

CARES Act Client Advisory

Obtaining a Loan Under the Keeping American Workers Paid and Employed Act¹

On March 27, 2020, President Trump signed into law the **Coronavirus Aid, Relief, and Economic Security Act (CARES Act)**. Title I of the CARES Act is called the **Keeping American Workers Paid and Employed Act**. This Act expands Section 7(a) of the **Small Business Act** by adding a new loan option for small businesses. This new loan option is referred to as the **Paycheck Protection Program**. Under the Paycheck Protection Program, businesses (including nonprofit organizations) with up to 500 employees can obtain forgivable loans (grants, essentially) to cover the cost of payroll, rent (or mortgage interest), and utilities for an 8-week period. Restaurants and franchised businesses will qualify for the loan if they have fewer than 500 employees at each location.

This advisory will outline key aspects of the Paycheck Protection Program, including the loan process and factors for employers to consider when evaluating the option for a loan under this program.

The Loan Process

1. **Determine if your business meets the size requirement.** Businesses (including nonprofit organizations) with up to 500 employees can obtain loans under the Paycheck Protection Program. Restaurants and franchised businesses are eligible for the loan if they have fewer than 500 employees at each location. Individuals who operate under a sole proprietorship or as an independent contractor and certain self-employed individuals are also eligible.

For a business to qualify for a loan under this program, it may not employ more than the greater of 500 employees or, if applicable, the size standard in number of employees established by the **Small Business Administration** for the industry in which the business operates.

Example: *If your industry is telecommunications and your business is a wired telecommunication carrier (NAICS code 517311), the size standard of 1500 employees will apply. Not all industries have a size standard in number of employees [many have revenue standards, which do not apply for the purpose of the Paycheck Protection Program]. This option only applies if the industry has a size standard in number of employees AND the number is greater than 500.*

Regulations have not yet been released to clarify how to determine if the 500-employee test is met (important for seasonal or other businesses that fluctuate above and below 500 employees); however, since the program amends the **Small Business Act (SBA)** and is administered by the Small Business Administration ("Administration"), we believe that the calculation will be based on the calculation used in the SBA to determine eligibility for other SBA financial assistance programs. Assuming this is accurate, to determine if your business meets the 500-employee threshold:

- a. Obtain payroll records for the preceding completed 12 calendar months (or the number of months you have been in business, if less than 12 calendar months).

This calculation can be run per location if:

- i. Your business is part of the food service or accommodation sector (NAICS code beginning with 72).
 - ii. Your business operates as a franchise that is assigned a franchise identifier code by the SBA.
- b. Count the number of employees on the payroll each pay period, including full-time, part-time, and temporary employees.

¹ This document was prepared on March 28, 2020, and is based on information in the Keeping American Workers Paid and Employed Act. The information is not all-inclusive and is subject to change at any time based on regulations issued by, or enforcement practices of, the U.S. Small Business Administration, the U.S. Department of the Treasury, and/or other federal government agencies. Information in this Client Advisory is not intended to be legal, tax, or financial advice; nor is it intended to provide recommendations for any specific circumstances. It is published for use by Seawright & Associates clients only.



- c. Calculate the average number of employees per pay period.
- d. Using averages for the pay periods, calculate an overall average for the 12-month period.

If, based on the above calculation, you employed fewer than 500 employees, your business (or location, for restaurants and franchises) will be eligible to obtain a forgivable loan under the Paycheck Protection Program.

2. Determine the maximum loan amount your business is eligible for. To determine how much money your business is eligible to receive under this loan program, follow these steps:

- a. Calculate the average total monthly payments of payroll costs (see definition below) incurred during the 1-year period before the date you apply for the loan.
 - i. If your business is seasonal (as determined by the Small Business Administration Administrator ["SBA Administrator"]), use the average total monthly payments of payroll costs for the 12-week period beginning on February 15, 2019, or March 1, 2019 (your choice), and ending on June 30, 2019.
 - ii. If your company was not in business during the period beginning on February 15, 2019, and ending on June 30, 2019, use the average total monthly payments of payroll costs for the period beginning on January 1, 2020, and ending on February 29, 2020.

Payroll Costs: *For the purpose of obtaining a loan under this program, "payroll costs" include the sum of the following payments for EMPLOYEES: (a) salary, wage, commission, or similar compensation; (b) payment of cash tip or equivalent; (c) payment for vacation, parental, family, medical, or sick leave; (d) allowance for dismissal or separation; (e) payment required for the provisions of group healthcare benefits, including insurance premiums; (f) payment of any retirement benefit; or (g) payment of state or local tax assessed on the compensation of employees; AND the sum of payments for any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, or similar compensation and that is not more than \$100,000 in one year, prorated for the covered period.*

Payroll costs cannot include the following: (a) compensation of any individual employee in excess of an annual salary of \$100,000, as prorated for the 1-year period (or 12-week period for seasonal businesses); (b) taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code for the applicable covered period; (c) any compensation of any employees whose principal place of residence is outside the United States; or (d) qualified sick leave or family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.

- b. Multiply the average total monthly payments of payroll costs obtained from the calculation in paragraph 2.a. by 2.5.
- c. Add the result of the calculation obtained in paragraph 2.b. to any refinanced SBA economic injury disaster loan obtained after January 31, 2020. (The Paycheck Protection Program permits employers to refinance economic injury disaster loans as a federally guaranteed loan under the program.)
- d. Your company will be eligible for a maximum loan amount that is the lesser of the calculations described above or \$10,000,000.

3. Understand what the loan can be used for. A loan obtained under the Paycheck Protection Program can be used for the following expenses during the period beginning on February 15, 2020, and ending June 30, 2020:

- a. Payroll costs (as defined above);
- b. Costs related to the continuation of healthcare benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- c. Employee salaries, commissions, or similar compensations;
- d. Payments of interest on any mortgage obligation (not including any prepayment of or payment of principal on a mortgage obligation);
- e. Utilities; and
- f. Interest on any other debt obligations incurred before the period noted above (February 15 – June 30).

To determine if payments for the above expenses that are made from loan proceeds will be forgiven, see paragraphs 6-8 below.

Loan money can be used to pay employees who are currently working or those who are in an inactive work status, such as a furlough.

4. **Loan Terms.** Employers can apply for loans under the Paycheck Protection Program from the time they are made available from lenders through June 30, 2020. The SBA Administrator will not collect a fee from the lender for making a loan under the Paycheck Protection Program (it's unclear if the lender can charge a fee to the employer) and lenders may not require personal guarantees or collateral from employers.

Loans with a remaining balance after application of forgiveness will have a maximum maturity of 10 years from the date the borrower applies for loan forgiveness and cannot bear an interest rate in excess of 4%. There is no penalty for prepayment of any portion of the loan that is not forgivable.

Lenders are expected to prioritize loan processing and disbursement of monies to businesses in underserved and rural markets, those owned and controlled by socially and economically disadvantaged individuals, women, and businesses in operation for less than 2 years.

The SBA Administrator will consider each employer that applies for a covered loan to have been adversely impacted by COVID-19. In turn, lenders must provide complete payment deferment relief for loans under this program for a period of not less than 6 months, including payment of principal, interest, and fees, and not more than 1 year.

5. **Employer Eligibility Criteria and Certification.** Lenders offering loans under the Paycheck Protection Program must consider if a borrower was in operation on February 15, 2020, and had employees for whom the borrower paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099.

We recommend that bring payroll records with you when you apply for the loan, going back one year to verify the amount of the loan you are seeking (based on the calculation under paragraph 2 above) and to establish that your company was in business on February 15, 2020.

Employers seeking a loan under the Paycheck Protection Program must make a **good faith certification** that the uncertainty of the current economic conditions makes necessary the loan request to support the ongoing operations of the business AND they must acknowledge that funds will be used to retain workers and maintain payroll or make utility payments and mortgage interest or lease payments.

Based on the required good faith certification, it appears that if your business has not been (or will not be) negatively impacted by COVID-19 to the point where additional funds are necessary to support ongoing operations, you will not qualify for a loan under this program.

Employers must also certify that they do not have an application pending for another loan under this program for the same purpose and duplicative amounts, and that they have not received any loan monies during the period beginning on February 15, 2020, and ending December 31, 2020, for the same purpose and duplicative amounts.

Individuals who operate under a sole proprietorship or as an independent contractor and self-employed individuals must submit documentation as necessary to establish qualification, including payroll tax filings, Forms 1099, and income and expenses from the sole proprietorship.

6. **Portion of Loan Eligible for Forgiveness.** If you receive a loan under the Paycheck Protection Program, you will be eligible for forgiveness in an amount equal to the **sum** of the following costs incurred and payments made during the **8-week period** beginning on the date of the origination of the loan:
- a. Payroll costs (as defined above);
 - b. Payments of interest on a mortgage incurred before February 15, 2020, for real or personal property (cannot include any prepayment of or payment of principal);
 - c. Payments for a rent obligated under a leasing agreement in force before February 15, 2020; and
 - d. Payments for utilities, including service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which services began before February 15, 2020.

Employers will be eligible for forgiveness of the loan in an amount equal to the sum of the costs incurred and payments made for these expenditures if the forgiveness application requirements outlined under paragraph 8 below are met.

Employers with **tipped employees** will receive forgiveness for additional wages paid to these employees. If customers pay tips via credit card and you include them in your payroll, then they are already considered. If customers leave cash tips, for the purpose of calculating the amount eligible for forgiveness, you may increase the wages to account for the cash tips.

Important Note: *You may be eligible for and could obtain a loan **in excess** of the amount of the expenditures listed above since the calculation in paragraph 2 that is used to determine the maximum amount of the loan you qualify for may yield an amount different from the amount of eligible expenditures you incur during the 8-week period. Any loan amount remaining after the forgiveness calculation is applied will be owed according to the terms of the loan, which include a minimum deferment period of 6 months and an interest rate no greater than 4%. **To avoid owing more than will be forgiven, calculate the anticipated costs of the above expenditures for the 8-week period and borrow only this much.***

- 7. Calculation of Amount Eligible for Forgiveness.** The amount of loan forgiveness can be reduced based on a reduction in the number of full-time equivalent employees OR a reduction in the wages of certain employees according to the following:

Employee Headcount Reduction: The amount of loan forgiveness will be reduced, but not increased, by multiplying the sum of the expenditure amounts listed in paragraph 6 by the quotient obtained by dividing:

- a. The average number of full-time equivalent employees per month (each pay period falling in the month) employed by the employer during the 8-week period beginning on the date of the origination of the loan **BY**
- b. The average number of full-time equivalent employees per month employed by the employer during the period beginning on February 15, 2019, and ending on June 30, 2019, OR the period beginning on January 1, 2020, and ending on February 29, 2020. (Seasonal employees can use the period February 15, 2019 – June 30, 2019)

Note: *The term “full-time equivalent employees” is not defined in the section of the CARES Act devoted to the Paycheck Protection Program, so employers should apply their own definition of full-time. Typically, two part-time employees equate to one full-time equivalent. Employers should use the same definition of full-time equivalent for the 8-week period and the period noted above in paragraph 7.b.*

Employee Salary Reduction: For any employee who earned **less than \$100,000** annualized in 2019, the amount of loan forgiveness will be reduced by the amount of any salary or wage reduction of the employee during the 8-week period that is **in excess of 25%** of the total salary or wages the employee received during the most recent full quarter the employee was employed before the 8-week period.

Example:

- Loan origination date: **April 10, 2020**
- 8-week period: **April 10–June 5, 2020**
- Amount borrowed: **\$200,000**
- Expenditures for payroll costs, rent/mortgage interest, and utilities over 8-week period: **\$200,000**
- Average number of full-time equivalent employees over the 8-week period: **18**
- Pay reductions over the 8-week period for employees earning less than \$100,000 in 2019: **0**
- Average number of full-time equivalent employees January 1–February 29, 2020: **20**
- $18/20 = .90$

Amount of loan forgiven: $.90 \times \$200,000 = \$180,000$

If you are subject to a reduction in the forgiveness amount based on one of the above two conditions, you may be able to remedy the situation and receive forgiveness for the full amount of eligible expenditures if, during the period beginning on February 15, 2020, and ending on the date that is 30 days after the enactment of this Act (presumably, April 26, 2020), you reduced headcount or wages as described above when compared to February 15, 2020, but you cure the reduction in headcount or wages by June 30, 2020.

For example, if you have already laid off 15 out of the 20 employees you had on your payroll February 15, 2020, as long as you transition the 15 employees from layoff to inactive work status before June 30 and begin paying them using proceeds from a loan under the Paycheck Protection Program, you will be eligible for the full amount of forgiveness for payroll expenditures for all 20 employees.

8. Application for Loan Forgiveness. To receive forgiveness for eligible expenses under the Paycheck Protection Program, you must submit the following to the lender serving the loan:

- a. Documentation verifying the number of full-time equivalent employees on payroll and wages paid for the 8-week period beginning on the date of loan origination and for the period of time used in paragraph 7.b.
- b. If wage rates for employees earning less than \$100,000 in 2019 were reduced, payroll records for the most recent full quarter prior to the 8-week period during which the employee whose wages were reduced was employed. *(If wage rates were reduced for employees earning more than \$100,000 in 2019, to establish that you are not subject to a reduction in forgiveness for these employees, you could be asked to submit payroll records for 2019 showing that their wages were in excess of \$100,000.)*
- c. Payroll tax filings reported to the IRS.
- d. State income, payroll, and unemployment insurance filings.
- e. Canceled checks, payment receipts, transcripts of accounts, or other documents verifying payments on mortgage or lease obligations and utility payments.
- f. Certification from a representative of the company authorized to provide certification that the documentation is true and correct and the amount for which forgiveness is requested was used to retain employees and make utility payments and interest payments on mortgage obligations or rent payments.
- g. Any other documentation the SBA Administrator deems necessary.

The lender has **60 days** from the date the application for loan forgiveness is submitted to issue a decision regarding forgiveness of covered expenditures.

9. Move Quickly to Identify a Lender and Apply for the Loan. Lending institutions that participate in lending programs under the SBA can provide loans under the Paycheck Protection Program. The Department of the Treasury, in consultation with the SBA Administrator and the Chairman of the Farm Credit Administration, is establishing criteria for insured depository institutions and credit unions, institutions of the Farm Credit System, and other lenders that do not already participate in SBA lending programs to provide loans under the Paycheck Protection Program.

Many large banks, such as **Wells Fargo, Bank of America, and Chase** (one of the highest volume SBA lenders) offer SBA lending. We recommend that employers contact the bank they have a relationship with to determine if they participate in SBA lending programs. If they do, loans under the Paycheck Protection Program should be available from these lenders sooner than from a lender that does not currently offer SBA loans.

Our understanding is that loan applications for this program will be available the week of March 30. Although there is \$350 billion available for loans under the Paycheck Protection Program, there is concern that the money will go quickly. Once the funds are depleted, another Congressional Act (more time, in other words) will be necessary to extend the program. **For this reason, if you are in need of a loan under this program, we recommend that you immediately identify and communicate with a lender that offers SBA funding, gather the necessary payroll records to apply for the loan, and complete the loan application as soon as it is available.** Our understanding is that smaller loans will be available immediately, but larger ones may take longer.