

CARES Act and SBA Paycheck Protection Program

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On March 27, 2020, U.S. President Donald Trump signed into law the Coronavirus Aid, Relief, and Economic Stability Act (CARES Act). The CARES Act is the third phase of government relief in the wake of the 2019 novel coronavirus (COVID-19) pandemic and associated economic decline. The CARES Act amends Section 7(a) of the Small Business Act to add a Paycheck Protection Program (PPP) under which some businesses may be eligible to receive a loan of up to \$10 million on favorable terms, including total forgiveness in the event businesses maintain or restore their payroll, essentially converting the loan into a government grant. The loans will be available through U.S. Small Business Administration (SBA) approved lenders until June 30, 2020.

Eligible businesses should immediately contact their bank to determine if they will be offering PPP loans and the expected timing for processing and approving applications. If your bank is not an SBA-approved lender, Godfrey & Kahn attorneys can assist you in identifying SBA-approved lenders. These loans will be critical for businesses that are evaluating layoffs to stay viable in light of the economic impact of the COVID-19 pandemic.

Eligibility for a PPP loan

Businesses meeting the following criteria will be eligible to receive a PPP loan:

- Any business that qualifies as a small business concern based on [SBA's size standards](#). Businesses can assess their size using [SBA's table of size standards](#).
- Any business concern, 501(c)(3) non-profit organization, 501(c)(19) veterans organization or tribal business with 500 or fewer employees (including individual employed on a full-time, part-time or other basis).
- Any business with 500 or fewer employees per physical location that is assigned a NAICS code beginning with 72, Accommodation and Food Services, which includes hotels, restaurants, other accommodation and food service businesses.
- Sole proprietorships, independent contractors and certain other self-employed individuals.

SBA rules generally prevent affiliated businesses (by ownership or control) from being eligible to receive an SBA loan. However, these affiliation rules are waived under the PPP for the following businesses:

- Businesses with not more than 500 employees that are assigned a NAICS code beginning with 72.
- Businesses operating as a franchise that are assigned a franchise identifier code by the SBA.
- Businesses that receive financial assistance from a small business investment company (SBIC).

SBA affiliation rules have historically prevented businesses owned by private equity sponsors, or that are backed by venture capital investors, from receiving SBA financial assistance. These rules require the aggregation of employees, or annual receipts, of all of the sponsor's or investor's controlled companies.

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

However, if an eligible business owned by a private equity sponsor or backed by venture capital investors also receives financial assistance from an SBIC, whether as a lender or an investor, SBA affiliation rules will not apply to that business. Additionally, it is possible that SBA may issue further interpretive guidance on the applicability of the affiliation rules to PPP loans generally.

PPP loan terms

The following are terms for SBA's PPP loans:

- The maximum principal amount of a loan is limited to the lesser of \$10 million or 2.5 times the average total monthly payments for payroll costs during the one-year period prior to the date of the loan. Payroll costs include salaries, wages, commissions, separation payments, payments for group health and retirement benefits, and payments of state or local employment taxes and compensation, but excludes compensation of an individual employee in excess of \$100,000.
- Economic injury disaster loans (EIDLs) made directly by SBA can be refinanced with proceeds of a PPP loan.
- All payments will be deferred for a period of six months up to one year.
- The maximum maturity of the principal balance not forgiven is 10 years.
- The interest rate will not exceed four percent.
- The proceeds of the loans may be used for the following:
 - Payroll costs;
 - Costs related to continuation of group health benefits during periods of paid sick, medical or family leave, and insurance premiums;
 - Employee salaries, commissions or similar compensation;
 - Mortgage interest payments;
 - Rent;
 - Utilities; or
 - Interest on other existing debt obligations.
- SBA guarantee increases to 100 percent through Dec. 31, 2020. After that date, the guaranteed portion will return to 75 percent for loans over \$150,000 and 85 percent for loans equal to or less than \$150,000.
- Collateral and personal guarantees will not be required.
- SBA loan fees will be waived.
- The SBA requirement that the business is unable to obtain credit elsewhere will be waived.
- The loans will not be subject to any prepayment penalty.
- The loans will be non-recourse to the business owners except to the extent they use the proceeds for an unauthorized purpose.
- Businesses will be required to certify that:
 - The uncertainty of current economic conditions makes the loan necessary;
 - The funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments and utility payments; and
 - It does not have an application pending, or it has not received a loan, under the PPP for the same purpose.

PPP loans are forgivable under these circumstances

A business that receives a PPP loan will be eligible for forgiveness of indebtedness, which will be nontaxable, in an amount equal to the sum of the following costs incurred and paid during the eight-week period beginning on the date of the origination of the loan:

- Payroll costs (using the same definition for determining the maximum principal amount of a loan as described above);
- Interest payments on mortgage loans (provided that the mortgage loan was incurred prior to Feb. 15, 2020);

- Rent obligations (provided that the leasing arrangement was in force prior to Feb. 15, 2020); and
- Utility payments (provided that services began prior to Feb. 15, 2020).

The amount forgiven may not exceed the principal amount of the PPP loan. The amount of loan forgiveness will be reduced according to the following formula:

- Amount of forgivable payroll and other costs described above, multiplied by the quotient of (A) the average number of full-time employees (FTEs) per month employed during the eight-week period beginning on the date of the origination of the loan by (B) at the election the borrower (1) the average number of FTEs per month employed during the period beginning on Feb. 15, 2019 and ending June 30, 2019, or (2) the average number of FTEs employed during the period beginning Jan. 1, 2020, and ending Feb. 29, 2020. For seasonal employers, the period described in (B) will be the period beginning Feb. 15, 2019, and ending June 30, 2019.

Example:

Total forgivable payroll and other costs	(A) Average number of FTEs per month during eight-week period beginning on loan origination			(B)
				(1) Average number of FTEs per month from Feb. 15, 2019 to June 30, 2019 or (2) Average number of FTEs from Jan. 1, 2020 to Feb. 29, 2020
\$1,000,000	X	300	÷	(1) 400 (2) 350

In this example the forgivable amount would be reduced to \$857,143 (\$1,000,000 x 300 ÷ 350).

The amount of loan forgiveness will also be reduced by the amount of any reduction in total salary or wages of any applicable employee during the eight-week period beginning on the date of the origination of the loan that is in excess of 25 percent of the total salary or wages of the employee during the most recent full quarter in which the employee was paid before this eight-week period. For purposes of this reduction, an applicable employee is any employee who did not receive annualized wages or salary for any pay period during 2019 in excess of \$100,000.

To encourage businesses to rehire employees or restore wages, the amount of loan forgiveness will be determined without regard to reductions in the number of employees or reductions in wages that occurred during the period beginning Feb. 15, 2020, and ending on the date that is 30 days after the date of the enactment of the CARES Act, if the business eliminates the reduction no later than June 30, 2020. For example, if a business lays off 50 employees on March 31, 2020, and rehires all of them before June 30, 2020, those 50 employees will be deemed to have been employed for purposes of calculating the average number of FTEs during the eight-week period beginning on the date of loan origination.

A business seeking loan forgiveness must submit an application to their lender, which shall include:

- Documentation verifying the number of FTEs on payroll and pay rates for the period beginning Feb. 15, 2020, and ending June 30, 2020, including payroll tax filings reported to the IRS and state income, payroll, and unemployment insurance filings;
- Documentation verifying payments on mortgage obligations, lease payments and utility payments;
- A certification that the amount for which forgiveness is requested was used to retain employees, make mortgage interest payments, make lease payments or make utility payments; and
- Any other documentation SBA determines necessary.

The lender must make a decision regarding an application for loan forgiveness within 60 days after receipt of the application.

Applying for a PPP loan

PPP loans will be made by SBA-approved lenders. Loan applications and supporting documentation will be submitted directly to these lenders. SBA is expected to issue guidance to lenders, including detail on how to apply and the criteria SBA will use to determine who will receive loans, within 15 days of enactment, although it may be issued sooner.

Banks are taking action now to prepare for the significant volume of applications they expect to receive. Businesses should start assembling documentation to expedite the application process, including these items:

- Articles of incorporation/organization;
- Bylaws/operating agreement;
- Payroll expense verification documents, including IRS Forms 941 and 944, payroll summary reports and bank statements, summary of payroll benefits;
- Trailing twelve-month profit and loss statement;
- Mortgage or rent statements; and
- Utility statements.

Advanced preparation will be critical for businesses wanting to take advantage of this loan program.

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