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NEWS ALERT

TAX AND BUSINESS GROUPS

CARES Act – Understanding the Requirements and Benefits of the Obtaining Paycheck Protection Program Loans

By Marc T. Finer | March 31, 2020

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") into law. The CARES Act includes a new small business loan program under which the Small Business Administration ("SBA") and its network of lending financial institutions may provide 100% federally-backed loans up to an aggregate amount of $349 billion to eligible businesses to help pay their operational costs like payroll, rent, health benefits, insurance premiums, and utilities for up to 8 weeks.

The loan program – called the Paycheck Protection Program – covers loans granted under the program during the period from February 15, 2020 through June 30, 2020 (the "Covered Period").

Businesses that are eligible to participate in the Paycheck Protection Program include:

- Businesses with up to 500 employees or which meets the applicable size standard for the industry as provided by current SBA regulations.
- Businesses in the food service or accommodation industry with more than one location but no more than 500 employees at each location.
- Certain nonprofits (Section 501(c)(3) and 501(c)(19) tax-exempt organizations)
- Certain eligible independent contractors, self-employed individuals and sole proprietors.

The features of the loans made under the Paycheck Protection Program include:

> Subject to certain conditions described below, the principal amount of the loan is forgivable.

> No collateral or personal guarantee is permitted to be required for a loan during the Covered Period. Additionally, there is no recourse against any individual, shareholder, member, or partner of an eligible loan recipient for non-payment, unless the individual uses the loan proceeds for unauthorized purposes.

Note: Because the prohibition on collateral or a personal guarantee only applies for the "Covered Period", it could be interpreted to allow lenders to require collateral and/or a personal guarantee to spring into effect upon the loan continuing to remain outstanding (or not completely forgiven) after June 30, 2020 absent terms in the loan documents to the contrary.

> Interest on the loan may not exceed 4%

> No prepayment penalty

> Maximum loan amount (capped at $10MM) is 2.5 times the borrower's average total monthly payroll costs incurred in the 12-month period before the date the loan originates. This payroll calculation does not include:

- Any compensation of an individual employee in excess of an annual salary of $100,000, as prorated for the Covered Period; or

- Any qualified sick or family leave wages for which a tax credit is allowed under the Families First Coronavirus Response Act.

> Loan proceeds may be used to pay the following expenses:

- Payroll Costs: Includes
  - Includes compensation to employees, such as salary, wages, commissions, cash, etc.
  - Paid leave (other than qualified sick or family leave wages for which a tax credit is allowed under the Families First Coronavirus Response Act)
  - Severance payments
  - Payments for group health benefits, including insurance premiums
  - Payments for retirement benefits
  - Payments of state and local taxes assessed on compensation of employees
  - Compensation to sole proprietorships or independent contractors (including commission based compensation) up to $100,000 in 1 year, prorated for the period February 15, 2020 through June 30, 2020

"Payroll costs" do not include: (1) the compensation of an individual employee in excess of an annual salary of over $100,000, prorated for the Covered Period; (2) FICA, Railroad Retirement and payroll taxes; (3) compensation of employees whose principal place of residence is outside of the United States; and (4) qualified sick and family leave for which a credit is allowed under the Families First Coronavirus Response Act.

- Group health care benefits during periods of paid sick, medical or family leave, and insurance premiums
- Salaries, commissions, or similar compensations
- Mortgage interest
- Rent/lease agreement payments
- Utilities
- Interest on any other debt incurred prior to February 15, 2020

> All loan payments (principal, interest and fees) are deferred for at least six months, and up to one year.

> <u>Loan Forgiveness Rules</u>

The principal amount of the loan is eligible for loan forgiveness up to an amount equal to the total costs incurred or paid for the following expenses during the 8-week period starting with the loan origination date (the "Covered Forgiveness Period"):

- Payroll costs;
- Interest payments on mortgages on real or personal property incurred prior to February 15, 2020 ("covered mortgages");
- Rent obligations on a lease agreement in force before February 15, 2020; and
- Utility payments (electricity, gas, water, transportation, telephone or internet access) for which service began before February 15, 2020.

<u>NOTE</u>: Loan amounts used to satisfy interest on pre-February 15, 2020 debt obligations that are not covered mortgages are not eligible for forgiveness.

The loan forgiveness amount is excluded from taxable income.

The amount of loan forgiveness will be reduced for (1) any employee cuts or (2) reductions in salary/wages.

Reduction in Loan Forgiveness Amount for Fewer Full-Time Employees

The reduction in the amount of loan forgiveness resulting from the termination of employees is calculated as follows:

(A) The maximum available loan forgiveness amount (limited to loan principal)

multiplied by a percentage obtained by dividing

(B) The borrower's average number of full-time employees ("FTEs") per month (calculated by the average number of FTEs for each pay period falling within a month) during the Covered Forgiveness Period

By

At the election of the borrower

a. The average number of FTEs per month employed from February 15, 2019 to June 30, 2019, or

b. The average number of FTEs per month employed from January 1, 2020 until February 29, 2020

Reduction in Loan Forgiveness Amount for Reduction in Salaries/Wages

For reductions in salaries/wages, the loan forgiveness amount is reduced dollar-for-dollar by the amount of any reduction in total salary/wages of any employee during the Covered Forgiveness Period that is in excess of 25% of the employee's salary/wages during the employee's most recent full quarter of employment before the Covered Forgiveness Period. "Employee" is limited to any employee who did not receive during any single pay period during 2019 a salary or wages at an annualized rate of pay over $100,000.

Relief from Loan Forgiveness Reduction Penalties

Relief from the debt forgiveness reduction penalties is available for employers who rehire employees or make up for salary/wage reductions by June 30, 2020. Specifically, reductions will be determined without regard to otherwise applicable reductions in workforce or salaries/wages if the reductions occurred between February 15, 2020 and 30 days following the enactment of the CARES Act (April 26, 2020) if:

- <u>Workforce Reductions</u>: the borrower reduces the number of FTEs between February 15, 2020 and April 26, 2020, as compared to February 15, 2020, and not later than June 30, 2020, the borrower has eliminated the reduction in FTEs, or
- <u>Salary/Wage Reductions</u>: there is a salary/wage reduction between February 15, 2020 and April 26, 2020, as compared to February 15, 2020, for one or more employees and that reduction is eliminated by June 30, 2020 (it is unclear whether this intended to be limited to employees who made $100,000 or less during 2019).

Any loan amount remaining after debt forgiveness is applied is carried forward, with a maximum maturity of 10 years from the date of the loan forgiveness application and a maximum interest rate of 4% with the option to defer payments of interest and principal for no more than 1 year.

> Banks and commercial lenders that currently have SBA authorization to originate loans will administer loans under this program. The Paycheck Protection Program waives the normal loan requirement that the borrower is unable to obtain credit elsewhere and the SBA pays processing costs for the loan.

> To be eligible for a loan under the Paycheck Protection Program, a borrower must provide a good faith certification:

(i) that the uncertainty of current economic conditions makes the loan request necessary to support its ongoing operations;

(ii) acknowledging that funds will be used to retain workers and maintain payroll or mortgage payments, lease payments and utility payments;

(iii) that the borrower does not have an application pending for a Paycheck Protection Loan for the same purpose and duplicative of amounts applied for or received under the covered loan;

(iv) during the period beginning on February 15, 2020 and ending on December 31, 2020, that the eligible recipient has not received a loan pursuant to the Paycheck Protection Program for the same purpose and duplicative of amounts applied for or received under the covered loan.

The SBA is required to issue regulations on many of the provisions of the Paycheck Protection Program within 15 days of enactment of the CARES Act. At the outset, the existing network of approved SBA lenders will administer the program, although the SBA is expected to expand its list of lenders over time. Lenders could begin taking loan applications as soon as mid-April. The specific documentation required is not yet available, but businesses planning to apply should begin assembling at least the following material.

- documentation verifying the number of FTEs on payroll and pay rates for the applicable periods, including payroll tax filings; and state income, payroll, and unemployment insurance filings; and
- documentation verifying payments on mortgage or lease obligations and utilities.

If you have any questions regarding the Paycheck Protection Program or how it might affect your business, please contact:

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