Paycheck Protection Program Loan Forgiveness and Flexibility Act Changes

June 30, 2020

On June 5, 2020, the President signed the Paycheck Protection Program Flexibility Act of 2020 (“Flexibility Act”). Thereafter, the SBA released implementing guidance, including loan forgiveness guidance. Additionally, the SBA released an EZ Application for borrowers not subject to penalties for reduced full-time equivalent employees (“FTEs”) or reductions in salary/hourly wages. The Long Form exists which you will be required to complete if you do not meet the eligibility requirements of the EZ Application due to FTE or salary/hourly wage reductions.

You may apply for forgiveness at any time on or before the maturity date of your loan, even before the end of your applicable covered period, if you have used all of the loan proceeds for which you are seeking forgiveness. Thus, if you have used all funds you may apply for loan forgiveness now.2 If you seek forgiveness before the end of your covered period and have reduced any employee’s salary by more than 25 percent, then you must account for the excess reduction for the full 8-week or 24-week period, whichever you choose.

You will submit your forgiveness application to your lender which reviews the application and makes its decision. Your lender has 60 days to conduct its review and make its decision on the application. The SBA then has 90 days to do the same. Thus, it could take 5 months for a final decision on your forgiveness application.3

This memorandum highlights:

1. Beneficial changes made by the Flexibility Act and additional guidance issued since its passage;
2. Eligibility for utilizing the new the PPP Loan Forgiveness Application Form 3508EZ (the “EZ Application”) compared to the long form Loan Forgiveness Application Revised June 16, 2020 (the “Long Form”);
3. Calculating forgivable payroll and non-payroll costs under the law; and
4. Walking you through the FTE and Salary/Hourly Wage reductions and their exceptions.

For further information, please contact Robert D. Tobin, Esq., Thomas J. Riley, Esq., Joseph J. Selinger, Esq. or Kristin L. Wainright, Esq. TCORS acknowledges the valuable contribution of its associate, Zachary A. Kohl, in the preparation of this memorandum.

If you have made reductions to salary, wages or FTEs, contact us to discuss whether it may be better to wait until the end of the 24-week period to apply for forgiveness.

Ongoing auditing by the SBA could extend this time further.
I. **Flexibility Act Changes**

The Flexibility Act extends the time for using loan funds, extends the deadline for bringing back, or replacing, employees who have been laid off or whose pay has been reduced, and provides additional exceptions to the requirement that you maintain the same number of employees. The Flexibility Act and SBA guidance do this in the following ways.

**A. 24-Week Period to Use Loan Funds**

The Flexibility Act extends the applicable loan forgiveness “covered period” from 8 weeks to 24 weeks or December 31, 2020, whichever comes first. Thus, you now may have three times as long to use your PPP loan funds on forgivable expenses. Provided that there you are not subject to any forgiveness penalties, this change should make it easier for you to obtain full loan forgiveness. This change also lengthens the period that you measure full-time equivalent employee (“FTE”) averages and average salary/hourly wages. This could make penalties due to reductions in FTEs or salary/hourly wages more or less likely, depending on your circumstance. It is not clear whether you may use loan funds after the covered period ends.

**B. Limits on Compensation**

- Cash compensation to employees is limited to
  - $46,154 during a 24-week period, or
  - $15,385 during an 8-week period.
  - Health and retirement benefits, as well as state and local taxes paid by the employer on employee compensation, are payroll costs that are still added outside this cash compensation cap.
- Generally, cash compensation to owners is limited to
  - $20,833 or 2.5/12 of their 2019 compensation, whichever is less, during a 24-week period, or
  - $15,385 or 8/52 of their 2019 compensation, whichever is less, during an 8-week period.

**C. Extension of the FTE and Salary/Hourly Wage Reduction Safe Harbor to December 31, 2020**

Under the CARES Act, any reduction in your FTEs compared to your chosen and applicable look back period, and any reduction in employee salary/hourly wages over 25% as compared to wages paid January to March 2020 results in a reduction penalty to your forgiveness amount. If you made either type of reduction between February 15, 2020 and April 26, 2020, the required penalty for such reductions may be avoided if you restore the pay and FTE numbers to their February 15, 2020 levels by December 31, 2020.

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4See Sec. II.B. regarding covered periods.
5If your loan was disbursed before enactment of the Flexibility Act on June 5, 2020, you can elect the statutory 8-week period instead of the new 24-week period.
6See Section II.C.2. and Footnote 8 regarding employee-owner, self-employed, and general partner compensation.
D. New FTE Reduction Exception and New Safe Harbor

The Flexibility Act also creates an additional exception to and an additional safe harbor from the FTE reduction penalty that otherwise would apply.

The new exception applies if you can document that you made a good faith, written offer to rehire an individual employed on February 15, 2020, who refused your offer, and you are unable to hire similarly qualified individuals by December 31, 2020.

The new safe harbor (the SBA calls this the “FTE Reduction Safe Harbor 1”) applies if you can in good faith document that you are unable to operate between February 15, 2020 and the end of your Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued by HHS, CDC or OSHA “related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID–19.” The SBA has determined that this safe harbor applies to state and local COVID orders based on such HHS, CDC, or OSHA requirements or guidance. The SBA places the burden on you to “in good faith maintain[] records regarding the reduction in business activity and the local government’s shutdown orders that reference a COVID Requirement or Guidance ....”

E. Payroll Costs Used as a Proportion of Your Loan Amount and as a Proportion of Forgiveness.

The Flexibility Act changes the SBA’s requirement that 75 percent of your forgivable expenses consist of payroll costs. Specifically, the Flexibility Act requires that 60 percent of your loan amount be used for payroll costs to receive loan forgiveness. The SBA has since issued guidance that indicates if you do not use 60 percent of your loan amount for payroll costs, your forgiveness amount will be reduced so that 60 percent of your forgiveness amount is attributable to payroll costs.

F. Extended Deferral of All Payments

The Flexibility Act extends your deferral period to up to the date SBA remits your forgiveness amount to your lender. If you do not apply for forgiveness within 10 months of the end of your covered period (24 weeks after origination or December 31, 2020), your payments on principal, interest and fees would begin on the day no earlier than 10 months following the end of your covered period. Therefore, you have 10 months from the end of the 24-week Covered Period or December 31, 2020, whichever is first, to file your forgiveness application to avoid or extend further any payments. The deadline for applying for forgiveness is your maturity date.

G. Extended Maturity for Some; Option to Extend Maturity for All

For loans made on or after June 5, 2020, the Flexibility Act, as implemented by the SBA, extends the maturity on any unforgiven loan balance to 5 years. This automatic extension of loan maturity does not apply to loans made before June 5, 2020, which continue to have a 2-year maturity. However, you and your lender may agree to change the maturity provisions of your loan to provide a 5-year maturity. There remains no prepayment penalty.

H. Deferral of Social Security Payroll Taxes

The CARES Act provides a deferral period for payments of social security taxes, allowing the deferral of a taxpayer’s 2020 payroll tax payments otherwise due through January 1, 2021. Half of the deferred amount is due by December 31, 2021 and the other half by December 31, 2022. The self-
employed are only entitled to defer 50 percent of their SECA payments for social security. Taxpayers who receive PPP loan forgiveness had been excluded from this deferral program. The Flexibility Act removes this exclusion.

I. End of New Loans

No new loans will be made after June 30, 2020.

II. Loan Forgiveness Regulations and Application

A. The Forgiveness Applications

The SBA has provided two possible loan forgiveness applications: the Long Form or the EZ Application.

According to the EZ Application instructions, you may use the simpler EZ Application if you meet one of the following criteria:

1. “[You are] a self-employed individual, independent contractor, or sole proprietor who had no employees at the time of [your] PPP loan application and did not include any employee salaries in [your] computation of average monthly payroll in [your] Borrower Application Form ....”

2. You did not during the applicable covered period reduce salary or hourly wages by more than 25 percent as compared to January to March 2020 for any employee who made less than $100,000 annualized in any pay period in 2019.

AND

“[You] did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the Covered Period. (Ignore reductions that arose from an inability to rehire individuals who were employees on February 15, 2020 if [you were] unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020. Also ignore reductions in an employee’s hours that [you] offered to restore and the employee refused.)”

3. You did not during the applicable covered period reduce salary or hourly wages by more than 25 percent as compared to January to March 2020 for any employee who made less than $100,000 annualized in any pay period in 2019.

AND

“[You were] unable to operate during the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued” by DHS, CDC or OSHA, or state or local orders based on those requirements or guidance.

To determine whether you have made a salary/hourly wage reduction of 25 percent, you divide the average annual salary or hourly wage of a specific employee during the applicable covered period by the employee’s average annual salary or hourly wage from January 1, 2020 to March 30, 2020. If the amount is .75 or more, then that individual’s pay has not been reduced by more than 25 percent.
Unless an exception listed in item 2 or 3 above applies, any reduction in the number of employees or average employee hours will require that you use the Long Form even though completing the Long Form may reveal that you have had no reduction in full-time equivalent employees or that additional exceptions may operate so that such a reduction is exempted.

B. Covered Period and Alternative Covered Period

The Flexibility Act extended the loan forgiveness Covered Period to 24 weeks. However, if your loan was disbursed before June 5, 2020, you may elect to use an 8-week Covered Period. Your loan forgiveness 24-week (168 day) or eight-week (56-day) Covered Period begins the day that your loan was or is disbursed. For example, if you received your PPP loan proceeds on Monday, April 20, 2020, the first day of your 24-week Covered Period was April 20 and the last day of the Covered Period will be Sunday, October 4. As you would have received your loan funds before June 5, 2020, you could elect to use the 8-week Covered Period in which case the last day of your Covered Period will have been June 14, 2020.

Alternatively, if you have a biweekly or more frequent payroll, you may elect to calculate eligible payroll costs using the 24-week (168-day) period or for loans received before June 5, 2020 at your election, the eight-week (56-day) period that begins on the first day of your first pay period following your PPP Loan Disbursement Date. For example, if you are using a 24-week Alternative Payroll Covered Period and received your PPP loan proceeds on Monday, April 20, and the first day of your first pay period following your PPP loan disbursement is Sunday, April 26, the first day of the Alternative Payroll Covered Period is April 26 and the last day of the Alternative Payroll Covered Period is Saturday, October 10. If you elect to use the Alternative Payroll Covered Period you must apply the Alternative Payroll Covered Period wherever there is a reference in the application to “the Covered Period or the Alternative Payroll Covered Period.” Where the application uses “Covered Period”, only that period may be used. Neither the 24-week Covered Period nor the 24-week Alternative Payroll Covered Period may extend beyond December 31, 2020.

C. Eligible Payroll Costs

1. Temporal Limits to Payroll Costs

Payroll costs paid or incurred during the applicable covered period are eligible for forgiveness. Payroll costs are incurred when earned. Payroll costs incurred at the end of the applicable covered period must be paid on or before the next regular payroll date to be eligible for forgiveness.

The governing language suggests that payroll costs paid at the beginning of the applicable covered period but earned before the period are an eligible expense. This may change and, if you are using a 24-week period, you may not need such expenses to achieve full forgiveness. You should contact us before submitting your forgiveness application to clarify whether these expenses are eligible.

2. Categorical and Monetary Limits to Payroll Costs

Payroll costs during the applicable covered period include:

- Cash compensation to employees (whose principal place of residence is the U.S.) which includes the “sum of gross salary, gross wages, gross tips, gross commissions, paid leave (vacation, family, medical or sick leave, not including leave covered by the Families First Coronavirus Response Act), and allowances for dismissal or separation paid or incurred” at a
maximum of $46,154 for a 24-week period or $15,385 for an 8-week covered period for each employee;

- The total amount that you paid for employee health plan contributions excluding pre- or post-tax contributions by employees. Health plan contributions for self-employed individuals, general partners, and owner-employees of an S-corporation are excluded from these costs;
- The total amount that you paid towards employee retirement plans excluding pre- or post-tax contributions by employees. Retirement contributions for self-employed individuals, general partners, and owner-employees of an S-corporation are excluded from these costs;
- The total amount that you paid for employer state and local taxes assessed on employee compensation (e.g., state unemployment insurance tax); and
- The total amount that you paid to owner-employees, a self-employed individual (excluding independent contractors), or general partners. For a 24-week period, this amount is capped at $20,833\(^7\) for each individual or the 2.5 month equivalent of their applicable compensation in 2019, whichever is less, in total across all businesses. For an 8-week period, this amount is capped at 8/52 of 2019 compensation (up to $15,385) in total across all businesses.\(^8\)

Note that the owner compensation cap is “in total across all businesses”. This would include affiliated businesses or businesses that are not affiliated but from which the owner receives compensation.

Salary, wages or commission payments to furloughed employees, employee bonuses, and employee hazard pay are eligible for loan forgiveness.

The SBA has not clarified whether “health plan” contributions include more than just employer medical insurance costs. As health plans often include a range of coverage beyond medical insurance, we believe that you may include more than just medical insurance. Such costs could include employer contributions to medical, dental, vision, long term care, HSA contributions, and health flexible spending account benefits but this does not include employee contributions to the same, short-term and long-term disability, or life insurance.

**D. Non-payroll Calculations**

Eligible non-payroll costs during the Covered Period include:

\(^7\)$20,833 is the 2.5 month equivalent of $100,000 per year.

\(^8\)With regard to specific business types, the Forgiveness Revisions Rule states:

“In particular, **C-corporation** owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement and health insurance contributions made on their behalf. **S-corporation** owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement contributions made on their behalf, but employer health insurance contributions made on their behalf cannot be separately added because those payments are already included in their employee cash compensation. **Schedule C or F filers** are capped by the amount of their owner compensation replacement, 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. For **self-employed individuals, including Schedule C or F filers and general partners**, retirement and health insurance contributions are included in their net self-employment income and therefore cannot be separately added to their payroll calculation.”
“(a) covered mortgage obligations: payments of interest (not including any prepayment or payment of principal) on any business mortgage obligation on real or personal property incurred before February 15, 2020 (‘business mortgage interest payments’);

(b) covered rent obligations: business rent or lease payments pursuant to lease agreements for real or personal property in force before February 15, 2020 (‘business rent or lease payments’); and

(c) covered utility payments: business payments for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020 (‘business utility payments’).”

Non-payroll costs must be paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date after the Covered Period. It is unclear whether bills paid at the beginning of the period but incurred before are included. If these expenses are not needed to meet forgiveness they should be omitted. You should contact us before submitting your application to determine whether such costs may be included. The Alternative Payroll Covered Period, as the name suggests, does not apply to non-payroll costs.

These non-payroll costs cannot exceed 40 percent of the loan amount. If they do, the forgiveness amount will be proportioned so that payroll costs consist of at least 60 percent of the forgiveness amount.

It appears that an oral lease will be allowed as a permitted use and forgivable expense if you can provide your lender account statements from February 2020 and from the Covered Period through one month after the end of the Covered Period verifying eligible payments.

E. **Forgiveness Calculations under the EZ Application**

Calculating loan forgiveness under the EZ Application is, as seemingly intended, rather simple. You enter the payroll costs, business mortgage payments, business rent or lease payments, and utility payments as those terms are discussed above for your applicable covered period. You then add those amounts together. Your forgiveness amount is the smallest of (1) the total just reached of your payroll and non-payroll costs paid or incurred; (2) your PPP loan amount; or (3) your payroll costs during your applicable covered period divided by .60.\(^9\) The SBA will determine and forgive interest accrued on your forgiven principal.

If you qualify for the EZ Application, there is no need to continue reading this memorandum.

F. **Forgiveness Calculations under the Long Form**

\(^9\)This calculation ensures that your forgiven non-payroll costs do not exceed 40 percent of your forgiveness amount. For instance, assume that you had a loan amount of $250,000 and spent $125,000 on payroll costs and $125,000 on non-payroll costs. This is a 50/50 split. Under this third possible forgiveness amount, you divide $125,000 by .60 for $208,333.33 as the maximum forgiveness amount. You will have spent $250,000 in payroll and non-payroll costs and your loan amount is the same. As $208,333.33 is the lesser of these numbers, it is your forgiveness amount: $125,000 of which is for all of the payroll costs expended and $78,333.33 for non-payroll costs. This results in a 60/40 distribution of payroll costs to non-payroll costs in the forgiveness amount. The remaining $46,166.67 of the loan funds utilized and spent on non-payroll costs will have to be repaid.
The Long Form and accompanying “Loan Forgiveness Application Instructions for Borrowers” (“Long Form Instructions”) walk you through entering the required information using the Calculation Form, a Schedule A and the Worksheet to Schedule A. Those documents instruct you on calculations of payroll costs (by employee), non-payroll costs, and reduction penalties. You should review the entire Long Form Instructions, Calculation Form, Schedule A and Worksheet before beginning to complete the Long Form. We are available to assist in completing either application and interpreting their provisions, especially when it comes to the reduction penalties and their exceptions. Completing these applications may also necessitate consulting your accountant.

1. **Reductions**
   
   a) **Salary and Hourly Wage Reductions**

   There is a dollar-for-dollar reduction of your forgiveness amount for any employee who earned less than $100,000 annualized in any pay period in 2019 whose salary or hourly wages is reduced by more than 25 percent, unless the safe harbor applies. If you seek forgiveness before the end of the covered period and have reduced any employee’s salary by more than 25 percent, you must account for the excess reduction for the full 8-week or 24-week covered period.

   Your forgiveness amount may be reduced if the average annual salary or hourly wages of certain employees during the applicable covered period was reduced by more than 25 percent as compared to the average annual salary or hourly wages during the period from January 1, 2020 to March 30, 2020. Whether a reduction penalty may occur is determined by dividing the average annual salary or hourly wage during your chosen applicable covered period by the average annual salary or hourly wage from January 1, 2020 to March 30, 2020. If the amount is .75 or more, then there is no reduction penalty for that employee. If the result is more than .75, the calculation that follows determines the reduction penalty amount for that employee.

   For salaried employees, multiply their average annual salary from January 1 through March 31, 2020, by .75. Then, subtract their average annual salary during the applicable covered period. The result is the reduction penalty for that employee.

   For hourly wage employees, multiply their average hourly wage from January 1 through March 31, 2020, by .75. Then, subtract their average hourly wage during the applicable covered period. This is the amount that their wage was reduced. Next, multiply their average hours worked from January 1 through March 31, 2020, by the amount that their wage was reduced. Multiply this result by 24. The final total is the reduction penalty for that employee.

   (1) **Salary/Hourly Wage Reduction Safe Harbor**

   A safe harbor applies to certain salary or wage reductions, which is determined by employee. This safe harbor applies if (1) the employee’s average annual salary or hourly wage from February 15, 2020 to April 26, 2020 is less than on February 15, 2020; and (2) the employee’s annual salary or hourly wage on December 31, 2020 meets or exceeds the employee’s annual salary or hourly wage on February 15, 2020.

   b) **FTE Reductions**

   Under the CARES Act, your loan forgiveness is subject to a reduction proportionate to any reduction in FTEs as compared to your chosen look back period, unless an exception or a safe harbor applies.
To calculate your average weekly FTE, for each employee, you calculate the average number of hours paid per week during the applicable covered period, divide by 40, and round the total to the nearest tenth. The maximum for each employee is capped at 1.0. Alternatively, you may choose to use 1.0 for every employee who works 40 or more hours per week and 0.5 for all employees who work less than 40 hours per week. Either way, you add together the FTEs for each employee for the applicable covered period to get your total average FTEs for your applicable covered period. You must use the same chosen covered period for payroll costs, salary/hourly wage, and FTE calculations. Owners are not included in these FTE calculations.

Your loan forgiveness is reduced if the total average FTEs during your applicable covered period are less than those in your chosen look back period and an exception or a safe harbor does not apply.

If you are a non-seasonal employer, you must calculate your weekly average FTEs using the method described previously (including the alternative 1.0 for FT employees and 0.5 for PT employees) for your chosen look back period during either (i) February 15, 2019 to June 30, 2019; or (ii) January 1, 2020 to February 29, 2020, at your election. If you are a seasonal employer (the SBA still has not defined “seasonal employers”), you may also elect to use either of the preceding periods or a consecutive twelve-week period between May 1, 2019 and September 15, 2019.

You then divide the total average FTEs for the applicable covered period by the average FTEs for your chosen look back period. The result is the FTE Reduction Quotient, which cannot exceed 1.0.

(1) FTE Reduction Exceptions

The Long Form Instructions provide five exceptions to the FTE reduction penalty.

First, if you make a good-faith, written offer to rehire an individual who was an employee on February 15, 2020 that is refused and you were unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020, there is no FTE reduction for that employee.

Second, if you make a good faith written offer to restore the reduced hours of an employee during the applicable covered period which the employee rejected, then this reduction in FTE does not count against you.

Contact us immediately if the first or second exception may apply so that you can comply with the requirements of these exceptions.

Additionally, the FTE reduction penalty does not apply to any employees who during the applicable covered period (a) were fired for cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction of their hours.11

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10Although not explicitly stated, this average would include all weeks for the applicable covered period, not just the weeks when the employee was on the payroll. Thus, the hours in which an employee is not on the payroll would have zero hours contributed to the average number of hours paid per week.

11All actions affecting FTE counts should be documented. The forgiveness application materials require you to retain for 6 years following the decision on your application: “Documentation regarding any employee job offers and refusals, refusals to accept restoration of reductions in hours, firings for cause, voluntary resignations, written requests by any employee for reductions in work schedule, and any inability to hire similarly qualified employees for unfilled positions on or before December 31, 2020.”
(2) FTE Reduction Safe Harbors

If you have experienced a reduction in FTEs as calculated by the FTE Reduction Quotient, there are two FTE safe harbors available to you:

1. If you can in good faith document that you are “unable to return to the same level of business activity [you] had on February 15, 2020 due to compliance with requirements from HHS, CDC or OSHA ‘related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID–19’”, then there is no FTE reduction penalty. The SBA has determined that this safe harbor applies to state and local COVID orders based on such HHS, CDC, or OSHA requirements. The SBA places the burden on you to “in good faith maintain[] records regarding the reduction in business activity and the local government’s shutdown orders that reference a COVID Requirement or Guidance.....”

2. If “(a) [you] reduced [your] FTE employee levels in the period beginning February 15, 2020, and ending April 26, 2020; and (b) [you] then restored [your] FTE employee levels by not later than December 31, 2020 to [your] FTE employee levels in [your] pay period that included February 15, 2020”, then there is no FTE reduction penalty.