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The Yellow Brick Road to PPP Loan Forgiveness: New Interim Final Rule Supplements Favorable Guidance Provided in the Loan Forgiveness Application

COVID-19 Resource

The Small Business Administration's (SBA) fourteenth in the continuing saga of [Interim Final Rules \(IFR\)](#) for the paycheck protection program (PPP) loans is out and provides details PPP borrowers need for obtaining loan forgiveness. (All of the IFRs can be found [here](#).) This IFR, issued May 22, comes on the heels of the [SBA loan forgiveness application](#), which we covered [here](#). Overall, the IFR conforms to the guidance provided by the forgiveness application and provides more details, but the primary addition in this IFR is the new guidance for the SBA's evolving treatment of payroll costs for owners of businesses.

The key takeaways from the IFR include:

Step-by-Step Description of the Forgiveness Process

The IFR provides for the following process:

1. The borrower completes and submits the loan forgiveness application to its lender. Notably, neither the CARES Act, the forgiveness application nor the IFR describes a due date for when a borrower must submit the forgiveness application. However, the PPP loan note or other documents may discuss a deadline by which the borrower must request forgiveness. Also, the current version of the forgiveness application lists an expiration date of October 31, which may indicate a default due date.
2. Within 60 days from receipt of the forgiveness application, the lender determines whether the borrower is entitled to forgiveness on some or all of the PPP loan and issues its decision about forgiveness to the SBA.
3. The lender requests payment from the SBA at the time the lender issues its decision to the SBA.
4. Within 90 days after the lender issues its decision to the SBA, the SBA will remit the appropriate forgiveness amount **plus interest accrued through the date of payment**. If applicable, the SBA will deduct the emergency injury disaster loan (EIDL) advance amounts.¹ The forgiveness application is subject to SBA review during this 90-day period.
5. If the SBA determines that the borrower was ineligible for loan forgiveness, then the lender is responsible for notifying the borrower of the forgiveness amount (or lack thereof).
6. 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.

As described by the SBA, the process “applies only to loan forgiveness applications that are not reviewed by SBA prior to the lender’s decision on the forgiveness application.” However, because the lender decision (Step 2 above) appears to be the first time the SBA learns of the forgiveness application with respect to a particular borrower, it is unclear when a

different process applies. We suspect that the SBA will clarify this limitation — for example, that the SBA can extend its 90-day deadline if it determines that it needs more time to review the lender’s decision and the forgiveness application.

Forgiveness of Interest?

The payment by the SBA to the lender includes “any interest accrued through the date of payment.” Further, nothing in the IFR indicates that the SBA will attempt to collect this interest amount from borrowers. This may indicate that borrowers will not owe any interest on the forgiven portion of a PPP loan. However, the “PPP Loan Amount,” defined in the forgiveness application as “the disbursed principal amount of the PPP loan (the total loan amount you received from the Lender)” is a cap for the forgivable amount, so we are not sure how the interest could be waived.

Refund to Borrower of Principal and Interest Payments

Borrowers must start making payments on PPP loans six months after receiving the PPP loan. The process described above could take 150 days (60 days for lender to submit decision + 90 days for SBA to submit payment). Further, the process cannot start until day 56, at the earliest. Accordingly, borrowers could have made one or more PPP loan payments with respect to PPP loan amounts later forgiven. The SBA helpfully clarified that in this situation the lender “must remit the excess amount, including accrued interest, to the borrower.” We suspect some borrowers will simply not (or will be unable to) make their scheduled PPP payments to the extent they anticipate deferral and, frankly, it is hard to imagine enforcement remedies during that period.

Favorable Rules for Payroll Costs

As we discussed in our [article](#) about the forgiveness application, the SBA adopted a broad, pro-borrower interpretation that allows forgiveness for both (1) payroll costs paid during the eight-week period **and** (2) payroll costs incurred during the eight-week period. The forgiveness application also allows borrowers to use an “alternative payroll covered period” if they use semi-weekly or more frequent payroll periods.² The IFR provides more details for these beneficial rules. In particular, the IFR confirms that, subject to the \$100,000 cap annualized (\$15,385 during the eight-week period):

1. Employers can receive forgiveness for amounts paid to employees “even if those employees are not able to perform their day-to-day duties, whether due to lack of economic demand or public health considerations.” For those immersed in PPP lore and law, this provision should trigger a yawn, but many borrowers are asking so it is probably appropriate to reiterate this rule.
2. As we discussed in this [article](#), there are bills in Congress that, in part, would provide even more flexibility or an extension of the eight-week period. The inability of businesses to reopen, coupled with the somewhat unnatural act for some businesses to continue to pay employees who have not been working, has prompted the call for this reform.
3. Employers can increase forgivable payroll costs with “hazard” pay and bonuses so long as the amount allocated to any one individual does not exceed \$15,385. Of course employers that call additional compensation “hazard pay” (presumably to preserve the ability to ratchet back compensation when the air clears) may find themselves at the wrong end of a lawsuit from an employee or customer afflicted with the virus who wants to debate whether the concept of hazard pay for the employee was the result of arm’s-length negotiations.

Limitations on Owner-Employees and Self-Employed

The IFR describes caps on loan forgiveness for owner-employees and self-employed individuals. The rule is ambiguous because it starts with a cap of “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.”³ On first reading, this statement seems to suggest that the \$15,385 limit, which is supposed to apply only to cash compensation, now also applies to additional amounts for employer payments for retirement benefits and healthcare contributions. However, the next paragraph appears to override this restrictive view, by providing different caps depending on the type of business:

- **Owner-Employees:** A cap is imposed on forgivable payroll costs based on “the amount of their 2019 employee cash compensation **and employer retirement and health care contributions made on their behalf.**” (Emphasis added.) It thus appears that employer retirement

and health care contributions above the \$15,385 cap for cash compensation can result in forgiveness, but aggregate compensation cannot exceed 2019 amounts.⁴

This provision indicates that a business cannot increase forgivable payroll costs by accelerating or increasing cash compensation, retirement contributions or health care contributions for owner-employees so that the total of **all** compensation (wages and noncash benefits) exceeds 8/52 of total 2019 compensation. In other words, for employees who are not owner employees, a business can increase payroll costs by increasing wages (subject to the \$15,285 cap) and/or the employer contributions to retirement and healthcare (subject to no cap), both compared to 2019. However, the same strategy cannot be used for owner employees.

The limitation creates several questions, the first being who is an employer-owner. For example, does it include a less than one percent shareholder with no control over management? What about an employee with unvested restricted stock or stock options? Questions also arise for owners who were not employees in 2019 but have had to provide services precisely **because of the pandemic**. Are these payroll costs entirely ineligible for forgiveness? What about owner employees who are working less in 2020, maybe because their business has been closed by government order? We suspect courts will be skeptical about enforcing such a vague and ill-defined rule that lacks any statutory authority. At this point, however, we simply flag this ambiguous language and promise another article soon addressing the grafting of yet another set of rules on an ill-defined group of *owner-employees*.

- **Schedule C Filers:** This is generally sole proprietors and independent contractors. The cap on forgivable payroll costs is “based on 2019 net profit.” Schedule C filers cannot increase payroll costs by increasing their cash compensation. Further, there is no additional forgiveness for **any** retirement or health insurance contributions because “such expenses are paid out of their net self-employment income.”
- **General Partners:** The cap on forgivable payroll costs is based on “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.” As with Schedule C

filers, no increase in forgivable payroll costs for (1) an increase in cash compensation or (2) retirement or health insurance contributions.

Favorable Rules for Nonpayroll Costs

As we discussed in our [article](#) about the forgiveness application, the SBA adopted a broad, pro-borrower interpretation that allows forgiveness for both (1) nonpayroll costs paid during the eight-week period **and** (2) nonpayroll costs incurred during the eight-week period. The IFR provides that payments eligible for forgiveness include payments during the eight-week period for amounts incurred before the eight-week period.⁵

In addition, as with the forgiveness application, the SBA (1) states that nonpayroll costs eligible for forgiveness include amounts “paid during the covered period” and (2) provides a specific rule prohibiting treatment of advance payments of **mortgage interest** as forgivable. Since interest only accrues based on the passage of time, this limitation makes perfect sense (and is included in the CARES Act). However, as we discussed in our prior [article](#) about the forgiveness application, the SBA stating this truism for interest expense indicates that advance payments of rent and utilities are eligible for forgiveness. Although this potentially could lead to abuse, as the SBA itself notes, “the 25 percent cap on nonpayroll costs will avoid excessive inclusion of nonpayroll costs.”

Statutory Reductions in Forgiveness for Reductions in FTEs and Compensation and June 30 Safe Harbor

As we discussed in our prior [article](#), the forgiveness application provides favorable interpretations of, and mechanical formulas to calculate, (1) the reduction in forgiveness for reductions in the number of full-time equivalent (FTE) employees, (2) the reduction in forgiveness for a reduction in salary or wages, and (3) avoiding these reductions in forgiveness by restoring the FTE or compensation reduction, as applicable, by June 30. We note the following:

- The statutory reductions in forgiveness do not apply if the employee(s) refuse to return to work. Employers should take note that the IFR requires a paper trail of written offer and rejection, which includes informing the applicable state unemployment insurance office of the offer and rejection within 30 days of the rejection.⁶

- The SBA has ensured that a business will not be penalized twice because of an FTE reduction that also results in a reduction in compensation for the employer. For example, if a business reduced salaried, full-time employees to 75 percent for both time and compensation, the business has both a reduction in FTEs and compensation. In the IFR, however, the SBA announced that the reduction in forgiveness for a reduction in compensation “applies only to the portion of the decline in employee salary and wages that is not attributable to the FTE reduction.”
- Our readers will recall a special statutory safe harbor for reductions in FTEs or compensation restored by June 30. This rule clarifies again a question that we hear continuously: the business doesn’t need to rehire the same employee, only to replace the FTE count and compensation. Second, safe harbor seems to use a snapshot on June 30 even if that is beyond or before the end of the eight-week forgiveness period. There doesn’t seem to be any requirement that the rehired/replaced employee be on payroll for more than a single day. These favorable rules about the statutory reductions in forgiveness and the restoration safe harbor do not impact the forgiveness cap based on payroll costs divided by 75 percent. We suspect that the SBA felt comfortable providing these favorable interpretations of the statutory reductions and safe harbor because of the backstop provided by its 75-25 split.

The IFR does not answer all questions about forgiveness, and, it certainly raises some new ones. Nonetheless, leaving aside the questionable restrictions on owner-employees, the IFR demonstrates the resurgence of the SBA providing favorable guidance that expands relief. We applaud these efforts and continue in our attempt to not let the perfect be the enemy of the good.

1 In preparing the forgiveness application, a borrower must list any EIDL advance, but does not take the EIDL advance into account in determining the forgivable amount. It appears that this was not a glitch. Instead, it appears that the SBA is taking on the responsibility of undertaking this calculation. We have no objection to this process, but predict news stories about borrowers being surprised when the forgiven amount of the PPP loan is less than amount listed on the forgiveness application.

2 This reduces administrative burdens by having payroll costs match pay periods. However, it generally reduces the amount of forgivable payroll costs because the first paychecks in the eight-week period will not include amounts paid for work done before the eight-week period.

3 The “across all businesses” provision provides guidance for owners of multiple businesses that each pay a salary. It appears that the owner is capped at \$100,000 total, rather than \$100,000 per business.

4 The concept of owner-employees was mentioned in the forgiveness application.

5 The IFR discusses this in terms of the prior month’s utility bill timely paid during the eight-week period. However, we are not aware of anything that would prohibit similar treatment to a late payment of a nonpayroll cost paid during the eight-week period.

6 The SBA doesn’t seem to appreciate that Congressionally-enhanced unemployment benefits through the end of July explicitly eliminate any requirement that the unemployed individual seek or accept employment. Further, many unemployment offices are not set up to receive much less track such notifications at a time when seeking employment has been eliminated as a requirement for unemployment benefits. So we look forward to seeing how the SBA effectuates their goal as reflected in the IFR.