for one of the FTE safe harbors, such that they would be able to pay themselves the full PPP loan amount. The application does not apply any thresholds to determine who is an "owner-employee" other than that they have self-employment income (that is, not W-2 income) and file a Schedule C (for single member LLCs or sole proprietorships) or F (for farm income).
- The SBA's [prior guidance](#) provided that at least 75% of the PPP loan proceeds would have to be paid or incurred on payroll costs, and if more than 25% of the proceeds were spent on non-payroll costs, that would limit forgiveness. The PPPFA modified this to require that at least 60% of the loan proceeds be paid or incurred on payroll costs, and subsequent SBA guidance clarified that the loan forgiveness amount would be proportionately reduced<sup>[5]</sup> if more than 40% of the proceeds are spent on non-payroll costs. This 60% test is reflected in the updated loan forgiveness applications.

## **Changes to Formulaic Reductions to Forgiveness Amount and Safe Harbor(s)**

Under the CARES Act, after an estimated forgiveness amount is calculated, it is then subject to downward adjustments based on headcount reductions or reductions in wages or salary amounts. If there were payroll reductions, the amount of otherwise eligible payroll costs would be reduced by the amount of the reduction in total salary or wages. If there were headcount reductions, the entire amount of the loan eligible for forgiveness (including mortgage interest, rent, and utilities) would be reduced by multiplying the potential forgiveness amount by a fraction comprising the borrower's average number of FTEs during the "covered period" divided by the borrower's average number of FTEs in the applicable comparison period.

The new loan forgiveness applications include changes to the formulas used to calculate reductions to loan forgiveness based on the PPPFA, as well as details regarding safe harbors for forgiveness reduction based on

FTE reductions by certain borrowers, as summarized below.

### **Measurement Period**

Importantly, changes to the definition of "covered period" in the PPPFA did not only affect the calculation of expenses eligible for loan forgiveness, but also affected the period used in measuring whether a borrower has reduced its FTEs, salary, or wages in a way that would trigger a formulaic reduction in loan forgiveness. For borrowers who received their loan before June 5, 2020, electing for the shorter 8-week covered period could avoid extending the measurement period for reductions. Electing for an 8-week or a 24-week period is binary, meaning that if you elect for the 24-week period for purposes of calculating your eligible expenses, you also elect for the 24-week period for measuring FTE or salary or wage reductions.

### **Headcount Reductions**

The PPPFA included provisions providing that reductions to loan forgiveness based on a reduction in FTEs will not apply if the borrower is able to document (1) their inability to rehire individuals who were employees of the borrower on February 15, 2020, and (2) an inability to hire similarly qualified employees for unfilled positions on or before December 31, 2020. The revised loan forgiveness applications give effect to this exception.

### **FTE Reduction Safe Harbors**

The CARES Act provided a mechanism for borrowers who engaged in a headcount reduction (including layoffs, reduced number of paid hours, or unpaid furlough) in the period between February 15, 2020, and April 26, 2020, to mitigate the reduction in loan forgiveness, if they "eliminated" the reduction in FTEs by June 30, 2020. The PPPFA modified this June 30, 2020, deadline to refer to December 31, 2020. The new form of loan forgiveness application modifies this further by applying this test as of the earlier of the date the loan forgiveness application is submitted or December 31, 2020. Employers should be thoughtful about the interplay of the timing of submitting the application for forgiveness and any modifications to salary and headcount that need to be undertaken after the end of the covered period.

In addition, the PPPFA provided that the reduction to forgiveness for FTE reductions will not apply if the borrower is able to document that they have been unable to return their business activity to the same level as it was operating before February 15, 2020, due to compliance with requirements or guidance issued by the Secretary of HHS, the Director of the CDC, or OSHA during the period between March 1, 2020, and December 31, 2020, related to the maintenance of standards for sanitation, social distancing, or other worker or customer safety requirements related to COVID-19. The new loan forgiveness application forms treat this as a new FTE reduction safe harbor and only require that the borrower check a box to indicate whether this safe harbor applies. Borrowers are not required to submit any documentation in support of this safe harbor, but are required to maintain such documentation, including copies of the applicable requirements for each borrower location and relevant borrower financial records.

### **Salary or Wage Reduction Safe Harbor**

To the extent that a borrower reduced by more than 25% the salary or wages of any of their employees who received compensation at an annualized rate of less than or equal to \$100,000 for all pay periods in 2019 or who were not employed by the borrower at any point in 2019, the borrower's loan forgiveness amount would be subject to reduction. As with the prior PPP loan forgiveness application, the revised application provides a safe harbor for this reduction to forgiveness if the salary or wage reduction is eliminated. Previously, this was to be measured as of June 30, 2020. Pursuant to the PPPFA, this measurement period was extended to December 31, 2020, but the updated loan forgiveness application form provides a form of relief for borrowers by saying that this is to be measured as of the earlier of December 31, 2020, and the date the loan forgiveness application is

submitted. For borrowers who may be required to reduce salaries or wages later in the year, this provides relief such that they can restore salaries and wages before applying for loan forgiveness and not be required to maintain those salary and wage levels until December 31, 2020.

## Other Observations

Although the SBA has provided loan forgiveness application forms, lenders may use their own electronic portals to gather this information. Accordingly, it is important for borrowers to work closely with their lenders to avoid unnecessary duplication of work in applying for loan forgiveness. Lenders are receiving these updates at the same time as borrowers, so there could be delays as lenders work to update their systems and processes to accommodate the new rules, and lenders may also be awaiting further guidance from the SBA before they fully roll out their loan forgiveness documentation.

In addition, as with prior iterations of the regulations and documentation surrounding PPP loans, the latest forms of loan forgiveness applications leave many open questions for borrowers seeking to maximize their loan forgiveness or rely on the safe harbors and other forms of relief referenced in the PPPFA. Interim final rule #19 provides modifications to the earlier interim final rule #3 and interim final rule #6 in response to the PPPFA, and the SBA previously modified interim final rule #1 twice in response to the PPPFA (interim final rules #17 and #18). The PPPFA was enacted as the earliest PPP loans reached the end of their original 8-week covered period and before borrowers were applying for loan forgiveness, so the SBA and lenders have not yet had to process applications for loan forgiveness. It is reasonable to expect that additional clarifications and adjustments will be announced in the coming weeks as loan forgiveness applications start being submitted, so borrowers should continue to monitor SBA guidance as it is released since it may affect their ability to obtain loan forgiveness.

## Resources

- [PPP Loan Forgiveness Application](#) - updated as of June 16, 2020
- [Instructions to PPP Loan Forgiveness Application](#) - updated as of June 16, 2020
- [EZ form of PPP Loan Forgiveness Application](#) - posted as of June 16, 2020
- [Instructions to EZ form of PPP Loan Forgiveness Application](#) - posted as of June 16, 2020
- [CARES Act](#) - Section 1102 addresses eligibility and other PPP loan requirements, while Section 1106 addresses loan forgiveness
- [Paycheck Protection Program Flexibility Act of 2020](#)
- [U.S. Department of the Treasury CARES Act Resources](#)

## Endnotes

[1] The instructions to the loan forgiveness application form apply this limit to "owner-employees, a self-employed individual, or general partners". In describing this limit, interim final rule #19 emphasizes that this applies to owner-employees who report self-employment income on a Schedule C (for single member LLCs or sole proprietorships) or F (for farm income). As such, this does not appear to apply to the owners of corporations.

[2] Only employees who did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount of more than \$100,000 are included in this calculation. This would include employees hired in 2020. Employees who received amounts in excess of the \$100,000 limit in 2019 are disregarded for this purpose.

[3] "Payroll Costs" are defined as (A) the sum of payments of any compensation with respect to employees that is a (1) salary, wage, commission, or similar compensation, (2) payment of cash tip or equivalent, (3) payment for vacation, parental, family, medical, or sick leave, (4) allowance for dismissal or separation, (5) payment required for the provisions of group health care benefits, including insurance premiums, (6) payment of any retirement benefit, or (7) payment of state or local tax assessed on the compensation of employees; and (B) the sum of payments of any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, or similar compensation and that is in an amount that is not more than \$100,000 in one year, as prorated for the covered period. Eligible "Payroll Costs" are subject to limitations, providing that "Payroll Costs" do not include (1) the compensation of an individual employee in excess of an annual salary of \$100,000, as prorated for the covered period, (2) taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code of 1986 during the covered period, (3) any compensation of an employee whose principal place of residence is outside of the United States, (4) qualified sick leave wages for which a credit is allowed under section 7001 of the Families First Coronavirus Response Act (Public Law 116–127), or (5) qualified family leave wages for which a credit is allowed under section 7003 of the Families First Coronavirus Response Act (Public Law 116–127).

[4] As defined in the CARES Act, "covered mortgage obligation" is defined to include 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. Although this uses the term "mortgage," it can be read to apply more broadly than just mortgages on real property since it expressly refers to a mortgage on personal property. The instructions to the loan forgiveness application similarly refer to "the amount of business mortgage interest payments paid or incurred during the Covered Period for any business mortgage obligations on real or personal property incurred before February 15, 2020."

[5] The language of the PPPFA led many to believe that a "cliff" approach would be applied, where borrowers who spent less than 60% of their PPP loan on payroll costs could lose the ability to obtain any forgiveness. The SBA subsequently clarified that this would result in a reduction to loan forgiveness, not a complete denial of forgiveness.

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