

May 25, 2020

The SBA kicked off Memorial Day weekend with a late Friday release of its long-awaited rules on the forgiveness provisions under the Paycheck Protection Program (PPP). It simultaneously issued a rule related to SBA's discretionary review of borrowers' loans and initial eligibility for the program. The rules do not add a great deal of detail beyond what was included in the forgiveness application and instructions, but a summary of the key points and clarifications from both rules follows.

Notably, eligibility for loan forgiveness will be assessed based on rules/guidance in place on the date of a borrower's forgiveness application. We do anticipate additional FAQ guidance and clarifications from SBA on these provisions, so it is important to stay abreast of new developments.

General Forgiveness Amount Determination Process & SBA Discretionary Audits –

a. Lenders' Role

As a general rule, lenders will make forgiveness amount determinations based on the forgiveness application and supporting documentation (detailed in the application instructions), subject to review by SBA of the borrower's original loan application and the forgiveness application.

Lender's obligations are limited to confirming receipt of a properly completed forgiveness application and related documentation. As with the original loan application process, lenders may rely – after a good faith review in a reasonable time – on borrower certifications and attestations as to the accuracy of their reported information and calculations.

Lender determinations may be in the form of: approval (in whole or in part); denial; or – if directed by the SBA – denial without prejudice due to a pending SBA review of the loan and/or forgiveness application.

Within 30 days of notice from the lender about forgiveness approval/denial, a borrower may request that SBA review the lender's decision. The SBA also may review the lender's decision in its sole discretion.

b. SBA's Role

SBA may, at its discretion, review a PPP loan of any size prior to or after a lender's forgiveness determination. SBA is authorized to review:

- A borrower's eligibility, including compliance with SBA's affiliation rules, certifications and representations made on the loan application, and the forgiveness application;
- Proper calculation of loan amounts and uses of loan proceeds; and

- Loan forgiveness amounts to which the borrower is entitled.

If questions arise about a borrower's loan or forgiveness eligibility, the borrower will have an opportunity to respond. The lender or SBA will request additional information from the borrower. Failure to provide additional requested information will result in a determination of ineligibility for the loan and/or forgiveness.

If SBA determines that the borrower was ineligible for a PPP loan in the first place, it will notify the lender that the borrower is ineligible for any forgiveness amount. If SBA concludes that the borrower is not eligible for the forgiveness amount claimed on the application, it will direct the lender to deny the forgiveness application in whole or in part, as appropriate. SBA may also seek repayment of the outstanding balance of the loan, but the rules do not specify the timing for such repayment.

Borrowers may appeal an SBA finding of ineligibility for a PPP loan or forgiveness amounts. SBA intends to issue rules on this process in the future.

The forgiveness application requires borrowers to maintain PPP documentation for six years after forgiveness or payment of the loan in full and allow SBA to access those files, which suggests that SBA may conduct oversight activities around these loans for an extended period after the program expires.

Timing of Forgiveness Determination & Payments –

Lenders have 60 days from receipt of a forgiveness application to submit a decision to SBA, and SBA has 90 days after that to remit the forgiveness amount plus any accrued interest to the lender.

If SBA opts to review a PPP loan or forgiveness application, it will notify the lender and the lender must then notify the borrower within 5 business days. While the SBA review is ongoing, the lender may not approve any forgiveness application.

Borrowers must pay any remaining balance on the loan on or before the 2-year maturity date. Borrowers will be reimbursed for any payments made on the loan after the 6-month deferment period if the forgiveness amount exceeds the remaining principal balance on the loan.

Calculating Forgiveness Amounts –

a. Payroll Costs and Alternative Payroll Covered Period

The rule retains the requirement that at least 75% of the forgiveness amount must be attributable to payroll costs.

Consistent with the forgiveness application, the rules provide some flexibility in the normal 8-week forgiveness period that runs from the loan disbursement date ("Covered Period") for payroll cost purposes. Specifically, borrowers with a biweekly or more frequent payroll schedule

may elect to calculate forgivable payroll costs using the 8 weeks beginning on the first day of the first pay period following the loan disbursement date (the “Alternative Payroll Covered Period” or “Alternative Period”).

The rules clarify that salary, wages, commissions, or similar compensation paid to furloughed employees are forgivable expenses (capped at the \$100,000 annualized rate). Additionally, hazard pay and bonuses are eligible for forgiveness (again, up to \$100,000).

For owners and individuals with self-employment income, the following compensation rules apply for determining “payroll costs,” all capped at \$15,385 –

- Owner-employees = 8/52 of 2019 compensation per individual in total across all businesses (may include 2019 employee cash compensation and employer retirement and healthcare contributions made on their behalf);
- Schedule C filers = eight weeks’ worth (8/52) of 2019 net profits (“owner compensation replacement”);
- General partners = amount of 2019 net earnings from self-employment (reduced by claimed 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235.

Note that retirement and health contributions for self-employed individuals, including Schedule C filers and general partners, are not forgivable payroll costs.

The forgiveness application further clarifies that borrowers should:

- Include employer contributions to employee health insurance, including self-insured plans, but exclude any pre-tax or after-tax contributions by employees (same for retirement plans); and
- Include amounts paid by the borrower for state and local taxes on employee compensation (e.g., state unemployment insurance tax), but exclude any taxes withheld from employee earnings.

Eligible payroll costs must be incurred (earned by the employee) and paid (paycheck distributed or ACH credit transaction originated) during the Covered Period or Alternative Payroll Period, except you may pay costs incurred during the last pay period of the Covered/Alternative Period on or before the next regular payroll date and still get forgiveness. For employees who are on payroll but not performing work, payroll costs are “incurred” based on a schedule established by the borrower (e.g., each day that an employee would have performed work).

b. Non-Payroll Forgiveness-Eligible Expenses

The rules do not contain a lot of additional detail here. They do clarify, however, that covered mortgage, rent, and utility payments are eligible for forgiveness if they are paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date, even if that falls after the Covered Period (note there is no alternative covered period for calculating these expenses).

Forgiveness Amount Reductions and Safe Harbors/Exceptions –

a. Reductions in Full-Time Equivalent Employees

A borrower's total eligible forgiveness amount will be reduced by the same percentage as any reductions in full-time equivalent employees (FTEEs) between the Covered Period or Alternative Payroll Covered Period and the borrower's chosen look-back period (for non-seasonal employers, either February 15, 2019 to June 30, 2019 or January 1, 2020 to February 29, 2020). The rules and the forgiveness application clarify, however, that employees who receive an offer of employment or an offer to restore previously reduced hours at the same salary/wages but decline the offer may be excluded from the full-time equivalent employee headcount/calculation if:

- The borrower makes a good faith written offer during the Covered Period or Alternative Payroll Covered Period;
- The offer is for the same salary/wages and number of hours earned by the employee in the last pay period prior to the separation or hours reduction;
- The offer is rejected by the employee;
- The offer maintains documentation of the offer and rejection; and
- The borrower informs the applicable state unemployment insurance office of the employee's rejection within 30 days of receiving it.

The forgiveness application and rules also exclude from the FTEE reduction penalty employees who, during the Covered Period or Alternative Payroll Covered Period, were fired for cause, voluntarily resigned, or voluntarily requested a reduction in hours (IF those positions were not filled by new employees). Employers must maintain records for such employees and events.

"Full-time equivalent employee" under the rules and forgiveness application means an employee who works 40 hours or more, on average, each week. Hours for employees who work fewer than 40 hours are recorded as proportions of a single FTEE and aggregated. There are two permissible methods for calculating FTEEs (borrowers may use either one, but it must be applied consistently across all employees and relevant timeframes):

- For each employee, the average number of hours paid per week during the relevant period divided by 40 (round to nearest tenth) with a maximum of "1" for each employee; or
- Using a simplified method, assign a "1" for any employee who works 40 hours or more per week and "0.5" for employees who work fewer than 40 hours (i.e., for any part-time employee, regardless of how many hours they actually work or were paid during the relevant periods).

b. Certain Salary Reductions

For each new employee in 2020 and for any employee who was not paid more than an annualized rate of \$100,000 in any pay period in 2019, a borrower's forgiveness amount will be reduced by the total dollar amount of salary/wage reductions in excess of 25% of the employee's

base salary/wages between January 1, 2020 and March 31, 2020. This is a per-employee calculation. The rules also clarify that the salary/wage reduction penalty applies only to the portion of salary/wage reduction not attributable to a FTEE reduction.

SBA provides a couple of examples –

- An employer reduces an applicable full-time employee's weekly salary from \$1000 to \$700 between the relevant periods. The first \$250 reduction is exempted from the reduction, so the forgiveness penalty/reduction would be \$400 (\$50 of non-exempt reduction times the 8 weeks of the Covered Period or Alternative Payroll Covered Period).
- An hourly employee worked 40 hours per week during the pre-crisis look back period, but is reduced to 20 hours during the Covered Period. There is no change in the employee's hourly wage, so the entire salary reduction is attributable to a reduction in FTEEs and there is no separate salary/wage reduction penalty amount.

c. Restoring Forgiveness Amounts through Rehires and Salary/Wage Increases

If employee salaries were reduced by more than 25% and/or FTEEs were laid off between February 15, 2020 and April 26, 2020 (the safe harbor period set forth in the CARES Act), but the employer eliminates those reductions on or before June 30, 2020, the employer is exempt from the penalties laid out above. Salary/wage and FTEE reductions made outside of the safe harbor period are not covered by this relief and the penalties for such reductions would apply.