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## **Let the Good Times Roll – The SBA Issues Interim Final Rules on PPP Loan Forgiveness, Including Guidance on the Payment of Bonuses and Hazard Pay, Loan Prepayments and the Loan Forgiveness Application**

By Larry Brant and Steven Nofziger and Peter Evalds on 5.28.20 | Posted in Legislation, Tax Laws, Tax Planning

On Friday, May 22, 2020, the Small Business Administration (“SBA”), in conjunction and consultation with the U.S. Department of the Treasury (“Treasury”), published an interim final rule (“IFR”) containing new guidance on the treatment of bonuses, prepayments, and the loan forgiveness application and process for Paycheck Protection Program (“PPP”) loans.

### Loan Forgiveness Process

Loan forgiveness under the PPP is not automatic. Rather, borrowers must apply for forgiveness using the [SBA's Loan Forgiveness Application](#) (SBA Form 3508) or their lender's equivalent form, if any. The process is somewhat streamlined:

- The application is submitted to the lender for review and approval.
- The lender will review the application and make a decision regarding loan forgiveness.
- The lender has 60 days from receipt of a complete forgiveness application to issue a decision to the SBA.
- The lender is responsible for notifying the borrower of the amount approved for forgiveness.
- The lender will then request that the SBA repay the amount forgiven.
- Within 90 days from the lender's request for payment, the SBA will pay the lender the amount forgiven, plus any accrued interest. (If applicable, the SBA will deduct the amount of advances under the Economic Injury Disaster Loan program from its payment to the lender.)

## Let the Good Times Roll – The SBA Issues Interim Final Rules on PPP Loan Forgiveness, Including Guidance on the Payment of Bonuses and Hazard Pay, Loan Prepayments and the Loan Forgiveness Application

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**Practice Alert:** If the SBA determines the borrower was ineligible for the PPP loan, the loan will not be eligible for loan forgiveness and the borrower will be required to repay it in accordance with the loan terms. Likewise, if only a portion of the loan is forgiven, or if the forgiveness application is denied by the lender, the borrower will have to repay it in accordance with the loan terms.

**Practice Alert:** The IFR provides a loan is not eligible for forgiveness if the SBA determines that the borrower was ineligible for the PPP loan based on the provisions of the CARES Act, SBA rules or guidance available at the time of the borrower's loan application, or the terms of the borrower's PPP loan application (for example, because the borrower lacked an adequate basis for the certifications that it made in its PPP loan application). This leaves open the possibility that guidance issued after the time a borrower submitted its PPP loan application might not invalidate loan forgiveness.

### Payroll Costs Eligible for Forgiveness

The IFR highlights, reiterates and amplifies the discussion from our [prior blog post](#) regarding prepayments and when costs must be incurred and paid to qualify for forgiveness.

Borrowers may seek forgiveness for payroll costs for the eight-week period beginning on either:

- The date of disbursement of the borrower's PPP loan proceeds from the lender (i.e., the start of the "covered period"); or
- The first day of the first payroll cycle in the covered period (the "alternative payroll covered period").

The IFR clarifies that, with one exception, payroll costs must be paid during the covered period (or alternative payroll covered period) to be eligible for forgiveness. The exception is for payroll costs incurred during the borrower's last pay period of the covered period (or the alternative payroll covered period), which are not paid until after the end of the covered period (or alternative payroll covered period) so long as such payroll costs are paid on or before the next regular payroll date.

### Bonuses and Hazard Pay; Payments to Furloughed Employees

The IFR provides welcome guidance on the treatment of bonuses, hazard pay and payments to furloughed employees.

## Let the Good Times Roll – The SBA Issues Interim Final Rules on PPP Loan Forgiveness, Including Guidance on the Payment of Bonuses and Hazard Pay, Loan Prepayments and the Loan Forgiveness Application

---

Hazard pay and bonuses paid to employees are eligible for inclusion in the loan forgiveness computation because they constitute a supplement to salary or wages, which is a qualifying form of compensation. Likewise, payments to furloughed employees during the covered period also qualify for inclusion in the forgiveness computation. In both cases, the payments are eligible for inclusion in the forgiveness computation as long as the payments do not exceed the \$100,000 annualized salary per employee limitation (i.e., \$15,385 per employee during the covered period). This is helpful guidance, as many employers have offered additional “hazard” pay to front-line employees or bonuses to retain employees during the pandemic.

The IFR also tells us that the amount of payroll qualifying for inclusion in the forgiveness computation for business owners and self-employed individuals cannot exceed the lesser of \$15,385 (under the prorated \$100,000 annual salary limitation) or the eight-week equivalent (15.38 percent) of their 2019 compensation. Thus, business owners and self-employed persons generally cannot pay themselves a bonus to increase the forgiveness amount.

### Non-Payroll Costs Eligible for Forgiveness; Prepayments

As we had surmised in our [prior blog post](#):

- The IFR clearly states that non-payroll costs are eligible for inclusion in the forgiveness computation if they are:
  - Paid during the covered period; or
  - Incurred during the covered period and paid on or before the next regular billing date after the end of the covered period.
- The IFR clearly states that advance payments and prepayments of non-payroll costs are not eligible for inclusion in the forgiveness computation.

**Practice Alert:** The IFR provides that non-payroll costs paid during the covered period but not incurred in the covered period because they relate to a prior time period (e.g., May utilities paid in June where the covered period begins June 1) are eligible for inclusion in the forgiveness computation, notwithstanding the seemingly contradictory statutory language that costs must be incurred and payments must be made during the covered period.

### Guidance on Loan Forgiveness Limitations

The CARES Act contained two limitations under which a borrower’s potential loan forgiveness amount would be reduced—one limitation for reduction in full-time equivalent (“FTE”) employees; another for reduction in salary/wages—both of which look at the covered period

## Let the Good Times Roll – The SBA Issues Interim Final Rules on PPP Loan Forgiveness, Including Guidance on the Payment of Bonuses and Hazard Pay, Loan Prepayments and the Loan Forgiveness Application

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relative to a base period. Each limitation provides a restoration rule with respect to employees who are rehired or who have their salaries restored by June 30, 2020.

### *Restoration Guidance*

The IFR clarifies that if a borrower offers to re-hire or restore the wages of an employee that it previously laid off or for whom it reduced hours, and the employee declines the offer, then that employee is excluded when calculating the loan forgiveness reduction (i.e., the employee's declination will not adversely impact the employer's loan forgiveness limitation).

To qualify, the borrower must: (a) maintain records documenting (i) a good-faith written offer for the same hours and salary/wage as prior to the layoff or reduction and (ii) rejection of the offer; and (b) inform the applicable state unemployment agency of the employee's rejected offer within 30 days of the rejection.

### *FTE Limitation*

The IFR also clarifies that for purposes of calculating FTE employees under the FTE limitation, the calculation is based on an employee working 40 hours or more per week. For part-time employees, the IFR allows employers to calculate full-time equivalency in one of two different ways:

- A borrower may calculate the average number of hours a part-time employee was paid per week during the covered period (e.g., 30 hours per week being a 0.75 FTE employee and 10 hours per week being a 0.25 FTE employee); or
- For administrative convenience, a borrower may elect to use a full-time equivalency of 0.5 FTE for each part-time employee regardless of actual hours worked.

Borrowers may only use one of these methods and must apply that method consistently to all of their part-time employees. For full-time employees, the calculation is capped at 40 hours, such that an employee working 48 hours is a 1.0 FTE employee.

### *Wage/Salary Reduction Limitation*

With respect to the loan forgiveness limitation for reductions in employee compensation in excess of 25 percent relative to the base period, the IFR states that the reduction calculation is performed on a per employee basis, not in the aggregate.

Thus, if an employer paid an employee \$1,000 per week during the base period and reduced the employee's pay to \$700 per week during the eight-week covered period (a 30 percent reduction), the \$50 excess over the first \$250 would be applied to reduce the loan forgiveness

## Let the Good Times Roll – The SBA Issues Interim Final Rules on PPP Loan Forgiveness, Including Guidance on the Payment of Bonuses and Hazard Pay, Loan Prepayments and the Loan Forgiveness Application

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amount. That is, the employer's loan forgiveness amount would be reduced by \$400 total (\$50 x eight weeks).

The IFR states that the salary/wage reduction limitation applies only to the portion of the decline in employee salary and wages that is *not* attributable to the FTE reduction. This ensures that borrowers are not doubly penalized by application of both limitations.

On this point, the IFR provides the following example:

An hourly wage employee had been working 40 hours per week during the base period (i.e., a 1.0 FTE employee) and the borrower reduced the employee's hours to 20 hours per week during the covered period (to 0.5 FTE status). There was no change to the employee's hourly wage during the covered period. Because the hourly wage did not change, the reduction in the employee's total wages is entirely attributable to the FTE employee reduction and the borrower is not required to conduct a salary/wage reduction limitation calculation for that employee.

### *For Cause and Voluntary Terminations*

Finally, for purposes of the FTE limitation, the IFR clarifies that when an employee of the borrower is fired for cause, voluntarily resigns or voluntarily requests a reduced schedule during the covered period (or the alternative payroll covered period), the borrower may count such employee during the covered period or the alternative payroll covered period at the same full-time equivalency level they experienced before the FTE reduction event when calculating the FTE limitation. Borrowers must keep records showing the employee was terminated for cause or voluntarily resigned or requested reduced hours.

### Loan Forgiveness Documentation Requirements

The loan forgiveness application form (SBA Form 3508) details the documentation that borrowers must submit with their loan forgiveness application, documentation that borrowers may voluntarily submit and documentation borrowers must maintain and make available upon request. As set forth on page 10 of SBA Form 3508, this documentation includes:

- **Payroll Documentation:** Documentation verifying the eligible cash compensation and non-cash benefit payments from the covered period or the alternative payroll covered period consisting of each of the following:
  - Bank account statements or third-party payroll service provider reports documenting the amount of cash compensation paid to employees.

## Let the Good Times Roll – The SBA Issues Interim Final Rules on PPP Loan Forgiveness, Including Guidance on the Payment of Bonuses and Hazard Pay, Loan Prepayments and the Loan Forgiveness Application

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- Tax forms (or equivalent third-party payroll service provider reports) for the periods that overlap with the covered period or the alternative payroll covered period:
      - Payroll tax filings reported, or that will be reported, to the IRS (typically, Form 941); and
      - State quarterly business and individual employee wage reporting and unemployment insurance tax filings reported, or that will be reported, to the relevant state.
    - Payment receipts, cancelled checks or account statements documenting the amount of any employer contributions to employee health insurance and retirement plans that the borrower included in the forgiveness amount.
  - **FTE Documentation:**
    - Documentation showing (at the election of the borrower) the FTE employees during the base period elected by the employer:
      - The average number of FTE employees on payroll per month employed by the borrower between February 15, 2019 and June 30, 2019;
      - The average number of FTE employees on payroll per month employed by the borrower between January 1, 2020 and February 29, 2020; or
      - In the case of a seasonal employer, the average number of FTE employees on payroll per month employed by the borrower between February 15, 2019 and June 30, 2019; between January 1, 2020 and February 29, 2020; or any consecutive 12-week period between May 1, 2019 and September 15, 2019.
    - Documents may include payroll tax filings reported, or that will be reported, to the IRS (typically, Form 941) and state quarterly business and individual employee wage reporting and unemployment insurance tax filings reported, or that will be reported, to the relevant state. Documents submitted may cover periods longer than the specific time period.
  - **Non-Payroll Cost Documentation:** Documentation verifying existence of the non-payroll obligations/services prior to February 15, 2020 and eligible payments from the covered period.
    - **Business Mortgage Interest Payments:** Copy of the lender amortization schedule and receipts or cancelled checks verifying eligible payments from the covered period; or lender account statements from February 2020 and the months of the covered period through one month after the end of the covered period verifying interest amounts and eligible payments.
    - **Business Rent or Lease Payments:** Copy of the current lease agreement and receipts or canceled checks verifying eligible payments from the covered period; or lessor account statements from February 2020 and from the covered period through

## Let the Good Times Roll – The SBA Issues Interim Final Rules on PPP Loan Forgiveness, Including Guidance on the Payment of Bonuses and Hazard Pay, Loan Prepayments and the Loan Forgiveness Application

---

one month after the end of the covered period verifying eligible payments.

- **Business Utility Payments:** Copy of invoices from February 2020 and those paid during the covered period and receipts, canceled checks or account statements verifying those eligible payments.
- **Documents That Each Borrower Must Maintain but Is Not Required to Submit:**
  - Documentation supporting the listing of each individual employee in PPP Schedule A Worksheet Table 1, including the “Salary/Hourly Wage Reduction” calculation, if necessary.
  - Documentation supporting the listing of each individual employee in PPP Schedule A Worksheet Table 2; specifically, that each listed employee received during any single pay period in 2019 compensation at an annualized rate of more than \$100,000.
  - Documentation regarding any employee job offers and refusals, firings for cause, voluntary resignations, and written requests by any employee for reductions in work schedule.
  - Documentation supporting the PPP Schedule A Worksheet “FTE Reduction Safe Harbor.”
  - All records relating to the borrower’s PPP loan, including documentation submitted with its PPP loan application, documentation supporting the borrower’s certifications as to the necessity of the loan request and its eligibility for a PPP loan, documentation necessary to support the borrower’s loan forgiveness application, and documentation demonstrating the borrower’s material compliance with PPP requirements.

The borrower must retain all such documentation in its files for six years after the date the loan is forgiven or repaid in full and permit authorized representatives of the SBA, including representatives of its Office of Inspector General, to access such files upon request.

### Conclusion

The IFR provides welcome guidance on a number of topics, especially the issues of the timing of payments of qualifying payroll and non-payroll costs, and whether payment of hazard pay and bonuses to employees and owners is included in the forgiveness computation.

There are still a number of aspects for which clarity is needed. We continue to look forward to further guidance from Treasury and the SBA.

**Tags:** bonuses, CARES Act, Coronavirus, Covered Period, COVID-19, Department of the Treasury, documentation, employers, forgivable loans, FTE employees, furloughed employees,

Let the Good Times Roll – The SBA Issues Interim Final Rules on PPP  
Loan Forgiveness, Including Guidance on the Payment of Bonuses and  
Hazard Pay, Loan Prepayments and the Loan Forgiveness Application

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