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CARES ACT: SUPPORT FOR SMALL BUSINESSES

This Client Alert discusses certain key provisions of the Paycheck Protection Program ("PPP") and Economic Injury Disaster Loans ("EIDL") under the Coronavirus Aid, Relief, and Economic Security Act ("CARES"), which was signed into law on March 27, 2020, and updates our prior Client Alert on this subject, dated March 27, 2020 (the "Original Alert"). Since the Original Alert was published, the Small Business Administration ("SBA") has issued interim rules ("Interim Rules") that necessitate this updated Client Alert.

CERTAIN KEY PROVISIONS OF PPP

PPP has been implemented through Section 7(a) of the Small Business Act, as amended by CARES. The PPP Borrower Application Form can be found on the SBA website. Certain key provisions of PPP include:

- Up to $349 billion of loans to support small businesses for the period from February 15, 2020 to June 30, 2020 (the "covered period").
- PPP loans will be issued on a "first come, first served" basis.
- The Interim Rules clarify which employers are eligible for PPP loans. An employer is eligible for a PPP loan if it: (i) has 500 or fewer employees whose principal place of residence is in the United States or is a business that operates in a certain industry and meets the applicable SBA employee-based size standards for that industry (such standard may be higher than 500 employees), with an exception for the accommodation and food sectors industry (NAICS Code beginning with 72) to the extent such business has no more than 500 employees per physical location; (ii) is (A) a small business concern and subject to SBA's affiliation rules, unless specifically waived by the CARES Act or (B) a 501(c)(3) tax-exempt non-profit organization, a 501(c)(19) tax-exempt veterans organization, a Tribal business concern defined in the Small Business Act, or any other business; and (iii) was in operation on February 15, 2020 and either had employees for whom it paid salaries and payroll taxes or paid independent contractors as of such date.
- Loans made during the covered period ("covered loans") will be 100% guaranteed by the SBA.
- An "employee" includes individuals employed on a full-time, part-time, or other basis but excludes independent contractors.
- Individuals who operate under a sole proprietorship or as an independent contractor and eligible self-employed individuals are eligible to receive a covered loan.

- Only SBA-approved lenders may issue covered loans, which include lenders who are not currently SBA-approved but are subsequently approved by the Treasury Department in consultation with the SBA during the covered period.
- Proceeds of the covered loans may be used to pay payroll costs; costs related to the continuation of group health care benefits during periods of paid sick leave, medical or family leave, and insurance premiums; employee salaries, commissions, or similar compensation; interest on mortgage obligations; rent; utilities; and interest payments on other debt obligations incurred prior to the covered period. The Interim Rules require that at least 75% of PPP loan proceeds must be used for payroll costs.
- "Payroll costs" include: compensation to employees (whose principal place of residence is the United States) in the form of salary, wages, commissions, or other similar compensation; cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips); payment for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums and retirement; and payment of state and local taxes assessed on compensation of employees.
- "Payroll costs" for an independent contractor or sole proprietor include wage, commissions, income, or net earnings from self-employment or similar compensation.
- "Payroll costs" excludes cash compensation of an individual employee in excess of an annual salary of $100,000, as pro-rated for the covered period, any compensation of an employee whose principal place of residence is outside the United States, the employer's share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7002 of the Families First Coronavirus Response Act.
- The maximum loan amount is determined by a formula based on the average total monthly payments for payroll costs incurred during the 1-year period before the date on which the loan is made multiplied by 2.5 plus any outstanding EIDL loan (discussed below) that is being refinanced by the covered loan, the total of which may not exceed $10 million (with special rules for seasonal businesses and businesses not in business from February 15, 2019 through June 30, 2019).
- No payments will be due for the first 6 months of the loan.
- There is no recourse against any individual shareholder, member, or partner of the business, except to the extent that the loan proceeds are used for an unauthorized purpose.
- No collateral or personal guarantees will be required.
- The interest rate will be 1%, and there will be no prepayment penalties.
- The maximum maturity of the loan will be 2 years.
- Applicants must certify that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of such applicant; the funds will be used to retain

workers and maintain payroll or make mortgage payments, lease payments, and utility payments; the eligible recipient does not have an application pending for a covered SBA 7(a) loan 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, the recipient has not received amounts under SBA 7(a) for the same purpose and duplicative of amounts applied for or received under a covered loan. Further, the Interim Rules impose additional certification requirements, including that the applicant was in operation on February 15, 2020 and had employees for whom it paid salaries and payroll taxes or paid independent contractors, that documentation verifying the number of full-time equivalent employees on payroll as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities for the 8-week period following the loan will be provided to the lender; that loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities; and that no more than 25% of the forgiven portion of the loan amount may be for non-payroll costs. The Interim Rules also require a certification as to the truth and accuracy in all material respects of the information provided and a confirmation that the tax documents submitted by the applicant are identical to those submitted to the Internal Revenue Service.

- The SBA will issue guidance no later than 30 days after CARES is implemented.

Affiliations Rule Generally Applicable to PPP

Notably, the “affiliations rule” under the SBA will apply to PPP, but for a few exceptions. The affiliations rule typically aggregates the employees of companies that are under common control. For example, if ABC Company has 300 employees and is owned by a private equity fund that has 1,000 employees across all of its portfolio companies, ABC Company will not qualify as a small business, assuming the SBA small business size standard for ABC Company’s industry is 500 employees. However, CARES waives the affiliations rule for: 1) any small business in the accommodation and food sectors industry (NAICS Code beginning with 72) that employs not more than 500 employees “per physical location”; 2) any small business operating as a franchise that is assigned a franchise identifier code by the SBA; and 3) any business concern that receives financial assistance from a company licensed under Section 301 of the Small Business Investment Act of 1958. Furthermore, the Interim Rules exempt all faith-based organizations from the affiliation rules.

Loan Forgiveness under PPP

CARES allows certain amounts of a PPP loan to be forgiven so long as it is an amount of principal that a lender reasonably expects a borrower to expend during an 8-week period (beginning on the date of the origination of the loan) on the sum of any:

- Payroll costs;
- Payments of interest only on any covered mortgage obligation;
- Payments on any covered rent obligation; and

- Covered utility payments.

Other important items of notes with respect to this loan forgiveness include:

- The amount forgiven may not exceed the principal amount.
- The costs eligible for forgiveness, other than payroll costs, must have originated or incurred from a source (such as a contract or lease agreement) that was in effect before February 15, 2020.
- The Interim Rules require that at least 75% of the forgiveness portion be from payroll costs.
- Any forgiven amounts will be treated as cancelled indebtedness by the lender and forgiven amounts will not be taxable to the borrower.
- The SBA will remit to the lender the forgiven amount, plus any interest accrued through the date of payment, no later than 90 days after the date that the amount is forgiven.
- Any remaining balance after a reduction based on the forgiveness amount will continue to be guaranteed by the SBA.
- An eligible recipient with tipped employees may receive forgiveness for additional wages paid to those employees.
- Any loan forgiveness will be reduced if (i) full-time employees were terminated or (ii) wages were reduced in excess of 25%.
- Borrowers that reduce full-time employment or wages between February 15, 2020 and April 26, 2020 will not be penalized for having a reduced payroll so long as the employer restores payroll levels by June 30, 2020.
- Any borrower seeking loan forgiveness must submit to the lender an application that contains the required information and certifications.
- The lender has a 60-day period to render a decision on the loan forgiveness application.
- The lender is held harmless, which means an enforcement action may not be taken against the lender relating to loan forgiveness for the categorical payments outlined, and the SBA cannot penalize the lender.
- The SBA is required to issue guidance and regulations related to loan forgiveness no later than 30 days after the enactment of CARES.

TAX CONSIDERATIONS

In a previous Client Alert, we explained the tax issues and implications associated with CARES; before borrowers apply for the PPP, borrowers should consider the following tax trade-offs:

- The Employee Retention Tax Credit will not be available for an employer who is a borrower under the PPP; and
- The deferral of employer payroll taxes will not be available for an employer who has indebtedness forgiven under the PPP.

CONTINUED AVAILABILITY OF EIDLS

EIDLs continue to be available to eligible recipients under Section 7(b)(2) of the SBA. Generally speaking, with respect to EIDLs:

- Recipients can apply directly with the SBA;
- Recipients must be located in a declared disaster area;
- Recipients must be economically impacted by the subject disaster;
- The maximum amount of an EIDL is $2 million secured for financial obligations and expenses (or $25,000 unsecured);
- The interest rate will be 3.75% for small businesses and 2.75% for non-profits; and
- CARES allows recipients of EIDLs for the period beginning January 31, 2020 to receive assistance through 7(a) loans, including PPP, so long as the uses of the loans are not duplicative.

TEMPORARY WAIVERS OF PRE-EXISTING 7(B)(2) REQUIREMENTS

During the covered period for an EIDL, CARES waives the following:

- The personal guarantee requirement on advances and loans of not more than $200,000;
- The requirement that an applicant needs to be in business for the 1-year period before the disaster (except that no waiver may be made for a business that was not in operation on January 31, 2020); and
- The requirement than an applicant be unable to obtain credit elsewhere.

EMERGENCY GRANTS

During the covered period, an eligible entity that applies for an EIDL can request, within three days after the SBA receives an application, that the SBA provide an advance of no more than $10,000. These advances are required to be used for an allowable purpose, such as:

- Providing paid sick leave to employees unable to work due to the direct effect of COVID-19;
- Maintaining payroll to retain employees;
- Meeting increased costs to obtain materials unavailable from the applicant's original source due to interrupted supply chains;
- Making rent or mortgage payments; and
- Repaying obligations that cannot be met due to revenue losses.

Notably, an applicant will not be required to repay any amounts of an advance, even if subsequently denied an EIDL. If an applicant receives an advance, yet the applicant then transfers into the 7(a) program (including PPP), the advance must be reduced from the loan forgiveness amount for a loan made for payroll costs. The SBA's authority to allow these grants terminates on December 31, 2020.

CARES has allocated $10 billion for these emergency advances, so it is recommended that any clients who are severely strained apply immediately for an EIDL and seek such an advance. Businesses may make an application online directly on the SBA website.

Final Thoughts

CARES uses, for the most part, the existing SBA structure to deploy the new $349 billion economic relief program for small businesses, but there are some changes to extend eligibility requirements and waive certain other requirements.

There will likely be a strain on the SBA, lenders and their respective resources and personnel due to the increase in demand for SBA loans. Thus, it is imperative that clients seeking SBA loans have documentation ready and apply as soon as possible.

For some clients who likely will not be able to use the SBA relief programs, such as many portfolio companies of private equity funds (unless relief from the affiliation rules is granted by the SBA), alternative resources spearheaded by the Treasury Department and the Federal Reserve may be available. Such programs are discussed in another Client Alert.

We Are Available to Help

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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