

SBA guidance clarifies “eligibility” and “payroll costs” under the Paycheck Protection Program



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Beginning April 3, 2020, businesses were able to start submitting loan applications under the [Paycheck Protection Program \(PPP\)](#). As applications are processed and approved, the U.S. Small Business Administration (SBA), in consultation with the U.S. Department of the Treasury, continues to issue further guidance regarding the implementation of the PPP. SBA intends to regularly update its [Frequently Asked Questions \(FAQ\)](#) document to address borrower and lender questions.

The following is a summary of key borrower questions regarding eligibility criteria and the calculation of payroll costs under the PPP and SBA's responses to those questions:

Are small business concerns (as defined in section 3 of the Small Business Act, 15 U.S.C. 632) required to have 500 or fewer employees to be eligible borrowers in the PPP?

No. Small business concerns can be eligible borrowers even if they have more than 500 employees, as long as they satisfy the existing statutory and regulatory definition of a “small business concern” under section 3 of the Small Business Act, 15 U.S.C. 632. A business can qualify if it meets the SBA employee-based or revenue-based size standard corresponding to its primary industry. [SBA's size standards](#) can help you determine whether or not your business qualifies as small.

Additionally, a business can qualify for the PPP as a small business concern if it met both tests in SBA's “alternative size standard” as of March 27, 2020:

1. Maximum tangible net worth of the business is not more than \$15 million; and
2. The average net income after federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than \$5 million.

A business that qualifies as a small business concern under section 3 of the Small Business Act, 15 U.S.C. 632, may truthfully attest to its eligibility for PPP loans on the Borrower Application Form, unless otherwise ineligible.

The [Coronavirus Aid, Relief, and Economic Security Act \(CARES Act\)](#) 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?

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

The information contained herein is based on a summary of legal principles. It is not to be construed as legal advice and does not create an attorney-client relationship. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.

- Payment of state and local taxes assessed on compensation of employees.

What time period should borrowers use to determine their number of employees and payroll costs to calculate their maximum loan amounts?

In general, borrowers can calculate their aggregate payroll costs using data either from the previous 12 months or from calendar year 2019.

For seasonal businesses, the applicant may use average monthly payroll for the period between Feb. 15, 2019, or March 1, 2019, and June 30, 2019.

An applicant that was not in business from Feb. 15, 2019, to June 30, 2019, may use the average monthly payroll costs for the period Jan. 1, 2020, through Feb. 29, 2020.

Borrowers may use their average employment over the same time periods to determine their number of employees, for the purposes of applying an employee-based size standard. Alternatively, borrowers may elect to use SBA's usual calculation: the average number of employees per pay period in the 12 completed calendar months prior to the date of the loan application (or the average number of employees for each of the pay periods that the business has been operational, if it has not been operational for 12 months).

Should payments that an eligible borrower made to an independent contractor or sole proprietor be included in calculations of the eligible borrower's payroll costs?

No. Any amounts that an eligible borrower has paid to an independent contractor or sole proprietor should be excluded from the eligible business's payroll costs. However, an independent contractor or sole proprietor will itself be eligible for a loan under the PPP, if it satisfies the applicable requirements.

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?

Under the CARES 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.

Notwithstanding the updated guidance, borrowers may rely on the laws, rules and guidance available at the time of the relevant application. However, borrowers whose previously submitted loan applications have not yet been processed may revise their applications based on clarifications reflected in the SBA FAQ document.

For more information on SBA PPP loans, contact Jennifer Wolff, John McDonald or Kristin Roeper to learn more.