

URGENT – U.S. Treasury and SBA Offer Additional Guidance on “Paycheck Protection Program” (PPP)

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On March 27, 2020, Congress approved the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) to provide financial assistance to individuals and businesses. Title I of the CARES Act (the “Keeping Workers Paid and Employed Act”) includes several provisions intended to help small business suffering the adverse economic effects of the coronavirus (“COVID-19”). Among those is the establishment of a new loan program called the [“Paycheck Protection Program” \(“PPP”\)](#) and the allocation of \$349 billion for the making of PPP loans. Additionally, for eligible borrowers, a portion, and potentially all, of the amount of funds borrowed under this program may be forgiven without payment. Our full description of the PPP is available [here](#).



Late yesterday, the U.S. Department of Treasury issued additional clarifying [rules and guidance](#) on the PPP. Here are some of the highlights:

- **Additional Eligibility Requirement.** In addition to the prior maximum employee count requirement, the new rules state that in order to be eligible, an applicant must be either:

- *“a [small business concern](#) as defined in section 3 of the Small Business Act (15 USC 632), and subject to SBA’s affiliation rules under 13 CFR 121.301(f) unless specifically waived in the [CARES Act].”* The SBA defines a “small business concern” as an entity which:

- is organized for profit;
- has a place of business in the U.S.;
- operates primarily within the U.S. (*or otherwise making a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor*);
- is independently owned and operated; and
- is not dominant in its field on a national basis;

or:

- *“a tax-exempt nonprofit organization described in section 501(c)(3) of the Internal Revenue Code (IRC), a tax-exempt veterans organization described in section 501(c)(19) of the IRC, Tribal business concern described in section 31(b)(2)(C) of the Small Business Act, or any other business.”* Note, this category specifically identifies only 501(c)(3) nonprofit organization organizations and thus appears to excluded all other categories.

The above qualification was not originally included in the CARES Act and will require applicants to now review whether they can now fall within one of the above categories.

- **Additional Eligibility Disqualifiers.** The new rules provide that an applicant that would otherwise be eligible for a PPP loan based on the eligibility requirements may be disqualified if:
 - the applicant is engaged in any activity that is illegal under federal, state, or local law;
 - the applicant is a household employer (individuals who employ household employees such as nannies or housekeepers);
 - any owner of 20 percent or more of the equity of the applicant is incarcerated, on probation, on parole; presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction; or has been convicted of a felony within the last five years; or
 - the applicant, or any business owned or controlled by the applicant or any of its owners, has ever obtained a direct or guaranteed loan from SBA or any other Federal agency that is currently delinquent or has defaulted within the last seven years and caused a loss to the government.

Without limiting the generality of the foregoing and although there is no definitive guidance on the subject to date, it would appear the first category above, on its face, may serve to automatically disqualify any cannabis related entity (i.e. as the growth and sale of cannabis is still prohibited on the federal level).

In addition to the above, the new rules specifically provide that any of the following types of businesses (as identified in Section 120.110) are specifically excluded:

- non-profit businesses (except for those specifically permitted under the CARES Act), however for-profit subsidiaries are eligible;
- financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (*pawn shops, although engaged in lending, may qualify in some circumstances*);
- passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (*except Eligible Passive Companies under Section 120.111*);
- life insurance companies;
- businesses located in a foreign country (*although businesses in the U.S. owned by aliens may qualify*);
- pyramid sale distribution plans;
- businesses deriving more than one-third of gross annual revenue from legal gambling activities;
- businesses engaged in any illegal activity;
- private clubs and businesses which limit the number of memberships for reasons other than capacity;
- government-owned entities (*except for businesses owned or controlled by a Native American tribe*);
- businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting;
- loan packagers earning more than one third of their gross annual revenue from packaging SBA loans;
- businesses with an associate who is incarcerated, on probation, on parole, or has been indicted for a felony or a crime of moral turpitude;

- businesses in which the lender or CDC, or any of its associates, owns an equity interest;
- businesses which:
 - present live performances of a prurient sexual nature; or
 - derive directly or indirectly more than de minimis gross revenue through the sale of products or services, or the presentation of any depictions or displays, of a prurient sexual nature;
- unless waived by SBA for good cause, businesses that have previously defaulted on a federal loan or federally assisted financing, resulting in the federal government or any of its agencies or departments sustaining a loss in any of its programs, and businesses owned or controlled by an applicant or any of its associates which previously owned, operated, or controlled a business which defaulted on a federal loan (or guaranteed a loan which was defaulted) and caused the federal government or any of its agencies or departments to sustain a loss in any of its programs. for purposes of this section, a compromise agreement shall also be considered a loss;
- businesses primarily engaged in political or lobbying activities; and
- speculative businesses (such as oil wildcatting).
- **Modified Loan Terms.** While the CARES Act provides that PPP loans will have a maximum interest rate of 4% and a maximum repayment term of 10 years, the new rules state specifically that PPP loans will have an interest rate of 1% and a term of only 2 years.
- **Treatment of Independent Contractors.** There was some ambiguity in the CARES Act with respect to the treatment of independent contractors by entity applicants. The new rules offer the following additional guidance:
 - independent contractors do not count as employees for purposes of determining the employee count required for general eligibility;
 - with respect to entity applicants, payments made to independent contractors should be excluded from determining average “payroll costs” for purposes of determining the maximum PPP loan the applicant is eligible for; and
 - with respect to entity borrowers, payments of PPP loan proceeds made to independent contractors will not be eligible for forgiveness.
- **Treatment of Federal Employment Taxes.** The new rules provided that in calculating average “payroll costs” for purposes of determining the maximum PPP loan the applicant is eligible for, all federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020 are to be excluded (including the employee’s and employer’s share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees).
- **Modified Rules Regarding Eligible Forgiveness Amount.** The CARES Act provides that a borrower who obtains a PPP loan may qualify for forgiveness of a portion (and potentially all) of the principal of the indebtedness if, and to the extent, the loan funds were used during the eight-week period commencing on the opening of the respective loan (**the “Forgiveness Period”**) to fund any one or more of the following (*collectively, the “Eligible Forgiveness Amount”*):
 - payroll costs;
 - payments of interest on indebtedness secured by a mortgage on real or personal property that was incurred prior to February 15, 2020;
 - payments on leases entered into and in force prior to February 15, 2020; and
 - payments for all utilities that were in service prior to February 15, 2020.

While the CARES Act does not provide any limitation on how loan proceeds are allocated among the above categories, the new rules provide that not more than 25% of the Eligible Forgiveness Amount may be attributable to non-payroll costs. Put another way, 75% or more of the Eligible Forgiveness Amount will need to be spent on payroll costs. It appears that this cap will only be applied in determining the ultimate amount that may be forgiven. So, for a borrower whose total Eligible Forgiveness Amount includes payments to one or more of the other categories in greater amounts than allowed by the cap will be limited on exactly how much of such amounts may ultimately be forgivable. It should also be noted that the new rules provide that the SBA will issue additional guidance on loan forgiveness so there may be further specifications/limitations as to how a borrower's actual forgiveness amount will be calculated.

- **Automatic Deferment.** The new rules specifically provide that PPP loan borrowers will not have to make any payments for the first 6 months following the date of disbursement of the loan.
- **Penalties for Improper Use of PPP Loan Funds.** Under the CARES Act, until June 30, 2020 loan funds may only be used to pay one or more of the following expenses:
 - direct payroll costs;
 - costs related to the continuing of group health care benefits (*including paid sick, medical or family leave and insurance premiums*);
 - employee salaries, commissions, or similar compensation;
 - payments of interest on any mortgage obligation (*specifically excluding the payment or prepayment of principal*);
 - rent (*including rent under any lease agreement*);
 - utilities; and
 - interest on other debt obligations that were incurred before February 15, 2020.

The new rules provide that a borrower who uses PPP loan funds for unauthorized purposes will be required to repay all such amounts. They also provide that: (a) if a borrower knowingly use PPP loan funds for unauthorized purposes, it will be subject to additional liability such as charges for fraud; and (b) if any shareholder, member, or partner of an entity borrower uses PPP loan funds for unauthorized purposes, the SBA will have recourse directly against such person(s).

- **Lenders Held Harmless.** Based on the provisions of the CARES Act which effectively pushed all PPP loan underwriting to the respective lending entities, many such lending entities were concerned about potential associated liability. The new rules assuage these concerns by providing that: (a) a lender issuing loans under the PPP *"does not need to conduct any verification if the borrower submits documentation supporting its request for loan forgiveness and attests that it has accurately verified the payments for eligible costs;"* and (b) the SBA *"will hold harmless any lender that relies on such borrower documents and attestation from a borrower."*
- **Lenders Not Required To Apply Credit Elsewhere Test.** Under a traditional SBA Section 7(a) loan an issuing lender is required to apply the "credit elsewhere test" (*as set forth in section 7(a)(1)(A) of the Small Business Act (15 USC 636) and SBA regulations at Section 120.101*) to determine if the applicant has access to credit other than the subject loan. While PPP loans are SBA Section 7(a) loans and would otherwise require such test to be performed, the new rules specifically release PPP lender from this requirement.
- **Modified Rules Regarding Affiliates.** Except for the specified limited exceptions currently made for hotel and restaurant applicants in the CARES Act, PPP loan applicants are currently subject to the applicable SBA affiliation rules, Section 121.103 and Section 121.301. However, the new rules specifically provide that the *"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."* As of the date of this publication that additional guidance has not yet been made available. That being said, many expect the SBA to loosen these affiliation rules to some extent so applicants who are otherwise currently not eligible for PPP loans should keep an eye out for this additional guidance.

In addition to the above, the SBA released a revised form of [PPP loan application](#). While it corrects some of the discrepancies from the prior form, there are still discrepancies between the application form and the terms of the CARES Act/new rules. Most notably, the application instructions state that applicants (*other than new/seasonal businesses*) should be calculating their average payroll costs based on the 2019 calendar year whereas the CARES Act/new rules appear to imply that these amounts should be calculated for the trailing twelve month (TTM) period.

We will continue to follow this and the other CARES Act programs and offer updates as further developments arise. If you have any questions, please contact Anthony Zeoli or another member of the Freeborn & Peters LLP CARES Act team: Steven M. Hartmann, Meghan E. Tepas, and Karen A. Hayes or visit [Freeborn's COVID-19 webpage](#).

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