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## Additional PPP Guidance

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During this past week, the U.S. Small Business Administration (the **SBA**) has released a number of new or amended rules (the **Rules**) providing additional guidance on the Paycheck Protection Program (**PPP**) in light of the changes made by the Paycheck Protection Program Flexibility Act of 2020 (the **Flexibility Act**), which was signed into law on June 5, 2020. Our previous alert on the Flexibility Act can be found [here](#). Additionally, the SBA has released new PPP loan forgiveness applications and instructions. Below are highlights of the additional guidance provided by the SBA.

### *Payroll Threshold Reduced to 60 Percent*

The Flexibility Act reduced the percentage of loan proceeds which must be spent on “payroll costs” from 75 percent to 60 percent. At the time the Act was passed, there was widespread concern that the language in the Act was an “all or nothing” proposition; that if a borrower did not meet the 60 percent threshold then no amount of the PPP loan was to be forgiven. The Rules clarify that the SBA is taking the position that the 60 percent threshold is to apply to determine the **amount to be forgiven**, not whether forgiveness is permitted in the first place. For example, if a borrower received a PPP loan of \$100,000 and had eligible payroll costs of only \$54,000, then the maximum amount to be forgiven would be \$90,000 ( $\$54,000 / 0.6$ ). This is consistent with how the SBA administered the original 75 percent threshold.

### *Maximum Per-Employee Compensation Eligible for Forgiveness*

Due to the Flexibility Act, the “covered period” for spending the proceeds of PPP loans funded before June 5, 2020 can be either eight weeks or 24 weeks, at the borrower’s election. For PPP loans funded after June 5, 2020, the covered period is 24 weeks, or until December 31, 2020, if earlier. For purposes of determining the amount of a loan that is eligible for forgiveness, payroll costs must be incurred during the applicable covered period and are limited to annualized compensation of \$100,000 (plus the amount of benefits paid or incurred during the covered period).

The SBA has explained that the maximum amount of compensation per employee eligible for forgiveness depends on the length of the covered period. For an eight-week covered period, the maximum amount of compensation eligible for forgiveness is \$15,385 per employee. A business owner or self-employed individual is capped at the lesser of eight weeks’ worth of 2019 net profit or \$15,385. For a 24-week covered period, however, the maximum compensation eligible for forgiveness is \$46,154 per employee. An owner or self-employed individual, however, has a maximum compensation eligible for forgiveness of only two and a half months’ worth of 2019 net profit, up to a maximum of only \$20,833. The SBA believes that this harsh treatment of owners and self-employed individuals is necessary to prevent owners from being granted a “windfall.”

### *Reduction of Forgiveness Under FTE Rules*

The extension of the covered period to 24 weeks and the reduction of the payroll cost threshold to 60 percent makes it much easier for borrowers to spend the loan proceeds on eligible costs that qualify for forgiveness of the loan. In many cases the main challenge facing borrowers of PPP loans will be to satisfy the requirement that the borrower not reduce the number of full-time equivalent (**FTE**) employees. The SBA has provided a number of “safe harbor” rules, however, that will enable many borrowers to satisfy the FTE requirement without going through complex calculations.

As a general rule, to receive full forgiveness for a PPP loan, a borrower must not reduce the average number of FTE employees employed during the applicable covered period below the average number of FTE employees employed during a prior "reference period." Under the general rule, if a borrower reduces its workforce during the covered period, then the amount to be forgiven may be proportionately reduced. The calculations are quite complex and unless a borrower can meet one of the safe harbors discussed below, any reduction in work force during the covered period may lead to a reduction in loan forgiveness. These rules are ameliorated to some extent by special rules providing that (1) an employee who was laid off, but later refused an offer to return to work, can be treated as remaining employed (providing certain conditions are satisfied), and (2) an employee who is fired for cause or voluntarily quits is not to be counted in the reduction calculation.

The loan forgiveness application form released by the SBA also suggests that it is possible to offset a reduction in FTE employees if the borrower incurs eligible payroll costs, interest, rent and utility expenses during the covered period **in excess of the amount of the PPP loan**. For example, if the amount of the PPP loan is \$100,000 and the average number of FTE employees on the payroll during the covered period was reduced by 50 percent compared to the reference period, it appears that there will be no reduction in loan forgiveness under the FTE rules as long as the borrower can show it paid or incurred total eligible costs of at least \$200,000. It is not clear that the SBA intended this result, but it follows from the way the loan forgiveness calculation is determined under the loan forgiveness application form. Further guidance is needed on this issue to confirm that the SBA agrees with this interpretation.

The SBA has also provided a number of safe harbor rules that allow a borrower to avoid having to deal with the onerous general rule regarding reduction in FTE employees. If a borrower meets any of these three safe harbors, then no reduction in the loan forgiveness amount will be required under the FTE rules.

**Safe Harbor #1** – A borrower meets this safe harbor if, during the period from January 1, 2020 until the end of the borrower's covered period, there has been no reduction in the number of employees (part-time or full-time) and no reduction in the average number of hours for which employees were paid. The main benefit of this rule is that the borrower can forego the extremely complicated calculations required under the general FTE reduction rule.

**Safe Harbor #2** – A borrower meets this safe harbor if, during the period from February 15, 2020 until the end of the borrower's covered period, it certifies that it was unable to operate at the same level of business activity as before February 15, 2020 due to compliance with safety requirements such as social distancing guidance issued by certain federal agencies, including the CDC and OSHA, from March 1, 2020 until December 31, 2020. This safe harbor can be very useful for businesses that have been substantially impacted by social distancing requirements, such as restaurants or retail stores that are required to limit the number of customers in the premises at one time. The SBA has not yet explained how a borrower is to tie a reduction in business activity to the federal guidance.

**Safe Harbor #3** – A borrower meets this safe harbor if (1) it laid off employees between February 15, 2020 and April 26, 2020, and (2) as of the earlier of December 31, 2020 or the date the borrower applies for loan forgiveness, the borrower has a number of FTE employees that is greater than or equal to the number of FTE employees on the payroll for the pay period that includes February 15, 2020. The idea behind this safe harbor is that borrowers that laid off employees before they received their PPP loans have an opportunity to restore their FTE levels to the pre-COVID-19 levels. The application does not explicitly require that the rehired employees remain on the payroll following the testing date, but it is worth noting that the application form asks the borrower for the number of employees at the time of the loan application. It is possible that this safe harbor might also be available if the borrower laid off employees between February 15, 2020 and April 26, 2020, and then laid off additional employees after April 26, 2020, as long as the borrower otherwise meets the safe harbor.

It is important to note that borrowers that received their PPP loans prior to June 5, 2020 have the option of choosing an eight-week covered period as opposed to the newly lengthened 24-week period. For borrowers that need to lay off workers, it may be advisable to elect the shorter covered period to minimize any reductions in forgiveness under the FTE rules.

### *"EZ" Forgiveness Application*

Along with the revised forgiveness application form, the SBA introduced a short-form forgiveness application for certain borrowers. To use the form a borrower must meet one of the following three tests:

1. The borrower is self-employed, an independent contractor or a sole proprietor and did not have any employees at the time of the application for its PPP loan.
2. The borrower (a) did not reduce the compensation of employees who make less than \$100,000 per year by more than 25 percent during the covered period, and (b) the borrower did not reduce the total number of employees or the average paid hours of employees between January 1, 2020 and the end of the covered period (disregarding employees that refused to return to employment as described above).
3. The borrower (a) did not reduce the compensation of employees who make less than \$100,000 per year by more than 25 percent during the covered period, and (b) was unable to operate at the same level of business activity as before February 15, 2020 due to compliance with safety requirements such as social distancing guidance issued by Federal agencies, including the CDC and OSHA, from March 1, 2020 until December 31, 2020.

These tests are a mixture of the requirement that a borrower not reduce compensation by more than 25 percent and the FTE reduction safe harbors discussed above. The "EZ" form is much shorter than the original forgiveness application and does not require the complex calculations regarding FTE reductions.

### *Borrowers With a Criminal History*

Under the original rules, a borrower was not eligible for a PPP loan if an owner of 20 percent or more of the equity of the applicant (a **20 percent equity holder**) had been convicted of a felony within the prior five years. These rules have been liberalized. Under the new rules, the rules making a borrower ineligible for a PPP loan only apply if a 20 percent equity holder has (1) within the past five years, been convicted of a felony involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance, or (2) within the prior year, been convicted of any other felony.

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