Forbes

May 22 PPP Final Interim Rules Provide Further Guidance and Some Surprises

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Just last night, the SBA gave new weekend plans to those of us who advise borrowers and banks on how to plan for and understand the PPP loan forgiveness rules and process.

The new Interim Final Rules consist of 26 pages that build upon what we learned from the Loan Forgiveness Application and Instructions, which cleared up several items, and resulted in several questions, and now some have been answered. A second set of Interim Final Rules, also released on May 22nd and consisting of 19 pages, provide guidance with respect to the SBA loan review process as well as borrower and lender responsibilities associated therewith.

Taking the 26 pages of double-spaced regulatory language that was issued last night page by page, and including things we already knew or thought we knew, I noted the following:

1. Time is of the Essence. The Interim Final Rules indicate that the first PPP loans were disbursed after April 3rd, so many borrowers are already in their 6th week of spending to facilitate forgiveness, and certainly in need of this guidance, which presumably can be relied upon by borrowers and lenders to determine forgiveness amounts for Loan Forgiveness Applications that are filed before the rules change again!

2. Better Defined Terms. The Interim Final Rules reiterate that borrowers will be eligible for forgiveness in an amount equal to "the following costs incurred and payments made

during the covered period." These "costs and payments" include (1) Payroll Costs, (2) interest on mortgage obligations, (3) rent, and (4) utilities.

Payroll Costs include "salary, wages, commissions, or similar compensation, cash tips or the equivalent (based on employer records of past tips, or, in the absence of such records, a reasonable, good-faith employee estimate of such tips), payment for vacation, parental, family, medical, or sick leave, allowances for separation or dismissal, payments for group health care coverage, including insurance premiums, and retirement, as well as payment of state and local taxes assessed on compensation of employees."

The above language is directly provided in Footnote 2 of page 6, and seems to tell us the following:

(i) Tips About Tips. Employers who have employees that receive tips will have the loan forgiven for tips provided during the "covered period," even though these come from customers, and not the employer, so the more the better.

The employer should keep records of tips, or if there are no such records, can use "a reasonable, good-faith, employee estimate of such tips."

The language indicates that this is for cash tips or the equivalent.

We are not sure what "the equivalent" means. Maybe gift cards and other items of value given to employees will qualify.

(ii) Always Read the Footnotes. The same Footnote refers to "employee benefits consisting of . . . retirement," with no definition given to what retirement means. We know that this includes tax qualified 401k, pension, and profit-sharing plans, but it is not clear whether it would include the contribution of stock to an employee stock ownership plan, or a non-tax qualified retirement plan, such as a "top hat plan" for highly compensated employees, or a "rabbi trust," where money is set aside contractually and in a separate fund,

but not considered to be tax-deductible by the employer or included in income by the employee.

3. Planning for Interest, Rent and Utilities. Besides the above discussion of "payroll costs," the Interim Final Rules review and give some new specificity and clarity to the other three categories of payments that are countable to determine the total amount forgiven, being interest, rent and utilities.

The Interim Final Rules confirm that the borrower can reduce what is owed back on the loan by the amount of any "Interest payments on any business mortgage obligation on real or personal property that was incurred before February 15, 2020 (but not any prepayment or payment of principal)."

The above language is consistent with the Loan Forgiveness Application Instructions, which indicate that interest on indebtedness secured by "personal property" (items that are not real estate) can be forgiven on debt that "was incurred" before February 15, 2020.

Presumably, this means that the debt had to be in place before February 15, 2020, but not necessarily that the debt had to be secured by a mortgage or security interest in the real or personal property, and there does not appear to be any prohibition against increasing the interest rate payable on debt that existed before February 15, 2020 to a fair market value interest rate when related parties are involved.

In addition, if there was an agreement to extend debt that was made on or before February 15, 2020, and the loan was made or increased after that date but before the beginning of the eight week period, then it would seem that the actual amount of interest incurred during the eight week period should count towards what is forgiven.

Borrowers should exercise caution in amending related party debt or lease agreements, as the SBA could disagree with this position. This could also be used as a sword by the SBA against the borrower in the event of an audit because if the borrower could afford to pay a

related party higher interest or higher rent, then there may be a question as to whether the loan was really necessary in the first place.

4. Timing is Everything. Page 13 of the new Interim Final Rules tells us that advance payments of interest are not eligible for loan forgiveness because the CARES Act's language specifically excludes "prepayments" of interest owed on indebtedness.

On the other hand, interest that has accrued before the beginning of the eight week period and paid during the eight week period would seem to be covered based upon the language of page 12 of the new Interim Final Rules, which reads as follows:

A nonpayroll cost is eligible for forgiveness if it was:

(i) Paid during the covered period; or

(ii) Incurred during the covered period and paid on or before the next regular billing date, even if the billing date is after the covered period.

It would therefore appear that interest that is accrued and owed as of the day before the beginning of the 56-day period that follows receipt of the first loan proceeds can be paid during the eight weeks to qualify for loan forgiveness.

Further, interest accrued during the eight weeks will be included in the forgiveness amount, as long as it is "paid on or before the next regular billing date" which follows the eight- week period.

The rules generally provide that rent is treated the same way and can be based upon the rental of real estate or non-real estate assets "under a Lease Agreement in force before February 15, 2020."

It does not appear that the property had to be in place or actually being leased as of February 15, 2020, as long as there was "a Lease Agreement in force" before that date that

provided that the lease arrangement would occur. For example, a "to be" lessor and a related party may have agreed under a binding written or oral agreement that an asset would be made available and provided to a lessee by a lessor.

There is also no apparent prohibition against increasing the rent being paid to fair market value. Many related party leases are at below fair market value in order to avoid state sales or use taxes that would otherwise apply. The Interim Final Rules do not appear to prevent amending leases to provide for fair market value rental from the effective date of the amendment forward. Fortunately, for rent there is no "prepayment" exclusion under the language of the CARES Act, so tenants will have greater forgiveness if they can defer paying rent until the beginning of the eight week period so that they can have forgiveness on the rent "paid during the covered period" and also the rent incurred during the eight week covered period "and paid on or before the next regular billing date, even if the billing date is after the covered period."

Again, any rent that is deferred from before the beginning of the eight-week period must be paid during the eight-week period in order to be credited.

5. The Utility of Utility Payments. The same rationale applies for "business utility payments for the distribution of electricity, gas, water, transportation, telephone or internet access for which service began before February 15, 2020."

This clause tells us that "utilities" means an expense "for the distribution of electricity, gas, water, transportation, telephone, or internet access", whatever the heck that is.

Certainly, these words include cell phone service and business costs of "internet access," but not costs paid to third parties for services provided on the internet, such as Netflix, even if used in the business, Cloud services and other computer-based or third party provided expenses that are incurred "on the internet".

Like rent, utility costs that are incurred before the eight-week period can be paid during the eight-week period in order to be included in the forgiveness amount.

6. Enough Already About the 75% Rule. The Interim Final Rules indicate that the total costs for interest, rent and utility payments "cannot exceed 25% of the loan forgiveness amount." This is another way of saying that 75% of the total forgiveness has to be based upon expenses paid for payroll, including health insurance and retirement contributions. If a borrower has $25,000 of interest, rent and utility expenses and $70,000 of payroll expenses, then only $23,333 of the interest, rent and utility expenses will be forgiven, because $23,333 is 25% of $70,000. We can now be sure that the 75% of payroll requirement does not mean that there is no forgiveness if payroll costs are less than 75% of the total loan amount.

7. The Further Reduction Tests. The total amounts that would otherwise be forgiven for the above payroll costs and costs for rent, interest and utilities will be further reduced if there are reductions in the number of employees considered to be employed during the eight week period, and by certain reductions of compensation as to one or more particular employees, as described below.

8. The Timing of Payroll. The Interim Final Rules go into significant detail with respect to the timing of payroll costs, and how the new Alternative Payroll Covered Period that was introduced in the Loan Forgiveness Application and Instructions will work. These new rules allow borrowers to use their normal payroll period of one week or two weeks, as explained in the following example:

Example: A borrower has a bi-weekly payroll schedule (every other week). The borrower's eight-week covered period begins on June 1 and ends on July 26. The first day of the borrower's first payroll cycle that starts in the covered period is June 7. The borrower may elect an alternative payroll covered period for payroll cost purposes that starts on June 7 and ends 55 days later (for a total of 56 days) on August 1. Payroll costs paid during this alternative payroll covered period are eligible for forgiveness. In addition, payroll costs

incurred during this alternative payroll covered period are eligible for forgiveness as long as they are paid on or before the first regular payroll date occurring after August 1. Payroll costs that were both paid and incurred during the covered period (or alternative payroll covered period) may only be counted once.

As the result of this, borrowers electing the Alternative Payroll Covered Period will not have forgiveness for payroll costs that are incurred between the day after receiving the PPP loan and the day that the next payroll period starts. It may be possible to delay paying employees, so that the amounts that are paid during the 56-day Alternative Payroll Covered Period will include amounts due for days worked before that period begins, and to also have forgiveness on amounts paid during and after the applicable 56 days for services rendered during Alternative Payroll Covered Period.

9. Bonuses and Hazard Pay. The Interim Final Rules also make it clear that compensation paid to a furloughed employee, and also bonuses and "hazard pay" will be included as legitimate payroll costs, except to the extent that such amounts would push an employee's total compensation above $15,385 ($100,000 times 8/52nds) during the measurement period.

10. New Harm Imposed Upon Employed Corporate Shareholders. The Interim Final Rules add a new and surprising limitation for compensation paid to "owner employees and self-employed individuals." The Rules state that compensation paid to owners cannot exceed the lesser of (1) 15,385, or (2) 8/52nds of their 2019 compensation. The Rules point out that this limitation applies to all businesses, so shareholders of S-Corporations or C-Corporations that paid low compensation amounts in 2019 may have limited forgiveness as a result of this. This will also severely punish new businesses where owners may not have taken a full year of compensation or had limited earnings in 2019. Hopefully, future guidance will clarify that businesses that were not in operation for all of 2019 will be able to use some alternative calculation to apply this limitation.

11. Some Relief for General Partners. While General Partners in a partnership are generally limited to the lesser of (1) $15,385 of forgiveness for compensation paid to them by the partnership, or (2) 8/52ds of their 2019 "net earnings from self-employment" (limited to $100,000 as prorated for the eight week period), their net earnings from self-employment will not be reduced by Section 179 expense deductions, un-reimbursed partnership expenses, or depletion from oil and gas properties, multiplied by 92.35%.

Therefore, partners that had low taxable income as a result of a significant Section 179 deduction or depletion deduction, income will not be unfairly penalized as a result of this. Many readers of the Interim Final Rules will wonder where the 92.35% comes from. This percentage is from Form 1040 Schedule SE, which assesses Self-Employment Taxes on partnership income. Self-employment income is reduced to 92.35% of net partnership income or net Schedule C income to take into account the "employer's" share of payroll taxes (7.65% consisting of 6.2% social security and 1.45% Medicare). By multiplying partnership income by this percentage, payroll costs for partner's self-employment income more closely resembles gross wages received by employees, which are not increased by the employer's share of payroll taxes.

12. Self-Employed Individuals Still Out of Luck. The Interim Final Rules emphasize that there is no forgiveness provided for retirement or health insurance contributions made for self-employed individuals (independent contractors or sole proprietors) or General Partners, using the reasoning that "such expenses are paid out of their net self-employment income." Net self-employment income is determined after reduction for contributions made towards employee retirement and health insurance expenses on the Form Schedule C and Form 1065, and such filers are not allowed to take deductions for contributions to their own retirement plan or health expenses, which is apparently the reasoning that the SBA is following for not allowing self-employed individuals or partners in a partnership to take health insurance and retirement plan costs into account.

13. What If You Tried to Bring Them Back, Jack? The question as to whether an employee who was laid off can be considered to have been brought back for purposes of the reduction to indebtedness that incurs when there is a reduction in the number of employees has been clarified and made more liberal by the following language:

Specifically, in calculating the loan forgiveness amount, a borrower may exclude any reduction in full-time equivalent employee headcount that is attributable to an individual employee if:

(i) the borrower made a good faith, written offer to rehire such employee (or, if applicable, restore the reduced hours of such employee) during the covered period or the alternative payroll covered period;

(ii) the offer was for the same salary or wages and same number of hours as earned by such employee in the last pay period prior to the separation or reduction in hours;

(iii) the offer was rejected by such employee;

(iv) the borrower has maintained records documenting the offer and its rejection; and

(v) the borrower informed the applicable state unemployment insurance office of such employee's rejected offer of reemployment within 30 days of the employee's rejection of the offer.

A Footnote [4] on page 14 indicates that further guidance on how borrowers will report rejected rehire offers to state unemployment insurance offices will be provided on the SBA's website, and the new Rules have added that employers will be required to "nark" on employees who do not come back to work and may be receiving the $600 a week federal unemployment compensation as part of the application process.

14. Headcount Reduction Relief. At page 22 of the Interim Final Rules, an employee who is "fired for cause, voluntarily resigns, or voluntarily requests a schedule reduction"

will not be counted as no longer being in the business for the "fewer employees" reduction test.

The Rules also add that **"borrowers should not be penalized for changes in employee headcount that are the result of employee actions and requests."** Many borrowers were wondering if they would be penalized for a headcount reduction in situations where employees have died or are incapacitated as a result of the virus or other circumstances. Do they have to make an offer to rehire such employee and document that it cannot be accepted with a death certificate? It may be possible that the above emphasized language can be used to show that the reduction due to death was not due to an employer action and that no reduction in loan forgiveness should occur.

15. Full-Time, Part-Time, All Around the Town. The Interim Final Rules also define "full-time equivalent employee" to mean an employee who works 40 hours or more, on average, each week. Hours in excess of 40 are disregarded for purposes of determining whether there has been a reduction in the number of employees.

The Interim Final Rules give more guidance on the election that borrowers can make to consider all part-time employees to be working exactly 20 hours a week for calculation purposes.

The Interim Final Rules also confirm that employees who were hired in 2020 will be included in the reduction calculation . . . 25% test.

16. Reducing Hours vs. Reducing Rate of Pay. The Interim Final Rules also confirm that a reduction in compensation that is attributable to a reduction in the number of employee's hours will not be counted as a reduction in compensation for the 75% or more test so that borrowers will not be double penalized for both a headcount and wage reduction.

In other words, if an employee making $10 an hour and working 40 hours a week would normally therefore earn $400 a week, and this employee is reduced to 20 hours a week, the

fact that she will only make $200 a week does not cause this to be considered a more than a 25% reduction in her compensation.

This would work the same way if she was reduced from $10 an hour and 40 hours a week to $7.50 an hour and 20 hours a week, because it would still not be a "more than 25% reduction in pay," as relative to hours worked. The borrower would still have a reduction in loan forgiveness because the employee headcount would be reduced by at least 0.5, although this reduction could be compensated for by hiring another part-time employee.

This applies notwithstanding whether there is an overall reduction in employee hours that causes a reduction in forgiveness as a result thereof.

The rules do not address whether an owner-employee or partner in a partnership is considered in the headcount calculations.

17. The Banker's Dozen (of Headaches). The second set of Interim Final Rules issued Friday night, which is cleverly known as SBA-2020-0033 outlines the "Loan Forgiveness Process" on page 7, and provide that a borrower must complete and submit the Loan Forgiveness Application (SBA Form 3508 or Lender Equivalent) to the lender servicing the loan.

The lender has 60 days after receipt of the complete Application to review the Application and supporting documentation and "issue a decision to SBA" as to how much is to be forgiven, at which time it will also request payment from the SBA of such forgiven amounts.

The SBA is to then remit the applicable amount to the lender, plus any interest accrued thereon, not later than 90 days after the lender has issued its decision.

The SBA will deduct up to $10,000 of EIDL advance amounts that have been given to the borrower from the amount remitted to the lender.

18. Ineligible Borrowers Cause Bankers to Lose Their 5% Loan Fees. If the SBA determines that the borrower was not eligible to receive a PPP loan based upon applicable rules, then the loan will not be eligible for any forgiveness whatsoever, and the lender will be responsible for notifying the borrower.

Any balance due on a PPP loan must be repaid by the borrower on or before the two year anniversary of when the loan was made.

If the borrower has made payments on the loan before they are due, then the lender must remit the amount that the borrower paid to the borrower, plus accrued interest if the amount that the SBA pays to the lender exceeds the remaining principal balance of the note.

19. SBA Review. The Interim Final Rule indicates that the SBA may review any PPP loan, and whether a borrower calculated the loan amount correctly and used loan proceeds for allowable uses in making its determination as to how much of the loan is to be forgiven, but the SBA is not required to do this and may rely upon the borrower and the lender to do this.

20. 6-Year Record Retention. Borrowers must retain the PPP documentation in their files for at least six years after the date that the loan is forgiven or repaid in full. If the SBA determines that a borrower was not eligible for a loan, then none of the loan can be considered as having been forgiven.

21. Banker Requirements. Lenders are required to do the following:

(i) Confirm receipt of borrower's certifications contained in the Loan Forgiveness Application Form.

(ii) Confirm receipt of the documentation that must be submitted to verify payroll and nonpayroll costs.

(iii) Confirm that the borrower's calculations on the Application are accurate.

(iv) Confirm that the 75% of payroll test is being complied with.

The lender is not required to independently verify the borrower's reported information, if the borrower attests to the fact that it has provided the appropriate documentation supporting its request.

Lenders will have to give back their loan processing fees within one year after a loan was disbursed, if the SBA determines that the borrower was not eligible to receive the loan, notwithstanding whether this was the fault of the bank or not.

Nevertheless, the SBA will still guarantee the loan, if the lender has complied with its obligations, so the lender's risk is limited to the loss of its fee and possible causes of action by borrowers against lenders who may allegedly give incorrect advice on the process.

CONCLUSION

We can be sure there will be further changes and clarifications by FAQ's and regulations as time marches on, but we appear to be well past the 50-yard line in understanding what is needed and required to comply with this program, and what planning and actions can occur to help assure that the intended effect of this program can be effectuated, at least to some degree, for all borrowers.

In the meantime, please be very kind to CPA's, who have both tax filing and now PPP loan deadlines to attend to as best they can.