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Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

Firm News

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On May 22, 2020, the SBA and Treasury Department issued additional guidance on two significant aspects of the Paycheck Protection Program (PPP): first, the loan forgiveness requirements and, second, the SBA's review process and the related borrower and lender responsibilities. Notably, the new regulations clarify the costs eligible for forgiveness, "full-time equivalent workers" definition, reductions to the loan forgiveness amount and the forgiveness application process. Those and other key clarifications are detailed below.

Please note that additional guidance and regulations may be released by the SBA, and as such, the explanations below may continue to evolve.

In addition to these FAQs, please refer to the following resources:

- Forgiveness Application and Instructions released May 15, 2020
- Interim Final Rule, dated May 22, 2020, regarding Loan Forgiveness (Forgiveness IFR)
- Interim Final Rule, dated May 22, 2020, regarding SBA Loan Review Procedures and Related Borrower and Lender Responsibilities (Loan Review IFR)

Loan Forgiveness Clarifications

Which costs are eligible for forgiveness?

A borrower's PPP loan is eligible for forgiveness in an amount equal to the sum of the following costs incurred and payments made during the covered period:

1. Payroll costs;
2. Interest payments on any business mortgage obligation on real or personal property that was incurred before February 15, 2020, but not any prepayment or payment of principal;

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

3. Payments on business rent obligations on real or personal property under a lease agreement in force before February 15, 2020; and
4. Business utility payments for the distribution of electricity, gas, water, transportation, telephone or internet access for which service began before February 15, 2020

The SBA reaffirmed that 75 percent of the loan forgiveness amount must consist of "payroll costs." More details regarding eligible costs can be found in our earlier article, "Payroll Protection Loans Under the CARES Act: Updated FAQs for Companies Seeking Assistance."

When must payroll costs be incurred and/or paid to be eligible for forgiveness?

Generally, payroll costs are eligible for forgiveness if paid or incurred during the eight-consecutive week (56 days) covered period (Covered Period). The SBA's new guidance clarifies that borrowers may seek forgiveness for payroll costs for the eight weeks beginning on either:

1. the date on which the lender disburses the borrower's PPP loan proceeds (i.e., the start of the Covered Period); or
2. the first day of the payroll cycle in the Covered Period (Alternative Payroll Covered Period).

In providing the Alternative Payroll Covered Period option, the SBA recognized that the eight-week covered period would not always align with a borrower's payroll cycle. As such, the SBA is permitting borrowers with bi-weekly (or more frequent) payroll schedules to use an "Alternative Payroll Covered Period" for administrative convenience. An example illustrating the differences between the Covered Period and the Alternative Payroll Covered Period is provided in Section 3(a) of the Interim Final Rule.

The SBA also clarified that, generally, payroll costs must be paid during the Covered Period (or the Alternative Payroll Covered Period) to be eligible for forgiveness. However, if payroll costs are incurred during the borrower's last pay period of the Covered Period (or the Alternative Payroll Covered Period), those costs are eligible for forgiveness if paid on or before the next regular payroll date. Payroll costs that were paid and incurred during the Covered Period (or Alternative Payroll Covered Period) may be only counted once.

Can the Alternative Payroll Covered Period be used for calculating covered nonpayroll costs?

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

No. The Alternative Payroll Covered Period may only be used for calculating covered payroll costs.

When are payroll costs considered “paid” or “incurred” for forgiveness purposes?

Payroll costs are “paid” on the day that paychecks are distributed or the borrower originates an ACH credit transaction.

Payroll costs are “incurred” on the day the employee’s pay is earned (i.e., the day that the employee worked). If a borrower has employees on its payroll who are not currently performing work, those payroll costs are incurred “based on the schedule established by the borrower.” According to the SBA, this is typically each day that the employee would have performed work.

Are salary, wages or commission payments to furloughed employees during the covered period eligible for loan forgiveness?

Yes, as long as the employee’s annual salary doesn’t exceed \$100,000, as prorated for the covered period.

Are bonuses or hazard pay during the covered period eligible for loan forgiveness?

Yes, as long as the employee’s total compensation does not exceed \$100,000 on an annualized basis.

Are there caps on the loan forgiveness amount for owner-employees and self-employed individuals’ own payroll compensation?

Yes. The loan forgiveness amount available for owner-employees and self-employed individuals’ own payroll compensation cannot exceed the *lesser* of 8/52 of 2019 compensation (i.e., approximately 15.38 percent of 2019 compensation) or \$15,385 per individual in total across all businesses.

Specifically, the loan for the following borrowers are subject to the caps listed below:

1. *Owner-employees* are capped by the amount of their 2019 employee cash compensation and employer retirement and health care contributions made on their behalf.
2. *Schedule C filers* are capped by the amount of their owner compensation replacement, calculated based on 2019 net profit.
3. *General partners* are capped by the amount of their 2019 net earnings from self-employment (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235.

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

The SBA further clarified that no additional forgiveness is available for retirement or health insurance contributions for self-employed individuals, including Schedule C filers and general partners, since those expenses are paid out of their net self-employment income.

When does a borrower need to incur and/or pay nonpayroll costs to be eligible for forgiveness?

A nonpayroll cost is eligible for forgiveness if it was:

1. paid during the Covered Period; or
2. 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.

For an example of this rule, see the IFR at section 4(a).

Are mortgage interest prepayments eligible for loan forgiveness?

No. Advance interest payments on a covered mortgage obligation are not eligible for loan forgiveness. Principal payments on mortgage obligations are also not eligible for forgiveness under any circumstances.

Who is considered a full-time equivalent employee for purposes of calculating loan forgiveness?

The IFR defines a “full-time equivalent employee” (FTE employee) as an employee who works 40 hours or more, on average, each week. Employees who work less than 40 hours are calculated as proportions of a single FTE employee and aggregated as explained below.

How should a borrower calculate the number of FTE employees?

Borrowers applying for forgiveness must document the average number of FTE employees during the covered period (or alternative payroll covered period) and their selected reference period. Then, the borrower must divide the average number of hours paid for each employee per week by 40, capping the quotient at 1.0.

For employees paid less than 40 hours per week, borrowers have the option of calculating full-time equivalency in one of two ways: one, calculate the average number of hours a part-time employee was paid per week during the covered period; **or** two, use a full-time equivalency of 0.5 for each part-time employee. It is important to note that borrowers may **only select one of these methods**, and for the method chosen, must **apply it consistently to all part-time employees** for the covered period (or alternative payroll covered period) and the selected reference period. The borrower must provide the aggregate total of FTE employees for both the selected reference period and the covered period by, first, adding together all of the

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

employee-level FTE employee calculations and then dividing the average FTE employees during the covered period (or Alternative Payroll Covered Period) by the average FTE employees during the selected reference period, which results in the reduction quotient.

How does a borrower's reduction of FTE employees impact the loan forgiveness amount?

Generally, a reduction in FTE employees during the covered period or alternative payroll covered period reduces loan forgiveness by the same percentage reduction in FTE employees. First, the borrower selects the reference period of either February 15, 2019-June 30, 2019, or January 1, 2020-February 29, 2020. If the borrower is a seasonal employer, the borrower may choose either of the two above listed reference periods **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 alternative payroll covered period) is **less than** during the reference period, the total eligible expenses available for forgiveness is reduced proportionally by the percentage reduction in FTE employees. For an example of this formula, see the IFR at section 5(b).

How does a borrower's reduction in employees' salary or wages affect the loan forgiveness amount?

For each new employee in 2020 and for 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 25 percent of base salary or wages between January 1, 2020, and March 31, 2020. The reduction calculation is performed on a per employee basis. It is worth noting that the salary/wage reduction **applies only to the portion of the decline in employee salary and wages that is not attributable to FTE reduction** so as not to doubly penalize borrowers.

Are there exceptions to a reduction in loan forgiveness for borrowers who restore employee salaries/wages or who eliminate FTE employee reductions?

Yes. If certain employee salaries and wages were reduced during the safe harbor period (between February 15, 2020, and April 26, 2020), 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. Likewise, if a borrower eliminates reductions in FTE employees that occurred during the safe harbor period, the borrower is exempt from any reduction in loan forgiveness amount that would otherwise be required.

Will a borrower's loan forgiveness amount be reduced if the borrower laid-off or reduced the hours of an employee, then offered to rehire the same employee for the same salary and same number of hours, or restore the reduction in hours, but the employee declined the offer?

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

No. The IFR excludes laid-off employees from the loan forgiveness reduction calculation for reduction in FTE employees if:

1. the borrower **made a good faith, written offer to rehire** the employee (or restore the reduced hours of the employee if applicable) during the covered period or alternative payroll covered period;
2. the offer was for the **same salary or wages and same number of hours** earned by the employee in the last pay period prior to the separation or reduction in hours;
3. the offer was **rejected by the employee**;
4. the borrower has **maintained records documenting the offer and its rejection**; and
5. the borrower **informed the applicable state unemployment insurance office** of such employee's rejected offer of reemployment within 30 days of the employee's rejection of the offer.

It is important to note that this same exemption is also available to borrowers who previously reduced the hours of an employee and offered to restore the employee's hours at the same salary or wages.

Will a borrower's loan forgiveness amount be reduced if an employee is fired for cause, voluntarily resigns or voluntarily requests a schedule reduction?

No. If an employee is fired for cause, *voluntarily* resigns or *voluntarily* requests a reduced schedule during the covered period or alternative payroll covered period (each being considered an FTE reduction event), the borrower may count the employee at the same full-time equivalency level before the FTE reduction event when calculating the FTE employee reduction penalty, and are thus considered exempt. As stated in the IFR, the SBA recognizes that borrowers should not be penalized for changes in employee headcount due to employee actions and requests. However, borrowers are required to maintain records demonstrating that each such employee was fired for cause, voluntarily resigned, or voluntarily requested a schedule reduction and the borrower shall provide such documentation upon request.

Loan Forgiveness Process

What is the process to apply for loan forgiveness?

The SBA has released the Loan Forgiveness Application (Forgiveness Application) that borrowers must complete and submit to their lender in order to have all or part of their loan forgiven. Borrowers will complete the Forgiveness Application and submit to the lender who will review and make a decision regarding approval. If the lender determines the borrower is eligible for forgiveness of some or all of the loan,

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

the lender will notify the SBA and request payment of the forgiveness amount. The SBA will then remit the appropriate forgiveness amount to the lender and the lender will notify the borrower.

Note that this process can change if the SBA reviews the loan prior to the lender rendering a decision on a Forgiveness Application.

What kind of documentation does a borrower need to submit with the Forgiveness Application?

Page 10 of the Forgiveness Application describes the types of documentation required for each category of eligible costs.

Who is responsible for verifying the information in the Forgiveness Application?

Borrowers are required to perform the calculations in the Forgiveness Application and verify and certify that they are correct. Lenders will review the Forgiveness Applications to an extent (as discussed below), and the SBA may opt to review and confirm the accuracy of Applications, as well; however, the liability is ultimately on the borrower.

Will lenders review the Forgiveness Applications?

Borrowers are responsible for accurately calculating the forgiveness amount, but lenders are expected to perform a good-faith review of the calculations and supporting documentation. Specifically, the new rules require lenders to:

- confirm receipt of the borrower certifications in the Forgiveness Application;
- confirm receipt of the documentation borrowers must submit to verify payroll and nonpayroll costs;
- confirm the borrower's calculations on the Forgiveness Application, including the dollar amounts of the: Cash Compensation, Non-Cash Compensation and Compensation to Owners claimed on Lines 1, 4, 6, 7, 8 and 9 on PPP Schedule A, and Business Mortgage Interest Payments, Business Rent or Lease Payments, and Business Utility Payments claimed on Lines 2, 3 and 4 of the PPP Loan Forgiveness Calculation Form; and
- confirm the borrower made the calculation on Line 10 of the PPP Loan Forgiveness Calculation Form correctly, which demonstrates that the borrowers used at least 75 percent of the forgiveness amount for payroll costs.

The lender is entitled to rely on the borrower's representations and is not required to independently verify the borrower's reported information if the borrower has submitted the proper supporting documentation and attested that it has accurately verified the payments for eligible costs. However, if the lender identifies any errors in the borrower's calculations or a material lack of substantiation in the borrower's

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

supporting documents, the new rules require that the lender work with the borrower to remedy the issue before submitting the Forgiveness Application.

How long will it take for a loan to be forgiven after a borrower submits a Forgiveness Application?

The lender has 60 days after receiving a borrower's complete Forgiveness Application to review and submit its decision regarding forgiveness to the SBA. The SBA then has 90 days to remit the forgiveness amount to the lender. During this 90-day period, the SBA may perform its own review of the loan and the Forgiveness Application.

What if a borrower has already started making payments on the loan when forgiveness is approved?

If the forgiveness amount remitted by the SBA to the lender exceeds the remaining principal balance of the loan because the borrower has already started making scheduled payments, the lender will pay the excess amount (including accrued interest) to the borrower to cover such payments.

What if a Forgiveness Application is denied?

If the lender determines the borrower is ineligible for forgiveness in any amount, the lender will provide the SBA with the reason for its denial, together with the Forgiveness Application materials. The lender must also notify the borrower in writing of the denial. The SBA has the right to review the lender's decision, in its sole discretion, and the borrower can also request that the SBA review the lender's decision within 30 days after receiving notice of the denial from the lender. If directed by the SBA, the lender may also deny the Forgiveness Application without prejudice due to a pending review of the loan by the SBA.

Any portion of the loan that is not forgiven must be repaid on or before the two-year maturity date. However, depending on the reason for denial of forgiveness, the SBA may also pursue other available remedies. (For example, if it is determined the borrower is not an "eligible recipient" of the loan because the borrower knowingly made false statements in original loan application, the SBA can pursue criminal penalties.)

If the lender denies the Forgiveness Application without prejudice due to a pending SBA review of the loan, the borrower may request that the lender reconsider the Forgiveness Application, unless the SBA has determined that the borrower is ineligible for the loan itself. There will also be a mechanism by which a borrower may appeal a decision of ineligibility by the SBA. The new rules indicate that the SBA intends to issue a separate interim final rule addressing this process.

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

What records do borrowers need to keep regarding loans and forgiveness applications?

A borrower must maintain records relating to its loan, including documentation submitted with the loan application, documentation supporting the borrower's certifications as to the necessity of the loan and its eligibility for the loan, documentation necessary to support the Forgiveness Application, and documentation demonstrating the borrower's material compliance with the PPP requirements for six years after the date the loan is forgiven or repaid in full.

Loan Review Process and Guidance

Which loans will be reviewed by the SBA?

As noted in earlier guidance, the SBA will be reviewing all loans over \$2 million (when aggregated with the loans of any affiliates, if appropriate) for compliance with the need certification in the original loan application. More broadly, however, the SBA reserves the right to review any loan it deems appropriate.

What exactly will the SBA review?

The new rules specify that the SBA is authorized to review the following:

- whether the borrower is eligible for the loan based on the provisions of the Act, the rules and guidance available at the time of the borrower's loan application, and the terms of the borrower's loan application
- whether the borrower calculated the loan amount correctly and used the loan proceeds for permissible uses
- whether the borrower is entitled to loan forgiveness in the amount claimed on the Forgiveness Application

When will the SBA conduct reviews of loans and/or Forgiveness Applications?

The SBA may review a loan of any size at any time, in the SBA's discretion.

How will reviews be conducted?

If the SBA decides to review a loan, the SBA will notify the lender, who in turn must notify the borrower within five business days. The lender must then submit to the SBA electronic copies of:

1. the borrower's loan application,
2. the Forgiveness Application and all supporting documentation provided by the borrower,

Payroll Protection Loans under the CARES Act: Clarifications on Loan Forgiveness and the SBA's Review Process

3. a signed and certified transcript of account
4. the executed note evidencing the loan, and
5. any other documents related to the loan requested by the SBA.

A lender may not approve a Forgiveness Application while an SBA review is in process.

The SBA may submit additional questions regarding the loan or the related documentation to the lender or directly to the borrower. The lender will submit to the SBA any additional information provided to it by the borrower, and the SBA will consider all information provided by the borrower. Failure to respond to the SBA's questions or requests for additional information may result in a determination that the borrower was ineligible for the loan, the loan amount or the amount of loan forgiveness claimed on the Forgiveness Application.

For assistance with specific PPP Loan questions, please contact your Fredrikson & Byron attorney.