LOEB & LOEB LLP

Finance

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Do You Care About the CARES Act?—$359 Billion To Help Small Businesses

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law March 26, is a massive $2 trillion stimulus package intended to help individuals and businesses weather the economic effects of the COVID-19 pandemic.

Title I of the Act, the "Keeping American Workers Paid and Employed Act," offers two forms of potential relief for small businesses:

1. A new loan program under the Small Business Administration's existing Section 7(a) loan programs called the "Paycheck Protection Program," which expands the types of businesses that are eligible for an SBA Section 7(a) loan and makes changes to the current 7(a) loan rules and regulations intended to make the loans more attractive to lenders and borrowers. The intent is to have quick underwriting and disbursement of Paycheck Protection Program loans.
2. Emergency grants of up to $10,000 under the SBA's Section 7(b)(2) Economic Injury Disaster Loan Program, as well as additional funding for the program.

According to the Department of the Treasury, applications for Paycheck Protection Program loans will be accepted starting on April 3 for small businesses and sole proprietorships and April 10 for independent contractors and self-employed individuals. Treasury has provided a helpful overview of the program, a fact sheet for borrowers, a fact sheet for lenders and a copy of the application.

What are Paycheck Protection Program loans?

- Available to small businesses (generally defined as businesses with not more than 500 employees) to pay for payroll, certain benefits (such as health insurance premiums), rent, utilities, and interest on mortgages or existing debt.
- Made by financial institutions approved by the SBA and the Department of the Treasury, not directly by the SBA.
- Available in an amount of 2.5 times the average monthly payroll costs (usually measured over a one-year period) or $10 million, whichever is less.
- 100% guaranteed by the SBA.
- Can be used for enumerated permissible purposes such as payroll, benefits, rent, mortgage interest and utilities.
- Portions may be forgiven if certain criteria are met.
- Interest rate will be a 1.00% fixed rate.
- No personal guarantee or collateral is required.
- All payments (including interest and fees) are deferred for six months, and the loan is due in two years.

- No prepayment penalty.

Who is eligible for the Paycheck Protection Program loans?

- Any small business concern as defined in the Small Business Act and its applicable regulations (13 CFR Part 121).
- Any business, nonprofit organization, veterans' organization or tribal business concern that employs not more than the greater of 500 employees (or a size standard for the industry established by the SBA, if applicable).
- Lodging and food service businesses with more than 500 employees but not more than 500 employees per physical location
- Sole proprietors.
- Independent contractors.

Individuals employed on a full-time, part-time or other basis are all considered employees for purposes of calculating the number of employees.

Under the SBA's affiliation rules (13 CFR 121.103 and 121.301), the SBA counts the number of all employees of "affiliates" of the borrower when calculating the borrower's size. Under the Paycheck Protection Program, the affiliation rules are waived with respect to:

- Lodging and food service businesses with not more than 500 employees on the date on which the loan is disbursed.
- Any business that is operating as a franchise and is assigned a franchise code by the SBA.
- Any company that receives financial assistance from a company licensed as a Small Business Investment Company.

What is the maximum amount of a Paycheck Protection Program loan?

A Paycheck Protection loan is available in an amount that is the lesser of $10 million or the sum of (a) the average total monthly payments for payroll costs in one year before the loan will be made multiplied by 2.5 (this formula is adjusted for seasonal employees) and (b) the outstanding amount of any existing SBA Section 7(b)(2) loans (disaster relief loans) made beginning on Jan. 31. If a business was not operating in the time period from Feb. 19, 2019, to June 30, 2019, calculate the first number by using the average total monthly payments for payroll costs for the period of Jan. 1, 2020 – Feb. 29, 2020.

If the business has an existing Section 7(b)(2) loan (Economic Injury Disaster Loan) made on or after Jan. 31, the outstanding amount of that loan is added to the total available amount under the Payroll Protection Program.

What can the Paycheck Protection Program loans be used for?

- Payroll costs.
- Costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums.
- Employee salaries, commissions or similar compensations.
- Payments of interest on any mortgage obligation (not including any prepayment of or payment of principal on a mortgage obligation).
- Rent (including rent under a lease agreement).
- Utilities.
- Interest on any other debt obligations that were incurred before Feb. 15.

What are "payroll costs"?

Payroll costs are the sum of the following categories of compensation to employees (except for employees whose principal residence is outside the United States:

- Salary, wage, commission or similar compensation (excluding annual salaries for employees in excess of $100,000 (as prorated for the covered period of Feb. 15 to June 30).
- Payment of cash tip or equivalent.
- Payment for vacation, parental, family, medical or sick leave.
- Allowance for dismissal or separation.
- Payment required for the provision of group health care benefits, including insurance premiums.
- Payment of any retirement benefit.
- Payment of state or local taxes assessed on employee compensation.

For independent contractors and sole proprietors, payroll costs include compensation that is not more than $100,000 in one year, as prorated for the covered period of Feb. 15 – June 30).

Excluded from payroll costs are:

- FICA taxes (Chapter 21 of the Internal Revenue Code).
- Income tax withholdings on wages (Chapter 24 of the Internal Revenue Code).
- Qualified sick leave and family leave wages for which a credit is allowed under previous COVID-19 relief laws.

What must a lender consider in its decision, and what documents are required?

The Paycheck Protection Program does not contain specific detail on the loan underwriting process for participating lenders.

According to the Department of the Treasury and SBA fact sheet, the lender will need to verify:

- The borrower was in operation on Feb. 15.
- The borrower had employees for whom the borrower paid salaries and payroll taxes.
- The dollar amount of average monthly payroll costs.

Lenders will also need to follow applicable Bank Secrecy Act requirements for customer identification and verification. Did the business have employees for whom the business paid salary and payroll taxes, or did the business pay independent contractors as reported on a Form 1099-MISC?

The borrower will have to make a number of certifications in good faith, including the following:

- Current economic uncertainty makes the loan necessary to support ongoing operations.
- The funds will be used to retain workers and maintain payroll or to make mortgage, lease and utility payments, and if the funds are used for unauthorized purposes, the federal government may pursue criminal fraud charges.
- The borrower has not and will not receive another loan under the program.
- The borrower will provide to the lender documentation that verifies the number of full-time equivalent employees on payroll and the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments and covered utilities for the eight-week period after getting the loan.

- Loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments and covered utilities.
- During the period beginning on Feb. 15 and ending on Dec. 31, the borrower has not and will not receive another loan under this program.

What requirements for Section 7(a) loans have been changed for Paycheck Protection Program loans?

- The requirement that the business be unable to obtain credit elsewhere is waived.
- Yearly fees paid by the lender and the guarantee fee (paid by the lender but typically passed on to the borrower) are waived.
- No personal guarantee is required.
- No collateral is required.

What is the loan forgiveness available under the Paycheck Protection Program?

Forgiveness is available for an amount equal to the sum of certain costs incurred and payments made during the eight-week period from the date a loan is originated.

- Payroll costs.
- Payment of interest on any mortgage on real or personal property incurred before Feb. 15.
- Payment of rent under a leasing agreement in force before Feb. 15.
- Payment of utility costs for which service began before Feb. 15.

Any amount of loan forgiveness that would normally be included in the gross income of the borrower is excluded from gross income. The Department of the Treasury and the SBA have stated that because of likely high subscription, it is anticipated that not more than 25% of the forgiven amount may be for nonpayroll costs.

Is the amount of forgiveness subject to any reduction?

The amount of loan forgiveness is reduced if the borrower reduces the number of full-time equivalent employees. The reduction is calculated by multiplying the total forgiveness amount by the quotient of:

- The average number of full-time equivalent employees per month employed during the eight-week period from the date the loan is originated, divided by the average number of full-time equivalent employees per month employed in one of the following time periods (at the election of the borrower):
  - Feb. 15, 2019 through June 30, 2019
  - Jan. 1, 2020 through Feb. 29, 2020
- The amount of loan forgiveness is reduced for any reduction in total salary or wages during the covered period (Feb. 15 – June 30) of any employee that is in excess of 25% of the employee's salary and wages during the most recent full quarter in which the employee was employed before the covered period. Count only employees who did not receive in any pay period in 2019 wages or salary at an annualized rate of not more than $100,000.

Any reduction in the amount of loan forgiveness can be mitigated if both of the conditions below are met:

- If during the period between Feb. 15 through April 26 (30 days after the enactment of the CARES Act) there is a reduction in the number of full-time equivalent employees or a reduction in salary or wages of one or more employees.
- If the employer eliminates either or both reductions not later than June 30.

Is loan forgiveness automatic?

No. A borrower must request loan forgiveness from the lender that is servicing the loan.

The borrower will be required to submit the following documentation:

- Documentation verifying the number of full-time equivalent employees and pay rates during the applicable time periods, including federal payroll tax filings and state income, payroll and unemployment insurance filings.
- Documentation (canceled checks, payment receipts, account transcripts) verifying payments on mortgage obligations, lease obligations and utility payments for which forgiveness is available.
- A certification from an authorized representative of the borrower that:
  - The documentation is true and correct.
  - The amount for which forgiveness is requested was used for the designated categories of payments under the loan forgiveness rules.

The lender will issue a decision on a loan forgiveness application within 60 days. Lenders may require additional documentation; forthcoming SBA guidance may clarify this.

What is the EIDL Program?

The EIDL Program (Section 7(b)(2) of the SBA) offers low-interest loans of up to $2 million to small businesses. The interest rate for the loans is 3.75% (2.75% for nonprofits). The loans can be used to pay fixed debts, payroll, accounts payable and other bills that the business cannot pay because of the economic impact of the coronavirus. The SBA works with state governors and directly funds the loans. The EIDL Program was made available in early March on a location-by-location basis as official disaster declarations were processed by the SBA.

What entities are eligible for EIDL Program loans?

The CARES Act temporarily expands the types of entities that are eligible for EIDL Program loans to include:

- A business with not more than 500 employees.
- A sole proprietor or an independent contractor.
- A cooperative with not more than 500 employees.
- An ESOP with not more than 500 employees.
- A tribal small business concern with not more than 500 employees.

These entities are eligible for EIDL Program loans from Jan. 31 through Dec. 31.

Small businesses in all U.S. states and territories that are experiencing COVID-19-related economic injury are currently eligible to apply for EIDL Program loans.

The application for the loan and the advance is available on the SBA website.

What EIDL rules and requirements are being waived?

From Jan. 31 through Dec. 31, the following rules and requirements with respect to EIDL Program loans are waived:

- Any rules related to the personal guarantee on advances and loans of not more than $200,000.
- The requirement that an applicant needs to be in business for the one-year period before the disaster, except that no waiver may be made for a business that was not in operation on Jan. 31.
- The requirement that an applicant be unable to obtain credit elsewhere.

What criteria will be used to determine eligibility?

The CARES Act indicates that the SBA will require more limited documentation and information from applicants for EIDL Program loans, but the details are still to be decided.

The Act states that the SBA may, but is not required to:

- Approve an applicant based solely on the applicant's credit score.
- Forego requesting an applicant to submit a tax return or tax return transcript.
- Use alternative methods to determine an applicant's ability to repay.

We are still waiting on additional guidance on underwriting criteria for these loans.

What emergency advances are available?

An applicant who applies for an EIDL Program loan may request an advance of up to $10,000 to be provided within three days of the date the application is received. The advance may be used for any allowable purpose under Section 7(b)(2), including:

- Providing paid sick leave to employees unable to work because of the direct effect of the pandemic.
- Maintaining payroll to retain employees during business disruptions or substantial slowdowns.
- Meeting increased costs to obtain materials unavailable from the applicant's original source because of interrupted supply chains.
- Making rent or mortgage payments.
- Repaying obligations that cannot be met because of revenue losses.

The applicant is not required to repay the advance, even if it is not subsequently approved for a loan.

However, if the applicant receives a Section 7(a) loan, the amount of any loan forgiveness for payroll costs for the Section 7(a) loan is offset against the amount of any advance. The application for the loan and the advance is available on the SBA website.

Can a business with an existing EIDL Program loan apply for a Payroll Protection Program loan?

Yes. An EIDL Program loan made during the period beginning Jan. 31 and ending on the date the Payroll Protection Program loans are made available may be refinanced as part of the Payroll Protection Plan loan.

Can a business apply now for both an EIDL Program loan and a Payroll Protection Program loan?

Yes. However, any proceeds from an EIDL Program loan made on or after Jan. 31 and ending on the date the Payroll Protection Program loans are made available would not be eligible for paying payroll costs and other allowable uses of Payroll Protection Program loans.

What relief is available to businesses with existing Section 7(a) loans?

In an attempt to create some parity between existing Section 7(a) loans and new Section 7(a) loans made after the effective date of the CARES Act (including Payroll Protection Program loans), the SBA is directed to encourage Section 7(a) lenders to provide payment deferments (when appropriate) and extend the maturity of existing loans to avoid balloon payments or any increases in payments.

Further, the SBA will pay the principal, interest and any associated fees on a Section 7(a) loan in regular servicing status as follows:

- If a loan was made before March 27 (the enactment date of the CARES Act) and is not on deferment, payments will be made for a six-month period beginning on the next payment due date.

- If a loan was made before March 27 and is on deferment, payments will be made for the six-month period beginning on the first payment due date after the deferment period.
- If a loan was made after March 27 and in the subsequent six-month period, payments will be made for the six-month period beginning on the first payment due date.

In addition to Section 7(a) loans, these provisions also apply to loans made under Title V of the Small Business Investment Act of 1958 (loans to state and local development companies) and loans made by an intermediary to a small business under the SBA's microloan program.

Please reach out to your Loeb estate planning attorney if you would like to make any changes to your current documents or discuss any of the planning opportunities described above. Most important, stay safe and healthy.

For more information on the business impacts of COVID-19, we encourage you to visit our COVID-19 Resource Center, which we will continue to update as the situation evolves. If you have questions about COVID-19's impact on your business, please reach out to your Loeb relationship partner, or email us directly at COVID19@loeb.com.

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