



What You Need to Know About the Latest Updates to the Paycheck Protection Program (PPP)

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This is an update to our eAlert dated April 3, 2020 entitled “Finding the Right Fit Under CARES: Understanding the SBA Loan Programs Available Under the CARES Act and Determining Eligibility and Business Need” and provides additional guidance relating to certain key components of the Small Business Administration’s (“SBA”) “Paycheck Protection Program” (the “PPP”). Since our April 3, 2020 eAlert, the SBA has issued the following guidance on its implementation and administration of the PPP: (1) the SBA’s Interim Final Rules (the “Interim Final Rules”) as published in the Federal Register on April 15 and 20, 2020 (see FR 20811, 20817 and 21747) and (2) the SBA’s Paycheck Protection Program Loans Frequently Asked Questions (FAQs) as of April 23, 2020 (“FAQs”) which is continuously being updated by the SBA.

This is not intended to be an exhaustive summary of the PPP or the information contained in the Interim Final Rules or FAQs. Readers are encouraged to click on the links above and visit the SBA’s website for more complete and up to date information regarding the PPP.

1. Additional Restrictions on Use of PPP Loan Proceeds. While the CARES Act provides that a borrower may use the proceeds of a PPP loan to cover payroll, insurance premiums and group healthcare compensation, interest on mortgage payments, rent, utilities and interest on debt incurred prior to February 15, 2020, the CARES Act does not impose restrictions how much must be spent on each category of expense.

The SBA has determined that at least 75% of the PPP loan proceeds must be used for payroll costs. Given that the overarching goal of the CARES Act is to keep workers paid and employed, the SBA believes that borrowers should be required to use a substantial portion of the PPP loan proceeds to pay payroll costs and that 75% is an appropriate percentage. For purposes of determining the percentage of use of proceeds for

payroll costs (but not for loan forgiveness purposes), the amount of any refinanced SBA Economic Injury Disaster Loan (“EIDL”) will be included.

2. Definition of Payroll Costs. The CARES Act excludes from the definition of payroll costs any employee compensation in excess of an annual salary of \$100,000. The SBA guidance clarifies this definition in the following ways:

(a) Treatment of Partners. Prior to the issuance by the SBA of the Interim Final Rules and FAQs, it was unclear how the compensation of partners in a partnership would be treated. As partners are not employees of a partnership, the wording of the CARES Act has led many practitioners to conclude that compensation paid to partners does not constitute payroll costs of the partnership and therefore cannot be taken into account in determining the maximum amount of PPP loan the partnership may borrow. Some commentators have also queried whether individual partners would be eligible to apply for their own PPP loans as self-employed individuals.

The SBA has clarified that partners in a partnership (including an LLC filing taxes as a partnership) may not submit a separate PPP loan application as self-employed individuals. Instead, the self-employed income of general active partners may be reported as a payroll cost, up to \$100,000 annualized, on a PPP loan application filed by the partnership. The SBA’s rationale for this approach is that as rent, mortgage interest, utilities and other expenses are generally incurred at the partnership level rather than at each individual partner level, to allow partners to apply as self-employed individuals would create unnecessary confusion. Partnerships who are still waiting for their application to be approved and who have excluded partner compensation from their loan amount calculation should reach out to their lenders as soon as possible to amend their applications to reflect the position taken by the SBA.

(b) The \$100,000 Cap. The SBA has clarified that the \$100,000 cap applies only to cash compensation and not to any non-cash benefits such as employer contributions to retirement plans, health insurance costs and payment of income taxes. Payments made to an independent contractor or sole proprietor should be excluded when calculating the eligible borrower’s payroll costs. In addition, payroll costs are calculated on a gross basis without regard to federal taxes imposed or withheld, including the employee’s and employer’s share of FICA and income taxes required to be withheld from employees.

3. Calculation of Maximum Loan Amounts. In determining the number of employees and payroll costs required to calculate the maximum PPP loan amount that can be borrowed, the SBA has confirmed that a borrower may elect to use either the time period that is the previous 12 months from the loan origination date or from the 2019 calendar year. For seasonal businesses, the borrower may use average monthly payroll for the period between February 15, 2019 or March 1, 2019 and June 30, 2019. A borrower that was not in business from February 15, 2019 to June 30, 2019 may use the average monthly payroll costs for the period January 1, 2020 through February 29, 2020. Borrowers may use their average employment over the same time periods to determine their number of employees for purposes of applying an employee-based size standard. Alternatively, they may use SBA’s usual calculation as follows: average number of employees per pay period in the 12 completed calendar months prior to the loan application date (or average number of employees for each of the pay periods the business was operational if less than 12 months).

4. Loan Forgiveness. The SBA has clarified that the amount of loan forgiveness can be up to the full principal amount of the loan plus accrued interest. The actual amount of loan forgiveness depends, in part, on the total amount spent over the eight-week period following the first disbursement of the loan on eligible

payments – i.e., the sum of payroll costs and certain overhead expenses (e.g., interest payments on mortgage obligations, rent payments on lease agreements, utility payments). Furthermore, for the reasons given above, the SBA has clarified that **at least 75% of the amount forgiven must be attributable to payroll costs.**

To substantiate a request for loan forgiveness, a borrower must document the proceeds used for payroll costs and submit evidence of business rent, business mortgage interest payments on real or personal property, or business utility payments during the covered period if PPP loan proceeds were used for those purposes. In addition, individuals with employees should submit Form 941 and state quarterly wage unemployment insurance tax reporting forms or equivalent payroll processor records that best correspond to the eight week covered period.

The SBA has stated that it will issue further guidance on loan forgiveness.

5. Maturity Date on a PPP Loan. While the CARES Act provides that a loan will have a maximum maturity of up to 10 years from the date the borrower applies for loan forgiveness, the SBA has determined that the maturity date on a PPP loan is limited to 2 years. The SBA's rationale for limiting the maturity date to 2 years is that the economic disruption caused by COVID-19 is expected to abate well before two years and borrowers should be able to recommence business operations and pay off any outstanding amounts on their PPP loans within that time period.

6. Affiliation Rules for PPP; Eligibility Requirements. Generally, a borrower will be considered together with its affiliates for purposes of determining eligibility for the PPP. Under the SBA rules, entities may be considered affiliates based on factors including stock ownership, overlapping management, and identity of interest which centers around control – i.e., when one entity controls or has the power to control the other, or a third party controls or has the power to control both, whether or not control is actually exercised so long as the power to control exists.^[1] Click here for additional information on these factors published by the SBA on April 3, 2020. Certain businesses are excluded from the SBA's affiliation rules, such as businesses with not more than 500 employees that are assigned a North American Industry Classification System code beginning with 72 (e.g., hotels and restaurants) and certain franchisees that are assigned a franchise identifier code by the SBA.^[2] In addition, the SBA's existing affiliation exclusions apply to the PPP.

Of note, venture capital and private equity-backed businesses are not excluded from the affiliation rules. That means that each venture capital and private equity firm and its portfolio companies in which their investors are affiliated are treated as one entity for purposes of meeting the 500 employee threshold test even though they operate as separate entities. Despite a big lobbying push which included public pension systems and other institutional investors who are indirect investors in small businesses and startups through their investments in private funds, the venture capital and private equity industry failed in an effort to amend the affiliation rules. As a result, many of the small business portfolio companies owned by these venture capital and private equity firms will not be able to access the new round of \$310 billion in PPP loan funds under the newly passed relief bill referenced below.

Among other eligibility requirements, an entity is eligible for the PPP if it, *combined with its affiliates*, is or has either (1) a small business concern as defined in section 3 of the Small Business Act (15 U.S.C. 632),^[3] (2) 500 or fewer employees whose principal place of residence is in the U.S., (3) a business that meets applicable SBA employee-based standards corresponding to its primary industry, or (4) a qualifying tax-exempt nonprofit organization under section 501(c)(3) of the Internal Revenue Code,^[4] a tax-exempt

veterans organization described in Section 501(c)(19) of the Internal Revenue Code or a Tribal business concern described in section 31(b)(2)(C) of the Small Business Act that has 500 or fewer employees whose principal place of residence is in the U.S., or meets the SBA employee-based size standards for the industry in which it operates.

The SBA just today put out a new FAQ to address the issue of larger companies (chain restaurants, hotels and publicly traded companies) taking out PPP loans that were intended for small businesses.^[5] The SBA stated that although the CARES Act suspends the ordinary requirements that borrowers must be unable to obtain credit elsewhere, all borrowers “should carefully review” the required good faith certification that their PPP loan request is necessary to support ongoing operations due to current economic uncertainty. When making this good faith certification, the SBA states that a borrower should take into account its current business activity and ability to access other sources of liquidity sufficient to support ongoing operations without significantly harming its business. The SBA gave as an example that it is unlikely that a public company with substantial market value and access to capital markets will be able to make this certification. Treasury Secretary Steven Mnuchin warned of “severe consequences” for large companies that took advantage of PPP loans. Of note, Shake Shack is reportedly returning its \$10 million loan amidst backlash over the distribution of the PPP funds and other large institutions such as Harvard University, Stanford University and Princeton University are doing the same (this is in addition to the severe backlash banks are facing over their handling of the PPP, allegedly prioritizing larger loan applications over small ones in order to collect larger processing fees). The SBA has indicated that any borrower that applied for a PPP loan prior to today’s issuance of the SBA’s guidance regarding necessity of the loan and repays the loan in full by May 7, 2020 will be deemed by the SBA to have made the required certification in good faith.^[6] So it is likely that we’ll see additional larger companies returning their loans in the next few weeks to avoid repercussions they will face from both the government and public.

In determining eligibility for a PPP loan, the SBA has clarified that lenders are not required to make an independent determination regarding applicability of the affiliation rules or necessity of the loan request, but rather are permitted to rely on a borrower’s certifications.

For more detailed information regarding the SBA’s affiliation rules and eligibility requirements for the PPP, please refer to the SBA’s Interim Final Rule published on the Federal Register on April 15, 2020.

7. Individuals With Self-Employment Income Who File a Form 1040, Schedule C

(a) **Eligibility.** An individual with self-employment income who files a Form 1040, Schedule C is eligible for a PPP loan if (i) he/she was in operation on February 15, 2020; (ii) he/she is an individual with self-employment income (e.g., independent contractor or sole proprietor); (iii) his/her principal place of residence is in the U.S.; and (iv) he/she filed or will file a Form 1040 Schedule C for 2019. The SBA has indicated that it will issue additional guidance for those individuals with self-employment income who (i) were not in operation in 2019 but were in operation on February 15, 2020 and (ii) will file a Form 1040 Schedule C for 2020.

(b) **Maximum Borrowing Amount.** Calculation of an individual’s maximum loan amount depends on whether he/she employs other individuals. There are also different deliverables the individual must provide with the PPP loan application depending on whether he/she has employees. Click here to view the different methodologies of calculation and required deliverables.

(c) Use of PPP Loan Proceeds. Self-employed individuals are limited in use of PPP loan proceeds to those types of allowable uses for which he/she made expenditures in 2019, which is line with the CARES Act's structure to maintain existing operations and payroll rather than for business expansion. Specifically, proceeds must be used for the following: (i) owner compensation replacement, calculated based on 2019 net profit; (ii) employee payroll costs for employees whose principal place of residence is in the U.S.; (iii) mortgage interest payments (excluding mortgage prepayments or principal payments) on any business mortgage obligation on real or personal property, business rent payments and business utility payments, provided that the individual claimed or is entitled to claim a deduction for such expenses on his/her 2019 Form 1040 Schedule C for them to be a permissible use during the eight-week period following the first disbursement of the loan; (iv) interest payments on any other debt obligations incurred before February 15, 2020 (however such amounts are not eligible for PPP loan forgiveness); and (v) refinancing an EIDL made between January 31, 2020 and April 3, 2020 (maturity will be reset to PPP's maturity of 2 years).^[6]

The SBA has indicated that it will issue additional guidance for those individuals with self-employment income who (i) were not in operation in 2019 but were in operation on February 15, 2020 and (ii) will file a Form 1040 Schedule C for 2020.

8. Single Signature on Application Form. Only an authorized representative of the business seeking a PPP loan may sign the application form on behalf of the business. An individual's signature as an "Authorized Representative of Applicant" constitutes a representation to the lender and the U.S. government that the signer is authorized to make the certifications on behalf of the borrower and lenders are entitled to rely on such representation and accept a single signature on that basis.

It should be noted that funding for the PPP is currently exhausted as the \$349 billion limit has been reached in just 2 weeks after its April 2nd launch. However, on April 21, 2020, the U.S. Senate passed a new \$484 billion relief bill which the U.S. House of Representatives passed today (and is expected to be signed into law by President Trump by the end of this week) to replenish small business loans, fund hospitals and testing, which includes \$310 billion allocated to the PPP. To help ensure that the PPP funds will be accessed by small businesses, \$60 billion of the \$310 billion allocated to the PPP will go to smaller lenders and credit unions that can provide loans to small businesses that might not bank with larger financial institutions. This is important because unfortunately as stated above, larger companies who technically qualified for the PPP accessed a significant portion of the limited PPP funds that were intended to assist struggling smaller businesses. Eligible borrowers are advised to continue submitting applications with lenders now so they are well positioned to receive the new round of PPP loan funds when funding becomes available.

[1] 13 CFR 121.301.

[2] See Section 7(a)(36)(D)(iv) of the Small Business Act (15 U.S.C. 636(a)(36)(D)(iv)), as added by the CARES Act, for a description of waiver of the affiliation rules contained in Section 121.103 of title 13, Code of Federal Regulations.

[3] Small business concerns can be eligible borrowers of PPP loans even if they have more than 500 employees so long as they satisfy the definition of a "small business concern" under the statute and meet the applicable SBA employee-based or revenue-based size standard, or meet the tests in SBA's alternative size standard as of March 27, 2020, after applying the affiliation rules, if applicable. See FAQs, Question 2.

[4] Prior to the CARES Act, such nonprofit organizations were not eligible for SBA Business Loan Programs under section 7(a) of the Small Business Act because these loans were limited to for-profit small business concerns.

[5] See FAQ, Question 31, published on April 23 2020.

[6] See FAQ, Question 31, published on April 23 2020.

[7] Individuals who received an EIDL loan from January 31, 2020 through April 3, 2020 can apply for a PPP loan. If the EIDL loans was not used for payroll costs, it does not affect eligibility for a PPP loan. However, if the EIDL loan was used for payroll costs, the PPP loan must be used to refinance the EIDL. Proceeds from any advance up to \$10,000 on the EIDL will be deducted from the loan forgiveness amount on the PPP loan.