

Over the last several days, the SBA revised the original loan forgiveness application, developed a new “EZ” loan forgiveness application, and issued rules to reflect changes under the PPP Flexibility Act, including an Interim Final Rule (“IFR”) issued on June 22nd that revises the Interim Final Rules on Loan Forgiveness and SBA Loan Review Procedures.

This memo provides a summary of the IFR’s revisions to the original Loan Forgiveness and SBA Loan Review Procedures.

Covered Period

The PPP Flexibility Act extended the length of the covered period to 24 weeks, while allowing borrowers that received PPP loans before June 5, 2020 to elect to use the original eight-week covered period.

The revised rule provides that borrowers are allowed to submit a loan forgiveness prior to the end of the covered period if they have expended all of the loan proceeds for which they will request forgiveness. This will allow borrowers who are using the 24-week period to file sooner than the end of its covered period.

As discussed later, the borrowers will still need to take the 24-week period into consideration when calculating the potential reduction in loan forgiveness due to wage reductions.

Owner Employee

The original loan forgiveness application introduced the term “owner-employee”, but to this point the SBA had not provided any clarity on who was included in this term. This term is important in that the SBA limits the amount of compensation, health care and retirement costs that can be included in payroll costs for a self-employed, general partners and “owner-employees”.

While the IFR provides that both S corporation and C corporation owners are included in the definition of “owner-employee”, the IFR allows C corporation owners to add in both health and retirement costs to payroll costs but only retirement costs for S corporation owners.

The SBA’s rationale for the different treatment is that health care costs are included in W-2 wages as taxable benefits for S corporation owners. Extending that rationale raises additional issues for consideration. First, IRS rules require that health care benefits are only included in taxable wages for greater than 2% S corporation shareholders. Does this mean that the health care costs for 2% or less S corporation shareholders can be added to payroll costs? Second, most corporations only adjust wages for taxable fringe benefits at year end. Therefore, it may be advisable to include an amount of health care costs proportionate to the length of the selected covered period in W-2 wages, prior to producing the payroll documentation that must be provided to the lender supporting the forgiveness application.

Payroll Costs Caps for Certain Individuals

The amount of payroll costs that can be included for consideration of loan forgiveness is capped for self-employed and owner-employee individuals. In general, for borrowers using the 8-week covered period the cap is the lesser of 8/52 of 2019 compensation or \$15,385 and for 24-week covered period borrowers the cap is lesser of 2.5/12 of 2019 compensation or \$20,833.

As noted above, C corporation borrowers can add both health care and retirement benefit costs for its owners to the compensation amounts calculated above, while S corporation borrowers' owners can only add retirement benefit costs.

Schedule C and Schedule F filers are capped by the amount of their owner compensation replacement. If they select the 24-week covered period, then the cash compensation limit of 2.5/12 of 2019 net income will be the same as their borrowing base and they can expect full loan forgiveness. Health care and retirement costs are included in their net income amounts so there is no separate addition back to their payroll computation for these items.

General partners' compensation is based on net earnings from self-employment, reduced by any IRC Section 179 expense, unreimbursed partner expenses, and oil and gas depletion, with the net sum multiplied by .9235.

Loan Forgiveness Wage Reduction

The loan forgiveness amount will be reduced if the employer did not maintain annualized payroll amounts during the covered period of at least 75% of annualized 1st quarter 2020 wages.

The reduction must be based on the full covered period (24-weeks, or 8-weeks if elected) even if the borrower files its loan forgiveness application before the end of the covered period.

Example: A borrower is using a 24-week covered period with a start date of April 17th and an end date of October 1st. By August 10th the borrower has used all its PPP loan and files its forgiveness application on August 22nd. The borrower reduced a full-time employee's weekly salary from \$1,000 per week during the reference period (Quarter 1 2020) to \$700 per week during the period from April 17th to August 22nd. The employee continued to work on a full-time basis during the same period, with an FTE of 1.0. In this case, the first \$250 (25 percent of \$1,000) is exempted from the loan forgiveness reduction. The borrower seeking forgiveness would list \$1,200 as the salary/hourly wage reduction for that employee (the extra \$50 weekly reduction multiplied by 24 weeks). This is the case even though the borrower applied for forgiveness before the end of the covered period. It must account for the salary reduction for the full 24-week covered period, (totaling \$1,200).

The IFR does not include a "claw back" provision for wages or FTE headcount that are reduced after the filing of the loan forgiveness application but before the end of the covered period. In the same example, it would seem that if the borrower maintained the required wage level until August 22nd and then reduced the employee's wages, there would be no loan forgiveness consequence. This may not be the intention of the SBA and further guidance would be beneficial.

Loan Forgiveness Review

Under the normal review process, the lender will have up to 60 days after receipt of a complete loan forgiveness application to make a recommendation to the SBA. That decision may take the form of an approval (in whole or in part) or a denial.

The lender must notify the borrower in writing if the lender has issued a decision to the SBA denying the loan forgiveness application. The SBA reserves the right to review the lender's decision in its sole discretion. Within 30 days of notice from the lender, a borrower may notify the lender that it is requesting that the SBA review the lender's decision. Within 5 days of receipt, the lender must notify the SBA of the borrower's request for review. The SBA will notify the lender if the SBA declines a request for review.

In general, the SBA has up to 90 days to decide on the lender recommendation and at that time will remit the appropriate forgiveness amount to the lender, plus any interest accrued through the date of payment. The lender is responsible for notifying the borrower of the forgiveness amount. 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 maturity date of the loan.

The general loan forgiveness process described above applies only to loan forgiveness applications that are not reviewed by the SBA prior to the lender's decision on the forgiveness application. The lender can also issue a loan forgiveness recommendation (if directed by the SBA) of a denial without prejudice where there is a pending SBA review of the loan. In the case of a denial without prejudice, the borrower may subsequently request that the lender reconsider its application for loan forgiveness, unless the SBA has determined that the borrower is ineligible for a PPP loan.

The SBA has indicated that it will issue a separate interim final rule addressing how borrowers can appeal an unfavorable SBA decision.

Loan Forgiveness Reduction Safe Harbors and Exemptions

There are several safe harbors or exemptions available to reduce or eliminate the reduction of the loan forgiveness amount due to FTE headcount or wage reductions. In summary, they are as follows:

1. No reduction in employees or average paid hours- any FTE reduction is eliminated if the borrower did not reduce its FTEs or the average hours of employees between January 1, 2020 and the end of the covered period.
2. FTE Reduction Safe Harbor #1- borrower is able to document in good faith an inability to return to the same level of business activity as the borrower was operating at before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020 by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention (CDC), or the Occupational Safety and Health Administration related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19 (COVID Requirements or Guidance).

The SBA has interpreted this latest statutory safe harbor to include both direct and indirect compliance with COVID Requirements or Guidance, because a significant amount of the reduction in business activity stemming from COVID Requirements or Guidance is the result of state and local government shutdown orders that are based in part on guidance from the three federal agencies.

Example: A PPP borrower is in the business of selling beauty products both online and at its physical store. During the covered period, the local government where the borrower's store is located orders all non-essential businesses, including the borrower's business, to shut down their stores, based in part on COVID-19 guidance issued by the CDC in March 2020. Because the borrower's business activity during the covered period was reduced compared to its activity before February 15, 2020 due to compliance with COVID Requirements or Guidance, the borrower satisfies the Flexibility Act's exemption and will not have its forgiveness amount reduced because of a reduction in FTEs during the covered period, if the borrower in good faith maintains records regarding the reduction in business activity and the local government's shutdown orders that

reference a COVID Requirement or Guidance as described above.

3. FTE Reduction Safe Harbor #2- If a borrower reduced average FTEs during the period February 15th to April 26th as compared to February 15th, the FTE reduction is removed if the borrower restores FTE headcount to at least February 15th levels by the earlier of December 31, 2020 or the date the loan forgiveness application is submitted.
4. Restore employee hours/wages FTE reduction exception- In calculating the loan forgiveness amount, a borrower may exclude any reduction in FTE headcount that is attributable to an individual employee if:
 - a. The borrower made a good faith, written offer to restore the reduced hours of such employee;
 - b. the offer was for the same salary or wages and same number of hours as earned by such employee in the last pay period prior to the reduction in hours;
 - c. the offer was rejected by such employee; and
 - d. the borrower has maintained records documenting the offer and its rejection.
5. Offer to rehire employee FTE reduction exception- In calculating the loan forgiveness amount, a borrower may exclude any reduction in FTE headcount where it made a good faith, written offer to rehire an individual who was an employee on February 15, 2020 and was unable to hire a similarly qualified employee for the unfilled position on or before December 31, 2020.

Borrowers are required to inform the applicable state unemployment insurance office of any employee's rejected rehire offer within 30 days of the employee's rejection of the offer. The documents that borrowers should maintain to show compliance with this exemption include, but are not limited to, the written offer to rehire an individual, a written record of the offer's rejection, and a written record of efforts to hire a similarly qualified individual.

6. Employee severance/resignation FTE reduction exception- In calculating the loan forgiveness amount, a borrower may exclude any reduction in FTE, as long as the position was not filled by a new employee, due to employees who during the covered period were:
 - a. fired for cause,
 - b. voluntarily resigned or retired, or
 - c. voluntarily requested and received a reduction of their hours.
7. Wage Reduction Safe Harbor- If a borrower reduced an employee's annualized wages by more than 25% during the period February 15th to April 26th as compared to their annualized wages for the 1st quarter of 2020, the wage reduction for that employee is removed if the borrower restores their annualized wages to at least February 15th levels by the earlier of December 31, 2020 or the date the loan forgiveness application is submitted.

This memo is for general guidance only. This memo is based on the law in effect as of the date of the memo. As noted, there are many unanswered questions regarding the loan forgiveness calculation. Wipfli LLP does not undertake any obligation to update the memo for subsequent changes to the law.