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The CARES ACT

Comprehensive Federal Legislative Response to COVID-19 PANDEMIC

On Friday, March 27, 2020, President Trump signed The Coronavirus Aid, Relief, and Economic Security (CARES) Act into law. Intended as an economic stimulus response to the crushing impact of the Coronavirus pandemic, the CARES ACT ("the Act") sets forth myriad amendments and modifications to, among others, current tax, banking, securities, and public health laws, as well as to the Medicare and Medicaid programs.

Of particular importance to our clients – but something perhaps lost amidst the focus on advance rebates and payroll tax deferrals – is a provision that expands the federal Small Business Administration's (SBA) Section 7(a) Small Business Loan program and provides avenues for the eventual forgiveness of those loans.

In what is being referred to as a "substantial – albeit temporary – modification" of the Section 7(a) of the Small Business Loan Act (SBA), the CARES Act's "Paycheck Protection Program (PPP)" essentially:

- expands the scope of businesses eligible for Section 7(a) loans;
- increases the maximum loan amount allowed to be disbursed;
- expands the permitted uses of loan proceeds; and
- provides opportunities for significant repayment relief / loan forgiveness.

These modifications are available for all otherwise qualifying loans made by the SBA between February 15, 2020 and June 30, 2020, i.e., "the PPP loans."

Although the SBA has been given 30 days (from the March 27, 2020 date of enactment) in which to issue specific guidance for the implementation of the PPP loans, the following are some of the key components of the new / expanded program.

Loan Amounts of up to $10 million Available

Borrowers may obtain loans in amounts equal to the lesser of:

- ***2.5 times average monthly payroll costs*** in the 12 months prior to the date of loan origination[1]; or

[1]Plus, the outstanding amount of any EIDL that is being refinanced, if applicable (as discussed below). Loan applicants that were not in business between February 15, 2019, and June 30, 2019, may use average monthly payroll costs during the period January 1, 2020, through February 29, 2020.

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- **$10 million.**

NOTE: In other words, only those applicants that average more than $4million in qualifying monthly payroll expense, will be subject to the $10 million loan principal limitation.

Loan Forgiveness without Federal Tax Consequences
Among the most attractive features of a new PPP loans may be forgiven – up to an amount equal to the Borrower's payroll costs plus certain mortgage, rent, and utility payments made during the eight-weeks immediately following the loan's origination. The parameters for loan forgiveness are discussed below.

Low Maximum Interest Rates – capped at 4% with no Prepayment Penalties
The interest rate for PPP loans is to be capped at 4% and lenders will not be allowed to charge prepayment penalties.

At Least 6 Months of Payment Deferment
The SBA is to require lenders under the PPP program to provide all impacted borrowers with at least 6 months (and up to one year) of payment deferment.

PPP Loan Proceeds May Be Used for Certain Otherwise Unallowable Expenses
PPP loan proceeds may be used by borrowers for certain expenses generally prohibited for Section 7(a) loans. Allowable uses of PPP loan proceeds include certain payroll costs, rent, utilities, interest on any mortgage obligation, and interest due on any other debt obligation (provided that such obligation was incurred before February 15, 2020).

Available to Businesses Otherwise Able to Access Credit in the Marketplace
Unlike the general rules for SBA Section 7(a) loans, businesses seeking to borrow through the PPP will not need to demonstrate that they have no other means of accessing credit.

Personal Guarantees and/or Collateral NOT Allowed to be Required
Lenders are not permitted to require personal guarantees from business owners, nor will a business need to provide collateral to secure a PPP loan.

SBA Guarantee Required; Lender and Borrower Fees Prohibited
Not only does the CARES Act require the SBA to guarantee 100% of the PPP loans, it requires the SBA to prohibit Lenders from charging fees for loan applications. Moreover, the SBA may only seek recourse against Borrowers to recover loan proceeds that they have used for unauthorized purposes. It is prohibited from going after

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Borrowers for nonpayment.

Eligibility for PPP Loan Application

In general, "small businesses" that were in operation on **February 15, 2020** and had employees for whom they were paying salaries and withholding payroll taxes are potentially eligible for PPP loans. The specific PPP loan eligibility requirements are set forth as, those businesses, nonprofit organizations, and veterans' organizations that:

- employ no more than the greater of either 500 employees or the size standard established by the SBA for the business' particular industry;

- sole proprietors, independent contractors, and "eligible self-employed individuals;"[2] and

- certain businesses with more than one physical location that are Food and Accommodations businesses[3] and which employ no more than 500 employees per physical location.

Businesses Must Establish

In addition to these provisions, the business must be able to establish that:

- the uncertain economic conditions make the loan necessary to support its operations; and

- that it will use the loan proceeds to retain workers and met payroll obligations or for other permitted uses (i.e., mortgage, lease, and utility payments).

Business applicants must also certify that they do not have another application pending for a Section 7(a) for the same purposes and that they have not otherwise received Section 7(a) loan proceeds for the same purposes, at any time during the period February 15, 2020, to December 31, 2020. To the extent that an applicant cannot satisfy these provisions, it can seek to have such loan(s) refinanced as PPP loans. This is discussed below.

Loan Forgiveness without Federal Tax Consequences

PPP loans may be forgiven up to the amount of payroll costs and certain mortgage, rent and utility payments paid during the eight-week period beginning on the date of the loan's origination.

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[2] An eligible self-employed individual is defined in the Families First Coronavirus Response Act as an individual who regularly carries on any trade or business and would be entitled to receive paid leave if the individual were an employee of an employer.

[3]As classified in the NAICS with a code beginning with 72.

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Importantly, any PPP loan amount forgiven will not be considered gross income for federal tax purposes.

Borrowers must submit an application for forgiveness to their lender that includes a certification and documentation demonstrating the relevant full-time employment figures, as well as their payroll costs, mortgage payments, rent payments and utilities payments.

> **NOTE:** Forgiveness will not be given without sufficient documentation, so borrowers are encouraged to develop and implement comprehensive recordkeeping practices. Lenders are required to render a decision on an application no later than 60 days after it is submitted.

Reduction in Amount of Loan Forgiveness

Because the PPP loan program is designed to enable and encourage employers to maintain their workforces, the amount of the PPP loan forgiveness, if any, is tied to the Borrower's employment figures and salary expenses.

Specifically, the amount of total loan forgiveness to which a Borrower is entitled will be reduced in proportion to:

- any reduction in the Borrower's average number of full-time employees (when compared to a prior period); and/or
- in an amount equal to any reduction of an employee's compensation in excess of 25% of the individual employee's compensation measured by their compensation in the prior full quarter.

However, the amount forgiven will not be reduced if a Borrower rehires full-time employees or eliminates the 25% decrease in the total compensation figures by June 30, 2020.

PPP Loans Not Forgiven – Still a Good Opportunity

Even without the opportunity of loan forgiveness, the PPP loan program may remain a worthwhile course of action for many clients. Among other things, any loan amount not forgiven by the Lender will retain the 4% interest rate, will be backed by a 100% SBA guaranty, and cannot be subjected to prepayment penalties. Moreover, unforgiven PPP loans may have repayment periods of up to 10 years.

Determining Payroll Costs supporting Loan Principal Application.

The following expenses qualify as "payroll costs" to be aggregated in the determination of the allowable loan amounts.

- salary, wages, commissions or similar compensation;
- payment of cash tips or an equivalent;
- payment for vacation, parental, family or sick leave;
- allowances for dismissal or separation;
- payments for group health care benefits, including insurance premiums;
- payment of retirement benefits;
- payment of state and local taxes assessed on employee compensation; and
- payments to sole proprietors or independent contractors that are compensation of not more than $100,000 in one year, as prorated for the "covered period."

However, the following expenses are not included in the determination:

- compensation of an individual employee in excess of an annual salary of $100,000, prorated for the "covered Period;
- IRC Chapters 21, 22 and 24 (FICA, FUTA, and FITW) taxes paid or withheld during the covered period;
- compensation of an employee whose principal place of residence is outside the United States; and
- qualified sick or family leave wages for which a credit is available under the Families First Coronavirus Response Act.

SBA Economic Injury Disaster Loans (EIDL) Borrowers

Those businesses that take or plan to take advantage of the SBA EIDL loans (at any time since January 31, 2020, but before to the date on which PPP loans become available) may refinance their EIDLs into a PPP loan. In lieu of a refinancing of the EIDL, a recipient of an EIDL that was obtained between January 31, 2020, and the date PPP loans are first available is not precluded from receiving a PPP loan so long as the EIDL was obtained for purposes of paying costs other than payroll costs and other PPP proceed eligible obligations.

Other SBA Loan Impacted Borrowers

For any business that was in existence on February 15, 2020 and had an application for an SBA loan approved or pending approval on March 27, 2020, the CARES Act requires that such Borrowers be provided with at least a 6 month payment deferment and that they not be subject to any prepayment penalties.