Alerts & Publications

SBA's Paycheck Protection Program and Economic Injury Disaster Loan Program

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***Note**: This update incorporates information contained in the Small Business Administration's Interim Final Rule, issued on April 3, 2020 and Frequently Asked Questions Guide, updated on April 8, 2020. The SBA and Treasury Department will continue to update these FAQs providing guidance on the PPP.*

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) into law. As described in our initial CARES Act client alert, the law provides more than US$2 trillion in emergency economic relief to individuals and businesses affected by the coronavirus crisis through numerous new stimulus and aid programs.

This alert provides more specific details on programs administered by the Small Business Administration (SBA) that small businesses may consider: (1) the CARES Act's new Paycheck Protection Program (PPP); (2) the SBA's existing Economic Injury Disaster Loan Program (EIDL) program; and (3) debt relief programs available for other SBA borrowers.

Section 1102 of the CARES Act provides for US$349 billion in funding for loans through the PPP, an expansion of the SBA's existing 7(a) loan program[1] aimed at supporting small businesses and encouraging those businesses to retain their workers. Loans made under the PPP can be used to cover costs incurred during the period from February 15, 2020 to June 30, 2020. The SBA has authorized lenders to start processing PPP loan applications on April 3, 2020.

The EIDL program is a pre-existing program[2] available to certain small businesses located in areas subject to a presidential disaster declaration that have suffered a substantial economic injury as a result. Section 1107 of the CARES Act includes US$10 billion to expand the EIDL program to businesses beyond previous size limits to include those with up to 500 employees, with some relaxed eligibility requirements. Additionally, an EIDL "grant" provision allows applicants to request that the SBA provide an immediate advance of up to US$10,000 within three days of an application, in an effort to get money into the hands of small businesses as soon as possible.

Additionally, Section 1112 of the CARES Act contains a debt relief program allocating US$17 billion for the SBA to pay the principal, interest, and fees for six months on non-PPP 7(a) loans, 7(m) microloans, and 504 loans for new and existing borrowers.

Who is Eligible?

	Paycheck Protection Program	**Economic Injury Disaster Loan Program**
What types of businesses are eligible?	Any business that qualifies as a small business under section 3 of the Small Business Act, 15 U.S.C. 632. Any business that qualifies as a small business by meeting both tests in SBA's alternative size standard: (1) maximum tangible net worth of the business is not more than US$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 US$5 million. Any business, 501(c)(3) public nonprofit organization, 501(c)(19) veterans organization, and tribal business with up to 500 employees (whose principal place of residence is in the U.S) **or** within the applicable SBA size standard for their industry, whichever is higher, that was in operation on February 15, 2020 and either had employees or independent contractors for whom they paid salaries or 1099 compensation.[3] Sole proprietors and independent contractors. **Note**: For purposes of calculating size, rules otherwise requiring aggregation of employees based on "affiliation" are waived for restaurants and hotels, as well as franchises listed on the SBA's Franchise Directory.	Any businesses, 501(c)(3) nonprofit organization, cooperative, or employee stock ownership plan with up to 500 employees **or** within the applicable SBA size standard for their industry, whichever is higher. Sole proprietors and independent contractors. Private nonprofit organizations. Small agricultural cooperatives.

Injury Required?	No	Must have suffered substantial economic injury and be located in a presidentially-declared disaster area. **Note**: The entire country has been declared a disaster area for COVID-19.

Are Borrowers Required to Apply SBA's Affiliation Rules?

Borrowers must apply the affiliation rules set forth in SBA's Interim Final Rule on Affiliation. Borrowers must determine which entities (if any) are its affiliates and determine the employee headcount of the borrower and its affiliates. Lenders are permitted to rely on borrowers' certifications and need not make independent determinations.

Under the SBA's affiliation rules, a minority shareholder in a business is deemed to control the business if the shareholder has the right to prevent a quorum or otherwise block action by the board of directors or shareholders. However, if a minority shareholder in a business irrevocably waives or relinquishes any of these rights, the shareholder is no longer considered an affiliate of the business (assuming no other relationship would trigger the affiliation rules).

What Factors Will Lenders Consider When Reviewing SBA Loan Applications?

While eligibility determinations rely on the "totality-of-the-circumstances," there are certain factors that a lender must consider, depending on the program, for loan eligibility. Importantly, while applications for PPP (and indeed all 7(a) loans) are submitted to third party lenders, EIDL loan applications are submitted directly to the SBA.

In addition to a PPP application form, borrowers must submit documentation necessary to establish eligibility such as payroll processor records, payroll tax filings, or Forms 1099. For borrowers that do not have those documents, the borrower must provide other supporting documentation, such as bank records, sufficient to demonstrate the qualifying payroll amount. Borrowers are not required to provide documentation demonstrating that they were unable to obtain credit elsewhere.

Lenders are required to confirm receipt of borrower certifications contained in the PPP application, as well as documentation demonstrating that the borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020. Lenders must also perform a good faith review, in a reasonable time, of the borrower's calculations and supporting documents concerning average monthly payroll costs. Apart from these requirements, lenders must also apply risk-based anti-money laundering controls to identify the borrower and its beneficial owners.

The CARES Act authorizes the SBA to approve EIDL applicants based solely on an applicant's credit score and does not require a tax return or tax return transcript, or may use alternative appropriate methods (not yet defined) to determine an applicant's ability to repay the loan.

How do Non-US Employees and Owners Affect Eligibility?

While foreign-owned businesses are eligible for a PPP loan, proceeds of a PPP loan cannot be used for compensation of employees whose principal place of residence is outside the US. Further, foreign employees do not count toward the number of employees considered for business size determinations, nor does their compensation count toward the maximum loan amount.

Generally, to be eligible for a 7(a) loan, an applicant must have a place of business in the US and operate primarily in the US or make a significant contribution to the US economy through tax, labor or use of products. The SBA has not yet issued guidance on the applicability of this requirement to PPP loans; we will update this alert if and when it does.

How Much Can a Business Receive in Grants or Loans?

PPP: The maximum loan amount is the lesser of (i) US$10 million, or (ii) 2.5 times a business's average total monthly payroll amount for calendar year 2019,[5] plus the outstanding amount of an EIDL loan made between January 31, 2020 and April 3, 2020, less the amount of any emergency grant advance (detailed below).

- For seasonal businesses, the maximum loan amount is 2.5 times a business's average total monthly payroll amount incurred during the 12-week period beginning February 15, 2019 or March 1, 2019, plus the amount of any pre-existing EIDL loan an applicant wants to refinance.

EIDL: The maximum loan amount is US$2 million. EIDL loans are based on an applicant's actual economic injury as determined by the SBA, less any recoveries such as insurance proceeds. The cap can be waived by the SBA if an applicant's business is a "major source of employment" in the area, as defined by 13 C.F.R. § 123.202.

- An applicant can also request an **emergency grant** advance of no more than US$10,000. This advance can eventually be forgiven if it is spent on

paid leave, maintaining payroll, mortgage or lease payments, increased costs due to supply chain disruption, or repaying obligations that cannot be met due to lost revenues.
- If additional EIDL funds are needed, under some circumstances, a small business may request an increase in the loan amount within the two years following initial approval of the EIDL loan.

What are the Fees and Interest Rates?

PPP: The SBA has waived all otherwise applicable 7(a) fees for PPP loans, and interest rates will be 1%.

EIDL: The CARES Act has altered the statutory 4% interest rate for EIDL loans. For businesses impacted by COVID-19, the interest rates for EIDL loans will be 3.75% for small businesses and 2.75% for nonprofits.

Are There any Collateral or Personal Guarantee Requirements?

PPP: No collateral requirements or personal guarantees are required.

EIDL: The personal guarantee requirement is waived for loans of US$200,000 or less from January 31, 2020 through December 31, 2020. Traditional collateral requirements under the EIDL—generally required for loans of more than US$25,000—appear to still apply.

What Can Small Businesses Use SBA Loan Money For?

PPP: A recipient can use loan proceeds under the PPP only to cover the following costs:

- "Payroll costs" (including salary, wages, commissions, tips, retirement and medical benefits, etc.)[6]
- Mortgage interest payments;
- Rent;
- Utilities;
- Interest on loans obtained before February 15, 2020; and
- Refinancing an EIDL loan made between January 31, 2020 and April 3, 2020.

An applicant must certify in good faith that the loan only will be used to cover allowed costs. At least 75% of PPP loan proceeds must be used for "payroll costs."[7]

EIDL:The CARES Act expands the allowable uses of EIDLs to cover:

- Working capital to continue business operations;
- Necessary expenditures to alleviate the specific economic injury suffered;
- Sick leave to employees unable to work due to the direct effects of COVID-19;

- Maintaining payroll;
- Increased supply costs;
- Rent or mortgage payments; and
- Repaying debt that cannot be otherwise repaid due to revenue losses.

Importantly, EIDL proceeds cannot be used to refinance debt incurred prior to the disaster, repair physical damage, or pay dividends.

Does Receiving One Type of Small Business Loan Make an Applicant Ineligible to Receive Another Type?

Under the PPP, a business must certify on its application that, among other things, it has not and will not receive another PPP loan. A borrower that received an EIDL loan between January 31, 2020 and April 3, 2020 can still receive a PPP loan. A borrower can also refinance an EIDL loan into a PPP loan. If an EIDL loan is used for payroll costs, the PPP loan must be must be used to refinance the EIDL loan. Proceeds from any advance up to US$10,000 on the EIDL loan will be deducted from the loan forgiveness amount on the PPP loan.

Does Participation in the PPP Preclude a Borrower From Taking Advantage of CARES Act Tax Relief Programs and Vice Versa?

CARES Act Section 2301 provides that borrowers that receive PPP loans under Section 1102 are ineligible to receive the employee retention tax credit. Additionally, Section 2302 of the CARES Act provides that the payroll tax deferral benefit is not available to a taxpayer that participates in the loan forgiveness program under the PPP.

It also appears that participation in CARES Act tax relief programs under sections 2301 and 2302 may preclude a borrower from applying for and receiving a PPP loan. We anticipate the SBA will provide further clarification regarding this issue.

Can SBA CARES Act Loans Be Forgiven?

PPP: Subject to certain limitations, a PPP loan is eligible for forgiveness up to the amount spent by the borrower in the eight-week period after the origination date of the loan on:

- Payroll costs[8]
- Interest payment on any mortgage obligation incurred before February 15, 2020;
- Payment of rent on any lease in force before February 15, 2020; and
- Payment of any utility for which services began before February 15, 2020.

Forgiveness of non-payroll costs is limited to 25% of the total forgiveness amount. The amount eligible for forgiveness may not exceed the principal amount of the loan.

The amount of the loan eligible for forgiveness will be **reduced proportionally by the number of employees laid off** during the eight-week period beginning on the date of the origination of the loan relative to the borrower's prior employment levels for one of two time periods, at the election of the borrower: (1) February 15, 2019 to June 30, 2019, or (2) January 1, 2020 to February 29, 2020.[9] That same reduction in forgiveness would also apply if employees' **salaries are reduced** by more than 25%.

The SBA has said that they will issue additional guidance on PPP loan forgiveness at a later date.

EIDL: These loans are generally not eligible for forgiveness, although advance grants up to US$10,000, as described above, need not be paid back if an EIDL application is subsequently denied. Furthermore, an EIDL loan may be forgiven if it is refinanced under a PPP loan depending on the date the EIDL loan was taken out. If an applicant receives an EIDL advance under the CARES Act but is approved for a 7(a) loan instead, the advance amount is reduced from the amount of the loan eligible for forgiveness under the 7(a) program.

Is a Business Eligible for Forgiveness If It Has Already Laid Off Workers and/or Reduced Salaries?

PPP: The CARES Act does not disqualify a business from loans under the PPP if it has already conducted reductions in force, furloughed, or otherwise laid off employees, or reduced employee salaries. However, in instances other than seasonal employers, the SBA calculates the number of employees based on the average number of employees over the preceding 12 months. Also, as discussed above, the amount of the loan that is eligible for forgiveness is based on the number and salaries of employees at the time of an application, taking into account any reductions that have recently been made.

Practically speaking, borrowers that lay off employees or reduce employee salaries between February 15, 2020 and April 26, 2020 should not be penalized with a reduction in loan forgiveness amount as long as they re-hire the employees that they previously laid off or eliminate the salary reductions by June 30, 2020. Otherwise, as discussed above, the amount of the 7(a) loan that is eligible for forgiveness is reduced as described above.

EIDL: EIDL loans are generally not eligible for forgiveness. The CARES Act does not otherwise modify the eligibility requirements for EIDLs with respect to any reductions in force, furloughs, or other layoffs or salary reductions

What relief does the CARES Act provide for existing SBA borrowers or borrowers who cannot access PPP loans?

The SBA will automatically pay the principal, interest, and fees on existing non-PPP 7(a) loans, 7(m) microloans, and 504 long-term fixed asset loans for six months. It will do the same for any *new* non-PPP 7(a), 7(m), and 504 loans originated between March 27, 2020 and September 27, 2020. Borrowers need take no additional action to receive this debt relief. The automatic payments will begin with the next payment due on the covered loan.

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[1] The SBA's 7(a) loan program, authorized by Section 7(a) of the Small Business Act of 1953 (15 U.S.C. § 636(a)), is the agency's flagship loan guaranty program for providing financial assistance to small businesses. As described in our prior alert, the 7(a) loan program has several subprograms, including SBA Express, Export Express, and Community Advantage Pilot programs, each of which have their own eligibility requirements, terms, and benefits, and provide different opportunities for expedited or expanded loans.

[2] The EIDL program is authorized under Section 7(b)(2) of the Small Business Act of 1953 (15 U.S.C. § 636(b)(2).

[3] Independent contractors do not count for purposes of a calculating the size of a PPP loan, nor do they count as employees for purposes of PPP loan forgiveness.

[4] Under Section 1102 of the CARES Act, payroll is defined to include the gross sum or payments of any compensation of employees (whose principal place of residence is in the United States) that is in the form of (1) salary, wage, commission, or similar compensation; (2) payment of cash tips or equivalent; (3) payment for vacation, parental, family, medical, or sick leave; (4) allowance for dismissal or separation; (5) payment required for the provisions of group healthcare benefits, including insurance premiums; (6) payment of any retirement benefits; and, (7) payment of state or local taxes assessed on the compensation of employees. The CARES Act excludes qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act. If an employee's annual cash compensation exceeds US$100,000, any amount in excess of US$100,000 shall not be used in calculating the maximum loan amount.

[5] *See* Small Business Administration, *Paycheck Protection Program Application* (April 2020).

[6] Whether applying as a company, or as a sole proprietor or independent contractor, payroll costs include compensation and benefits up to an annual salary of US$100,000.

[7] For purposes of determining the percentage of use of proceeds for payroll costs, the amount of any refinanced EIDL will be included. For purposes of loan forgiveness, however, the borrower will have to document the proceeds used for payroll costs in order to determine the amount of forgiveness.

[8] Independent contractors do not count as employees for purposes of PPP loan forgiveness, as they have the ability to apply for PPP loans on their own.

[9] The time period of February 15, 2019 to June 30, 2019 applies to seasonal employers.

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