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COMPREHENSIVE OVERVIEW OF THE PAYCHECK PROTECTION PROGRAM

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On March 27, President Trump signed the Coronavirus Aid, Relief and Economic Security (CARES) Act, a historic $2 trillion stimulus package to provide financial assistance to individuals and businesses.

One of the most important components of the CARES Act is the Paycheck Protection Program (PPP), administered by the Small Business Administration (SBA). The program provides forgivable loans to businesses in order to maintain payroll and keep workers employed at or near current wage levels. Businesses may also use the loans for rent, interest payments and utilities. A portion or even all of the loan may be forgiven, depending upon the amount of eligible expenditures made within the eight-week period following loan funding, and subject to further requirements that the borrower maintains headcount and wage levels, as described below.

What entities are generally eligible for a PPP loan?

- Any small business concern, 501(c)(3) non-profit, 501(c)(19) veterans organization or tribal business concern described in section 31(b)(2)(C) of the Small Business Act is eligible for a PPP loan, provided such entity has no more than 500 employees whose principal place of residence is the US.

- Such entities may also be eligible if they have more than 500 employees but fall under the traditional SBA size standards based on headcount or the sum of annual gross revenue plus the cost of goods sold, available here.

- According to Treasury Department FAQs as updated on April 10, 2020, a business may also qualify if it meets the SBA's alternative size standard as of March 27, 2020: (1) maximum tangible net worth not exceeding $15,000,000 and (2) average net income after federal taxes (excluding any carry-over losses) for the last two fiscal years not more than $5,000,000.

What other rules apply to eligibility?

- Entities must have been operational and remitting payroll taxes as of February 15, 2020.

- Except for 501(c)(3) non-profits with less than 500 employees, entities listed in 13 CFR 120.110 are not eligible; some notable exclusions are financial businesses such as banks, passive businesses owned by developers and landlords, businesses located in foreign countries (although foreign-owned businesses in the US are eligible), private clubs and businesses that limit their memberships for reasons other than capacity, and businesses in which the lender or any of its associates (defined as officers, directors, owners of more than 20% of the equity or key employees) owns an equity interest.

- For purposes of calculating the number of employees, SBA affiliation rules apply, and the employee calculation must include all affiliate employees whose principle place of residence is the US, provided that this rule does not apply to businesses classified under NAICS codes beginning with 72 (Accommodation and Food Services), franchise businesses that have been assigned a franchise identifier code by the SBA, or any business that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958.

- Further, for businesses classified under NAICS codes beginning with 72 (Accommodation and Food Services), the 500-employee cap shall be measured separately for each physical location.

- For purposes of measuring the 500-employee cap, employees include individuals employed on a full-time, part-time or other basis.

- The Treasury Department FAQs as updated on April 10, 2020, provide that in applying employee-based size standards, the employer uses average employment over the same time period used to calculate the maximum loan amount (discussed below), or alternatively, they can calculate the average number of employees per pay period in the 12 completed calendar months preceding the application.

- The guidance to date has not provided a specific definition of US residence. Some SBA representatives have advised that only US citizens and green card holders are included.

- The borrower must make a good faith certification that the uncertainty of the current economic conditions makes the loan request necessary to support ongoing operations.

- The program is open through June 30, 2020, and borrowers can only obtain one PPP loan.

What is the maximum amount of the PPP loan?

- The maximum loan amount is 2.5 times the average monthly payroll, but not to exceed $10,000,000.

- The borrower can choose calendar year 2019 or the most recent 12-month period ending prior to the loan date to determine average monthly payroll.

- For a seasonal business, the average monthly payroll is determined during the 12-week period beginning February 15, 2019, or at the borrower's election, March 1, 2019 to June 30, 2019.

- Payroll costs include salary, wages, commissions and cash tips (limited to $100,000 per employee per year); payment for vacation, parental, family, medical or sick leave (except to the extent such payments are eligible for tax credits under the Families First Coronavirus Response Act); severance; group health care coverage; retirement benefits and payment of state and local taxes assessed on compensation (i.e., unemployment). Payments to non-US residents are not included.

- An employer may not include payments to independent contractors.

- For an independent contractor applying for a PPP loan directly, payroll costs include wages, commissions, income or net earnings from self-employment.

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- Employers previously faced uncertainty over whether the $100,000 limit applies to the defined term "payroll costs" or to only the wage/salary component of payroll costs. The Treasury Department FAQs as updated on April 10, 2020, provide that the $100,000 limit only applies to cash compensation.

- The borrower can refinance an SBA Economic Injury Disaster Loan (EIDL) into a PPP loan. The outstanding amount of any EID loan would be added to the PPP loan (less the amount of any advance made on the EID loan).

- The CARES Act provides that payroll costs do not include federal income taxes or employment taxes imposed or withheld between February 15, 2020 and June 30, 2020. According to Treasury Department FAQs updated as of April 10, 2020, payroll costs are not reduced by taxes imposed on the employee and withheld by the employer, but payroll costs do not include the employer's share of payroll tax. This was an extremely important clarification of the CARES Act that applies for purposes of determining the maximum loan amount, allowable uses of a PPP loan, and the amount of loan forgiveness. Further, the Treasury Department FAQs clarify that this interpretation will apply to withholdings after June 30, 2020 as well.

What are the terms of a PPP loan?

- 2-year term, 1% interest
- All payments of principal and interest deferred for the first six months
- Remaining balance after forgiveness (discussed below) amortized over the remaining 18 months
- No prepayment penalty
- No application fee; SBA pays lenders directly
- No personal guarantees
- No collateral
- 100% SBA-guaranteed
- Loan proceeds can be use to pay payroll costs (including health care and retirement benefits), rent, utilities and interest.

What is the potential forgiveness amount?

- The maximum loan forgiveness amount is the total of the following expenses over an eight-week period starting on the date the loan funds are disbursed to the borrower: payroll costs (as defined above, including the limitation of $100,000 in cash compensation per year on an annualized basis), rent, utilities and interest on mortgage obligations (not interest on unsecured debts, even though loan proceeds can be used for such payments).

- No more than 25% of the maximum loan forgiveness amount can be non-payroll expenses.

- It is important to remember that borrowers must first calculate the maximum loan forgiveness amount, then determine whether the maximum loan forgiveness amount is subject to reduction. Regardless of whether any reductions can be offset, borrowers can never be forgiven for more than the maximum loan forgiveness amount. Some borrowers have been under the impression that rehiring employees who have been laid off will allow the entire loan amount to be forgiven. That is incorrect. Employees who are not paid during the eight-week period following the loan date are not generating "payroll costs," and therefore, the maximum loan amount is, by definition, lower.

- The forgiveness amount is not considered a cancellation of indebtedness income and is therefore not taxable.

- The forgiveness amount cannot exceed the loan amount.

Under what circumstances is the maximum forgiveness amount reduced?

- The maximum forgiveness amount will be reduced if the borrower does not maintain headcount or reduces wages.

- With respect to headcount, the average number of full-time equivalent employees (FTEs) within the eight-week period starting on the date of loan funding is compared to base employment. Base employment is measured at the borrower's election during the period from (a) February 15, 2019 to June 30, 2019, or (b) January 1. 2020 to February 29, 2020.

- For a seasonal employer, the average is determined by measuring average FTEs between February 15, 2019 and June 30, 2019.

- With respect to wages, the CARES Act provides that the maximum loan forgiveness amount is reduced if the employer reduces any employee's salary or wages within the eight-week period starting on the date of loan funding by more than 25% as compared to the prior quarter. That is a mismatch of time periods, which we expect to be clarified, perhaps by measuring average weekly pay in the prior quarter, times eight. Only the reduction above and beyond 25% will reduce the maximum loan forgiveness amount.

- Salary or wage reductions for employees who received $100,000 or more in wages or salary in any pay period on an annualized basis in 2019 are not taken into account. For this purpose, employers should look at the highest amount of pay in any pay period in 2019 for each employee.

- If the borrower would otherwise face a reduction in the maximum loan forgiveness amount, the borrower can nevertheless avoid a reduction based on headcount or wage declines under the following circumstances:

  - With respect to headcount, if employment declined between February 15, 2020 and April 26, 2020, but the employer fully restores the positions on or before June 30, 2020, there will be no reduction in the maximum loan forgiveness amount due to a headcount decline.

  - With respect to wages, if there is a decline in wages between February 15, 2020 and April 26, 2020, but the employer fully restores the wages on or before June 30, 2020, there will be no reduction in the maximum loan forgiveness amount due to a wage decline.

Does participation in the PPP preclude any other benefits?

- Employee Retention Tax Credit – Recipients of PPP funds are not eligible for this tax credit also included in the CARES Act.

- Employer Payroll Tax Deferral – Recipients of PPP loans that have any indebtedness forgiven are not eligible to take advantage of this program.

- Economic Injury Disaster Loan Program – Businesses can apply and receive loans under both the PPP and the EIDL Program. However, loan funds may not be used for the same purpose. A borrower may also refinance an EIDL into a PPP loan. If you have used your EIDL funds for payroll costs and seek a PPP loan, you must refinance the EID loan into a PPP loan.

- EFMLA/Sick Leave Credits – Recipients of PPP loans may still receive reimbursement for sick leave payments made pursuant to the Families First Coronavirus Response Act, provided that such payments would not count toward "payroll costs," as described above.

How do I apply, and what information will be required?

- PPP loans are administered by banks and other financial institutions, not directly by the SBA.

- Eligible lenders include previously authorized SBA lenders as well as a much broader group of financial institutions that obtained approval to participate in the PPP program.

- Because of "know your customer" compliance regulations on banks accepting new borrowers, most employers will have to apply for PPP loans through banks at which they are an existing customer. We strongly recommend contacting banks with whom you currently do business.

- The SBA form loan application is available here.

- Each bank will decide what additional information is required. Examples of information that may be required are as follows:
  - Detailed calculation of average monthly payroll costs and maximum loan amount
  - Description of affiliated entities
  - Detailed explanation of ownership of the borrower
  - 2019 IRS Form 941 (for each quarter) or 944 (annual)
  - 2019 W-2 for any employee paid over $100,000
  - 2019 reports of PTO, severance pay, health care, retirement costs and state unemployment taxes
  - Government-issued ID for all individuals signing loan documents
  - Entity resolutions authorizing loan application
  - Loan request and disbursement forms specific to the lender

- If approved, the borrower will execute the SBA form note, available here. The note will be modified by each lending institution to include specific payment terms, subject to the requirements discussed above (i.e., no personal guarantee, no collateral, no prepayment penalty, six-month deferral of payments).

Important References:

CARES Act (full text)

SBA Interim Final Rule

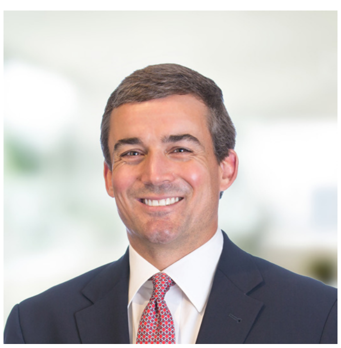
Treasury FAQs

Information Sheet for Borrowers

Additional Treasury Resources

This summary is current through April 13, 2020, but we anticipate additional guidance from the Small Business Administration and Treasury Department, which could provide further clarifications and potential changes to the guidance described above.

Please contact Will Johnson or Perry MacLennan for additional information.



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