

# COVID-19 ALERT

## PAYCHECK PROTECTION PROGRAM GUIDE

The Paycheck Protection Program (“PPP”), a cornerstone of the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”), aims to provide relief to small businesses impacted by the COVID-19 pandemic. Since the initial enactment of the CARES Act on March 27, 2020, the Small Business Administration (“SBA”), in consultation with the Department of Treasury, has issued several Interim Final Rules and Frequently Asked Questions intended to provide guidance with respect to the implementation and administration of the PPP. In this alert, we have summarized the principal terms of the PPP, inclusive of recent rules and supplemental guidance.

We continue to monitor the additional rules, interpretations and guidance released by the SBA and Department of Treasury related to the PPP. Our attorneys are available to guide you through this critical time and answer any questions regarding the PPP or other aspects of the CARES Act.

### WHO IS ELIGIBLE TO APPLY FOR PPP FUNDING?

**Eligible Borrowers, Generally:**

- Businesses (including some non-profits) with fewer than 500 employees operating in the United States, subject to the SBA’s existing affiliation rules (detailed below).
- Any U.S. business assigned a NAICS Code beginning with 72 (i.e., restaurant and hospitality industry), that employs no more than 500 employees per physical location.
- Businesses with more than 500 employees operating in the United States that (i) meet statutory employee-based or revenue-based size standards for the applicants primary industry (based on NAICS Code), or (ii) meet the SBA’s “alternative size standard” as of March 27, 2020 (based on maximum tangible net worth of not more than \$15 million and average net income after taxes of not more than \$5 million for the full two fiscal years prior to the application).
- Sole proprietorships, self-employed individuals and independent contractors. Self-Employed individuals are eligible to receive a PPP loan if such individual (i) self-employment income (e.g., independent contractors and sole proprietors), (ii) has a principal place of residence in the United States, and (iii) has filed or will file a Form 1040 Schedule C for the 2019 tax year. In order to be eligible for a PPP loan, the applicant business must have been in operation as of February 15, 2020.

**Specific Exclusions:**

The SBA has determined that the following businesses are ineligible to apply for a PPP loan:

- x Hedge funds and private equity firms
- x Debtors in bankruptcy proceedings (at the time it submits the application or any time prior to the loan being disbursed)
- x Individuals that employ household employees such as nannies or housekeepers.
- x Businesses owned or controlled by the applicant or any of its owners that are currently delinquent or has defaulted within the last seven years on a direct or guaranteed loan from the SBA or any other Federal agency that has caused a loss to such government agency.
- x Businesses engaged in any activity that is illegal under federal, state or local laws.
- x Businesses that are owned 20% or more by someone who is presently (i) incarcerated, (ii) on probation, (iii) on parole, (iv) subject to an indictment, criminal information, arraignment, or by which criminal charges are brought, or (v) has been convicted of a felony or certain other criminal matters in the last five years.
  
- x Certain real estate businesses:
  - x Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds.
  - x Businesses primarily engaged in subdividing real property lots and developing it for resale.
  - x Businesses that are primarily engaged in owning or purchasing real estate and leasing it for any purpose.
  - x Businesses that lease land for the installation of cell phone towers, solar panels, billboards or wind turbines.
  - x Businesses that have entered into a management agreement with a third party that grants the third-party manager sole discretion to manage operations of the business.
  - x Apartment buildings.
  - x Residential facilities that do not provide healthcare or medical services.

**Determining Number of Employees for Eligibility Purposes:**

- Applicants must include all individuals employed on a full-time, part-time or other basis.
  
- Self-employed individuals and independent contractors are eligible to apply separately, and therefore should be excluded from the calculation for an entity application.
  
- Partners of a partnership are required to apply on behalf of the partnership as a whole, rather than for their own benefit (by claiming “self-employment” income). Such limitation applies equally to members of a limited liability company that files as a partnership for tax purposes.

**Required Certification:**

- The PPP Borrower Application Form requires applicants to certify as to a number of important matters, including that “[c]urrent economic uncertainty makes [this] loan request necessary to support the ongoing operations of the Applicant.” Any borrower that submitted an application prior April 23, 2020, and repays such loan in full by May 7, 2020, will be deemed to have made the required certification in good faith. This “safe harbor” is intended to ensure that borrowers promptly repay PPP loans that were obtained based on misunderstanding or misapplication of the required certification standard, taking into account updated guidance on such standard.
- The applicant must: (1) assess their economic need for the loan; (2) certify in good faith that the loan is necessary; and (3) make this certification in good faith, taking into account their current business activity and its ability to access other sources of liquidity sufficient to support ongoing operations in a manner that is not significantly detrimental to the business. While the CARES Act does not require that borrowers be unable to obtain credit elsewhere, access to capital and current financial and business conditions should be carefully analyzed. Each applicant should be prepared to demonstrate to the SBA, upon request, the basis for the determination.
- The SBA will review all loans in excess of \$2 million, in addition to other loans, as appropriate, following the submission of the loan forgiveness application, to confirm need, eligibility and other compliance matters.
- It is unlikely that public companies with substantial market value and access to capital markets will be able to make the required certification.
- *Penalties for False Statements and/or Certifications:*
  - x Imprisonment of up to five years and/or a fine in the amount of up to \$250,000 (18 U.S. Code 1001 and 3571);
  - x Imprisonment of up to two years and/or a fine in the amount of up to \$5,000 (15 U.S. Code 645); and
  - x If the loan application is submitted to a federally insured institution, imprisonment up to 30 years and/or a fine in the amount of up to \$1 million (18 U.S. Code 1014).

**HOW ARE AFFILIATED ENTITIES TREATED IN DETERMINING ELIGIBILITY?**

**SBA Affiliation Rules:**

- Most applicants will be considered collectively with its affiliates for the purpose of qualifying for a PPP loan. Businesses are deemed “affiliated” when they are under common control, which may be exercised through ownership, management or other relationship between the parties.

	<ul style="list-style-type: none"> <li>○ <i>Ownership:</i> A person or entity is deemed an affiliate if such person or entity owns or controls more than 50% of the voting stock of a business concern. Where the voting stock of a business is widely held, or in the event that no person or entity is found to control, the Board of Directors or Chief Executive Officer or President (or other officers, managing members, or partners who control the management of the entity) are deemed to have control.</li>   <li>○ <i>Minority Shareholders:</i> A minority shareholder is deemed to be an affiliate of an applicant if such shareholder has control over the business by virtue of the right to prevent a quorum or otherwise block actions by the board of directors or other shareholders. A minority shareholder will not be considered an affiliate of an applicant if such rights are irrevocably waived or otherwise relinquished.</li>   <li>○ <i>Unvested Rights:</i> For purposes of determining size, the SBA treats all stock options, convertible securities and agreements to merge as fully vested and/or exercised. Options, convertible securities and agreements that are subject to conditions precedent that are either speculative, unenforceable under applicable law or incapable of fulfillment are not considered vested/effective.</li>   <li>○ <i>Management:</i> A person or entity is deemed an affiliate if the Chief Executive Officer or President of the applicant (or other officers, directors, managing members or general partners vested with management authority) also control the management of one or more additional businesses.</li>   <li>• Private equity-owned portfolio companies are bound by SBA affiliation rules in the same manner as any other business concern subject to outside ownership or control.</li> </ul>
<p><b>Exceptions:</b></p>	<ul style="list-style-type: none"> <li>• Businesses operating under NAICS Code 72 (Accommodation and Food Services) with fewer than 500 employees per physical location. Additionally, if each hotel or restaurant location owned by a parent business is a separate legal entity, each such legal entity is eligible to apply for a separate loan so long as such entity uses its unique Employer Identification Number.</li>   <li>• Franchises, so long as they are listed on the SBA Franchise Directory. Each franchisee that meets the SBA's applicable size standard is eligible to apply for its own PPP loan.</li>   <li>• Government-funded hospitals receiving less than 50% of its funding from state or local governments (exclusive of Medicaid).</li>   <li>• Faith-based organizations, for which a relationship among affiliated entities constitutes part of religious practice or is otherwise based on sincere religious teachings or beliefs.</li> </ul>

- A business's participation in an Employee Stock Ownership Plan (ESOP) does not create an affiliation between such business and the ESOP.

## HOW IS THE MAXIMUM LOAN AMOUNT CALCULATED?

### Business Applicants:

- **2.5 times** an applicant's average monthly payroll costs for either (i) the trailing 12-month period or (ii) calendar year 2019 *plus* the outstanding amount of any Economic Injury Disaster Loan ("EIDL") made between January 31, 2020 and April 3, 2020 *less* the amount of any advance made under an EIDL COVID-19 loan. If the proceeds of an EIDL were used for payroll costs, the PPP loan must be used to refinance the EIDL. In all cases, the maximum loan amount is capped at \$10 million.
- Applicants that were not in business from February 15, 2019 through June 30, 2019 may instead use average monthly payroll costs for the period January 1, 2020 through February 29, 2020.
- For seasonal businesses, the measurement period with respect to the average monthly payroll calculation may start on February 15, 2019 or March 1, 2019 and end on June 30, 2019, at the applicant's option.

### Self-Employed and Independent Contractors:

*Applicants Without Employees:* **2.5 times** an applicant's average monthly net profit amount, as identified on IRS Form 1040 Schedule C, Line 31 *plus* the outstanding amount of any EIDL made between January 31, 2020 and April 3, 2020 *less* the amount of any advance made under an EIDL COVID-19 loan. All amounts in excess of \$100,000 are excluded from net profits and, in all cases, the maximum loan amount is capped at \$10 million.

*Applicants With Employees:* **2.5 times** an applicant's average monthly payroll costs for fiscal year 2019, plus the outstanding amount of any EIDL made between January 31, 2020 and April 3, 2020 *less* the amount of any advance made under an EIDL COVID-19 loan. In all cases, the maximum loan amount is capped at \$10 million. For purposes of the calculation, payroll costs include:

- Net profit amount as reflected on the applicant's 2019 Form 1040 Schedule C, line 31, up to \$100,000 annualized. If the net profit amount is negative, this component should be set to zero.
- 2019 gross wages and tips paid to employees (with a principal place of residence in the United States) on a quarterly basis, calculated using 2019 Form IRS Form 941 (Taxable Medicare Wages & Tips), *plus* any pre-tax employee contributions for health insurance or other fringe benefits excluded from taxable wages. Amounts in excess of \$100,000 per employee must be subtracted, as well as amounts paid to non-U.S. resident employees.

	<ul style="list-style-type: none"> <li>• 2019 employer health insurance contributions, retirement contributions and state and local taxes assessed on employee compensation.</li> </ul>
<p><b>Payroll Costs:</b></p>	<p><i>Qualifying Payroll Costs:</i></p> <ul style="list-style-type: none"> <li>• Compensation to U.S. employees in the form of salary, wages, commissions or similar compensation, and cash tips or the equivalent (based on employer records of past tips or a reasonable good-faith employer estimate)</li> <li>• Payment for vacation, parental, family, medical, or sick leave</li> <li>• Allowance for separation or dismissal</li> <li>• Payment for group health care benefits (including insurance premiums) and retirement</li> <li>• Payment of state and local taxes assessed on compensation of employees</li> <li>• For independent contractors and sole proprietors only: wages, commissions, income or net earnings from self-employment or similar compensation</li> </ul> <p><i>Specific Exclusions:</i></p> <ul style="list-style-type: none"> <li>x Compensation to non-U.S. employees.</li> <li>x Cash compensation (not authorized benefits) in excess of \$100,000 per employee on an annualized basis.</li> <li>x Federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020.</li> <li>x Qualified sick and family leave wages for which a credit is allowed under Sections 7001 and 7003 of the Families First Coronavirus Response Act.</li> <li>x Partnership income, which is instead required to be reported as payroll costs (up to \$100,000 annualized) on a PPP loan application filed by the partnership itself. This prohibition applies not only to active partners of a partnership, but also to members of a limited liability company that files as a partnership for tax purposes.</li> </ul>

**HOW CAN PPP LOAN PROCEEDS BE DEPLOYED? WHAT ARE THE BASIC TERMS?**

<p><b>Operational Expenses:</b></p>	<p>PPP loan proceeds can be used to cover the following operational expenses:</p> <ul style="list-style-type: none"> <li>• Payroll costs (see above).</li> <li>• Costs related to continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums.</li> <li>• Interest on mortgage obligations, where such mortgage obligations were incurred before February 15, 2020.</li> <li>• Rent obligations under lease agreements in force before February 15, 2020.</li> <li>• Utilities for which service commenced prior to February 15, 2020.</li> </ul>
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	<ul style="list-style-type: none"> <li>• Interest payments on any other debt obligations incurred prior to February 15, 2020.</li> <li>• Refinancing an EIDL loan made from January 31, 2020 through April 3, 2020.</li> </ul> <p>An applicant who received an EIDL from January 31, 2020 through April 3, 2020, can apply for a PPP loan. If the proceeds of an EIDL were used for payroll costs, the PPP loan must be used to refinance the EIDL. Proceeds from any advance (up to \$10,000) on the EIDL will be deducted from the forgiveness amount on the PPP loan.</p>
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<p><b>Terms:</b></p>	<ul style="list-style-type: none"> <li>• <i>Interest Rate:</i> 1.0%</li> <li>• <i>Term:</i> 2 years</li> <li>• No prepayment penalties or premiums</li> <li>• Loan is unsecured, uncollateralized and is not required to be personally guaranteed.</li> <li>• Payment is deferred for 6 months following the date of disbursement of the PPP loan (however, interest will accrue from the date of disbursement).</li> <li>• PPP loan documentation is not uniform, with each lender using its own form, subject to the PPP requirements and otherwise not inconsistent with the PPP. Applicants should carefully review all terms and conditions prior to executing PPP loan documents to confirm accuracy and to confirm that such terms and conditions are not unnecessarily restrictive.</li> </ul>
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<p><b>Disbursements:</b></p>	<p>PPP lenders must make a one-time, full disbursement of the PPP loan within ten calendar days of loan approval (i.e., upon assignment of a loan number by the SBA). For PPP loans approved prior to April 29, 2020, such ten-day period begins on April 28, 2020, and the eight-week covered period begins on the date of first disbursement.</p>
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**HOW IS THE FORGIVENESS AMOUNT DETERMINED?**

<p><b>Generally:</b></p>	<ul style="list-style-type: none"> <li>• PPP loans are eligible for forgiveness up to the full principal amount of the loan and any accrued interest. The aggregate forgiveness amount is calculated based on the total loan proceeds deployed to cover payroll costs and the above-mentioned operational expenses over the eight-week period following disbursement of the loan, subject to adjustment as detailed below.</li> <li>• Not more than 25% of loan forgiveness may be attributable to non-payroll costs (i.e., interest on mortgage obligations, rent and utilities) deployed over such eight-week covered period.</li> </ul>
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	<ul style="list-style-type: none"> <li>• The SBA has indicated that more detailed forgiveness rules are forthcoming.</li> </ul>
<p><b>Adjustments:</b></p>	<p>Forgiveness amounts are subject to decrease in the event that an applicant (i) reduces its full-time employees, or (ii) decreases salaries and wages by more than 25% for employees making less than \$100,000 per year, in each case, during the eight-week covered period, as compared to the periods below. For purposes of determining the workforce reduction amount, the CARES Act uses a “full-time equivalent employee” (“FTE”) standard, which is calculated based on the average number of full-time equivalent employees per month (which is the average number of FTEs each pay period in the month).</p> <ul style="list-style-type: none"> <li>• <i>Workforce Reduction:</i> Workforce reduction during such eight-week covered period is measured against the period from February 15, 2019 to June 30, 2019 or January 1, 2020 to February 29, 2020 at the borrower’s option. For seasonal employers, the applicable measurement period is February 15, 2019 to June 30, 2019.</li> <li>• <i>Compensation Reduction:</i> Compensation reduction is measured against the employee’s most recent full quarter prior to the PPP loan disbursement and applies only to those employees whose salary at no time exceeded \$100,000.</li> </ul> <p>“Savings” Clause: Borrowers have until June 30, 2020 to restore (i) any reduction in FTEs that occurred between February 15, 2020 and April 26, 2020 to at least the number of FTEs employed on February 15, 2020, and (ii) any reduction in salary or wages for each employee compared to February 15, 2020, in order to regain eligibility for forgiveness of the entire PPP loan amount. If an employee does not accept a rehire offer on comparable terms during the cure period, there will not be a reduction in forgiveness. Any replacement of employees by other employees (in the same quantity), will not impact forgiveness.</p>
<p><b>Unauthorized Use of Proceeds:</b></p>	<p>In the event that PPP loan proceeds are used for an unauthorized purpose, the entirety of the loan amount used for such improper purpose must be repaid in full. If funds are knowingly used for an unauthorized purpose, the applicant will be subject to additional liability, including charges for fraud. If funds are used for an unauthorized purpose by a shareholder, member or partner of the applicant, the SBA will have recourse against such shareholder, member or partner for the unauthorized use.</p>



## WHAT ARE THE TAX IMPLICATIONS OF OBTAINING A PPP LOAN?

### Credits and Deductions:

A borrower is not entitled to payroll tax credits under the CARES Act for employee payments if they have a PPP loan. Any employer may defer payment of the employer's share of social security taxes for wages starting on March 27, 2020 through December 31, 2020. The deferred taxes will be due 50% by December 31, 2021 and 50% by December 31, 2022.

The proceeds of PPP loans are used to pay salary, rent and certain other operational expenses, which would normally be tax deductible for a business. In the event a loan is forgiven, the borrower will not recognize income upon cancellation of the debt. In that case, allowing a tax deduction for the salary, rent and other expenses paid by the borrower would produce a tax windfall to the borrower. In recognition of this special situation, the IRS released Notice 2020-32, which states that no deduction should be allowed for such expenses if the repayment of the loan is forgiven.

## APPLICATION AND ADDITIONAL GUIDANCE

### Application:

The SBA-approved Borrower Application Form can be found [here](#). All applications should be submitted directly to the applicant's lender (not to the SBA). As demonstrated by the first round of applications, PPP funds are expected to be in high demand and will likely exhaust quickly.

### SBA Guidance:

The SBA, in consultation with the Department of Treasury, is continuously releasing additional guidance with respect to the PPP. An up to date listing of all SBA interim final rules, frequently asked questions and supplemental guidance, can be found [here](#), under the heading "Program Rules".

### Additional Assistance:

We are continuing to monitor as additional guidance is released by the SBA and Department of Treasury and will provide updates to this guide as appropriate. Our attorneys are available to answer any questions and assist in determining how best to navigate these relief measures for the benefit of your business.

For additional information on the COVID-19 pandemic, the CARES Act and the Paycheck Protection Program, please visit the Resource Center on our website:



[Resource Center](#)

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