

Business Practice Group

Karyn P. Forbes, Esq.
kforbes@shaheengordon.com

Sean T. O'Connell
soconnell@shaheengordon.com

The CARES Act Has Become Law: What Businesses Need to Know About the Act's Small Business Loans

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, which was enacted on March 27, 2020, includes extraordinary public health spending, immediate cash relief for some individuals, targeted relief for some industries, and – most importantly for small businesses – a Paycheck Protection Program.

The Paycheck Protection Program, among other things, expands the scope of the Small Business Administration's ("SBA") available 7(a) loans during a covered period beginning on February 15, 2020 and ending on June 30, 2020. Key elements of the Paycheck Protection Program are described below.

Paycheck Protection Program Overview

For loans under the Paycheck Protection Program during the covered period ("covered loans"), the SBA will guaranty 100 percent of the amount advanced by participating lenders to eligible borrowers. The interest rate on a covered loan will not exceed 4 percent. Lenders will not be permitted to require personal guarantees or collateral. The SBA will have no recourse against any individual shareholder, member, or partner of a borrower for nonpayment of a covered loan, unless the loan proceeds are not used for an allowed use.

Eligible borrowers. Eligible borrowers include any business concern, nonprofit organization, and certain other borrower types that employ 500 or fewer employees. Eligible borrowers will be required to have been in operation on February 15, 2020 and have had employees for whom the borrower paid salaries and payroll taxes or paid independent contractors as reported on Form 1099-MISC,

Maximum loan amount. The maximum loan amount available to an eligible borrower is the **lesser** of \$10 million or 2.5 times the borrower's average total monthly payroll costs incurred during the one-year period before the date on which the loan is made, plus the outstanding amount of a loan made under the SBA's Disaster Loan Program between January 31, 2020 and the date on which such loan is refinanced under this new program. Adjustments to this formula are available for borrowers that are seasonal employers, as well as for borrowers that were not in business during the period from February 15, 2019 through June 30, 2019.

Payroll costs. Payroll costs include: (i) salary, wage, commission, or similar compensation; (ii) payment of cash tip or equivalent, (iii) payment for vacation, parental, family, medical, or sick leave; (iv) allowance for dismissal or separation; (v) payment required for the provisions of group health care benefits, including insurance premiums; (vi) payment of any retirement benefit; (vii) payment of State or local tax assessed on the compensation of employees; and (viii) payments to independent contractors that are wages, commissions, or income. The following are excluded from payroll costs: (A) compensation of an individual employee in excess of an annual salary of \$100,000, as prorated from February 15, 2020 through June 30, 2020; (B) taxes imposed under Chapters 21, 22, and 24 of the Internal Revenue Code; and (C) any compensation of an employee whose principal place of residence is outside of the United States.

Allowed Uses. Allowed uses include: (i) payroll costs; (ii) costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums; (iii) employee salaries, commissions, or similar compensations; (iv) payments of interest on any mortgage obligation (which shall not include any prepayment of or payment of principal on a mortgage obligation); (v) rent (including rent under a lease agreement); (vi) utilities; and (vii) interest on any other debt obligations that were incurred before the covered period.

Deferment relief. During the covered period, the SBA will require lenders to provide complete payment deferment relief for impacted borrowers with covered loans for a period of at least six months and no more than one year, including payment of principal, interest, and fees. An impacted borrower is a borrower in operation on February 15, 2020 that has a covered loan application in process or pending on or after the enactment of the Paycheck Protection Program. The SBA is directed to provide guidance on the deferment process to lenders within 30 days.

Loan Forgiveness under the Paycheck Protection Program

Loan forgiveness is probably the most important component of the program. A borrower will be eligible for forgiveness of a loan for the following costs incurred *during the eight-week period beginning on the origination date of a covered loan*: (i) payroll costs; (ii) interest payments on any covered mortgage obligation; (iii) payments on any covered rent obligation; and (iv) covered utility payments. Again, as mentioned above, payroll costs exclude, among other things, compensation of an individual employee in excess of the prorated portion of an annual salary in excess of \$100,000 earned within the loan forgiveness covered period and compensation of an employee whose principal place of residence is outside of the United States.

The amount of loan forgiveness may be reduced (but not increased) if the borrower reduces the number of covered employees or reduces the pay of any covered employee by more than 25% as of the last calendar year. A reduction in number of covered employees will result in a proportional reduction in forgiveness amount determined by (i) the average number of full-time equivalent covered employees during the loan forgiveness covered period *divided by* (ii) the average number of full-time equivalent covered employees during either, at the election of the borrower, (A) the period from

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February 15, 2019 through June 30, 2019 or (B) the period from January 1, 2020 through February 29, 2020. A reduction in wages for any covered employee in excess of 25% will result in a dollar for dollar reduction in the amount of the loan forgiven.

“Covered employee” refers only to any employee who did not receive, during any single pay period during 2019, wages or salary at an annualized rate exceeding \$100,000.

Borrowers must apply for loan forgiveness by submitting required documentation and will receive a decision within 60 days. If a balance remains after loan forgiveness, the outstanding balance will have a maximum maturity date of 10 years after the application for loan forgiveness. The SBA is directed to provide guidance and regulations on the forgiveness process to lenders within 30 days.

The CARES Act appropriated \$349 billion for commitments for 7(a) loan guarantees during the covered period. In addition, the CARES Act provides COVID-19-related relief in other areas of the SBA’s purview, including, among others, entrepreneurial development, the state trade expansion program, the women’s business center program, the minority business development agency, and subsidies for certain loan payments.

You may find more information about the SBA loans and other items affecting businesses on our website: <https://www.shaheengordon.com/COVID-19-Resources/Business-Law-FAQs.aspx>. Please let us know if we can assist in any way.

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Karyn P. Forbes and Sean T. O’Connell contributed to this business group legal update.

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