

The Paycheck Protection Program: Forgivable Loans

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In its recent battle to salvage the economy and businesses during the Coronavirus pandemic, the federal government enacted the Coronavirus Aid, Relief and Economic Security Act (“CARES Act”) on March 27, 2020. The CARES Act contains many measures that offer financial relief and assistance to individuals, families, businesses, the health care system and other distressed sectors of the economy. The focus of this article is the new Small Business Administration (“SBA”) loan program called the Paycheck Protection Program (“PPP”). For businesses that qualify, the PPP offers no fee, low-interest loans with repayment deferred for six months and the potential to have amounts spent during an eight-week period on payroll costs, mortgage interest, rent, and utility expenses completely forgiven.

I. Expanded Eligibility Requirements

Unlike other SBA loan programs, the PPP does not limit eligibility on gross receipts or assets – only number of employees.¹ The PPP also does not require that the borrower establish an inability to obtain credit elsewhere and does not require personal guarantees or collateral.²

Any business concern, sole proprietor, eligible self-employed individual, independent contractor, nonprofit organization under 501(c)(3) of the Internal Revenue Code, veterans organization under 501(c)(19) of the Internal Revenue Code, or tribal business that employs 500 or fewer employees is eligible to apply for a PPP loan.³ In some limited circumstances businesses with more than 500 employees may qualify.⁴ For businesses in the hospitality and food industries, eligibility can be determined by store location.⁵ As long as a hospitality or food business does not employ more than 500 employees per physical location, each location may be eligible for the loan.

To be eligible, borrowers must have been in operation on February 15, 2020, and paid employee salaries and payroll taxes or paid independent contractors.⁶ Borrowers must also apply no later than June 30, 2020, before the \$349 Billion allocated for the program is depleted,⁷ and make the following good faith certifications:

- that the uncertainty of the current economic conditions makes necessary the loan request to support ongoing operations;
- that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments and utility payments;
- that the borrower does not have another application pending for a PPP loan for the same purpose; and
- that the borrower has not received a previous PPP loan for the same purpose.⁸

Household employers (of housekeepers or nannies) are not considered businesses so are not eligible.⁹ Businesses engaged in illegal activities, or owned by persons who are incarcerated or on probation or parole or charged with crimes or convicted of felonies within the last five years are not eligible. Businesses owned or controlled by persons who have ever defaulted on an SBA loan or who have defaulted on any other federally backed loan within the last seven years also are not eligible.¹⁰

II. Loan Terms

The initial term for PPP loans is 2 years and the initial interest rate set by the SBA is 1% with the rate never to exceed 4% under the CARES Act.¹¹ Payments on the loan are deferred for six months, and employers who use the loan proceeds as required and maintain their workforce qualify for 100% forgiveness of the loan.¹² Forgiven amounts are not taxable as income.¹³ All of the usual SBA loan initiation fees are waived (with lenders to receive reimbursement for processing fees from the government).¹⁴

Under the CARES Act, the maximum loan amount for a borrower under the program is the *lesser* of \$10 million dollars or two and a half times the borrower's average monthly¹⁵ payroll costs¹⁶ plus the amount of any Economic Injury Disaster Loan ("EIDL") the borrower received on or after January 31, 2020, that was for payroll costs and is being refinanced under the program less any advance received on the EIDL loan.¹⁷ The Act specifies that payroll costs "shall not include . . . the compensation of an individual employee in excess of an annual salary of \$100,000, as prorated for the covered period," so \$100,000 is the maximum annual salary for an individual employee that can be included in the payroll costs calculation.¹⁸ The Act also requires that compensation for employees who principally reside outside the United States be excluded from the payroll costs calculation.¹⁹

During the covered period, the loan must be used for: payroll costs; "costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave and insurance premiums," "salaries, commissions or similar compensations," "payments of interest on any mortgage obligation (which shall not include any prepayment of or payment of principal on a mortgage obligation)," rent, utilities, and "interest on any other debt obligations that were incurred before the covered period."²⁰

III. Forgiveness

All loan proceeds used for payroll costs, rent, utilities and mortgage interest within the eight-week period following the loan are eligible to be forgiven.²¹ However, in light of the expected high demand for the loans and the core purpose for the loans (to keep workers employed), the SBA has determined that "no more than 25 percent of the loan forgiveness amount may be attributable to non-payroll costs."²²

The CARES Act also provides that the amount forgiven shall be reduced in the event workforce is reduced or if there is more than a twenty-five percent (25%) decrease in salaries and wages for employees making less than \$100,000 per year during the eight-week "covered period" following origination of the loan.²³ Importantly, borrowers can avoid reductions of the forgiveness amount based on reductions in workforce or salaries and wages that occurred during the period from February 15, 2020, through April 26, 2020, by re-hiring or increasing salaries and wages to prior levels on or before June 30, 2020.²⁴

With respect to workforce reductions, the CARES Act requires that the amount forgiven be reduced by the same percentage that the borrower's average full-time equivalent employees per month was reduced during the covered period as compared to either the average monthly workforce calculated using January and February, 2020, or the average monthly workforce calculated using the period of February 15, 2019, to June 30, 2019, at the borrower's option.²⁵ Again, employers can avoid having the forgiveness amount decreased based on any reduction in workforce that occurred between February 15 and April 26, 2020, by quickly rehiring employees so that the workforce reduction is eliminated before June 30, 2020.²⁶

The CARES Act also provides that the forgiveness amount shall be reduced in the event salaries or wages of employees making less than \$100,000 annually are reduced by more than twenty-five percent (25%) of the amount the employees earned during the most recent full

quarter of employment before the loan.²⁷ The forgiveness amount will be reduced by the amount of any employee salary and wage reduction in excess of 25% during the covered period.²⁸ However, employers can avoid reduction of the forgiveness amount based on decreases in employee salaries or wages that occurred between the dates of February 15, 2020 and April 26, 2020, by increasing employee salaries and wages to prior levels to eliminate the reduction before June 30, 2020.²⁹

IV. How to Apply

PPP loans can be obtained through SBA approved lenders or other participating federally insured banks, credit unions, or farm credit institutions. The application is simple, but applicants must still provide documentation to verify the number of full-time equivalent employees on payroll, payroll costs, mortgage interest, rent, and utility payments and attest to the accuracy of the information submitted.

¹ 116 P.L. 136 at §1102(a)(2)(36)(D).

² *Id.* at §1102(a)(2)(36)(I) and (J).

³ *Id.* at §1102(a)(2)(36)(D)(i) and (ii).

⁴ Businesses in industries with an SBA established size standards that exceed 500 employees are eligible so long as they do not employ more than allowed under the size standard. *Id.* at §1102(a)(2)(36)(D)(i)(II); see 13 C.F.R. §121.201 for SBA employee size standards.

⁵ *Id.* at §1102(a)(2)(36)(D)(iii).

⁶ *Id.* at §1102(a)(2)(36)(F)(ii)(II).

⁷ *Id.* at §1102(a)(36)(A)(iii) and (D); §1107(a)(1).

⁸ *Id.* at §1102(a)(2)(36)(G).

⁹ Payroll Protection Program Interim Final Rule, SBA Docket No. SBA 2020-01, Apr. 2, 2020, www.sba.gov/document/policy-guidance---ppp-interim-final-rule (“PPP Interim Final Rule”) at 7, Sec. III.2.b.ii.

¹⁰ *Id.* at Sec. III.2.b.i., iii., and iv.

¹¹ *Id.*; 116 P.L. 136 at §1102(a)(2)(36)(L).

¹² 116 P.L. 136 at §1102(a)(2)(36)(M) and §1106.

¹³ 116 P.L. 136 at §1106(i).

¹⁴ 116 P.L. 136 at §1102(a)(2)(36)(H) and (P).

¹⁵ The average monthly payroll costs are determined using the monthly payroll costs incurred during the one-year period before the loan. 116 P.L. 136 at §1102(a)(2)(36)(E)(i)(I). Alternatively, if the borrower was not in business between February and June, 2019, payroll costs for January and February, 2020 will be used to determine the average monthly payroll costs. *Id.* at §1102(a)(2)(36)(E)(i)(II).

¹⁶ Payroll costs are defined to include payment for the following: “salary, wage, commission, or similar compensation; . . . cash tip[s] or equivalent; . . . vacation, parental, family medical, or sick leave; . . . allowance for dismissal or separation; . . . the provision of group health care benefits, including insurance premiums; . . . any retirement benefit; or . . . State or local tax assessed on the compensation of employees.” *Id.* at §1102(a)(2)(36)(A)(viii)(I). Payroll costs do not include taxes imposed or withheld under the Internal Revenue Code during the covered period nor qualified leave benefits for which a credit is permitted under the Families First Coronavirus Response Act. *Id.* at 1102(a)(2)(36)(A)(viii)(II)(bb), (dd) and (ee).

¹⁷ *Id.* at §1102 (a)(2)(36)(E). If the EIDL was used for payroll costs, it must be refinanced as part of the PPP loan. If the EIDL was not used for payroll, the same purposes of the PPP loan, the EIDL loan will not affect eligibility. PPP Interim Final Rule at 15-16, Sec. III.2.r.vii.

¹⁸ 116 P.L. 136 at §1102(a)(2)(36)(A)(viii)(II)(aa).

¹⁹ *Id.* at §1102(a)(2)(36)(A)(viii)(II)(cc).

²⁰ *Id.* at §1102(a)(1)(F).

²¹ *Id.* at § 1106(b).

²² PPP Interim Final Rule at 13-14, Sec. III.2.o.

²³ 116 P.L. 136 at §1106(d)(2) and (d)(3).

²⁴ *Id.* at §1106 (d)(5).

²⁵ *Id.* at §1106(d)(2)(A).

²⁶ *Id.* at §1106 (d)(5).

²⁷ *Id.* at §1106(d)(3).

²⁸ *Id.*

²⁹ *Id.* at §1106 (d)(5).