



ALFA International Webinar Series

Understanding the Paycheck Protection Program
April 2, 2020



OUR SPEAKERS



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OBJECTIVES

- Discuss the impact of the Paycheck Protection Program included in the “Coronavirus Aid, Relief, and Economic Security Act” or the “CARES Act” (Pub. L. 116-136), as signed by the President and enacted into law on 3/27/2020
- Review Paycheck Protection Program Loans
 - Who is eligible
 - Loan terms
 - Loan forgiveness
- Small Business Opportunities in the CARES Act

BACKGROUND

- March 27, 2020: President signed and enacted into law the Coronavirus Aid, Relief, and Economic Security Act or the “CARES Act” (Pub. L. 116-136)
 - The CARES Act amended the Small Business Act (SBA) to create a new Business Loan Program category (Paycheck Protection Program)
 - Paycheck Protection Program is a modification of the SBA’s 7(a) loan program, in which banks make loans to businesses that are guaranteed by the SBA
- The US Treasury has a 15-day period (beginning 3/27/2020) to issue guidance
- March 31, 2020: US Treasury issued the first set of guidance
- Substantial additional guidance is expected

SMALL BUSINESS OPPORTUNITIES IN THE CARES ACT

- **Individual Direct Check Payments**
 - \$1,200/person (\$2,400/couple filing jointly) + \$500 per dependent child
 - max income for individual \$75,000 (\$150,000 for couples filing jointly)
- **Tax Credit Separate from SBA Loans**
 - Up to 50% of wages for each employee (up to \$10,000) for each quarter
- **Unemployment Benefits**
 - Up to \$600/week for up to 4 months
- **SBA Loans**
 - **Economic Injury Disaster Loans (EIDLs)**
 - **\$10 billion** in direct disaster assistance: \$10,000 advance grant on loans up to \$2 million
 - *Window to Apply: Jan. 31, 2020 – Dec. 31, 2020*
 - **Paycheck Protection Program (PPP) & Small Business Interruption Loans**
 - **\$349 billion** for SBA 7(a) loans but new eligibility criteria, up to \$10 million, & forgivable
 - *Window to Apply: April 3, 2020 or April 10 – Jun. 30, 2020*

PAYCHECK PROTECTION PROGRAM LOANS

- Authorizes \$349 billion of federally guaranteed loans to qualifying small and medium sized businesses
- Modifies the 7(a) loan program in four important ways:
 - Expands the businesses that are eligible for loans
 - Modifies the loan terms
 - Allows for forgiveness of loan if the borrower maintains its payroll
 - Modifies provisions to incentivize banks to lend, and make the process faster and more efficient

WHO IS ELIGIBLE FOR PAYCHECK PROTECTION LOANS?

- Generally: businesses, 501(c)(3) non-profits or veteran's organizations with:
 - 500 or fewer employees
 - The applicable size standard for the industry as provided by SBA, if higher
- Includes certain sole-proprietors, independent contractors, and other self-employed individuals as eligible for loans
- 500 employee limit waived for accommodation and food service businesses so long as business employs no more than 500 employees at any physical location
- Must meet the SBA's definition of "business concern"

SMALL BUSINESS CONCERN

- “A small business concern” is a business that:
 - Organized for profit (non-profits eligible separately)
 - place of business in the U.S.
 - Operates primarily within the U.S. or makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor
 - Is independently owned and operated
 - Is not dominant in its field on a national basis
- The business may be a sole proprietorship, partnership, corporation, or any other legal form

FOREIGN BUSINESSES

Foreign Businesses are Eligible for SBA Loans if:

- operates primarily within the United States *or*
- makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials, or labor

SBA considers the receipts or employees (or other measure) of an applicant, and all of its domestic and foreign affiliates, when determining a business concern's size.

A joint venture can have no more than 49% participation by foreign business entities in the joint venture.

Employees based outside of the US are excluded from "Payroll Costs".

AFFILIATION

- Employee limit includes employees of affiliates, except:
 - Hospitality and restaurant businesses
 - Franchises on the SBA's Franchise Directory
 - Businesses who receive financing through the Small Business Investment Company (SBIC) program
- Affiliation based on control, one party has the power to control the other, or a third party or parties controls or has the power to control both
- It does not matter whether control is exercised, so long as the power to control exists

AFFILIATION

- SBA defines affiliation broadly, and includes:
 - Ownership
 - Management
 - Close Relatives
 - Identity of Interest
 - Economic Dependence
 - Common Investments
 - Newly Organized Business
 - Totality of the Circumstances
 - Franchise Agreements (waived for Paycheck Protection Loans)

INELIGIBLE BUSINESSES

- Did not modify the types of businesses that are generally ineligible for SBA business loans, which includes (among others):
 - Financial businesses engaged in lending
 - Passive business
 - Foreign businesses
 - Gambling businesses
 - Private clubs
 - Life insurance
 - Religious businesses
- Hobbies
- Applicant's Character (including owners)

CREDIT AVAILABLE ELSEWHERE

- CARES Act waives the “credit available elsewhere” test normally applicable to SBA loans
- This means that owners of business are not required to seek other sources of capital, including equity or debt investments from owners with prior to obtaining a Paycheck Protection Loan
- Very Important distinction with traditional SBA loans

PAYCHECK PROTECTION LOAN TERMS

- Loan Amount: 2.5x monthly payroll costs, max of \$10 million
- Interest Rate: Up to .5%
- Permitted Uses:
 - Payroll costs (defined term), group health costs, insurance premiums, and interest on a preexisting mortgage / other debt, rent, and utility payments
 - Employee compensation above \$100,000 excluded
 - NOT to be used to prepay or refinance debt
- Collateral: None
- Guarantee: None
- Maturity: 2 years
- Deferment: Automatic deferment for at least six months
- SBA Disaster Loans: Cannot have both (with some exceptions)

PAYROLL COSTS

Payroll costs include:

- salaries, wages, commissions, tips;
- vacation, parental, sick, and other paid leave;
- severance costs;
- group healthcare costs;
- retirement benefits;
- state and local payroll taxes; and
- compensation or income to sole proprietors or independent contractors that is a wage, commission or net earnings from self-employment or similar compensation, and that is in an amount not more than \$100,000.

Payroll costs specifically exclude:

- the compensation of any employee in excess of an annual salary of \$100,000 annually [unclear if this applies to only salary or all compensation);
- employees whose principal place of residence is outside the United States;
- FICA and income tax withholdings; and qualified paid sick and family leave under the Families First Coronavirus Response Act for which tax credits are allowable.

PAYCHECK PROTECTION LOAN FORGIVENESS

- Eligible for loan forgiveness equal to the amount spent by the borrower during an 8-week period after loan closing on:
 - Payroll costs (same exclusions)
 - Interest on any mortgage / debt incurred prior to Feb. 15, 2020
 - Rent on any lease in force prior to Feb. 15, 2020
 - Utility payments for which service began before Feb. 15, 2020
- Maximum forgiveness is principal amount of the loan
- Loan forgiveness will not be taxable income

LOAN AMOUNT ELIGIBLE FOR FORGIVENESS

- Amount eligible for forgiveness reduced proportionally by:
 - Reduction in employees retained compared to the prior year and
 - Reduction in pay of any employee in excess of 25%
- Borrowers re-hiring workers previously laid off will not be penalized and payments to such workers eligible for forgiveness
- Businesses should ensure they can rehire workers
- Borrowers must document payroll and payments
- Borrower certifications required regarding use of loan
- Many are looking for guidance and safe harbors here

INCENTIVES FOR BANKS

- Like SBA 7(a), banks who lend will take risk that SBA won't guaranty loan
- Increased SBA guaranty of such loans to 100% for the remainder of 2020
- Modified the procedures and requirements of lending banks
- Banks will likely be seeking additional guidance from Treasury / SBA on these aspects prior to making loans
- Contains funding to make payments on existing SBA 7(a) or 504 loans (and such payments will not be deemed to be deferral payments)

PROCESS AND TIMING

- Applications are available for download:
<https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Application-3-30-2020-v3.pdf>
- April 3, 2020: small businesses and sole proprietorships can apply for and receive loans to cover their payroll and other certain expenses through existing SBA lenders.
- April 10, 2020: independent contractors and self-employed individuals can apply for and receive loans to cover their payroll and other certain expenses through existing SBA lenders.
- Other regulated lenders will be available to make these loans as soon as they are approved and enrolled in the program.

SBA ECONOMIC INJURY DISASTER LOANS

- Loan Amount: max of \$2 million
- Interest Rate: 3.75% for small businesses; 2.75% for non-profit organizations
- Permitted Uses:
 - Pay fixed debts
 - Payroll
 - Accounts payable
 - Other approved expenses that cannot be paid because of COVID-19's impact
- Collateral: most loans require collateral from owners
- Guarantee: 20% or more owners are generally required to personally guaranty the loan
- Maturity: maximum of 30 years
- Deferment: Automatic deferment 12 months

SBA ECONOMIC INJURY DISASTER LOAN DETAILS

- SBA uses credit scores of business owners in their decisions for approval
- SBA must be reasonably assured an applicant can repay its loan
- Borrowers will be required to retain receipts and evidence of how loan proceeds are used for 3 years
 - Such receipts are subject to SBA audit
 - Borrowers who misapply loan proceeds may be liable to SBA for 1.5x of the total loan proceeds disbursed when SBA learns of the misapplication
- Owner Guarantee
 - 20% or more owners are generally required to personally guaranty the loan
 - May be secured or unsecured – but most loans require collateral from owners
 - May be limited
 - Changing ownership prior to submitting application to lower an individual's ownership to avoid a personal guaranty could jeopardize eligibility

WHO CLASSIFIES AS A “SMALL BUSINESS”?

- SBA “small businesses”, has two elements:
 - SBA’s size standards for small business
 - Small business concern
- Size standards are determined on an industry-specific (using NAICS codes) sliding scale based on the annual receipts or revenues of the business or in some cases, the number of employees
- Businesses should review the sliding scale to see if they could potentially qualify
- Annual receipts maximums vary widely by industry

FRANCHISES

- Applicant franchisee must have the right to profit from its efforts and bear the risk of loss commensurate with ownership
 - This limitation applies generally
- Franchisee must be free from significant control by franchisor
- SBA considers only the franchise agreements of the applicant
- SBA maintains a centralized list of franchise agreements that are eligible for SBA financial assistance
- SBA may require additional documentation necessary to resolve issues in the franchise agreement

OTHER REQUIREMENTS

- Private non-profit organizations also eligible (rules are a bit different)
- Businesses must be unable to (i) meet its obligations as they mature or (ii) pay its ordinary and necessary operating expenses
- Businesses including their affiliates and 20% owners must have “used all reasonably available funds” in the business and be “unable to obtain credit elsewhere”

CONCLUSION

There has been and will continue to be unprecedented interest in both these programs, which will inevitably strain the SBA's and lending banks' resources. As banks and borrowers continue to work through details, there will be questions that require SBA guidance.

It will be crucial for companies to understand if they are eligible for certain programs, which program is best for them, and get a bank and advisors involved early. Incomplete or incorrect documents and applications will cause delay.

Please consult your local ALFA firm for assistance. We and many other ALFA firms are assisting numerous small businesses and non-profits in this process.