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Client Alert: Additional Guidance on Paycheck Protection Program (PPP) Qualifications

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The Treasury Department has been releasing additional guidance through its Frequently Asked Questions ("FAQ") publication, located at <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>. This alert updates previous Shumaker Client Alerts.

Certification for Paycheck Protection Program Loan

When submitting a Paycheck Protection Program (PPP) application, all borrowers must certify in good faith that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the applicant." On April 23, 2020, the Small Business Administration (SBA) updated the FAQ document to add number 31, which suggests that public companies with access to capital markets may not be able to make the certification in good faith. Less than a week later, the SBA added FAQ 37 to impute the same standard on "businesses owned by private companies," followed by FAQ 39, which insinuated that *all* borrowers had to be mindful of whether the certification was made in good faith. The SBA allows borrowers to repay PPP loans by May 14, 2020 to avoid any issues with the certification standards and to instead be eligible for the Employee Retention Credit created under Section 2301 of the CARES Act.

The latest update added FAQ 46, which states that any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the relevant certification in good faith. To further ensure PPP loans are limited to eligible borrowers in need, the SBA decided, in consultation with the Department of the Treasury, that it will review all loans in excess of \$2 million, in addition to other loans as appropriate, following the lender's submission of the borrower's loan forgiveness application.

For borrowers that, together with their affiliates, received loans in excess of \$2 million, if the SBA determines the borrower lacked the adequate basis for the certification, the SBA will inform the borrower that no part of

the loan will be forgiven and will request the borrower to repay the outstanding PPP loan balance. If the borrower repays the loan after receiving notification from the SBA, the SBA will not pursue administrative enforcement or referrals to other agencies based on its determination.

Finally, the SBA advises that if an employer that repays its PPP loan by the safe harbor deadline (May 14, 2020), it will be eligible for the Employee Retention Credit.

Borrower Eligibility – Counting Employees

A borrower must calculate the total number of employees, including part-time employees, when determining its employee headcount for purposes of the eligibility threshold. For example, if a borrower has 200 full-time employees and 50 part-time employees each working 10 hours per week, the borrower has a total of 250 employees. For purposes of loan forgiveness, however, the CARES Act uses the standard of “full-time equivalent employees” to determine the extent to which the loan forgiveness amount will be reduced in the event of workforce reductions.

For purposes of the PPP’s 500 or fewer employee size standard, an applicant must count all of its employees and the employees of its U.S. and foreign affiliates, absent a waiver of, or an exception to the affiliation rules. Business concerns seeking to qualify as a “small business concern” under Section 3 of the Small Business Act on the basis of the employee-based size standard must do the same. PPP applicants and lenders may consider IRS regulations (26 CFR § 1.121-1(b)(2)) when determining whether an individual employee’s principal place of residence is in the United States.

Changes in Ownership of a Business

PPP loans are available only to applicants that were “in operation on February 15, 2020.” If a business was in operation on February 15, 2020, but had a change in ownership after February 15, 2020, it would likely be eligible for a PPP loan if it meets the other eligibility criteria. Even if an acquiring business that was not in operation until after February 15, 2020 acquired a business that was in operation on February 15, 2020, by purchasing substantially all the assets of the business and the change in ownership results in the assignment of a new tax ID number, the business acquiring the assets will be eligible to apply for a PPP loan. If the acquiring business has maintained the operations of the pre-sale business, the acquiring business may rely on the historic payroll costs and headcount of the pre-sale business for the purposes of its PPP application, except where the pre-sale business had applied for and received a PPP loan.

Forgiveness of PPP Loan When Employees Refuse to Return to Work

The interim final rule will exclude laid-off employees whom the borrower offered to rehire (for the same salary/wages and same number of hours) from the CARES Act’s loan forgiveness reduction calculation. A borrower’s PPP loan forgiveness amount will not be reduced if the borrower laid off an employee, offered to rehire the same employee, but the employee declined the offer. The borrower must have made a good-faith, written offer of rehire, and the employee’s rejection of that offer must be documented by the borrower. Employees and employers should be aware that employees who reject offers of re-employment may forfeit eligibility for continued unemployment compensation.

Seasonal Employers

A seasonal employer that elects to use a 12-week period between May 1, 2019 and September 15, 2019 to calculate its maximum PPP loan amount may make all the required certifications on the Borrower Application Form. On April 27, 2020, Treasury issued an interim final rule allowing seasonal borrowers to use

an alternative base period for purposes of calculating the loan amount for which they are eligible under the PPP. An applicant that is otherwise in compliance with applicable SBA requirements and that complies with Treasury's interim final rule on seasonal workers, will be deemed eligible for a PPP loan under SBA rules. Instead of following the instructions on page three of the Borrower Application Form for the time period for calculating average monthly payroll for seasonal businesses, an applicant may elect to use the time period in Treasury's interim final rule on seasonal workers.

Clarification of Certain Payroll Costs

Payroll costs include all cash compensation paid to employees, subject to the \$100,000 annual compensation per employee limitation, and may include housing stipends or allowances.

Nonprofit Hospitals

The SBA clarified that nonprofit hospitals exempt from taxation under Section 115 of the Internal Revenue Code will indeed qualify as "nonprofit organizations" under Section 1102 of the CARES Act even though they are not exempt under Internal Revenue Code Section 501(a). As background, many nonprofit hospitals are exempt under Section 115 of the Internal Revenue Code and not under Section 501(a). Section 1102 of the CARES Act defines the term "nonprofit organization" as "an organization that is described in Section 501(c)(3) of the Internal Revenue Code of 1986 and that is exempt from taxation under Section 501(a) of such Code." It seemed that the CARES Act drafters unintentionally omitted nonprofit hospitals exempt from taxation under Section 115 of the Internal Revenue Code, and which have not sought to be recognized by the IRS as exempt in Section 501(a) because they are otherwise fully tax-exempt under a different provision of the Internal Revenue Code.

Accordingly, the Administrator will treat a nonprofit hospital exempt from taxation under Section 115 of the Internal Revenue Code as meeting the definition of "nonprofit organization" under Section 1102 of the CARES Act if the hospital reasonably determines, in a written record maintained by the hospital, that it is an organization described in Section 501(c)(3) of the Internal Revenue Code and is therefore, within a category of organization that is exempt from taxation under Section 501(a). The hospital's certification of eligibility on the Borrower Application Form cannot be made without this determination. This approach helps accomplish the statutory purpose of ensuring that a broad range of borrowers, including entities that are helping to lead the medical response to the ongoing pandemic, can benefit from the loans provided under the PPP. This determination need not account for the ancillary conditions set forth in Section 501(r) of the Internal Revenue Code and elsewhere associated with securing the tax exemption under that section. Section 501(r) states that a hospital organization shall not be treated as described in Section 501(c)(3) unless it meets certain community health and other requirements. However, Section 1102 of the CARES Act defines the term "nonprofit organization" solely by reference to Section 501(c)(3), and Section 501(r) does not amend Section 501(c)(3). Therefore, for purposes of the PPP, the requirements of Section 501(r) do not apply to the determination of whether an organization is "described in Section 501(c)(3)."

Agricultural Producers, Farmers and Ranchers, Agricultural Cooperatives, and OtherCo-ops

Agricultural producers, farmers, and ranchers are eligible for PPP loans if: (i) the business has 500 or fewer employees, or (ii) the business fits within the revenue-based sized standard, which is average annual receipts of \$1 million. Additionally, agricultural producers, farmers, and ranchers can qualify for PPP loans as a small business concern if their business meets SBA's "alternative size standard." The "alternative size standard" is currently: (1) maximum 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. For all of these criteria, the applicant

must include its affiliates in its calculations. Also, so long as other PPP eligibility requirements are met, small agricultural cooperatives and other cooperatives may receive PPP loans.