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Small Business Administration Business Loan Program Temporary Changes; Paycheck Protection Program

Jan W. Pitchford, Partner | jpitchford@shumaker.com | 941.364.2710
W. Kent Ihrig, Partner | kihrig@shumaker.com | 813.227.2354
Steve S. Grieco, Partner | sgrieco@shumaker.com | 813.221.7427
John Pedro Dombrowski, Associate | jdombrowski@shumaker.com | 419.321.1411



Pitchford



Ihrig



Grieco



Dombrowski

Interim Final Rule¹

We are updating our Client Alert of April 3, 2020,² in light of additional guidance issued by the Small Business Administration (the "SBA"), in consultation with the Department of the Treasury, on the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act" or the "Act") and the interim final rule issued by the SBA on April 2, 2020, (the "Interim Rule") announcing the implementation of sections 1102 and 1106 of the CARES Act. The additional guidance has been released in the form of Frequently Asked Questions, with answers reflecting the SBA's position with respect thereto, released on and as of April 6, 2020 and April 8, 2020.

Summary: The Interim Rule announced the implementation of sections 1102 and 1106 of the CARES Act. Section 1102 of the Act temporarily adds a new product, titled the "Paycheck Protection Program," (PPP) to the SBA's 7(a) Loan Program. Section 1106 of the Act provides for forgiveness of up to the full principal amount of qualifying loans guaranteed under the PPP. The Interim Rule requests public comment.

Applicability Date: Through June 30, 2020, or until funds made available for this purpose are exhausted.

Section 1102: Paycheck Protection Program (PPP) - Authorizes SBA to temporarily guarantee loans under this new 7(a) loan program. Loans guaranteed under the PPP will be 100 percent guaranteed by the SBA, and the full principal amount of the loans may qualify for loan forgiveness. PPP loans are processed and granted on a first come, first served basis (subject to the \$349 billion limit currently authorized by the U.S., Federal Government, which may or may not be subsequently increased).³ No applicant can apply for more than one loan under the PPP program. The following outlines the key provisions of the PPP.

Eligible borrowers: Borrowers have to meet all three of the following requirements to be eligible for the PPP:

Size - The PPP is only available to borrowers that either have 500 or fewer employees whose principal place of residence is in the United States, or that meet the applicable SBA employee-based size standards for certain industries.

Type of entity - The PPP is only available to small business concerns as defined in Section 3 of the Small Business Act and subject to the SBA's affiliation rules, or the following tax-exempt organizations—Internal Revenue Code (Code) section 501(c)(3) organizations, veterans organizations (under Code section 501(c)(19)), and Tribal business concerns described in section 31(b)(2)(C) of the Small Business Act.

Going concern - The borrower must have been in operation on February 15, 2020 and had employees for whom they paid salaries and payroll taxes.

Independent contractors and sole proprietors are also eligible to apply to the PPP.

Ineligible borrowers:

In spite of meeting the above requirements, the following types of businesses are likely ineligible for the PPP due to the SBA's Standard Operation Procedure SOP 5010:

Financial businesses, passive businesses, life insurance companies, businesses located in a foreign country or owned by illegal aliens, pyramid sales distributions programs, loan packagers, businesses with associates of poor character, businesses where the lender or any associate of the lender has an ownership interest, businesses providing prurient sexual material, businesses where there was a prior loss to the government, businesses primarily engaged in political or lobbying activities, speculative businesses, illegal businesses such as, those related to direct and indirect marijuana and hemp businesses, and businesses that restrict patronage for any reason (can be overcome with affidavits).

The SBA intends to release further guidance on eligibility requirements in the near future.

Maximum Loan Amount:

The maximum loan amount is the lesser of \$10 million or the result of the following formula based on "payroll costs" (defined in the next paragraph):

Step 1: Aggregate payroll costs for the last year for employees whose principal place of residence is the United States. The employer shares of FICA or FUTA are not included, but the employee's share of FICA and withheld income tax are included in payroll costs for purposes of determining the loan amount. The PPP application form instructs most borrowers to use 2019 payroll costs, but the interim guidance suggests using costs from the past year (April 1, 2019 through March 31, 2020). Your lending institution will dictate the necessary information.

Step 2: Subtract all cash compensation to an employee in excess of \$100,000. The same applies to independent contractors and sole proprietors that apply to the PPP.

Step 3: Calculate the average monthly payroll by dividing the result of Step two by 12.

Step 4: Multiply the average monthly payroll costs by 2.5.

Step 5: If applicable, add the outstanding amount of an Economic Disaster Injury Loan (EIDL) made between January 1, 2020 and April 3, 2020, less the amount of any "advance" under an EIDL COVID-19 loan.

"Payroll costs" consist of compensation to employees with a principal place of residence in the U.S. and that comes in the form of:

- Salary, wage, commission, or similar compensation;
- Payment of cash tip or equivalent based on employer records of past tips of, in the absence of employer records, a reasonable, good faith employer estimate of past tips;
- Payment for vacation, parental, family, medical, or sick leave;
- Allowance for dismissal or separation;
- Payment for the provision of employee benefits including retirement and group health care coverage, including insurance premiums;

- Payment of state and local taxes assessed on the compensation of employees

The following are excluded from "payroll costs":

- Any compensation to an employee whose principal place of residence is outside the United States;
- Any cash compensation of an individual employee in excess of \$100,000, prorated as necessary. The exclusion does not apply to non-cash benefits, including employer contributions to defined benefit or 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 the compensation of an employee.
- Federal employer taxes imposed or withheld between February 15, 2020 and June 30, 2020, including the employee's and employer's shares of FICA and the Railroad Retirement Tax, and income taxes withheld during that period;
- Qualified sick and family leave wages for which a credit is allowed under Sections 7001 and 7003 of the Families

Affiliation Rules:

Eligibility, including counting employees, are subject to the SBA's Affiliation Rules under 13 CFR 121.301(f) unless specifically waived in the Act. The Act specifically waives these rules for businesses in Sector 72 under the NAICS (accommodation and food service sector) with 500 or fewer employees, franchise businesses with franchisor identifier codes, and any business that receives financial assistance from a Small Business Investment Company. SBA intends to promptly issue additional guidance with regard to the applicability of affiliation rules at 13 CFR §§ 121.103 and 121.301 to PPP loans.

Treatment of Independent Contractors:

Independent contractors and sole proprietors are not counted for determining the number of employees of a business to which they provide services, the maximum amount of the loan for such business, or the amount of forgiveness available to such business. However, independent contractors and sole proprietors are eligible to apply for a loan under the PPP on their own. For independent contractors or sole proprietors, payroll costs include wage, commissions, income, or net earnings from self-employment or similar income.

Interest Rate:

One percent per annum.

Maturity:

Two years.

Payment Deferral: All payments, including principal and accrued interest, are deferred for six months.

Certain Waivers:

Loans approved under the PPP program are 100 percent guaranteed by the SBA at the time of inception. No guarantee fees or annual service fees will apply, and certain other SBA fees are also waived. No collateral and no personal guarantees are required. Borrowers need not show that they are unable to obtain credit elsewhere in order to have a PPP loan application approved.

Section 1106: Forgiveness of PPP Loans

An amount up to the entire amount of the loan can be forgiven, including accrued interest, if the borrower uses all of the loan proceeds for forgivable costs as described below and employee and compensation levels are maintained. Forgivable costs include costs incurred over the eight-week period following the date of the loan (the "covered period") that consists of payroll costs, payments of interest on mortgage obligations incurred before February 15, 2020, rent payments on leases dated before February 15, 2020, and utility payments under service agreements entered into before February 15, 2020. However, non-payroll costs can only account for up to 25 percent of the forgivable costs.

Section 1106 of the CARES Act described a proportional reduction formula that applied to a reduction of full-time equivalent employees, but the interim guidance omits the formula and states the SBA will provide further guidance on loan forgiveness. In addition, any proceeds of a PPP loan used for purposes other than those permitted will not be eligible to be forgiven and knowingly violating the permitted uses restrictions could result in additional liability for the borrower.

Lenders are not required to conduct any verification of borrower certifications and can rely on such certifications for purposes of loan forgiveness.

The information in this Client Alert is current as of April 9, 2020 and is an update to our initial Client Alert April 3, 2020 (*Small Business Administration Business Loan Program Temporary Changes; Paycheck Protection Program*). We are committed to keeping our clients informed of important issues that affect them, including as a result of the COVID-19 pandemic.

Shumaker's Financial Services practice group has extensive experience in representing both financial institutions and commercial borrowers in a variety of transactions and structures, in all areas of commercial lending. Please contact us if you have questions regarding this Client Alert or if we can be of assistance in reviewing loan documentation and advising of potential courses of action.

¹ [Docket No. SBA-2020-0015]; 13 CFR Part 120

² Client Alert: Federal Financial Institution Regulators Encourage Financial Institutions to Work with Borrowers, April 8, 2020 <https://www.shumaker.com/latest-thinking/publications/2020/04/client-alert-federal-financial-institution-regulators-encourage-financial-institutions-to-work-with-borrowers>

³ On April 7th, Secretary Mnuchin announced that the administration intends to request an additional \$250 billion for this program.

For the most up-to-date legal and legislative information related to the coronavirus pandemic, please visit our Shumaker COVID-19 Client Resource Center at [shumaker.com](https://www.shumaker.com). We have also established a 24/7 Legal & Legislative Helpline at 1.800.427.1493 monitored by Shumaker lawyers around the clock.

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