

Review of the New Small Business Administration Loan Provisions Under The CARES Act

On Friday March 27, 2020 President Trump signed into law the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act. This new legislation so far provides the largest ballast in the government’s continued efforts to stimulate the economy during the COVID-19 pandemic. Among other provisions, the CARES Act both amends the existing loan programs available under the Small Business Administration (“SBA”) and adds a new type of loan specifically to help employers deal with the economic slowdown while maintaining existing payroll levels.

While we await any regulations that will clarify the fine terms of the new legislation, we at Tamkin & Hochberg want to give our clients helpful information these lines of credit available for their businesses in these trying times.

NEW PAYCHECK PROTECTION LOAN PROGRAM

First and foremost, the SBA is now offering a new \$349 Billion loan program called the Paycheck Protection Program. The federal government created this new program to incentivize employers to maintain their current payroll and avoid any furloughs or laying off of employees where possible. As a result, the SBA has greatly expanded its definition of “small businesses” to include almost any business with fewer than 500 employees, including sole proprietors and independent contractors. Moreover, the biggest aspect of this stimulus is the potential forgiveness of any loans issued under the Paycheck Protection Program. According to the SBA website, these loans can be obtained through “any existing SBA 7(a) lender or through any federally insured depository institution, federally insured credit union, and Farm Credit System institution that is participating. Other regulated lenders will be available to make these loans once they are approved and enrolled in the program.” Accordingly, businesses may want to check with their local lender as to whether it is participating in the program.

In order to apply, applications must certify the following: (a) that due to the uncertainty of the current economic conditions, the loan is necessary to support the employer’s ongoing operations; (b) that the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments and utility payments; and (c) the applicant does not have any applications pending nor has the applicant received any loan funds for Disaster Recovery Loans or Economic Stabilization Loans under the COVID-19 Stimulus package. Furthermore, applicants must have been in operation as of March 1, 2020 and have enough employees to support ongoing operations.

Paycheck Protection loans have the following terms:

- All businesses with less than 500 employees¹ may apply for loans worth the **lesser of:**

¹ For business in the hospitality industry, this requirement is changed to 500 or less employees **per physical location**).

- 2 ½ times their average monthly “Payroll Costs” for the one year period ending on the date the loan was made, **plus** any disaster loan offered by the SBA previously taken out after January 31, 2020 that has been refinanced into a Paycheck Protection Program loan

and

- \$10 Million
- The interest rate is capped at 4.0%
- Maximum maturity of 10 years
- These loans may be used **solely** for: Payroll Costs, healthcare, rent, utilities and other debts incurred by the business
- No collateral or personal guaranty required for loans less than \$200,000.

For the purposes of calculating an eligible borrower’s maximum loan amount, “Payroll Costs” under the law is defined as:

- 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 health care benefits, including insurance premiums
- Payment of any retirement benefit
- Payment of State or local tax assessed on the compensation of employees
- The sum of payment of any compensation to or income of a sole proprietor that is a wage, commission, income, net earnings from self-employment, or similar compensation that is not more than \$100,000 in one year, as pro-rated for the covered period.

Importantly, Payroll Costs under the bill does **not** include:

- the compensation of any individual employee in excess of an annual salary of \$100,000. Meaning if you have an employee making \$150,000 that you want to keep on staff, only \$100,000 of that salary would count towards “Payroll Costs”
- Foreign employees’ salary or wages of any kind
- Payments made under the Families First Coronavirus Relief Act (FFCRA), the prior federal response to COVID-19 that provides government sick leave and extended paid emergency Family Medical Leave Act related to employees affected by the pandemic
- Taxes imposed or withheld by chapters 21, 22, or 24 of the Internal Revenue Code are not included in this calculation (*e.g.*, payroll taxes)

Certain adjustments to this formula have been made for new businesses and seasonal businesses. For seasonal businesses, the maximum loan amount is 2.5 x the average monthly payments for Payroll Costs for the 12-week period beginning **either** February 15, 2019 **or** March 1, 2019

(decided by the borrower) and ending June 30, 2019. For new businesses, the maximum loan amount is 2.5 x the average monthly Payroll Costs incurred for January and February 2020.

While these loans are certainly useful for providing working capital over the next few months for businesses in desperate need, the most attractive aspect of the Paycheck Protection Program lies in the loan **forgiveness** provisions under the CARES Act.

The amount forgiven is the sum of the following payments made by the borrower during the 8-week period following the issuance of the loan:

- Payroll Costs (as defined above)
- Mortgage interest
- Rent
- Certain utility payments
- Any other debt obligations that were incurred before the loan began.

An example of how forgiveness would work is as follows. If Business A's average monthly payroll costs for the prior year is \$100,000, then Business A would be able to apply for a loan worth up to \$250,000 (2.5 x \$100,000). In the following 8 weeks after receiving the loan proceeds Business A spends \$200,000 on payroll costs, and another \$20,000 on eligible utilities and rent. Accordingly, Business A is eligible to have \$220,000 of its Economic Injury Disaster Loan forgiven on a tax-free basis (that is, the company will not be deemed to have profited off having \$220,000 removed from its liabilities ledger for tax purposes).

However, if Business A at any point in this 8-week period reduced either its workforce or the salary being paid to its workforce, the forgiveness amount will be reduced by either reduction in expenditures. If Business A had previously furloughed or laid off employees prior to applying for the loan program, Business A must rehire these employees in order to get the full benefit of forgiveness.

This provision speaks to the fundamental purpose of the law. Businesses are to keep paying employees their full salary (up to \$100,000 for purposes of the loan amount/forgiveness). Any attempt to avoid doing so will jeopardize the amount of loan proceeds your business is eligible for and any subsequent relief down the road. This point cannot be stressed enough.

There are additional provisions for businesses with existing SBA loans (such as if a business already received a loan from the EIDL program after January 31, 2020 in response to the COVID-19 outbreak). In that case, such businesses are entitled to a subsidy in which the SBA will pay six months of principal, interest and fees on these qualifying loans.

Due to the benefits of this new loan program, it may be in a business' best interest to refinance any previously received EIDL loan received into a Paycheck Protection Program loan. Indeed, the Paycheck Protection Program allows businesses to fold any existing EIDL loans into their total loan amount calculation to refinance their loan and take advantage of the Paycheck Protection Program. In any event, businesses considering converting their loans should only use their EIDL loans for the purposes permitted by the Paycheck Protection Program to preserve their ability to have any part, or even the entire loan forgiven in the future.

More information about the Paycheck Protection Program and loan application process may be found at: <https://www.sba.gov/funding-programs/loans/paycheck-protection-program>.

CHANGES TO ECONOMIC INJURY AND DISASTER LOAN PROGRAM

As part of the initial response to COVID-19, the SBA began offering Economic Injury and Disaster Loans (“EIDL”) for small businesses in designated economic disaster zones. Under this program, businesses can apply for a loan worth up to \$2 Million, with the actual amount varying depending on the business’ needs. These loans have a fixed interest rate of 3.75% per annum.

With the enactment of the CARES Act the SBA has made significant changes to this program. The SBA expanded the definition of “small business” to include virtually all businesses with fewer than 500 employees, including sole proprietors and independent contractors (provided they satisfy the SBA’s previous requirements for industry standard sizes). The personal guaranty and collateral requirements have been increased to only apply to loans worth more than \$200,000 (it should be noted that the SBA will not deny EIDL loan applications on the basis of insufficient collateral to secure the EIDL loan). As noted above, any existing loans taken under the EIDL program due to COVID-19 may be folded into a new Paycheck Protection Program loan.

One potential benefit of taking a loan under the EIDL program as opposed to the Paycheck Protection Program is that loan proceeds may be used for business expenses and obligations that the applicant would have otherwise been able to pay had the disaster not occurred. However, EIDL loan proceeds **cannot** be used to replace lost profits or to expand the applicant’s business.

The SBA will approve applications from eligible employers for an EIDL loan between now and December 31, 2020 in response to the effects of COVID-19 based either solely on the applicant’s credit score or it will “use alternative appropriate methods to determine an applicant’s ability to repay.” As with the SBA’s express loans, the “no credit elsewhere” requirement for EIDL loans has been waived. As a result, the process for obtaining one of these loans has been considerably streamlined.

Accompanying the broader and easier access to EIDL loans is the SBA’s provision of emergency cash grants of up to \$10,000 to eligible EIDL loan applicants within 3 days of the SBA receiving the applicant’s request for a grant. The grant may be used to pay only certain costs, including: “Providing sick leave to employees unable to work due to the direct effect of the COVID-19”; “Maintaining payroll to retain employees during business disruptions or substantial slowdowns”; “Meeting increased costs to obtain materials unavailable from the applicant’s original source due to interrupted supply chains”; “Making rent or mortgage payments”; and “Repaying obligations that cannot be met due to revenue losses.”

An emergency EIDL grant does not need to be repaid, however, if the applicant later receives a loan under the Paycheck Protection Program and folds its existing EIDL loan into the

Paycheck Protection Program, the total emergency grant money provided will be reduced from the ultimate loan forgiveness amount. Access to the emergency grant funds will expire on December 31, 2020.

More information about the EIDL program and loan application process may be found at: <https://covid19relief.sba.gov/#/>.

EASY ACCESS LOANS FROM THE SBA

Certain EIDL loans can be done directly through the SBA. Toward this end, the SBA has created easier access to larger loans through the SBA's express loan process. Changes to the current law increase the previous maximum loan amount under the express loan process, from \$350,000 to \$1,000,000. In addition to increasing the potential loan maximums, the CARES Act amended the Small Business Administration Act by waiving the "no credit elsewhere" requirement and temporarily allowing the SBA to guarantee 100% of the loans. Finally, employers applying for a loan through the express loan process may defer all loan payments for at least 6 months (to a year) and, as mentioned above, forgo providing the lender with a personal guarantee or collateral to secure the loan.

CONSIDERATIONS FOR LARGER BUSINESSES

The CARES Act also provides relief for larger businesses with between 500 and 10,000 employees with over \$500 Billion in funding. These larger businesses are also eligible for direct loans under the Emergency Relief and Taxpayer Protections portions of the CARES Act, however certain certifications will have to be made in order for any such business to qualify.

These "good-faith certifications" include:

- The intention to restore at least 90% of its workforce as of February 1, 2020, including all compensation and benefits for those employees as of the same date. To be completed no later than 4 months after Health and Human Services declares an end to the public health emergency related to COVID-19;
- Not outsourcing jobs for the term of the loan (which cannot exceed five years) and for two years after repaying the loan;
- Agreeing to not "abrogate" an existing collective bargaining agreement for the term of the loan and for two years after completing repayment of the loan. This language may impede efforts to engage in concessionary bargaining in the midst of such agreements;
- Agreeing to remain "neutral in any union organizing effort for the term of the loan." The term "neutral" in the context of union organizing traditionally means imposing significant restrictions on employer conduct beyond those imposed by other federal labor laws and regulations imposed by agencies such as the National Labor Relations Board (NLRB). Under these terms, a business may forfeit the extent to which it could otherwise resort to its lawful "free speech" rights under these circumstances.

Failure to comply with these terms could result in the rescission of the loan.

TAX CREDITS

In addition to the Paycheck Protection Program, certain employers may want to consider the option of payroll tax credits. In this regard, the CARES Act provides that certain employers will be eligible for a payroll tax credit in each applicable quarter in an amount equal to 50% of the first \$10,000 of qualified wages paid to employees (including health benefits) between March 13, 2020 and December 31, 2020. However, be advised that these tax credits are not available to employers who participate in the Paycheck Protection Program.

Payroll tax credits are be available to employers whose business (i) was fully or partially suspended due to a government shutdown order or (ii) experienced a decline of gross receipts of at least 50% vs. the same calendar quarter in the prior year (until such time as gross receipts for a quarter are greater than 80% vs. the same calendar quarter in the prior year).

Eligibility for the payroll tax credits are based upon employer size. Businesses with greater than 100 full-time employees, the tax credit is only available to the extent wages are paid to employees who are unable to work as a result of a government shutdown order. For businesses with fewer than 100 full-time employees, the tax credit is available for all employees, even if the employee works from home during the business closure.

Finally, because this payroll tax credit for wages paid is not available to employers who participate in the Paycheck Protection Program, an employer would need to evaluate its particular situation and choose between taking this credit or obtaining a loan under the Paycheck Protection Program.

Tamkin & Hochberg's attorneys continue to work with our clients to review their specific business needs and assisting with the SBA EIDL loans, the new Paycheck Protection Program loans, and other benefits that have been made available under the CARES Act. Feel free to contact us to discuss any of your questions or concerns.

This memorandum is provided by Tamkin & Hochberg LLP for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.