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Important Relief for Small Businesses Under Title I of the CARES ACT:

Revised April 24, 2020

Forgivable Paycheck Protection Program Loans, Grants in Connection with Economic Injury Disaster Loans, Relief for Other SBA Loans, and Increased SBA Express Loans

****Update**: This article has been updated in certain respects to reflect the enactment of the Paycheck Protection Program and Healthcare Enhancement Act ("Enhancement Act"), as well as additional regulatory guidance received since its initial publication.****

Title I of the recently enacted Coronavirus Aid, Relief, and Economic Security Act ("Title I") makes a number of sweeping changes to the statutory framework governing several United States Small Business Administration ("SBA") loan programs. These changes are aimed at providing significant and impactful economic relief to small businesses and their employees. Note that although labeled as "loans," several of these modified and new loan programs are, in many respects, grants. In other words, **small businesses will receive funds and not be required to pay them back, provided they follow certain guidelines**.

The following is a summary of the four main economic incentives/programs available under Title I.

I. Paycheck Protection Program Loans

a. Overview

As the name implies, Paycheck Protection Program Loans ("PPP Loans") incentivize lenders to lend and small businesses to borrow funds and use those funds to maintain pre-pandemic payroll/employment levels.

Essentially, eligible borrowers can (a) obtain PPP Loans in an amount up to 250% of their average monthly payroll expenses; (b) not make any payments for six (6) months to one (1) year; and (c) if certain employment levels are maintained, the borrower can cause the loan to be forgiven (i.e., canceled and not repaid) in an amount equal to actual payroll, mortgage interest, rent, and utilities expenses paid during the first eight (8) weeks of the loan.

Title I establishes the PPP Loan program by amending statutory framework governing the SBA's 7(a) loan program. Accordingly, the same statutes and regulations that govern 7(a) loans govern PPP Loans (except as amended in Title I and in any regulations or amendments that follow).

Title I, as amended by the Enhancement Act, authorizes a total of $659,000,000,000 for government guaranteed lending under the 7(a) program (PPP Loans and all other 7(a) loans) for the period of February 15, 2020 through June 30, 2020 (the "Covered Period").

b. PPP Loan Terms.

- Loan Amount: Two and one half (2.5) times average monthly[1,2] payroll costs, plus, if applicable, the outstanding balance of any SBA Economic Injury Disaster Loan ("EIDL") made to the applicant after January 31, 2020 and on or before April 3, 2020.[3]
- Interest Rate: The interest rate for all PPP Loans will be 1%.
- Eligible Uses of Loan Proceeds: 75% of loan proceeds utilized must be spent on payroll costs[4], while the remaining 25% of the Loan proceeds may be spent on rent, utilities and interest (not principal) on mortgages and other[5] debts.[6]
- Guaranty: Not required.
- Collateral: Not required.
- SBA Fees: No fees initially. No SBA Guaranty Fee and the SBA's annual fee is waived through June 30, 2020.
- Prepayment: No prohibition or penalty for prepayment.
- Payments: No payments are required for a period of six (6) months (minimum) and up to one (1) year (as determined by the SBA).
- Maturity of any loan amount not forgiven: The term for all PPP Loans will be 2 years.

c. Loan Forgiveness.

- Maximum Amount Forgiven: PPP Loan obligations will be forgiven (i.e., canceled and not repaid) in an amount up to the sum of the following expenses paid by the borrower during the eight (8) weeks following origination[7] of the loan (the "Forgiveness Period"): (a) Payroll Costs (as defined in paragraph I.d. below); (b) mortgage interest (mortgage must have been in existence prior to February 15, 2020); (c) rent (lease must have been in effect prior to February 15, 2020); and (d) utilities[8] (collectively, the "Maximum Amount").

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[1] The SBA calculates this amount as the average total monthly payroll payments during the 1-year period before the loan or 2019. In the case of an applicant who is a seasonal employer, however, it is the average total monthly payments for payroll for the "12-week period" beginning February 15, 2019, or at the election of the borrower, any consecutive 12-week period between May 1, 2019 and September 15, 2019.

[2] If the borrower was not in business from February 15, 2019 through June 30, 2019, the loan amount is 2.5 times the average total monthly payroll payments during January 1, 2020 through February 29, 2020.

[3] But not any EIDL made after the SBA establishes a means to refinance an EIDL through a PPP Loan.

[4] See Section I.d. below for what may be included as payroll costs.

[5] Other than mortgages, only debts incurred prior to February 20, 2020.

[6] Interim Final Rule 1, issued April 2, 2020.

[7] Origination is not defined in Title I and the SBA has thus far interpreted it to mean the date funded.

[8] Specifically, the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020.

- Actual Amount Forgiven Reduced by Employment Level:[9] The actual amount forgiven is calculated by reducing (but not increasing) the Maximum Amount (a) in direct proportion[10] to the amount the borrower reduces its full-time workforce, and (b) dollar for dollar by the amount the borrower reduces the wages or salary of employees that earn under $100,000 per year by 25% or more below the total earned in the first quarter of 2020.[11]
- 75% of Loan Proceeds Must Be Used For Payroll Costs:[12] At least 75% of the PPP Loan proceeds must be spent on Payroll Costs to receive forgiveness. No more than 25% of the PPP Loan proceeds (or no more than 1/3 of the amount spent on Payroll Costs) may be spent on the non-payroll expenses (which include payments for mortgage interest, rent, or utilities).
- Corrective Actions: The amount of the reduction may be countered to the extent (a) the reduction in employees and/or salary occurs between February 15, 2020 and April 26, 2020 and (b) the borrower negates the reduction (rehire, hire new employees, increases salaries) by June 30, 2020.[13]
- Cancelation of Indebtedness Income: Forgiven debt is *not* taxable per Title I. In other words, if the reduction occurs early it won't reduce the amount forgiven so long as the reduction is negated by June 30, 2020.
- Forgiveness Process: The Borrower must provide certain documentation[14] evidencing and regarding the use of the proceeds for eligible purposes. Title I provides a safe harbor[15] for lenders relying on such documents. Within sixty (60) days of submittal of the documentation, the lender must approve or reject the forgiveness.

d. What Payroll Costs Include.

- Costs that may be included as Payroll Costs (if not excluded):
  - Salary, wage, commission, or similar compensation;
  - Self-employment income (where the sole proprietor files a 1040 Schedule C)[16]
  - Cash tips or equivalent;
  - Vacation, parental, family, medical, or sick leave;

[9] Title I provides that the SBA and Secretary of Treasury may provide additional exemptions from reduction in forthcoming regulations.
[10] Calculated as monthly average of full-time equivalent employees (based on the number of full-time equivalent employees for each pay period falling in the particular month) during the Forgiveness Period divided by, either (at the borrower's option): (a) monthly average full-time equivalent employees during February 15, 2019 through June 30, 2019; or (b) monthly average full-time equivalent employees during January 1, 2020 through February 29, 2020. An alternate denominator exists for seasonal employers.
[11] A reduction to the salary or wages during the 8 weeks following the funding of the loan for those who earned $100,000 or less in 2019 that is greater than 25% of the amount the same employee earned in Q1 of 2020 will result in a reduction in the amount of forgiveness. To calculate the reduction in forgiveness due to a salary or wage reduction: (a) calculate 25% of the applicable employee's total salary and wages in Q1 of 2020 ("Applicable Limit"), (b) determine the amount of the pay-cut during the 8-week period after the funding of the loan (the "Actual Pay-cut"), and then (c) reduce the forgiveness amount by the amount the Actual Pay-cut exceeds the Applicable Limit. Note, the exact application of this limitation is unclear under the Act and may be clarified under forthcoming regulatory guidance.
[12] Interim Final Rule 1, issued April 2, 2020.
[13] It is unclear if the employees must be retained through the end of the term ending June 30, 2020.
[14] Including the following: (a) payroll tax filings; (b) state income, payroll, and unemployment insurance filings; (c) canceled checks, payment receipts, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments; (d) a signed certificate of the borrower regarding the use of the proceeds; and (e) other documentation the SBA determines as necessary.
[15] With respect to SBA enforcement actions and penalties.
[16] Special rules apply for sole proprietors. See this Interim Final Rule for additional guidance: Interim Final Rule on Additional Eligibility Criteria and Requirements for Certain Pledges of Loans (4/14/2020)

- 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; and
- Compensation/income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, or similar compensation not more than $100,000 in 1 year, as prorated for February 15, 2020 to June 30, 2020. Note, independent contractors can apply for a loan and may not be included in an employers' calculation.

- Costs that must be excluded from Payroll Costs:
  - Individual employee salary in excess of $100,000, as prorated for February 15, 2020 to June 30, 2020;
  - All employment taxes (i.e., Social Security and Medicare) and income tax withholdings required to be paid or withheld;
  - Compensation of an employee that principally resides outside of the United States;
  - Qualified sick leave wages for which a credit is allowed under the Families First Coronavirus Response Act (Public Law 116–127); and
  - Qualified family leave wages for which a credit is allowed under the Families First Coronavirus Response Act (Public Law 116–127).

***e. Businesses Eligible for PPP Loans*.**

Excluded Business: Ordinarily, certain business types are *per se* ineligible for SBA loans, including illegal businesses and those listed as ineligible under SBA Regulations.[17] The SBA has not yet issued regulations specific to PPP Loans and so, for now, it is uncertain if the same or differing exclusions will apply.

Included Businesses: SBA loan eligibility determinations are complicated. Title I eases the determination process for businesses with less than 500 employees and expands the number and types of businesses that qualify; however, there is no single test applicable to all applicants. At the risk of some oversimplification, the 6-step process described below captures the most commonly applicable PPP Loan eligibility criteria. Please note that the following assumes that the applicant is not a *per se* excluded business, and in most instances requires consideration of the size of the business together with all of its affiliates (see the following section I.f. for more information on affiliates).

- **Step 1**: Provided the business is not *per se* excluded from eligibility (as described above), determine if the applicant was in operation on February 15, 2020, and during that time, either (a) had employees for whom the borrower paid salaries and payroll taxes; or (b) is a sole proprietor, filing a 1040 Schedule C, or independent contractor, as reported on a Form 1099–MISC. If not, the business is ineligible. If yes, continue to Step 2.

[17] *See* 13 C.F.R. § 120.110.

- **Step 2**: If the applicant is (a) a business concern[18] employing 500 or fewer employees (full-time, part-time, other employees) or less; or (b) is an eligible self-employed individual[19] or an individual operating under a sole proprietorship or as an independent contractor, it is eligible to receive a PPP Loan. If not, continue to Step 3.
- **Step 3**: Check the applicable size standard for the business concern under the applicable SBA Regulations,[20] which will indicate that the business concern is limited in size based on (a) annual receipts or (b) number of employees.
- **Step 4**: If the business concern is (a) limited by number of employees *and* (b) satisfies the applicable limitation stated in the SBA Regulations,[21] then it is qualified. If not, continue to Step 5.
- **Step 5**: If the business concern is (a) limited by annual receipts, (b) satisfies the applicable limitation stated in the SBA Regulations, [22] *and* (c) is a small business concern,[23] then it is qualified. If not, continue to Step 6.
- **Step 6**: If the business concern (a) has a tangible net worth not in excess of $15 million and an average net income after Federal Income Taxes (excluding any carry over losses) not in excess of $5 million for the preceding two completed fiscal years, and (b) the combined size calculation of the applicant and its affiliates meets the size standard for (i) the primary industry of either the business concern or (ii) the collective primary industry of the business concern and its affiliates, whichever is less restrictive.[24] If not, the business is not eligible.

Note, unlike traditional SBA 7(a) loans, an inability to obtain credit elsewhere and creditworthiness are **not** part of the underwriting process.

f. Affiliates Affecting Eligibility.

Affiliation Rules are Waived for Certain Businesses: Under existing regulation,[25] affiliation consideration is not required for certain businesses (specifically, those listed in 13 CFR § 121.103(b)). Under Title I, the following additional businesses are also exempt from affiliation consideration when applying for a PPP Loan:

- Businesses in the Accommodation and Food Services Industry that employ 500 or fewer people per location;
- Franchisees operating a franchise that is assigned an identifier code by the SBA (check here); and
- Businesses that receive assistance from a Small Business Investment Company.

What Constitutes an Affiliate: Typically, the size of a business's affiliates are included in calculating its size for eligibility purposes. Generally, a business is an "affiliate" for SBA purposes if it controls or has the power to control the applicant, or if a third party controls or has the power to control both that business

[18] Specifically any business concern, nonprofit organization, veterans organization, or tribal business concern described in 13 U.S.C. § 657A 31(b)(2)(C).
[19] As defined in section 7002(b) of the Families First Coronavirus Response Act (Public Law 116–127).
[20] 13 C.F.R. § 121.201.
[21] *Id.*
[22] *Id.*
[23] As defined in 15 U.S.C. § 632(a).
[24] 15 U.S.C. § 632(a)(5).
[25] *See* 13 C.F.R. § 121.103.

and the applicant. Affiliation is also found in certain other circumstances, including but not limited to, the following:[26]

- Ownership – an entity owns or has the power to control more than 50% of the applicant's voting equity. Note that a minority shareholder is in control if it has the ability to prevent a quorum or otherwise block action by the applicant's board or shareholders.
- Options, convertible securities, agreements to merge – an entity has control with the exercise of options and/or convertible securities and agreements to merge.
- Common management – officers, managing members or partners who control management of an entity also control the management of another entity.
- Identity of interest – SBA may presume "identity of interest" (and thus affiliation), where individuals or firms have substantially identical business or economic interests, such as close relatives, where there are common investments, or when a firm economically relies on another (e.g., for 85% or more of its receipts).
- Newly organized concern rule – the firm's officers, directors, principal shareholders, managing members, general partners or key employees organize another concern in the same or related industry, and serve in such capacity for the new concern and the one furnishes the other with contracts, or other assistance.
- Franchise and License agreements – there is a license agreement, and the licensee has no right to profit from its efforts with regard to the agreement and does not bear the risk of loss.
- Totality of the circumstances – the SBA determines that affiliation exists "based upon the totality of the circumstances."

Testing Size When Including Affiliates: For a business to be eligible when it has one or more affiliates, (a) the business itself cannot exceed the SBA size standard for the industry in which the business it primarily engages, and (b) when the business is combined with its affiliates, it must not exceed the size standard designated for either (i) the business's primary industry, or (ii) the primary industry of the business together with its affiliates, whichever size standard is higher.[27] In other words, the business must meet its own size standard and, when combined with its affiliates, they must collectively meet the least restrictive size standard that would apply to borrower or the standard that would apply to the industry of the borrower and the affiliates when taken as a whole.

g. When will PPP Loans be Available?

Lenders were first able to process PPP Loan applications on April 3, 2020, but the initial fund ran out as of April 16, 2020. Enactment of the Enhancement Act, on April 24, 2020, injected an additional $310 billion into the PPP Program. As such, the program will reopen at 10:30 a.m. April 27, 2020.

The SBA has a large network of existing 7(a) lenders to which it has delegated authority and which are capable of processing and funding PPP Loans. Through provisions of Title I, the SBA plans to expand that

[26] 13 C.F.R. § 121.301(f).
[27] SOP 50 10 5(K), Subpart B, Ch. 2, § II(D)(1) (citing 13 CFR Part 121).

network by authorizing additional banks, credit unions, finch lenders, and other financial institutions to make PPP loans.

h. Time from Application to Funding

Title I amends section 7(a) of the Small Business Act[28] to permit private sector lenders to provide PPP loans that are 100% backed by the federal government. Given the 100% government guaranty and certain other underwriting requirement waivers under Title I, unlike traditional loans, lenders will not be concerned with the borrower's ability to pay. Accordingly, the loan application and funding process may be extraordinarily short. To this end, the Secretary of the Treasury has suggested that turn-around times for loans may occur within less than 24 hours and has issued regulatory guidance suggesting that Lenders must fund loans within 10 days of approval.

i. Fees to Lenders and Agents

Lender Fees: The SBA (not borrowers) will pay the lender the following fee within five (5) days of loan funding:

- 5% for loans of not more than $350,000;
- 3% for loans of more than $350,000 and less than $2,000,000; and
- 1% for loans of not less than $2,000,000.

Agent Fees: Fees that borrowers' agents may charge in connection with applications for PPP Loans must be disclosed and are subject to limitations established, or to be established, by the SBA.

j. One Loan Per Business.

The SBA has determined that no borrower may receive more than one PPP Loan.[29] However, Title I states that its PPP Loan provisions do not otherwise prohibit a borrower that obtains an EIDL *prior to the date that PPP Loans are available* from obtaining a PPP Loan. If a borrower received an EIDL between January 31, 2020 and April 3, 2020, the regulations provide that the borrower can obtain a PPP loan.[30] If the borrower uses the EIDL proceeds for payroll costs, it does not affect the borrower's eligibility. However, if they use the EIDL proceeds for payroll costs, the PPP Loan obtained by the borrower must refinance the EIDL loan.[31] Title I expressly prohibits PPP Loans obtained for the "same purpose" and duplicative of amounts previously applied for or received by the applicant through a prior EIDL or PPP Loan. Based on regulatory guidance issued to date, use of an EIDL for payroll costs (regardless of the period) is the same purpose as a PPP loan.

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[28] 15 U.S.C. § 631, *et seq.*
[29] Interim Final Rule 1, issued April 2, 2020.
[30] *Id.*
[31] *Id.*

II. <u>Economic Injury Disaster Loan Grants</u>.

Our comprehensive summary of Economic Injury Disaster Loans ("EIDL"), as in effect prior to the enactment of the CARES Act, can be found here. In short, the EIDL program provides low interest rate loans of up to $2,000,000, with no payments for twelve (12) months and with up to 30-year terms, for working capital purposes to small businesses affected by the COVID-19 pandemic.

Title I makes the following key changes to the EIDL program:

- <u>Expanded Eligibility</u>: Eligibility for EIDL is expanded to all businesses, cooperatives and ESOPs with 500 or fewer employees and individuals who operate under a sole proprietorship, with or without employees, or as an independent contractor.
- <u>EIDL Grants</u>: Within 3 days of submitting an application, qualified applicants can receive a grant in the amount of up to $10,000. The SBA recently announced that this advance is limited to $1,000 per employee of the business, up to ten employees. Provided the granted funds are used for eligible working capital purposes, they do not need to be repaid, *even if the SBA ultimately rejects the loan application*. The amount of any such grant reduces the available loan forgiveness under any PPP loan to the same borrower. The CARES Act initially appropriated $10 billion for these Grants, which was exhausted as of April 10, 2020. However, with the enactment of the Enhancement Act on April 25, 2020, an additional $10 billion has been appropriated to these grants.
- <u>Guaranties</u>: Loans less than $200,000 no longer require a guaranty.
- <u>Time in Existence</u>: A business need only have been in existence prior to January 31, 2020.
- <u>Credit Available Elsewhere</u>: There is now no requirement that the borrower be unable to obtain credit elsewhere.

In addition, the SBA recently updated its on-line application process for EIDL. This is a significant improvement over the SBA's prior system. The first page includes an eligibility test that helps simplify certain aspects of the eligibility determination process. The application can be accessed here.

III. <u>Relief for Other SBA Loans</u>

Title I provides the following relief to borrowers with existing SBA loans:

- <u>The SBA will make payments</u>: The SBA will pay borrowers' principal, interest, and associated fees owed for six (6) months on:
  - Existing Loans not in deferment and new loans (other than PPP loans) made prior to September 27, 2020, beginning with the next/first payment due; or
  - Loans already in deferment, beginning with the next payment due after the existing deferment period.

  The borrower will never be responsible to reimburse these payments. Title I provides that this relief is not to be viewed as a deferment in any way. Lenders must apply the payments to the loan as if the payments had been made by the borrower themselves.
- <u>Waiver of limits on extending maturity</u>: If the lender needs to extend a maturity to provide a deferral for a borrower between March 27, 2020 and March 27, 2021, the SBA will waive any applicable statutory limits on maximum loan maturities.

- Relief to lenders regarding site visits: The SBA will provide additional time for lenders to make site visits when necessary, but not more than ninety (90) days after a payment default and not more than sixty (60) days (unless extended by the SBA) after any other adverse event causing the loan to be classified as in liquidation.

IV. Increased SBA Express Loans

SBA Express loans fall under the 7(a) loan program and provide a means for borrowers to obtain a loan on an expedited basis. Title I temporarily increases the maximum loan size for SBA Express Loans from $350,000 to $1,000,000 until the end of 2020.

We are ready to assist you and your business in navigating these unprecedented times. Please feel free to consult with us for any questions or assistance. For SBA and government-backed lending specific questions, please reach out to:

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On behalf of the firm, we hope you, your employees, and your loved ones remain healthy and safe.

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