



PAYCHECK PROTECTION LOANS

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One of the most helpful set of provisions to small businesses in the *Coronavirus Aid, Relief, and Economic Security or “CARES Act”*, signed by President Trump on March 27, 2020, may be the *Payment 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. Currently, it is anticipated that lenders may be in a position to start accepting applications as early as *April 3, 2020*. The SBA is required to issue guidance and regulations on or before *April 27, 2020*.

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.

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.

Accommodation and food services with more than 1 physical location?

Are also eligible for a loan.

Number of Employees. *What 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.

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; or
 - in the case of an applicant that is seasonal employer, as determined by the SBA, either, at the election of the business, the average total monthly payments for payroll for: (i) the 12-week period beginning February 15, 2019, or (ii) beginning March 1, 2019, and ending June 30, 2019; by

- 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.

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;
- 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; and
- interest on any other debt obligations that were incurred before the covered period.

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;
- payment of cash tip or equivalent;
- payment for vacation, parental, family, medical, or sick leave;
- 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.

Also included is any compensation to, or income of, a 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;
- 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;
- any compensation of an employee whose principal place of residence is outside of 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?*

A business should be prepared to, and will be required to, make the following certifications:

- that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient;
- acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- does not have an 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; and
- during the period beginning on February 15, 2020, and ending on December 31, 2020, has not received amounts pursuant to the Program for the same purpose and duplicative of amounts applied for or received under a covered loan.

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 loan origination and processing fees;
- 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;

- Maximum 4 percent interest rate;
- To the extent a portion of the outstanding principal balance is not forgiven, the loan will continue to be guaranteed by the SBA, with a maximum maturity of 10 years from the date on which the borrower applies for loan forgiveness;
- Deferral of payment of principal, interest, and fees for 6 months (not to exceed 1 year) with respect to borrower's in operation on February 15, 2020; 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 loan 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 of the origination of the loan:

- Payroll costs;
- Any payment of interest on any covered mortgage obligation (which shall not include any prepayment of or payment of principal on a covered mortgage obligation);
- Any payment on any covered rent obligation; and
- Any covered utility payment.

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 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, ending 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 not later than June 30, 2020, the reduction has been eliminated.

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 business concerns and entities in underserved and rural markets, including veterans and members of the military community, small business concerns 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.

AFFILIATION RULES

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 PPP 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 PPP 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.

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;
- 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; or
- Any business that receives financial assistance from a Small Business Investment Corporation.

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 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;

- Previous relationships or ties; and
- Contractual relationships.

However, the SBA may find affiliation even though no single factor is sufficient to constitute affiliation.

What are examples of affiliation?

- *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 (i) 50% or more of voting stock or (ii) a large percentage of voting stock when compared to all other outstanding blocks of stock even though the percentage owned is less than 50%.
 - Stockholders of minority holdings that are equal in size and taken together are large compared to any other stock holdings.
 - If a business's voting stock is widely held with no large single block of stock when compared with all other stock holdings, then the business's board of directors and CEO or president 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 general partners of a business control the board of directors and/or management of another business.
- *Identity of Interest.* Individuals or firms that have identical or substantially identical business or economic interests. Examples include:
 - Firms owned or controlled by married couples, parties to civil unions, parents, children, and siblings that conduct business with each other or share or provide loans, resources, equipment, locations, or employees with one another;
 - Firms or individuals with common investments; or

- Firms that are economically dependent on each other through contractual or other relationships and derive seventy percent (70%) or more of the firm's receipts from the other firm over the previous three (3) fiscal years.
- Newly Organized Business. A new business will be affiliated with an existing business if:
 - The new business is formed or organized by the same officers, directors, principal stockholders, managing members, or key employees of the old business;
 - The founders or organizers of the new business serve as the new business's officers, directors, principal stockholders, managing members, or key employees;
 - Both businesses are in the same or related industry or field; and
 - The old business will furnish the new business with contracts, financial or technical assistance, indemnification on bid or performance bonds, and/or other facilities, whether for a fee or otherwise.
- Joint Ventures. A joint venture is an association of individuals and/or entities with interests in any degree or proportion consorting to engage in and carry out a business venture for joint profit. The parties to a joint venture are considered affiliates for all purposes, unless (i) the joint venture receives no more than three contract awards over a two- (2-) year period; or (ii) an exception applies. Additionally, a contractor and its ostensible subcontractor are treated as joint venturers for size determination purposes.

Parties to a joint venture will also be affiliates of each other when:

- One partner seeks SBA financial assistance for use in connection with the joint venture; or
- The parties submit an offer for a particular procurement or property sale. Unless an exception applies, the parties are affiliated with each other for performance of that particular contract.

Even if an exception to affiliation exists, a party to a joint venture must include (i) in its receipts: its proportionate share of joint venture receipts, and (ii) in its total number of employees: its proportionate share of joint venture employees.

- *Franchise and License Agreements.* Affiliation may arise among franchises and license agreements when there is common ownership or management or excessive restrictions upon the sale of a franchise interest. Affiliation **does not** arise based only on restraints on the franchisee or licensee related to standardized quality, advertising, accounting format, and other similar provisions; provided, however, the franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership.