

# Small Business Administration Publishes Additional Interim Final Rules and New Guidance Related to PPP Loan Eligibility and Accessibility

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To Our Clients and Friends:

In the last week, as the U.S. Small Business Administration (“SBA”) prepared for additional Paycheck Protection Program (the “Program” or “PPP”) funding and began accepting—for the second time—applications from participating lenders, the SBA issued a series of new guidance materials related to Program eligibility, fund accessibility, and loan amount calculations.

With an additional \$349 billion in funding to PPP under the *Paycheck Protection Program and Health Care Enhancement Act* (the “*PPP and Health Care Enhancement Act*”), the Program, established by the *Coronavirus, Aid, Relief, and Economic Security (“CARES”) Act*, is set to provide a total of \$659 billion to help small businesses impacted by COVID-19 with funds to pay eight weeks of payroll and other eligible costs. The *PPP and Health Care Enhancement Act*, which was enacted into law on April 24, 2020, and primarily designed to replenish funds for the Program, did not substantially change the overall structure of the Program. The new law did, however, set aside \$60 billion in funding for “community financial institutions” to serve underserved small businesses and nonprofit organizations<sup>[1]</sup> and directed the SBA to allow agricultural enterprises<sup>[2]</sup> to apply for Economic Injury Disaster Loans. With the additional funds Congress provided in the *PPP and Health Care Enhancement Act*, the SBA started accepting PPP applications from lenders again on April 27, 2020.

This client alert, the sixth in a series of alerts regarding the Program,<sup>[3]</sup> will address the SBA’s (1) Fourth Interim Rule (the “Fourth IFR”), which speaks to, among other topics, the eligibility (or ineligibility) of private equity firms, hedge funds, and the gaming industry to participate in the Program; (2) certification that a PPP loan is needed in order to support ongoing operations; (3) Fifth Interim Final Rule (the “Fifth IFR”), acknowledging a disparity in treatment under the maximum loan calculation under the *CARES Act* for seasonal employers and Sixth Interim Final Rule (the “Sixth IFR”) on disbursements; (4) guidance on how to calculate maximum loan amounts and related payroll documentation requirements; and (5) guidance on how to calculate the number of employees under employee-based size standards for eligibility.

Thematically, much of the new guidance is cautionary in nature; warning public, private equity-held, and other businesses with access to liquidity that PPP loans are not for them. Adding teeth to those warnings the Treasury Department also announced that all PPP loans of more than \$2 million will be audited.

## **The Fourth Interim Final Rule**

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Under the Fourth IFR, hedge funds and private equity firms are explicitly prohibited from receiving a PPP loan because they are “primarily engaged in investment or speculation.” This rule is consistent with prior restrictions on Section 7(a) loans identified in 13 CFR §120.110 and described in [SBA’s Standard Operating Procedure \(SOP\) 50 10](#), which prohibited loans to “speculative businesses” for the “sole purpose of purchasing and holding an item until the market price increases” or “[e]ngaging in a risky business for the chance of an unusually large profit.” Prior to the Fourth IFR “speculative” businesses included those “[d]ealing in stocks, bonds, commodity futures, and other financial instruments.”<sup>[4]</sup>

The Fourth IFR acknowledges, however, that a portfolio company of a private equity fund may still be eligible for a PPP loan and concludes that “[t]he affiliation rules apply to private equity-owned businesses in the same manner as any other business subject to outside ownership or control.” The acknowledgment comes with a cautionary note: that borrowers should “carefully review” the PPP loan application certifications, including that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”

The Fourth IFR also contains the following additional clarifying provisions:

- **Government-Owned Hospitals.** Hospitals otherwise eligible to receive a PPP loan are not determined ineligible because of ownership by state or local government if the hospital receives less than 50% of its funding from state or local government sources, exclusive of Medicaid.
- **Legal Gaming Activities.** Businesses that receive legal gaming revenues are eligible for PPP loans. In a shift from the SBA’s Third Interim Rule, the Fourth IFR states that 13 CFR 120.110(g) (providing that businesses deriving more than one-third of gross annual revenue from legal gambling activities are ineligible for SBA loans) is inapplicable to PPP loans. Businesses that receive illegal gaming revenues remain ineligible.
- **Employee Stock Ownership Plans.** Participation in an ESOP (as defined in 15 U.S.C. § 632(q)(6)) does not result in an affiliation between the business and the ESOP.
- **Bankruptcy Proceedings.** An applicant is ineligible for PPP loans if it, or its owner, is the debtor in a bankruptcy proceeding at the time of the application or any time before the loan is disbursed.

## **Borrower Certification Safe Harbor**

In the SBA’s FAQ, the SBA reiterates that “all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application.” Regardless of eligibility requirements, borrowers must certify in good faith that the PPP loan request is necessary even though the *CARES Act* suspended the ordinary requirement that borrowers must be unable to obtain credit elsewhere. Specifically, the guidance states that borrowers need to consider “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,” when certifying that the PPP loan request is necessary to ongoing operations.

The guidance concluded that it is “unlikely” a public company “with substantial market value and access to capital markets will be able to make the required certification in good faith, “ and cautioned that such companies should be prepared to demonstrate to the SBA, upon request, the basis for its certification. In addition, yesterday, Secretary of the Treasury Steven Mnuchin said that the government will audit any PPP loans above \$2 million.

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Notably, the Fourth IFR establishes a form of amnesty by allowing “borrowers [to] promptly repay PPP loan funds that the borrower obtained based on a misunderstanding or misapplication of the required certification standard.” Under the Fourth IFR, any borrower that applied prior to April 23, 2020 and repays the loan in full by May 7, 2020 “will be deemed by SBA to have made the required certification in good faith.”

## **The Fifth and Sixth Interim Final Rules**

On April 27, 2020, the SBA issued the Fifth Interim Final Rule (available [here](#)) to provide seasonal employers with an alternative method to calculate their maximum loan amount. In doing so, the Fifth IFR stated that without the rule, “many summer seasonal businesses would be unable to obtain funding on terms commensurate with those available to winter and spring seasonal businesses.” Under Section 1102 of the *CARES Act*, a seasonal employer may determine its maximum loan amount by reference to the employer’s average total monthly payments for payroll during “the 12-week period beginning February 15, 2019, or at the election of the eligible [borrower], March 1, 2019, and ending June 30, 2019.” The Fifth IFR allows seasonal employers to calculate the maximum loan amount using any consecutive 12 week period between May 1, 2019 and September 15, 2019. The Rule also clarifies that if a seasonal business was not fully operating or dormant as of February 15, 2020, it is still eligible to receive a PPP loan.

The Sixth Interim Final Rule, posted on April 28, 2020 and available [here](#), provides that lenders must make a one-time, full disbursement of the PPP loan within ten calendar days of loan approval (defined as when the loan is assigned an SBA loan number). Loan approvals will be cancelled for any loans that are not disbursed because of a borrower’s failure to provide required loan documentation, including a promissory note, within 20 calendar days of loan approval. The Sixth IFR provides for transition rules for those loans that have received an SBA loan number prior to the posting of the Sixth IFR but are not yet fully disbursed.

## **Maximum Loan Calculation and Payroll Documentation Requirements**

In addition, on April 24, 2020, the SBA provided guidance (available [here](#)) to assist businesses in calculating their payroll costs for determining the maximum possible PPP loan amount. Under the guidance, the SBA outlines the methodology potential borrowers should use to calculate the maximum amount they can borrow, as well as the documentation the borrower should provide to substantiate the loan amount. A table summarizing the required documentation as articulated in the guidance is below.

The SBA guidance reminds borrowers that, under most circumstances, “PPP loan forgiveness amounts will depend, in part, on the total amount spent during the eight-week period following the first disbursement of the PPP loan.”

Records from a retirement administrator, or a health insurance company or third-party administrator for a self-insured plan can be used to demonstrate employers retirement and health insurance contributions.

## **Supporting Documentation Requirements**

<b>No.</b>	<b>Eligible Borrower</b>	<b>2019 Documentation</b>	<b>2020 Documentation</b>
1.	Self-employed with no employees	<ul style="list-style-type: none"><li>• IRS Form 1040 Schedule C.</li><li>• IRS Form 1099-MISC detailing nonemployee compensation</li></ul>	Invoice, bank record establishing operation on February 15, 2020.

		received (box 7), invoice, bank statement, or book of record establishing you were self-employed in 2019.
2.	Self-employed with employees	<ul style="list-style-type: none"> <li>• IRS Form 1040 Schedule C. Payroll statement or similar documentation from the pay period that covered February 15, 2020.</li> <li>• IRS Form 941<sup>[1]</sup>, or IRS Form W-2s, IRS Form W-3, or payroll processor reports, including quarterly and annual tax reports.</li> <li>• State quarterly wage unemployment insurance tax reporting form from each quarter (or equivalent payroll processor records or IRS Wage and Tax Statements).</li> <li>• Documentation of any retirement or health insurance contributions.</li> </ul>
3.	Self-employed farmers	<ul style="list-style-type: none"> <li>• IRS Form 1040 Schedule 1 and Schedule F.</li> </ul>
4.	Partnerships without employees	<ul style="list-style-type: none"> <li>• IRS Form 1065 (including K-1s). Invoice, bank statement, or book of record establishing the partnership was in operation on February 15, 2020.</li> </ul>
5.	Partnerships with employees	<ul style="list-style-type: none"> <li>• IRS Form 1065 (including K-1s). Payroll statement or similar documentation from the pay period that covered February 15, 2020.</li> <li>• IRS Form 941,</li> </ul>

6. S Corporations or C Corporations
- or IRS Form W-2s, IRS Form W-3, or payroll processor reports, including quarterly and annual tax reports.
  - State quarterly wage unemployment insurance tax reporting form from each quarter (or equivalent payroll processor records or IRS Wage and Tax Statements).
  - Documentation of any retirement or health insurance contributions.
  - IRS Form 941, Payroll statement or IRS Form W-2s, IRS Form W-3, or payroll processor reports, including quarterly and annual tax reports.
  - IRS Form 941, Payroll statement or similar documentation from the pay period that covered February 15, 2020.
  - State quarterly wage unemployment insurance tax reporting form from each quarter (or equivalent payroll processor records or IRS Wage and Tax Statements)
  - Filed business tax return (IRS Form 1120 or IRS 1120-S) or

7. Eligible Non-Profit Organizations
- other documentation of any retirement and health insurance contributions.
  - IRS Form 941, Payroll statement or or IRS Form W-2s, IRS Form W-3, or payroll processor reports, including quarterly and annual tax reports. similar documentation from the pay period that covered February 15, 2020.
  - State quarterly wage unemployment insurance tax reporting form from each quarter (or equivalent payroll processor records or IRS Wage and Tax Statements)
  - IRS Form 990 or other documentation of any retirement and health insurance contributions

## **Employee-Based Size Standards and Definitions**

In guidance issued on April 26, 2020 (available [here](#)), the SBA reiterated that under the 500-employee or other applicable employee-based threshold, the term “employee” under the *CARES Act* includes “individuals employed on a full-time, part-time, or other basis.” Although this is consistent with the original text of the *CARES Act*, the guidance confirms that a part-time employee working 10 hours per week should be counted the same as a full-time employee for purposes of loan eligibility. In contrast, the guidance acknowledges, to determine the extent of any reduction in the loan forgiveness amount in the event of a reduction in headcount, the *CARES Act* uses the standard of “full-time equivalent employees.”

Although the *CARES Act* and related guidance issued to date do not define the term in the context of the Program, Title II of the *CARES Act* defines “full-time employee” by referencing the Internal Revenue Code, 26 U.S.C. § 4980H, which defines the term as “an employee who is employed on average at least 30 hours of service per week.” In addition, the Internal Revenue Service defines “full-time equivalent employee” as “a combination of employees, each of whom individually is not a full-time employee, but who,

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in combination, are equivalent to a full-time employee.” Absent further guidance, these definitions may be instructive.

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[1] A search tool for identifying all eligible lenders is available on the SBA website [here](#).

[2] Existing law defines “agricultural enterprises” to mean “small business concerns engaged in the production of food and fiber, ranching, raising of livestock, aquaculture, and all other farming and agricultural-related industries.”

[3] For additional details about the PPP please refer to Gibson Dunn’s [Frequently Asked Questions to Assist Small Businesses and Nonprofits in Navigating the COVID-19 Pandemic](#) and prior Client Alerts about the Program: [SBA “Paycheck Protection” Loan Program Under the CARES Act; Small Business Administration and Department of Treasury Publish Paycheck Protection Program Loan Application Form and Instructions to Help Businesses Keep Workforce Employed; Small Business Administration Issues Interim Final Rule and Final Application Form for Paycheck Protection Program; Small Business Administration Issues Interim Final Rule on Affiliation, Summary of Affiliation Tests, Lender Application Form and Agreement, and FAQs for Paycheck Protection Program](#), and [Analysis of Small Business Administration Memorandum on Affiliation Rules and FAQs on Paycheck Protection Program](#).

[4] See [SBA’s Standard Operating Procedure \(SOP\) 50 10](#).

[5] Very small businesses that file an annual IRS Form 944 instead of quarterly IRS Form 941 should provide IRS Form 944.

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Gibson Dunn’s lawyers are available to assist with any questions you may have regarding these developments. For further information, please contact the Gibson Dunn lawyer with whom you usually work, or the following authors:

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