



MDM&C Update

June 7, 2020

SBA PAYCHECK PROTECTION LOANS FOR SMALL BUSINESS CONCERNS

SIGNIFICANT AMENDMENT TO PAYCHECK PROTECTION LOAN PROGRAM.

On June 5, 2020, the President signed into law the *Paycheck Protection Program Flexibility Act of 2020* (the “Flexibility Act”), a new law that significantly changes the Paycheck Protection Loan Program. A direct response to the plight of many small businesses that remain fully or partially shuttered by state and local government mandate, the new law aims to alleviate some of the program restrictions that disadvantaged, or outright penalized, borrowers unable to restart business operations within the 8 week “covered period” established by the original law. In addition, this new law overrules some of the Paycheck Protection Loan restrictions imposed by the Treasury and the SBA under rulemaking authority.

In summary:

Extension of Maturity Date. The Flexibility Act establishes that new Paycheck Protection Loans will have a maturity date of not less than five years (up from the original 2 year maturity). This aspect of the Flexibility Act is not retroactive to Paycheck Protection Loans made prior to June 5, 2020. The Act does suggest, however, that lenders and borrowers of existing Paycheck Protection Loans may mutually agree to extend the maturity to five years.

Payroll Costs Reduced to 60%. Overruling the SBA mandate that 75% of loan proceeds be used for Payroll Costs to be eligible for forgiveness, the Flexibility Act reduces the Payroll Costs requirement to 60%, allowing 40% of loan proceeds to be used for rent, utilities and mortgage interest.¹

Option to Extend 8 Week Covered Period to 24 Weeks. Borrowers of existing Paycheck Protection Loans now have the option to retain the original 8 week “covered period”² or elect a “covered period” of 24 weeks (but not past December 31, 2020) as the measurement period for loan forgiveness (and also for measurement of employee headcount, addressed below). For new loans, the “covered period” to measure eligibility for loan forgiveness is 24 weeks (but not past December 31, 2020).

June 30 is now December 31, 2020. Deadlines or time periods ending on June 30 in the original law are now extended to December 31, 2020 (more on this below on the employee rehire exemption).

¹ Principal payments or prepayments on mortgages are not permissible uses of Paycheck Protection Loans.

² Commencing on the date of origination of the loan.

Extension of Repayment Deferral and Application for Forgiveness. Consistent with the longer “covered period,” the original 6-month repayment deferral has been extended to coincide with the date the forgiveness determination is made. Applications for loan forgiveness must be made within 10 months of the last day of the applicable covered period. If a borrower fails to apply for loan forgiveness within this timeframe, the borrower must commence making loan amortization payments.

Revised Exceptions to Employee Headcount Reduction of Loan Forgiveness. Under the Paycheck Protection Program, the amount of the loan eligible for forgiveness (loan proceeds used for permitted uses and conforming to the 60/40 split) is proportionally reduced based on reduction in employee headcount, and employee compensation, during the “covered period” as compared to headcount and employee compensation in stated earlier, pre-pandemic periods. So the election of a “covered period” of 8 weeks or 24 weeks will affect the headcount measurement for purposes of determining any proportional reduction in the amount of the loan eligible for forgiveness. But, under the original law, borrowers who laid off workers between February 15 and April 26, 2020 and “eliminate” these layoffs by June 30, 2020 avoid this reduction in the amount eligible for forgiveness.³ The Flexibility Act changes June 30 to December 31, 2020.⁴ The Flexibility Act also adds two new circumstances in which borrowers can avoid this proportionate reduction of forgiveness eligibility: (1) if the borrower can document an inability to rehire individuals who were employees on February 15, 2020 or similarly qualified employees for unfilled positions on or before December 31, 2020, or (2) if the borrower can document an inability to return to the same level of pre-February 15, 2020 business activity due to compliance with Federal requirements or guidance⁵ relating to COVID-19 employee or customer safety.

Payroll Tax Delay Now Available. Under the original CARES Act, an employer who was not a borrower under the Paycheck Protection Program could defer 50% of payment of the employer’s share of Federal Social Security payroll taxes for Q2-Q4 of 2020 to December 31, 2021 and defer the remaining 50% to 2022. The Flexibility Act now allows borrowers of Paycheck Protection Loans to also avail themselves of this Social Security payroll tax deferral.

SBA GUIDANCE AND RULES REGARDING THE PAYCHECK PROTECTION LOAN PROGRAM

On April 24, 2020, the SBA issued, and has since periodically updated, guidance in the form of *Frequently Asked Questions* (link to the FAQs below):

<https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>

The SBA’s FAQs of more common interest are copied below. As a result of public and political backlash over several larger companies receiving Paycheck Protection Loans, the SBA has been motivated to heighten its scrutiny of the “need” qualifications of applicants, which arguably was presumed under the intent of the original legislation. The SBA’s guidance on this issue is

³ Some SBA rules softened this requirement in the instance where workers offered in writing to be rehired declined to return to work.

⁴ Appears the new December 31 date will apply even to borrowers who elect to retain the original 8 week covered period.

⁵ Requirements or guidance issued by the Centers for Disease Control (CDC), U.S. Department of Health and Human Services (HHS), or the federal Occupational Health and Safety Administration (OHSAs).

contained in FAQ 31. In FAQ 48, the SBA clarified that borrowers of Paycheck Protection Loans below \$2 million will not be subject to such scrutiny.

7. Question: *The CARES Act excludes from the definition of payroll costs any employee compensation in excess of an annual salary of \$100,000. Does that exclusion apply to all employee benefits of monetary value?*

Answer: *No. The exclusion of compensation in excess of \$100,000 annually applies only to cash compensation, not to non-cash benefits, including:*

- *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.*

8. Question: *Do PPP loans cover paid sick leave?*

Answer: *Yes. PPP loans covers payroll costs, including costs for employee vacation, parental, family, medical, and sick leave. However, the CARES Act excludes qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act (Public Law 116–127).*

16. Question: *How should a borrower account for federal taxes when determining its payroll costs for purposes of the maximum loan amount, allowable uses of a PPP loan, and the amount of a loan that may be forgiven?*

Answer: *Under the Act, payroll costs are calculated on a gross basis without regard to (i.e., not including subtractions or additions based on) federal taxes imposed or withheld, such as the employee’s and employer’s share of Federal Insurance Contributions Act (FICA) and income taxes required to be withheld from employees. As a result, payroll costs are not reduced by taxes imposed on an employee and required to be withheld by the employer, but payroll costs do not include the employer’s share of payroll tax. 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.*

31. Question: *Do businesses owned by large companies with adequate sources of liquidity to support the business’s ongoing operations qualify for a PPP loan?*

Answer: *In addition to reviewing applicable affiliation rules to determine eligibility, all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application. Although the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere (as defined in section 3(h) of the Small Business Act), borrowers still must certify in good faith that their PPP loan request is necessary. Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business. For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.*

46. **Question:** How will SBA review borrowers' required good-faith certification concerning the necessity of their loan request?

Answer: [Excerpts] When submitting a 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.” * * * 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 required certification concerning the necessity of the loan request in good faith.

Importantly, borrowers with loans greater than \$2 million . . . may still have an adequate basis for making the required good-faith certification, based on their individual circumstances [A]ll PPP loans in excess of \$2 million, and other PPP loans as appropriate, will be subject to review by SBA for compliance with program requirements If SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request . . . [SBA footnotes omitted].

In addition to its FAQs, the SBA and Department of the Treasury have exercised their authority to enact regulations governing the Paycheck Protection Program, some of which we highlight below:

SBA Rule on Program Requirements, Affiliation and Eligibility (issued April 24, 2020):

- Clarified eligibility requirements (or ineligibility) of various business enterprises (for example, hedge funds, private equity firms, hospitals) for Paycheck Protection Loans.
- Established a safe harbor through May 7 (later extended to May 18) for borrowers who determined they are ineligible in light of the new SBA guidance to return loan funding without penalty.

SBA Rule on Treatment of Entities with Foreign Affiliates (issued May 18, 2020):

- Employees of a borrower's foreign affiliates (as determined by the SBA affiliation rules) are included for purposes of determining whether it is under the 500-employee eligibility threshold.
- Under no circumstances may PPP funds be used to support non-U.S. workers or operations.

SBA Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities (issued on May 22, 2020):

- Regardless of the size of a PPP loan, the SBA may review any individual PPP loan with regard to borrower eligibility, loan amounts, and use of proceeds, and loan forgiveness amounts.

- Borrowers will have the opportunity to respond to the SBA questions arising from a review. However, failure to respond to an SBA inquiry may result in a determination that the borrower was ineligible for a PPP loan or ineligible to receive the loan amount or loan forgiveness amount claimed.
- If the SBA determines a borrower is ineligible for a PPP loan, SBA will direct the lender to deny the loan forgiveness application and seek repayment of the outstanding PPP loan balance or pursue other available remedies.

SBA Rule on Loan Forgiveness (issued on May 22, 2020) (Anticipate that the SBA will revise this Rule in light of the new Flexibility Act extending the “covered period” from 8 to 24 weeks):

- Salary, wage, or commission payments to furloughed employees and bonus and hazard pay during the covered (8-week) period are eligible for loan forgiveness.
- Loan forgiveness applicable as to loan proceeds paid to owner-employees, self-employed individuals, general partners and Schedule C filers are subject to stated limitations.
- Non-payroll costs (rent, utilities, certain interest payments) are eligible forgiveness if they are 1) paid during the covered period; or ii) incurred during the covered period and paid on or before the next regular billing date, even if the billing date is after the covered period.
- A borrower’s loan forgiveness amount will not be reduced if the borrower laid off or reduced the hours of an employee and then offered in writing to rehire ***the same employee*** for the same salary and same number of hours, or restore the reduction in hours, but the employee declined the offer, and the employer reports this information to the applicable state unemployment insurance office.
- For purposes of calculating a reduction in loan forgiveness based on a reduction in employee headcount, Full-Time Equivalent Employee is defined as an employee who works 40 hours or more per week on average. The Rule provides guidance on how to characterize employees who work more or less than 40 hours per week during the covered period.
- Borrowers seeking loan forgiveness account for the reduction based on a reduction in the number of employees, the salary/wage reduction applies only to the portion of the decline in employee salary and wages that is not attributable to the full time employee reduction.
- A borrower’s loan forgiveness amount will not be reduced on account of an employee fired for cause, or who voluntarily resigns, or voluntarily requests a schedule reduction.
- Provides some clarification on the eligibility for forgiveness of Payroll Costs incurred” but not paid during the “covered period” by allowing employers whose payroll cycle does not align with the covered period to adopt alternate methodology.

SUMMARY OF THE PAYCHECK PROTECTION PROGRAM UNDER THE CARES ACT

On March 27, 2020, Congress passed, and the President signed into law, the CARES Act, a \$2 trillion stimulus and rescue bill designed to address the impact of the COVID-19 pandemic on the US economy and healthcare system. Among many other things, the CARES Act provides:

- \$300 billion⁶ in financial aid directed to individuals, including direct payments of \$1,200 to all Americans earning less than \$75,000 (phasing out through incomes up to \$99,000), or \$150,000 for joint returns (phasing out through joint return incomes of \$198,000) and \$112,500 for head of household), plus \$500 for each dependent child.
- \$260 billion to expand eligibility for unemployment insurance to many workers previously not eligible (such as furloughed workers and the self-employed), and add \$600 per week on top of current State unemployment benefits for up to four months.
- \$500 billion in financial assistance to mid-sized and large businesses, of which \$46 billion is earmarked for the airline industry, to be administered by the Department of the Treasury in the form of loans, loan guarantees and investments.
- \$340 billion in aid to state and local governments.
- \$117 billion in aid to hospitals and a \$100 billion public health and social emergency fund earmarked for health care providers.
- \$349 billion for loan guarantees by the Small Business Administration of loans to small businesses (increased by an additional \$310 billion on April 24, 2020).

This memorandum highlights the provisions of the “Paycheck Protection Program” under the Keeping Workers Paid and Employed Act that should be of interest to US small businesses.

As outlined above, one of the provisions of the CARES Act allocates \$349 billion in new funding for “Paycheck Protection Loans” guaranteed by the Small Business Administration for eligible small businesses and restaurants. In addition to favorable loan terms, proceeds of Paycheck Protection Loans used by borrowers for payroll, rent, utilities and mortgage interest during the 8 or 24 week period following the date of the loan may be forgiven, in essence turning a portion (or all) of the loan into a grant.

Paycheck Protection Loans under this program will be made by SBA approved banks and other lending institutions. The SBA will guarantee 100% of the loan. A business may only have one Paycheck Protection Loan.

Here are the highlights of the SBA Paycheck Protection Loan program:

Eligible Businesses. During the period February 15 to June 30, 2020, businesses in operation prior to February 1, 2020 with no more than 500 employees (or such higher number of

⁶ Allocations of the Federal funding are estimated or rounded.

employees as set by the SBA on an industry basis) are eligible for a Paycheck Protection Loan. Also, businesses in the “Accommodations and Food Service Industry” (NAICS 72) who employ not more than 500 employees per physical location are eligible for an SBA loan under the program (and SBA affiliation rules are waived for NAICS 72 businesses). Finally, sole proprietorships and self-employed individuals are also eligible for a Paycheck Protection Loan. “Employees,” for purposes of the 500 employee limit, includes full and part-time employees.

Maximum Loan Amount. The maximum loan amount is the lesser of \$10 million or the amount determined by the following method:

- 1) aggregate payroll costs⁷ from the last twelve months for employees whose principal place of residence is the United States
- 2) subtract (a) any compensation paid to an employee in excess of an annual salary of \$100,000, (b) any amounts paid to any independent contractor (1099 recipients) and/or (b) any amounts paid to a sole proprietor in excess of \$100,000 per year;
- 3) calculate average monthly payroll costs (divide the amount from step 2 by 12);
- 4) multiply the average monthly payroll costs by 2.5;
- 5) add the outstanding amount of any economic injury disaster loan (EIDL) made between January 31, 2020 and April 3, 2020, less the amount of any “advance” under an EIDL COVID-19 loan (because it does not have to be repaid).

Note that independent contractors (1099 recipients) are removed from “payroll” completely, on the notion that an independent contractor is eligible to apply for his or her own PPL as a sole proprietor.

For seasonal employers, the maximum amount is 2.5 times average monthly payroll costs during the 12 week period beginning February 15, 2019 or March 1, 2019. In all events, the cap on Paycheck Protection Loans is \$10 Million.

Allowable Uses of Loans. During the period February 15 to June 30, 2020 (the “covered period”), loan proceeds may be used for payroll costs; health care benefits; employee compensation; interest on mortgages; rent; utilities; interest on debt incurred before February 15, 2020; and refinancing SBA Economic Injury Disaster Loan made after January 31, 2020. **However, at least 60% of the proceeds must be used for “Payroll” costs.**

Loan Terms. Under this program, interest rates on Paycheck Protection Loans are 1% per annum; term is 2 years for loans originated prior to June 5, 2020, and 5 years for loans originated after June 5, 2020; lenders are required to offer payment deferment for a period of time until loan forgiveness (addressed below) is determined; no prepayment penalties; no personal guarantee requirement, loans are non-recourse to individual shareholders, members or partners (except to the extent loan proceeds are used for purposes not specified in the program);

⁷ Payroll costs includes salary, wage, commission or similar; cash tip; payment of vacation, family, medical, sick leave; allowance for dismissal or separation; health care insurance premiums; retirement benefits; state or local tax assessed on employee compensation; compensation to or income of a sole proprietor or independent contractor that is wage, commission, earnings from self-employment not more than \$100,000 in 1 year, prorated for covered period [\$37,500]; but not: compensation of any employee in excess of \$100,000 in 1 year prorated for the covered period; Federal payroll taxes for the “covered period”; compensation for a non-US resident; or qualified sick leave and family leave for which payroll tax credit is allowed under the Family First Coronavirus Response Act.

no collateral requirement; and no requirement that the business is unable to obtain credit elsewhere.

Loan Amount Eligible for Forgiveness. Some or all of the Paycheck Protection Loan is eligible for forgiveness, effectively turning the forgiven portion of the loan into a Federal grant.⁸ Subject to reduction as outlined below, the amount of the loan eligible for forgiveness is the amount equal to the borrower's payroll costs (including additional wages paid to tipped employees), mortgage interest, rent and utility payments incurred and paid during the 8 week period beginning on the date of origination of the Paycheck Protection Loan, not to exceed the principal amount of the loan. **However, at least 60% of the loan eligible for forgiveness must be used for Payroll costs.**⁹

Reduction in Forgivable Amount of Loan. The portion of the Paycheck Protection Loan eligible for forgiveness will be reduced based on reductions in employee headcount, and reductions in pay, as follows (unless the rehire exemption outlined below is applicable):

- The amount eligible to be forgiven shall be reduced by multiplying such amount by the borrower's
 - average number of full time equivalent employees per month employed during the 24 week period following the date of the loan (or shorter period ending December 31, 2020)divided by
 - average number of full time equivalent employees per month during the period February 15, 2019 to June 30, 2019 (or, alternatively at the option of borrower, the period January 1, 2020 to February 29, 2020).
- In addition, the amount eligible to be forgiven shall be reduced by the amount that pay for any employee earning less than \$100,000 per year is reduced during the 24 week period following the date of the loan (or shorter period ending December 31, 2020) in excess of 25% of such employee's pay for the prior calendar quarter. (So borrowers can reduce employee pay by up to 25% without impacting loan forgiveness; and pay can be reduced for employees earning more than \$100,000 without impacting loan forgiveness.)

Rehire Exemption from Reduction in Forgivable Amount. If between February 15, 2020 and April 26, 2020, a Borrower reduced the number of its full time equivalent employees and/or reduced by more than 25% the pay of its employees earning less than \$100,000 per year, and by December 31, 2020, the borrower eliminates such reduction in number of employees and reduction in pay, then the amount eligible for loan forgiveness shall not be reduced by reason of the prior reduction of number of employees or reduction in pay of employees earning less than \$100,000 per year.

⁸ Amounts forgiven shall be treated as cancelled indebtedness.

⁹ At present, it is uncertain if the 75% rule will be applied such that (a) if less than 75% of the proceeds used during the 8 week period are for Payroll costs, none of the loan is eligible for forgiveness, or (b) loan proceeds used during the 8 week period for Payroll Costs, plus an additional 25% of the loan proceeds used for rent, utilities and other allowable uses, becomes the amount eligible for forgiveness.

Additional Exemptions from Reduction in Forgivable Amount. In addition to the rehire exemption outlined above, if the borrower can document (1) an inability to rehire individuals who were employees on February 15, 2020 or similarly qualified employees for unfilled positions on or before December 31, 2020, or (2) an inability to return to the same level of pre-February 15, 2020 business activity due to compliance with Federal requirements or guidance relating to COVID-19 employee or customer safety, then the loan amount eligible for forgiveness will not be reduced by reason of the prior reduction of number of employees or reduction in pay of employees earning less than \$100,000 per year.

Relationship to Economic Injury Disaster Loans (EIDL). If an applicant received an Economic Injury Disaster Loan from the SBA between January 31, 2020 and April 3, 2020, the applicant can apply for a Paycheck Protection Loan. If the Economic Injury Disaster Loan was not used for payroll costs, it does not affect eligibility for a Paycheck Protection Loan. If the Economic Injury Disaster Loan was used for payroll costs, the Paycheck Protection Loan must be used to refinance the Economic Injury Disaster Loan.

Please do not hesitate to contact us for further information or assistance with the needs of your business.

Offices

[NEW JERSEY](#) | [NEW YORK](#) | [COLORADO](#) | [PENNSYLVANIA](#)
[CONNECTICUT](#) | [MASSACHUSETTS](#) | [DELAWARE](#) | [RHODE ISLAND](#) | [FLORIDA](#)

The information provided in this Newsletter should not be relied upon as legal advice or a legal opinion on any specific set of facts or circumstances. The contents are intended for general information purposes only and you are urged to consult an attorney concerning your own situation and any specific legal questions you may have. This Newsletter may be considered Advertising under the court rules of certain states.

© COPYRIGHT 2020 MCELROY, DEUTSCH, MULVANEY & CARPENTER, LLP. ALL RIGHTS RESERVED.