

# CARES ACT PAYCHECK PROTECTION PROGRAM

## FREQUENTLY ASKED QUESTIONS

AS OF APRIL 5, 2020

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### Below is an FAQ Koley Jessen

prepared to address some of the common questions on the new \$349 billion SBA loan program, known as the Paycheck Protection Program, included in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). On April 2, 2020, the Small Business Administration (SBA) issued its Interim Final Rule implementing the sections of the CARES Act applicable to the Paycheck Protection Program (the Rules) (Docket No. SBA-2020-0015). On April 3, 2020, the SBA issued Affiliation Rules Applicable to the U.S. Small Business Administration Paycheck Protection Program (the Affiliation Rules). The below is intended to be a general summary of the applicable statutory provisions of the CARES Act, the Rules, and the Affiliation Rules. Please also note that the provisions described below are subject to additional regulations and guidance to be promulgated by the SBA and the U.S. Treasury Department.

A copy of the application for the Paycheck Protection Program is available on the Treasury Department's website. Still, we encourage all prospective borrowers to contact their lenders for the information and documentation the specific lender will require.

### What is the Paycheck Protection Program?

The Paycheck Protection Program is an expansion of the loan program created under Section 7(a) of the Small Business Act. The loans are made by private lenders and will be guaranteed by the SBA. Private lenders approve the loans pursuant to authority delegated by the SBA in accordance with criteria and requirements established by the SBA; no separate SBA approval is needed.



## The loans are also available to sole proprietors, independent contractors, and eligible self-employed individuals.

In addition to all previously approved SBA 7(a) lenders, the Rules provide that any federally insured depository institution, any federally insured credit union, or any Farm Credit System institution that applies the requirements under the Bank Secrecy Act as a federally regulated financial institution, upon delivery of SBA Form 3506, shall be automatically qualified to make loans under the Paycheck Protection Program. A copy of SBA Form 3506 is available on the Treasury Department's website. The Rules also provide that certain non-depository financing providers may be eligible to apply to make loans under the program.

### When is the Paycheck Protection Program available?

The loans must be made by June 30, 2020. The Rules state that the loans are available on a "first-come, first-served" basis. Although policymakers have indicated that additional funding will be made available if the \$349 billion of funds currently appropriated for the Paycheck Protection Program are exhausted, many industry experts believe these funds will be exhausted before the June 30, 2020, deadline. We encourage eligible borrowers to contact their lenders and apply as soon as possible.

### Who is eligible to receive a loan under the Paycheck Protection Program?

In addition to businesses that already qualify as small businesses under the SBA regulations, the program is available to any business, nonprofit organization, veterans' organization, or tribal business that has fewer employees (full-time, part-time, or employed on any other basis) than the greater of:

- 500; or
- the size standard for employees set by the SBA for the organization's applicable industry (revenue restrictions will not apply).

In other words, if the applicable SBA size standards for a business in a particular industry already permit greater than 500 employees the larger number will apply.

The employee counts for businesses with NAICS code 72 designations (accommodations and food services) are also to be made on a per-location basis.

The Affiliation Rules confirm that the employee count will include employees of any affiliates of the borrower. Under the Affiliation Rules, which are somewhat complex, businesses under common control with the borrower are affiliates (factors include, but are not limited to, common ownership, common management, identity of

interest and stock options, convertible securities, and agreements to merge). For this reason, the Affiliation Rules may exclude many companies owned by private equity funds, venture capital funds, and family offices from eligibility under the Paycheck Protection Program. The Affiliation Rules, however, create an exemption for faith-based organizations and the affiliation regulations do not apply between two organizations if the relationship is based on religious teachings or belief or otherwise constitutes a part of the exercise of religion.

However, the affiliation requirements have been waived for the following:

- Businesses with NAICS code 72 designations (accommodations and food services)
- Franchise businesses with SBA franchisor identifier codes
- Any business that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act (SBICs)

The loans are also available to sole proprietors, independent contractors, and eligible self-employed individuals.

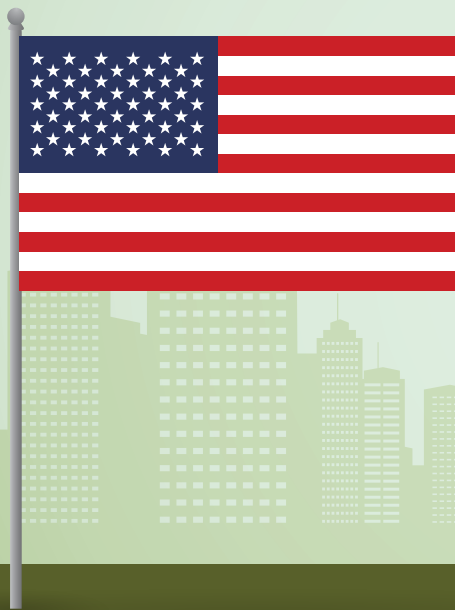
### How does a business apply for a loan under the Paycheck Protection Program?

A borrower with an existing SBA loan or with a non-SBA loan from an existing SBA-preferred lender may want first to contact their existing lenders to inquire about applying for loans under the Paycheck Protection Program. Lenders began taking applications for loans under the Paycheck Protection Program on April 3, 2020. In addition to the Rules, we expect the SBA to continue to issue additional regulations and guidance on the Paycheck Protection Program.

### What is the maximum principal amount for a loan under the Paycheck Protection Program?

The maximum principal amount is limited to the lesser of (a) 2.5 times the average total monthly payroll costs incurred by the borrower for the trailing 12-month period from the date of the loan plus any outstanding loans made under the SBA's Disaster Loan Program made after Jan. 31, 2020, or (b) \$10 million.

This means that existing disaster loans can be refinanced under this program. To the extent the disaster loans were made for purposes other than the permitted loan uses under this program (see below), additional funds under the Paycheck Protection Program would be available to existing disaster loan borrowers. A borrower is not



permitted to receive duplicative amounts for the same expenses under multiple SBA programs.

We note that the Rules provide that the maximum principal amount calculation is based on the average monthly payroll costs for “the last 12 months,” which would suggest that these payroll costs are to be measured on a trailing 12-month basis. However, the most recent draft of the application for the Paycheck Protection Program instructs applicants to use their “average monthly payroll for 2019” for purposes of determining the principal amount. The SBA has not yet provided any additional guidance to resolve the inconsistency between the Rules and the application.

The Rules also clarify that a borrower may not receive more than one loan under the Paycheck Protection Program and suggest that, for this reason, borrowers should consider applying for the maximum principal amount.

Additionally, the Rules provide that because independent contractors can apply for a loan under the Paycheck Protection Program on their own, any payments made to an independent contractor do not count for purposes of a borrower’s payroll cost calculation.

### **What is the maximum interest rate on the loans made under the Paycheck Protection Program?**

The Rules set the interest rate on all loans made under the Paycheck Protection Program at 1% per annum.

### **What are the permitted uses for the proceeds of loans made under the Paycheck Protection Program?**

In addition to uses already permitted under the SBA Business Loan Program, the proceeds of the loan may be used for the following purposes:

- Payroll costs, including, but not limited to, wages, salary, vacation and sick leave, and retirement benefits
- Group health care benefits
- Interest on mortgage obligations
- Rent payments
- Utility expenses
- Interest on debt incurred before Feb. 15, 2020

Payroll costs are capped at \$100,000 per year for any employee, prorated for the covered period.

The Rules provide that borrowers under the Paycheck Protection Program must apply at least 75% of the loan proceeds toward

payroll costs. The Rules also provide that the proceeds of the loan may only be used for the specific purposes enumerated in the CARES Act and not for any purposes permitted under the SBA Business Loan Program, acknowledging that this further restriction will help achieve Congress' overarching goal of keeping workers paid and employed.

### Are the loans made under the Paycheck Protection Program forgivable?

Any amount of the proceeds of the loan used for the following purposes during the eight-week period beginning when the loan is made shall be forgiven by the SBA:

- Payroll costs (subject to the same \$100,000 cap per employee)
- Group health care benefits
- Interest on mortgage obligations
- Rent payments
- Utility expenses

Increases in wages to compensate tipped workers are also eligible for forgiveness.

The Rules provide that non-payroll cost expenses can only account for 25% of the total forgiveness amount.

The amount of forgiveness permitted under the Paycheck Protection Program is subject to a reduction in the event a borrower reduces its full-time employee equivalents (FTEE) or its total wages paid to employees.

A reduction in FTEE will reduce the forgiveness amount according to the following formula: The total amount eligible for forgiveness

multiplied by (a) FTEE during the covered period divided by (b) the lesser of (i) the average FTEE between Jan. 1, 2020, and Feb. 29, 2020, or (ii) the average FTEE between Feb. 15, 2019, and June 30, 2019.

A reduction in total payroll paid by a borrower to its employees in excess of 25% will result in a corresponding decrease in the amount eligible for forgiveness in the amount of such reduction in total wages/salary.

To the extent the reductions in FTEE or total wages occur before 30 days after the enactment of the CARES Act and are reversed before June 30, 2020, the reductions will not result in a corresponding reduction in the forgiveness amount.

Any amounts forgiven will not be treated as taxable income.

The SBA has indicated it will issue additional guidance on loan forgiveness.

### How are loans forgiven under the Paycheck Protection Program?

A borrower seeking forgiveness for its loan must submit documentation verifying the payroll and number of employees during the covered period; documentation verifying other reimbursable costs such as mortgage payments, rent, and utilities; and a certification from the borrower that such documentation is true and correct. A lender shall issue its decision on an application for forgiveness within 15 days after receipt of the application. Within 90 days after determining the forgiveness amount, the SBA will remit the payments directly to the lender.

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### **What is the maximum term for loans made under the Paycheck Protection Program?**

The Rules set the term for all loans made under the Paycheck Protection Program at two years.

### **Are the loans under the Paycheck Protection Program required to be secured or personally guaranteed?**

No. Lenders may not require the borrower to pledge any collateral or require a personal guaranty.

### **Are the loans under the Paycheck Protection Program non-recourse?**

The loans will be non-recourse to any holder of equity interests in a borrower, except to the extent such holder of equity interest uses the loans for a purpose not permitted under the program.

### **What other conditions must be met to obtain a loan under the Paycheck Protection Program?**

A borrower must certify in good faith that (a) the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the borrower, (b) the proceeds of the loan will be used for purposes permitted under the program, and (c) the borrower has not received duplicative amounts under this program. The requirement for a borrower to demonstrate that it cannot obtain credit elsewhere has been waived.

In addition to the requirement listed above, the final application released by the Treasury Department requires borrowers to certify that (i) the United States is the principal place of residence for all employees of the borrower included in the borrower's payroll application, (ii) the borrower is eligible under the CARES Act and the Rules, as in effect as of the date of the application, to receive a loan under the Paycheck Protection Program, (iii) the borrower meets the applicable size standards with respect to the number of employees, and (iv) any loan received under the SBA Disaster Loan program between Jan. 31, 2020, and April 3, 2020, was for a purpose other than paying payroll costs and other allowable uses under the Paycheck Protection Program. Under the Rules, lenders are entitled to rely on the certifications made by the borrower with respect to eligibility for the Paycheck Protection Program.

### **Are payments of the loans under the Paycheck Protection Program deferred?**

Loans made under the Paycheck Protection Program are presumed to qualify for payment deferral for not less than six months to not more than one year. Congress has directed the SBA to provide additional guidance to lenders on this point.

The Rules clarify that all payments on all loans made under the Paycheck Protection Program will be deferred for six months, but interest will continue to accrue on the loan during the deferment period.

### **How are loans made under the Paycheck Protection Program guaranteed by the SBA?**

The Rules confirm that the SBA will provide a 100% guaranty of any loans made under the Paycheck Protection Program. ◀



**The Rules set the interest rate on all loans made under the Paycheck Protection Program at 1% per annum.**



*For more information, contact Jeff Schaffart or Benjamin Herbers at Koley Jessen at [jeff.schaffart@koleyjessen.com](mailto:schaffart@koleyjessen.com) or [benjamin.herbers@koleyjessen.com](mailto:benjamin.herbers@koleyjessen.com), respectively. Schaffart solves complex tax and legal issues by providing timely, pragmatic advice to private equity sponsors, general counsel, management teams, and business owners. Herbers' practice focuses on financing transactions, including construction financing, commercial real estate loans, revolving credit facilities, term loan facilities, and tax-exempt financings.*