

Federal Relief Package Includes \$350 Billion for Small Business – Here Are the Details

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The United States Senate passed H.R. 748, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) late in the evening of Wednesday, March 25. The House of Representatives is expected to consider and pass the bill on Friday, and, President Trump to sign it shortly thereafter.

Title I of Division A of the CARES Act is entitled the Keeping American Workers Paid and Employed Act. Title I provides over \$350 billion in, in part, short-term economic relief for small businesses, non-profit organizations, veterans organizations, and Tribal business concerns facing business disruption from the novel coronavirus COVID-19. For its part, Title I creates what is known as the “Paycheck Protection Program” (“PPP”).

In summary, the PPP provides \$349 billion for expedited, low-interest business interruption loans to small entities. The loans will be backed with a 100% federal guarantee and funding, through the Small Business Administration’s traditional Section 7(a) lending authority. The Section 7(a) program is the SBA’s primary program for providing financial assistance to small businesses that would not otherwise have access to credit for the same uses or on the same terms. There are nearly 2,000 SBA-approved lenders nationwide. The PPP broadens and increases the flexibility of the Section 7(a) lending program in significant ways.

Principally, under the PPP, funding can be used for a wide range of daily operating expenses. Under the PPP, the loan’s term can be up to ten years. Fees for these loans are waived. Significantly, no collateral or personal loan guarantee is required. These loans are also non-recourse to a borrower’s principals, if the loan is used for permissible purposes (described below). No pre-payment penalty is allowed. The interest rate is capped at 4%. The maximum loan amount calculation is largely made using monthly payroll costs and capped at \$10 million. For eligible “impacted” borrowers (basically, any borrower that qualifies for a loan), loan repayment deferral is available for no less than six months and up to one year. Flexible terms are also available for loan modifications. PPP lending authority will extend “during the covered period” of February 15, 2020, through June 30, 2020.

Further, and with some qualifications, the PPP provides tax-free forgiveness of that portion of these PPP small entity loans used for paying workers, mortgage interest and rent expenses, and utilities during the 8-week period beginning on the date the loan was originated. In addition to current Section 7(a)-approved SBA lenders, the PPP authorizes the SBA and Treasury Department quickly to approve the participation of other lenders (insured depository institutions, credit unions, farm credit system lenders, and other lenders) in originating and servicing these loans.

Because the PPP is utilizing an existing lending program, lending should be able to begin over the near term. The CARES Act sets a 15-day deadline for the SBA to issue regulations needed to carry out the PPP. Once SBA-approved lenders can proceed to make loans under the program, under

standard SBA timelines, an SBA loan can be made available in as little as 36 hours, but generally within 5 to 10 business days. These loans can be made by the lender without seeking specific SBA approval for any loan.

PPP Qualification

An entity qualifies as a eligible borrower under the PPP if it meets the following: (1) the borrower can make a “good faith” certification of COVID-19-related business injury (quoted below); (2) the borrower meets applicable SBA size standards for number of employees and independence; (3) the borrower was in business on February 15, 2020; (4) the borrower will use the funds to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments; and (5) the employer is not double-dipping, that is, seeking or having already obtained the same type of PPP loan from another lender.

Summary of Small Business Qualification Threshold

Small business size standards vary by industry sector and subsector. In addition to small businesses that qualify as small under current regulations, the CARES Act small, business loan provisions expand the pool of eligible businesses to include businesses with the greater of (1) 500 employees or (2) an SBA established size standard of greater than 500 employees. For instance, the United States manufacturing sector has NAICS codes in the 500, 750, 1000, 1250 and 1500 employee count depending on the subsector. For a business to qualify as “small” in counting employees to determine size, the SBA considers a company’s domestic and foreign affiliates. As a result, the application of SBA’s “affiliation” rules are important in determining program eligibility.

For PPP purposes, “employee” is defined to include “individuals employed on a full-time, part-time, or other basis.”

COVID-19 Related Business Injury Certification

To demonstrate injury, the borrower must make a “good faith certification” ... “that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the [prospective borrower].” This certification appears to be a qualitative determination by the prospective borrower, and does not require extensive, if any, quantitative documentation. The SBA regulations may provide more detail.

Expanded Eligibility for Section 7(a) Lending Criteria under PPP

The PPP extends eligibility for a CARES Act-based small business loan beyond the pool of “small business concerns,” as that termed is traditionally defined for SBA lending and other purposes. More specifically, in addition to a “small business concern” as defined in the Small Business Act (which is limited to a small-sized for-profit operating company), the PPP extends eligibility to “any business concern, non-profit organization, veterans organization, or Tribal business concern” if the entity “employs not more than the greater of (I) 500 employees; or (II) if applicable, the size standard in number of employees the SBA has established for the industry in which [the entity] ... operates.” Section 7(a) requirements for a borrower to demonstrate an inability to obtain credit are waived.

Self-employed individuals, sole proprietorships, and independent contractors are also eligible for relief under the PPP, up to \$100,000 per year as prorated for the covered period of February 15 through June 30, 2020. This provision extends to “gig economy” workers.

The PPP also includes what is termed a “Sense of the Senate” provision, in which the legislation

recommends that the SBA “issue guidance to” lenders to prioritize processing and loan origination to borrowers in underserved and rural markets, including business concerns owned and controlled by veterans and socially and economically disadvantaged individuals, women, and businesses in operation for less than 2 years.

Meeting the Size Threshold

As explained above, the CARES Act’s PPP-specific qualification standards are based on a business concern’s employment level. The SBA establishes size thresholds based on business categories. To do so, SBA utilizes the North American Industry Classification System (“NAICS”).

An entity’s NAICS code is a six -digit number can be determined from the *North American Industry Classification System Manual* (Office of Management and Budget, 2017) ([available here](#)), and then applied to the SBA size standards ([available here](#)).

The NAICS divides the economy into 20 sectors. The first two digits of an entity’s NAICS code represent a business concern’s industry sector. NAICS then divides these 20 sectors into subsectors, and then industry groups, and NAICS industries. The *NAICS Manual* is indexed by sector in the front, and alphabetically at the back.

Affiliation standards

The SBA has traditionally been quite diligent in enforcing its size standards and a false certification can bring significant penalties. Classification as a small business generally affords a business concern an important range of government-provided benefits (for instance, favorable lending arrangements and government contracting preferences). As noted above, SBA will count a company’s affiliates to determine size, and will apply legal tests that examine common ownership and control to determine affiliation and whether an entity is beneath the applicable SBA size threshold. The SBA bases affiliation on a “totality of the circumstances” test.

SBA regulations on affiliation and corresponding SBA Office of Hearing and Appeals decisions are quite detailed. SBA’s affiliation standards are included in the Code of Federal Regulations, at 13 C.F.R. § 121.103. In addition to reviewing traditional factors such as ownership (e.g. 51% of stock) and control (e.g. board voting, management decisions), it also considers other factors including a controlling minority shareholder interest; common investments; family and business relationships between the entities’ owners; stock options and other debt or equity investments; economic dependence of firms on each other; common management; and other common interests.

Waiver of Physical Location and Affiliation Standards for Certain Sectors

Under SBA size standards generally, a business concern must add together employees at all its physical locations to determine the number of employees it has for qualification purposes.

The PPP, however, allows businesses in NAICS sector 72 to consider each physical location separately for purposes of qualifying for its lending program. NAICS sector 72 is the hard-hit traveler accommodation, and food and drinking service businesses, broadly defined. Thus, for instance, a restaurant or hotel chain that has over 500 employees at all its locations, combined, may treat each physical location individually for purpose of determining PPP eligibility if it employs not more than 500 employees at any one location.

The PPP also waives the affiliation standards, described above, for these sector 72 businesses in the travel and hospitality industries. Affiliation standards are also waived for PPP lending purposes for any business concern operating as a franchise that is assigned a franchise code identifier by the SBA, as well as any business concern that receives financial assistance from a Small Business Investment Company licensed under section 301 of the Small Business Investment Act of 1958.

Maximum Loan Amount

In short, the maximum loan amount is two and one-half months of “payroll costs,” as the PPP defines that term, or \$10 million, whichever is less. Certain very recently-originated SBA loans can also be re-financed, provided the loan remains below the \$10 million cap.

“Payroll costs” are defined to include the sum of an entity’s payments for salary, wage, commission or similar compensation; payment of cash tips or the equivalent; payment for vacation, parental, family, medical, or sick leave; allowance for dismissal or separation; payment required for the provisions of group health care benefits, including insurance premiums; payment of any retirement benefits; and payment of State or local tax assessed on the compensation of employees.

The Paycheck Protection Program excludes certain costs from the calculation of an entity’s payroll costs: the allocable monthly share of an employee’s salary in excess of \$100,000; taxes imposed under chapters 21, 22, or 24 of the IRC (26 U.S. Code § 21, § 22, § 24); compensation of any employee whose principal place of residence is outside the United States; qualified sick leave wages or family leave wages under the Families First Coronavirus Response Act.

The maximum loan amount is 2.5 times the average total monthly payments for “payroll costs” (described above) that the applicant incurred during the one-year period before the date on which the loan was made. Special calculation factors are available for seasonal employers, as well as employers that have not been in existence for 12 months. A borrower may also refinance—under the PPP’s more forgiving terms—any amount borrowed under the traditional Section 7(a) SBA loan program from January 21, 2020, through the date on which the PPP loan was made. The overall limit is \$10 million.

Allowable Uses of PPP Loans

The PPP changes the range of allowable uses for an SBA Section 7(a) loan. A loan made under its provisions can be for “payroll costs” as defined under the Act (and described above); costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums; employee salaries, commissions, or similar compensation; mortgage interest (not principal) payments and rent payments; utilities; and interest on any other debt obligations that were incurred before February 15, 2020.

Loan Origination

Lenders qualifying to participate in the SBA small business lending program are eligible to make PPP loans on the SBA’s behalf. As explained above, additional lenders may also be eligible to make loans if approved by the SBA and Treasury Department.

Borrower Certifications and Requirements

The PPP requires a loan applicant to make the following “good faith certification”:

(I) that the uncertainty of current economic conditions makes necessary the loan request to support

the ongoing operations of the eligible recipient; and

(II) acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments; and

(III-IV) the borrower has not applied for, and has not received, a “duplicative” PPP loan.

Loan Forgiveness

The PPP allows a borrower to apply for and receive tax-free forgiveness for that portion of its loan that includes payroll costs as defined above; payments of interest on any of the entity’s mortgage obligations on real or personal property for any mortgage incurred before February 15, 2020; rental payments under a leasing agreement in force before February 15, 2020; and utility (electricity, gas, water, transportation, telephone, or internet access) payments for service which began before February 15, 2020. The covered period for eligible reimbursement is the 8-week period beginning on the date of the loan’s origination. The amount of loan forgiveness cannot exceed the principal amount borrowed.

Notably, the degree of loan forgiveness is conditioned on how much of its workforce an entity maintains during the eight-week period following the date the PPP loan was originated. Reduction in forgiveness is based on the ratio of the average number of full time equivalents maintained during February 15 through June 30, 2020, to (at the borrower’s election) either (i) the average number of full time equivalents the borrower employed during the February 15 through June 30 period in 2019, or (ii) the average number of full-time equivalents the borrower employed between January 1 and February 29, 2020. (Loan forgiveness cannot, however, be expanded if the employer increased payroll from these two comparator time periods.) Separate calculations are available for seasonal employers with a work force during the covered period of February 15 through June 30, 2020, as well as for businesses not in operation before June 30, 2019. The number of employees in this specific portion of the PPP is determined by calculating the average number of full time equivalent employees for each pay period falling within a month.

The loan forgiveness amount would also be reduced if the employer reduced the total salary or wages of an employee making less than \$100,000 by more than 25% from the most recent full quarter during which the employee was employed before February 15 through June 30, 2020. Special provisions are also made for tipped employees.

An employer can mitigate the above-described reduction in loan forgiveness by re-hiring the same number of full-time equivalent employees, or else by restoring the affected employees’ salary or wages, not later than June 30, 2020.

Application for Loan Forgiveness

An eligible borrower seeks loan forgiveness by applying to the lender. The PPP provisions detail the documentation required. Employment and compensation levels are to be documented using IRS payroll tax filings, and state income, payroll, and unemployment insurance filings. Mortgage, lease and utility payments may be documented using canceled checks, payment receipts, account transcripts or other, similar documentation. The borrower must also certify under criminal penalty that the documentation is true and correct, and “the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation, or make covered utility payments.” The documentation requirements are mandatory.

The lender is to determine forgiveness within 60 days of receiving a borrower's application.

Implementation of Forgiveness Program

Within 30 days of the CARES Act's enactment, the SBA Administrator shall issue guidance and regulations to implement the loan forgiveness provisions of the PPP. Within 90 days of when a lender determines an amount to be forgiven, the SBA will repay the lender the forgiven amount, plus any interest accrued through the date of payment by SBA.