

Client Alert

April 2020

Paycheck Protection Program Updates: Additional Funding, New Interim Final Rule, and Updated Guidance

Friday, April 24, 2020, was another seminal day for the Paycheck Protection Program, which has had quite a few of them. Just as President Trump signed the latest \$484 billion coronavirus relief bill into law with an additional \$310 billion for the Paycheck Protection Program (the “Triple P”), the Small Business Administration (the “SBA”) released a new interim final rule (the “IFR”) as well as additional guidance (the “April 24th Guidance”) on borrower eligibility and calculating loan amounts.

With lenders gearing up for what is expected to be a lighting round of funding as the SBA reopens the Triple P portal, we have summarized the major updates from Friday that lenders and borrowers should know.

The Paycheck Protection Program and Health Care Enhancement Act

Unlike the CARES Act, the Paycheck Protection Program and Health Care Enhancement Act (the “Triple P Act”) is a relatively short and straightforward piece of legislation.¹ The Triple P Act infuses the Triple P with an additional \$310 billion for small business loans while appropriating a total of approximately \$321 billion for the cost of the Triple P. Presumably, the additional \$11 billion is intended to cover principally the origination fees due to lenders as well as SBA expenses. The SBA has indicated needing significant funding to support the ongoing expenses related to this massive program that has drastically increased its administrative responsibility.

Of the \$310 billion set aside for the Triple P, the Act specifically reserves no less than \$30 billion for loans made by insured depository institutions and credit unions with between \$10 billion and \$50 billion in assets as well as an additional no less than \$30 billion for insured depository institutions and credit unions with less than \$10 billion in assets.²

Interim Final Rule on Requirements for Promissory Notes, Authorizations, Affiliation and Eligibility

The latest IFR supplementing the Triple P formalizes guidance previously provided in the SBA’s FAQs on promissory notes, authorizations, and eligible borrowers. The following list summarizes the key provisions in the new rule:

- Requirements for promissory notes and SBA Authorizations is identical to guidance provided in previous FAQs, but the requirements are now incorporated into the IFR; i.e., lenders may use their own promissory notes and there is no need for a separate SBA Authorization.

¹ The CARES Act is formally titled the “Coronavirus Aid, Relief, and Economic Security Act.

² While the Act specifically provides that “no less than \$30 billion” shall be set aside for these lenders, the SBA has the authority to set aside more and we believe it should considering community banks with less than \$10 billion in assets originated 60% of the first \$349 billion in funding.

- Lenders must execute Form 2484 to issue Triple P loans and receive loan numbers. Lenders may include additional terms and conditions in their promissory notes, as long as they are not inconsistent with Sections 1102 and 1106 of the CARES Act.³
- Hedge funds and private equity firms are ineligible to receive a Triple P loan. The rules have not changed for portfolio companies owned by such firms. For such businesses to be eligible, they must pass the [affiliation test](#).⁴
- New language stresses the need for companies to carefully consider the affiliation rules as well as the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” This guidance comes one day after the SBA released an additional FAQ urging larger and publicly traded companies,⁵ in reviewing this “necessary” certification, to consider “in good faith” “their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.”
- The SBA has now added a second significant test. The first was whether an applicant could certify the need for funding. Now, applicants in round two will need to evaluate their funding alternatives. This change is so significant that the SBA advised lenders that they have no liability for borrowers in round one who would have failed the test. Moreover, the SBA established a relatively short “no questions asked” deadline to return funds without liability. Presumably the SBA will not pay an origination fee on returned, and thereby, cancelled loans. The issue of the processing fee and interest while the loan was outstanding was not addressed, but the lender should collect interest on the returned funds unless the SBA issues further guidance stating this is not required. This change creates a limited safe harbor for any applicants that repay the loan in full by May 7, 2020 – such borrowers will be deemed to have made the “economic uncertainty” certification in good faith even if they can no longer make the certification in good faith based on updated guidance and new rules. The SBA determined this safe harbor is necessary and appropriate to ensure borrowers promptly repay Triple P funds that borrowers obtained based on a misunderstanding or misapplication of the required economic need certification. We have prepared a model notice to customers who may be impacted by this new test—please contact us if you would like such a letter to send to your customers.
- Otherwise eligible hospitals will no longer be considered ineligible due to state or local government ownership so long as the hospital receives less than 50% of its funding from state or local government sources, exclusive of Medicaid.
- The IFR revises the third Triple P interim final rule by removing the legal gambling restriction that only a certain percentage of the business’ revenue could be from legal gambling. This allows for a company that has greater percentages of legal gambling revenue to apply for a Triple P loan.
- Participation in an Employee Stock Ownership Plan (“ESOP”) does not trigger affiliation between the business and the ESOP.

³ Primarily with respect to loan use, applicable interest rate, maturity, and forgiveness.

⁴ The IFR makes clear that if an applicant receives financial assistance from a licensed Small Business Investment Company (SBIC), *in any amount*, that applicant can receive Triple P assistance. Such SBIC financing can include debt as well as equity. Two of our clients sponsor SBICs that are interested in making investments.

⁵ Specifically, “[f]or example, it is unlikely that a public company with **substantial** market value and **access to capital markets** will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.” (emphasis added).

- Businesses in bankruptcy cannot apply for a Triple loan. These businesses are ineligible if the applicant is in a bankruptcy proceedings at the time of application or any time before funds are disbursed. It is the applicant's duty to inform the lender if it becomes the debtor in a bankruptcy proceeding if it occurs between the time of application and loan disbursement. Failure to inform the lender will deem all use of PPP funds as unauthorized uses. The fear is that the funds would be allocated for unauthorized uses such as repayment of unforgiven loans. Lenders may rely on applicant's representation that it has no involvement in a bankruptcy proceeding.

How to Calculate Maximum Loan Amounts – By Business Type

The SBA released long-awaited [guidance](#) to assist various types of businesses with calculating payroll costs for the purposes of determining the maximum loan amount that the business may apply for under the Triple P.⁶ Specifically, the April 24th Guidance provides step-by-step calculations for self-employed individuals, partnerships, Subchapter S corporations, LLCs, eligible non-profit organizations, eligible religious institutions, veterans organizations, and tribal businesses. The guidance also reminds potential borrowers that the Triple P loan forgiveness amounts depend, in part, on the total amount spent during the eight-week period following the first disbursement of the loan.

The guidance also provides that the U.S. government will not challenge lender actions that conform to the April 24th Guidance and reiterates that this informal protection extends to any lenders or borrowers acting in accordance with any interim final rules in effect at the time.⁷ However, the guidance also notes that it does not carry the force and effect of law—something lenders and borrowers need to keep in mind with all guidance and other FAQs that have not been formally adopted in a final rule.

According to the ICBA, lenders need not apply new rules retroactively to applications received (even if not yet approved and funded) prior to the adoption of such changes. Thus, applications received before April 24, 2020 are governed by the rules that were in place before the most recent changes to the FAQs and IFR—all borrowers will still need to meet the two part test discussed above.

Self-Employed Individuals

The April 24th Guidance provides three separate examples for self-employed individuals: self-employed individuals with no employees, self-employed individuals with employees, and self-employed individuals who report income on IRS Form 1040, Schedule F. The guidance clarifies that the place to start is net income as provided on the individuals' 2019 IRS Form 1040. If individuals have not yet filed a 2019 return, then those individuals are expected to complete the applicable sections of IRS Form 1040 and use these to substantiate the total loan amount. The step-by-step guidance also clarifies certain other aspects such as accounting for insurance contributions and state and local taxes.

Partnerships

The April 24th Guidance explains how partnerships can apply for Triple P loans and determine maximum loan amounts. Partnerships can compute 2019 payroll costs by looking at their 2019 Schedule K-1 (or completing the schedules if 2019 taxes have not yet been filed). Partnerships with employees are required to provide documentation to establish that the business was in operation on February 15, 2020 and partnerships without employees are permitted to provide an invoice, bank statement, or book of record to establish that the business was in operation on February 15, 2020. Lenders are required to substantiate applied for loan amounts by reviewing 2019 IRS Form 1065 (including K-1s) and other relevant supporting documentation if the partnership has employees, including the 2019 IRS Form 941 and state quarterly wage unemployment insurance tax reporting form from each quarter (or equivalent payroll processor records or IRS Wage and Tax Statements) along with records of retirement or health insurance contributions.

⁶ <https://home.treasury.gov/system/files/136/How-to-Calculate-Loan-Amounts.pdf>

⁷ However, this protection does not appear to extend to borrowers who fail the new test regarding the ability of a borrower to secure adequate funding elsewhere.

The guidance also clarifies that partners' self-employment income must be included on the partnership's Triple P loan applications; individual partners may not apply separately.

Corporations

Both S and C corporations can use the methodology outlined in the April 24th Guidance. Corporations can calculate payroll costs by adding gross wages and tips paid to employees as reflected on the company's 2019 IRS Form 941, insurance and retirement contributions, and 2019 state and local taxes. Lenders will need to substantiate applied-for loan amounts by reviewing the corporation's 2019 IRS Form 941, along with filed business tax returns (IRS Form 1120 or 1120-S) or other documentation of any retirement and health insurance contributions. Additionally, lenders have to receive either a payroll statement or similar documentation to verify that the business was in operation and had employees as of February 15, 2020.

Nonprofit Organizations

Eligible nonprofit organizations, including religious institutions, veterans organizations, and tribal businesses, can calculate payroll costs by referencing their 2019 IRS Forms 941 and 990. Nonprofits with gross receipts less than \$50,000 that do not file an IRS Form 990 should follow the methodology outlined for nonprofit religious institutions, veterans organizations and tribal businesses. As is required for all borrowers, nonprofit organizations are required to provide lenders with a payroll statement or similar documentation from the pay period that covered February 15, 2020, to establish that the organization was in operation and had employees on that date.

LLCs

LLCs are expected to follow the instructions that apply to the company's specific tax filing situation. The methodology varies depending on whether an LLC files taxes as a sole proprietor, partnership, or corporation.

Other Documentation for Substantiating Loan Amounts

Lenders may rely on certain alternative documentation for the purpose of substantiating applied-for Triple P loan amounts. IRS Form W-2s and W-3 or payroll processing reports, including quarterly and annual tax reports, can be used in place of IRS Form 941. Very small businesses that file an annual IRS Form 944 instead of Form 941 can provide the Form 944 instead. Records from a retirement administrator can be used to document employer retirement contributions while records from a health insurance company or third-party administrator for a self-insured plan can document employer health insurance contributions.

We recognize that most businesses have not completed their 2019 tax returns. Nonetheless, the SBA expectation seems to be that businesses will prepare the applicable parts of the return or develop other documentation to prove the requested amount. In light of the short time frame, borrowers may need to apply for the maximum amount they believe to be appropriate and then provide the documentation to lenders over the next 10 days.

Updated FAQs

The last major Triple P update from Friday is the revised [FAQs](#) released by the SBA in consultation with the U.S. Treasury and the SBA added yet another question to the FAQs on Sunday, April 26th.⁸ Additional questions have been added to address:

- Housing allowance as a payroll cost;⁹

⁸ Like a modern day water torture, FAQs are released on a near-daily basis.

- Employee principal place of residence information;
- Agricultural, farm and ranch eligibility for PPP;
- Agricultural and other cooperatives eligibility for PPP; and
- Counting employees to determine borrower eligibility.

As noted above in the summary of the new IFR, an additional FAQ was added on April 24th for businesses owned by large companies cautioning those companies to carefully consider their eligibility, particularly with respect to making the required economic need certification. Borrowers must make the economic need certification in good faith, taking into account their current business activity and ability to access other sources of liquidity to support ongoing operations. The language in the FAQ implies public companies will generally not be able to qualify for the Triple P due to the ability to look to the capital markets for liquidity.

Takeaways

Understandably, most lenders are laser focused on the new round of funding and preparing to submit borrower applications as quickly as possible before the additional \$310 billion is exhausted. We caution lenders to focus on continuing to process applications in the order submitted to them while obtaining confirmation that applicants understand funding may run out again soon (maybe within 2-3 days) before their application can be processed. Again, we encourage lenders to consider a certificate from borrowers attesting to their awareness of program limitations. Borrowers are growing increasingly frustrated as they realize funds will not reach every small business that needs those funds to stay in business. Clear communication and consistent processing procedures can help lenders minimize risks that they will later be considered to have acted inappropriately.

The SBA mentioned that it needs an additional \$2.5 billion in funding to support the agency's costs related to supporting the Triple P servicing and forgiveness process. We are anxiously waiting for additional information on the forgiveness part of the Triple P. We expect the forgiveness process will be a heavy lift for borrowers and lenders. If lenders are considering one of the many technology solutions to assist with managing the forgiveness part of the Triple P, please see our recent [client alert](#) covering 10 key considerations to evaluate before signing such an agreement.

We will release a forgiveness-specific Triple P client alert as soon as the SBA releases additional information. As always, please do not hesitate to contact any of the authors if you have questions regarding the Triple P.

Contacts

Peter G. Weinstock
pweinstock@HuntonAK.com

Patrick Boot
pboot@HuntonAK.com

Dean Elazab
delazab@HuntonAK.com

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⁹ The FAQ clarifies that payroll costs includes all cash compensation paid to employees, subject to the \$100,000 annual compensation per employee limitation.
