

CARES Act Signed into Law, Includes Paycheck Protection Program to Provide Critical Cash-Flow Assistance in Form of Forgivable SBA Loans to Small and Medium Sized Businesses

The Coronavirus Aid, Relief, and Economic Security Act, or the CARES Act, includes a **“Paycheck Protection Program”** that authorizes up to \$349 billion of federally guaranteed SBA loans to qualifying small and medium sized businesses. The program provides 100% federally guaranteed loans to employers who maintain their payroll during this emergency. The loans can be up to \$10 million per business and can be forgiven if the business maintains its payroll through June 30, 2020. **Loans under the program are available through June 30, 2020.**

The following is an overview of the key features of the Paycheck Protection Program included in the CARES Act. We anticipate that the U.S. Department of Treasury (the “Treasury”) and the U.S. Small Business Administration (“SBA”) will release additional guidance in the coming weeks that will provide further detail on the program which may change or modify the information summarized below.

Paycheck Protection Program will be Administered by the SBA

The Paycheck Protection Program (hereinafter “Program”) is a modification of the SBA’s existing 7(a) loan program under which the SBA partially guarantees loans made by banks to qualifying small businesses. The Program modifies the 7(a) loan program in the following ways:

1. It expands the businesses that are eligible for loans;
2. It relaxes the borrowing requirements, by eliminating personal guarantees and collateral requirements;
3. It allows all or a portion of the loan to be forgiven if the borrower maintains its payroll; and

4. It modifies certain provisions to incentivize banks to make such loans and to speed up the loan process.

Eligible Businesses

Businesses and entities must have been in operation on February 15, 2020. Generally, business concerns and 501(c)(3) non-profits that employ not more than (i) 500 employees, or (ii) the applicable size standard for the industry as provided by the SBA, if higher, are eligible for Program loans. In addition, sole proprietors, independent contractors, and other self-employed individuals are also eligible for loans. "Employees" include all persons employed on a full-time, part-time or other basis.

To prevent large businesses from qualifying, there are affiliation rules to determine whether a business's affiliations preclude them from being considered "small." However, the 500 employees limit is waived under the CARES Act for accommodation and food service businesses so long as they do not have 500 or more employees in any one physical location.

Paycheck Protection Program (PPP) Loans Terms

1. **Loan Size** – Eligible small businesses can generally borrow up to 2.5 times their monthly payroll costs, measured over the prior twelve months, or \$10 million, whichever is smaller. There are some alternate ways to calculate the maximum loan amount for seasonal businesses and businesses that were not in operation for the prior twelve-month period.
2. **Payroll Costs** – Defined broadly to include salary, wage, commission, or similar compensation. It includes certain employee benefits (including group health care and retirement benefits), state and local taxes and certain types of compensation to sole proprietors or independent contractors up to \$100,000. In addition, payroll costs specifically exclude the compensation for any individual employee in excess of \$100,000 annually, compensation of foreign employees, FICA and income tax

withholdings, and certain qualified sick and family leave for which a separate tax credit is allowed under the *Families First Coronavirus Response Act*.

3. Use of Loan Proceeds – Loan proceeds may be used to pay the following:

- Payroll costs (as defined above)
- Costs related to continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums
- Employee salaries, commissions, or similar compensations (see exclusions above)
- Payments of interest on any mortgage obligation (which shall not include any prepayment of or payment of principal on a mortgage obligation)
- Rent
- Utilities
- Interest on any other debt obligations that were incurred before the covered period

4. Collateral – PPP loans do not require collateral from either the business or its owners.

5. Guarantee – PPP loans do not require personal guarantees from owners.

6. Interest Rate – Interest rate on PPP loans shall not exceed 4%.

7. Deferment – PPP loans allow automatic deferments of principal and interest payments for at least six months and not more than one year for all borrowers.

8. Prepayment – PPP loans can be paid off early without any prepayment penalty

9. Coordination with SBA Disaster Loans – After PPP loans are made available, business will not be able to obtain both SBA Disaster Loan and a PPP loan for the same purpose.

10. One loan limit – An entity is limited to one PPP loan as each loan is registered under the applicable taxpayer identification number with the SBA.

Loan Forgiveness

PPP loans are eligible for loan forgiveness for businesses that maintain their payroll during the eight-week period after the origination date of the loan. The loan forgiveness is equal to the amount spent by the business during this eight-week period on the following:

- Payroll costs (as defined above),
- Interest payments on any mortgage obligation incurred prior to February 15, 2020,
- Rent payments on any lease in force prior to February 15, 2020, and
- Utility payments for which service began before February 15, 2020

The loan forgiveness is proportionally reduced by any reduction in the number of employees during the covered period as compared to certain prior periods. The loan forgiveness can be subject to a further reduction equal to the reduction in pay of certain employees in excess of 25%.

There are also provisions to encourage employers to rehire any workers who may already have been laid off due to the COVID-19 crisis without being penalized for having a reduced payroll at the start of the covered period.

Borrowers requesting loan forgiveness are required to submit an application along with supporting documentation through the lender bank. Any loan amounts not forgiven are carried forward as an ongoing loan with a maximum loan term of 10 years.

While loan amounts forgiven are considered cancellation of indebtedness, the CARES Act provides an exclusion of the forgiven amount from gross income (i.e., the forgiven amount is non-taxable).

Incentives for Lending Banks to Speed Up Processing of PPP Loans

To incentivize banks to make PPP loans and to speed up the lending process, the CARES Act makes several enhancements to this SBA loan program. First, the SBA guaranty on such loans is increased to 100% for the remainder of 2020. Second, the Act significantly modifies the procedural requirements for lending banks to have their loans guaranteed by the SBA.

Further, the Act provides authority for new lenders to be approved by Treasury and contains other provisions such as fee waivers, limits on lender liabilities for ineligible borrowers, facilitation of loans sales to secondary markets, and requires the SBA to pay certain processing fees to lenders.

Summary

The Paycheck Protection Program will provide substantial relief to many small and medium-sized businesses. It provides much needed cash flow assistance in the form of federally guaranteed loans to allow employers to maintain their workforce during this crisis. The ability to receive loan forgiveness up to the amount of the loan that is used to make payroll and other eligible outlays can be a decisive factor, and one that will enable many businesses to retain (and perhaps re-hire) workers during this emergency. Additionally, the program is greatly enhanced by its exclusion of loan forgiveness income from taxable income.

Disclaimer - The above information was developed using guidance issued through March 27, 2020. As additional guidance is issued with respect to the Paycheck Protection Program, we will continue to provide updated guidance accordingly.