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What the Paycheck Protection Program Flexibility Act Means for Businesses with PPP Loans

By Jessica Summers

On Friday (June 5, 2020), the President signed into law the new Paycheck Protection Program Flexibility Act of 2020 (the "PPPFA")

In a nutshell, the PPPFA, which is intended to provide more flexibility for businesses that had to remain fully or partially closed after receiving a Paycheck Protection Program (PPP) loan, does the following:

- Expands, from 8 weeks to 24 weeks (or until the end of the year whichever is sooner), the time period after receiving a PPP loan during which a business can use the loan proceeds and seek loan forgiveness.
- Extends, from June 30, 2020 to December 31, 2020, the deadline by which a business can avoid a reduction in their loan forgiveness amount by eliminating reductions in employee headcount or compensation levels that occurred between February 15 and April 26.
- Adds additional safe harbors for businesses that have eliminated employees and have been unable to rehire them.
- Lowers the percentage of the loan forgiveness amount that must be spent on payroll costs from 75% to 60%.
- Allows businesses that receive a PPP loan to also defer payment of 2020 payroll taxes as provided for in the CARES Act (originally businesses had to choose one or the other).
- Adds deferral options and extends the first payment date for PPP loan recipients that either don't qualify, or don't apply, for full loan forgiveness.
- Extends, from 2 years to 5 years, the maturity date for any PPP loans made on or after June 5, and gives borrowers and lenders the option to negotiate an extension to the maturity date of PPP loans that were made before June 5.

It is important to note that while the PPPFA's changes, in particular the expansion of the forgivable use period, will be helpful for many businesses, PPP loan recipients need to understand their options and take careful steps to maximize their loan forgiveness.

So how does the PPPFA change the loan forgiveness landscape and what should businesses be mindful of? Let's dive in …

The "Covered Period"

The biggest changes hinge on the fact that the PPPFA changes the definition of "covered period" for the purposes of the loan forgiveness rules.

The CARES Act, which originally established the PPP loan program, defined the "covered period" as the 8 weeks after a business' PPP loan originated. The PPPFA changes that definition and provides that the "covered period" starts when the loan originates and runs either 24 weeks or until December 31, 2020, whichever is shorter. **Of critical importance, the PPPFA gives businesses that have already received a PPP loan the option to stick with the original 8 week definition. Thus, these businesses will need to carefully assess which covered period will be better for them.**

The "covered period" definition comes into play twice in the PPP loan forgiveness process. First the "covered period" is the window of time during which the business can use the PPP loan on eligible expenses and then apply to have those amounts forgiven. The "covered period" is also the window of time that will be looked at to calculate whether there will be any reductions to the business' loan forgiveness amount as a result of the business reducing its average number of full-time equivalent (FTE) employees or reducing the average salary or hourly rates paid to any employee making $100k or less per year.

In short, the PPPFA expands both the time that a business will have to use up its PPP loan AND the time during which a business' actions could cause a reduction in its loan forgiveness amount – hence why businesses with the option to choose between the original 8 week covered period and the new longer covered period should look long and hard at their options.

Reductions to Loan Forgiveness: The Basics

The way that the PPP loan program is structured, borrowers are eligible to have up to the principal amount of their loan forgiven. However, the eligible loan forgiveness amount will be reduced if either, or both, of the following occur:

- The business reduces the number of employees it has or the hours being paid to employees, such that the business' average number of FTE employees during the defined cover period is less than its average number of FTE employees during the business' selected comparison period. The business may choose between two comparison periods, either (1) January 1 through February 29, 2020, or (2) February 15 through June 30, 2019 (there is also a third special window for businesses with seasonal employees).
- The business reduces the average salary or hourly rate of any employee making equal to or less than $100k annually by more than 25% during the defined covered period. This analysis is conducted as to each employee making $100k or less.

While a business may see reductions to its loan forgiveness amount arising from reductions to employee headcount and reductions to compensation, reductions that stem from an employee's hours being reduced will not be double counted. In other words, if a business reduces the number of hours that an employee is working or being paid for, this will only be relevant for calculating a reduction to the loan forgiveness based on the business' average number of FTE employees. The fact that the reduction in hours means that the individual employee's total earnings is less will not also result in a reduction to loan forgiveness based on employee compensation as long as the employee's average rate of compensation for those hours worked or paid is not also reduced (as compared to the average during the most recent full quarter before the covered period started). For example, if an hourly employee was working 40 hours per week at $30 per hour before COVID-19 and the business reduces the employee to only working 20 hours per week but still at $30 per hour, that reduction in hours would only be looked at as far as whether the business reduced its FTE employee headcount. If, under the same example, the business also reduced the employee's hourly rate to $15 per hour that reduction in the hourly rate will be factored in as a reduction to employee compensation.

Forgiveness Reductions Based on the Average Number of FTE Employees

Whether using the PPPFA's new longer covered period or the original 8 week covered period, the steps to assessing whether the eligible loan forgiveness will be reduced based on the average number of FTE employees are:

1. Calculate the average number of FTE employees the business had during the covered period. A full-time employee is an employee who typically works at least 40 hours per week. For employees who typically work less than 40 hours per week, the business can choose to either (a) count each part time employee as .5 or (b) manually calculate a full time equivalency by dividing the hours that the employee works by 40 (so an employee who works 30 hours would be counted as .75). The business has to use the same method for all part time employees and for all calculations.
2. Calculate the average number of FTE employees that the business had during the comparison period (Jan. 1-Feb. 29, 2020 or Feb. 15-June 30, 2019) selected by the business.
3. If the average number of FTE employees during the covered period was equal to or greater than the average number of FTE employees during the comparison period, there will be no reduction based on headcount. If the average number of FTE employees during the covered period is less than the average number of FTE employees during the comparison period, the business will have to determine if a safe harbor applies, if no safe harbor applies the loan forgiveness amount will be reduced proportionately to the reduction in the average number of FTE employees.

With the additions made by the PPPFA, a business may use the following safe harbors to avoid or reduce a reduction in loan forgiveness based on a decrease in its average number of FTE employees:

- Safe Harbor for Reductions Occurring Between February 15 and April 26 – If the business reduced its headcount in this window, the business can avoid a forgiveness reduction by "eliminating" the reduction by December 31, 2020 (the original date was June 30, 2020 – the PPPFA bumped it back). Specifically, if the business had a lower average headcount during its covered period than it did during its comparison period, the business will qualify for the safe harbor and avoid a reduction in the loan forgiveness if, as of December 31, 2020, it has at least as many FTE employees as it did during the pay period that included February 15, 2020. So for this safe harbor, the focus is entirely on how many employees the business had in the February 15 pay period and how many it has as of December 31.

Again, this safe harbor only applies if the reduction (layoff, furlough, reduction in hours, etc.) occurred between February 15 and April 26. Any reductions that occurred after April 26 cannot be corrected with this safe harbor.

- Safe Harbor for Certain Employee Departures or Reductions – In calculating whether a business' loan forgiveness amount will be reduced based on reductions in employee headcount, the SBA loan forgiveness application allows businesses to exclude from their calculations, reductions that result from any employee who left during the covered period and was not replaced if:
    - (a) the employer made a written offer to rehire the employee during the covered period which was rejected by the employee,
    - (b) the employee was terminated for cause during the covered period, or
    - (c) the employee voluntarily resigned during the covered period.

The forgiveness application further provides that the forgiveness will not be reduced if an employee voluntarily requested, and received, a reduction in his/her regular scheduled hours during the covered period.

- <u>Safe Harbor for Inability to Rehire</u> – The PPPFA added a new safe harbor to provide that a business can exclude, and will not be penalized for, a reduction in the business' average number of FTE employees that is the result of the business being (1) unable to rehire someone who was an employee as of February 15, 2020, and (2) unable to hire someone similarly qualified to fill that employee's position by December 31, 2020. We will have to wait for the SBA's updated loan forgiveness application to see what the business will need to do to show that it has been unable to rehire the employee or hire a qualified replacement.
- <u>Safe Harbor for Decline in Business Activity Due to COVID</u>-19 Related Requirements or Guidance – The PPPFA also added a second safe harbor to allow a business to exclude, and not be penalized for, a reduction in its average number of FTE employees that is the result of the business being unable to "return to the same level of business activity as such business was operating at or before February 15, 2020" because of COVID-19 related requirements or guidance established by the Department of Health and Human Services (HHS), the Centers for Disease Control (CDC) or the Occupational Safety and Health Administration (OSHA) between March 1, 2020 and December 31, 2020. Thus, for example, if because of social distancing guidance, a business is unable to bring back its full workforce, this will not be counted against its loan forgiveness. Again, this new safe harbor and what employers will be required to show to qualify for it will need to be fleshed out by the SBA on the updated Loan Forgiveness Application.

Because the safe harbors are each limited in their own way, businesses that have a choice should be careful about selecting the longer 24-week covered period as this will mean the business is committing to a longer period over which it may be restrained in its ability to reduce hours or employees without suffering a reduction to loan forgiveness.

<u>Forgiveness Reductions Based on Employee Compensation</u>

As noted above, the loan forgiveness amount may also be reduced if the business reduces salaries or hourly rates of employees making equal to or less than $100k annually by more than 25% during the covered period.

A reduction in compensated is calculated first by determining the average hourly rate or salary the employee was paid as compared to the number of hours the employee worked or was paid for during the covered period (remember there is no double counting here if the employee's total compensation reduction resulted from a reduction in hours worked or paid). Then that number is compared to the same average as calculated for the last full quarter that preceded the origination of the loan. So for example, for a business that got a PPP loan on May 1, the comparison would be the average rate of compensation over the covered period as against the average compensation from Q1 (Jan. 1 – Mar. 31). If an employee's average compensation during the covered period is less than 75% of what it was in Q1, then the forgiveness amount will be reduced unless a safe harbor applies.

There is only one safe harbor for employee compensation rates. This safe harbor allows the business to eliminate reductions that occurred between February 15 and April 26, 2020. To determine if the reduction occurred in this window, the business must first calculate the employee's average rate of compensation for the period from January 1 through February 15 and compare it against the average for the period from February 15 through April 26, 2020. If the average from the Feb. 15-Apr. 26 period is equal to or greater than the average from Jan. 1 through Feb. 15, the reduction did not occur during the Feb. 15-Apr. 26 window and the business is ineligible for the safe harbor as to any changes to that employee's compensation (this analysis is conducted as to each employee).

In other words, if the business reduces the compensation rate of an employee who makes $100k or less a year by more than 25% during its covered period and after April 26, this will result in a reduction in the loan forgiveness amount and there is no safe harbor that will allow the business to avoid the reduction. **Thus, again, in exchange for having longer to use the loan under the PPPFA's 24-week/yearend covered period, the PPPFA also expands the time period during which the business will be restrained from reducing employee compensation rates by more than 25%.**

If an employee's compensation reduction did occur between February 15 and April 16, the business can avoid a reduction in its loan forgiveness if the employee's average rate of compensation across all of 2020 (previously it was only through June 30, but the PPPFA extended it through the end of the year) is at least equal to average rate of compensation between January 1 and February 15. In such instance, the business will be considered to have "restored" the employee compensation levels and would qualify for the safe harbor to avoid a reduction in loan forgiveness.

Takeaways

All PPP loan recipients should be aware that existing guidance may change, or be added to, when the SBA releases the new Loan Forgiveness Application reflecting the PPPFA's updates.

The PPPFA, true to its name, will provide more flexibility for many businesses in using their PPP loans. However, businesses that must (by law or necessity) use the new longer PPPFA covered period should be cognizant of any actions during that longer period of time that might result in a reduction in their loan forgiveness amount. Businesses that have the option to choose between the new longer period and the original 8-week period should carefully calculate which option is best for them.

Please do not hesitate to contact your friends at Paley Rothman if you need any assistance making these assessments and calculations.

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