



PAYCHECK PROTECTION LOANS

Last updated May 14, 2020

OVERVIEW

By Laura Fent, with contributions by Scott Pohl, Scott MacBeth, Chris Arellano, and Krystle Dalke

One of the most helpful set of provisions to small businesses in the *Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”)*, signed by President Trump on March 27, 2020, may be the *Paycheck Protection Program (the “Program”)*. Below is an overview of the Program. Businesses should contact their primary attorney to obtain additional information and for assistance through the process. Lenders began accepting applications on April 3, 2020, and the first tranche of funding was exhausted on April 16, 2020. Additional funding in the amount of **\$310 billion** was approved and is currently being disbursed.

Interpretation of the CARES Act, with respect to the Program, is in a state of flux. However, borrowers may rely upon the laws and guidance available to them at the time of their application (*See FAQ # 17*). The Small Business Administration (“SBA”) has issued several interim final rules with respect to the Program (*collectively, the “[Interim Final Rule](#)”*). In addition, the SBA and the Department of Treasury collaborate to issue frequently asked questions (*collectively, “[FAQ](#)”*) on a regular basis. Although these sources of guidance have answered many questions by legal practitioners and the business community alike, they have raised far more.

The Benefit. *How does the Payment Protection Program benefit small businesses?*

Eligible businesses may apply for a Small Business Administration or “SBA” loan to cover expenses such as payroll, rent, interest on mortgage payments, and utilities and, if the loan is used by the business to pay for these expenses, the amount so used will be forgiven. Among other things, any amount forgiven, which would normally be included in gross income, is excluded from gross income.

In reviewing this alert, please keep in mind, however, that there are other SBA programs which may also provide benefits to small businesses.

Economic Injury Disaster Loan. Can I apply for a loan pursuant to the Program if I've already received an economic injury disaster loan after January 31, 2020?

Yes. The economic injury disaster loan may be refinanced as part of the loan pursuant to the Program.

Eligible Businesses.

Which businesses are eligible?

In addition to “small business concerns” as historically defined in the Small Business Act, “any business concern, nonprofit organization, veterans organization, or Tribal business concern described in section 31(b)(2)(C)” will be eligible to receive the loan if it has **500 employees or less** (see the “Affiliation Rules” section below to determine affiliates for calculating size of business). However, on an industry-by-industry basis, the ceiling on the number of employees to determine eligibility may be higher. Preference is given to businesses in operation on February 15, 2020, with paid employees or independent contractors. No business may apply for more than one loan under the Program.

See FAQ #9 with respect to seasonal businesses not in business on February 15, 2020, but which might be eligible if in operation between February 15, 2019, and June 30, 2019.

See FAQ #10 with respect to professional employer organizations (“PEOs”).

See FAQ #12 with respect to businesses owned by individuals with criminal records.

See FAQ #34 with respect to agricultural producers, farmers, and ranchers.

See FAQ #35 with respect to agricultural and other forms of cooperatives.

See FAQ #38 with respect to businesses experiencing a change of ownership after February 15, 2020.

See FAQ #42 with respect to nonprofit hospitals exempt from taxation under section 115 of the Internal Revenue Code as to whether they qualify as “nonprofit organizations”.

See Interim Final Rules generally; See Interim Final Rule – Additional Criterion for Seasonal Employers.

See Interim Final Rule – Promissory Notes, Authorizations, Affiliation, and Eligibility relative to the eligibility of hedge fund or private equity firms; portfolio

company of private equity funds; hospitals owned by governmental entities; and businesses involved in bankruptcy proceedings.

Sole proprietorships or independent contractors?

Are eligible. They will need to document their eligibility by providing documentation, including payroll tax filings reported to the Internal Revenue Service, Forms 1099-MISC, and income and expenses from the sole proprietorship.

See Interim Final Rule for details regarding how to calculate the maximum loan amount and required documentation.

Partners and Partnerships?

In the Interim Final Rule the SBA announced that partners of a partnership may not submit separate Program loan applications. Instead, the self-employment income of “general active partners” may be reported as a payroll cost, up to \$100,000 annualized, on a Program loan application filed by or on behalf of the partnership.

Accommodation and food services with more than 1 physical location?

Are also eligible for a loan.

Are there reasons my business may be disqualified from participating in the Program?

Yes, even if your business otherwise meets the eligibility criteria set forth above, the business will be disqualified if your business:

- Is engaged in an illegal activity;
- Is a household employer;
- Is owned 20% or more by an individual who is incarcerated, on probation, on parole; presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction; or has been convicted of a felony within the last five years; or
- Or any business owned or controlled by you or any of your owners, has a currently delinquent, or defaulted in the last 7 years, SBA or other federal loan causing a loss to the government.

See Interim Final Rule.

Number of Employees. Who counts as an “employee” for purposes of determining whether a business is eligible for a loan?

Employee is broadly defined to include individuals employed on a full-time, part-time, or other basis. *See FAQ #36.*

Loan Period. *How long will the SBA make loans pursuant to the Payment Protection Program?*

The period covered by the Program commences February 15, 2020, and ends June 30, 2020.

Maximum Loan Amount Calculation. *How does a business determine the maximum amount of a loan for which it is eligible?*

For businesses in operation between February 15, 2019, and June 30, 2019, the maximum loan amount is the *lesser of (a) \$10,000,000 and (b) the outstanding amount of a loan made under the SBA's disaster loan program, between January 31, 2020, and the date such loan is refinanced through the Program, plus, the product obtained by multiplying the following:*

- One of the following calculations:
 - the average total monthly payments by the applicant for payroll costs incurred during the 1-year period before the date on which the loan is made (*See FAQ #14 which also permits borrowers to use data from calendar year 2019*); or
 - in the case of an applicant that is a seasonal employer, as determined by the SBA, either, at the election of the business, the average total monthly payments for payroll: (i) beginning February 15, 2019, and ending June 30, 2019, or (ii) beginning March 1, 2019, and ending June 30, 2019 (*See FAQ #14; See Interim Final Rule – Additional Criterion for Seasonal Employers for additional guidance*);
- by 2.5.

Note that there is a similar, but different, calculation for businesses that are otherwise eligible, but were not in business during the period from February 15, 2019, to June 30, 2019 (*See FAQ #14 in which such businesses may use the average monthly payroll costs for the period January 1, 2020, through February 29, 2020*).

No business may apply for more than one loan under the Program, so borrowers should consider applying for the maximum loan amount for which they are eligible. *See Interim Final Rule.*

Covered Costs. *How can the proceeds of the loan be used?*

Below is a complete listing of the allowable uses of the proceeds from the loan pursuant to the CARES Act:

- payroll costs (*See FAQ #15 relative to independent contractors and sole proprietors whose compensation must be excluded from this calculation*);
- costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- employee salaries, commissions, or similar compensations;
- payments of interest on any mortgage obligation (which shall not include any prepayment of or payment of principal on a mortgage obligation);
- rent (including rent under a lease agreement);
- utilities;
- interest on any other debt obligations that were incurred before February 15, 2020; and
- refinancing an SBA EIDL loan made between January 31, 2020, and April 3, 2020 (if the EIDL loan was used for payroll costs, the loan under the Program must be used to refinance the EIDL loan).

See the Interim Final Rule.

Payroll Costs.

What types of costs are included in payroll costs?

Below is a complete listing of applicable payroll costs, of any compensation with respect to employees, set forth in the CARES Act:

- salary, wage, commission, or similar compensation (*See “What types of payroll costs may not be included below; See FAQ #15 relative to independent contractors and sole proprietors whose compensation must be excluded from this calculation; See FAQ #16 which explains payroll costs are calculated on a gross basis with respect to the employee; but do not include the employer’s share of payroll costs; See FAQ #32 concerning the inclusion of housing stipends and/or allowances*);
- payment of cash tip or equivalent;
- payment for vacation, parental, family, medical, or sick leave (*See FAQ #8*);
- allowance for dismissal or separation;
- payment required for the provisions of group health care benefits, including insurance premiums;

- payment of any retirement benefit; or
- payment of State or local tax assessed on the compensation of employees.

Payroll costs for sole proprietors or independent contractors applying for a loan under the Program include any compensation to, or income of, the sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, or similar compensation and that is in an amount that is not more than \$100,000 in 1 year, as prorated for the covered period.

What types of payroll costs may not be included?

Below is a complete listing of payroll costs that may not be included in the loan:

- the compensation of an individual employee in excess of an annual salary of \$100,000, as prorated for the covered period (note that this exclusion only applies to cash compensation, not to non-cash benefits). *See FAQ #7; See FAQ #15 relative to independent contractors and sole proprietors whose compensation must be excluded from this calculation.*
- taxes imposed or withheld under chapter 21 (i.e., FICA, relating to taxes for social security and Medicare), chapter 22 (i.e., Railroad Retirement Tax Act, relating to the taxes to fund the retirement program of U.S. railroad workers, who, as a group, do not participate in social security), or chapter 24 (i.e., income tax withholding from wages and from interest and dividends) of the Internal Revenue Code of 1986 during the covered period. The SBA interprets the foregoing exclusion to mean that payroll costs are not reduced by the amount of federal income tax withholding or the employee portion of FICA (*See FAQ #16*);
- any compensation of an employee whose principal place of residence is outside of the United States (*See FAQ #33 which states that IRS regulations may be considered when determining whether an individual employee's principal place of residence is in the United States*);
- qualified sick leave wages for which a credit is allowed under section 7001 of the Families First Coronavirus Response Act (Public Law 116–127); or
- qualified family leave wages for which a credit is allowed under section 7003 of the Families First Coronavirus Response Act (Public Law 116–127).

Borrower Certification.

What certifications should a business be prepared to make?

The authorized representative of a business should be prepared to, and will be required to, make certain certifications, including, without limitation, the following certifications:

- the applicant was in operation on February 15, 2020, and had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC;
- that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient;
- the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- if the funds are knowingly used for unauthorized purposes, the federal government may hold the authorized representative legally liable (such as for charges of fraud);
- documentation verifying the number of full-time equivalent employees on payroll as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities for the eight week period following this loan will be provided to the lender;
- loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities;
- there is no application pending for a loan pursuant to the Program for the same purpose and duplicative of amounts applied for or received under a covered loan;
- not more than 25 percent of loan proceeds may be used for non-payroll costs and not more than 25 percent of the forgiven amount may be for non-payroll costs;
- during the period beginning on February 15, 2020, and ending on December 31, 2020, the applicant has not and will not receive another loan under the Program;
- the information provided in the application and the information provided in all supporting documents and forms is true and accurate in all material respects;
- knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law; and
- lender will confirm the eligible loan amount using tax documents submitted; these tax documents are identical to those submitted to the IRS; and lender can share the tax information with SBA's authorized representatives.

See the Interim Final Rule.

See FAQ #11 with respect to individuals authorized to sign on behalf of borrowers.

See FAQ #41 relative to certifications made by seasonal employers.

Is there any guidance as to the certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of Applicant”?

The SBA provided additional guidance relative to this certification on **May 13, 2020**. *See FAQ #46*. In FAQ #46, the following guidance was provided:

Loans less than \$2 Million.

“When submitting a PPP application, all borrowers must certify in good faith that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” SBA, in consultation with the Department of the Treasury, has determined that the following *safe harbor* will apply to SBA’s review of PPP loans with respect to this issue: ***Any borrower that, together with its affiliates, 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 request in good faith.*** SBA has determined that this safe harbor is appropriate because borrowers with loans below this threshold are generally less likely to have had access to adequate sources of liquidity in the current economic environment than borrowers that obtained larger loans. This safe harbor will also promote economic certainty as PPP borrowers with more limited resources endeavor to retain and rehire employees. In addition, given the large volume of PPP loans, this approach will enable SBA to conserve its finite audit resources and focus its reviews on larger loans, where the compliance effort may yield higher returns.

Loans greater than \$2 Million.

Importantly, borrowers with loans greater than \$2 million that do not satisfy this safe harbor may still have an adequate basis for making the required good-faith certification, based on their individual circumstances in light of the language of the certification and SBA guidance. SBA has previously stated that all PPP loans in excess of \$2 million, and other PPP loans as appropriate, will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form. If SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek

repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. ***If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request. SBA's determination concerning the certification regarding the necessity of the loan request will not affect SBA's loan guarantee.***

Can a borrower repay a loan made under the Program if it no longer believes it made the required certifications in good faith?

Yes, a borrower repaying a loan made under the Program shall be deemed to have made the required certifications in good faith, as long as the repayment is made on or before **May 18, 2020**. See FAQ #47; See the Interim Final Rule.

Will the SBA review loans made under the Program?

The SBA will review all loans made under the Program in excess of \$2 Million, as well as other loans as appropriate. The review will occur after submission of the request for forgiveness. See FAQ #39.

Loan Terms. Upon what terms and conditions will the SBA be providing these loans?

The terms and conditions are more favorable than a typical SBA loan. Below is a non-exhaustive list of the major terms and conditions:

- Elimination of certain fees, including up-front guarantee fee payable to SBA;
- No personal guaranties;
- No collateral;
- No recourse for non-payment against any individual, shareholder, member, or partner; unless loan proceeds are used for an unauthorized purpose;
- 1% interest rate (*See Interim Final Rule*);
- 2 year maturity (*See Interim Final Rule*);
- Deferral of payment of principal, interest, and fees for 6 months following the date of disbursement of the loan, with interest accruing during the deferral period (*See Interim Final Rule*); and
- No prepayment penalty.

Loan Forgiveness.

How does forgiveness work for a loan made pursuant to the Program?

The borrower will need to subsequently apply for loan forgiveness. The full amount of principal and accrued interest will be forgiven to the extent of the following costs ***incurred and paid**** by the borrower during the 8 week period commencing on the

date the lender makes the first disbursement of the loan (*See FAQ #20 and Interim Final Rule - Disbursements for additional timing guidance*):

- Payroll costs;
- Any payment of interest on any covered mortgage obligations incurred before February 15, 2020 (which shall not include any prepayment of or payment of principal on a covered mortgage obligation);
- Any payment on any covered rent obligation incurred before February 15, 2020; and
- Any covered utility payment under service agreements dated before February 15, 2020.

No more than 25% of the loan forgiveness amount may be attributable to non-payroll costs (*See Interim Final Rule*).

**Note that the interpretation of this phrase is the subject of discussion.*

Under what circumstances would I not be eligible for the full forgiveness amount?

There are two separate calculations pursuant to which the forgiveness amount could be reduced - one relative to number of employees and one relative to salary and wages.

Number of Employees. The amount which is eligible for forgiveness (based upon the amounts calculated immediately above) will be reduced, and not eligible for an increase, by multiplying that amount by the quotient obtained by dividing:

- the average number of full-time equivalent employees* per month employed by the eligible recipient during the covered period; by
- one of the following calculations:
 - at the election of the borrower:
 - the average number of full-time equivalent employees per month employed by the eligible recipient during the period beginning on February 15, 2019, and ending on June 30, 2019; or
 - the average number of full-time equivalent employees per month employed by the eligible recipient during the period beginning on January 1, 2020, and ending on February 29, 2020; **or**
 - in the case of an eligible recipient that is a seasonal employer, as determined by the SBA, the average number of full-time equivalent

employees per month employed by the eligible recipient during the period beginning on February 15, 2019, and ending on June 30, 2019.

*Determined by calculating the average number of full-time equivalent employees for each pay period falling within a month.

Salary and Wages. The amount which is eligible for forgiveness will be reduced by the amount of any reduction in total salary or wages of any full-time equivalent employee** during the 8 week forgiveness period that is in excess of 25 percent of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the 8 week forgiveness period.

**Any employee who did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000.

Exemption for Re-Hires. *Am I ineligible if I laid off employees or reduced salaries and wages?*

No, the amount of loan forgiveness for which a borrower is eligible will not take into consideration reductions in the number of full-time equivalent employees, or reductions in the salary of 1 or more employees, during the period commencing February 15, 2020, and ending on April 26, 2020, if:

- during that period, there is a reduction, as compared to February 15, 2020, in the number of full-time equivalent employees ***and***, not later than June 30, 2020, the reduction has been eliminated; and
- during that period, there is a reduction, as compared to February 15, 2020, in the salary or wages of 1 or more employees ***and***, not later than June 30, 2020, the reduction has been eliminated.

See FAQ #40 which addresses the effect on forgiveness that an offer of rehire of the same employee has when declined by the employee.

Presumption and Processing Priority.

The CARES Act mandates the presumption that applicants for a loan qualify for payment deferment relief. The CARES Act also mandates that the SBA issue guidance to lenders to prioritize processing of disbursement to small businesses and entities in underserved and rural markets, including veterans and members of the military community, small businesses owned and controlled by socially and economically disadvantaged individuals, women, and businesses in operation for less than 2 years.

Loan Forgiveness Application Process.

What documentation will businesses need to provide to the SBA lender as part of the application process to request loan forgiveness?

The documentation to be provided includes:

- documentation verifying the number of full-time equivalent employees on payroll and pay rates, including payroll tax filings reported to the Internal Revenue Service; and state income, payroll, and unemployment insurance filings;
- documentation, including cancelled checks, payment receipts, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments;
- a certification that the documentation presented is true and correct and the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation, or make covered utility payments; and
- any other documentation the SBA determines is necessary.

When will a business know whether loan forgiveness has been granted?

The lender must issue a decision within 60 days after the application for loan forgiveness has been submitted.

Misuse of Loan Proceeds. What happens if the proceeds of a loan under the Program are misused?

In addition to repayment of the misused amounts, knowingly using funds for an unauthorized purpose will potentially subject your business and/or owners to liability for fraud.

See the Interim Final Rule.

AFFILIATION RULES

By Krystle Dalke

When determining eligibility for SBA loans under the Program provided by the CARES Act, applicants must identify their affiliates to properly determine their size. To be eligible for a Program loan, unless you fit within an exception (see the “Eligible Businesses” section above), your business must not employ the greater of (i) 500 employees or (ii) the number of employees allowed by the employee-based size standard applicable to that entity. Therefore, correctly determining your business’s size is necessary before applying for a Program loan.

Determining Size.

What elements does the SBA count to determine the size of my business?

When determining whether a business qualifies as a small business, the SBA counts the following:

- **Receipts**, as defined in 13 C.F.R. § 121.104, which generally include “total income” plus “cost of goods sold” as defined by the IRS and reported on tax return forms;
- **Employees**, which includes all full-time employees, part-time employees, and employees from temp agencies; or
- Other measures of size, *i.e.* set industry standards.

When counting employees, the SBA considers the totality of the circumstances, including criteria used by the IRS for federal income tax purposes when determining whether individuals are employees or independent contractors.

If the SBA determines that an affiliation exists, then the SBA also counts all of the receipts, employees, or other measures of size of the business’s domestic and foreign affiliates, regardless of whether the affiliates are organized for profit. *See FAQ #44.*

Exceptions under the CARES Act. *What exceptions to the SBA’s affiliation rules does the CARES Act carve out?*

The CARES Act, expressly waives the SBA’s affiliation principles for:

- Any business in the accommodation and food services sector (NAICS Code starting with “72”), e.g. hotels and restaurants, with less than 500 employees at each physical location as of the date on which the loan is disbursed (*See FAQ # 24*);

- Any business operating as a franchise that is assigned a franchise identifier code by the SBA, which can be found in the SBA Franchise Directory (*See FAQ # 23*);
- Any business that receives financial assistance from a Small Business Investment Corporation; or
- The SBA's Interim Final Rule issued on April 2, 2020, also exempts faith-based organizations from the SBA's affiliation rules, provided that they are otherwise eligible for a Program loan. Specifically, the relationship between a faith-based organization and other organization is not an affiliation if the relationship is based on a religious teaching or belief or otherwise constitutes a part of the exercise of religion.

If your business does not fall under one of these exceptions, then the SBA's general affiliation principles apply to determine the size of your business. The SBA's affiliation principles may be broader than what you expect. Below is an overview of the SBA's affiliation principles as they relate to Program loans under the CARES Act.

Affiliation.

How do I identify an affiliate of my business?

Businesses and other third parties are affiliates of your business if the business or third party controls or has the power to control your business. It does not matter whether control is exercised as long as the power to control exists. Control may be affirmative or negative, and directly or indirectly exercised.

What factors does the SBA consider?

The SBA considers the following factors when determining whether affiliation exists:

- Ownership;
- Management;
- Identity of interests; and
- Relationships and contractual relationships.

What are examples of affiliation that are applicable to borrowers of Program loans?

- ***Stock Ownership.*** Stock ownership is a key factor when determining an individual's or entity's power to control your business. Affiliation will be found in the following circumstances:

- Any individual or entity owning or controlling, or being able to control **more than** 50% of voting equity.
 - Minority owners who, under the entity's corporate governance documents, have the ability to prevent a quorum or otherwise block action by the board of directors and/or other owners. Please note, however, that a minority owner can irrevocably give up such right of control and not be considered an affiliate (assuming no other relationship triggers affiliation).
 - If no individual or entity is found to control, then the business's board of directors and CEO or president, or other officers, managing members, or controlling partners will be deemed to have the power to control the business.
- *Stock Options, Convertible Securities, and Agreements to Merge.* The SBA treats the rights granted in stock options, convertible securities, and agreements to merge (including agreements in principle or to sell stock) as though such rights have been exercised. Affiliation exists when the rights afforded by any such document confer control or the power to control.
 - *Common Management.* When one or more officers, directors, managing members, or controlling partners of a business control the board of directors and/or management of another business. Similarly, affiliation arises when an individual or entity controls the management of the applicant through a management agreement. The SBA Interim Final Rule issued on April 2, 2020, recommends that applicants use the Borrower Application Form, SBA Form 2483, updated April 2, 2020, to assess whether they have affiliates under the common management standard.
 - *Identity of Interest.* For Program loans, affiliation arises when there is an identity of interest among close relatives, i.e. married couples, parties to civil unions, parents, children, and siblings, with identical or substantially identical business or economic interests. An example is when family members operate businesses in the same or similar industry in the same city.

See Interim Final Rule – Promissory Notes, Authorizations, Affiliation, and Eligibility concerning treatment of employee stock ownership plans (ESOP) under the affiliation rules.