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Congress Creates the Paycheck Protection Program Through the SBA to Provide Loans and a Loan Forgiveness Program to Eligible Entities Impacted by COVID-19

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5/18/20: PPP Guidance Update: SBA Releases Loan Forgiveness Application for Borrowers

5/14/20: PPP Guidance Update: SBA Creates Limited Safe Harbor for Borrowers who have Received Less than \$2,000,000

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Congress Creates the Paycheck Protection Program Through the SBA to Provide Loans and a Loan Forgiveness Program to Eligible Entities Impacted by COVID-19

Phase III of the federal COVID-19 relief legislation—the CARES Act, which President Trump signed into law on March 27, 2020 and is summarized in a [previous alert](#)—amends Section 7(a) of the Small Business Act to create the Paycheck Protection Program (PPP). Under this expansion of the SBA's traditional loan program, the government will provide or 100% guarantee loans made to eligible persons or entities over the next several months in an effort to help small businesses impacted by COVID-19. The CARES Act also creates a loan forgiveness program for certain payments made with the PPP loans.

This alert provides answers to some of the preliminary questions a potential borrower might be asking as they consider applying for a loan under the PPP.

Who is eligible for a PPP loan?

The PPP expands the typical definition of who is eligible for these SBA loans to any business concern, nonprofit organization, veterans' organization or Tribal business concern if they employ not more than the greater of (a) 500 employees; or (b) if applicable, the size standard for the business's industry. The PPP specifically provides that individuals who operate under a sole proprietorship or as an independent contractor and eligible self-employed individuals may be eligible under the PPP, even though they are not eligible for a traditional SBA loan. Unlike a previous version of the bill, the enacted version of the CARES Act does not exclude non-profits that receive Medicaid reimbursements from eligibility.

The PPP further relaxes other typical eligibility requirements for any business concern that is assigned a NAICS code beginning with 72, which generally applies to the hospitality and food service industry. The PPP makes these businesses eligible for a PPP loan if they employ not more than 500 employees **per physical location**. Further, the PPP waives affiliation rules for these restaurant and hospitality businesses, and also for any business concern operating as a franchise that is assigned a franchise identifier code by the Administration and any business concern that receives financial assistance from a SBIC.

What is the “covered period” for the PPP loans?

These PPP provisions cover loans that are made between February 15, 2020 and June 30, 2020.

How large are the PPP loans?

The loan size will be determined by a formula generally based on payroll costs from the previous year, with a maximum loan amount of \$10 million. The formula is set out in greater detail in Section 1102(a)(1)(E) of the CARES Act.

How can I use the PPP loan funds?

In addition to other allowable uses, a borrower can use the PPP funds for: (a) Payroll costs; (b) Costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums; (c) Employee salaries, commissions, or similar compensations; (d) Payments of interest on any mortgage obligation (which does not include any prepayment of or payment of principal on a mortgage obligation); (e) Rent; (f) Utilities; and (g) Interest on any other debt obligations that were incurred before the covered period. See Section 1102(a)(1) of the CARES Act for a more detailed definition of what is and is not included in the term “payroll costs.”

How does the loan forgiveness aspect work?

The CARES Act implements a loan forgiveness program for loans received under the PPP. A borrower is eligible for loan forgiveness in an amount equal to the costs incurred and payments made **during the eight week period following loan origination** in the following categories:

- Payroll costs;
- Any payment of interest on any covered mortgage (which does not include any prepayment of or payment of principal on a mortgage obligation);
- Any payment on any covered rent obligation; and
- Any covered utility payment.

A borrower with tipped employees may receive forgiveness for additional wages paid to those employees. The forgiveness amount cannot exceed the principal amount of the loan.

Borrowers seeking loan forgiveness must provide sufficient documentation verifying all employee and salary information. Lenders will be required to make a decision on forgiveness within 60 days of receiving a loan forgiveness application. Amounts forgiven under this section are considered canceled indebtedness by a lender authorized under 7(a) of the Small Business Act. For IRS purposes, any amount which would be includible in gross income of the eligible recipient by reason of loan forgiveness shall be excluded from gross income.

Will my loan forgiveness amount be affected if my business experiences layoffs?

The loan forgiveness amount will be reduced based on employee and salary reductions, but the PPP makes exemptions for that reduction if a borrower re-hires its employees or eliminates the salary reductions by June 30, 2020.

To calculate the amount to be forgiven as reduced based on employee reduction, the PPP uses the following formulas:

- **Non-seasonal employers** - Forgiveness amount x (the average number of FTE employees per month between February 15, 2020 and June 30, 2020 ÷ the average number of FTE employees per month between [February 15, 2019 and June 30, 2019 **or** January 1, 2020 and February 29, 2020 at the election of the borrower]).
- **Seasonal employers** - Forgiveness amount x (the average number of FTE employees per month between February 15, 2020 and June 30, 2020 ÷ the average number of FTE employees per month between February 15, 2019 and June 30, 2019).

The loan forgiveness amount will also be reduced by the amount of any reduction in total salary or wages of any employee that is in excess of 25% of the total salary or wages of the employee during the most recent full quarter before the covered period. This does not apply for individuals who, in any single pay period, received wages at an annualized rate of pay over \$100,000.

What happens to loan amounts that are not forgiven?

For covered loans that have a remaining balance after the loan forgiveness reduction, the remaining balance is guaranteed by the SBA, the loan will have a maximum maturity date of 10 years from application of loan forgiveness, and the interest rate cannot exceed 4%. There is no prepayment penalty for covered loans. The PPP also provides for no debt service payments for at least six months and not more than one year.

What is the process for obtaining a PPP loan?

You should contact your lender to determine if they are participating in this program and, if so, the details of their application process. The PPP permits the government to expand the number of lenders under this program, and allows those lenders to make and approve loans, including determining borrower eligibility. In evaluating eligibility, the lender is required to consider whether the borrower was in operation on February 15, 2020 and if it either had employees for which it paid salary and payroll taxes or paid independent contractors as reported on a Form 1099-Misc.

As part of the application, an applicant must make a good faith certification:

- That current economic conditions makes the loan necessary to support ongoing operations;
- Acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- That the recipient does not have an application pending for a loan under this subsection **for the same purpose** and duplicative of amounts applied for or received under a covered loan; and
- Between February 15, 2020 and December 31, 2020, the recipient has not received amounts under this subsection for the same purpose.

The PPP waives several typical SBA loan requirements, including the requirement that a small business concern is unable to obtain credit elsewhere (the “credit elsewhere” requirement) and the personal guarantee requirement.

Does the CARES Act provide any other types of relief for small businesses?

The SBA is also offering low-interest federal disaster loans (EIDL loans) of up to \$2 million for working capital to small businesses suffering substantial economic injury. Be aware that this program is separate from the PPP and uses different definitions and terms. To qualify for these federal disaster loans, a small business must meet the eligibility requirements, which include:

- Located within a state or territory in which the SBA has issued a disaster declaration, which now cover nearly all, if not all, of the United States;
- Demonstration of the financial impact of COVID-19 on its business operations.

For EIDL loans made in response to the COVID-19 between the period of January 31, 2020 and December 31, 2020, the government is waiving (1) the personal guarantee requirement for loans up to \$200,000; (2) the requirement that an applicant must be in business for more than one year; and (3) the requirement that an applicant is unable to obtain credit elsewhere.

Be careful when deciding whether to apply for an EIDL loan or a PPP loan. Based on the certification required for a PPP loan, it appears that a borrower may not apply for and obtain a PPP loan if they have an application pending for or have received an EIDL loan intended for the same purposes. The PPP does, however, allow a borrower to refinance into a PPP loan the outstanding amount of an EIDL disaster loan unrelated to COVID-19 made between January 31, 2020 and the refinancing date. Future guidance from the SBA will hopefully further clarify how the various loan programs work together.

The CARES Act also encourages lenders to provide payment deferments on already existing SBA loan products, and requires SBA to pay the principal, interest, and any fees that are owed on an existing SBA loan product for 6 months beginning with the next payment date, even if the loan was sold on the secondary market.

What if I don't qualify for the PPP loans or other SBA programs?

Title IV of the CARES Act creates funding for loan programs that can apply to medium and large size businesses. A summary of those programs can be found in [this alert](#).

The newly formed PPP and other SBA relief efforts may be available to provide substantial relief efforts for small businesses impacted by COVID-19. Please call Drew Parobek, Marty Gates, or your Vorys attorney today if you have questions about if these programs are available for your business. We will continue to monitor the rollout of these programs and any guidance or regulations issued by the SBA.

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VORYS COVID-19 TASK FORCE

Vorys attorneys and professionals are counseling our clients in the myriad issues related to the coronavirus (COVID-19) outbreak. We have also established a comprehensive Coronavirus Task Force, which includes attorneys with deep experience in the niche disciplines that we have been and expect to continue receiving questions regarding coronavirus. Learn more and see the latest updates from the task force at [vorys.com/coronavirus](https://www.vorys.com/coronavirus).