WILLKIE FARR & GALLAGHER LLP

COVID-19 NEWS OF INTEREST

SBA Revises Guidance on the Treatment of Entities with Foreign Affiliates for Paycheck Protection Program, Releases Information on Loan Forgiveness Process

May 20, 2020

AUTHORS

David Mortlock | Neil W. Townsend | Bruce C. Herzog | Jeffrey R. Poss
Matthew J. Rizzo | John Joy | Ahmad El-Gamal

On May 18, 2020, the Small Business Administration ("SBA") published an interim final rule providing further clarification on how a business should calculate the number of its employees when determining the business' eligibility to receive a loan under the Paycheck Protection Program ("PPP") as well as guidance on the standards and process for recipients seeking forgiveness of the loans.

I. Foreign Employees to Be Included in Eligibility Calculations

Under the new interim final rule, the SBA has stated that a business must count all, meaning both domestic and foreign, employees of its domestic and foreign affiliates, except in limited circumstances where an exemption to the SBA's affiliation rules applies.

To account for the SBA's previous conflicting guidance, the SBA has stated that due to reasonable borrower confusion, the SBA will not find any borrower that applied for a PPP loan prior to May 5, 2020 to be ineligible based on the borrower's exclusion of non-U.S. employees from its calculation of its employee headcount if the borrower, together with its affiliates, had no more than 500 employees whose principal place of residence is in the United States.

II. Guidance on Loan Forgiveness

Additionally, on May 15, 2020 the SBA released an application form for recipients of a PPP loan to use when they apply for their loan to be forgiven. The aim of the PPP was to allow small businesses to retain employees and maintain wage levels during the economic crisis caused by the COVID-19 pandemic and accordingly, eligibility for loan forgiveness is based on the employer maintaining or rehiring employees and maintaining wage levels. If PPP loan recipients have complied with all of the SBA's requirements and utilized the funds for the purposes permitted by the SBA, then their loan would be eligible for forgiveness beginning eight weeks after the loan was disbursed.

Of note, the PPP Loan Forgiveness Application provides some updates to the general loan forgiveness requirements, simplifies the safe harbor calculations for employee or payroll reduction, and provides detailed instructions on how to complete the application for loan forgiveness.

A. Loan Forgiveness Basics

Section 1106 of the CARES Act provides that a PPP loan is eligible for forgiveness for (1) certain costs incurred, and (2) certain payments made by the loan recipient during the eight-week period beginning on the date of the origination of the loan.

The general requirement for loan forgiveness is that at least 75% of the PPP loan must be used for payroll costs[1] and that no more than 25% of the loan amount may be attributable to non-payroll costs, specifically mortgage interest, rent, and covered utility payments. However, the amount of forgiveness will be reduced (1) proportionally to any reduction in full-time equivalent ("FTE") employee levels between the borrower's chosen reference period and during the covered period or alternative covered period; and (2) on a dollar-for-dollar basis for any reduction of more than 25% of any employee's compensation other than a portion of salary above $100,000. A borrower can cure any reductions to the amount of forgiveness for headcount and wage reductions by rehiring or hiring new FTE employees and/or by eliminating the reduction in wages of its employees no later than June 30, 2020 in either case.

[1] Payroll costs are defined in the CARES Act at section 1102(a)(2)(A)(viii) as the sum of (i) all compensation of any kind paid to any employee, including (a) salaries, wages, commissions and similar compensation, (b) paid leave (vacation, parental, family, medical or sick leave), (c) severance payments, (d) payments for group health care benefits, including insurance premiums, (e) retirement benefits and (f) state and local payroll taxes *plus* (ii) compensation or income paid to a sole proprietor or independent contract (including commission-based compensation and earnings from self-employment) up to $100,000 in one year (prorated for the Covered Period); however, **"Payroll Costs" do not include** (1) compensation to an individual employee above $100,000 per year, prorated for the Covered Period (meaning only the first $100,000 of an employee's total compensation may be included for determining a borrower's Payroll Costs), (2) federal withholding taxes, (3) compensation to employees whose principal place of residence is outside of the United States or (4) qualified sick leave or family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.

B. Key Issues in the Loan Forgiveness Application Form

In the loan forgiveness application form, the SBA has provided additional guidance and detailed instructions to ease the process for borrowers applying for loan forgiveness. Key issues illuminated in the form include the following:

- **Calculating Payroll Costs**. The SBA provides the option for borrowers to calculate payroll costs using an "alternative covered period." Specifically, borrowers with a biweekly or more frequent payroll schedule may elect to calculate eligible payroll costs using the eight-week period that begins on the first day of their first pay period following the date their PPP loan was disbursed. The process of receiving a PPP loan has been unpredictable and difficult; it is not guaranteed that a borrower would receive its loan at the beginning of a pay period. The alternative covered period allows borrowers to maximize the use of their PPP loan and loan forgiveness.

- **Rehiring Employees by June 30**. The SBA also has provided additional guidance on the June 30 safe harbor for rehiring employees and eliminating wage/hours reductions. First, the SBA reaffirmed that a borrower is exempt from the reduction in loan forgiveness based on headcount if:

  1) the borrower reduced its FTE employee levels between February 15, 2020 and April 26, 2020; and

  2) the borrower then restored its FTE employee levels by no later than June 30, 2020 to its FTE employee levels in its pay period that included February 15, 2020.

  If a borrower made a good-faith, written offer to rehire an employee during the covered period or alternative covered period which was rejected by the employee, that employee will not be counted for the purposes of reducing the amount of loan forgiveness a borrower may receive. Additionally, employees who were fired for cause, voluntarily resigned, or voluntarily requested and received a reduction in hours will not be counted for the purposes of reducing the amount of loan forgiveness a borrower may receive.

- **Reversing Wage Cuts by June 30**. Additionally, for employees whose salaries or hourly wages were reduced by more than 25% during the covered period or alternative covered period as compared to the period of January 1, 2020 through March 31, 2020, the borrower may take advantage of the Salary/Hourly Wage Reduction Safe Harbor if the reduction is reversed by June 30.

- **Reporting Loans in Excess of $2 Million**. Borrowers applying for loan forgiveness are required to check a box if they, together with their affiliates, received PPP loans with an original principal amount in excess of $2 million. In order to correctly determine the total loan amount, a borrower must aggregate the amounts of any PPP loan it received and all PPP loans received by its affiliates. This will determine which loans are eligible for review as the SBA has stated that it will review the borrower's certification of the necessity of the loan for all PPP loans in excess of the $2 million threshold.

- **Detailed Instructions**. The loan forgiveness application is accompanied by detailed instructions on how to fill out the form and a list of the documentation that must be submitted with the loan forgiveness application. The SBA has used this opportunity to make the form as user friendly as possible, as shown by the simplification of the FTE reduction safe harbor. We recommend that borrowers applying for loan forgiveness pay careful attention to the instructions and guidance provided by the SBA in the application form.

III. Potential Updates to the PPP

As Congress continues to work on an additional stimulus package, there have been calls to modify the PPP in order to keep up with the growing crisis. The PPP has enjoyed bipartisan support and several members of Congress have called for the program to be extended. The House of Representatives $3 trillion coronavirus relief bill, which passed in the House on May 15, would extend the eight-week period for loan forgiveness in the PPP to 24 weeks. In addition, there have been calls to relax the PPP’s strict requirement that at least 75% of the loan be used for payroll costs based on the nature of the crisis and reports that a significant number of borrowers will not be eligible for total loan forgiveness due to the requirement.

It remains to be seen how and when changes to the PPP will be made. Updates to the PPP carried in a larger stimulus vehicle will likely experience significant delays as members of Congress negotiate the provisions that may alter the program.

Willkie has multidisciplinary teams working with clients to address coronavirus-related matters, including, for example, contractual analysis, litigation, restructuring, financing, employee benefits, SEC and other corporate-related matters, and CFTC and bank regulation. Please click here to access our publications addressing issues raised by the coronavirus. For advice regarding the coronavirus, please do not hesitate to reach out to your primary Willkie contacts.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

David Mortlock
202 303 1136
dmortlock@willkie.com

Neil W. Townsend
212 728 8272
ntownsend@willkie.com

Bruce C. Herzog
713 510 1717
bherzog@willkie.com

Jeffrey R. Poss
212 728 8536
jposs@willkie.com

Matthew J. Rizzo
212 728 8454
mrizzo@willkie.com

John Joy
212 728 8713
jjoy@willkie.com

Ahmad El-Gamal
202 303 1142
ael-gamal@willkie.com