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PAYCHECK PROTECTION – A PRACTICAL GUIDE TO THE SMALL BUSINESS LOAN PROVISIONS OF THE CARES ACT

[U.S. TECH LAW UPDATE](#)¹

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1. Introduction.

On March 27, 2020, United States President Donald Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (the “[CARES Act](#)”). The CARES Act,² passed to combat the devastating economic effects of the COVID-19 pandemic, allocates over US\$2 trillion in aid to various sectors of the American economy. Of particular interest to small businesses is Section 1102, known as the Paycheck Protection Program (“[Paycheck Protection](#)”) and Section 1106, which provides for forgiveness of Paycheck Protection loans in some circumstances. Under this program, the Small Business Administration (the “[SBA](#)”), with support from the US. Department of the Treasury (the “[Treasury Department](#)”), is authorized to allow the issuance of special loans that carry both generous terms and the possibility of forgiveness if used to pay for certain costs, which include payroll, mortgage interest, rent, and utility expenses.³ In this tech law update, we will focus on the following key aspects of Paycheck Protection: 1) program benefits, 2) program eligibility, 3) application procedures, and 4) miscellaneous concerns that small business owners may have regarding the program.

It is important to note that the current landscape of the CARES Act and its associated provisions is still very much fluid and is constantly evolving. On April 1, 2020, the Treasury Department issued guidelines to help the public interpret, prepare, and apply for Paycheck Protection loans. While these guidelines provide clarity and further information, they also occasionally seem to contradict the CARES Act. Whenever relevant, we note such inconsistencies.

2. Paycheck Protection Key Features.

The CARES Act authorizes the SBA to provide up to US\$349 billion of loan guarantees through a new program that supplements its existing Section 7(a) loan guaranty system.⁴ The purpose of this new program is to create incentives for small business owners to continue paying

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² You can read the full text of the CARES Act [here](#).

³ See [§ 1102 of the CARES Act](#).

⁴ *Id.*



their employees, as well as support other eligible expenses. To do this, the new loan program will issue loans with the following terms:⁵

- **Principal Amount:** Twice the business's average monthly payroll cost plus twenty five percent of that same amount, to a maximum of \$US10 million.⁶
- **Interest Rate and Fees:** 1% per year fixed rate.⁷ All SBA loan fees are waived.
- **Term:** 2 years.
- **Repayment Terms:** Principal, interest, and fee payments are deferred for six months, though interest will accrue during that period.
- **Use of Loan Funds:** For payroll costs, salaries, rent, utilities, mortgage interest, and certain other costs.
- **Other Terms:** Loans are uncollateralized, do not require a personal guarantee, and are nonrecourse with regards to borrowers' shareholders, partners, or members. There are no prepayment penalties.
- **Relevant Dates:** Small businesses and sole proprietorships can begin applying on April 3, 2020. Independent contractors and the self-employed can begin applying on April 10, 2020. Applications close on June 30, 2020.
- **Guaranty:** The SBA will guarantee 100% of the loans.

Loan Forgiveness.

One of the most important elements of Paycheck Protection is its provision for loan forgiveness. Loans will be forgiven if the loan proceeds are used to cover payroll costs, mortgage interest, rent, and utilities for the first eight weeks after the loan is made.⁸ Payroll costs include the following:⁹

- Salary, wages, commissions, or tips (which are capped at US\$100,000 annually for each employee).
- Employee benefits (vacation, parental, family, medical, sick leave costs; separation or dismissal allowances, payments for group health care benefits, insurance premiums, and retirement benefits).
- State and local taxes assessed on compensation.
- For sole proprietors or independent contractors: wages, commissions, income, or net earnings from self-employment, capped at US\$100,000 annually for each employee/person.

⁵ See the [U.S. Treasury Department's Paycheck Program Protection Borrower Information Fact Sheet](#), released April 1, 2020.

⁶ This formula contradicts the CARES Act, which calculates the amount by multiplying the average monthly payroll cost by 2.5 and adding the amount of any Emergency Injury Disaster Loans ("EIDLs") taken out between January 31, 2020, and the date Paycheck Protection loans become available. In practice, the two formulas are the same if EIDLs are not accounted for.

⁷ On April 2, 2020, Treasury Secretary Steve Mnuchin stated that interest rates would now be at 1% per year. ([See this article for details.](#)) Previously the Treasury Department had set the interest rate at 0.5% per year.

⁸ See the [U.S. Treasury Department's Paycheck Program Protection Borrower Information Fact Sheet](#).

⁹ *Id.*



The borrower must spend the loan proceeds in eight weeks after receiving them to qualify for loan forgiveness.¹⁰ The Treasury Department indicated that not more than 25% of the forgiven amount may be used for non-payroll costs.¹¹

However, the amount of loan that is forgiven will be proportionally reduced if a business, during the period from February 15, 2020 to April 26, 2020, does any of the following: 1) decreases its full-time employee headcount¹² or 2) decreases salaries and wages by more than twenty-five percent for any employee that earned less than US\$100,000 annualized in 2019.¹³ Restoring any employment changes and salary levels before June 30, 2020 will make an employer re-eligible for loan forgiveness. Seasonal businesses are subject to a different set of guidelines for determining loan forgiveness.¹⁴

If a borrower complies with the use of proceeds restrictions, the loan becomes a grant and the borrower is not required to repay the loan. After the loan is forgiven, the loan proceeds will not be treated as taxable income by the IRS.¹⁵

3. Eligibility

There are three main eligibility requirements for Paycheck Protection loans: the business must 1) employ less than 500 employees,¹⁶ 2) be in operation on or before February 15, 2020, AND 3) have paid salaries and payroll taxes to employees or independent contractors. When applying for a Paycheck Protection loan, a business must provide payroll documentation and a good faith certification stating that the business intends to use the funds only in the manners provided for in the Cares Act See Section 4 (The Application Process) for additional details on these requirements.

One potential obstacle for some small businesses is the SBA affiliation rules, which apply to the eligibility requirements other than in a very narrow set of exceptions.¹⁷ The affiliation rules require that “affiliates” of the business are counted towards the 500-employee limit. “Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both.”¹⁸ For example, a venture capital or private equity firm that owns more than fifty percent of a small business’s voting stock would have “control” over that business,¹⁹ and thus the employees of that investment firm, along with the employees of any other investee companies that it controls, would be counted towards the 500-employee limit. Control can also be deemed to exist as a

¹⁰ [“Need a Small Business Loan? Here’s What You Need to Know”](#), The Wall Street Journal, April 1, 2020.

¹¹ See the [U.S. Treasury Department’s Paycheck Program Protection Borrower Information Fact Sheet](#). This restriction is not present in the CARES Act. As a result, it is possible that this rule might be more of a guideline than a hard and fast standard to be strictly enforced.

¹² See [§ 1106\(d\)\(2\)\(A\)\(i\)\(aa\) and \(bb\) of the CARES Act](#). The headcount is calculated relative to the period from February 15, 2020 to June 30, 2020, against the borrower’s choice of either February 15, 2019 to June 30, 2019, or January 1, 2020 to February 29, 2020.

¹³ See the [U.S. Treasury Department’s Paycheck Program Protection Borrower Information Fact Sheet](#)

¹⁴ See [§ 1106\(d\)\(2\)\(A\)\(ii\)\(II\) of the CARES Act](#).

¹⁵ See [§ 1106\(i\) of the CARES Act](#).

¹⁶ See the [U.S. Treasury Department’s Paycheck Program Protection Borrower Information Fact Sheet](#). A business with more than 500 employees will qualify if it 1) is considered small by SBA industry standards, 2) has been issued an NAICS code beginning with 72, or 3) falls under a list of Eligible Franchises.

¹⁷ See the [U.S. Treasury Department’s Paycheck Program Protection Borrower Information Fact Sheet](#). The affiliation rules are waived for 1) hotel and food service industries (NAICS code 72 businesses), 2) franchises in the SBA’s Franchise Directory, and 3) businesses receiving financial assistance from small business investment companies licensed by the SBA.

¹⁸ See 13 CFR §121.03(a)(1).

¹⁹ *Id.* at (e)(1).

result of contractual relationships,²⁰ or when a minority shareholder has the potential to block actions by a company.²¹

4. The Application Process

The SBA has released a sample application form on its website.²² A business may apply through any of the following institutions that are participating in the Paycheck Protection program: existing SBA lenders, federally insured depository institutions, federally insured credit unions, and Farm Credit System institutions.²³ When applying, businesses must provide the following documentation: 1) the Paycheck Protection Program Application Form, and 2) payroll documentation supporting the loan application,²⁴ including federal tax forms.

On the application form, a borrower must provide a good faith certification in response to the following:

- Current economic uncertainty makes this loan request necessary to support ongoing operations.
- The funds will be used to retain workers, maintain payroll, make mortgage payments, lease payments, and utility payments.
- Documentation verifying the number of full-time equivalent employees, the dollar amounts of payroll costs, covered mortgage interest payments, and covered utilities for the eight-week period will be provided to the lender.
- During the period beginning on February 15, 2020 and ending on December 31, 2020, the borrower has not and will not receive another loan under this program.
- The borrower certifies that all information provided in this application and supporting forms are true and accurate.
- The borrower acknowledges that the lender will calculate the eligible loan amount using tax documents submitted by the borrower identical to those provided to the IRS.

In addition to the borrower application forms, lenders must also submit their own lender application forms to the SBA, which may require lenders to collect credit information from applicants.²⁵ As of April 2, 2020, financial institutions are still awaiting guidance from the SBA and the Treasury Department on what obligations they may have under the program.

5. Other Forms of Assistance Under CARES.

In addition to Paycheck Protection, other forms of assistance are available to small businesses under the CARES Act, including those described below.

- Employee Retention Tax Credit: Small businesses that have either 1) fully or partially suspended operations due to COVID-19 or 2) suffered greater than 50% reduction in gross quarterly receipts relative to the previous year's quarter are eligible for a payroll tax

²⁰ *Id.* at (a)(2).

²¹ *Id.* at (a)(3).

²² The form can be found [here](#).

²³ See the [U.S. Treasury Department's Paycheck Program Protection Borrower Information Fact Sheet](#). Visit www.sba.gov for a list of approved lenders.

²⁴ As of the time of this writing, there is confusion about what forms lenders will need borrowers to fill out. Additional documentation and procedures may be forthcoming.

²⁵ "[The Rush for \\$350 Billion in Small Business Loans Starts This Friday. Banks Have Questions](#)", The Wall Street Journal, April 2, 2020.



credit of 50% on wages paid to employees (limited to US\$10,000 per employee) from March 13, 2020 through December 31, 2020.²⁶ **Businesses receiving Paycheck Protection loans are not eligible.**²⁷

- Delay of Payment of Employer Portion of Payroll Taxes: Employer payroll taxes for the period beginning March 27, 2020 to December 31, 2020²⁸ will be deferred in two halves: payments for the first half of the payroll taxes will be due on December 31, 2021, while payments for the second half of the payroll taxes will be due on December 31, 2022. **Businesses receiving Paycheck Protection loans are not eligible.**²⁹
- Emergency Injury Disaster Loans: Businesses suffering from COVID-19 can apply for up to US\$2 million in disaster loans from the SBA, if the business was in existence on January 31, 2020. As part of the program, applicants for EIDLs can also receive an advance of US\$10,000 for payroll and other costs. This advance does not need to be repaid even if the applicant ultimately does not receive an EIDL. **Businesses receiving Paycheck Protection loans are eligible, as long as the loans are not duplicative or for the same purpose.**³⁰

6. Conclusion

The Paycheck Protection program provides some of the broadest relief under the CARES Act. The Treasury Department and the SBA continue to revise and update their guidelines and procedures for these loans, and thus we expect to see further developments as the program is implemented.

²⁶ See § 2301(m) of the CARES Act.

²⁷ *Id.* at § 2301(j)

²⁸ *Id.* at § 2302((d)(2)

²⁹ *Id.* at § 2302(a)(3).

³⁰ *Id.* at § 1110(e)(6) but note that the advance will be reduced by the amount of any loans taken out under Paycheck Protection.