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Client Alert: Paycheck Protection Program Loan Forgiveness

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Loan Forgiveness](#)

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Jan W. Pitchford

MEDIA CONTACT

Wendy M. Byrne
wbyrne@shumaker.com

Register [here](#) for Shumaker's May 28th **Paycheck Protection Program Loan Forgiveness webinar**.

On May 22, 2020, the Small Business Administration ("SBA") released its Interim Final Rule on Loan Forgiveness (the "Loan Forgiveness Rule"), which describes the costs eligible for forgiveness under the Payroll Protection Program ("PPP") and how to apply the reduction formulas to the loan forgiveness amount. Separately, the SBA also released its Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities (the "Forgiveness Process Rule"), which details the loan forgiveness process that is briefly described in the Loan Forgiveness Rule.

The Loan Forgiveness Rule

The CARES Act (the "Act") described costs eligible for forgiveness as "costs incurred and payments made during the covered period." For purposes of loan forgiveness, the Act defines the "covered period" as the eight-week (56 day) period that begins on the date of disbursement of the borrower's PPP loan proceeds. The Loan Forgiveness Rule maintains that definition, while also providing an "alternative payroll covered period" solely for purposes of determining which payroll costs are eligible for forgiveness.

Whereas the Act may be interpreted to require that costs must be incurred and paid during the covered period, the Loan Forgiveness Rule clarifies that costs eligible for forgiveness may include costs paid or incurred during the covered period, or alternative payroll covered period in relation to payroll costs.

Payroll Costs Eligible for Loan Forgiveness

Borrowers with a bi-weekly (or a more frequent) payroll cycle can choose between using the covered period or the alternative payroll covered period that begins on the first day of the first payroll cycle during the covered period.

Example: A borrower with a bi-weekly payroll schedule has a covered period that begins June 1 and ends on July 26. The first day of the borrower's payroll cycle that starts during the covered period is June 7. The borrower may elect to use the covered period or alternative payroll covered period that begins on June 7 and ends on August 1.

Payroll costs are considered paid on the day paychecks are distributed or the borrower originates an ACH credit transaction. Payroll costs are generally incurred on the day the employee's pay is earned (i.e., on the day the employee worked). Payroll costs incurred during the borrower's last pay period of the covered or alternative covered period are eligible for forgiveness if paid on or before the next regular payroll date.

The Loan Forgiveness Rule clarifies that payroll costs include bonuses and hazard pay, but such payments are included with an employee's salary, wages, and commission payments for purposes of applying the annualized \$100,000 limit on each employee's cash compensation. Eligible payroll costs also include payments to furloughed employees and employees not able to perform their day-to-day duties, whether due to lack of economic demand or public health considerations.

Loan forgiveness for owner-employees and self-employed individuals' payroll compensation is limited to the lesser of 8/52 (approximately 15.38 percent) of 2019 compensation or \$15,385 per individual in total across all businesses. No 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.

Nonpayroll Costs Eligible for Loan Forgiveness

Nonpayroll costs eligible for forgiveness include costs 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. The borrower may not elect to use the alternative payroll covered period for purposes of determining eligible nonpayroll costs.

Example: A borrower's covered period begins June 1 and ends on July 26. The borrower pays its May and June electricity bill during the covered period and pays its July electricity bill on August 10, which is the next regular billing date. The borrower may seek loan forgiveness for its May and June electricity bills because they were paid during the covered period. The borrower may also seek forgiveness for the portion of its July electricity 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.

The Loan Forgiveness Rule expressly prohibits pre-payments of interest on covered mortgage obligations in compliance with the Act's provisions, but is silent as to pre-payments of rent and utilities. In order to limit the excessive inclusion of nonpayroll costs, the Rule also maintains the cap on loan forgiveness that requires that only 25 percent of the amount forgiven may be attributable to nonpayroll costs.

Reductions in the Forgiveness Amount

The Small Business Administration ("SBA") has issued additional guidance regarding the reductions in the loan amounts that qualify for forgiveness. A summary of this guidance is set forth below:

Laid-Off Employees or Reduction in Hours with Offer to Rehire or Reinstate

The loan forgiveness amount will not be reduced if the borrower laid off or reduced the hours of an employee, provided that the borrower offered to rehire the same employee for the same salary and the same number of hours, or if the borrower offered to restore the reduction in hours, but the employee declined the offer. Specifically, a borrower may exclude any reduction in full-time equivalent employee headcount as it relates to an individual employee if:

- i. the borrower made a good-faith, written offer to rehire an affected employee (or, if applicable, restore the reduced hours of such employee) (the "Offer") during the covered period or the alternative

payroll covered period;

ii. the Offer was for the same salary or wages and same number of hours as earned by the affected employee in the last pay period prior to the separation or reduction in hours;

iii. the Offer was rejected by the affected employee;

iv. the borrower has maintained records documenting the Offer and its rejection; and

v. the borrower informed the applicable state unemployment insurance office of affected employee's rejection of the Offer of reemployment within 30 days of the employee's rejection of the Offer.

Further information on the requirement to inform the state unemployment insurance office will be provided on the Small Business Association's website: <https://www.sba.gov>.

Effect of Reduction in Borrower's Number of FTE Employees Has on the Loan Forgiveness Amount

A borrower's reduction in FTE employees during the covered period or the alternative payroll covered period reduces the loan forgiveness amount by the same percentage as the percentage of reduction in the borrower's FTE employees.

The borrower has the option to choose a reference period:

(i) February 15, 2019 through June 30, 2019;

(ii) January 1, 2020 through February 29, 2020; or

(iii) in the case of a seasonal employer, either of the two preceding methods or a consecutive 12-week period between May 1, 2019 and September 15, 2019.

If the average number of FTE employees during the covered period or the alternative payroll covered period is less than the average number of FTE employees during the reference period, the total eligible expenses available for forgiveness is reduced proportionally by the percentage reduction in FTE employees.

Example: If a borrower had ten (10) FTE employees during the borrower's chosen reference period, and the borrower then reduced down to eight (8) FTE employees during the covered period, the percentage of FTE employees would have declined by one-fifth (1/5) or twenty (20) percent and as a result only four-fifths (4/5) or eighty (80) percent of what would have been otherwise eligible expenses would be available for forgiveness.

PPP Definitions of FTE

Under the PPP, a FTE is defined as an employee who works forty (40) hours or more, on average, each week for a borrower. The hours of employees who work less than forty (40) hours are calculated as proportions of a single full-time equivalent employee and aggregated.

Borrower's Calculations of FTE Employees

Borrowers are required to 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 forty (40), with the maximum quotient not to exceed one (1.0).

Example: An employee who was paid forty-eight (48) hours per week during the covered period would be considered to be an FTE employee of one (1.0).

If a borrower has employees who were paid for less than forty (40) hours per week, borrowers may choose to calculate the full-time equivalency by two different methods:

Method One – the borrower may calculate the average number of hours a part-time employee was paid per week during the covered period. By way of example, if an employee was paid for thirty (30) hours per week on average during the covered period, the employee could be considered to be an FTE employee of three fourths (3/4) or seventy-five percent (0.75). Likewise, if an employee was paid for ten (10) hours per week on average during the covered period, the employee could be considered to be an FTE employee of one fourth (1/4) or twenty-five percent (0.25).

Method Two – the borrower may elect to use a full-time equivalency of one half (1/2) or fifty (50) percent for each part-time employee (in recognition of the fact that not all borrowers maintain hours-worked data).

Utilizing either of the above two methods, the borrower must provide the aggregate total of FTE employees for both the selected reference period and the covered period, or the alternative payroll 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.

Effect of Borrower's Reduction in Employees' Salary or Wages on the Loan Forgiveness Amount

The reduction in an employee's salary or wages in excess of twenty-five (25) percent will result in a reduction in the loan forgiveness amount, unless an exception applies. This reduction calculation is performed on a per employee basis, not in the aggregate.

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 twenty-five (25) percent of base salary or wages between January 1, 2020 and March 31, 2020 (the reference period). The foregoing is subject to exceptions for borrowers who restore reduced wages or salaries, as further explained herein.

Example: A borrower reduced a full-time employee's weekly salary from \$1,000 per week during the reference period to \$700 per week during the covered period. The employee continued to work on a full-time basis during the covered period with a FTE quotient of one (1.0). The first \$250 (25 percent of \$1,000 = \$250) is exempted from the reduction. A borrower seeking forgiveness would reflect \$400 as the salary/hourly wage reduction for that employee (the extra \$50 weekly reduction x eight (8) weeks = \$400).

Method for Borrowers Seeking Loan Forgiveness to Account for the Reduction Based on a Reduction in the Number of Employees Relative to the Reduction Relating to Salary and Wages

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.

Example: An hourly wage employee had been working forty (40) hours per week during the borrower selected reference period (FTE employee quotient of 1.0) and the borrower reduced the employee's hours to twenty (20) hours per week during the covered period (FTE employee quotient of 0.5). There

was no change to the employee's hourly wage during the covered period. Due to the fact that the hourly wage did not change, the reduction in the employee's total wages is attributable in total to the FTE employee reduction and the borrower is not required to conduct a salary/wage reduction calculation for that employee.

Restoring Reductions Made to Employee Salaries and Wages or FTE Employees No Later than June 30, 2020, to Avoid a Reduction in its Loan Forgiveness Amount

If certain employee salaries and wages were reduced between February 15, 2020 and April 26, 2020 (the safe harbor period), 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 due to reductions in salaries and wages. Likewise, 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 due to reductions in FTE employees.

This does not change or affect the requirement that at least seventy-five (75) percent of the loan forgiveness amount must be attributable to payroll costs.

No Reduction in Loan Forgiveness Amount if an Employee is Fired for Cause, Voluntarily Resigns, or Voluntarily Requests a Schedule Reduction

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 (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. Borrowers must maintain records demonstrating that each affected employee was fired for cause, voluntarily resigned, or voluntarily requested a schedule reduction. The borrower shall provide such documentation upon request.

The Forgiveness Process Rule

The Loan Forgiveness Rule maintains that lenders will have 60 days upon the receipt of a borrower's application for loan forgiveness (SBA Form 3508 or the lender equivalent) within which it has to render a decision on forgiveness (in whole or in part) to the SBA and request payment for the amount determined. The SBA will, subject to any SBA review, remit the appropriate amount of forgiveness to the lender, plus any accrued interest, not later than 90 days from the receipt of the lender's request. The lender is responsible for notifying the borrower of the forgiveness amount.

While previous SBA guidance suggests the SBA will only review loans with principal amounts in excess of \$2 million, the Forgiveness Process Rule states the SBA may review any PPP loan the SBA deems appropriate. Specifically, the SBA may review any borrower's representations or certifications as related to borrower eligibility, loan amounts and use of proceeds, and loan forgiveness amounts. Important to borrowers with principal loan amounts under \$2 million, the Forgiveness Process Rule does not amend previous SBA guidance that deemed such borrowers to have made in good faith the certification about the uncertainty that made the loan necessary. The SBA's review of whether a borrower was eligible for a PPP loan will be based on the provisions of the Act, the rules and guidance available at the time of the borrower's application, and the terms of the borrower's loan application. If the SBA determines that a borrower was ineligible, the loan will not be eligible for forgiveness. Further, the nonrecourse provisions of the Act will not apply if a borrower is deemed ineligible.

If any documentation submitted to the SBA indicates that the borrower was ineligible to receive a PPP loan

or any portion of the loan is not eligible for forgiveness, the SBA will require the lender to inform the borrower of the decision in writing and request additional information. The SBA may also contact the borrower directly. The SBA will consider all information provided by the borrower in response to an inquiry. The SBA will provide further guidance that describes how borrowers can appeal SBA determinations.

The Forgiveness Process Rule requires lenders to confirm the receipt of the required documentation for forgiveness, as specified in the [Loan Forgiveness Application Form](#), and confirm the borrower's calculations on the Application Form based on the documentation provided. Lenders are expected to perform a good-faith review in a reasonable time. For example, minimal review of calculations based on a payroll report by a recognized third-party payroll processor would be reasonable. Lenders may rely on borrower representations and should work with borrowers if the lender identifies errors in the borrower's calculations or a material lack of substantiation in the borrower's supporting documents.

Within 60 days upon receipt of a borrower's application for forgiveness, lenders shall submit a decision of approval (in whole or in part), denial, or (if directed by the SBA) a denial without prejudice due to a pending SBA review of the loan for which forgiveness is sought. In the case of a denial without prejudice, the borrower may subsequently request the lender to reconsider its decision, unless the SBA determined that the borrower is ineligible for a PPP loan. If the lender determines the borrower is ineligible for forgiveness in whole or in part, the lender must provide the SBA with a reason for its denial along with the loan forgiveness calculation form, PPP Schedule A, and the (optional) PPP borrower demographic form. Within 30 days of notice from the lender, a borrower may request that the SBA review the lender's decision. The SBA will use the 90-day window described above to review PPP loan forgiveness applications.

The SBA may undertake a review at any time within the SBA's discretion and within six years after the date the loan is forgiven or repaid in full, which is in line with the requirement that borrowers maintain PPP documentation for six years. Lenders must also comply with the normal records retention rules applicable to SBA loans.

If the SBA determines that a borrower was ineligible for a PPP loan, the lender will not be eligible for a processing fee, and may be required to pay back a processing fee previously received if the SBA makes such a determination within one year after the loan was disbursed.

For the most up-to-date legal and legislative information related to the coronavirus pandemic, please visit our [Shumaker COVID-19 Client Resource Center](#) at shumaker.com. We have also established a 24/7 Legal & Legislative Helpline at 1.800.427.1493 monitored by Shumaker lawyers around the clock.