

CLIENT ALERT: CARES Act – Needed Relief for Small Business Concerns

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*March 2020-Revised to Reflect
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On March 27, 2020 the President signed into law the \$2 trillion Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”), providing much-needed relief for the economic shock caused by the COVID-19 pandemic. This Alert summarizes the key elements of the CARES Act, with a focus on the Paycheck Protection Program, and advises all eligible businesses to begin the borrowing process *now* by contacting their bank or, if it will not make SBA loans, an alternate SBA lender.

Additional SBA regulation is expected over the next couple of weeks. This Alert is not meant to detail all the technical provisions of the CARES Act and is qualified in its entirety by its terms which can be found here: <https://www.congress.gov/bill/116th-congress/senate-bill/3548/text>

PAYCHECK PROTECTION PROGRAM

The Paycheck Protection Program (“PPP”) is an expanded SBA loan program for loans fully guaranteed by the Small Business Administration (“SBA”) to made by banks, credit unions, and other lenders. *The PPP loans may be completely forgiven if certain conditions of the program are met.* Since the CARES Act currently authorizes \$349 billion through June 30, 2020 to expand the SBA §7(a) loan program, eligible businesses are advised to apply for the loans as soon as possible before the cap is reached. Starting **April 3, 2020, small business and sole proprietorships** can apply for and receive PPP loans through existing SBA lenders. Starting **April 10, 2020, independent contractors and self-employed individuals** can apply for and receive PPP loans through existing SBA lenders.

Eligible Businesses:

- The CARES Act expands eligible businesses to include, in addition to businesses already covered by the SBA loan program, any business concern, nonprofit, veteran’s organization

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or tribal business, during the period ending June 30, 2020, that was in business on February 15, 2010 and that:

- Employs not more than 500 employees
 - Include individuals employed on part-time or other basis – part-time employees are counted the same as full-time employees
 - Also include employees obtained from a temporary employee agency, professional employee organization or leasing concern
 - For “Accommodation and Food Services” businesses with an NAICS code beginning 72, the 500-employee limit is assessed per each physical location and not the company overall
 - SBA affiliation rules will apply to aggregate employees under common control or direction
 - Exceptions: (i) “Accommodation and Food Services” businesses with an NAICS code beginning 72; and (ii) a franchise business that is assigned a franchise identifier code by SBA (i.e., franchisee does not have to aggregate all other individuals employed by the franchisor or other franchisees)
- Sole proprietors, independent contractors, and self-employed individuals (so-called “gig economy” workers)
- “Small Business Concern” under SBA regulations
- An entity with not more than the number of employees established by the SBA for the particular industry in which the entity operates (e.g., electric power distribution may have up to 1,000 employees)

Loan Underwriting Requirements: Underwriting standards are significantly relaxed compared to SBA loan programs in effect when the CARES ACT was enacted

- Main underwriting standards: (i) proof that the business was operational on February 15, 2020; and (ii) had employees for whom the business paid salaries and payroll taxes (or a paid independent contractor)
 - PPP loans not subject to these typical SBA loan requirements: (i) determination as to repayment ability; (ii) personal guarantee and collateral; or (iii) certification by borrower that it cannot obtain credit elsewhere
- PPP borrowers must make a good faith certification:

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- That loan is necessary due to uncertainty of current economic conditions caused by COVID-19 pandemic to support borrower's ongoing operations
 - Acknowledging that the borrowed funds will be used to retain workers and maintain payroll, or make mortgage, lease and utility payments
 - That the borrower does not have an application pending for a loan under another SBA program for the same use and has not received such a loan
 - Borrower that received an Economic Injury Disaster Loan for a purpose other than the permitted uses of the PPP program during the period January 31, 2020 through the date the loans are available under the PPP, can still access PPP loans.
 - Borrowers with an existing EIDL loan may be able to refinance that loan in the process of applying for a new loan under the PPP.

PPP Loan Terms:

- 1.00% fixed rate
- All payments are deferred for 6 months; however, interest will accrue over that period
- Loan is due in 2 years and there are no prepayment penalties or fees

Amount Borrowed:

- Maximum amount of PPP loan is the lesser of (i) 2.5 times the employer's average monthly payroll costs during the one-year period before the loan is made, and (iii) \$10 million
 - Step 1: aggregate "payroll costs" from the last 12 months for employees whose principal place of residence is the United States
 - Step 2: Subtract any compensation paid to an employee in excess of an annual salary of \$100,000 (and/or any amounts paid to an independent contractor or sole proprietor in excess of \$100,000 per year)
 - Step 3: Calculate average monthly payroll costs (divide annual salary from Step 2 by 12)
 - Step 4: multiply the average monthly payroll costs from Step 3 by 2.5
 - Step 5: Add the outstanding amount of an Economic Injury Disaster Load (EIDL) made between January 31, 2020 and April 3, 2020, less the amount of any "advance" under an EIDL COVID-19 loan (because it does not have to be repaid)
- "Payroll costs" include:

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- Salaries, wages, commissions or similar compensation
 - Cash tips or the equivalent
 - Severance
 - Group health care benefits, including insurance premiums
 - Covered leave
 - Retirement benefits
 - Other expenses, including payments to state or local taxes assessed on employee compensation (but not federal taxes)
 - With respect to sole proprietors or independent contractors, “payroll costs” include their net income from a business up to \$100,000 (pro-rated for the relevant period)
 - “Payroll costs” do not include:
 - Compensation of any individual employee in excess of an annual salary of \$100,000 (pro-rated for the relevant period)
 - Federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including the employee’s and employer’s share of FICA
 - Railroad Retirement Act taxes
 - Income taxes required to be withheld from employees
 - Compensation of an employee whose principal place of residence is outside the US
 - Qualified sick or family leave wages for which credit is available under the Families First Coronavirus Response Act

Permitted Uses for PPP Loan:

- Payroll costs
- Costs related to continuation of group healthcare benefits during periods of paid sick, medical, or family leave, and insurance premiums
- Employee salaries, commissions, or similar compensation
- Mortgage interest (but not prepayment of principal)
- Rent
- Utilities
- Interest on any other debt incurred prior to February 15, 2020 (but not prepayment of principal)

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KEY-Calculating Forgiveness of PPP Loan: PPP borrowers are eligible for forgiveness up to the amount spent by borrower (i) on specified expenses (not more than 25% of which may be attributable to nonpayroll costs) (ii) during the 8-week covered period after the loan is originated (iii) but not more than the amount of the PPP loan (iv) subject to reduction based on decreases in headcount or compensation over a base period

- No adverse tax consequence as a result of forgiveness of PPP debt (i.e., no income tax on forgiveness of debt)
- “Specified expenses” considered in calculating forgiveness:
 - Payroll costs (discussed above)
 - Payments under a lease obligation in effect before February 15, 2020 (not limited to real estate)
 - Utility payments
 - Payment of interest on any covered mortgage obligation, including loans secured by personal property as well as real estate (but not including prepayment of principal)
- Not more than 25% of the forgiveness amount may be attributable to nonpayroll costs.
- Proceeds of any advance up to \$10,000 on the EIDL will be deducted from the loan forgiveness amount on the PPP loan.
- Amount of the EIDL refinanced is included for purposes of determining the percentage of use of proceeds for the payroll costs.
- Forgiveness is subject to complex adjustment calculations based on reduction in full time equivalent (FTE) or reduction in compensation over 25% for those who never received pay in 2019 that annualized (based on each pay period) to more than \$100,000
- Ability to cure adjustment: PPP loan forgiveness adjustments can be cured by eliminating the FTE reduction or compensation adjustment, as applicable, prior to June 30, 2020
- *Calculating forgiveness adjustment based upon FTE reduction:* maximum amount otherwise forgiven will be reduced by percentage based upon reduction in FTEs relative to a baseline number
 - For baseline number, borrower chooses between the lower of:
 - average number of FTEs per month employed by borrower during the period beginning February 15, 2019 and ending June 30, 2019
 - the average number of FTEs per month employed by borrower during the period beginning January 1, 2020 and ending on February 29, 2020

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- Baseline number is the denominator and the numerator will be the average FTEs employed by borrower during the 8-week covered period
 - Example - assume: (i) PPP loan of \$1.5 million; (ii) borrower's specified expenses during eight-week period are \$1 million; (iii) FTEs during eight-week covered period is 50% of the baseline FTEs; (iv) no additional reduction for decrease in compensation; and (v) no "cure" on or before June 30
 - Maximum amount of PPP loan that can be forgiven would be \$500,000 – or 50% of \$1 million in specified expenses
 - *Calculating forgiveness adjustment based upon reduction in compensation for those earning \$100,000 or less in 2019:*
 - Additional reduction in forgiveness amount to the extent borrower reduces by greater than 25% the compensation paid during the eight-week covered period to any employee whose annualized compensation in any 2019 pay period did not exceed \$100,000
 - Forgiveness amount is reduced dollar for dollar by the total amount of compensation reduction during 8-week period that exceeds 25% of total salary or wages for any such employee

Applying for PPP Forgiveness:

- Borrower would apply for forgiveness to lender that makes the PPP loan.
- Lender is required to make decision on loan forgiveness within 60 days after lender received complete application for loan forgiveness.

Supporting Records for PPP Loan Application:

- Schedule of employees to confirm satisfies 500 or less employees requirement (or other industry-specific requirement provided by the SBA)
- Report of average of monthly "payroll costs" for past 12 months showing amounts included and excluded from definition of "payroll costs"
 - Start with 12-month period April 1, 2019 to March 31, 2020 and be prepared to update analysis to cover 12-month period prior to origination of PPP loan
 - Identify amounts for 2019

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- Calculation demonstrating that requesting PPP loan does not exceed maximum loan limit for which the prospective borrower is eligible
 - Lesser of 2.5 times average monthly payroll costs during one-year before the loan is made, or \$10 million
 - Profit and loss from 2019 tax return if available
 - Modified version of SBA Form 1919 is expected out soon on SBA website

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ECONOMIC INJURY DISASTER LOANS AND GRANTS

EIDLs of up to \$2 million are made directly by the SBA to small businesses, nonprofits of any size, small agricultural cooperatives, and small aquaculture enterprises that have been financially impacted as a direct result of COVID-19 since January 31, 2020. EIDLs are to help pay financial obligations and operating expenses.

- Interest rate is 3.75% for small businesses and 2.75% for nonprofits
- Term of loan can be up to a maximum of 30 years
- Applicant for an EIDL may request an advance on that loan of not more than \$10,000 which advance the SBA must distribute in 3 days
 - *If EIDL application is denied, recipients of emergency grant are not required to repay the grant*
 - Emergency advance funds can be used for payroll costs, increased material costs, rent or mortgage payments, or for repaying obligations that cannot be met due to revenue losses
- If a borrower received an EIDL loan through April 3, 2020, such borrower can apply for a PPP loan. If the EIDL loan was not used for payroll costs, it does not affect eligibility for a PPP loan. If the EIDL loan was used for payroll costs, then the PPP loan must be used to refinance the EIDL loan.
 - Proceeds of any advance up to \$10,000 on the EIDL will be deducted from the loan forgiveness amount on the PPP loan
 - The amount of the EIDL refinanced is included for purposes of determining the percentage of use of proceeds for the payroll costs
- Borrowers may not have applications concurrently pending for both an EIDL and a PPP loan
 - Underwriting Requirements – more onerous than PPP: acceptable credit history, ability to repay, must be physically located in disaster-designated area

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UNEMPLOYMENT BENEFITS

The CARES Act allocates \$250 billion for unemployment benefits and relaxes eligibility requirements, extends the duration of payments and increases the amount people will receive.

- Available to individuals out of work for nearly any reason attributable to the pandemic
- Includes self-employed, and those seeking part-time employment, with insufficient work history, or otherwise would not qualify for benefits
- Extends regular weekly benefits for up to 39 weeks between January 27, 2002 and December 31, 2020 (from 26 weeks)
- Workers are eligible for an *additional* \$600 weekly benefit payable until July 31, 2020
 - Massachusetts benefits are usually about 50% of average weekly wages with an \$823 per week cap (which would be hit for an approximate annual salary of \$85,000) – that cap is now \$1,423 per week
 - Those with lower salaries may receive more than their compensation through July 31st because of the additional \$600 per week

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ANTICIPATED ASSISTANCE TO MID-SIZE BUSINESSES

Title IV of the CARES Act, the Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy, directs the Secretary of the Treasury “to endeavor to seek implementation of” a program to lend to financial institutions which in turn make direct loans to eligible businesses of between 500 and 10,000 employees. Some of the elements of such lending program include:

- Deferred principal and interest payments for the first 6 months and the Treasury may waive interest for a longer period
- Interest rate not to exceed 2%
- Borrower certifications
 - Loan is necessary to support ongoing obligations given the uncertain economic conditions
 - Recipient will retain at least 90% of its workforce at full compensation through September 30, 2020
 - Recipient will restore its workforce to at least 90% of its workforce as of February 1, 2020 and will restore all compensation/benefits to its workers no later than 4 months after the termination date of the COVID public health emergency declared on January 31, 2020
 - Recipient is domiciled in the U.S. with significant operations and employees in the U.S.
 - Recipient is not a debtor in bankruptcy proceeding
 - Recipient was created or organized in the U.S., it has significant operations in the U.S., and a majority of its employees are based on the U.S.
 - While loan is outstanding, recipient will not (i) pay dividends on its common stock or (ii) repurchase public equity securities of eligible business or any parent company except pursuant to contracts in effect as of date of the CARES Act
 - While loan is outstanding and for 2 years thereafter, the recipient will not outsource or offshore jobs
 - While the loan is outstanding and for 2 years thereafter, the recipient will not abrogate existing collective bargaining agreements

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- While the loan is outstanding, the recipient will remain neutral in any union organizing effort
