

New Paycheck Protection Program FAQs Released

Alert

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On the night of April 6, 2020, the Small Business Administration (SBA) and the Department of the Treasury released answers to updated Frequently Asked Questions (FAQs) relating to the Paycheck Protection Program (PPP) on the Department of the Treasury website. This is likely only the first batch of updated FAQs, which are intended to be updated periodically. The FAQs constitute binding interpretive guidance and may be relied upon by borrowers and lenders. The federal government will not challenge actions taken in reliance on guidance in the FAQs. This alert describes some of the key clarifications provided by the FAQs.

Previously submitted applications need not be revised. If information in a previously submitted PPP application would need to be presented differently based on updated guidance reflected in the FAQs, borrowers and lenders do not need to worry about having provided incorrect information based on the then-applicable guidance. The FAQs state that borrowers and lenders may rely on the guidance available at the time of the application. However, for PPP applications that have not yet been processed, it is permissible for borrowers to revise their applications based on the FAQs.

There are no new exceptions to the SBA affiliation rules. The FAQs do not provide any relief from the SBA's affiliation rules so as to allow more VC- and PE-backed companies to be eligible for PPP loans. Further guidance or relief on this topic may still be forthcoming, but for now the FAQs clarify that the existing affiliation rules continue to apply. Many clients in the past week have been discussing whether a finding of affiliation based on certain governance veto rights of an owner with a minority ownership stake could be overcome by a modification of those veto rights. The FAQs clarify that affiliation on this basis would be overcome if the minority owner "irrevocably waives or relinquishes" the blocking rights that cause the affiliation.

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Only salary (and not other costs) in excess of \$100,000 should be excluded from “payroll costs.” The CARES Act provides that “payroll costs” (used to calculate the amount of an eligible loan) exclude “the compensation of an individual employee in excess of an annual salary of \$100,000, as prorated for the covered period.” Since the concept of payroll costs includes not only salary but also non-cash components and the payment of state and local taxes on behalf of employees, there was confusion over whether this exclusion should apply to the total payroll costs of a particular employee with an annual salary in excess of \$100,000, or only to the actual salary component. The FAQs provide that only salary in excess of \$100,000, and not any other components of payroll costs, should be excluded from the calculation.

Average payroll costs for non-seasonal businesses can be calculated based on either the prior twelve-month period or calendar year 2019. The CARES Act states that the calculation of average monthly payroll costs should normally be based on “the 1-year period before the date on which the loan is made,” yet the PPP application form, and the SBA’s Interim Final Rule published April 2, 2020 on the Department of the Treasury website (but still not published in the Federal Register as of this writing) indicated that the calculation could be based on calendar year 2019, leading to significant confusion. Many banks have also utilized calculators based on calendar year 2019. The FAQs state that the borrowers can calculate their payroll costs using either the prior twelve-month period or calendar year 2019.

A borrower’s payroll costs do not include payments to independent contractors. Businesses would not normally have considered payments to their independent contractors to be payroll costs, but ambiguity around this issue was created when the CARES Act defined “payroll costs” to include “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.” This led some borrowers to include amounts paid to independent contractors within payroll costs. Some commentators pointed out that perhaps this component of the payroll cost definition was only intended to define payroll costs for a borrower that is a sole proprietor or independent contractor. The Interim Final Rule supported this interpretation but did not address the ambiguity directly. The FAQs now clearly state that a borrower is not to include in its payroll costs calculation payments made to independent contractors.

Payroll costs should be calculated on a gross basis, without subtracting withholdings, for the applicable period; however employer-side payroll tax should be excluded. The treatment of FICA withholdings has also been a significant source of confusion. The CARES Act provides that FICA withholdings for the period from February 15, 2020 through June 30, 2020 are excluded from the definition of payroll costs. This made little sense to anyone, since payroll costs for purposes of calculating an eligible loan amount would be based in whole or in part on periods preceding February 15, 2020. Some banks were advising borrowers to nevertheless follow the express wording of the CARES Act and subtract from a 2019 average payroll cost calculation FICA withholdings after February 15, 2020.

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The FAQs state that payroll costs should be calculated for the relevant period (calendar year 2019, prior 12 months, or seasonal period) on a gross basis, without subtracting federal taxes imposed or withheld on the employee side. Employer-side payroll taxes, however, should be excluded. In a footnote, the FAQs both claim that this interpretation is “consistent with the text of the statute” and also confirm that this interpretation ignores the reference to the period of February 15, 2020 to June 30, 2020. Putting aside whether the interpretation in the FAQs is consistent with the actual text of the CARES Act, it does represent a reasonable and logical approach to the issue.

Qualification for PPP Loan Based on SBA Alternative Size Standard. The CARES Act and the SBA’s Interim Final Rule provide that “small business concerns” as defined under the Small Business Act are eligible borrowers. The result is that some businesses with more than 500 employees may still qualify for PPP loans if their maximum number of employees does not exceed the size specified for their NAICS Code under existing SBA regulations. The FAQs state that a business may also:

Qualify for the Paycheck Protection Program as a small business concern if it met both tests in SBA’s “alternative size standard” as of March 27, 2020: (1) maximum tangible net worth of the business is not more than \$15 million; and (2) the average net income after Federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than \$5 million.

This FAQ appears to be consistent with the concept that any “small business concern” is an eligible borrower, but highlights an alternative standard that may permit some borrowers to qualify. The SBA affiliation rules apply with respect to calculating tangible net worth and average net income for purposes of the alternative size standard.

The PPP is a complex program that is being implemented at high speed, without the usual time for considered rule making. Guidance on key provisions has been changing on an almost daily basis. We will continue to track the SBA and Department of Treasury activities and guidance issued for implementing the CARES Act, and will report back on additional details, including any additional guidance on affiliation rules under the PPP.

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