SBA Paycheck Protection Program (PPP) Loan Forgiveness: In Brief

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The Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136) created the Small Business Administration (SBA) Paycheck Protection Program (PPP) to provide short-term loans to certain small business and nonprofits. For more information on COVID-19-related assistance to small business, including a summary of enacted legislation and select bills, see CRS Report R46284, *COVID-19 Relief Assistance to Small Businesses: Issues and Policy Options*, by Robert Jay Dilger, Bruce R. Lindsay, and Sean Lowry.

Congress initially authorized $349 billion for SBA 7(a) loans, including PPP loans. Lending began on April 3, 2020, and the initial authorization was exhausted by April 16. On April 24, 2020, Congress authorized another $310 billion ($659 billion total) for 7(a) loans—including PPP loans—in the Paycheck Protection Program and Health Care Enhancement Act (P.L. 116-139).

PPP loans used for payroll expenses and for specified nonpayroll operating costs paid or incurred during an eight-week "covered period" can be forgiven if the borrower meets certain payroll and employment retention criteria. Based on previous regulations, not more than 25% of the loan forgiveness amount may be attributable to nonpayroll costs.[1] Borrowers who received the earliest PPP loans can file for forgiveness as soon as May 29, 2020.

On May 18, 2020, SBA released the first version of the borrower's application for PPP forgiveness.[2] On May 22, 2020, SBA issued an Interim Final Rule (IFR) on PPP forgiveness.[3]

This In Brief report discusses statutes, regulations, and agency guidance relevant to the PPP loan forgiveness process and determination. A summary of the Paycheck Protection Program Flexibility Act (H.R. 7010) is also provided. H.R. 7010 was passed by the House on May 28, 2020, and the Senate on June 3, 2020, and is to be presented to the President.

PPP Forgiveness Provisions and Process

The PPP loan forgiveness process is summarized and key terms are defined below, followed by an explanation of situations in which loan forgiveness amounts may be reduced.[4]

Forgiveness Application Process

According to the IFR, borrowers must complete the SBA application (or a lender equivalent) for PPP forgiveness and submit it to their lender, who is to then make a decision on the application within 60 days after submission.[5] If the lender determines that the borrower is entitled to some or all of the applied forgiveness amount, then the lender must request payment from the SBA. SBA is to review all loans in excess of $2 million following the lender's submission of the borrower's

[1] Small Business Administration (SBA) and Department of the Treasury (Treasury), "Interim Final Rule - Business Loan Program Temporary," 85 *Federal Register* 20811, April 15, 2020, at https://home.treasury.gov/system/files/136/PPP—IFRN%20FINAL.pdf.

[2] SBA, "Paycheck Protection Program – Loan Forgiveness Application," at https://home.treasury.gov/system/files/136/3245-0407-SBA-Form-3508-PPP-Forgiveness-Application.pdf.

[3] SBA and Treasury, "Interim Final Rule - Business Loan Program Temporary," 85 *Federal Register* 33004, June 1, 2020. Hereinafter referred to as the "IFR."

[4] The CARES Act gives private lenders "delegated authority" to issue PPP loans. These lenders (e.g., banks, credit unions, community financial institutions) have enrolled with SBA to issue PPP loans (or SBA loans, generally). SBA is not issuing the loans directly to borrowers.

[5] According to the PPP Forgiveness application, borrowers must retain documentation for six years after the loan is forgiven and make it available to the SBA or its Office of Inspector General upon request.

loan forgiveness application.[6] Data on loans approved through May 30, 2020, indicate that less than 1% of all loans were larger than $2 million, representing slightly more than 20% of loan amounts.[7]

SBA is to then remit the appropriate forgiveness amount to the lender, plus any interest accrued through the payment date, no later than 90 days after the lender issues its decision to SBA. The borrower must repay any amount not forgiven within the PPP loan's two-year maturity period.

Payroll Costs

According to the IFR, generally only payroll costs paid *or* incurred during the eight-week (56 consecutive days) "covered period" are eligible for forgiveness. Borrowers can consistently apply one of two start dates: (1) the date that their lender disbursed their PPP loan or (2) the first day of their first payroll cycle in the covered period (termed the "alternative payroll covered period").[8] There is an exception for payroll costs incurred during the borrower's last pay period of the covered period, which are eligible for forgiveness only if paid on or before the next regular payroll date. This is intended for the borrower's administrative convenience.[9]

Compensation to furloughed employees, even if they are not performing their day-to-day functions, is considered a "payroll cost" eligible for forgiveness.

No more than $15,385 in cash compensation per individual during the covered period is eligible for forgiveness ($100,000 prorated for eight weeks). Noncash compensation, such as retirement or health plan contributions, is not subject to this limitation.[10]

Self-employed individuals (e.g., sole proprietors, independent contractors) are limited to forgiveness based on their positive net profit or earnings amounts from their 2019 federal income tax filings.[11] The SBA has labeled this as "owner compensation replacement."

Nonpayroll Costs

Nonpayroll costs eligible for forgiveness include payments for the following expenses:

1. interest on any business mortgage obligation on real or personal property,
2. business rent obligations on real or personal property under a lease agreement, and

[6] SBA may also review other smaller loans as it deems appropriate, following the lender's submission for loan forgiveness. During a review process, SBA could choose to review the initial PPP loan application, forgiveness application, or both. (In addition, borrowers may request that SBA review the lender's forgiveness decision.) See FAQ #39 in SBA, "Paycheck Protection Program Frequently Asked Questions," at https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf.

[7] SBA, "Paycheck Protection Program Loan Report (Approvals through 5/30/2020)," at https://www.sba.gov/sites/default/files/2020-06/PPP_Report_200530-508.pdf.

[8] According to the IFR, payroll costs are considered paid on the day that paychecks are distributed or the borrower originates an automated clearing house (ACH) credit transaction.

[9] The IFR is silent on cases in which a business incurred an eligible cost before the covered period but made a payment within the covered period.

[10] See FAQ #37 in SBA, "Paycheck Protection Program Frequently Asked Questions," at https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf.

[11] CRS Insight IN11341, *SBA's Paycheck Protection Program (PPP) Loans and Self-Employed Individuals*, by Sean Lowry.

3. business utility payments for the distribution of electricity, gas, water, transportation, telephone, or internet access.[12]

Eligible expenses must have been incurred, in force, or in service as of February 15, 2020. No more than 25% of the loan forgiveness amount can be attributed to nonpayroll costs.

Nonpayroll costs are eligible for forgiveness if they were paid during the covered period, or incurred during the covered period and paid on the next regular billing date. If a billing cycle covers a period within and outside of the covered period, only the portion of the payment attributed to costs incurred during the covered period is eligible for forgiveness.

Reductions in Forgiveness

Under Section 1106 of the CARES Act, forgiveness for borrowers' PPP-eligible expenses during the covered period is to be reduced if they reduce employment or employee compensation by certain amounts. Specifically, the CARES Act reduces the forgiven amount if a borrower (1) reduces its full-time equivalent (FTE) employees, or (2) reduces the amount of compensation paid to certain FTE employees by more than 25% below levels in a reference period.[13] There is also a "safe harbor" provision that overrides the two-prong forgiveness formula calculation if the borrower "cures" any reductions in FTE employees and compensation reductions in excess of 25% by June 30, 2020. This is commonly referred to as the "rehiring provision." Reducing loan forgiveness means borrowers would have to repay some or all of their original PPP loan amount.

Calculating Full-Time Equivalent Employees

If the average number of FTE employees during the covered period is less than during the reference period, then the forgiveness amount is reduced proportionately. For example, if an employer had an average of 100 FTE employees in its reference period and 80 FTE employees during the covered period, then it would be eligible for loan forgiveness on up to 80% (8/10) of its total eligible expenses (payroll and nonpayroll) during the covered period.

The IFR defines an FTE as an employee who works 40 hours per week.[14] FTE employee counts are determined on an aggregate basis, based on the hours of all employees on the borrower's payroll divided by the number of employees. An employee working more than 40 hours per week is capped as counting as one FTE employee. For example, an employee who was paid 48 hours per week during the covered period would be considered to be 1.0 FTE employee. As an administrative convenience, employees who were paid for less than 40 hours per week may be counted in one of two ways: (1) based on the average hours worked per week, or (2) counting each part-time employee as 0.5 FTE employees. Borrowers must consistently apply their calculation methods across all employees.

[12] Advance interest payments (prepayment) on a covered mortgage or loan principal payments are not eligible for forgiveness.

[13] Borrowers have the following options for their reference period: (1) February 15, 2019, through June 30, 2019; (2) January 1, 2020, through February 29, 2020; or (3) in the case of a seasonal employer, either of the two preceding methods or a consecutive 12-week period between May 1, 2019, and September 15, 2019.

[14] Note that this is different than the 30 hour per week FTE employee definition and determination under the Affordable Care Act's Employer Shared Responsibility Provision. See CRS Report R45455, *The Affordable Care Act's (ACA's) Employer Shared Responsibility Provisions (ESRP)*, by Ryan J. Rosso.

Calculating Salaries and Wages

A reduction in an employee's salary or wages in excess of 25% will generally result in a reduction in the loan forgiveness amount. However, employees who earned more than $100,000 in 2019 are not taken into account for the compensation reduction part of the reduction formula. In other words, such employees may have their pay reduced by more than 25% without affecting the borrower's forgiveness amounts.

According to the IFR, the salary and wages reduction formula only applies to the decline in compensation that is not attributed to FTE employee reductions to prevent borrowers from being "doubly penalized" for FTE employee reductions. For example, an employee worked 40 hours per week during the reference period and was reduced to 20 hours per week during the covered period with no hourly wage reduction. Although the employee earned half the compensation during the covered period, the employer's forgiveness amount will only be reduced with respect to a reduction in FTE employees (from 1.0 to 0.5 FTE employees).

Three other groups of employees do not affect a borrower's forgiveness:

1. employees who were laid off or forced to reduce their hours, but then declined their employer's subsequent offer to return to work or restore their previous schedules;[15]
2. employees who were fired for cause; and
3. employees who requested a schedule reduction.

The borrower must make a good faith certification attesting to the above conditions and maintain various documentation (e.g., employee-employer communications) outlined in the IFR.

Paycheck Protection Program Flexibility Act (H.R. 7010)

This section summarizes the provisions of H.R. 7010 and discusses the potential effects of two of its features: (1) increasing the covered period and rehiring safe harbor, and (2) the forgiveness cap on nonpayroll expenses.

H.R. 7010 would

- increase the maximum maturity for PPP loans from two years (under SBA regulations) to five years for loans made on or after the date of enactment, giving borrowers more time to pay off any remaining loan balances (not forgiven) at the 1% interest rate;
- change the forgiveness covered period from eight weeks after the origination date to the sooner of 24 weeks or December 31, 2020;[16]
- change the rehiring safe harbor deadline from June 30, 2020, to December 31, 2020;
- expand the three groups of employees in the IFR that do not affect a borrower's forgiveness to account for instances in which a borrower could not rehire the

[15] According to the IFR, the offer must be 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. For example, an employer cannot offer an employee compensation at half the employee's previous pay rate or hours and qualify for the safe harbor.

[16] A 24-week covered period for the earliest PPP loans (issued April 24, 2020) would end on September 18, 2020.

same individual or a comparable individual, or is unable to return to its February 15, 2020, level of business activity due to compliance with COVID-19 related safety standards;

- increase the cap on PPP forgiveness that can be attributed to nonpayroll costs from 25% (under SBA regulations) to 40%;
- allow borrowers to elect for an eight-week covered period to apply for forgiveness;
- extend the PPP loan deferral period from 6 months (under SBA regulations) to the sooner of 10 months or the date on which the lender receives the amount of forgiveness determined; and
- allow PPP borrowers to defer employer payroll taxes even after obtaining PPP forgiveness.[17]

These changes, other than the five-year minimum loan term, would apply to all PPP loans (including those made prior to enactment).

Increasing the Covered Period and Delaying the Rehiring Deadline

Proponents may argue that increasing the covered period and rehiring deadline would give businesses more time to wait until government-imposed limitations on business operations are lifted, or until economic conditions improve. Then, borrowers could use their PPP loan amounts to meet business demand, rather than paying employees to stay on payroll even if they are not working. In addition, proponents of extending the forgiveness covered period may argue that under the June 30 deadline, some borrowers could rehire employees and restore compensation just to obtain forgiveness and then lay off these workers right after. In other words, the June 30 deadline could create a short-term incentive for borrowers to artificially inflate their payrolls to obtain loan forgiveness. They may also argue that more time could enable some borrowers to meet requirements that a certain percentage of the loan be used for payroll costs.

Opponents may argue that these changes could delay paycheck assistance to workers and create uncertainty for borrowers. If borrowers are not obligated to spend their PPP funds earlier, then they may choose not to pay their workers. These workers may have to rely on unemployment payments, if they are eligible. Further, lengthening the forgiveness covered period could delay the forgiveness application process for small businesses.

[17] Section 2302 of the CARES Act allows employers and self-employed individuals to defer, or postpone, the employer share of the Social Security payroll tax through the end of 2020. Deferred tax liability can be paid in two installments: one due by December 31, 2021, and the second by December 31, 2022. The Social Security trust funds are not affected. See CRS Report R46279, *The Coronavirus Aid, Relief, and Economic Security (CARES) Act—Tax Relief for Individuals and Businesses*, coordinated by Molly F. Sherlock. Section 2302 prohibits taxpayers who obtain PPP forgiveness from also benefiting from deferral, though. Based on Internal Revenue Service (IRS) guidance, employers who obtain a PPP loan are able to defer their payroll taxes. However, "Once an employer receives a decision from its lender that its PPP loan is forgiven, the employer is no longer eligible to defer deposit and payment of the employer's share of Social Security tax due after that date." IRS, "Deferral of employment tax deposits and payments through December 31, 2020," at https://www.irs.gov/newsroom/deferral-of-employment-tax-deposits-and-payments-through-december-31-2020. H.R. 7010 would repeal the prohibition in Section 2302 of the CARES Act.

Increasing the Cap on Nonpayroll Expenses

Proponents may argue that increasing the SBA-imposed cap on nonpayroll expenses is warranted because some businesses might have higher nonpayroll costs, such as business facilities in high-rent areas. Other businesses might also have fewer employees, making it more difficult for them to meet the 25% nonpayroll cost limit. Opponents may argue that relaxing the requirement could reduce the amount of PPP proceeds used to maintain payroll for employees. However, it is unclear whether the 25% restriction encourages employers to retain employees *throughout* the covered period since businesses still may receive loan forgiveness as long as they *restore* FTE counts and compensation payments by the rehiring safe harbor deadline.

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