

Larry's Tax Law

We Can Work It Out: The SBA Continues Providing Guidance on the PPP and Loan Forgiveness

By Larry Brant and Peter Evalds on 6.23.20 | Posted in Federal Law, Legislation, Tax Laws

The Small Business Administration (“SBA”) continues its quest to provide guidance relative to the Paycheck Protection Program (“PPP”) enacted as part of the CARES Act and the Paycheck Protection Program Flexibility Act of 2020 (“PPPFA”) enacted by Congress to provide clarification and remove some of the rigidity surrounding the PPP.

The PPP legislation and much of the guidance PPP borrowers have received to date is fraught with complexity and inconsistency. The SBA is doing its best, as Paul McCartney and John Lennon expressed in their hit song *We Can Work It Out*, to help PPP borrowers get through these trying times:

Try to see it my way

Only time will tell if I am right or I am wrong

While you see it your way

There’s a chance that we might fall apart before too long

We can work it out

We can work it out

In that vein, the SBA recently issued interim final rules (“IFRs”) focused on PPP loan forgiveness. Additionally, last week the SBA published a revised PPP loan forgiveness application (“Form 3508”), and a new short-form forgiveness application (“Form 3508EZ”).

Background

As [previously discussed](#), Section 1106 of the CARES Act provides for forgiveness of PPP loans if certain criteria are met. Also, as [we have discussed](#), the PPPFA, signed into law on June 5, 2020, made certain changes to the CARES Act, including the following:

- It extends the covered period for purposes of Section 1106(a) from eight weeks from the date of the loan (i.e., disbursement of loan proceeds) to the earlier of December 31, 2020 or 24 weeks from the date of the loan, effective retroactively.

- It provides that all PPP loans made on or after June 5, 2020 will have a five-year maturity, rather than the initial two-year maturity.
- It changes the loan proceeds use formula of 75 percent payroll/25 percent rent, interest on debt and utilities rule to 60 percent payroll/40 percent rent, interest on debt and utilities.
- It provides that the amount potentially forgiven will not be lessened due to a reduced full-time equivalent (“FTE”) workforce count if the taxpayer, in good faith, can document an inability to return to the “same level of business activity” as prior to February 15, 2020 due to sanitation, social distancing, and worker or customer safety requirements.

As we discussed last week, the SBA recently [released revisions](#) to the First IFR (“[Revisions to First IFR](#)”) that provide as follows:

- Taxpayers whose PPP loans were disbursed prior to June 5, 2020 have the option of choosing an eight-week or 24-week covered period.
- The SBA will allow a taxpayer to use less than 60 percent of PPP loan proceeds for payroll costs and still qualify for partial loan forgiveness (despite apparently contradictory language in the PPPFA).
- For loans entered into prior to June 5, 2020, lenders and taxpayers may mutually agree to extend the two-year maturity up to five years.

In light of the changes made by the PPPFA and the Revisions to First IFR, the SBA made revisions to two other IFRs and Form 3508. Additionally, in an effort to further simplify matters, it published Form 3508EZ, a short-form PPP loan forgiveness application that borrowers meeting certain criteria may use.

Interim Final Rule Revisions

On June 16, 2020, the SBA released revisions (the “[Revisions to Third and Sixth IFRs](#)”) updating the following earlier IFRs in light of the PPPFA and the Revisions to First IFR:

- The Interim Final Rule on Additional Eligibility Criteria and Requirements for Certain Pledges of Loans (“[Third IFR](#)”), posted on SBA’s website on April 14, 2020 and published in the Federal Register on April 20, 2020 (85 FR 21747); and
- The Interim Final Rule on Disbursements (“[Sixth IFR](#)”), posted on SBA’s website on April 28, 2020 and published in the Federal Register on May 4, 2020 (85 FR 26321).

Most of the changes made by the Revisions to Third and Sixth IFRs replace references of eight-week covered periods to 24-week covered periods, update maturity date references, and change references of 75 percent of payroll costs to 60 percent of payroll costs.

The Revisions to Third and Sixth IFRs also update guidance in the Third IFR with respect to the forgiveness limits for self-employment and owner-employee income. Section 1102 of the CARES sets a limit on the amount of payroll costs that may be considered for purposes of determining the amount of a PPP loan. That limit is generally 2.5 times a taxpayer's average monthly total payments for payroll costs in a one-year period prior to the date the loan is made. Pursuant to the Revisions to Third and Sixth IFRs, the Third IFR is amended so that for taxpayers with 24-week covered periods, self-employment income eligible for forgiveness is limited to 2.5 months' worth of 2019 net profit, or \$20,833. According to the SBA, this approach is "consistent with" the CARES Act's structure and focus on paying employees and is necessary to prevent "windfalls" to self-employed business owners.

PPP Loan Forgiveness Application

In light of the changes discussed above, the SBA released a [revised Form 3508 and instructions](#) last week. Both documents reflect the revised payroll cost thresholds, covered period, and the 2.5 multiplier cap on self-employed business owners.

The revised documents also expand the FTE reduction safe harbors to include a situation where a reduction in FTEs was due to the inability to operate at the same level of business activity after February 15, 2020 as before that date due to compliance with CDC, OSHA, or HHS requirements or guidance related to sanitation, social distancing, or other worker or customer safety standards or requirements related to COVID-19.

The revised documents also change references to amounts "paid" for mortgage interest, rent, utilities, health insurance, retirement plans, and state and local taxes, to amounts "paid or incurred."

Practice Alert: The change to "paid or incurred" should be a welcome bit of guidance for most PPP borrowers. As we [previously discussed](#), the CARES Act considers in the debt forgiveness computation certain "costs incurred *and* payments made" during the covered period (emphasis added). The original instructions to Form 3508 provided, however, that the forgiveness computation considers certain non-payroll costs "paid during the Covered Period *or* 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" (emphasis added). Thus, the SBA's use of the disjunctive "or" in the original instructions appears to go beyond the plain language of the conjunctive "and" used in the statute (but is good for taxpayers). The SBA's further use in the revised instructions to Form 3508 with respect to amounts paid *or* incurred means that the SBA has continued its favorable position with respect to such amounts.

The revised instructions to Schedule A to Form 3508 clarify a few additional items:

- On Line 6 (employee health insurance), taxpayers should not add contributions for self-employed individuals, general partners or S corporation owner-employees because those payments are already included in compensation.
- On Line 7 (employer contributions to employee retirement plans), taxpayers should not add employer contributions made for self-employed individuals or general partners because those payments are already included in compensation.

The revised instructions also update the documentation that should be retained by PPP borrowers (but not submitted with Form 3508):

- Documentation related to employee refusals to return to work now includes failures to accept restoration or reduction in hours; and
- Employers should maintain documentation to support their inability to operate at the same level of business activity after February 15, 2020 as before that date due to compliance with CDC, OSHA, or HHS requirements or guidance related to sanitation, social distancing, or other worker or customer safety standards or requirements related to COVID-19 (presumably only if they are relying on that safe harbor).

Short-Form PPP Loan Forgiveness Application

The SBA created [Form 3508EZ](#) and [instructions](#). It is a short-form PPP loan forgiveness application.

According to the instructions, Form 3508EZ may only be used if **one** of the following three criteria are met:

- The taxpayer is a self-employed individual, independent contractor or sole proprietor who had no employees at the time of the PPP loan application and did not include any employee salaries in the computation of average monthly payroll in the loan application form; **or**
- Both of the following requirements are satisfied:
 - The taxpayer did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period compared to the period between January 1, 2020 and March 31, 2020 (“employees” meaning only employees that did not receive wages or salary at an annualized rate of pay of more than \$100,000 during 2019); **and**

- The taxpayer 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 (ignoring reductions arising from an inability to rehire employees on February 15, 2020 if the taxpayer was unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020 and reductions in an employee's hours that the taxpayer offered to restore and the employee refused); **or**

- Both of the following requirements are satisfied:
 - The taxpayer did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period compared to the period between January 1, 2020 and March 31, 2020 ("employees" meaning only employees that did not receive wages or salary at an annualized rate of pay of more than \$100,000 during 2019); **and**
 - The taxpayer was unable to operate during the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with CDC, OSHA, or HHS requirements or guidance related to sanitation, social distancing, or other worker or customer safety standards or requirements related to COVID-19.

Unlike Form 3508, Form 3508EZ does not require the detailed Schedule A or the complex accompanying worksheet. The much abbreviated format is most definitely a welcome change for many PPP borrowers.

Conclusion

There is no doubt that the SBA is trying to help PPP borrowers "work it out." It has been busy updating guidance and its forgiveness applications in light of the PPPFA. Taxpayers who have not yet submitted their forgiveness applications should use the new forms. Taxpayers who meet one of the criteria listed above may find it easier to use Form 3508EZ.

As the SBA continues its quest to help PPP borrowers work through the complex forgiveness web, we expect it will issue more guidance. Stay tuned! We will do our best to report it in a timely manner.

Tags: CARES Act, Coronavirus, Covered Period, COVID-19, forgivable loans, interim final rule, Paycheck Protection Program, Paycheck Protection Program Flexibility Act of 2020, small business, Taxpayer