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OBSERVATIONS

CARES Act – Loan Forgiveness Interim Final Rules 1

May 27, 2020

On Friday, May 22, the Small Business Administration (SBA) released the Interim Final Rule (IFR) for the requirements of Loan Forgiveness under the CARES Act. Procedurally, the IFR is subject to public comment for 30 days before it can become final.

The SBA has already released the Paycheck Protection Program (PPP) Loan Forgiveness Application ("Forgiveness Application"). The Application can be found at https://home.treasury.gov/system/files/136/3245-0407-SBA-Form-3508-PPP-Forgiveness-Application.pdf.

The IFR is 26 pages but only 18 pages of substantive regulations. The SBA also released a 19-page interim final rule with respect to Review Procedures and Related Borrower and Lender Responsibilities (SBA Review Procedures).

We will provide several blogs to address the issues raised in the IFR. This blog will address:

- Loan Forgiveness Process
- Definitions of Payroll Costs

Loan Forgiveness Process

The borrower must complete Form 3508 (Loan Forgiveness Application). The lender must, within 60 dates of receipt of a complete application, determine if the loan can be forgiven. If yes, then the lender must request payment from the SBA. The SBA must complete its review within 90 days. If the forgiveness is approved, the SBA will pay the lender the loan forgiveness principal and accrued interest.[1]

Note: the process can therefore take five months. The 'covered period' (i.e. eight weeks, beginning with the date the loan was funded) is 2 months and the loan provides for a deferral of six months. Therefore, it is possible that the SBA funding will be after the six month deferral period.

Question: Does the borrower have to make the loan payment beginning in month seven and continuing until the SBA funds the forgiveness? Apparently, the answer is Yes.

[1] IFR Section 2, page 7

The IFR provides:

> If the amount remitted by SBA to the lender exceeds the remaining principal balance of the PPP loan (because the borrower made scheduled payments on the loan after the initial deferment period), the lender must remit the excess amount, including accrued interest, to the borrower.[2]

Therefore, the IFR clearly recognizes that the review process may not be completed by the time the first monthly payment is due in month 7. Borrowers therefore need to have cash on hand to start making the required payments.

If the SBA determines that some or all of the requested loan forgiveness does not qualify, the lender must so inform the borrower. A later blog will address the SBA Review Procedures.

Definitions of Payroll Costs

a. Covered Period

The IFR clarified many questions. First: to address the 'paid and incurred' language of the statute, the IFR gives the borrower two alternative periods. Both alternatives are limited to eight weeks ('covered period'). The covered period can start either:

1. The date of the disbursement of the PPP loan proceeds; or
2. The first day of the first payroll cycle in the covered period (the 'alternative payroll covered period')[3].

Note that the last payroll of the alternative payroll covered period is outside of the eight week covered period. The requirement is that the last payroll, which is beyond the end of the covered period, must be paid on or before the next regular payroll date.

The IFR helpfully provides an example:[4]

Assume that the borrower is funded on June 1 and the covered period therefore runs from June 1 to July 26. However, the borrower has a bi-weekly payroll cycle. The first date of the first payroll cycle begins June 7. Assume that the payroll is paid 5 days after close of the payroll cycle (unfortunately, the IFR example does not discuss the actual payment date but the following appears to be consistent with the intent).

Therefore, the payroll cycle is as follows:

[2] IFR Section 2, page 8
[3] IFR Section 3, page 9
[4] IFR Section 3, page 10

Begins	Ends	Pay Date
24-May	7-Jun	12-Jun
7-Jun	21-Jun	26-Jun
21-Jun	5-Jul	10-Jul
5-Jul	19-Jul	24-Jul
19-Jul	2-Aug	7-Aug

Without the alternative payroll covered period, the borrower would have to calculate the portion of the June 12 payment date that is attributed to the June 1 to June 6 period. The next three payment dates would be included. The final payment (made August 7 for period ending August 2) would have to be calculated to include only the days in the covered period (July 19 to July 26).

The alternative payroll covered period lets the borrower use the four periods beginning June 7, June 21, July 5 and July 19, even though the final period covers days outside of the 'covered period'. The example dealt expressly with a bi-weekly payroll cycle but presumably it would apply for other cycles as well. Note: this alternative covered period applies only to payroll costs.

b. When is Payroll Deemed Paid?

Payroll costs are deemed paid on the date when:

i. paychecks are distributed; or
ii. the borrower originates an ACH credit transaction[5]

The beauty of a straightforward answer.

c. Are Payments to Furloughed Employees Covered?

Yes. Salary, wages or commissions paid to employees who are furloughed will be deemed to be payroll costs.[6]

d. What About Bonuses or Hazard Pay?

Yes. Bonuses and hazard duty pay are deemed to be supplements to salary or wages and therefore qualify[7] as payroll costs.

e. Are Retirement Costs included?

Yes. Payments for retirement, group health coverage (including insurance premiums) vacation, parental, family, and medical or sick leave[8] are included. There is also a discussion of how to treat tips.

[5] IFR Section 3, page 9
[6] IFR Section 3, page 11
[7] IFR Section 3, page 11

There is no discussion of pro ration of retirement contributions. For example, if a company has accrued the retirement contribution for an employee for the prior year, and actually pays the entire amount during the covered period, will all or just 8/52 of the payment qualify as a payroll cost. The IFR does not place a limit on the contribution.

Note: If the payroll costs are not wages or salaries (e.g. retirement or medical benefits), the payment would have to be within the same time period used for the wages and salaries.

Note: None of these costs will apply to independent contractors or sole proprietors. Although not clear in the footnote, the IFR later provides that this limitation applies to partners as well[9].

f. What Are the Limitations on Owners?

The IFR is more restrictive than many people expected.

There is no definition of 'owner-employee'. It appears to refer to shareholders in a corporation who are employees. The Forgiveness Application makes references to owners of 20% or more of the equity. However, the IFR has no such qualification. Presumably, there should be some de minimus rule that the payroll caps could apply to, for example, a large privately held company that provides for stock ownership as a means of compensation so that employees could own a small fractional interest of the company.

The IFR provides for two caps on owner-employees and the lower one applies:

- $15,385 (i.e. 8/52 times $100,000); or
- 8/52 times 2019 compensation

For Owner/Employees, the 8/52 figure appears to allow the payment of retirement benefits and health care contributions[10] so long as the $15,385 threshold is not reached. Presumably this would apply only to corporate entities (C or S Corp) for whom the owners are also compensated as employees. Such payments would appear not to be allowed for Sole Proprietors or Partners in a Partnership as these are considered paid out of their self-employment income.[11]

Moreover, in the case of self-employed owners (i.e. Schedule C or partners), the second limitation is 92.35% of the 2019 earnings from self-employment (but reduced for Section 179 deductions and unreimbursed partnership expense).[12]

In short, eligible payments for employee payroll costs could be much larger than similar costs for owners.

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[8] IFR Section 2, page 6, footnote 2
[9] IFR Section 3, page 12
[10] IFR Section 3, page 12
[11] IFR Section 3, page 12
[12] IFR Section 3, page 12

We will shortly provide subsequent blogs that deal with other aspects of the IFR and the SBA Review Procedures.

We encourage businesses to review the Application and work towards addressing the various documentation and calculation requirements so that they can submit their forgiveness Application soon after the covered period has ended.

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