CARES Act: Loan Assistance for Small Businesses

By Nicoleas Mayne
May 7, 2020

The Coronavirus Aid, Relief, and Economic Security (CARES) Act includes a number of loan access, deferment, and forgiveness provisions of interest to small businesses (which, for purposes of the Act, generally includes businesses and some nonprofits with fewer than 500 employees). In addition to loan assistance, the Act includes a number of potential tax cuts and credits, all with the goal of preventing small businesses from going out of business due to economic losses caused by the COVID-19 pandemic, and helping protect small-business employees from losing their jobs.

The Act has potential to serve as a lifeline for small-business owners, managers, and employees who are sorting through the pros and cons of various stimulus loan programs and unemployment benefit changes, and making decisions about how to navigate the next few months in a way that best serve the interests of owners, managers, and employees alike. Below are some answers to frequently asked questions about the loan programs established by the Act, which directly impact small businesses.

Since the Act was passed, on March 27, 2020, the Small Business Administration (the "SBA") and the Department of the Treasury have issued additional guidance impacting the terms of small business loan programs such as the Paycheck Protection Program ("PPP") established by Title I of the Act. Additional guidance includes:

- Paycheck Protection Program Loans FAQ (Frequently Updated)
- First Interim Final Rule (April 2, 2020)
- Applicable Affiliation Rules Fact Sheet (April 3, 2020)
- Second Interim Final Rule (April 4, 2020)
- Third Interim Final Rule (April 14, 2020) – Additional Eligibility Criteria and Requirements for Certain Pledges of Loans
- Fourth Interim Final Rule (April 24, 2020) – Promissory Notes, Authorizations, Affiliation, and Eligibility
- How to Calculate Maximum Loans (April 24, 2020)
- Fifth Interim Final Rule (April 27, 2020) – Additional Criterion for Seasonal Employers
- Sixth Interim Final Rule (April 28, 2020) - Disbursements

What types of small-business loans are available?

Under the Act, the PPP initially provided nearly $350 billion of funds to the SBA, to provide loans and loan forgiveness through the SBA's Section 7(a) business loan program.

Those funds were swiftly used up, and Congress approved an additional $310 billion in Paycheck Protection Program loan funds on April 24. The SBA began processing second round applications on April 27.

Disclaimer: This article is not legal advice. It is provided solely for informational and educational purposes and does not fully address the complexity of the issues or steps business must take under applicable laws.

The 7(a) loan program is one of the SBA's primary programs for providing financial assistance to small-business concerns. In addition to providing program funding to help employers maintain payroll levels, Paycheck Protection Program loans are 100 percent guaranteed by the federal government through December 31, 2020—meaning that there is more incentive than usual for lenders to approve applications.

The Act also allotted $10 billion to the SBA's existing economic injury disaster loan ("EIDL") program, under which certain business concerns located in an area affected by a disaster (currently, all U.S. states and territories) may qualify for loan assistance. This too, was replenished, with an additional $50 billion in funding on April 27. Under the Act, the EIDL program is open to businesses that have suffered substantial economic injury due to a pandemic for the first time. While the full EIDL program is not covered in detail here, key amendments include:

- providing emergency cash grant advances of $1,000 per employee up to a maximum of $10,000 for a small business to spend on qualifying expenses (including payroll and rent);
- allowing the SBA to approve an EIDL loan solely based on an applicant's credit score; and
- allowing the SBA to approve an EIDL loan under $200,000 without a personal guaranty.

Who may borrow?

Paycheck Protection Program loans are open to businesses, 501(c)(3) and 501(c)(19) nonprofits, , tribal businesses, and even sole proprietors, independent contractors, and self-employed individuals. To be eligible, a business must have been in operation as of February 15, 2020, and must: i) not employ more than 500 employees (unless the SBA has established a greater size standard for the industry, ii) qualify as a small business concern under 15 U.S.C. 632, or iii) meet the alternative size standard of a maximum tangible net worth of $15 million or less and average net income for the two full fiscal years before application of $5 million or less.

Generally, the 500-employee limit includes all affiliate businesses. For businesses in the dining and hospitality industries, franchises, and small-business investment companies (defined in the Small Business Investment Act of 1958), the 500-employee limit is per location. As explained in more detail below, the borrower must also either have employees for which the employer paid salaries and payroll taxes, or have paid independent contractors on Form 1099-MISC (in the case of independent contractors or sole proprietors).

A Paycheck Protection Program borrower must also certify that:

- the loan is necessary to support ongoing operations due to the uncertainty of current economic conditions;
- loan funds will be used only to retain workers and maintain payroll, or make mortgage/lease and utility payments; and
- the borrower (1) does not have a pending Section 7(a) loan application for the same purpose and (2) has not received a Section 7(a) loan between February 15, 2020, and December 31, 2020, for the same purpose.

If the certifications above are provided, the lender does not need to require collateral or personal guaranties. Additionally, the requirement that the borrower not be able to obtain financing from alternative sources without causing undue hardship (the "credit elsewhere" test) is waived for Paycheck Protection Program loans.

Additional guidance published April 23, 2020 clarifies that while the normal “credit-elsewhere” test for 7(a) loans is waived for PPP loans, borrowers do need to make the certification that current economic uncertainty makes the loan request necessary, taking into account current business activity and their ability to access other sources of liquidity. At minimum, public companies with substantial market value and access to capital markets are likely excluded from the program, however, private companies with sufficient liquidity (or businesses owned by private companies with sufficient liquidity) may also be unable to make the certification. In light of this issue, the SBA has allowed borrowers who applied for a loan prior to April 23, 2020 to repay in full by May 14, 2020 without penalty.

Can a business receive a Paycheck Protection Program loan and an EIDL loan?

Yes, as long as the funds are used for different purposes. In addition, a business that receives an EIDL loan can refinance that loan into a Paycheck Protection Program loan.

If a business receives a portion of the EIDL loan as a grant, that amount will be subtracted from any potential forgiveness under the Paycheck Protection Program loan.

How big are the loans?

A loan is capped at the lesser of $10 million or 2.5 times average total monthly payroll costs. So if average monthly payroll for 2019 was $10,000, a business could receive a loan of up to $25,000.

Payroll costs include:

- salary, wages, commissions, or tips (capped at $100,000 annually for each employee);
- employee benefits, including costs for vacation, parental, family, medical, and sick leave; allowance for separation or dismissal; payments required for the provision of group health care benefits, including insurance premiums; and payment of any retirement benefit;
- state and local taxes assessed on compensation; and
- for a sole proprietor or independent contractor: wages, commissions, income, or net earnings from self-employment, capped at $100,000 annually for each employee.

How may the funds be used?

Permitted uses of PPP loan funds include payroll costs (see above), mortgage, rent, utility payments, and interest on certain other debt obligations which were entered into before February 15, 2020.

What portion of the loans may be forgiven?

If funds are used for a permitted use, all amounts used in the first eight weeks after receiving a loan are eligible to be forgiven, provided that at least 75% of funds are spent on payroll costs and subject to reduction if the borrower reduces full time employee count or the salaries of individuals making less than $100,000 annualized Businesses who laid off full time employees or reduced salaries prior to April 26 can avoid a reduction in forgiveness by rehiring those workers or reinstating pay by June 30.

Any amount forgiven will be excluded from federal taxable gross income. In some circumstances, money received by a business that doesn’t need to be paid back would count as income, but under the PPP, this isn’t the case. The IRS, however, has clarified that to avoid a double tax benefit, expenditures of PPP loan funds will not be tax deductible. At this writing, several members of Congress have pledged to reverse that holding with additional legislation.

What are the loan terms?

PPP loans are due two years from the date of disbursement and have a fixed interest rate of 1 percent. There are no prepayment penalties or fees.

How do small businesses borrow?

PPP loans are administered by local lenders—many of which are requiring prospective borrowers to have an existing core banking relationship. A list of eligible PPP lenders is available at: https://www.sba.gov/paycheckprotection/find.

EIDL loans are available through the SBA directly at https://covid19relief.sba.gov.

What are the benefits to existing SBA loan borrowers?

The Act also provides up to $17 billion for relief to current Section 7(a) borrowers. The SBA will pay the principal, interest, and fees owed on existing 7(a) loans in a regular servicing status for a six-month period, starting on the next payment due date. Loans already in deferment are eligible for a six-month payment subsidy starting on the first payment due after deferment.

What other benefits does the Act provide for small businesses?

A number of other provisions of the Act may benefit small businesses; many of these provisions are contained in Title II of the Act. But receiving a Paycheck Protection Program loan may disqualify a small business from receiving certain benefits.

For example, the Act provides for an "Employee Retention Tax Credit," which is a refundable tax credit against payroll tax liability. The credit is equal to 50 percent of the first $10,000 in wages per employee, including the value of health plan benefits, and is effective for wages paid after March 12, 2020, and before January 1, 2021. This credit is generally available to employers of all sizes that have had operations fully or partially suspended as a result of government orders limiting gatherings, travel, or commerce, or that experience a year-over year reduction in gross receipts of at least 50 percent. If an employer has more than 100 full-time employees, only wages of those employees who aren't providing services due to a COVID-19-related suspension of operations are eligible to be counted toward the credit. The Employee Retention Tax Credit is not available, however, to employers that receive Paycheck Protection Program loans.

Additionally, employer payroll taxes on wages paid during 2020 can be deferred and paid over the next two years (50 percent each on December 31 of 2021 and 2022). This deferral is not available, however, to PPP loan borrowers after application for and approval of loan forgiveness.

Some tax benefits in the Act will be available to small businesses that do receive Paycheck Protection Program loans. For example, certain changes have been made to the Tax Cuts and Jobs Act to allow companies to utilize greater losses and claim refunds for specific losses, including allowing companies to carry back net operating losses in the 2018-2020 tax years for up to five years, suspending limitations on the use of pass-through business

---

Disclaimer: This article is not legal advice. It is provided solely for informational and educational purposes and does not fully address the complexity of the issues or steps business must take under applicable laws.

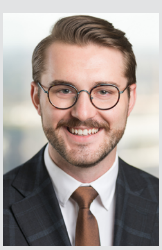
losses against nonbusiness income for three years, and suspending the 80 percent taxable income limit on net operating loss carryovers for three years. Formerly repealed corporate alternative minimum tax credits will be allowed as refundable credits until 2021, and the refund timeline has been accelerated. In addition, the limitation on interest deductions under the Tax Cuts and Jobs Act is increased to a 50 percent adjusted taxable income threshold for the 2019 and 2020 tax years (more on that here).

Where can more information be found?

Check the U.S. Department of the Treasury website and SBA's COVID-19 resource page for updates as additional details become available, in addition to the frequently updated FAQ for Lenders and Borrowers.

For more information about ongoing developments related to COVID-19, visit Miller Nash Graham & Dunn's resource library.

Disclaimer: This article is not legal advice. It is provided solely for informational and educational purposes and does not fully address the complexity of the issues or steps business must take under applicable laws.



Nicoleas Mayne focuses on reviewing, drafting, and negotiating a wide variety of contracts, including service agreements, sponsorship and endorsement agreements, distribution agreements, asset purchase and sale agreements, IP licenses and assignments, and early-stage agreements for corporations, limited liability companies, partnerships, and joint ventures. Nic also works with business owners and executives on choice-of-entity and formation agreements, and assists established clients throughout the M&A process with merger, employment, nondisclosure, and other related agreements.

Direct: 503.205.2336 | **Email:** nic.mayne@millernash.com