

COVID-19: SENATE INCLUDES SBA "PAYROLL PROTECTION PACKAGE" LOAN RELIEF TO SMALL BUSINESSES IN CARES ACT

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On March 25, 2020, the U.S. Senate unanimously approved another major piece of legislation to address the economic and medical concerns arising from the coronavirus; the Coronavirus Aid, Relief, and Economic Security Act, or "CARES Act." This alert summarizes the provisions of the CARES Act that amend the Small Business Act ("SBA") to provide loan support to small businesses and other eligible recipients as they fight the potential consequences of the pandemic. The House of Representatives is scheduled to consider and likely vote on the CARES Act on Friday, March 27.

The CARES Act amends the SBA to add a "Paycheck Protection Program" under which a special class of business concerns may qualify for forgivable SBA loans. The total amount of loans to be supported by the SBA during the "covered period" of February 15 to June 30, 2020, including the loans for the Paycheck Protection Program, will be \$349 billion.

ELIGIBLE BORROWERS

Eligible borrowers during the covered period will include "small business concerns" as already defined in the SBA, and any business concern, nonprofit organization, veterans organization, and certain Tribal business concerns, that employ no more than 500 employees or, if applicable, any higher number of employees established by the Small Business Administration for the industry of the business in question. Under the SBA prior to and after the CARES Act, a small-business concern includes enterprises that are engaged in the business of production of food and fiber, ranching and raising of livestock, aquaculture, and all other farming and agricultural related industries, as well as businesses that are independently owned and operated and which are not dominant in their field of operation.

In addition, individuals who operate under a sole proprietorship or as an independent contractor and certain self-employed individuals also would be eligible to receive a covered loan. Businesses in the accommodations and food services sector with no more than 500 employees per physical location of the business concern also may be eligible to receive a covered loan.

For purposes of the 500-employee limitation, the term "employee" includes individuals employed on a full-time, part-time, or other basis.

An eligible recipient applying for a loan must make a good-faith certification:

- that the uncertainty of current economic conditions makes the loan necessary to support the business's ongoing operations;
- acknowledging that the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- that the eligible recipient does not have an application pending or a loan under subsection 7(a)(2) of the SBA for the same purpose and duplicative of amounts applied for or received under a covered loan; and
- during the period beginning on February 15, 2020 and ending on December 31, 2020, that the eligible recipient has not received amounts under SBA subsection 7(a)(2) for the same purpose and duplicative of amounts applied for or received under a covered loan.

LOAN TERMS

The maximum loan amount under the CARES Act will be \$10 million. More precisely, it will be the lesser of \$10 million or an amount equal to the sum of (1) a multiple of the business's monthly "payroll costs" and (2) the outstanding amount of any loan that was made under SBA Section 7(b)(2) relating to areas affected by disasters during the period beginning on January 31, 2020 and ending on the date on which covered loans are made available to be refinanced. In terms of the payroll costs multiple, an eligible recipient of a covered loan can choose to use the average total monthly payments of the one-year period before the covered loan is made (or a special rule for seasonal employers) or the average total monthly payments during the period beginning on January 1, 2020 and ending on February 29, 2020.

While the definition of "payroll costs" broadly includes such expenses as payments made to employees for vacation or family leave and payments for certain group health care benefits, it does not include the compensation of an individual employee in excess of an annual salary of \$100,000.

During the covered period, a covered loan will bear interest at a rate not to exceed 4 percent.

During the covered period, no collateral would be required for the loans made under the CARES Act, and no personal guaranties would be required. However, the Small Business Administrator could have recourse against any individual shareholder, member or partner of an eligible recipient of a covered loan for nonpayment of that loan if that individual uses the covered loan proceeds for a purpose other than an allowable use (see below).

Contrary to the standard SBA rule, the requirement that a small business concern must be unable to obtain credit elsewhere in order to receive an SBA loan will not apply to a covered loan.

ALLOWABLE USES OF COVERED LOANS

Covered loan proceeds may be used for payroll costs; costs related to the continuation of group health care benefits of paid sick, medical, or family leave, and insurance premiums; employee salaries, commissions, or similar compensations; payment of interest on any mortgage obligation (but not including prepayment of or payment of principal on the mortgage obligation); rent and utilities payments; and interest on any other debt obligation that was incurred before the covered period.

Lenders that are approved to make these loans are deemed to have the delegated authority to make and approve covered loans. In evaluating the eligibility of a borrower for a covered loan, the lender must consider whether the

borrower (1) was in operation on February 15, 2020 and (2) had employees for whom the borrower paid salaries and payroll taxes, or paid independent contractors as reported on a Form 1099-MISC.

REFINANCING OF DISASTER LOANS

Any loan made under SBA Section 7(b)(2) during the period beginning on January 31, 2020 and ending on the date on which covered loans are made available (a "Qualifying SBA Disaster Loan") may be refinanced as part of a covered loan.^[1] However, the amount of the Qualifying SBA Disaster Loan is added into the calculation for determining the maximum amount of the loan under the new Paycheck Protection Program.

LOAN DEFERMENT

The CARES Act requires lenders participating in the Paycheck Protection Program to provide "complete payment deferment relief for impacted borrowers with covered loans" for at least six months and up to one year, including for payment of principal, interest and all fees. An "impacted borrower" is an eligible recipient that is in operation on February 15, 2020 and has an application that is approved or pending on or after the date of enactment of this law, and an impacted borrower is presumed to have been adversely affected by COVID-19.

LOAN FORGIVENESS

Eligible recipients of covered loans will be eligible for forgiveness of indebtedness on a covered loan in an amount equal to: (1) the sum of the costs incurred and payments made during the covered period for payroll costs, (2) any payment of *interest* on any covered mortgage obligation, (3) any payment on any covered rent obligation, and (4) any covered utility payment.

Within 90 days after the date on which the amount of the forgiveness is determined, the Small Business Administrator is required to remit to the lender an amount equal to the forgiveness, plus any interest accrued through the date of payment.

The amounts that are forgiven will be considered canceled indebtedness by a lender authorized under section 7(a) of the SBA. However, the forgiven debt would not be includible in gross income (as cancellation of indebtedness income) for purposes of the Internal Revenue Code.

There are, however, limits to the loan forgiveness. As noted above, the definition of "payroll costs" does not include the compensation of an individual employee in excess of an annual salary of \$100,000, so loan amounts spent to compensate higher paid employees apparently could not be forgiven.

The amount of the loan forgiveness also may not exceed the principal amount of the financing. However, the principal amount of the loan would be forgiven by the SBA lender, who then would be reimbursed by the Small Business Administration for the amount of principal forgiven plus any interest accrued through the date of payment. It is unclear how this will work in practice, but one possibility is that the lender would be reimbursed by the SBA for principal and interest, but the borrower would remain liable to the SBA for the interest. In addition, if a covered loan has a remaining balance after reduction based on the loan forgiveness amount, the remaining balance would continue to be guaranteed by the Small Business Administration and the loan then would have a maximum maturity of 10 years from the date the borrower applied for loan forgiveness.

The amount of the loan forgiveness would also be reduced based on a formula that accounts for any reduction in the number of the borrower's full-time equivalent employees during the covered period, as well as a formula that

accounts for reductions in the total salary or wages of any lower paid employee. With respect to the latter point, loan forgiveness would be reduced by the amount of any reduction in total salary or wages of any employee during the covered period in excess of 25 percent of the employee's salary or wages during the most recent full quarter before the covered period, if that employee did not receive an annualized rate of pay of more than \$100,000 in any pay period in 2019.

However, there are important exceptions to this loan forgiveness reduction formula when the eligible recipient re-hires employees or eliminates reductions in salaries by June 30, 2020. The exceptions depend on the eligible recipient's activities during the period beginning on February 15, 2020 and ending on the date that is 30 days after the enactment of the CARES Act (the "Crisis Period") and the eligible recipient's activities between February 15 and June 30, 2020 (the "Stabilization Period").

If the eligible recipient (1) reduces the number of its full-time equivalent employees during the Crisis Period as compared to the number of such employees on February 15, 2020, or the eligible recipient reduces the salary or wages of one or more of its employees during the Crisis Period as compared to such employee's salary on February 15, 2020, but (2) during the Stabilization Period, re-hires the employee or eliminates the reduction in salary, then the prior reductions in the number of employees or their salary are disregarded for purposes of loan forgiveness. In other words, an employer who might have found it necessary or prudent to cut staff or salaries before the enactment of the CARES Act can reverse those actions by June 30, 2020 and still take advantage of loan forgiveness.

OTHER LENDER REIMBURSEMENTS

Under the CARES Act, the Small Business Administrator would reimburse a lender authorized to make covered loans at a rate based on the balance of the financing outstanding at the time of disbursement of each covered loan. This rate will range from 5 percent for loans of not more than \$350,000 to 1 percent for loans of \$2,000,000 or more. This reimbursement would be made within five days after the disbursement of the covered loan.

REGULATORY CAPITAL REQUIREMENTS

The Federal banking agencies and the National Credit Union Administration are directed by the CARES Act to provide a risk weight of zero percent to each covered loan for purposes of capital requirements. This should encourage banking institutions, including credit unions, to make covered loans.

Notes:

[1] The Section 7(b)(2) loans are, in general, loans made to qualifying borrowers that suffered a substantial economic injury as a result of specified disasters. These are sometimes referred to as "economic injury disaster loans."

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