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Post-PPPFA: SBA Stays the Course for Business-Friendly Interpretations in Statutory Reductions in PPP Loan Forgiveness and Non-statutory Limits on Forgiveness for Owner Payroll Costs

COVID-19 Resource

The Small Business Administration (SBA) made some significant revisions to the Paycheck Protection Program (PPP) loan forgiveness application and instructions. This guidance implements changes made under the Paycheck Protection Program Flexibility Act (PPPFA), summarized in this article. The PPPFA's key change is extension of the "covered period" to incur forgivable costs from eight weeks to 24 weeks. Before the new guidance, the SBA had issued its 17th interim final rule (IFR) for PPP loan forgiveness, which revises its first interim final rule to reflect the new law

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and adds some spice to the forgiveness recipe, discussed in this article. The SBA has provided additional significant PPP loan guidance, including:

- A revised PPP loan forgiveness application and instructions: other than making updates necessary because of the PPPFA and updating the special owner limit (discussed below), this largely conforms to the original application. As part of incorporating the PPPFA, the SBA added a safe harbor for a reduction in forgiveness because of a reduction in full-time equivalent employees (FTEs).
- An EZ PPP loan forgiveness application and instructions: the EZ application is available to borrowers that (1) applied for the PPP loan as self-employed, an independent contractor or a sole proprietor and did not have employees at the time of their loan application; (2) did not reduce salary or wages for any employee by more than 25 percent and did not reduce FTEs (ignoring certain reductions), or (3) did not reduce salary or wages for any employee by more than 25 percent during the covered period and was unable to operate at the same level as before February 15, due to compliance with certain COVID-19 requirements by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration. Essentially, it is a simplified form for businesses that would not be subject to the Statutory Reductions (as defined below).
- The 18th IFR, which modifies the 3rd IFR and the 6th IFR: in addition to making changes that conform to the PPPFA, the SBA used the 18th IFR to continue imposing a special limitation on forgivable payroll costs for owners. This limit is discussed in more detail below.

Many businesses — and their lenders — had hoped that the SBA would allow borrowers the flexibility to choose a covered period between eight weeks and 24 weeks. This would provide significant assistance to businesses that do not have sufficient forgivable costs after eight weeks, but do before 24 weeks; it would also flatten the curve for lender review of forgiveness applications and SBA review of the determinations made by lenders. The revised and EZ forgiveness applications only provide a binary choice for the covered period: eight weeks or 24 weeks. In its 19th IFR, which will be discussed in a forthcoming article, the SBA announced that businesses can submit an application before the end of the covered period. However, the SBA still left open several questions arising because a borrower must make a certification about information only known at

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the end of the covered period. Accordingly, submission of a forgiveness application during the covered period remains unclear.

In this article, we focus on two themes of the revised forgiveness application, the EZ forgiveness application and the 18th IFR: (1) retention of the SBA's favorable interpretations of the statutory reductions in forgiveness for a reduction in average FTEs or a reduction in compensation (collectively, the Statutory Reductions) and (2) continued imposition of SBA-created (*i.e.*, nonstatutory) limitations on forgivable payroll costs for owners.

Continued Marginalization of the Statutory Reductions

As we discussed in this article and this article, the SBA provided favorable interpretations of the Statutory Reductions that greatly simplified the necessary calculations. For example, the SBA calculates an FTE based on a 40-hour week and allows businesses to treat any employee working less than 40 hours as a 0.5 FTE. Thus, for example, a business is not subject to a forgiveness reduction attributable to the FTE ratio for an employee that worked 35 hours a week in the reference period (the denominator of the FTE ratio) and 10 hours a week in the covered period (the numerator of the FTE ratio) because the business can use 0.5 for the employee for both periods. The SBA also determined that a business is not treated as reducing compensation for an hourly employee if the business keeps the hourly rate the same, but has fewer hours for the employee.

Previously, SBA rules capped forgiveness at the amount equal to payroll costs paid or incurred over an eight-week covered period divided by 75 percent. We advised that this SBA-created limit provided a thoughtful backstop to prevent businesses from dropping payroll or FTE count. Consider, for example, an employee who earned $20/hour for 35 hours a week (i.e., $700/week) but the business reduces the employee to only 10 hours per week and retains the same hourly rate. That employee would make $1,600 in an eight-week covered period ($20*10*8), instead of $5,600 ($20*35*8). As described above, there would be no Statutory Reductions in forgiveness for this employee. However, the forgiveness cap associated with the $1,600 of cash compensation to this employee was $2,133 ($1,600/75 percent). Absent the reduction in hours, the cap would have been a little under $7,500 ($5,600/75 percent).

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As we previously discussed, in this article, Congress undermined the impact of this regulatory backstop by expanding it to payroll costs over 24 weeks and then allowing that total to be divided by 60 percent for purposes of determining the maximum forgiveness amount. For example, the forgiveness cap for the cash compensation for the hypothetical employee discussed above is now $8,000 (($20*10*24)/60 percent). The PPPFA did not change any of the operative provisions of the Statutory Reductions; rather, the PPPFA only changed the meaning of the term "covered period" from eight weeks to 24 weeks and lowered (to 60 percent) the percentage of covered expenses that needed to be used for payroll costs when computing maximum forgiveness.[1] The SBA has confirmed that it has not changed its interpretation of the Statutory Reductions.

Continued But Redesigned Special Limit on Owners

Nothing in the CARES Act or PPPFA treats payroll costs differently depending on whether the recipient is an owner of the business. Nonetheless, the SBA created special limitations with respect to forgiveness for payroll costs of owners. As we discussed in this article, the SBA introduced these caps in the 3rd IFR but limited those rules to individuals with self-employment income — that is, sole proprietors and partners. In the first forgiveness application and the 14th IFR, however, the SBA extended this limitation to "owner-employees," without defining the term.

Prior to the PPPFA, the SBA generally capped forgiveness for business owners to 8/52 of the 2019 payroll costs used to compute their PPP loan. In a prior article, we described how we believed that the PPPFA effectively overrode these SBA-created limits because of the way such limits were computed; if the covered period was extended from eight weeks to 24 weeks then naturally the fraction used for the cap on forgivable payroll costs to the business's owners should increase from 8/52 to 24/52. Indeed, that is exactly what the SBA did for purposes of computing forgivable cash compensation for other employees — increasing it from 8/52 of $100,000 ($15,385) to 24/52 of $100,000 ($46,154).

Hubris. We should know by now that neither consistency nor statutory language is a useful tool for predicting SBA actions. The revised forgiveness application, the EZ application and the revisions to the 3rd

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IFR, only allow 2.5 months of 2019 payroll costs to count toward forgiveness for compensation paid to business owners. That is, the SBA caps PPP loan forgiveness with respect to owners to the amount of the PPP loan the business received with respect to 2019 payroll costs for owners.[2]

To support this special owner-only limit, the SBA posits the following hypothetical in the 18th IFR:

For example, a borrower with one other employee would receive a maximum loan amount equal to five months of payroll (2.5 months of payroll for the owner plus 2.5 months of payroll for the employee). If the owner laid off the employee and availed itself of the safe harbor in the Flexibility Act from reductions in loan forgiveness for a borrower that is unable to return to the same level of business activity the business was operating at before February 15, 2020, the owner could treat the entire amount of the PPP loan as payroll, with the entire loan being forgiven. This would not only result in a windfall for the owner, by providing the owner with five months of payroll instead of 2.5 months, but also defeat the purpose of the CARES Act of protecting the paycheck of the employee.

This simplistic explanation disregards the numerous situations in which an "employee-owner" or a partner lacks the type of operational control to effect such a plan and exacerbates the problems we noted for employee-owners. Further, although such scheming may have been theoretically possible back in March when the CARES Act became law and in April when many of the PPP loans were first dispersed, the rules in effect before the PPPFA would have rendered such scheming ineffective because no business planned for an extension of the covered period to 24 weeks.[3] Finally, a business devious enough to take the steps discussed in the SBA's example could easily avoid the limitation by replacing the fired employee with a spouse, child or family member (so long as the replacement employee performed services that justified the compensation level).

In attempting to bring order to chaos, the SBA had been providing important guidance, much of which had a dubious basis in law but which still reflected thoughtful policy implementation. For example, we always respected that the SBA created forgiveness cap equal to payroll costs during the covered period divided by 75 percent. We also respected and

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applauded the special limit for partners and sole proprietors even while lamenting the confusion and irrationality of expanding that rule to other employee owners. Neither the 75 percent cap nor the limits on partners and sole proprietors had any basis in the CARES Act, as originally enacted. The PPPFA codified the cap, but with a much more favorable 60 percent formula. Congress, however, did not codify any special limit for partners and sole proprietors, much less employee-owners. Congress changed eight weeks to 24 weeks, without ever mentioning 2.5 months in 2019.

With the PPPFA, Congress sent a clear message that it wants businesses to be able to receive full PPP loan forgiveness. At this point, we do not know if the SBA-created limit for owners will have a material impact on forgiveness, given the other benefits of the PPPFA and SBA interpretations. However, we expect that businesses denied full forgiveness because of the new cap will litigate against the SBA to challenge this limitation.

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1 Some PPP practitioners thought the SBA would announce more restrictive interpretations in light of the PPPFA tripling the covered period. After all, for many businesses the sum of forgivable costs in a 24-week covered period (the starting point for calculating the Statutory Reductions) provides a sufficient cushion so that Statutory Reductions often will not have a substantive impact on PPP loan forgiveness.

2 Query whether this means that a business gets no forgiveness for payroll costs paid to a current owner who did not work for the company in 2019. As our readers (but maybe not the SBA) know, the pandemic has required many owners to fill in for other employees who could not or would not come to work.

3 If this were a concern for post-PPPFA borrowers, the SBA could have imposed this limit on loans made after June 5, when President Trump signed the PPPFA.

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