WEBCAST –
SBA Loans and Other Financial Lessons for Law Firms – What You Need to Know Now

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The CARES Act: Relief for Small and Mid-Sized Businesses

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On Friday, March 27, 2020, Congress passed and President Trump signed into law the Coronavirus Aid, Relief and Economic Security Act ("CARES Act"), which contains several important tax and financing provisions designed to provide relief to small and mid-sized businesses (and larger businesses in certain sectors). This alert summarizes several of the main programs the CARES Act makes available to small and middle market businesses.

Paycheck Protection Program

The Paycheck Protection Program ("PPP") is an expansion of the Small Business Administration's ("SBA") existing loan program under Section 7(a) of the Small Business Act, with more generous eligibility criteria and loan amounts, and a very attractive forgiveness feature designed to encourage businesses to keep their workers employed.

Eligibility

The PPP is generally available to business concerns with no more than 500 employees. The traditional revenue limits under Section 7(a) do not apply to the PPP, nor do the collateral and personal guarantee requirements. In addition, business concerns are not required to show that they are unable to obtain credit for other sources.

Maximum Loan Amount

Eligible applicants in business since February 15, 2019, may obtain loans up to a maximum loan amount that is the lesser of:

(a) the sum of

(i) the product of (x) average total monthly payroll costs in the one-year period prior to the loan and (y) 2.5 and

(ii) the outstanding amount of an SBA economic injury disaster loan that was made during the period beginning on January 31, 2020, and ending on the date on which covered loans are made available to be refinanced under the PPP, or

(b) $10,000,000.

The term "payroll costs" as used above is defined as including:

- Payments of any compensation with respect to employees that is:
  - Salary, wage, commission or similar compensation, up to a prorated portion of $100,000 per year per employee
  - Payment for vacation, parental, family, medical or sick leave (but not amounts for which credits are allowed under the Families First Coronavirus Response Act)
  - Allowance for dismissal or separation
  - Payment required for the provision of group health benefits, including insurance premiums
  - Payment of any retirement benefit
  - Payment of state or local tax assessed on the compensation of employees

- Payments of any compensation to sole proprietors or independent contractors up to $100,000 per year (prorated)

It is important to note that the term “payroll costs” does not include compensation to employees or independent contractors in excess of $100,000 per year (prorated). The definition also excludes employer- and employee-side Social Security and Medicare taxes, as well as federal income tax withholding. Finally, this definition excludes compensation to employees whose principal residence is outside of the United States.

Application Process and Loan Terms

Business concerns wishing to apply for the PPP should do so through banks and other institutional lenders qualified under the Small Business Act. As part of the loan application process, borrowers must certify to the following:

- The uncertainty of current economic conditions makes necessary the loan request to support ongoing operations;
- The funds will be used to retain workers and maintain payroll, mortgage, rent or utility payments;
- The borrower does not already have a pending application under Section 7(a) that would be duplicative of amounts received under the PPP; and
- During the period beginning on February 15, 2020 and ending on December 31, 2020, the borrower has not received amounts under Section 7(a) that would be duplicative of the funds received under the PPP.

The interest rate of a PPP loan cannot exceed 4%, and SBA fees are waived by the CARES Act. Any balance remaining on a loan after forgiveness (described below) will be guaranteed by the SBA and will have a maturity date of not more than 10 years from the date the borrower applies for loan forgiveness.

Use of Funds

Businesses may use PPP funds for salaries and other payroll costs, insurance premiums and costs related to the continuation of group health care benefits during paid leave, mortgage payments, rent, utilities and interest on debt obligations, in each case incurred during the period from February 15, 2020, through June 30, 2020.

Loan Forgiveness

The PPP contains loan forgiveness provisions, under which the SBA will forgive loans made under the program by remitting the forgiven amount to the applicable lender.

The amount of loan forgiveness is based on amounts expended for payroll costs, interest on covered mortgage obligations, rent and utilities during the eight-week period following the origination of the loan, not to exceed the principal amount of the loan. The total of these costs is then reduced (but in no event increased) by multiplying such amount by the following:

(a) The average number of full-time equivalent employees per month during the eight-week period, divided by

(b) At the borrower's option, either (i) the average number of full-time equivalent employees during the period beginning on February 15, 2019, and ending on June 30, 2019, or (ii) the average number of full-time equivalent employees during the period beginning on January 1, 2020, and ending on February 29, 2020.

If the salary of any employee making less than $100,000 annually is reduced by more than 25% during the eight-week period, the amount of any such reduction must be further subtracted from the reduced loan forgiveness amount described above.

Businesses who furlough or reduce the salaries of their full-time equivalent employees between February 15, 2020, and April 26, 2020, will be permitted to ignore such reductions for purposes of the reduction calculation described above, provided that they eliminate the reduction in the number or salaries of such employees by June 30, 2020.

Importantly, the CARES Act provides that amounts forgiven under the PPP are not treated as "cancellation of debt" income, but are instead excluded from gross income for U.S. federal income tax purposes. New Jersey law already excludes "cancellation of debt" income from gross income for individuals and other non-corporate taxpayers, and generally follows federal tax rules with respect to corporations. Thus, a forgiven PPP loan will generally be tax-free income for New Jersey taxpayers.

Expansion of Economic Injury Disaster Loan Program

The CARES Act also expands the SBA's existing Economic Injury Disaster Loan ("EIDL") program. The EIDL program, which entails direct applications to the SBA rather than applying through banks, provides working capital loans of up to $2 million for certain businesses that are intended to assist through the disaster recovery period for economic injury suffered as a result of the disaster. The loans are for a maximum term of up to 30 years and have a fixed interest rate determined by a formula, with a maximum of 3.75% per year. The expanded program is applicable to each state and subdivision of the United States, whether or not a disaster declaration has been issued. Below are some of the changes to the EIDL program effectuated by the CARES Act:

Expansion of Eligible Entities and Waiver of Certain Requirements

Loans under the EIDL program are now available to:

a. Businesses with 500 or fewer employees;

b Individuals operating as sole proprietorships (with or without employees) or as independent contractors;

c. Cooperatives with 500 or fewer employees;

d. Employee stock option plans with 500 or fewer employees; and

e. Indian tribal small business concerns.

The CARES Act also waives certain requirements under the EIDL program, including:

a. Any rules related to personal guarantees on advances or loans of not more than $200,000;

b. The requirement that the applicant must have been in business for at least one year, which has been relaxed to now require that the applicant must have been in existence as of January 31, 2020; and

c The requirement that an applicant is unable to obtain credit elsewhere.

Relaxed Application Requirements and Emergency Advances

The authority of the SBA has been expanded to permit it to approve an application based solely on the credit score of the applicant and not require an applicant to submit a tax return. The SBA is also permitted to use alternative appropriate methods to determine an applicant's ability to repay.

In addition, the SBA can make emergency advances of up to $10,000 within 3 days after an application is received, based on self-certification from the applicant under penalty of perjury. Advances do not have to be repaid, even if the application for the loan is subsequently denied, subject to other limitations.

Choosing PPP vs. EIDL

A business can participate in both programs, but only under certain circumstances: (a) when the EIDL is received after January 31, 2020, but before the PPP is available, and the funds are used for a purpose other than those permitted under PPP; and (b) if the business receives an EIDL for a disaster other than COVID-19.

Businesses should carefully review their operating costs when choosing between the two programs. While funds under the PPP may be used for things other than payroll, the program is primarily intended for businesses to keep their workers employed, as the maximum loan amount available under PPP is directly tied to payroll costs. If a business's rent exceeds its payroll costs, for example, the EIDL program may be preferable to PPP, despite the PPP's loan forgiveness provisions. Another factor to consider is the repayment for each program: an EIDL is repayable over 30 years and has a slightly lower maximum interest rate, while the unforgiven portion of a loan under the PPP is repayable over 10 years.

Payroll Tax Deferral

The CARES Act also contains payroll tax deferral provisions, under which employers may defer employer-side Social Security taxes on wages paid between March 27, 2020, and December 31, 2020. These deferred taxes are now due in two installments: 50% on December 31, 2021, and the remaining 50% on December 31, 2022. Notably, this deferral is not available to taxpayers who receive loan forgiveness under the PPP.

Payroll Tax Credit

The payroll tax credit provision provides for a refundable payroll tax credit for 50 percent of wages paid by employers to employees during the COVID-19 crisis. The credit is available to employers whose (1) operations were fully or partially suspended due to a COVID-19-related shutdown order or (2) gross receipts declined by more than 50 percent when compared to the same quarter in the prior year. For employers with more than 100 full-time employees, qualified wages are wages paid to employees when they are not providing services due to the COVID-19-related circumstances described above. For employers with 100 or fewer full-time employees, all employee wages qualify for the credit, whether the employer is open for business or subject to a shutdown order, so long as the shutdown order is in effect or until gross receipts climb to more than 80 percent of what they were in the same quarter in the prior year. The credit is provided for the first $10,000 of compensation, including health benefits, paid to an eligible employee. The credit is provided for wages paid or incurred from March 13, 2020, through December 31, 2020. Similar to the payroll tax deferral, this payroll tax credit is not available to employers who participate in the PPP.

Relief for Larger Businesses

The CARES Act also contains relief for U.S.-based businesses with between 500 and 10,000 employees. The Act directs the U.S. Treasury Department to provide financing to banks and other lenders so that they can make loans at a maximum interest rate of two percent per annum, and with no principal or interest payable for the first six months. Loan applicants must certify that (1) the uncertainty of economic conditions necessitates financing to support their operations; (2) funds received will be used to retain 90 percent of the workforce at full compensation and benefit levels through September 30, 2020; and (3) they intend to restore not less than 90 percent of their workforce as it existed on February 1, 2020 and to restore all compensation and benefits to employees no later than four months after the end of the COVID-19 public health emergency. Applicants must also certify, among other things, that they will not outsource or offshore jobs for the term of the loan and two years following repayment, will not engage in stock buybacks or pay dividends during the term of the loan, will not abrogate collective bargaining rights for the term of the loan and two years following repayment, and will remain neutral in a union organizing effort for the term of the loan.

While the CARES Act does not contain many details regarding this program, there do not appear to be any industry limitations for this particular program. Unlike PPP loans, loans under this program may not be forgiven.

The CARES Act also authorizes additional lending programs under the Federal Reserve if such programs restrict stock buybacks and dividends and limit executive compensation, among other things.

Summary

As described above, the CARES Act contains multiple means of relief for businesses and self-employed individuals. If you have any questions about how these relief provisions, and other provisions under other federal or state programs, may apply to you or your business, please contact Jason Navarino, Rich Lomuscio, or any member of Riker Danzig's Corporate and Tax Departments.

Please visit Riker Danzig's COVID-19 Resource Center to stay up to date on all related legal issues.

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