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PAYCHECK PROTECTION PROGRAM – AN ECONOMIC LIFELINE DURING AN UNPRECEDENTED CRISIS

This article does not address businesses that employ seasonal workers, which have separate requirements.

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APRIL 7, 2020 UPDATE

The U.S. Treasury Department released new implementation guidance on April 6, 2020 regarding the Paycheck Protection Program (PPP), including changes to interpretations for loan amount calculation. Additionally, the new guidance provides relaxed standards for applicants and underwriting banks. **These changes could have a material impact on a borrower's loan amount** (it will likely increase the loan amount) and should make the funding process much more efficient. Even though the guidance may not be entirely consistent with certain provisions of the CARES Act, borrowers and lenders have been reassured by the following statement contained in the guidance: "Borrowers and lenders may rely on the guidance provided in this document as SBA's interpretation of the CARES Act and of the Paycheck Protection Program Interim Final Rule ***. The U.S. government will not challenge lender PPP actions that conform to this guidance, and to the PPP Interim Final Rule and any subsequent rule-making in effect at the time." Where we have updated this article in light of the guidance, we note those differences in **blue text** below. To aid the reader, we provide the following chart that identifies key updates contained in the April 6, 2020 guidance.

ISSUE	GUIDANCE CLARIFICATION
"Small business concern"	A "small business concern" under 15 USC § 632, even one with more than 500 employees, may participate in the PPP. The PPP is an expansion on the requirement that only small businesses can qualify for a SBA loan. The PPP permits participation by business entities that do not qualify as a "small business concern" to participate, including businesses with fewer than 500 employees with US residency, qualifying 501(c) tax exempt organizations, veterans organizations under 501(c)(19), tribal businesses, sole proprietors, and independent contractors.
Affiliation rules	Borrowers must apply the affiliation rules contained in the SBA's Interim Final Rule of Affiliation.
$100,000 compensation cap	The $100,000 cap applies to cash compensation only, not non-cash benefits which include employer retirement contributions, health care benefits, or payment of state and local payroll related taxes. This means that Payroll costs for employees earning in excess of $100,000 annually can be increased (or "stacked") for employer contributions to defined-benefit or defined-contribution retirement plans; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums; and payment of state and local taxes assessed on compensation of employees.
Applicable time period to determine FTE status and payroll costs to calculate maximum loan amounts	To determine payroll costs and FTE amounts, borrowers can base calculations either on previous 12 months, or calendar 2019. Seasonal businesses have different time periods. Additional guidance was provided for determining FTE status for businesses that have not been operational for 12 months: "the average number of employees per pay period in the 12 completed calendar months prior to the date of the loan application (or the average number of employees for each of the pay periods that the business has been operational, if it has not been operational for 12 months)."
Accounting for federal taxes when determining payroll costs for purpose of maximum loan and loan forgiveness amounts	Payroll costs are calculated on a gross basis without regard for federal taxes imposed or withheld. Borrowers do not add to payroll costs the employer's share of FICA or Medicare and do not decrease payroll costs by the employee's share of FICA or Medicare or federal income tax withholdings.
Amending application given new guidance	Borrowers and lenders can rely on the laws, rules, and guidance existing at the time of a PPP application, but if the application has not been processed, a borrower may revise its application based on clarifications in current guidance.

On March 27, 2020, the President signed into law the "Coronavirus Aid, Relief, and Economic Security Act" or the "CARES Act." Key components of the CARES Act include loans to help businesses minimize the economic impacts of the COVID-19 virus. Two loan options under the CARES Act are: the Economic Injury Disaster Loans & Emergency Economic Injury Grant (EIDL), and the Paycheck Protection Program (PPP). This article focuses on the PPP which can help companies pay their staff, interest on their mortgages or their rent, and utilities for an eight week period at no cost to the business. This is a **first-come, first-served** program, so time is of the essence in pursuing this opportunity.

SUMMARY OF THE EIDL PROGRAM

A more detailed explanation of the EIDL program will be forthcoming. We would be remiss if we did not briefly summarize the EIDL and its interplay with the PPP. The EIDL provides up to a $10,000 loan advance to small business owners impacted by COVID-19. It also permits loans up to $2 million at a low interest rate. Importantly, the amount awarded as a loan advance (up to $10,000) becomes a grant and does not need to be repaid. Any additional funds obtained under the EIDL program are treated as a loan that will not be forgiven. The advantage of an EIDL advance/grant (up to $10,000) is that it is available within three days of the EIDL application. There are certain underwriting requirements for an EIDL loan, such as the ability to repay. Personal guarantees are required for loans in excess of $200,000, and collateral is required for loans in excess of $25,000. EIDL loan proceeds can be used to pay payroll costs, fixed debts, accounts payable, and other bills that would be paid if not for COVID-19.

Funds received from the EIDL loan program work in conjunction with funds received from a PPP loan as follows. First, the loan advance/grant of up to $10,000 will reduce the amount forgiven on a PPP loan. These funds cannot be stacked. Further, any funds obtained through an EIDL loan cannot be used for the same purpose as a PPP loan. The US Senate Committee on Small Business & Entrepreneurship issued guidance on this point saying, "For example, if you use your EIDL to cover payroll for certain workers in April, you cannot use PPP for payroll for those same workers in April, although you could use it for payroll in March or for different workers in April." A consult with an accountant can help your business understand whether it is better to furlough employees or maintain a business workforce, and whether there is an advantage to obtaining an EIDL loan to supplement funds received from a PPP where a workforce is maintained.

INTRODUCTION TO THE PPP PROGRAM

To better understand the PPP, we have provided a matrix of pertinent terms and their import below. In summary, the PPP authorizes up to $349 billion of forgivable loans for small businesses, sole proprietorships, independent contractors, non-profits, Tribal concerns, and self-employed individuals to maintain their workforce. The PPP accomplishes this goal by providing loans, up to $10,000,000, that can be forgiven if the loan recipient maintains their workforce during the eight week period beginning on the date of the origination of a covered PPP loan at close to the pre-pandemic pay rate. An exception is granted to employers where a reduction, as compared to February 15, 2020, occurs between February 15, 2020 and April 26, 2020, and the reductions have been eliminated by June 30, 2020.

Who Qualifies for a PPP?

Any small business concern under 15 U.S.C. 632, self-employed individual (passive income is excluded), independent contractor, or any business concern, non-profit organization, veterans organization, or tribal business that employs no more than 500 employees or the size standard number of employees established by the Administration for Industry in which the entity operates. Under certain circumstances, a small business concern can have more than 500 employees.

Ineligibility rules

According to interim final rules issued by the Small Business Administration (SBA) on April 2, 2020, the following business categories are not eligible under the PPP:

- Businesses identified in SOP 50-10, including certain lending institutions, passive businesses, life insurance companies, gambling companies, marijuana businesses, etc.
- Any company engaged in illegal activities;
- Household employers;
- Any business in which the owner of 20 percent or more of the equity of the applicant is incarcerated, on probation, on parole, subject to an indictment, or other means by which formal criminal charges are brought in any jurisdiction, or has been convicted of a felony in the last five years;
- Or any business that is delinquent on an SBA loan, or has defaulted on the last seven years and caused a loss to the government.

Does the 500 employee limit apply per location?

Generally, no. The 500-employee limit applies per business, and not per business location. However, there is an exception for certain accommodation (hotel/motel, etc.) and food services (restaurants/bars, etc.) entities that fit within the North American Industry Classification System code beginning with 72.

What is the maximum PPP loan amount?

The maximum PPP loan amount is the lesser of:

- For businesses that were in business between February 15, 2019 to June 30, 2019, 2.5 times the average total monthly payments for payroll costs incurred in the year preceding the application, plus the amount of any outstanding disaster loan (including an EIDL loan);
- For businesses that were not in business between February 15, 2019 to June 30, 2019, 2.5 times the average total monthly payments for payroll costs between January 1, 2020 and February 29, 2020, plus the amount of any outstanding disaster loan (including an EIDL loan); or
- $10,000,000.

What costs can be used to compute the maximum PPP loan amount?

The PPP maximum loan amount is based on payroll costs. Payroll costs are treated differently for entities than they are for sole proprietors or independent contractors.

Entities can include the following in calculating payroll costs:

- Salary, wage, commission or similar compensation (but not more than $100,000/year/employee);
- Cash tip or equivalent;
- Vacation/parental/family/ medical or sick leave;
- Allowance for dismissal or separation;
- Group health care benefits (including insurance premiums);
- Retirement benefit; or
- Payment of state or local tax assessed on the compensation of employees.

The statute indicates that entities cannot include the following in calculating payroll costs:

- Taxes under Chapters 21, 22, or 24 of the IRC (FICA, RRTA, Unemployment);
- Compensation for non-US residents;
- Qualified sick leave for which a credit is allowed under § 7001 of the Families First Coronavirus Response Act;

- Qualified family leave wages for which a credit is allowed under § 703 of the Families First Coronavirus Response Act; or
- Payments to independent contractors (because they can get their own loans).
- Sole proprietors or independent contractors can include the following in calculating payroll costs:
- Income that is a wage, commission, income, net earnings from self-employment and that is in an amount that is not more than $100,000/year as prorated for the covered period.

The April 6, 2020 guidance clarifies that the $100,000 salary cap is for cash payments only and is not intended to exclude the costs of health insurance, retirement, or state or local taxes related to those employees. In other words, after the $100,000 limit for cash payments, taxes and benefits can be stacked to obtain payroll costs in excess of $100,000 for those employees.

Sole proprietors or independent contractors can not include the following in calculating payroll costs:

- Taxes under Chapters 21, 22, or 24 of the IRC (FICA, RRTA, Unemployment);
- Compensation for non-US residents;
- Qualified sick leave for which a credit is allowed under § 7001 of the Families First Coronavirus Response Act; or
- Qualified family leave wages for which a credit is allowed under § 703 of the Families First Coronavirus Response Act.

The April 6, 2020 guidance clarifies that the $100,000 salary cap is for cash payments only and is not intended to exclude the costs of health insurance, retirement, or state or local taxes related to those employees. In other words, after the $100,000 limit for cash payments, taxes and benefits can be stacked to obtain payroll costs in excess of $100,000 for those employees.

What is the interest rate for a PPP loan?

According to the statute, the interest rate will be no more than 4%. Recent guidance issued by the US Treasury Department states that the interest rate is 0.50% fixed rate. However, guidance issued by the SBA on April 2, 2020 indicates that the rate will be 1%.

How can the PPP loan proceeds be used?

The proceeds of a PPP loan can be used for payroll costs, continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums; employee salary, commission or similar compensation; mortgage interest (but not prepayment of interest or principal); rent; and utilities.

When do payments under a PPP loan start?

All payments are deferred for six months, but interest accrues during that period.

Can the PPP loan be forgiven?

Yes, but only for payroll costs (which according to SBA guidance should account for 75% of the amount forgiven), interest on covered mortgage obligations, covered rent obligations, and/or covered utility payments (which should be limited to 25% of the amount forgiven) for the eight week period after the loan is originated. And, any amount forgiven will not be treated as cancellation of debt income. But, there are limits on the loan forgiveness. The amount forgiven may not exceed the principal amount of a covered loan, and the amount forgiven will be reduced if the number of employees has been reduced (see formula below) or where the total salary or wages of an employee during the covered period is more than 25% lower than the employee's wages during the most recent quarter of employment.

What happens if only part of the PPP loan is forgiven?

Any portion of the PPP loan that is not forgiven continues to be guaranteed by the Administration and **according to the statute**, has a maximum ten year maturity from the date of any application for forgiveness with an interest rate up to 4%. Cancelation of a portion of the debt does not otherwise modify the loan terms. **The** Interim Final Rules **indicate that the maturity date of all PPP loans will be two years.**

Are owners of the company personally responsible to repay the loan?

These are non-recourse loans. So long as the loan proceeds are spent consistent with the PPP, and absent fraud or other criminal conduct, owners of the company are not personally liable to repay any portion of the loan.

What information is required to apply for the PPP loan?

The US Treasury has issued guidance to lenders regarding underwriting requirements. That guidance states that banks "will need to verify that a borrower was in operation on February 15, 2020. [Lenders] will need to verify that a borrower had employees for whom the borrower paid salaries and payroll taxes. [Lenders] will need to verify the dollar amount of average monthly payroll costs. [Lenders] will need to follow applicable Bank Secrecy Act requirements."

More recent guidance from the SBA indicates that the SBA will not require lenders to comply with § 120.150 "What are SBA's lending criteria?" The guidance further states that the SBA will allow lenders to rely on certifications from borrowers in order to determine eligibility of the borrower and use of loan proceeds, and to rely on specified documents provided by the borrower to determine qualifying loan and forgiveness eligibility.

The guidance goes on to say that each lender will be required to confirm:

- Receipt of the PPP Application form certifications;
- Receipt of information demonstrating that a borrower has employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020;
- The dollar amount of average monthly payroll costs for the preceding calendar year by reviewing payroll documentation submitted with the borrower's application; and
- Lenders should continue to follow their BSA protocols when making PPA loans to new or existing eligible borrowers under the PPP. The guidance later suggests the following documents to satisfy a lender's underwriting obligations:
    - Payroll processor records;
    - Payroll tax filings; or
    - For sole proprietorships and presumably independent contractors, Form 1099-MISC or income and expenses.

This is a fluid situation, and the process is moving faster than financial institutions are likely to be able to meet the need. Be prepared for banks to request the following categories of documents when applying for a PPP loan:

- PPP Loan application;
- Organization documents;
- Bylaws or operating agreements;
- Driver's license;
- IRS Form 940 or 941;
- Payroll summary report;
- Bank statements;

- Itemization of payroll benefits;
- 1099s (for independent contractors);
- Certification that all employees live in the US;
- Trailing 12-month P & L;
- 2019 tax returns or year-end financials;
- Mortgage or rent statements; and
- Utility bills.

When should a business apply for the PPP loan?

In guidance issued by the US Treasury, applicants are encouraged to apply as quickly as possible because there is a funding cap. The most recent guidance from the SBA explains that PPP Loans will be made on a first-come, first-served basis. The timing of any application should be coordinated with your accountant and/or your legal advisors. This is particularly important given the funding cap on the PPP loans which will be awarded on a first-come, first-served basis.

What are some of the issues an applicant should consider before applying for a PPP loan?

Interest rate differences between an EIDL and a PPP Loan

As of April 2, 2020, the interest rate for an EIDL loan is 3.75% (2.75% for nonprofits), and the interest rate for a PPP loan is 1.0% fixed rate. There may be advantages to seeking an EIDL for costs not covered by the PPP and rolling the EIDL into the PPP. This decision should be made in consultation with accounting and legal advisors.

Accurately calculating payroll costs

The PPP does not permit more than one loan. This program is a work in progress, and changes are occurring regularly. The current application lists payroll costs, then asks the applicant to multiply those costs by 2.5, add in any EIDL amount, minus any advance as the total loan request. The current loan application now explains the component parts of what can be included, and what must be excluded, in payroll costs under the PPP.

There are two very important considerations in calculating payroll costs. The first, of course, is not to overinflate payroll costs. Equally important, is to make sure all permissible costs, such as health insurance, retirement benefits, and state and local taxes are included. Failure to include these components could significantly reduce the amount of a PPP loan. This is particularly important because the PPP permits only one loan per business.

PPP TERMS MATRIX

TERM	EXPLANATION	REFERENCE
Covered loan	Paycheck Protection Program Loan	15 U.S.C.A. § 636 (36) (A) (ii)
Covered loan period	February 15, 2020 to June 30, 2020	15 U.S.C.A. § 636 (36) (A) (iii)
Eligible self-employed individual	An individual who earns income from any trade or business carried on by that individual or a partnership of which he/she is a member. (This does not include an individual whose income is derived from passive income.)	15 U.S.C.A. § 636 (36) (A)(v); Section 7002(b) of the Families First Coronavirus Response Act; 26 U.S. Code § 1402
Eligible businesses and organizations	During the covered period, in addition to small business concerns, any business concern, nonprofit organization, veterans organization, or Tribal business concern shall be eligible to receive a covered loan if it employs not more than the greater of: • 500 employees; or • if applicable, the size standard in number of employees established by the Administration for the industry in which the business concern, nonprofit organization, veterans organization, or Tribal business concern operates.	15 U.S.C.A. § 636 (36) (D) (i)
Business concerns with more than 1 covered location	Business concerns with more than 1 physical location are eligible to receive a covered loan if, during the covered period, they do not employ more than 500 employees per physical location and they fit within North American Industry Classification System code beginning with 72 – accommodation and food services including hotels and motels and other travel accommodations including RV parks and recreational camps, restaurants, drinking places, mobile food services, caterers, and special food services.	15 U.S.C.A. § 636 (36) (D) (iii)
Sole proprietors, independent contractors, and eligible self-employed individuals	Individuals who operate under a sole proprietorship or as an independent contractor and eligible self-employed individuals are eligible to receive a covered loan	15 U.S.C.A. § 636 (36) (D) (ii)
Payroll costs	For employees: • Salary, wage, commission or similar compensation (except compensation over $100,000/year); • Cash tip or equivalent; • Vacation/parental/family/ medical or sick leave; • Allowance for dismissal or separation; • Group health care benefits (including insurance premiums); • Retirement benefit; or • Payment of state or local tax assessed on the compensation of employees.	15 U.S.C.A. § 636 (36) (A)(viii); 26 U.S. Code §§ 21, 22, and 24

TERM	EXPLANATION	REFERENCE
Payroll costs (continued)	**For sole proprietor or independent contractor:** • Income that is a wage, commission, income, net earnings from self-employment and that is in an amount that is not more than $100,000/year as prorated for the covered period. **Exclusions:** • Taxes under Chapters 21, 22, or 24 of the IRC (FICA, RRTA, Unemployment); • Compensation for non-US residents; • Qualified sick leave for which a credit is allowed under § 7001 of the Families First Coronavirus Response Act; or • Qualified family leave wages for which a credit is allowed under § 703 of the Families First Coronavirus Response Act. • For businesses, payments to independent contractors (because they can get their own loans). **The April 6, 2020 guidance clarifies that the $100,000 salary cap is for cash payments only and is not intended to exclude the costs of health insurance, retirement, or state or local taxes related to those employees. In other words, after the $100,000 limit for cash payments, taxes and benefits can be stacked to obtain payroll costs in excess of $100,000 for those employees.** **Additionally, the April 6, 2020 guidance clarifies that employee or employer paid federal payroll or income taxes withheld do not increase or decrease the calculation. In other words, borrowers do not add to payroll costs the employer's share of FICA or Medicare and do not decrease the payroll costs by the employee's share of FICA or Medicare or federal income tax withholdings.**	**15 U.S.C.A. § 636 (36) (A)(viii); 26 U.S. Code §§ 21, 22, and 24**
Employee	**For purposes of determining whether a business concern, non-profit organization, veterans organization or Tribal concern has fewer than 500 employees, the term "employee" includes individuals employed on a full-time, part-time, or other basis.**	**15 U.S.C.A. § 636 (36) (D)(v)**

TERM	EXPLANATION	REFERENCE
Maximum loan amount	**During the covered period the maximum amount of a covered loan is the lesser of:** • The product obtained by multiplying the average total monthly payments for payroll costs incurred during the preceding 1-year before the date on which the loan is made (except for seasonal workers) by 2.5, and the outstanding amount of any disaster loan under subsection (b)(2) made between January 21, 2020 and the date covered loans are made available to be refinanced under the covered loan; or • If requested by an otherwise eligible recipient not in business between February 15, 2019 and June 30, 2019, the product obtained by multiplying the average total monthly payments by the applicant for payroll costs incurred during the period beginning on January 1, 2020 and ending on February 29, 2020 by 2.5 and the outstanding amount of any disaster loan under subsection (b)(2) made between January 21, 2020 and the date covered loans are made available to be refinanced under the covered loan; or • $10,000,000	**15 U.S.C.A. § 636 (36) (E) (West)**
Allowable uses of covered loans	• **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 compensation;** • **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.**	15 U.S.C.A. § 636 (36) (F) (i)
Nonrecourse	**There is no recourse against any individual shareholder, member, or partner of an eligible recipient of a covered loan for nonpayment of any covered loan, except to the extent that such shareholder, member, or partner uses the covered loan proceeds for a purpose not authorized.**	**15 U.S.C.A. § 636 (36) (F) (v)**

TERM	EXPLANATION	REFERENCE
Borrower certification	**Eligible recipients applying for a covered loan must make a good faith certification:** • 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; • that the eligible recipient does not have an application pending for a loan under this subsection 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, that the eligible recipient has not received amounts under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan.	**15 U.S.C.A. § 636 (36) (G)**
Treatment of remaining balance	**The balance of a covered loan after loan forgiveness shall have a maximum maturity of ten years from the date upon which the borrower applied for loan forgiveness and shall bear an interest rate not to exceed 4 percent.**	**15 U.S.C.A. § 636 (36) (K)**
Loan deferment	**Lenders are required to provide complete payment deferment (including payment of principal, interest, and fees) for impacted borrowers with covered loans for a period of not less than 6 months, and not more than 1 year. The statute presumes that all applicants have been adversely impacted by COVID-19.**	**15 U.S.C.A. § 636 (36) (M)**
Loan forgiveness	**A recipient of a covered PPP loan shall be eligible for forgiveness of indebtedness for the following amounts for the eight-week period beginning on the date of the origination of a covered 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. • Any covered utility payment.	**15 U.S.C.A. § 636 (36) (K); § 1106 of the CARES Act.**

TERM	EXPLANATION	REFERENCE

Loan forgiveness (continued)	**Limits on amount of forgiveness**
	• Amount may not exceed principal amount of a covered PPP loan.
	• Amount will be reduced where the number of employees has been reduced by the quotient obtained by dividing the average number of full-time equivalent employees per month employed by the eligible recipient during the 8 week period beginning on the date of the origination of a covered PPP loan; by 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.
	• Amount will be reduced by the amount of any reduction in total salary or wages of an employee during the 8 week period beginning on the date of the origination of a covered PPP loan 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 covered period.
	• Exemption for rehires where a reduction, as compared to February 15, 2020, occurs between February 15, 2020 and April 26, 2020, and the reductions have been eliminated by June 30, 2020.
		15 U.S.C.A. § 636 (36) (K); § 1106 of the CARES Act.

Taxability	**For tax purposes, any amount of the PPP that is forgiven and would otherwise be includable in gross income of the eligible recipient is excluded from gross income.**	**§ 1106 of the CARES Act. (i)**

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