

SBA Additional Guidance on PPP Loan Forgiveness and Loan Reviews

On May 22, the SBA issued two new rules that provide some additional insight into Paycheck Protection Program (PPP) loan forgiveness and for the first time explain the process for lenders and the SBA to review PPP loans and forgiveness applications. The forgiveness guidance is consistent with our May 19 Alert concerning the forgiveness application form. The review process guidance is not unexpected but should help borrowers and lenders understand the events to unfold over the coming weeks and possibly months or longer. With funds first disbursed under the PPP back on April 3, the eight-week period to spend PPP funds will be ending soon for many loan recipients.

We will not repeat the conclusions of our May 19 Alert concerning the forgiveness process and formulas based upon guidance that was contained in the application and instructions. Instead, we will focus only on new, different, or clarifying items set out in the rules. Notably, the new rules **did not** extend the eight-week (56 day) period for which loan funds must be spent in order to qualify for forgiveness or change the rule requiring borrowers to spend at least 75 percent of the funds on eligible payroll costs to qualify for forgiveness. Many borrowers (particularly hotels and restaurants that have been unable to open or otherwise bring their furloughed employees back) have raised concerns about the practical application of these rules, and these issues are currently being discussed in Congress. Further, to the extent that entities with a good faith economic hardship as the result of COVID-19 elected to voluntarily return PPP funds due to lack of utility of the program due to the strict limitations of the eight-week forgiveness period (e.g., hotels or restaurants unable to open for much or all of their eight week forgiveness period), the new rules do not contemplate a path for reinstatement of loans or reapplication by those entities.

Payroll Costs

Although this was already understood to be the case, the rule confirms that for persons other than non-owner employees, all forms of cash compensation, including bonuses, hazard pay, and pay to furloughed employees, may be included as “payroll costs,” up to the \$100,000 cap (prorated to \$15,385 for the eight-week period).

For owner-employees and self-employed individuals, the amount of their loan forgiveness is capped at either \$15,385 — which is the eight-week equivalent of a \$100,000 annual salary — or the eight-week equivalent of their 2019 compensation, whichever is less. For owner-employees, the 2019 cap includes cash compensation and health insurance and retirement contributions. Schedule C filers are capped at their owner compensation replacement (as described in the SBA’s April 20 guidance), calculated based on 2019 net profit. General partners are capped by the amount of their 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. No additional forgiveness is provided for retirement or health insurance contributions for self-employed individuals, including Schedule C filers and general partners, as such expenses are paid out of their net self-employment income.

Nonpayroll Costs

Eligible mortgage interest, rent, and utilities may be forgiven if paid during the covered period or incurred during the covered period and paid by the first regular due date after the covered period. The rule confirms that amounts paid during the covered period are permitted even though they relate to periods prior to the covered period. For amounts paid by the next scheduled payment date after the end of the covered period, the borrower must prorate the total amount for only the days that fall in the covered period. The rule states specifically that advance payments of mortgage



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interest and all payments of principal are **not** eligible for forgiveness.

FTE-Based Reductions in Forgiveness Amount

Under the CARES Act and the forgiveness form, forgiveness of the eligible amounts is reduced because of reductions in full-time equivalent employees (FTEs) during the covered period compared to one of two reference periods. The rule provides some new or additional information on several issues.

FTE Definition

The rule confirms that FTEs are calculated using a 40-hour week. SBA considered using a 30-hour standard for FTEs, which is used by SBA in some other contexts and is used in the CARES Act for other purposes. However, SBA determined that 40 hours “better reflects what constitutes full-time employment for the vast majority of American workers.”

Calculating FTEs

FTEs must be calculated on a per-employee, per-week basis consistently for the covered period and for the applicable reference period. The borrower may either use the ratio of actual hours per week to 40 hours (but not to exceed 1.0) or may treat all employees who worked 40 or more hours as 1.0 and all other employees as 0.5.

Offers to Rehire

The rule confirms that a borrower may exclude a reduction in FTEs that occurs because the employer made a written, good faith offer to rehire a laid off or furloughed employee, and the offer was rejected. However, the rule adds a **new requirement** — the borrower must report the refusal to the applicable state unemployment insurance office within 30 days of the employee’s rejection of the offer. The rule says that further information on how to make this report will be provided on the SBA’s website. The rule also retains the exemptions in the forgiveness form for employees who are terminated for cause, voluntarily resign, or voluntarily request a schedule reduction.

Salary Reduction Adjustment

The rule makes clear that the forgiveness reduction for reduced salary levels excludes not only persons who earned \$100,000 prorated during any pay period of 2019, but also persons who were employed during the covered period but not employed during 2019. The rules also states that, to ensure a borrower is not doubly penalized, the salary reduction adjustment only applies to an actual reduction in salary and not to a reduction in FTEs. Thus, an employee whose hours were reduced from 40 to 20, but who continues to be paid at the same per-hour rate, will be reflected in the FTE adjustment calculation but not the salary adjustment calculation.

Loan Forgiveness Mechanics

The forgiveness process starts with the borrower completing and submitting to the lender¹ SBA Form 3508, or the lender’s equivalent, together with the supporting documentation specified in the instructions to the form. The required information is quite extensive, so borrowers may wish to begin collecting it as soon as possible.

In general, the lender reviews and decides on the forgiveness application. The lender has 60 days in which to issue a decision to SBA. If the lender determines the borrower is entitled to forgiveness, in whole or in part, the lender at the same time requests reimbursement from SBA for the forgiven amount. Subject to any review of the application (see below), SBA will remit the payment to the lender within 90 days after the lender issues its decision to SBA.

If the SBA’s decision and payment to the lender occurs before the borrower starts making payments on the loan, the payment amounts will be adjusted to reflect the forgiveness. If the lender receives the SBA’s decision and payment after the borrower has started making payments, the lender is required to refund excess payments to the borrower. Thus, the rule contemplates the possibility a borrower may not receive a final determination on forgiveness within six months from the date it received the loan proceeds.

Lender Review of a Forgiveness Application

Upon receipt of a forgiveness application, the lender is required to do each of the following:

1. Confirm receipt of the borrower certifications contained in the Loan Forgiveness Application Form.
2. Confirm receipt of the documentation borrowers must submit to aid in verifying payroll and nonpayroll costs, as specified in the instructions to the Loan Forgiveness Application Form.
3. Confirm the borrower's calculations on the borrower's Loan Forgiveness Application, including the dollar amount of the (A) Cash Compensation, Non-Cash Compensation, and Compensation to Owners claimed on Lines 1, 4, 6, 7, 8, and 9 on PPP Schedule A and (B) Business Mortgage Interest Payments, Business Rent or Lease Payments, and Business Utility Payments claimed on Lines 2, 3, and 4 on the PPP Loan Forgiveness Calculation Form, by reviewing the documentation submitted with the Loan Forgiveness Application.
4. Confirm that the borrower made the calculation on Line 10 of the Loan Forgiveness Calculation Form correctly, by dividing the borrower's Eligible Payroll Costs claimed on Line 1 by 0.75.

The rule confirms that the borrower is responsible for these items, but the lender is to “perform a good-faith review, in a reasonable time.”

SBA Loan Review

Scope of Review

The rule confirms that SBA may review any loan regardless of size, as it deems appropriate. Under prior guidance, loans over \$2 million should expect a review, but smaller loans may be reviewed in SBA's discretion. This review may include eligibility (i.e., access to other sources of liquidity), loan amount, use of proceeds, and forgiveness amounts.

Timing of Review

The SBA may review a loan at any time. Borrowers are required by the terms of the loan application and forgiveness form to retain all records for six years after the date the loan is forgiven or repaid in full. They are also required to make those records available to SBA on request.

Notice

SBA will notify the lender if it undertakes a review, and the lender must notify the borrower within five business days of receipt.

Review Participation

The lender is required by the rule to submit certain information to the SBA if notified of a review. In addition, the SBA may ask the lender to request additional information from the borrower, or SBA may request information directly. SBA will consider any information provided by the borrower as part of its review. Failure to respond to an inquiry may result in an adverse determination. A borrower may appeal an adverse determination within 30 days of receipt, pursuant to rules to be issued.

Consequences of Ineligibility

If the borrower is found to be ineligible, the loan will not be forgiven, and SBA will seek immediate repayment of the loan or pursue “other available remedies.” In addition, the rule says the lender is not entitled to its processing fee for the loan, and SBA may even claw back fees previously paid to the lender within one year after disbursement of proceeds. If the lender complied with its underwriting obligations under Section III.3.b of the first interim rule and with the document collection and retention requirements specified in the SBA lender application form, then the SBA guarantee of the loan will not be affected. If the lender did not comply with these requirements, then the SBA may not only recover the processing fee but may also cancel the guarantee.

¹ Lenders are permitted to sell PPP loans into the secondary market, and published reports indicate this is starting to happen. If the loan has been sold, the borrower will deal with the purchaser or a servicing agent in the loan forgiveness process. For convenience, in this Alert "lender" refers to the current holder of the PPP loan and any servicing agent.