

Analysis

Paycheck Protection Program Loan Forgiveness Interim Final Rule

Late on Friday, May 22, the Small Business Administration (SBA) released long-awaited [guidance on loan forgiveness](#) under the Paycheck Protection Program (PPP). Established in March 2020 in the [CARES Act](#) (Pub. Law 116-136), the PPP makes low-interest loans available to charitable nonprofits and small businesses of a certain size and permits up to 100 percent forgiveness of those loans under certain circumstances. The Interim Final Rule on loan forgiveness attempts to clarify those circumstances and complements the [loan forgiveness application and instructions](#) announced by SBA on May 15.

Payroll Costs

The CARES Act and the Interim Final Rule define the term “payroll costs” broadly to include compensation in the form of salary, wages, commissions, or similar compensation.¹ Salaries subject to loan forgiveness are capped at \$100,000 on an annualized basis (\$15,384 maximum in the covered period). The Interim Final Rule makes clear that employee hazard pay and bonuses are eligible for loan forgiveness, subject to the \$100,000 annualized limit.

Nonpayroll Costs

In addition to payroll costs, Section 1106 of the CARES Act permits forgiveness of certain nonpayroll costs. The Interim Final Rule lists these as payments on business obligations in force before February 15, 2020 for (1) mortgage interest on real or personal property (but not prepayments or payment of principle), (2) rent on real or personal property, and (3) utilities for electricity, gas, water, transportation, telephone, or internet access. The Interim Final Rule clarifies that a nonpayroll cost is eligible for loan forgiveness if it was either (a) paid during the covered period or (b) incurred during the period but paid on a regular billing date after the period.

Although permissible PPP expenses under Section 1102 of the CARES Act, “interest on any other debt obligations that were incurred before the covered period” are not included as nonpayroll costs in the forgiveness section of the CARES Act nor in the Interim Final Rule.

The Interim Final Rule repeats the limit in a previous rulemaking that “eligible nonpayroll costs cannot exceed 25 percent of the loan forgiveness amount.”²

¹ The Interim Final Rule, at footnote 2, summarizes what are considered eligible payroll costs: “Payroll costs consist of compensation to employees (whose principal place of residence is the United States) in the form of salary, wages, commissions, or similar compensation; cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips); payment for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums, and retirement; payment of state and local taxes assessed on compensation of employees; and for an independent contractor or sole proprietor, wages, commissions, income, or net earnings from self-employment, or similar compensation. See 15 U.S.C. 636(a)(36)(A)(viii); 85 FR 20811, 20813.”

² The limitation of forgiveness for nonpayroll expenses to 25 percent is not found in the CARES Act but was announced in the first [Interim Final Rule](#) on April 15, 2020. In public comments, the [National Council of Nonprofits](#) and other organizations called the limitation “arbitrary, capricious, and contrary to the will of Congress.” The House-passed HEROES Act ([H.R. 6800](#)) and another pending bill ([H.R. 6886](#)) would abolish the 25 percent limitation.

Reductions to Loan Forgiveness

As a general rule, borrowers that retain their workforce and maintain employees' salaries for the eight-week (56-day) covered period of the PPP loan will be eligible for the greatest loan forgiveness. On the other hand, Section 1106 of the CARES Act requires reductions in a borrower's loan forgiveness amount based on the number of full-time equivalent employees or amount of employee salary and wages paid during the covered period compared to the employer's pre-pandemic experience. The Interim Final Rule provides information for determining whether reductions are required and identifies safe harbors and exemptions that are beneficial to borrowers.

Retaining the Workforce

The determination of whether an employer has maintained its workforce is based on a count of full-time equivalent (FTE) employees prior to the pandemic and during the loan period. The Interim Final Rule states, "If the average number of FTE employees during the **covered period or the 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." The Rule provides borrowers several options for designating when the highlighted periods begin and end.

- **Covered Period:** Borrowers have the option of starting the covered period either on the day it receives the loan proceeds (date of disbursement) or the first day of the next biweekly or more frequent payroll cycle ("alternative payroll covered period").
- **Reference Period:** Each borrower is entitled to select one of several reference periods for use in gauging its workforce complement prior to the pandemic. Most employers can choose between (1) February 15, 2019 through June 30, 2019, or (2) January 1, 2020 through February 29, 2020. Seasonal employers can choose either of the preceding options, or select a consecutive 12-week period between May 1, 2019 and September 15, 2019.

For calculating full-time employees, the normal method is to divide the average number of hours paid for each employee per week by 40, capping this quotient at 1.0. The overtime regularly worked by an employee is disregarded for this calculation. Borrowers have two options for determining how each part-time employee will be counted for purposes of identifying total FTEs. They can apply the same calculation as above, and apply a quotient, such as 0.75 for an employee who averages 30 hours per week. In the alternative, SBA allows borrowers to elect to use an FTE of 0.5 for each part-time employee. The borrower must use the same method in both the covered period and reference period.

Exemptions: SBA has announced several safe harbors or exemptions that allow borrowers to count employees who have not been on the payroll through the covered period or are no longer on the payrolls.

- The CARES Act expressly allows borrowers to count a formerly laid-off or furloughed employee at the time of loan forgiveness if the employee was (a) laid off or furloughed between February 15 and April 26, 2020, and (b) rehired by June 30, 2020.
- Employees who decline offers of rehire will also be counted as on the payroll for forgiveness purposes. The borrower must have made a good faith, written offer to rehire the employee at the same wages and hours, the employee must have rejected the offer, and the borrower must retain records of the offer and rejection and inform the state unemployment office within 30 days of the rejection.³
- Borrowers may still include in their covered period FTE count those employees who are fired for cause, voluntarily resign, or voluntarily request a reduced schedule during the covered

³ The Interim Final Rule at footnote 4 states, "Further information regarding how borrowers will report information concerning rejected rehire offers to state unemployment insurance offices will be provided on SBA's website."

period. SBA's rationale is that "borrowers should not be penalized for changes in employee headcount that are the result of employee actions and requests." Employers must maintain records that document the reason that employees are no longer on the payroll.

Once the covered and reference periods are selected, the FTE status of each employee is identified, and employees are properly accounted for based on the safe harbor and exemptions, it's time to calculate whether a proportional reduction in PPP loan forgiveness is necessary. This is done by dividing the average number of FTEs during the selected covered period by the average number of FTEs during the selected reference period. The resulting quotient, if less than 1.0, is the percentage of amount of eligible expenses that may be claimed for forgiveness based on the FTE analysis.⁴

Maintaining Employee Salaries

The CARES Act also calls for a reduction in loan forgiveness 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 reference period), subject to exceptions for borrowers who restore reduced wages or salaries. Stated another way, borrowers will suffer a dollar-for-dollar reduction in loan forgiveness for all employees who earn less than 75 percent of their pre-pandemic wages. This is best explained in an example. An employee's average wages during the reference period were \$1,000/week and \$700/week during the covered period. The borrower is not "docked" for the first 25 percent in reduction (\$250/week), but would not be entitled to forgiveness of the excess (\$50/week), which over the eight-week covered period would amount to a \$400 reduction in loan forgiveness.

Exemptions: The Interim Final Rule provides some exemptions and exceptions. The borrower will not be subject to a reduction in forgiveness based on salary reductions if (a) the salary reduction occurred between February 15 and April 26, 2020, and (b) the borrower restores the salary (eliminates the reduction) on or before June 30, 2020. Also, reductions in wages due to reduced hours will be treated as a change in FTE status (discussed above) and will not also be counted as a reduction in pay, assuming the employee's wage rate is the same.

Application Process and Timing

Once the borrower submits the [loan forgiveness application](#) and documentation to its lender, the lender has 60 days to make a decision regarding loan forgiveness. The lender then sends its determination of full or partial forgiveness (or ineligibility) to SBA, which has 90 days to review and respond. SBA could determine that the borrower is ineligible for the PPP loan. The SBA has initiated [separate rulemaking](#) for its procedures for reviewing applications for PPP loans and loan forgiveness.

The Loan Forgiveness Interim Final Rule is effective immediately, but still subject to public review and comment. **Public comments are due approximately on June 25, 2020.**

NOTE: *This document is neither intended to be nor should it be used as legal advice.*

⁴ CARES Act Section 1106(d)(2) provides that the amount of loan forgiveness shall be reduced by multiplying the loan amount of forgivable expenses by the quotient obtained by dividing the average number of FTE employees per month employed during the covered period by the average number of FTE employees per month during the selected reference period. The Interim Final Rule, in Section 5(b), appears to misstate the calculation this way: "This formula implements section 1106(d)(2) of the CARES Act, which expressly requires that the loan forgiveness amount be reduced by the amount resulting from multiplying the amount that the borrower would otherwise receive by the quotient of the average FTE employees in the relevant reference period *divided by the average FTE employees in the covered period.*" The calculation is stated correctly in Section 5(d), where it explains, "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."