Paycheck Protection Program under the CARES Act

Oregon Association of Hospitals and Health Systems

May 4, 2020
Paycheck Protection Program (PPP)

- Section 1102 of the CARES Act
- Section 7(a) Covered Loan through the SBA
  - Maximum loan amount of $10 million
  - 1.0% interest rate
  - 2 year repayment period (with 6-month deferral)
  - 100% guarantee by SBA (forgiveness component)
  - No collateral required
  - No credit history/repayment review – no personal guarantee required
  - No borrower or lender fees payable to SBA
  - Lender/Reviewer – Financial Institutions
Paycheck Protection Program (PPP)

- **Eligibility Criteria:**
  - Small business with <500 employees
  - Small business that otherwise meets SBA’s size standard
  - 501(c)(3) with <500 employees
  - Individual who operates as a sole proprietor, independent contractor, or self-employed individual who regularly carries on any trade or business
  - Tribal business concern that meets SBA size standard
  - 501(c)(19) Veterans Organization that meets SBA’s size standard
  - Faith-based organizations
  - Operating on February 15, 2020
  - Had employees receiving salaries and payroll taxes (or independent contractors) on February 15, 2020
  - Use of Funds: payroll, rent/lease, mortgage interest, interest on other debt
Paycheck Protection Program (PPP)

- SBA’s “Alternative Size Standard”
  - Maximum tangible worth of the business is not more than $15M; **and**
  - The average net income after Federal income taxes (excluding any carryover losses) of the business for the 2 full fiscal years before date of PPP application is not more than $5M

- Special Eligibility Rules
  - The <500-employee rule is applied on a per physical location basis for businesses in the accommodation and food services sector (NAICS 72)
  - The normal affiliation rules do not apply for small businesses in NAICS 72, those operating as a franchise, or those receiving financial assistance from an approved Small Business Investment Company

*Note*: 500-employee threshold includes all employees – full-time, part-time, temporary, seasonal, etc.

*Note*: Typical affiliation rules apply for most businesses
Paycheck Protection Program (PPP)

- Hospitals owned by governmental entities are eligible for PPP
  - A hospital that is otherwise eligible to receive a PPP loan as a business concern or nonprofit organization (described in section 501(c)(3) of the Internal Revenue Code (IRC) of 1986 and exempt from taxation under section 501(a) of IRC) shall not be rendered ineligible for a PPP loan due to ownership by a state or local government if the hospital receives <50% of its funding from state or local government sources, exclusive of Medicaid
  - Exception to the general ineligibility of government-owned entities, 13 CFR 120.110(j)
  - FAQ #42 published May 3, 2020 – A nonprofit hospital exempt from taxation under section 115 of the IRC may meet the definition of “nonprofit organization” under section 1102 of the CARES Act
Paycheck Protection Program (PPP)

- To provide further guidance, SBA/Treasury has issued FAQs and Interim Final Rules; borrowers should review these.

- For example, SBA’s Interim Final Rules also clarified the following (among other things):
  - Individuals with self-employment income are eligible if their principal residence is in the U.S.
  - Limited partnerships and its partners are limited to one PPP loan
  - Any business currently in bankruptcy not eligible for PPP loans
  - Limit of $20M of PPP loans in aggregate for businesses that are part of a single corporate group
Paycheck Protection Program (PPP)

- Through Interim Final Rules, SBA reaffirmed affiliation rules for borrowers
  - Prior to CARES Act, non-profit entities were not eligible for assistance under Section 7(a) of the Small Business Act (SBA).
  - CARES Act made non-profit entities eligible for assistance and subjected them to the SBA affiliation standards.
  - Confusion created by the Act regarding which set of SBA affiliation rules govern non-profits – 13 CFR 121.103 (government contracting) or 13 CFR 121.301 (financial assistance)
  - Exempts affiliations between faith-based organizations, if the affiliation is based on a religious teaching or belief or otherwise constitutes a part of the exercise of religion.
Paycheck Protection Program (PPP)

- **Affiliation:**
  - For purposes of determining the number of employees of a PPP applicant, the applicant is considered together with its affiliates.
  - 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 – 13 CFR 121.301(f).
  - Control does not have to be exercised.
  - Six affiliation tests under 13 CFR 121.301(f).
Paycheck Protection Program (PPP)

  - Four tests apply to participants in the Paycheck Protection Program:
    1. Affiliation based on ownership
    2. Affiliation arising under stock options, convertible securities and agreements to merge
    3. Affiliation based on management
    4. Affiliation based on identity of interest
  - Does not include discussion of “newly organized concern” or “totality of circumstances” tests
  - Limits application of “identity of interest” to close relatives spouse; a parent; or a child or sibling, or the spouse of any such person, 13 CFR 120.10
Paycheck Protection Program (PPP)

1. Affiliation based on Ownership:
   - An entity is affiliated if it owns or has the power to control more than 50% of the applicant’s voting equity
   - A minority owner can be found to be in control if that individual or entity can prevent a quorum or otherwise block action by the board of directors or owners
     - A minority owner may be found to be in control if a minority owner can block ordinary course actions essential to operating the business
     - Power to block only extraordinary actions probably does not constitute “control” where the provisions are crafted to protect the investment
     - A requirement that actions taken to manage the company require 75% vote has been held to confer negative control on the minority
   - An irrevocable waiver of minority rights is acceptable to terminate minority control
Paycheck Protection Program (PPP)

2. Affiliation arising under Stock Options, Convertible Securities, and Agreements to Merge:

- Treats such options, securities, and agreements as though the rights granted have been exercised
- Agreements to open or continue negotiations at some later date are not given present effect
- Instruments subject to conditions precedent which are incapable of fulfillment, or where the probability of a transaction (or exercise of the rights) occurring is extremely remote, will not be given present effect
- The ability to divest all or part of an individual’s, concern’s, or entity’s ownership interest in order to avoid a finding of affiliation will not be given present effect
Paycheck Protection Program (PPP)

3. Affiliation based on Management:

- Affiliation arises where the CEO, President, or other individuals controlling the management of one concern also control the management of one or more other concerns.
- Affiliation arises where a single individual, concern, or entity that controls the Board of Directors or management of one concern also controls the Board of Directors or management of one or more concerns.
- Affiliation arises where a single individual, concern, or entity controls the management of the applicant concern through a management agreement.
Paycheck Protection Program (PPP)

4. Affiliation based on Identity of Interest:

- Individuals or firms that have identical or substantially identical business or economic interests may be treated as one party:
  - Close relatives – spouse; a parent; or a child or sibling, or the spouse of any such person, 13 CFR 120.10

- For PPP purposes, does not include the following:
  - Common investments
  - Economic dependence – affiliation may arise when a concern derived more than 85 percent of receipts over previous three fiscal years from a contractual relationship with another concern unless:
    - The contract does not restrict the concern from selling the same type of products or services to another purchaser
    - SBA agrees that the contract does not provide the purchaser with control or power to control the seller
Paycheck Protection Program (PPP)

- Special Affiliation Issues in Healthcare:
  - 501(c)(3)s
  - Private Equity “Roll Ups”
  - Hospital Subsidiaries
  - Ambulatory Surgery Centers
  - Joint Ventures
  - Professional Services Agreements
  - Management Agreements
Paycheck Protection Program (PPP)

- Maximum Loan Amount = 2.5 x average total monthly payroll costs incurred during the year prior to the loan date (not to exceed $10M)
  - For Businesses not Operational in 2019 = 2.5 x average total monthly payroll costs incurred for January and February 2020
  - For Seasonal Employers = 2.5 x average total monthly payments for payroll costs for the 12-week period beginning February 15, 2019 or March 1, 2019 and ending June 30, 2019
- For corporate groups, the maximum for the whole group is $20M
Paycheck Protection Program (PPP)

- Payroll Cost **Includes**:
  - **For Employers**: The sum of payments of any compensation with respect to employees that is a:
    - Salary, wage, commission, or similar compensation
    - Payment of cash tip or equivalent
    - Payment for vacation, parental, family, medical, or sick leave
    - Allowance for dismissal or separation
    - Payment required for the provisions of group healthcare benefits, including insurance premiums
    - Payment of any retirement benefit
    - Payment of state or local tax assessed on the compensation of the employee

*Note*: Does **not** include Form 1099-MISC compensation paid
Paycheck Protection Program (PPP)

- Payroll Cost **Includes**:
  - **For Sole Proprietors, Independent Contractors, and Self-Employed Individuals with No Employees:**
    - 2019 Form 1040, Schedule C Line 31 Net Profit Amount up to $100K annualized
      - If not yet filed 2019 return, fill out and compute the value
      - If amount is zero or less, not eligible for PPP loan
  - **For Sole Proprietors, Independent Contractors, and Self-Employed Individuals with Employees:**
    - 2019 Form 1040, Schedule C Line 31 Net Profit Amount up to $100K annualized
      - If not yet filed 2019 return, fill out and compute the value
      - If amount is less than zero, set amount at zero
    - Gross wages and tips computed using 2019 Form 941 Quarterly Reports
    - 2019 employer health insurance contributions, retirement contributions, and state and local taxes assessed on employee compensation
Paycheck Protection Program (PPP)

- Payroll Cost *Excludes*:
  - Cash compensation of an employee in excess of an annual salary of $100K (also exclude payments to independent contractors)
  - Self-employment income (or net profit amount) in excess of $100K annualized
  - Federal employment taxes imposed or withheld between February 20 and June 30, including the employee’s and employer’s share of FICA and Railroad Retirement Act taxes, and income taxes required to be withheld from employees
  - Compensation of an employee whose principal place of residence is outside of the United States
  - Qualified sick leave wages (Section 7001) or qualified family leave wages (Section 7003) for which a credit is allowed under the Families First Coronavirus Response Act
Paycheck Protection Program (PPP)

- Lenders will require *good faith certification* that:
  - The uncertainty of current economic conditions makes the loan request necessary to support ongoing operations
  - The borrower will use the loan proceeds to retain workers and maintain payroll or make mortgage, lease, and utility payments
  - Borrower does not have an application pending for a loan duplicative of the purpose and amounts applied for under PPP
  - From February 15, 2020 to December 31, 2020, the borrower has not received a loan duplicative of PPP
    - There is an opportunity to fold EIDL loans made between January 31, 2020 and April 3, 2020 into a new PPP loan
  - For independent contractor, sole proprietor, or self-employed individual, lenders will also request certain documents such as payroll tax filings, Forms 1099-MISC, and income and expenses from the sole proprietorship
Paycheck Protection Program (PPP)

- SBA has not provided any specific metrics or quantitative standards to determine “necessity” of the PPP loan, but provided the following guidance:
  - Borrowers must make a *reasonable, good faith* determination of necessity
  - Borrowers must assess “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*”
  - Example: “it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith”, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification
Paycheck Protection Program (PPP)

- Any borrower that applied for a PPP loan prior to April 24, 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.

- It is likely that the lenders will audit eligibility and necessity in connection with forgiveness requests.

- In addition, the Department of Treasury has indicated it will audit any loans over $2M and may audit loans under $2M.

- A false certification could lead to repayment of the loan, civil or criminal liability, and possible liability of owners.
Paycheck Protection Program (PPP)

- Recommended steps related to confirming necessity:
  - Approve and ratify (a) eligibility, and (b) necessity
  - Determine whether the PPP loan was necessary at the time of application and at the current time → tie to ongoing operations
    - Consider decline in revenues, increases in costs of supplies, unavailability of supplies, reduced need for employees, cancellation of revenue generating activities, customers’ breach or non-fulfillment of contracts, additional operating expenses relating to COVID-19 pandemic (e.g., remote working and/or cleaning and sanitizing facilities)
  - Analyze alternative sources of capital to determine availability and/or whether such capital is materially detrimental
  - Establish best practices for the PPP loan, including use of funds
  - Confer with counsel in connection with the “necessity” analysis

- If the loan was not necessary, repay by **May 7, 2020**
Paycheck Protection Program (PPP)

- False Statement
  - Applicant certifies that the information provided in the application and all supporting documents is **true** and **accurate** in all **material respects**

I further certify that the information provided in this application and the information provided in all supporting documents and forms is true and accurate in all material respects. I understand that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to $250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than $5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than $1,000,000.
Paycheck Protection Program (PPP)

- Application states knowingly making a false statement is punishable by various criminal statutes:
  - 18 USC §§ 1001 (false statements)
    - Imprisonment of not more than 5 years
    - Fine up to $250,000
  - 15 USC § 645 (false statement to obtain a loan)
    - Imprisonment of not more than 2 years
    - Fine up to $5,000
  - 18 USC § 1014 (false statements on loan application if submitted to a federally insured institution)
    - Imprisonment of not more than 30 years
    - Fine up to $1,000,000
Paycheck Protection Program (PPP)

- Fraud involving more than $10,000 is an aggravated felony. Fraud is also a crime involving moral turpitude.

- No criminal liability for **accidentally** provided false information.
  - Why? No intent to defraud.

- No criminal liability for SBA errors.
  - *BUT* . . .
Paycheck Protection Program (PPP)

- Certifications on PPP applications may trigger civil liability under the **False Claims Act**, 31 USC § 3729 *et seq.* ("FCA")
  - Enacted in 1863 to combat fraudulent sales of supplies to Union Army during Civil War
  - Powerful whistleblower provision provides financial incentives for individuals to bring cases on behalf of the government
    - Whistleblowers entitled by law to receive between 15-30% of any settlement or judgment, plus attorneys fees
  - Potentially applies whenever a claim for payment is submitted to the federal government
  - FCA cases in healthcare and government contracts / procurement contexts are common
Paycheck Protection Program (PPP)

- During the last ten years, nearly $38 billion was recovered under the FCA from companies that do business with the federal government.
- Why? Whistleblower incentives to identify and bring cases, plus astronomical potential liability.
  - Treble (3x) damages
Paycheck Protection Program (PPP)

- FCA triggered by a knowing submission of a false claim
- Knowledge under the FCA does not require actual knowledge – “reckless disregard” of the truth or falsity is enough
- FCA cases can be based on false certifications of compliance if the certification was false when made
- The underlying violation that is covered by the certification, however, must be material to payment
  - Would government have awarded the loan if it had known the true facts?
  - Misspelled middle name v. falsified eligibility requirement
Paycheck Protection Program (PPP)

- Unique risks under FCA
  - Timeframes may force applications to be submitted without careful review
  - CARES Act and the PPP lack finalized rules, regulations, and guidance
    - What funding is truly “necessary” to support a small business’s “ongoing operations”?
  - Consider “reverse false claims” risk if errors are made by SBA
    - FCA liability includes knowing retention of payments to which one is not entitled
  - De facto grant status of PPP loans will inevitably lead to scrutiny of whether funds were in fact used for eligible purposes
  - “Pay and chase” recovery strategy
Paycheck Protection Program (PPP)

- **Don’t** rely on this! (Despite what government says)

  Borrowers and lenders may rely on the guidance provided in this document as SBA’s interpretation of the CARES Act and of the Paycheck Protection Program Interim Final Rules (“PPP Interim Final Rules”) (link). The U.S. government will not challenge lender PPP actions that conform to this guidance,¹ and to the PPP Interim Final Rules and any subsequent rulemaking in effect at the time.

- Whistleblowers will be happy to argue that a borrower’s actions did not conform to SBA guidance or future rulemaking

- Courts and DOJ have questioned reliance on sub-regulatory guidance in FCA context – SBA FAQs are not laws or rules and do not have force and effect of law
Paycheck Protection Program (PPP)

- Potential Loan Forgiveness:
  - Section 1106 of CARES Act
  - Equal to the amount the borrower spent on the following items during the 8-week covered period, which begins on the date of the first disbursement:
    - Payroll costs
      - For 8 weeks, maximum of $15,385 per individual for salary, wages, and tips
    - Owner Compensation Replacement based on 2019 net profit from Schedule C
      - Limited to eight weeks’ worth (8/52) of 2019 net profit (maximum of $15,385)
    - Interest on mortgage obligations incurred in the ordinary course of business
    - Rent payments on lease agreements
    - Payments on utilities (electricity, gas, water, transportation, telephone, or internet)
    - For borrowers with tipped employees, additional wages paid to those employees

*Note*: rent, mortgage, and utilities must be pursuant to obligations in place before February 15 (i.e. not new obligations)
Paycheck Protection Program (PPP)

- Limits on Amounts of Forgiveness:
  - At least 75% of loan proceeds must be used for payroll costs
  - Not more than 25% of the forgiven amount may be for rent, mortgage interest, or utilities
  - Reduction based on Reduction in Number of FTEs
    - Payroll Cost \( \times \) Average # of FTEs per Month for 8-week Covered Period divided by one of the following: (Hint: use the lesser of)
      - Option 1: Average # of FTEs per month from February 15, 2019 to June 30, 2019
      - Option 2: Average # of FTEs per month from January 1, 2020 to February 29, 2020
  - Reduction based on Reduction in Salaries and Wages
    - For any employee who did not earn during any pay period in 2019 wages at an annualized rate more than $100K, the amount of any reduction in wages that is greater than 25% compared to their most recent full quarter
  - Self-employed individuals limited to eligible forgiveness expenses to the extent deductible on Form 1040, Schedule C
    - Loan forgiveness limited to proportionate 8-week share (8/52) of 2019 net profit
Paycheck Protection Program (PPP)

- Limits on Reductions in Amounts of Forgiveness:
  - Reductions in employment or wages that occur during the period beginning on February 15, 2020 and ending April 26, 2020 shall **not** reduce the amount of loan forgiveness **IF** by June 30, 2020, the borrower eliminates the reduction in employees or reduction in wages.

  *Note:* It is unclear whether the re-hire exemption is all or nothing, i.e. whether all wages / salary reductions must be cured in order to avoid reductions to loan forgiveness.
Paycheck Protection Program (PPP)

- $349 Billion + $310 Billion = $659 Billion for PPP
- 100% guarantee by SBA
- Application Periods:
  - April 3 – small businesses and sole proprietors
  - April 10 – self-employed individuals and independent contractors
- Applicant to submit SBA Form 2483 (Paycheck Protection Program Application Form) and Payroll documentation to lender
- SBA will pay lender fees for processing – not borrower
- Apply quickly because there is a funding cap!

*Note:* Applicants may apply for both PPP & EIDL loans
Thank You

Chrissy Leggett, CPA/ABV, CVA
Senior Manager, Healthcare
HORNE, LLP
chrissy.leggett@hornellp.com

Laura Warf, Counsel
Business Transactions Group
Davis Wright Tremaine, LLP
laurawarf@dwt.com

Renee Howard, Partner
Healthcare Practice Group
Davis Wright Tremaine, LLP
reenehoward@dwt.com