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PPP Borrowers may Choose the 24-week Covered Period and Apply Early for Loan Forgiveness

The Small Business Administration (SBA) issued another [Interim Final Rule on June 22, 2020](#), addressing loan forgiveness and loan review procedures. The June 22 Interim Final Rule amends the Interim Final Rules originally posted on May 22, 2020.

The June 22 Interim Final Rule clarifies that borrowers may file their loan forgiveness applications at any time on or before the maturity date of the loan, including before the end of the forgiveness covered period (e.g., the 8-week or 24-week period as selected by the borrower). This option may be appealing to borrowers who have used all their Paycheck Protection Program (PPP) funds. The June 22 Interim Final Rule also clarifies that borrowers unable to operate during the forgiveness covered period at the same level of business activity before February 15 due to state and local shutdown orders should qualify for the new full-time equivalent (FTE) reduction safe harbor created by the Paycheck Protection Program Flexibility Act. With these new clarifications, borrowers who have a choice of 8-week or the 24-week forgiveness covered period should consider any salary/hourly wage and FTE reductions for each covered period and when it makes sense for them to apply for loan forgiveness to maximize their loan forgiveness amount.

Is the Salary Reduction Test a Factor?

If borrowers file before the end of the covered period, borrowers need to consider the impact of the salary/hourly wage reduction and the average FTE reduction to the forgiveness amount. The salary/hourly wage reduction requires a borrower, to the extent it cannot fall within the safe harbor, to reduce its total forgiveness amount by the aggregate value of all salary/hourly wage reductions during the covered period that exceed 25% of the salary/hourly wage of the individual employee (compared to the average salary/hourly wage of the employee during the period of January 1,

2020 to March 31, 2020) if the employee earned \$100,000 or less at an annualized rate for all pay periods in 2019. Borrowers are required to aggregate the salary/hourly wage reductions for the full 8-week or 24-week period, as applicable, and subtract this amount dollar-for-dollar from the potential forgiveness amount.

The implications of this requirement are best explained through an example. We will start with a borrower that is using the 24-week covered forgiveness period but intends to file its forgiveness application at week 12 (i.e., all PPP funds have been used within the first 12 weeks). If there is a full-time salaried employee who earned \$1,000 per week for January 31 through March 31, 2020 (who continues to work full time) who only earns \$700 per week during the 12 weeks, then \$50 for each week of the covered period must be aggregated and shown as a reduction to the forgiveness amount (noting that the first \$250 of the reduction is within the 25% reduction threshold).

Even though the application is filed at week 12, the full reduction amount is \$1,200 (\$50 x 24). The amount of the applicable salary reduction that exists at the time the application is filed will set the mark that is carried through the entire covered forgiveness period. Even if the borrower is able or intends to return the employee's rate of pay to \$1,000 later in the covered period, this will not change the required reduction to the forgiveness amount if the application is filed early. If a borrower expects to increase salary or wages before the end of the covered period, they may want to wait to file their forgiveness application until after any such increase to the annual salary/hourly wage for the covered period.

However, if a borrower has employees with salary/hourly wage reductions that are eligible for the Salary/Hourly Wage Safe Harbor (i.e., with salary or wage reductions occurring between February 15 and April 26, 2020 that are restored to their February 15, 2020 level), filing as soon as the salary or wages are restored is probably advantageous. The forgiveness application allows a borrower to exclude any reduction in salary/wages for the entire covered period so long as these are returned to the February 15, 2020 level before the earlier of the application date or December 31, 2020 (noting that the previous "return to" date was June 30, 2020 prior to the

June 5, 2020 effectiveness of the Paycheck Protection Flexibility Act). Using our example above, if the average annual salary of the individual was \$52,000 (\$1,000 x 52) on February 15, 2020 but is effectively reduced to \$36,400 (\$700 x 52) between February 15 and April 26, 2020, and the salary is returned to the original weekly equivalent of \$52,000, or \$1,000 per week, in week 12 of the covered forgiveness period when the application is filed, there will be no reduction to the forgiveness amount relating to this employee. Filing early will reduce the risk that later employee or salary reductions will have an impact on the amount to be forgiven.

Is the FTE Reduction Test a Factor?

The June 22 Interim Final Rule only addresses the salary/hourly wage reduction to the forgiveness amount if a borrower files for loan forgiveness prior to the end of the chosen forgiveness covered period and is silent as to the potential reduction to forgiveness that results from a reduction in the number of FTE employees. While not specifically addressed, it appears that borrowers in this situation will need to carry through the average FTE that exists at the time of filing the forgiveness application through the remainder of the covered forgiveness period. The forgiveness application requires that the average FTE, like the salary/hourly wage level, be determined for the applicable covered forgiveness period, either the 8-week period or the 24-week period. Carrying through this average may not be as mathematically significant on a per employee basis, as compared to doing this for the salary reduction test, since it is a comparison of rounded averages and not the determination of a dollar amount. The calculation should not take into account any FTE reductions that occur after the borrower files for loan forgiveness. Because the June 22 Interim Rule specifically permits the filing of an application before the end of a covered period, borrowers who will have to reduce their FTE may want to consider filing early before making the reductions.

Borrowers intending to take advantage of the FTE Reduction Safe Harbor relating to reductions in FTE during the period of February 15 to April 26, 2020 in which FTE are returned (now known as FTE Reduction Safe Harbor 2) will find a similar treatment as the

Salary/Hourly Wage Reduction Safe Harbor. Borrowers can take advantage of this safe harbor, and realize no reduction to the forgiveness amount for FTE reductions during this period so long as the FTE are returned to their February 15, 2020 level by the earlier of the application date or December 31, 2020. Borrowers who have returned their FTE to the February 15, 2020 level and want to take advantage of this safe harbor should consider filing their forgiveness application before the end of their covered period, particularly if they are either unsure of future FTE levels or if they plan further FTE reductions.

It is important to remember that both the salary reduction and FTE reduction can apply. Borrowers will need to carefully determine the impacts under both tests before deciding to file early or waiting until the end of their covered period.

Is the FTE Reduction Safe Harbor for an Inability to Operate a Factor?

The PPP Flexibility Act created a new safe harbor to the FTE reduction to the forgiveness amount for borrowers who are:

The June 22 Interim Final Rule establishes critical flexibility in the application of this new safe harbor. Direct or indirect compliance with state and local government restrictions or shutdowns (e.g., “stay-at-home” orders) based on the guidance of the referenced federal agencies will fit within the safe harbor. This addresses the concern of several commentators that since the federal agencies did not actually restrict operations, but just issued guidance, the safe harbor would be of limited value.

Borrowers must be able to certify in the forgiveness application that they have been unable to operate between February 15, 2020 and the end of their covered period at the same level as they were prior to February 15, 2020. While the language of the application is not clear, it appears the requirement applies to any period between February 15, 2020 and the end of the covered period and does not require that the inability to operate apply to the entire timeframe. Most state and local government orders did not begin until mid-March at the earliest. The safe harbor leaves room for new guidance

or orders to be issued before December 31, 2020 that will still entitle borrowers to claim the safe harbor.

Use of this safe harbor is not expected to be relevant to the decision whether to file for forgiveness early. What will be important is a borrower's ability to document the inability to operate at the same pre-pandemic level due to compliance with applicable restrictions. While many borrowers (e.g., restaurants and retailers) will be able to create a clear connection between their inability to operate at pre-pandemic levels due to direct compliance with the restrictions or guidance, many more borrowers will need to carefully consider arguments around "indirect" compliance that may be eligible to fit within the safe harbor. In some situations, this will circle back to those early decisions made concerning what constituted an "essential business" and the approach taken by the applicable state or local government, not to mention the definition of what constitutes an inability to operate at the same level as before February 15, 2020.

The timing of filing a forgiveness application also has significant implications for the payment deferral period of PPP loans. Please see our article [SBA Issues New Forgiveness Applications \(and You Don't Need to Wait Until After December 31 to Apply\)](#) for more information concerning this issue.

As we have become accustomed to with nearly all facets of the PPP, each answer we receive from the SBA tends to lead to its own questions. Our SBA Lending Team will work with borrowers to accurately complete their forgiveness applications and identify the best time to file. For more information, please contact [Becky Moore](#), [Shannon Kuhl](#), or any attorney with Frost Brown Todd's [Financial Services](#) industry team.

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