May 26, 2020

Overview of the Latest Paycheck Protection Program Regulations & The Outlook Further Legislative and Regulatory Changes Ahead

Prior to Memorial Day Weekend, the U.S. Small Business Administration unveiled several important interim final rules (IFR) governing its Paycheck Protection Program (PPP). Those IFRs include and this summary covers:

- **I.** **Interim Final Rule on Loan Forgiveness**
  - **A. The 75%/25% payroll cost/non-payroll cost forgiveness rule**
  - **B. Payroll costs eligible for loan forgiveness**
  - **C. Non-payroll costs eligible for loan forgiveness**
  - **D. Reductions to loan forgiveness amount**

- **II.** **Interim Final Rule on Second Extension of Limited Safe Harbor with Respect to Certification Concerning Need for PPP Loan and Lender Reporting**
  - **A. Good faith need safe harbor for borrowers of PPP loans less than $2 million**
  - **B. Good faith need safe harbor for PPP loan repayment by May 18, 2020**

- **III.** **Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities**
  - **A. The Who, What, When and How of SBA Loan Review Procedures for Borrowers**

As opposed to the U.S. Department of the Treasury and SBA's "Frequently Asked Questions" document on the PPP, these IFRs serve as binding rules on PPP loan borrowers. This means that PPP loan borrowers must rely on and follow the information included in these IFRs. That stated, each one of these IFRs could be revised before they become final rules.

Under the notice and comment requirements of the Administrative Procedures Act, the public must have at least 30 days from the IFR's publication in the Federal Register to comment on it. AGC will provide comments on these IFRs and encourages AGC members to share their thoughts and concerns with these IFRs to AGC's Director, Congressional Relations, Tax, Fiscal Affairs, & Accounting Matt Turkstra at matthew.turkstra@agc.org.

In the document below, AGC lays out a brief overview of each one of these IFRs, focusing on the items of greatest importance to the construction industry. The association also notes the possibility of certain legislative or regulatory to occur.

The information in this document is for educational purposes only, as nothing in the document constitutes legal advice. AGC recommends that its members consult legal and accounting professionals to assist them with interpreting these regulations concerning their circumstances.

I. Interim Final Rule on Loan Forgiveness

The IFR on Loan Forgiveness provides significant information borrowers will need to properly complete the loan forgiveness application. The information below provides some insight into this IFR by also incorporating important pieces on loan forgiveness from the First IFR the SBA issued on the PPP.

A. The 75%/25% payroll cost/non-payroll cost forgiveness rule.

- The IFR on Loan Forgiveness maintains the restrictive 75%/25% rule for determining forgivable costs. Under this rule—as set forth in the First IFR—loan forgiveness is available for applicable payroll costs representing 75% of the total PPP loan. Meanwhile, loan forgiveness is available for applicable non-payroll costs (e.g., mortgage, rent or utilities payments) up to 25% of the total PPP loan.
  - **AGC Advocacy & Outlook:** AGC opposes the 75%/25% forgiveness rule, as it is not included in the statute and hampers the flexibility Congress intended to give construction contractors when it established this program. AGC included reasoned arguments for why this rule cannot stand legal muster under federal regulatory law in recent comments to the SBA. In addition, AGC is working with members of Congress to repeal this arbitrary and capricious rule through legislation. The House of Representatives is scheduled to vote on such legislation the week of May 25. There is also bipartisan support for such a change in the Senate. However, it is unclear if the Senate will vote in short order on standalone legislation that includes this change (or PPP changes in general) or incorporate it and other PPP reforms into the next pandemic relief bill.

B. Payroll costs eligible for loan forgiveness.

- Forgivable payroll costs. Up to 75% of the PPP loan used for payroll costs may be forgiven. This section provides a high-level overview of the items defined as "payroll costs" under the SBA regulations in the First IFR and this IFR on Loan Forgiveness to provide perspective on the definition of "payroll costs."
  - The First IFR defined "payroll costs" to include compensation to employees (whose principal place of residence is the United States) in the form of:
    - salary, wages, commissions or similar compensation;
    - cash tips or the equivalent;
    - payment for vacation, parental, family, medical or sick leave;
    - allowance for separation or dismissal;
    - payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums, and retirement; and
    - payment of state and local taxes assessed on compensation of employees.

- The First IFR also expressly excluded the following from the definition of "payroll costs":

  - Any compensation to an employee whose principal place of residence is outside the United States;
  - The compensation of an individual employee in excess of an annual salary of $100,000, prorated as necessary;
  - Federal employment taxes imposed or withheld between February 15, 2020, and June 30, 2020, including the employee's and employer's share of Federal Insurance Contributions Act (FICA) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees; and
  - The wages for which a credit is allowed under the federal emergency paid sick leave (section 7001) and federal emergency paid family and medical leave (section 7003) of the Families First Coronavirus Response Act.

- The IFR on Loan Forgiveness provides additional clarification regarding forgivable payroll costs. The IFR specifically notes that:

  - Salary, wages or commission payments to furloughed employees during the eight-week covered period are eligible for forgiveness as long as they do not exceed an annual salary of $100,000, as prorated for the covered period.
  - If an employee's total compensation does not exceed $100,000 on an annualized basis, the employee's hazard pay and bonuses are eligible for loan forgiveness because they constitute a supplement to salary or wages, and are thus a similar form of compensation.
  - The amount of loan forgiveness requested for owner-employees and self-employed individuals' payroll compensation can be no more than the lesser of 8/52 of 2019 compensation (i.e., approximately 15.38% of 2019 compensation) or $15,385 per individual in total across all businesses.

    - Owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement and health care contributions made on their behalf.
    - Schedule C filers are capped by the amount of their owner compensation replacement, calculated based on 2019 net profit.
    - General partners are capped by the amount of their 2019 net earnings from self-employment (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235.
    - No additional forgiveness is provided for retirement or health insurance contributions for self-employed individuals, including Schedule C filers and general partners, as such are paid out of their net self-employment income.

- **AGC Advocacy & Outlook:** Another issue brought up by many construction firms has been the flexibility of the $100,000 annual salary cap calculation. For construction firms that can work throughout the year and have employees that do the same, the simple calculation of 8/52 multiplied by $100,000 (approximately $15,384 over eight weeks or $1,923 per week) covers them. However, many construction firms and their employees who work in northern areas of the country cannot perform work during the winter, early spring or late fall months of the year. As a result, they may not have begun work until weeks after receiving PPP loan funds and find themselves at a disadvantage for loan forgiveness based on the seasonal restrictions on their businesses. AGC plans to seek clarity for these construction firms in additional comments relating to seasonal businesses with PPP loans. Specifically, and at a minimum, AGC will seek that such firms have the flexibility to use the cap of the annualized $100,000 eight-week salary figure, even if such employees did not work or get paid during the entire eight-week period because of the seasonal nature of some construction.

- Timing of forgivable payroll costs. Payroll costs paid or incurred may be forgiven for such costs during the eight-week covered period beginning on either:

  - The date of disbursement of the borrower's PPP loan proceeds from the lender ("**the covered period**"); OR
  - The first day of the first payroll cycle in the covered period ("**the alternative payroll covered period**").

  - **AGC Advocacy & Outlook:** One of the most critical issue facing construction industry PPP borrowers is the brevity of the eight-week covered period for use of the loan proceeds. While some construction firms faced total work stoppages as a result of government orders, many others did not. For these others, while they may have had some work stoppages, project delays or cancellations, they continue to work through their project backlogs. As a result, many construction firms will not face the worst of the economic downturn until they work through those backlogs either later in 2020 or 2021. That is why AGC is working to extend the current eight-week covered period to at least 24-weeks. AGC-backed legislation in the House that includes this change could be passed as early as the week of May 25. Nevertheless, as noted above, how such legislation moves in the Senate remains unclear.

C. Non-payroll costs eligible for loan forgiveness

- Forgivable non-payroll costs.

  - Up to 25% of the PPP loan used for non-payroll costs may be forgiven. The IFR on Loan Forgiveness provides some more clarity to the First IFR regarding non-payroll costs eligible for forgiveness. Rather than merely state that mortgage, rent and utility costs are forgivable, it provides more flexibility and context that should be helpful to construction firms. Specifically, the IFR on Loan Forgiveness notes that forgivable non-payroll costs include:

    - Interest payments on any business mortgage obligation on real or personal property that was incurred before February 15, 2020 (but not any prepayment or payment of principal);
    - Payments on business rent obligations on real or personal property under a lease agreement in force before February 15, 2020; and
    - Business utility payments for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020.

  - *Construction firms take notice.* An important item to note about the forgivable non-payroll costs in this IFR is that it includes certain costs not only on real property, but also personal property (i.e., property that is not real property like land or buildings, but instead moveable property, like equipment). This is critical to the construction industry, in which equipment and vehicle fleet costs are significant. As a result, construction contractors may be able to receive forgiveness for payments on equipment and vehicle fleet costs under a lease agreement in force before February 15, 2020.

  - **AGC Advocacy & Outlook:** AGC's recent comments to the SBA addressed the need for such forgiveness consideration. There, the association discussed the capital-intensive nature of construction and the fact that payroll costs rarely amount to 75% of project costs. Payments on construction equipment also represent a significant cost that need to be considered for loan forgiveness, as construction businesses cannot pay their employees if they cannot pay for the equipment needed to complete projects.

- Timing of forgivable non-payroll costs. A non-payroll cost is eligible for forgiveness if it was (a) paid during the eight-week covered period; or (b) incurred during the covered period and paid on or before the next regular billing date, even if the billing date is after the eight-week covered period.

D. Reductions to loan forgiveness amount

- The loan forgiveness reduction calculation. Section 1106 of the CARES Act included a formula under which a borrower's loan forgiveness would be reduced.

  - *Selecting the reference period to compare to the payroll period.* The borrower must first select a reference period to compare with either the covered period[1] or the alternative payroll covered period[2]:

    - February 15, 2019, through June 30, 2019;
    - January 1, 2020, through February 29, 2020; OR
    - 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.

  - *Determining the impact of a reduction in number of full-time equivalent (FTE) employees on the amount of loan forgiveness.*

    - **The definition of FTE employee:** The IFR on Loan Forgiveness defines a full-time equivalent (FTE) employee as "an employee who works 40 hours or more, on average, each week." The hours of employees who work less than 40 hours are calculated as proportions of a single FTE employee and aggregated.

    - **The FTE reduction calculation:** When the average number of FTE employees during the covered period or the alternative payroll covered period is less than during

[1] As noted above, the "covered period" is the eight-week covered period beginning on the date of disbursement of the borrower's PPP loan proceeds from the lender.
[2] As noted above, the "alternative payroll covered period" is the eight-week covered period beginning on the first day of the first payroll cycle in the covered period.

the referenced period, the total eligible expenses available for forgiveness is reduced proportionally by the percentage reduction in FTE employees. For example, if a borrower had 10.0 FTE employees during the reference period and this declined to 8.0 FTE employees during the covered period, the percentage of FTE employees declined by 20% and thus only 80% of otherwise eligible expenses are available for forgiveness. This formula implements section 1106(d)(2) of the CARES Act, which expressly requires that the loan forgiveness amount be reduced by the amount resulting from multiplying the amount that the borrower would otherwise receive by the quotient of the average FTE employees in the relevant reference period divided by the average FTE employees in the covered period.

- <u>Calculating the average number of FTE employees</u>. Divide the average number of hours paid for each employee per week by 40, capping the quotient at 1.0. For example, an employee who was paid 48 hours per week during the covered period would be an FTE employee of 1.0.

  - For employees who were paid for less than 40 hours per week, borrowers may choose to calculate the full-time equivalency in one of two ways:

    - Calculating the average number of hours a part-time employee was paid per week during the covered period. For example, if an employee was paid for 30 hours per week on average during the covered period, the employee could be an FTE employee of 0.75; OR
    - Electing to use a full-time equivalency of 0.5 for each part-time employee.

      - Borrowers may select only ONE of these two methods and must apply that method consistently to all of their part-time employees for the payroll covered period or the alternative payroll covered period and the selected reference period.

  - In either case, the borrower must provide the aggregate total of FTE employees for both the selected reference period and the covered period or the alternative payroll covered period, by adding together all of the employee-level FTE employee calculations. The borrower must then divide the average FTE employees during the covered period or the alternative payroll covered period by the average FTE employees during the selected reference period, resulting in the reduction quotient.

- *Determining the impact of a reduction in employees' salary or wages on loan forgiveness.*

  - **General rule.** A reduction in an employee's salary or wages in excess of 25 percent will generally result in a reduction in the loan forgiveness amount, unless an exemption applies.

  - **New employees in 2020 and existing employees not paid more than the annualized equivalent of $100,000 in a 2019 pay period.** For each new employee in 2020 and each existing employee who was not paid more than the annualized equivalent of $100,000 in any pay period in 2019, the borrower must reduce the total forgiveness amount by the total dollar amount of the salary or wage reductions that are in excess of 25% of base salary or wages between January 1, 2020, and March 31, 2020 (the reference period), subject to exceptions for borrowers who restore reduced wages or salaries. This reduction is performed on a per employee basis, not in the aggregate.

- Exemptions from loan forgiveness reduction calculation.

  - In calculating the loan forgiveness amount, a PPP loan borrower may exclude any reduction in full-time equivalent employee headcount that is attributable to an individual employee if:

    - The borrower made a good faith, written offer to rehire such employee (or, if applicable, restore the reduced hours of such employee) during the covered period or the alternative payroll covered period, as discussed above;
    - The offer to rehire such employee was for the same salary or wages and same number of hours as earned by such employee in the last pay period to the separation or reduction in work hours;
    - The offer to rehire was rejected by such employee;
    - The borrower has maintained records documenting the offer and its rejection; AND
    - The borrower informed the applicable state unemployment insurance office of such employee's rejected offer of reemployment within 30 days of the employee's rejection of the offer.

  - 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 at the same full-time equivalency level before the FTE reduction event when calculating the FTE employee forgiveness reduction. Borrowers that avail themselves of this exemption must have records demonstrating that each employee was fired for cause, voluntarily resigned, or voluntarily requested a schedule reduction.

  - A borrower can avoid a reduction in its loan forgiveness amount if the borrower restores reductions made between February 15, 2020, and April 26, 2020 (the safe harbor period) to either:

    - employee salaries and wages by not later than June 30, 2020; OR
    - FTE employees by not later than June 30, 2020.

II. Interim Final Rule on Second Extension of Limited Safe Harbor with Respect to Certification Concerning Need for PPP Loan and Lender Reporting

The CARES Act requires that each applicant applying for a PPP loan certify in good faith "that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing obligations" of the applicant.

A. **Good faith need safe harbor for borrowers of PPP loans less than $2 million.** This IFR references the SBA and Treasury FAQ document guidance question #46 that provides any PPP borrower, together with its affiliates, that received PPP loans with an original principal amount of less than $2 million will be deemed to have made the required certification concerning the necessity of the loan in good faith.

   - **AGC Advocacy & Outlook**. On April 23, the SBA and Treasury issued guidance (question #31 of the FAQs document) that added additional considerations to the CARES Act good faith loan need certification to include a borrower's (a) "current business activity"; and (b) "ability to access other sources of liquidity." Shortly thereafter, the agencies issued question #39, stating that the SBA would review all loans in excess of $2 million, in addition to other loans as appropriate. AGC called into question these short-sighted and new parameters for PPP loan terms that were driving many AGC members to consider returning their PPP loan funds that they otherwise had a good faith need for under statute. In addition, the association and its members sent tens of thousands of messages to the Trump Administration and Congress pressing them for this guidance to be addressed and clarity to be had, among other things. Ultimately, this safe harbor came as a result of this persistent AGC advocacy. Because this IFR was published on May 26 in the Federal Register and comments on it are not due until June 25, it is not clear if a final rule will be released before June 30.

B. **Good faith need safe harbor for PPP loan repayment by May 18, 2020.** Any borrower that applied for a PPP loan and repaid the loan in full by May 18, 2020, will be deemed by SBA to have made the required certification in good faith.

   - **AGC Advocacy & Outlook.** There remains a lack of clarity for those AGC members with PPP loans of $2 million or more and how the SBA will review their good faith need for the loans, if they did not repay them by May 18, 2020. That is why AGC has called upon the agency to explain that construction firms that maintain strong cash reserves and access to credit sufficient to support their ongoing and future operations qualify for PPP loans if sufficient uncertainty exists about future economic conditions. Furthermore, SBA must clarify that construction firms that are actively working on current projects, but are sufficiently concerned about future economic uncertainty, are facing future project cancellations, or have otherwise seen a reduction in their construction backlog, will be deemed to have certified in good faith that current economic uncertainty makes their loan request necessary to support ongoing operations. In addition, the association will work to have the SBA include language in the final rule explicitly allowing PPP borrowers of $2 million or more to return those funds without penalty if SBA review determines the borrower did not meet the good faith need certification. Because this IFR was published on May 26 in the Federal Register and comments on it are not due until June 25, it is not clear if a final rule will be released before June 30.

III. Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities

A. The Who, What, When and How of SBA Loan Review Procedures Related to Borrowers

- Who may be subject to SBA loan review: A borrower PPP loan of any size.

- What may such a review cover: A borrower's PPP loan eligibility, loan amount granted, use of loan funds and loan forgiveness amount.

  - It should be noted that there is likely a distinction between a borrower's loan eligibility (i.e., the borrower's business—or the aggregate number of employees among its affiliates—has 500 or fewer employees) and the good faith certification for the need of the loan discussed above. AGC will seek clarity on this in its comments.

- When may the SBA review loans: At any time in SBA's discretion within six years after the date the PPP loan is forgiven or repaid in full. However, based on the IFR, a key time and place for inquiries to arise would be during lender review of the PPP loan forgiveness application.

- How will this SBA loan review process take place: If loan documentation indicates that the borrower may not have been eligible for a PPP loan, a loan of the amount granted, or loan forgiveness claimed, the SBA or the lender on the SBA's behalf will contact the borrower in writing. Failure to respond to any inquiry may result in a determination that the borrower did not qualify for any of the aforementioned items. A borrower may appeal any ineligibility determinations, which the SBA will address in another, separate IFR.