

# UPDATES TO THE PAYCHECK PROTECTION PROGRAM

*Hodgson Russ Banking & Finance Alert*  
April 8, 2020

On March 30, 2020, Hodgson Russ issued an alert summarizing the basics of the Paycheck Protection Program (“PPP”). Since that release, the Treasury Department issued additional guidance regarding the PPP, found here. Below are a number of updates relevant to any business’s determination of whether and how to apply for a PPP loan.

Before we go further, two important notes:

(1) The Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), is difficult to summarize in brief. There is nuance to many of its provisions; this alert is intended only to flag issues for those considering PPP loans, and should not replace advice specific to your business’ situation from a qualified legal or financial advisor.

(2) PPP guidance and interpretation is evolving at a rapid pace. Please contact Chris Fattay (716.848.1757) or Valerie Stevens (646.218.7614) with questions and to make sure you are up to date on this topic.

## What is the \$349 Billion Paycheck Protection Program?

The CARES Act was signed into law on Friday, March 27, 2020. Among the programs in the Act is the PPP, which is a \$349 billion boost to the existing Small Business Administration (SBA) loan guaranty program.

***UPDATE: The President has requested an additional \$250 Billion for the PPP. More to come!***

How does the program work? – The PPP, found in Title I of the Act, is a \$349 billion boost to the SBA’s existing 7(a) guaranty program. These are NOT loans from the Federal Government. Instead, the Federal Government guarantees loans made by eligible lenders to eligible borrowers. The PPP also expands eligibility for, and liberalizes other requirements of, the SBA 7(a) guaranty program. Perhaps most notably, the Act sets forth the possibility for PPP loans to be forgiven under certain circumstances.

***UPDATE: Lenders will begin accepting applications for sole proprietors and independent contractors on April 10, 2020. Applications began to be accepted for all other eligible borrowers on April 3, 2020. Note that the application form***

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## UPDATES TO THE PAYCHECK PROTECTION PROGRAM

*requires that the borrower applicant certify that they are “eligible to receive a loan under the rules in effect at the time this application is submitted”, so it is important to be sure you qualify based on existing guidance before submitting an application.*

Who is eligible? – Businesses or non-profits with 500 or fewer employees (with certain exceptions, discussed below) are eligible for PPP loans under the Act. The number of employees is considered on an affiliated-company basis, such that all businesses under common control would count employees in the aggregate. The affiliation rule is waived for businesses in the hospitality/restaurant businesses (within NAICS code 72), franchises, and recipients of Small Business Investment Company (SBIC) investment. Note that the 500 employee cap can be exceeded for certain excepted industries. (See this link for a current table of industries and employee standards.)

**UPDATES:** *There have been a number of developments in the eligibility arena.*

1. **U.S. Employee Count:** *Pursuant to the issued guidance, the only employees who count toward the 500 limit are employees whose principal place of residence is in the United States. This is a significant development for businesses with overseas affiliates who may have a large number of employees.*
2. **Small Business Concerns:** *Treasury has clarified that a small business concern who would otherwise be eligible for an SBA 7a loan (without the temporary, broadened eligibility created under the CARES Act) continue to be eligible under the PPP. These small business concerns would need to meet the standard size and income limitations of the 7a program.*
3. **Alternate Size Standard:** *Guidance also states that a business can qualify for a PPP loan as a small business concern if it met both tests in SBA’s “alternative size standard” as of March 27, 2020: (1) maximum tangible net worth of the business is not more than \$15 million; and (2) the average net income after Federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than \$5 million.*
4. **Affiliation Rules:** *There have been 2 different releases that attempt to further detail the relevant affiliation rules for the PPP. The additional guidance prescribes that entities may be considered affiliates based on common control factors that include equity ownership, overlapping management and identity of interest (including with close relatives). Notably, the guidance states that the SBA will deem even a minority owner to be in “control” of an entity if owner has the ability, under the relevant organizational documents, to prevent a quorum or otherwise block action by the board or equity holders unless that minority owner irrevocably relinquishes or waives that right. Also note that the guidance states that faith-based organizations will be exempt from the affiliation rules where the application of the affiliation rules would substantially burden those organizations’ religious exercise.*
5. **Non-Profits:** *Unfortunately, guidance confirmed that not all non-profits are eligible for the PPP. Only non-profits organized under 501(c)(3) and 501(c)(19) of the Internal Revenue Code are eligible. Affiliation rules apply to non-profits as well as for profit businesses.*
6. **Ineligibility Factors:** *Even if they might otherwise qualify under the employee count and other rules, household employers are ineligible, as are borrowers that are engaged in illegal activity, have owners with criminal issues, or have had previous SBA default issues.*

## UPDATES TO THE PAYCHECK PROTECTION PROGRAM

Is there a net income limitation? – No. Borrowers must make a good faith certification that the PPP loan is necessary due to the uncertainty of current economic conditions caused by COVID-19 and that the funds will be used to retain workers, and maintain payroll, or make mortgage payments, lease payment and utility payments.

**UPDATE:** *The final certifications on this topic in the application (note that these are not the only certifications) are as follows:*

*“Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”*

*“The funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under the Paycheck Protection Program Rule; I understand that if the funds are knowingly used for unauthorized purposes, the federal government may hold me legally liable, such as for charges of fraud.”*

How much money can be borrowed? – The maximum loan amount is 2.5 times the Borrower’s average total monthly payroll costs, not to exceed \$10 million. Note that under the Act, “payroll costs” include health care benefits, vacation, family and sick leave, retirement benefits and other additional similar costs but exclude compensation of employees with salaries in excess of \$100,000 per year.

**UPDATES:** *Again, a number of relevant updates in this area.*

- 1. Which 12 Month Historical Period? After some initial confusion, guidance has clarified that borrowers can calculate aggregate payroll costs using data either from the previous 12 months or from calendar year 2019. Additionally, the guidance has clarified that Borrowers may use their average employment over those same time periods to determine their number of employees, or the SBA’s standard calculation of the average number of employees per pay period in the 12 completed calendar months prior to the date of the loan application. This calculation is limited to employees whose principal place of residence is the United States.*
- 2. \$100,000 Limit: Although the statute was initially somewhat vague on this point, guidance has clarified that employees with compensation in excess of an annual salary of \$100,000 are included in the program, but only up to \$100,000. Additionally, the exclusion of compensation in excess of \$100,000 annually applies only to salary, not to benefits like retirement contributions and health insurance premiums.*
- 3. How to Account for Federal Taxes? Guidance clarifies that payroll costs are calculated on a gross basis without adjustment based on federal taxes imposed or withheld. Therefore, (a) payroll costs include taxes imposed on an employee and required to be withheld by the employer, and (b) payroll costs exclude the employer’s share of payroll tax. Guidance uses the following example:*

*“For example, an employee who earned \$4,000 per month in gross wages, from which \$500 in federal taxes was withheld, would count as \$4,000 in payroll costs. The employee would receive \$3,500, and \$500 would be paid to the federal government. However, the employer-side federal payroll taxes imposed on the \$4,000 in wages are excluded from payroll costs under the statute.”*

## UPDATES TO THE PAYCHECK PROTECTION PROGRAM

*4. Independent Contractors: One highly discussed issue was whether payments made by an applicant to an independent contractor or sole proprietor should be included in calculations of payroll costs for loan amount or forgiveness calculations. Guidance has clarified that those amounts should NOT be included in the applicant's payroll costs. Instead, the independent contractor or sole proprietor will itself be eligible for a PPP loan if it satisfies the applicable requirements.*

*5. Payments to Partners: Notably, no guidance has been issued on the issue of whether payments made to partners or shareholders should be included in the definition of payroll costs. We would expect further guidance regarding the treatment of W-2 wages paid to a corporate shareholder and guaranteed payments made to a partner, distinct from dividends and distributions made.*

What can I use the loan proceeds for? – Proceeds of the loans can be used for payroll and payroll support (including paid sick or medical leave), rent and utility payments, insurance premiums and interest payments on other debt.

How can my loan be forgiven? – Borrowers would be eligible for loan forgiveness in an amount equal to the sum spent for the 8 weeks after the loan origination date on (i) payroll costs (excluding employees with compensation in excess of \$100,000 per year); (ii) group healthcare benefit costs and insurance premiums; (iii) interest payment on any mortgage incurred before 02/15/2020; (iv) rent on any lease in force before 02/15/2020; and (v) utilities for which service began before 02/15/2020.

The amount of loan forgiveness shall be reduced proportionately by (i) the number of employees during the covered period as compared to either the prior year or January and February 2020; and (ii) any reductions in salary in excess of 25% of an employee's total salary or wages as compared to the last quarter that the employee was employed. There are exemptions for such reductions (aka, forgiveness is still available) if the employer re-hires its employees or re-instates salaries not later than June 30, 2020.

Notably, for U.S. Federal tax purposes, forgiven amounts will not be taxable cancellation of indebtedness income.

### UPDATE:

- 1. 25% Limit on Non-Payroll Costs: Although not mentioned in the CARES Act, the interim final rule states that no more than 25 percent of the loan forgiveness amount may be attributable to non-payroll costs.*
- 2. Forgiveness of Principal and Interest: Guidance has clarified that the amount of loan forgiveness can be up to the full principal amount of the loan and any accrued interest if borrower uses all of the loan proceeds for forgivable purposes and employee and compensation levels are maintained as required.*
- 3. Awaiting Guidance: As of this writing, we still await guidance clarifying most of the substantive forgiveness provisions. We expect this guidance is forthcoming, as many of the forgiveness provisions (including some of those discussed in the original alert) have multiple interpretations.*

What happens to loan amounts not forgiven? – Any portion of the loan not forgiven will have a maximum term of 10 years, and the interest rate cannot exceed 4%. The balance of the loan will continue to be guaranteed by the SBA.

## UPDATES TO THE PAYCHECK PROTECTION PROGRAM

**UPDATE:** *Treasury guidance has clarified that the loan term will be 2 years, the interest rate will be 1%, and the loan may be prepaid without penalty.*

Do I have to make payments right away? – No. The Act states that payments on these loans will be deferred for 6-12 months. The SBA is expected to issue guidance on this deferral program.

**UPDATE:** *Treasury guidance has clarified that the deferral period will be 6 months.*

Do I need to provide collateral or a guaranty? – Certain lenders could require collateral or a guaranty, but they are not required to obtain the SBA guaranty.

What do I do now? – Call your financial institution to get the process started. If your lender is not an SBA-approved lender, your local SBA District Office can provide a list of approved lenders. See this link to find the district office closest to your location.

**UPDATE:** *No change here. Call your lender!*

Please check our Coronavirus Resource Center and our CARES Act page to access additional information related to these rapidly evolving topics.

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