

SBA “Paycheck Protection” Loan Program under the CARES Act

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On March 25, 2020, the Senate passed (96-0) the *Coronavirus Aid, Relief, and Economic Security Act* (“*CARES Act*”), a \$2.2 trillion stimulus package providing aid for individuals, States, small businesses, and businesses impacted by the coronavirus pandemic. It is expected that the House will swiftly pass the *CARES Act*, which the President, in turn, will promptly sign into law.

The *CARES Act*, through a proposal authored by Senators Susan Collins (R-ME) and Marco Rubio (R-FL), authorizes the Small Business Administration (“SBA”) to provide loan guarantees for up to \$349 billion in loan commitments under the SBA’s 7(a) program, through a new “paycheck protection” program under which loans may be forgiven. This client alert discusses how the SBA provisions in the *CARES Act* will impact businesses.

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Overview of SBA “Paycheck Protection” Loan Program

Eligibility

Size Standard

Under existing law, in order to be eligible for a loan under the SBA’s 7(a) program, the recipient must be a small business concern.^[1] The SBA typically uses standards that are stated in terms of number of employees or average annual receipts to determine the largest size that a business concern (including its domestic and foreign affiliates) may be to still be classified as a small business concern.

Under the *CARES Act*, any business concern would be eligible to receive an SBA loan authorized by the *CARES Act* (a “covered loan”) if the business concern employs not more than the greater of (I) 500 employees^[2] or (II) if applicable, the size standard in number of employees established by the SBA for the industry in which the business concern operates.

The *CARES Act* also includes some exceptions to this standard. These exceptions are:

- Business Concerns with More than One Physical Location

Any business concern with not more than 500 employees per physical location and that is assigned a North American Industry Classification System (“NAICS”) code beginning with 72 (*i.e.*, a business concern in the Accommodation and Food Services sector) at the time of disbursement is eligible to receive a covered loan.

- Waiver of Affiliation Rules

As noted above, the SBA ordinarily counts the employees or annual receipts of a business concern’s affiliates when determining whether the business concern qualifies as a small business. Section 121.103 of Title 13 of the Code of Federal Regulations sets forth the

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general principles the SBA uses to determine affiliation. For example, business concerns and other persons (entities or individuals) 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.^[3] Control of a business concern may be established by, for example, ownership or control, or the power to control 50% or more of such party's voting stock, or a block of such party's voting stock that is large compared to all other outstanding blocks of voting stock.^[4] Control of a business concern may also be established through, among other things, a party's ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders of the business concern. The CARES Act provides that this regulation is waived with respect to eligibility for a covered loan for:

- any business concern with not more than 500 employees that is assigned a NAICS code beginning with 72;
- any business concern operating as a franchise that is assigned a franchise identifier code by the SBA; and
- any business concern that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958.

Industries

To be covered by the first exception outlined above, the business concern must be assigned a NAICS code beginning with 72.^[5] Below is a list of industries with a NAICS code beginning with 72.

- Hotels and Motels
- Casino Hotels
- Bed-and-Breakfast Inns
- All Other Traveler Accommodation
- RV Parks and Campgrounds
- Recreational and Vacation Camps
- Rooming and Boarding Houses, Dormitories, and Workers' Camps
- Food Service Contractors
- Caterers
- Mobile Food Services
- Drinking Places (Alcoholic Beverages)
- Full-Service Restaurants
- Limited-Service Restaurants
- Cafeterias, Grill Buffets, and Buffets
- Snack and Non-Alcoholic Beverage Bars

Effect of the Waiver of Affiliation Rules

The CARES Act would allow certain business concerns that previously did not qualify for an SBA loan because its affiliations caused the business concern to exceed the applicable thresholds to qualify for a covered loan. For example, assume that a business concern in a covered industry with 300 employees received financing from a private equity fund and granted the fund control rights. That business concern is currently deemed an affiliate of the fund, and of any other portfolio company controlled by the fund. Further assume that such affiliation caused the business concern to no longer be considered a small business because when measured against the SBA's standards, the business concern is deemed to have all the employees of the private equity fund and the fund's other portfolio companies. As a result of the waiver of affiliation rules in the CARES Act, the business concern would no longer be an affiliate of the private equity fund and the other portfolio companies, and the business concern may qualify for a covered loan.

The proposed waiver of affiliation rules may also help some businesses that are structured so that they consist of more than one business concern. For example, assume a corporation owns three hotels through three separate limited liability companies, and that

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each such subsidiary has fewer than 500 employees. Further assume that the corporation does not qualify as a small business because it is too large when you consider the total number of its affiliates' employees, *i.e.*, the employees of the three subsidiaries it controls. However, if the affiliation rules are waived, each such subsidiary may apply for a covered loan.

However, the proposed waiver of affiliation rules will not necessarily benefit businesses that own separate establishments through the same business concern. For example, assume the three hotels in the example above are owned directly by the corporation, and the corporation has 1,000 employees, including over 500 employees who work at its largest hotel. The corporation would be a single business concern with over 500 employees and would not be eligible to apply for a covered loan as a result of the waiver of affiliation rules.^[6]

Other Eligibility Requirements

Along with small business concerns, nonprofit organizations also are eligible to receive a covered loan. The *CARES Act* recommends that the SBA issue guidance to lenders to prioritize small business concerns and entities in underserved and rural markets, including veterans and members of the military community, small business concerns owned and controlled by socially and economically disadvantaged individuals, women and businesses in operation for less than 2 years.

A recipient of an SBA economic injury disaster relief loan made between January 31, 2020 and the date covered loans are available under the *CARES Act* for a purpose other than paying payroll costs and other covered loan purposes described below is still eligible for a covered loan.

Loan Terms

An eligible recipient may receive one covered loan. The *CARES Act* provides that proceeds of covered loans may be used for: payroll costs; continuation of group health care benefits during periods of paid sick, medical, or family leave, or insurance premiums; salaries or commissions or similar compensation; interest on mortgage obligations; rent; utilities; and interest on other outstanding debt.

The maximum loan amount is the lesser of (1)(a) the average total monthly payments by the applicant for payroll costs^[7] incurred during the one-year period before the date the loan is made^[8] multiplied by (b) 2.5 and (2) \$10 million. If an applicant was not in business from February 15, 2019 to June 30, 2019, the maximum loan amount is the lesser of (1)(a) the average total monthly payments by the applicant for payroll costs incurred from January 1, 2020 to February 29, 2020 multiplied by (b) 2.5 and (2) \$10 million. No collateral or personal guarantee is required for a covered loan.

Loan Forgiveness

The loan forgiveness amount is equal to the payroll costs, mortgage interest payments, rent, and utilities (the "forgivable costs") incurred or paid by a recipient during the covered period. For purposes of determining the loan forgiveness amount, "covered period" means the 8-week period beginning on the date of the origination of a covered loan. (the "covered period"). The loan forgiveness amount is excluded from taxable income.

The amount of loan forgiveness will be reduced by multiplying (1) the forgivable costs by (2) the quotient obtained by dividing (a) the average number of full-time equivalent employees per month during the covered period by (b) at the election of the borrower, (i) the average number of full-time equivalent employees per month from February 15, 2019 to June 20, 2019 or (ii) the average number of full-time equivalent employees per month from January 1, 2020 to February 29, 2020.^[9] The amount of loan forgiveness will also be reduced by the amount of any reduction in total salary or wages of any employee

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during the covered period that is in excess of 25 percent of the total salary or wages during the most recent full quarter during which the employee was employed before the covered period.^[10] There are exceptions for these reductions if, during the period beginning on February 15, 2020 and ending 30 days after enactment of the Act, there is a reduction in the number of full-time equivalent employees or salary and the reduction is eliminated no later than June 30, 2020.

If a covered loan has a remaining balance after the forgiveness described above, it will have a maximum maturity of 10 years and an interest rate not exceeding 4 percent. Lenders must defer payments under the loan for at least six months and up to one year.

What a Prospective Borrower Can Do Now

To seek loan forgiveness, an eligible business concern must submit an application to the lender that originated the covered loan that will include:

1. documentation verifying the number of full-time equivalent employees on payroll and pay rates for the applicable periods, including payroll tax filings; and state income, payroll, and unemployment insurance filings; and
2. documentation verifying payments on mortgage obligations, lease obligations and utilities, including cancelled checks, payment receipts, transcripts of accounts, or other documents.

The SBA must issue regulations within 15 days of enactment of the *CARES Act* without regard to notice and comment requirements. Hence, it is possible that lenders could begin taking loan applications as soon as mid-April.

SBA Economic Injury Disaster Loans

In early March of 2020, Congress passed an \$8.3 billion appropriations measure to combat the effects of the coronavirus pandemic, the *Coronavirus Preparedness and Response Supplemental Appropriations Act of 2020*. The Act allows the SBA to provide up to \$1 billion in loan subsidies for economic injury disaster loans. This funding enables the SBA to provide an estimated \$7 billion in economic injury disaster loans. Additionally, the Act provides the SBA \$20 million to cover the cost of administering these loans. Small businesses in all U.S. states and territories are currently eligible to apply for an economic injury disaster loan due to COVID-19. The SBA's Economic Injury Disaster Loan program provides small businesses with working capital loans of up to \$2 million. Affiliation rules have not been waived in connection with determining the eligibility of participants in the Economic Injury Disaster Loan program.

[1] The *CARES Act* does not propose any changes to the SBA's definition of "business concern." The SBA defines a "business concern" as a business entity organized for profit, with a place of business located in the U.S., which operates primarily within the U.S. or which makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials, or labor. A business concern may be in the legal form of an individual proprietorship, partnership, limited liability company, corporation, joint venture, association, trust or cooperative, except that where the form is a joint venture there can be no more than 49 percent participation by foreign business entities in the joint venture (13 CFR § 121.105).

[2] In determining a concern's number of employees the, SBA counts all individuals employed on a full-time, part-time, or other basis. The regulation setting forth how the SBA calculates the number of employees does not exclude non-U.S. employees from this calculation (13 CFR § 121.105).

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[3] 13 CFR § 121.103(a).

[4] 13 CFR § 121.103(c).

[5] NAICS codes may be self-assigned, *i.e.*, a company can select the code that best represents its primary business activity, or the activity of a particular establishment. NAICS codes may also be assigned by an organization, such as a government agency, trade association, etc., to a company or establishment for various purposes. According to the U.S. Census Bureau, there is no central government agency that assigns, monitors or approves NAICS codes, or changes to NAICS codes. See: <https://www.census.gov/eos/www/naics/faqs/faqs.html#q1>.

[6] If the hotel in our example had fewer than 500 employees at each of its three hotels, it could apply for one covered loan as a result of the proposed exception described above for business concerns with more than one physical location.

[7] "Payroll costs" are defined to include payments for salary, wage, commission, or similar compensation; payments for cash tip or equivalent; payments for vacation, parental, family, medical, or sick leave; allowance for dismissal or separation; payment required for the provisions of group health care benefits; payment of any retirement benefit; payment of state or local tax assessed on the compensation of employees; payments of any compensation or income of a sole proprietor or independent contractor that is an amount not more than \$100,000 in 1 year, as prorated for the covered period. "Payroll costs" do not include the compensation of an individual employee in excess of an annual salary of \$100,000, as pro-rated for the covered period; taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code; compensation of an employee whose principal place of residence is outside of the United States; and qualified sick leave wages or qualified family leave wages for which a credit is already allowed under the *Families First Coronavirus Response Act*. For purposes of determining the maximum loan amount, "covered period" means February 15, 2020 through June 30, 2020.

[8] For seasonal employers, the applicable payments are the average total monthly payments for payroll during the 12-week period beginning February 15, 2019, or at the election of the recipient, March 1, 2019, and ending June 30, 2019

[9] In the case of a seasonal employer, the denominator is the average number of full-time equivalent employees per month employed by the eligible recipient from February 15, 2019 through June 30, 2019.

[10] An employee described in this subparagraph is any employee who did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding developments related to the COVID-19 outbreak. For additional information, please contact any member of the firm's [Coronavirus \(COVID-19\) Response Team](#).

Gibson Dunn lawyers regularly counsel clients on issues raised by this pandemic, and we are working with many of our clients on their response to COVID-19. Please also feel free to contact the Gibson Dunn lawyers with whom you usually work, any member of the firm's [Public Policy Group](#), or the authors:

Michael D. Bopp – Washington, D.C. (+1 202-955-8256, mbopp@gibsondunn.com)
Roscoe Jones, Jr.* - Washington, D.C. (+1 202-887-3530, rjones@gibsondunn.com)
Alisa Babitz – Washington, D.C. (+1 202-887-3720, ababitz@gibsondunn.com)
Samantha Ostrom – Washington, D.C. (+1 202-955-8249, sostrom@gibsondunn.com)

* *Not admitted to practice in Washington, D.C.; currently practicing under the supervision of Gibson, Dunn & Crutcher LLP.*

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