

# WASHINGTON UPDATE

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## Legislative Changes to Small Business Assistance (PPP Loans) in the CARES Act of 2020

On March 31 and April 4, 2020 the Incentive Federation's Washington Updates summarized the most important provisions of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") of 2020, an omnibus law aimed at providing relief to big businesses, small businesses, households, the unemployed, mortgage holders, and those with student loans, among others. This update reviews Title I of the CARES Act, which provided relief to small businesses through Paycheck Protection Program loans, and it analyzes the important ameliorative changes Congress made in the Paycheck Protection Program loan process through the Paycheck Protection Program Flexibility Act enacted on June 5, 2020.

### **Creation of Payment Protection Program**

Title I of the CARES Act provided relief to small businesses by creating in section 1102 a new program within the Small Business Administration's ("SBA") 7(a) Loan Program called the "Paycheck Protection Program" ("PPP"). Under the newly created PPP, the SBA *guarantees* the full amount loaned by participating lenders to certain U.S. small businesses, nonprofit organizations, veterans organizations, and tribal businesses that employ not more than the greater of (1) 500 employees, or (2) the size standards in number of employees that the SBA has established for the industry in which the small business, nonprofit organization, veterans organization, and tribal business operates. Section 1102(a)(1)(B). Sole proprietors, self-employed individuals, or independent contractors are eligible for the newly created PPP. Section 1102(a)(1)(B). Eligible participants may borrow up to \$10 million under the PPP ("covered loans") from February 15, 2020 through June 30, 2020 (the "covered period"). Section 1102(a)(1)(B). In determining "size standards," the SBA defines a small business based on the norms applicable to the particular industry in which a business operates based on either the average number of employees over the past twelve months, or the average annual receipts over the last three years. The SBA provides a size standards tool that a business can use to determine if it is "small." The tool is available at <https://www.sba.gov/size-standards/>

Section 1107 of the CARES Act initially appropriated \$349 billion for the PPP for the government's current fiscal year. There are about 30 million small businesses, and the \$349 billion that Congress allocated initially to PPP covered loans program under the

CARES Act was inadequate, resulting in the depletion of the initial allocation to the program by mid-April. Fortunately, on April 24, 2020, Congress allocated an additional \$310 billion to PPP covered loans.

The SBA started accepting applications at 9:30 a.m. on April 27, 2020 for PPP loans under the additional funds Congress allocated. Although there was an initial rush to take advantage of the additional funds Congress allocated, a substantial amount of PPP covered loans appears to remain available currently to eligible small businesses. As of June 2, 2020, the unused amount of such funds may be as much as \$120 billion.

### **Payment Protection Program Covered Loans – A Technical Overview**

Covered loans have been disbursed through the extensive network of banks that participate in SBA's 7(a) Loan Program. The CARES Act also empowered SBA to extend authority to additional lenders, which has included finance companies and fintech companies such as BlueVine, Intuit QuickBooks, PayPal, Ready Capital, and Square, to make covered loans. Here is a link to the 100 most active lenders under SBA 7(a): <https://www.sba.gov/article/2020/mar/02/100-most-active-sba-7a-lenders>

Although the SBA 7(a) Loan Program is used generally to help small businesses buy property and fixed assets or to complete capital projects, under Section 1102(a)(2) of the CARES Act, the proceeds from a covered loan can be used for (1) payroll support, including paid sick, medical or family leave, and costs related to the continuation of group health care benefits during those periods of leave; (2) employee salaries; (3) mortgage, lease and utility payments; and (4) any other debt obligations. The legislation includes other attractive features, such as (1) increases in the size standard for eligible business concerns, (2) payment deferrals, and (3) loan forgiveness that would enable portions of the loan to be forgiven without resulting in cancellation of indebtedness income for tax purposes.

The PPP also permits the recipient of an economic injury disaster loan ("EIDL") made after January 31, 2020 that is for a purpose other than paying payroll costs and other similar obligations described below as among the permitted uses of proceeds from covered loans (eligible EIDL) to refinance that loan into a covered loan under the PPP. All of these features are designed to encourage businesses to retain their employees in the near term given the sudden cessation of nearly all commercial economic activity, which, according to recent reports, has resulted in approximately 6.648 million jobs lost in the United States last week and nearly 10 million in the last two weeks.

In most cases, the maximum amount a small business may borrow under a covered loan is 2.5 times the average monthly payroll costs the business has incurred for the one-year period before the loan is made, *plus* the amount of any eligible EIDL to be refinanced into the covered loan. For a "seasonal employer," the covered loan amount is set at 2.5 times the total payroll costs of the business for a twelve-week period beginning on February 15, 2019 or March 1, 2019, *plus* the amount of any eligible EIDL to be refinanced into the covered loan. If the small business was not in business between February 20, 2019 and June 20, 2019, the payroll costs will be those incurred for January and February 2020.

The CARES Act defines “payroll costs” for covered loans broadly to include employee compensation that is salary, wage, commission or similar compensation, payment of cash tip or equivalent, vacation, parental, family, medical or sick leave, allowance for dismissal or separation, payment required for the provisions of group health care benefits, including insurance premiums, the payment of any retirement benefit, or the payment of state or local tax assessed on the compensation of employees. As to self-employed persons, sole proprietorships, and one-member limited liability companies, payroll costs include the sum of payments of any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment or similar compensation and that is in an amount not more than \$100,000 in one year, as prorated for the covered period.

Payroll costs do *not* include the **compensation** of an individual employee in excess of an annual salary of \$100,000, as prorated for the covered period, FICA taxes imposed or withheld (the employer and employee portion of Social Security and Medicare taxes), railroad retirement tax, or the withholding obligations from employees. Payroll costs do not include compensation paid to an employee whose principal place of residence is outside of the United States.

The proceeds from covered loans may be used only for employee salaries, commissions or similar compensation, payroll costs, the payment of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums, the payment of interest on any mortgage obligation (but not any prepayment of or payment of principal on a mortgage), rent, utilities, and interest on any other debt obligations that the small business had incurred before February 15, 2020.

The interest rate for a covered loan may not exceed 4%, and there is no prepayment penalty. The interest rate for covered loans was scheduled to be set at 0.5%, but after some lobbying by various commercial lenders, including Bank of America, it will be set initially at 1%. The SBA is permitted to charge a fee to each lender (which may not be passed through to the borrower) for each guarantee under the 7(a) Loan Program. The CARES Act prohibits the SBA from collecting its loan guarantee fee for a covered loan during the covered period. The loans are nonrecourse, and there are no personal guarantees or collateral for covered loans.

The most important aspect of the small business relief enacted in Title I of the CARES Act is the *possibility of loan forgiveness* as set forth in section 1106. The amount of the PPP covered loan that is eligible for forgiveness is the sum of the certain costs incurred and payments made during the eight weeks after the origination of the covered loan (“forgivable amount”). Under section 1106(b), the eligible forgivable amount includes payroll costs (as defined above), interest payments on a mortgage incurred before February 15, 2020 (“covered mortgage obligation”), rent under a lease that was in effect before February 15, 2020, and various types of covered utility payments (water, electricity, gas, telephone, transportation, and internet access) for service in effect before February 15, 2020. An employer with employees who receive tips would also be eligible for loan forgiveness on the amount of those tips. Section 1106(d)(4). On April 2, 2020, the SBA promulgated a rule adding a requirement that 75% of the loan forgiveness amount must be attributable to payroll costs (that is, not more than 25% of the amount forgiven may be non-payroll costs)

The amount of loan forgiveness would be reduced based on a reduction of employees. The reduction would be the eligible forgiveness amount multiplied by a fraction the numerator of which is the average number of full-time equivalent employees per month that the small business employs during the eight-week period after the origination of the covered loan and the denominator is the average number of full-time equivalent employees that the small business employer employed from February 15 through June 30, 2019 or (at the election of the business) for the period from January 1 through February 29, 2020 and the. The fraction cannot be greater than one. The average number of full-time equivalent employees is determined by calculating the average number of full-time equivalent employees for each pay period falling within a month. Section 1106(d)(2).

The amount of loan forgiveness is reduced also by the amount of any reduction during the eight-week period after the origination of the covered loan in the total salary or wages of any employee who did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000 by more than 25 percent of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the beginning of that eight-week period. Section 1106(d)(3). Section 1106(d)(6) of the CARES Act gave the Secretary of Treasury and the Administrator of the SBA the authority to prescribe regulations granting de minimis exemptions from the requirements that limit loan forgiveness.

Section 1106(e) set forth the requirements for seeking loan forgiveness. The small business borrower seeking loan forgiveness shall provide the lender servicing the covered loan an application for forgiveness that includes the following: (1) documentation verifying the number of full-time equivalent employees on payroll and their pay rates for the relevant pay periods, including IRS the employer's: IRS payroll tax filings and its state income, payroll and unemployment tax filings, (2) documentation, including cancelled checks, payment receipts, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, covered lease obligations, and covered utility payments, (3) a certification from a representative of the small business borrower authorized to make such certifications that the documentation presented is true and correct, and that the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, a covered rent obligation, or covered utility payments, and (4) any other documentation the SBA Administrator determines to be necessary.

The lender has sixty days after receiving a complete application for loan forgiveness to approve or deny the loan forgiveness. Section 1106(g). If a lender has received the required documentation, the SBA may not take an enforcement action under section 47(e) of the Small Business Act, and the lender may not be subject to any penalties by the SBA relating to the loan forgiveness.

As stated previously, section 1106(i) of the CARES Act provides that the amount of the covered loan that is forgiven will not constitute cancellation of indebtedness income under section 108 of the Internal Revenue Code. If a small business defaults on a covered loan, and the SBA pays the lending bank pursuant to its guarantee, the SBA will have a subrogation claim against the small business. Regardless, the covered loan will be

nonrecourse for the SBA against the small business borrower, its shareholders, members, or partners, except if they used the covered loan proceeds for unauthorized purposes. Section 1102(a)(1)(B).

If the covered loan has a remaining balance after loan forgiveness, the SBA will continue to guarantee the loan balance. The loan will have a maximum maturity date of no more than ten years after the small business borrower applies for loan forgiveness under section 1106 of the CARES Act. Section 1102(a)(1)(B). The loan repayment period was initially set at a maximum of two years.

### **The Paycheck Protection Program Loan Process**

For purposes of making a covered loan, lenders may only consider if the small business was operating on February 15, 2020 and had employees to whom it paid salaries (and from whom it withheld payroll taxes) and/or independent contractors to whom it paid compensation and issued Form 100-MISC. A small business applying for a PPP loan (a covered loan) may not be required to show that it could not obtain a loan elsewhere, put up collateral for such loan, or be required to provide personal guarantees. Section 1102(a)(1)(B). It need only certify that the current economic conditions make the loan necessary to support the ongoing business operations, that it will use loan proceeds to retain workers and maintain payroll, pay its mortgage, rent, and utilities, and that it has not or will not receive a duplicative PPP covered loan for the period from February 15, 2020 through December 31, 2020.

Here is a sample loan application form: [https://www.sba.gov/sites/default/files/2020-03/Borrower%20Paycheck%20Protection%20Program%20Application\\_0.pdf](https://www.sba.gov/sites/default/files/2020-03/Borrower%20Paycheck%20Protection%20Program%20Application_0.pdf)

How well the overall PPP loan process will work remains to be seen. Initially, lenders were hesitant to make loans because they were concerned about the documentation process and the rate of return. (Even though the SBA guarantees the PPP covered loan the interest rate is 1% only.) In addition, large banks have not been terribly receptive to making loans to smaller business customers. Small businesses should apply for loans with banks with which they already have a good banking relationship, as that may expedite the loan process. Accordingly, if a small business does not have a reliable, established banking relationship already, then it should consider going to a smaller local or community bank that specializes in SBA loans and which would often be eager to establish a banking relationship with a local small business. Moreover, all banks do not have established SBA loan expertise, and those familiar with such loans are more efficient and can act faster.

Small businesses should complete the sample PPP loan application form and have payroll records for the last 12 months ready and available as well as their last federal income tax return and a profit and loss statement for the last 12 months. All banks do not have established SBA loan expertise, and those familiar such loans are more efficient and can act faster. Carrying too much debt can be a big burden for a small business, but this is not the typical debt. A substantial portion of it is eligible for forgiveness, and it will allow the business to keep employees on payroll, while hopefully helping it and its employees to survive the financial and health havoc that the coronavirus has unleashed.

The PPP loan program may make the difference between the failure and survival of many small businesses.

### **Important Legislative Changes to the Paycheck Protection Program**

The Paycheck Protection Program Flexibility Act of 2020 (the “PPPF Act”), which the president signed into law on June 5, 2020 has made some important changes to PPP covered loans that should make it much easier for small businesses to have a substantial part of their covered loans forgiven. The most important such change is that the requirement that 75% of the loan forgiveness amount must be attributable to payroll costs has been amended. Henceforth, an eligible small business recipient (borrower) is only required to use 60% of the covered loan for payroll costs to receive loan forgiveness. PPPF Act section 3(b)(2); new section 1106(d)(8) of the CARES Act. This important ameliorative change allows small businesses to spend more on overhead and fixed expenses such as utilities and still receive loan forgiveness.

Although Congress reduced the payroll costs requirement from 75% to 60%, the provision is now a cliff. If a borrower does not spend at least 60% of the PPP covered loan on payroll costs, *none* of the covered loan can be forgiven. Under pre-existing rules, a borrower was required to reduce the loan amount eligible for forgiveness if the small business used less than 75% of the loan amount on payroll costs, but partial loan forgiveness was still available even if the small business did not meet the 75% threshold. Rep. Chip Roy (R-TX), who co-sponsored the PPPF Act in the House, and Senators Marco Rubio (R-FL) and Susan Collins (R-ME) have stated that Congress had intended the sliding scale for loan forgiveness to remain in effect at 60%, and they have indicated that Congress would seek to pass a technical corrections bill to correct this drafting error.

Under current law, the amount of the PPP covered loan that is eligible for forgiveness is the sum of certain costs incurred and payments made during the eight weeks after the origination of the covered loan. The new law permits current borrowers under the PPP to extend the eight-week period to 24 weeks if they elect to do so. PPPF Act section 3(b)(3); new section 1106(l) of the CARES Act. Small businesses that borrow under the PPP on or after the date of enactment of the PPPF Act (June 5, 2020) will have a period of 24 weeks, but the covered period must end on December 31, 2020. Congress extended the period to 24 weeks to allow borrowers to have most, if not all, of their PPP covered loans forgiven. PPPF Act section 3(b)(1); amended section 1106(a)(3) of the CARES Act. Small business borrowers can use the period of 24 weeks to restore their workforce to levels before COVID-19 to achieve full loan forgiveness. The period for doing so has been extended from June 30 to December 31, 2020. PPPF Act section 3(b)(2); amended section 1106(d)(5)(B) of the CARES Act.

The PPPF Act has two new provisions that would assist borrowers in having the full amount of their PPP covered loan forgiven even if they are unable to rehire their pre-existing workforce. Under current law, the small business is permitted to exclude employees who turned down a bona fide, good faith effort to be rehired at the same hours and wages as before COVID-19. The new PPPF Act clarifies that the loan forgiveness amount will *not* be reduced if the small business borrower *can document* in good faith that it is unable (i) to rehire those it had employed on February 15, 2020 or (ii) to find

similarly qualified employees by December 31, 2020. In addition, the loan forgiveness amount will not be reduced for failure to maintain employment levels if the borrower can document in good faith that it is unable to restore its business operations to the levels of February 15, 2020 due to compliance with requirements established or guidance issued by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration during the period beginning on March 1, 2020, and ending December 31, 2020, related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19. In all these circumstances, the loan forgiveness amount of the small business borrower shall be determined *without regard to proportional reduction* in the number of full-time equivalent employees. PPPF Act section 3(b)(2); new section 1106(d)(7) of the CARES Act.

The PPPF Act extends the period borrowers may defer principal and interest payments on any portion of the PPP loan that is not forgiven from six months to the time that the SBA compensates the lender for the forgiven amount of the loan, except that the borrower may be required to begin repayment if it has not applied for loan forgiveness within ten months of its covered period. PPPF Act section 3(c)

The PPPF Act extends the minimum maturity term (repayment period) for PPP loans for new borrowers from two to five years. Existing borrowers may apply to extend the terms of their PPP covered loans to five years also. PPPF Act section 2(a). In a departure from the CARES Act, the PPPF Act allows PPP borrowers to defer the employer's share of the social security tax due through the end of 2020. The deferred portion of the social security tax will be due in two equal lump sum payments in December of 2021 and 2022. The CARES Act had previously prohibited the deferral of any social security taxes after any portion of the PPP covered loan was forgiven. PPPF Act section 4, repealing section 2302 of the CARES Act.

## **Conclusion**

The CARES Act as amended by the PPPF Act is a complicated and often overwhelming piece of legislation that is 880 pages long that has made fundamental changes to the U.S. economy. My goal in this relatively brief update is to summarize the relief to small businesses in Title I of the CARES Act and to report on the important changes made to it in the PPPF Act, as those changes should help many small business borrowers have their PPP covered loans forgiven. If you have any questions about the CARES Act or the PPPF Act, you may contact me at [gdelta@verizon.net](mailto:gdelta@verizon.net) or at (703)582-7040.