

## Client Alert: Congress Replenishes Paycheck Protection Program; SBA Provides Further Guidance

On April 24, 2020, the President signed into law the Paycheck Protection Program and Health Care Enhancement Act (the Health Care Enhancement Act), a \$484 billion legislative package that provides, among other things, an additional \$310 billion to replenish the Paycheck Protection Program (PPP) created by the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The Act also provides additional funding for the Economic Injury Disaster (EID) Loan Program, reimbursements for healthcare providers, and COVID-19 testing efforts. The full text of the Act can be found [here](#).

The Paycheck Protection Program and Healthcare Enhancement Act does the following:

- Increases the amount of loans that may be guaranteed under the PPP by \$310 billion and provides an additional \$321 billion in funding for the PPP;
- Sets aside \$60 billion of the PPP funding to guarantee loans made by smaller insured depository institutions, credit unions and community financial institutions;
- Provides an additional \$50 billion in funding for Economic Injury Disaster Loans (EIDL);
- Provides an additional \$10 billion in funding for Emergency EIDL Grants authorized by the CARES Act;
- Adds agricultural enterprises with not more than 500 employees as eligible borrowers under the PPP;
- Provides \$75 billion for the Public Health and Social Services Emergency Fund (the Relief Fund) of the Department of Health and Human Services to reimburse eligible health care providers for health care-related expenses or lost revenues that are attributable to the coronavirus; and
- Provides an additional \$25 billion to the Relief Fund for necessary expenses to research, develop, validate, manufacture, purchase, administer, and expand capacity for COVID-19 tests, including specific allocations to states and various governmental agencies to support activities necessary to accelerate the research, development, manufacturing, and production of COVID-19 tests.

### Additional SBA Guidance

The Small Business Administration (SBA) has issued additional guidance regarding the implementation and management of the PPP since April 14, 2020, which consist of Interim Final Rules and a PPP Frequently Asked Questions (the FAQs), all of which can be found on SBA's website for the CARES Act Provides Assistance to Small Businesses, [here](#).

### Eligibility Guidelines

On April 24, 2020, SBA issued an Interim Final Rule (the April 24 Rule) that, among other things, provides additional guidance regarding entities eligible to receive PPP loans. In addition, SBA addressed some eligibility questions in its April 14, 2020 Interim Final Rule (the April 14 Rule) and in updates to the FAQs:

- **Self-Employed Individuals** – The April 14 Rule provides that a self-employed individual will be eligible for a PPP loan if (1) the individual was in operation on February 15, 2020, (2) the individual has self-employment income, (3) the individual's principal place of business is in the U.S., and (4) the individual has filed or will file a Form 1040 Schedule C for 2019. The rule states that SBA will provide additional guidance for self-employed individuals who were not in operation in 2019. In addition, it provides that partners in a partnership may not apply for a PPP loan; the partnership should apply instead.
- **Hedge Funds and Private Equity Firms Not Eligible for PPP Loans** – The April 24 Rule provides that hedge funds and private equity firms are prohibited from obtaining PPP loans because they are primarily engaged in investment or speculation.
- **Eligibility of Businesses Owned by Large Companies and Public Companies** – In Question 31 of the FAQs, regarding whether businesses owned by large companies with adequate sources of liquidity qualify for a PPP loan, SBA stated that all borrowers must assess their economic need at the time of applying for a PPP loan and should carefully review the certification that "current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." In determining whether they can make this certification, applicants must take 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. SBA stated that it is unlikely that a public company with substantial market value and access to capital markets will be able to make the certification that the PPP loan was necessary in good faith. In addition, SBA cautioned that any such company that obtains a PPP loan should be prepared to demonstrate the basis for such certification on request.

- **Eligibility of Private Equity Portfolio Companies** – The April 24 Rule confirms that all borrowers are subject to the affiliation rules in 13 C.F.R. section 121.301(f), including private equity-owned businesses. In addition, while addressing the application of the affiliation rules to private equity-owned businesses, SBA cautioned that all borrowers should carefully review the required certification regarding economic uncertainty. In addition, in Question 37 of the FAQs, regarding whether a private company with adequate sources of liquidity to support its ongoing operations qualifies for a PPP loan, SBA referred to the response it provided regarding large companies and public companies with other sources of liquidity, described above.
- **No Affiliation between ESOPs and Business** – The April 24 Rule provides that participation by a business in an ESOP does not result in an affiliation between the ESOP and the business.
- **Borrowers Allowed to Apply for PPP Loans Through Affiliated Lenders** – The April 14 Rule provides that applicants that are owned (in whole or part) by an outside director or holder of less than 30% of the equity interests of a PPP lender are allowed to obtain a PPP loan from such affiliated PPP lender, provided that such loan applicants follow the same process as any similarly situated customer or account holder of the affiliated PPP lender. However, if the director or owner is also an officer or key employee of the PPP lender, the applicant may not be able to obtain a PPP loan from that lender.
- **Businesses that Receive Revenue from Legal Gaming Eligible for PPP Loans** – The April 24 Rule provides that businesses that are otherwise eligible for a PPP loan are not rendered ineligible due to their receipt of legal gaming revenues.
- **Agricultural Producers, Farmers, Ranchers and Agricultural Cooperatives Eligible** – Questions 34 and 35 of the FAQs clarify that agricultural producers, farmers, ranchers and agricultural and other cooperatives are eligible for PPP loans if they meet the applicable size and other eligibility requirements for a PPP loan.
- **Government-Owned Hospitals May Be Eligible for PPP Loans** – The April 24 Rule provides that a hospital that is owned by a state or local government and is otherwise eligible to receive a PPP loan as a business concern or a nonprofit will not be rendered ineligible due to such government ownership if the hospital receives less than 50% of its funding from state or local government sources, excluding Medicaid.
- **Businesses in Bankruptcy Proceedings Not Eligible** – The April 24 Rule provides that an applicant is not eligible for a PPP loan if it or its owner is the debtor in a bankruptcy proceeding, either at the time it submits the application or at any time before the loan is disbursed. If the applicant or its owner becomes the debtor in a bankruptcy proceeding after submitting a PPP application but before the loan is disbursed, the applicant must notify the lender and request cancellation of the application.

### Safe Harbor for Borrowers to Repay PPP Loan

In an April 27, 2020, interview with CNBC, Secretary of the Treasury Steven Mnuchin stated that businesses that receive PPP loans of more than \$2 million will be audited by the federal government and that businesses that make false certifications will face criminal liability. The April 24 Rule and Question 31 to the FAQs provide that any borrower that applied for a PPP loan prior to April 23 and repays the loan in full by May 7, 2020 will be deemed to have made the certification regarding necessity in good faith. This effectively allows borrowers who received PPP loans but would likely not be eligible for a PPP loan under the new SBA guidance to return their loans without repercussion.

### Calculation of Maximum Loan Amount; Use of Proceeds

The April 14 Rule and April 24 Rule, as well as the FAQs, also provide guidance regarding the calculation of an applicant's maximum loan amount and the use of PPP loan proceeds. In addition, SBA issued a guide on "How To Calculate Maximum Loan Amounts - By Business Type" on April 24 (the Guide). SBA also issued another Interim Final Rule on April 28 (the Seasonal Employer Rule) providing further guidance for employers with seasonal workers. Among other things, these rules and other guidance clarify the following:

- **Maximum Loan Amounts for Self-Employed Individuals** – The April 24 Rule and the Guide provide that, for

purposes of determining their maximum loan amount, a self-employed individual may include as payroll costs his or her net profits as reported on line 31 of the individual's 2019 Form 1040, Schedule C, up to a maximum of \$100,000. If the individual has employees, payroll costs also include the gross wages and tips paid to U.S. employees (which can be computed using the individual's 2019 IRS Form 941 Taxable Medicare wages and tips), including pre-tax employee contributions for health insurance or other benefits excluded from taxable Medicare wages, 2019 employer health insurance contributions (the portion of the individual's Form 1040, Schedule C, line 14 attributable to health insurance), employee retirement plan contributions (Form 1040, Schedule C, line 19) and state and local taxes assessed on employee compensation. Such payroll costs should be reduced by any amount paid to an individual employee in excess of \$100,000.

- **Use of Proceeds by Self-Employed Individuals** – Generally, self-employed PPP loan recipients are allowed to use their PPP loan proceeds on the same terms as other PPP loan recipients (i.e., at least 75% of the proceeds must be used to pay payroll costs and up to 25% of the proceeds may be used to pay existing business mortgage interest, rent and business utility payments). Additionally, self-employed PPP loan recipients may use PPP loan proceeds to pay owner compensation, calculated based on 2019 net profits as described above. In order to use PPP loan proceeds to pay utility payments, rent or mortgage interest expenses, the individual must have claimed or be entitled to claim a deduction for such expenses in 2019. If the individual did not claim or is not entitled to claim a deduction for any such expenses, he or she cannot use PPP loan proceeds to pay such expenses.
- **Forgiveness of PPP Loans by Self-Employed Individuals** – Generally, self-employed PPP loan recipients are eligible to have such loan amounts forgiven on the same terms as other PPP loan recipients. However, the amount of a PPP loan that is used to pay owner compensation of a self-employed individual that will be forgiven may not exceed 8 weeks (8/52) of the self-employed individual's 2019 net profits. In addition, to obtain forgiveness for PPP loan proceeds used to pay utility payments, rent or interest expenses, the individual must be entitled to claim a deduction for such expenses.
- **Maximum Loan Amount for a Partnership** – The April 14 Rule and the Guide provide that, in determining the maximum amount of a PPP loan, a partnership or an LLC that is taxed as a partnership may include in its payroll costs the net earnings of its U.S. based general partners that are subject to self-employment tax, computed from box 14a of the partners' 2019 Schedule K-1 (reduced by any section 179 expense deductions claimed, unreimbursed partnership expenses claimed, and depletion claimed on oil and gas properties), multiplied by 0.9235 (to remove the employer's share of self-employment taxes), up to \$100,000 per partner.
- **Housing Stipends** – Question 32 of the FAQs clarifies that housing stipends and allowances may be included in payroll costs, subject to the \$100,000 per employee limitation on annual compensation.
- **Determination of Employee's Residence** – Only compensation to employees whose principal residence is in the U.S. may be included in payroll costs. Question 33 of the FAQs clarifies that employers should consult 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.
- **Alternative Measurement Periods for Seasonal Employees** – The Seasonal Employer Rule provides further guidance for applicants with seasonal employees. Under the CARES Act, seasonal employers may calculate their maximum loan amount by using their monthly average payments for payroll during "the 12-week period beginning February 15, 2019, or at the election of the eligible recipient, March 1, 2019, and ending June 30, 2019." Recognizing that these periods may not be relevant for all seasonal employers, the Seasonal Employer Rule permits a seasonal employer to determine its maximum loan amount as the average total monthly payments for payroll during any consecutive 12-week period between May 1, 2019 and September 15, 2019. In addition, the Seasonal Employer Rule provides that a seasonal business will be considered to have been in operation as of February 15, 2020 (and therefore eligible to obtain a PPP loan), if the business was in operation for any 8-week period between May 1, 2019 and September 15, 2019.

## Disbursement of PPP Loans; Cancellation of Certain Undisbursed Loans

Pursuant to an Interim Final Rule issued on April 28, 2020, all PPP loans must be funded in a single disbursement within 10 days of the date the loan is approved. The date a loan is approved is the date on which a loan number was assigned by SBA. For loans approved prior to the adoption of the rule that have not been fully disbursed, the 10-day period begins on April 28, 2020, and the 8-week period for determining loan forgiveness commences on the date of the first disbursement of the loan. If a PPP loan is not disbursed within 20 days after the loan is approved

because the borrower has failed to provide required loan documentation (such as a promissory note), the loan will be cancelled.

For additional background on small business loans available under the CARES Act, including PPP loans, please see our Client Alert on Small Business Loans under the CARES Act, available [here](#). For additional background on SBA's guidance with respect to PPP loans, please see our Client Alerts on SBA Updates to PPP loans [here](#) and [here](#). Due to the recent adoption of the CARES Act, interpretation of some of its provisions is uncertain, and it is subject to additional clarification and interpretation by Treasury, IRS, SBA and other federal regulatory agencies.