

Summary of Paycheck Protection Program Loan Forgiveness Guidance

Prepared by The Groom Law Group

On the evening of May 22, the Small Business Administration (“SBA”) and Department of Treasury released two interim final rules (“IFRs”) – one IFR relating to the rules that will apply in determining the amounts eligible for loan forgiveness under the Paycheck Protection Program (“PPP”) (“Forgiveness Rules IFR”), and a second IFR relating to the process under which requests for loan forgiveness will be reviewed by lenders and the SBA (“Forgiveness Process IFR”).

Forgiveness Rules IFR

Much of the content of the Forgiveness Rules IFR affirms concepts that were already reflected in the Loan Forgiveness Application (“LFA”) that SBA released last Friday, May 15. However, some of the highlights are as follows:

Eligible Payroll Costs

- Affirms that borrowers can measure payroll costs based on either the 8-week default covered period (beginning on the loan disbursement date) or an “alternative payroll covered period” (which begins on the first day of the first payroll cycle in the covered period). The alternative payroll covered period may only be used by borrowers who pay on a bi-weekly or more frequent basis.
- Payroll costs include costs (i) paid during the covered period, or (ii) incurred during the covered period and paid in due course after close of the covered period. Payroll costs are considered paid on the day that the paychecks are “distributed or the borrower originates an ACH credit transaction” and “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 period or the alternative payroll covered period are only eligible for forgiveness if paid on or before the next regular payroll date.
- Eligible payroll costs include amounts paid to “furloughed employees.” 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).”
 - **Groom Comment:** “Furloughed employees” is not formally defined, but the IFR suggests it includes “employees [who] are not able to perform their day-to-day duties, whether due to lack of economic demand or public health considerations.” We would read it to encompass any employees who are on the borrower’s payroll and not providing services during the relevant covered, regardless of how they are designated in a payroll

system.

- “Bonuses” and “hazard pay” can be eligible payroll costs as well, “if an employee’s total compensation does not exceed \$100,000 on an annualized basis.”
 - **Groom Comment:** There is likely to be confusion around this rule. The IFR does not provide any further gloss on what amounts can qualify (or not) as a “bonus” or “hazard pay.” Additionally, the IFR does not discuss whether borrowers seeking to maximize their forgivable amount could issue additional bonus compensation or hazard pay. The CARES Act provides that “compensation of an individual employee in excess of an annual salary of \$100,000, as prorated for the covered period” is excluded from what is considered “payroll costs.” (The LFA states that a borrower cannot request more than \$15,385 in cash compensation paid to any given employee during the covered period, which is the eight-week equivalent of \$100,000.) Bonuses and hazard pay would not generally be considered “salary,” which is typically thought of as the predetermined amount than an employee receives per pay period- so based on the statutory language, bonuses and hazard pay might not be considered subject to the \$100,000 prorated cap. However, the IFR seems to suggest that in applying the \$100,000 prorated cap, SBA will look at all cash compensation made during the covered period, including non-salary amounts.

Payroll Costs for Owner-Employees and Self-Employed Individuals

- The amount of loan forgiveness requested for owner-employees and self-employed individuals can be no more than the lesser of 8/52 of 2019 compensation, or \$15,385 per individual.
- 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. Retirement and health insurance contributions are not included (as those expenses are paid out of their net self-employment income).
- General partners are capped by the amount of their 2019 net earnings from self-employment (reduced by any claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235. Retirement and health insurance contributions are not included (as those expenses are paid out of their net self-employment income).

Eligible Non-Payroll Costs

- Eligible costs must be either (i) paid during the covered period, or (ii) incurred during the covered period and paid on or before the next regular billing date (even if such date is after close of the covered period).

- Advance payments of interest on mortgage obligations are not eligible for forgiveness.
 - **Groom Comment:** This is interesting in that it could be read to support a reading that prepayments of other costs (payroll and non-payroll) are otherwise permitted.

Forgiveness Amount Reductions

- A “full-time equivalent” employee is defined as an employee that is paid for at least 40 hours per work.
 - **Groom Comment:** The IFR states, “For purposes of this calculation, borrowers must divide the average number of hours paid for each employee per week by 40, capping this quotient at 1.0.” It then says, “For example, an employee who was paid 48 hours per week during the covered period would be considered to be an FTE employee of 1.0.” What is unclear is whether an employer should determine this “FTE score” on a weekly basis, and then average the “FTE scores” over the eight-week covered period (as implied by the first sentence), or whether the employer should simply determine the employee’s average hours per week during the covered period (as implied by the second sentence). However, it appears the second approach is acceptable based on examples in the IFR.
- Affirms the “simplified” method as included in the LFA Instructions whereby any employee with a score of less than “1.0” can be assigned a score of “0.5”.
- The LFA Instructions provide some exemptions to the FTE reduction factor. One is when the borrower makes a good faith offer to rehire an individual (or increase their hours to pre-pandemic levels), but the individual turns down the offer. The IFR provides guidance on what qualifies as a good faith offer for this purpose. The requirements are: (1) the rehire offer must be written; (2) the offer must be for same salary or wages; (3) the offer must be for same number of hours as earned by employee in the last pay period prior to reduction or separation; (4) the offer must be rejected by “such” (i.e., same) employee; (5) the borrower must retain the record of written offer and rejection; and (6) the borrower must inform the State UI office of such employee’s rejection within 30 days. The IFR notes that this rule technically could be applied to terminations that occurred prior to February 15, 2020, but they indicate that the risk of abuse is de minimis.
 - **Groom Comment:** The IFR does not require that the “rejection” by the employee be in writing (as opposed to the rehire offer, which must be written). Employers will have to consider how they will document such rejections and whether they can take the position that a “no response” to a rehire offer could be considered a “rejection.”
- Provides that if an employee “is fired for cause, voluntarily resigns, or voluntarily requests a reduced schedule ... the borrower may count such employee at the same full-time equivalency level [as] before the FTE reduction.” Notably, borrowers that seek to utilize these exceptions “shall maintain records demonstrating that each such employee was fired for cause, voluntarily resigned, or voluntarily requested a schedule reduction” and “shall provide such documentation upon request.”

- The IFR provides “[I]f 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” (emphasis added).
 - **Groom Comment:** This suggests that a borrower could restore FTE reductions earlier than June 30, 2020, and seek forgiveness prior to June 30; however, it is unclear if this was intended. Additionally, it leaves unanswered whether the restored workforce level must also be maintained through June 30.

Salary/ Hourly Wage Reduction Factor

- With regard to employees who were paid not more than the annualized equivalent of \$100,000 for any pay period in 2019, a reduction in an employee’s salary or hourly wage over the covered period (when compared to the historic reference period) in excess of 25% will generally result in a reduction in the forgiveness amount. However, the IFR clarifies that “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.”
- Also, “[I]f 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 under section 1106(d)(3) of the CARES Act” (emphasis added).
 - **Groom Comment:** This suggests that a borrower could restore the salaries and wages earlier than June 30, 2020, and seek forgiveness prior to June 30; however, it is unclear if this was intended. Additionally, it leaves unanswered whether the restored levels must also be maintained through June 30.

Lender Responsibilities

- Once the application is complete, the lender has 60 days to issue a decision to the SBA regarding what amounts are forgivable.” [T]he lender must request payment from SBA at the time the lender issues its decision to SBA. 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.
- If only a portion of the loan is forgiven, or if the forgiveness request is denied, any remaining balance due on the loan must be repaid by the borrower on or before the two-year maturity of the loan. If, however, the forgiveness amount exceeds the remaining principal balance of the loan, e.g., because the borrower made prior payments on the loan, “the lender must remit the excess amount, including accrued interest, to the borrower.”

Forgiveness Process IFR

- The SBA “may review any PPP loan, as the Administrator deems appropriate.” It may review a loan regarding one or more of the following issues: (a) whether the borrower was eligible for the loan; (b) whether the borrower calculated the loan amount correctly; (c) whether the borrower used loan proceeds for the allowable uses” or (d) whether a borrower is entitled to loan forgiveness. The SBA can undertake that review “at any time in SBA’s discretion.”
 - **Groom Comment:** Presumably, the ability to review is limited by the applicable statute of limitations.
- Borrowers will have an opportunity to respond to SBA questions/concerns raised as part of a review, and appeal an SBA determination (pursuant to a process to be set forth in separate rulemaking).
- If the SBA determines that the borrower was ineligible for a PPP loan in the first place, no amounts are eligible for forgiveness. Additionally, the SBA “may seek repayment of the outstanding loan balance or pursue other available remedies.”
- Lenders must confirm borrower’s LFA certifications, confirm receipt of necessary borrower documentation, and confirm the borrower’s calculations that give rise to the forgiveness amount. The IFR states “lenders are expected to perform a good-faith review, in a reasonable time, of the borrower’s calculations and supporting documents concerning amounts eligible for loan forgiveness.”
 - **Groom Comment:** The IFR states that “minimal review of calculations based on a payroll report by a recognized third-party payroll processor would be reasonable.” This would appear to be good news for the PEO industry in that it is signaling to lenders that they can rely in good faith on third-party payroll reports.
- The lender can (i) approve the LFA (in whole or in part), (ii) deny the LFA with prejudice, or (iii) if directed by the SBA, deny without prejudice because of a pending SBA review. If the lender denies the LFA Application, the borrower can request (within 30 days) that the SBA review the lender’s denial.
- The IFR provides that lender processing fees are subject to clawback if a lender “has not fulfilled its obligations under PPP regulations.”
 - **Groom Comment:** This is likely to result in increased diligence/rigor by lenders in processing LFAs, as they will want to ensure their processing fees are not put at risk. Additionally, some lenders will likely adopt less than generous interpretations to minimize risk of clawback.