

> Covid-19 Client Alert

CARES Act Update – Welcome Guidance on Paycheck Protection Loans

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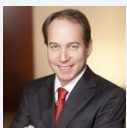
Authors and Key Contacts

If you have any questions about this alert, please contact any of the attorneys listed below.

Randi Mason, Partner
P (212) 735-8643
rmason@morrisoncohen.com



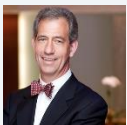
Alan M. Levine, Partner
P (212) 735-8694
alevine@morrisoncohen.com



Alec Nealon, Partner
P (212) 735-8878
anealon@morrisoncohen.com



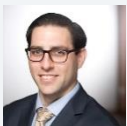
Brian B. Snarr, Partner
P (212) 735-8831
bsnarr@morrisoncohen.com



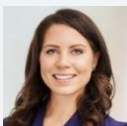
Walter T. Rahmey, Partner
P (212) 735-8855
wrahmey@morrisoncohen.com



Benjamin A. Vitcov, Associate
P (212) 735-8713
bvitcov@morrisoncohen.com



Alyssa L. Pehmoeller, Associate
P (212) 735-8795
apehmoeller@morrisoncohen.com



The Paycheck Protection Program (the “PPP”) portion of the CARES Act was rushed into almost immediate operation due to the urgent need to get money into the hands of United States businesses and employees. Unfortunately, the accelerated timeline for PPP loans left many unanswered questions about how the loans are intended to work. On April 6 and 7, 2020, the Small Business Administration and the U.S. Department of the Treasury released the first set of questions and answers and have continued to revise and update the questions and answers (as updated, the “Q&As”), on some of the most pressing interpretive questions, available [here](#). They also indicated that new guidance will continue to be provided through updates to the Q&As.

The \$100,000 Salary Cap Clarified

The Q&As have settled a hotly-debated question of how the \$100,000 salary cap is calculated. The cap is important for both the amount of a PPP loan as well as the portion of the loan that can be forgiven. It is now clear that the \$100,000 limit applies to cash compensation **only**, and not to non-cash benefits like health coverage, severance and retirement plan contributions.

Lender Diligence Standards Relaxed

Uncertainty about lenders’ obligations to verify borrowers’ calculations of payroll eligibility and documentation has slowed the approval of PPP loans. The Q&As absolve lenders from testing all of the borrowers’ calculations on the PPP loan application, as long as they perform a good faith review. Lenders are expressly authorized to rely on borrowers’ representations in their loan applications, including the “affiliation” rules for counting employees for the not-more-than 500 employee threshold. Finally, lenders who have not yet collected the required beneficial ownership information for **existing** customers are excused from doing so when extending a PPP loan to an existing customer, unless the borrower would trip the lender’s typical customer risk factors.

Mistakes or Changes on Loan Applications

Lenders are directed to work with borrowers who make mistakes on their loan applications to remedy any issues, rather than simply rejecting the applications. The Q&As also allow, but do not require, borrowers who submitted loan applications before the Q&As were released to correct those applications in light of the new guidance.

Employers using PEOs (Professional Employer Organizations)

Many smaller employers use PEOs to process payroll and report payroll taxes. For PPP loan purposes, employees will be considered to work for the employer – not the PEO. Lenders are also expressly authorized to use the payroll records of the PEO to verify an employer’s eligibility for a loan.

Reinforcing Ability to Use SBA's "Alternative Size Standard" for Size Determinations

The Q&As reinforced that small business concerns can be eligible borrowers, even if they have more than 500 employees, if they otherwise meet one of two sets of standards set forth by the SBA. First, a small business concern that has more than 500 employees but otherwise meets the SBA's employee-based or revenue-based size standard corresponding to its primary industry will be considered eligible. The latest SBA size standards can be found [here](#). Alternatively, a business can qualify for a PPP loan as a small business concern if it meets both tests in the SBA's "alternative size standard" as of March 27, 2020. The "alternative size standard" requires that: (1) the 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 application is not more than \$5 million. As with the employee-based and revenue-based size standards, the "alternative size standard" is applied taking into account the SBA's affiliation rules.

Waving 500 Employee Affiliation Rules for Certain non-Controlling Owners

The SBA's affiliation rules can cause a minority owner (*i.e.* a non-controlling owner for this purpose) who has blocking rights over board or shareholder actions to be deemed to "control" the business, potentially tipping both that business, and another business controlled by the same person over the 500 employee loan-eligibility threshold. The Q&As allow a non-controlling owner with blocking rights to escape affiliated owner status, but only if the minority owner *irrevocably* waives its blocking rights. Minority owners have to weigh the permanent loss of negotiated blocking rights against the benefits to the business of obtaining a PPP loan.

Employers Have a Choice in the Base Period for Establishing Payroll Costs

The Q&As cleared up a discrepancy between the CARES Act and the loan application forms provided on government websites. Borrowers can calculate their average aggregate payroll on **either** the trailing twelve months (*e.g.* April 1, 2019 to March 31, 2020) or calendar year 2019.

Payments to Independent Contractors NOT Included in Payroll Costs

Payments to independent contractors or sole proprietors that an employer would report on Form 1099 are not considered "payroll costs" of the employer. This is to prevent double-counting, because independent contractors and sole proprietors are themselves eligible for PPP loans. Not answered is the question of whether partners of partnerships or members of limited liability companies who are considered self-employed should be included in the "payroll costs" of the business, or should (or can) file their own loan applications. This remains a large and important question that has not been addressed yet.

Employee (but not Employer) Withholding Taxes Are Counted in Payroll Costs

The CARES Act excludes FICA costs from the definition of "payroll costs". The Q&As have clarified that this exclusion applies **only** to the employer portion of FICA taxes. So for an employee earning \$4,000 a month who takes home \$3,500 a month after income tax and FICA withholding, the "payroll cost" is still \$4,000 a month. The employer portion of FICA (paid by the employer *on top of* the \$4,000 employee salary) still does not count as a "payroll cost".

The rules regarding Paycheck Protection Loans can be complex, and a full discussion of all rules and exceptions is beyond the scope of this alert. We encourage you to contact your attorney at Morrison Cohen LLP, or one of the attorneys listed on this alert, to discuss your particular circumstances.

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Morrison Cohen LLP has created the [COVID-19 Resource Taskforce](#), a multidisciplinary taskforce comprised of attorneys with deep expertise in a broad range of legal areas, to assist clients navigating the challenging and uncertain business and legal environment caused by the COVID-19 pandemic. We encourage clients to utilize our capabilities by reaching out to their primary Morrison Cohen attorney contact, who will put you in touch with the appropriate Taskforce person. You may also reach out directly to Joe Moldovan and Alec Nealon, the Taskforce co-chairs:

Joseph T. Moldovan

Chair, Business Solutions,
Restructuring & Governance
Practice

Co-Chair COVID-19 Taskforce

P (212) 735-8603

C (917) 693-9682

F (917) 522-3103

jmoldovan@morrisoncohen.com



Alec Nealon

Partner, Executive
Compensation & Employee
Benefits Practice

Co-Chair COVID-19 Taskforce

P (212) 735-8878

C (646) 318-4845

F (917) 522-9978

anealon@morrisoncohen.com

