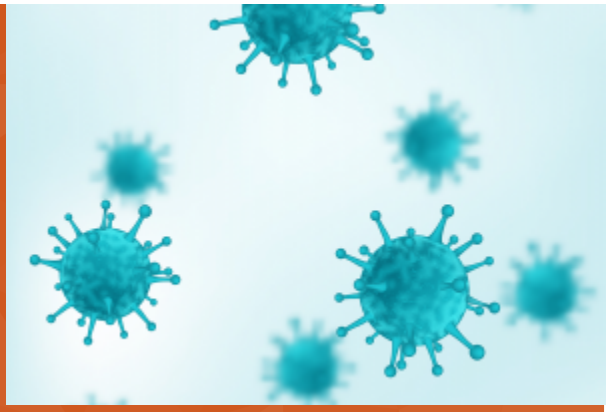
COVID-19 Alert: Interim Forgiveness & Audit Rules

PPP Update: *Treasury Department Releases New Regulations Related to PPP Forgiveness*

By:Matthew L. Mitchell and Scott R. Bleier
May 27, 2020



As we have previously reported, a recipient of a Paycheck Protection Program ("PPP") loan may be excused from the obligation to repay the loan if certain "Forgiveness Criteria" are met.

On Friday, May 22, 2020, the Treasury Department released two Interim Rules that detail those Forgiveness Criteria (collectively, the "Interim Forgiveness & Audit Rules"):

- *Interim Final Rule on Loan Forgiveness* (the "First Interim Rule"); and
- *Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities* (the "Second Interim Rule").

The Interim Forgiveness & Audit Rules follow the May 15, 2020 release of, and provide the regulatory foundation for, the *Paycheck Protection Program Loan Forgiveness Application* (the "Forgiveness Application").

The Interim Forgiveness & Audit Rules inform the instructions contained in the Forgiveness Application. As such, it is critical that PPP loan recipients that intend to request forgiveness fully understand the standards set forth in the Interim Forgiveness & Audit Rules.

The Interim Forgiveness & Audit Rules are complex and nuanced. The following is a guidepost summary that is intended to facilitate a loan recipient's own review and understanding of these standards.

THE PPP LOAN FORGIVENESS PROCESS

The First Interim Rule establishes the process by which PPP loan forgiveness is determined. That process includes the following steps:

- A PPP loan recipient that is seeking forgiveness (a "Forgiveness Applicant") completes the calculations, and discloses the documentation, identified in the Loan Forgiveness Application, in a manner that is consistent with the standards stated in the Interim Loan Forgiveness & Audit Rules.
- The Forgiveness Applicant submits the completed Loan Forgiveness Application to its lender after the eight-week loan forgiveness period.
- The lender reviews the Loan Forgiveness Application, and makes a loan forgiveness determination, based on information provided in the application, within 60 days of submission.

- The lender remits its forgiveness determination to the Small Business Administration (the "SBA") for review.

- The SBA, no later than 90 days after the lender issues its forgiveness determination, either: **(a)** accepts the lender's forgiveness determination and remits the appropriate forgiveness amount to the lender; or **(b)** reverses the lender's forgiveness determination in whole or in part.

- The lender notifies the Forgiveness Applicant of the SBA's final determination.

- If only a portion of the loan is forgiven, or if the forgiveness request is denied outright, any remaining balance due on the loan must be repaid by the Forgiveness Applicant before the two-year maturity date of the loan.

- The SBA may also intercede in this process, and conduct its own independent review of a Forgiveness Application prior to the lender's determination.

DEFINITION OF FORGIVABLE EXPENSES

Payroll costs that are eligible for forgiveness

The First Interim Rule instructs that a PPP Forgiveness Applicant may apply for forgiveness for loan amounts that are used for "payroll costs" that are paid ***or*** incurred during the eight-week period beginning on either:

- The date of disbursement of the loan proceeds from the lender (the "Covered Period"); ***or***

- If the Forgiveness Applicant pays employee wages on a bi-weekly, or more frequent, payroll cycle, the first day of the first payroll cycle after the date of disbursement of the loan proceeds from the lender (the "Alternative Covered Period"; the Covered Period and the Alternative Covered Period are both referred to as the "Period" throughout this alert).

A payroll cost is "incurred" during the Period if the employee earns the wage during the Period for hours worked, and payment for that earned wage is made on or before the next regular payroll date after the Period.

The First Interim Rule further clarifies that:

- Payments made to or incurred by furloughed employees during the Period are forgivable.

- Hazard pay and bonuses paid to or incurred with respect to an employee during the Period are forgivable, so long as the employee's total compensation during the Covered Period does not exceed $100,000 on an annualized basis.

- Loan forgiveness amounts requested by owner-employees and self-employed individuals are capped at 8/52 of that owner's or self-employee individual's 2019 cash compensation, with additional special rules for calculating forgivable payroll costs applicable to general partners.

Non-payroll costs that are eligible for forgiveness

The First Interim Rule also instructs that a PPP Forgiveness Applicant may apply for forgiveness for loan amounts that are used for "non-payroll costs" – *certain rent, utility payments, and mortgage interest costs* – that are paid ***or*** incurred during the Covered Period (*the Alternative Covered Period may not be used for forgiveness determinations related to non-payroll costs*).

The First Interim Rule appears to indicate that if a Forgiveness Applicant decides to use loan proceeds to pre-pay future but not-yet-incurred rent or utility payment obligations (or to pay past due rent or utility payments), those pre-payments (or catch-up payments) may be forgiven so long as such pre-payments (or catch-up payments) are "paid during" the loan forgiveness period. The First Interim Rule does clarify, however, that "*advance payments of interest on a covered mortgage obligation are not eligible for loan forgiveness*" as a result of specific language in the CARES Act that expressly excludes mortgage interest "prepayments" from forgiveness.

THE FORGIVENESS DEDUCTION CALCULATION

The First Interim Rule confirms that the forgiveness rate for a specific PPP loan will be decreased *if*: **(a)** a Forgiveness Applicant reduces its number of full-time equivalent ("FTE") employees during the Period (the "FTE Deduction"); or **(b)** *with certain exceptions*, the Forgiveness Applicant reduces employee wages during the Period (the "Wage Decline Deduction").

The specific "Forgiveness Deduction" rules provided in the First Interim Rule are complex and numerous, and include the following broad concepts:

- ***The FTE Deduction***. If the average number of FTE employees employed by the Forgiveness Applicant during the Period is less than the number of FTE employees employed during an applicable reference period (the "FTE Reference Period"), the forgiveness rate is reduced proportionally by the percentage reduction in FTE employees.

  For example: If a Forgiveness Applicant employed 10 FTE employees during the FTE Reference Period, and 8 FTE employees during the Period, the percentage of FTE employees declined by 20 percent, and only 80 percent of eligible expense are available for forgiveness.

  The following details, and exceptions, apply to this general rule:

  – The Forgiveness Applicant may use one of two alternative FTE Reference Periods to complete the Forgiveness Deduction calculation: *February 15, 2019 through June 30, 2019*; ***or*** *January 1, 2020 through February 29, 2020.*

  – The Forgiveness Applicant may use one of two alternative methods to determine the number of FTE employees employed by the Forgiveness Applicant – *both of which are different than general FTE calculation methods adopted in other employment law contexts.*

  – The following categories of employee reductions do not result in FTE Deductions: **(a)** employees who were laid-off or subject to reduced schedules, and who are re-called to regular employment during the Period, but refuse to return to work; **(b)** employees who are terminated for cause during the Period; and **(c)** employees who voluntarily resign, or voluntarily request a schedule reduction during the Covered Period.

  – A reduction in employee headcount during the Period is not considered in the Forgiveness Deduction calculation if the reduction is eliminated by no later than June 30, 2020 (the "Rehire Safe Harbor"). In other words, it appears that so long as the Forgiveness Applicant's employee headcount on June 30, 2020 is the same as, or exceeds, the Forgiveness Applicant's average employee headcount during the Reference Period, a reduction of headcount during the Period is not considered for purposes of the Forgiveness Deduction calculation.

- ***The Wage Decline Deduction***. If the Forgiveness Applicant reduces the wages of certain categories of employees ("Protected Employees"), in excess of 25%, during the Period, as

compared to a specified reference period (the "Wage Reference Period"), the forgiveness amount is deducted by the dollar amount of the wage reduction. This reduction calculation is performed on a per employee basis, and not in the aggregate.

> *For example, if a Forgiveness Applicant reduces the weekly salary of a Protected Employee by 30% – from $1,000 per week to $700 per week – for the eight-week Period, the amount of loan forgiveness must be reduced by $400 – $50 (the amount of the weekly reduction in excess of 25%) times eight weeks.*
>
> The following details, and exceptions, apply to this general rule:
>
> – The Wage Reference Period applicable to the Wage Decline Deduction is defined as January 1, 2020 to March 31, 2020.
>
> – A decline in a Protected Employee's wages, that was first imposed between February 15, 2020 and April 26, 2020, will not be included in the Forgiveness Reduction calculation if the wage rate for the Protected employee is restored no later than June 30, 2020 (the "Wage Restoration Safe Harbor").

- ***The Forgiveness Deduction Calculation Does Not Require "Double" Deductions.*** The First Interim Rule addresses the intersection between the FTE Deduction and the Wage Decline Deduction and clarifies that the Wage Decline Deduction applies only to a decline in a Protected Employee's wages that is attributable to a reduction in hourly wage rate (*and does not apply to a decline in wages that results only from a reduction in assigned hours*). This clarification is intended to avoid a "double penalty" that would otherwise trigger upon reducing the work schedule of a Protected Employee during the Period – which would result in both a reduction of the Forgiveness Applicant's FTE count and a decline in the Protected Employee's total wage amount. As such, under this clarification, a wage amount decline that results only from a work hours reduction is treated as a FTE Deduction, and not as a Wage Decline Deduction.

REQUIRED DOCUMENTATION TO SUPPORT A FORGIVENESS APPLICATION

The First Interim Rule confirms that all documentation requirements for obtaining PPP loan forgiveness are identified in the Loan Forgiveness Application.

SMALL BUSINESS ADMINISTRATION AUDIT RULES

The Second Interim Rule confirms that the Small Business Administration (the "SBA") has discretion to audit PPP Forgiveness Applicants, and clarifies that for "*a loan of any size, SBA may undertake a review at any time in SBA's discretion*" of the following:

- *Borrower Eligibility*: Whether the Forgiveness Applicant meets the various PPP eligibility requirements, including affiliation requirements.
- *Loan Amounts and Use of Proceeds*: Whether the loan amount requested was consistent with PPP loan amount calculation standards.
- *Loan Forgiveness Amounts*: Whether forgiveness amounts claimed are consistent with applicable forgiveness standards.

As previously reported, the "Question 46 Guidance" had resulted in questions regarding the scope of SBA audits for recipients of PPP loans of under $2 Million. The Second Interim Rule clarifies that the SBA is reserving the right to audit *any* Forgiveness Applicant, irrespective of

loan size.

The Second Interim Rule further establishes the following PPP audit procedures:

- *Notice of Audit*: The SBA will inform the Forgiveness Applicant of the PPP loan is subject to review.
- *Opportunity to Respond*: A Forgiveness Applicant that is subject to an SBA audit is permitted to submit to the SBA information that supports its loan application, and the SBA is obliged to consider such information.
- *Opportunity to Appeal*: A Forgiveness Applicant may appeal any negative audit outcome.

Finally, the Second Interim Rule establishes various audit outcomes. Specifically, if the SBA determines that the Forgiveness Applicant is ineligible for the PPP loan, or is ineligible for the loan amount or loan forgiveness claimed, the "*SBA will direct the lender to deny forgiveness in who or in part, as appropriate. . . , and may also seek repayment of the outstanding PPP loan or pursue other available remedies*," such as criminal or civil fines and penalties.

WHAT'S NEXT?

On May 11, 2020, U.S. House of Representatives Dean Phillips (Democrat -Minnesota) and Chip Roy (Republican – Texas) introduced legislation that proposes significant modifications to the PPP that are designed, in part, to relax and simplify PPP forgiveness.

The bill, titled the *Paycheck Protection Flexibility Act*, includes language that would:

- Extend the covered loan forgiveness period from eight-weeks to twenty-four weeks.
- Permit a greater percentage of non-payroll costs to be forgivable.
- Extend the repayment term for PPP loans from two years to a longer term.
- Ensure that PPP Forgiveness Applicants have full access to payroll tax deferments.
- Extend the Rehire and Wage Restoration Safe Harbors past June 30, 2020.

Media outlets are reporting that the *Paycheck Protection Flexibility Act* has broad bipartisan support, including backing from White House. A vote on this legislation is expected this week. As such, additional, significant changes to PPP forgiveness rules may be on the immediate horizon.

Morse continues to review the evolving regulatory landscape related to PPP loans and is focused on assisting our clients through these unprecedented and challenging times. Please contact the Firm should you have questions concerning this subject, or any other COVID-19 response matters.

Go to our full COVID-19 Resource Collection.