

CROKE FAIRCHILD MORGAN & BERES

The Coronavirus Aid, Relief, and Economic Security (CARES) Act and Aid for Businesses

March 29, 2020

On March 27, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law. The law provides emergency assistance for many businesses affected by the recent COVID-19 pandemic.

The legislation includes a new loan program – the Paycheck Protection Program administered through the SBA – that provides up to \$349 billion in loans to eligible entities, with such loans being subject to forgiveness under certain circumstances. The loans are 100% federally guaranteed available under a new subsection 36 of Section 7(a) of the Small Business Act.

The loans may be used for a variety of purposes, including payroll costs (as described below), rent, utilities, mortgage interest (not principal) and interest on debt existing prior to February 15, 2020. No collateral or personal guaranties are required.

Application Process: Eligible entities may file applications with an SBA-approved lender. Lenders have been delegated authority to make loans without SBA review. For example, in Illinois, Wintrust is the largest SBA-approved lender.

Eligibility:

- Applicants must have been in operation on February 15, 2020 and will have paid employee salaries and payroll taxes or independent contractors.
- Applicants must certify: (i) that the loan is necessary due to the uncertainty of current economic conditions; (ii) that they will use the funds to retain workers, maintain payroll, or make lease, mortgage, and utility payments; and (iii) that they are not receiving any other loan for the same purposes through December 31, 2020.
- For entities with fewer than 500 employees, **both for profit businesses and 501(c)(3) nonprofit organizations are eligible**, as are independent contractors, sole proprietorships, and certain eligible self-employed individuals.
- Any business with fewer than 500 employees per physical location at the time of disbursement that is in the accommodation and food services industry (NAICS 72) is eligible to receive a loan.
- Independent contractors are eligible to apply for the loans directly.

Determining Number of Employees:

- For purposes of determining the number of employees of an applicant, the applicant should include **full-time, part-time, and other basis employees**.
- Generally, an entity **must include the number of employees of its “affiliates”** in determining the number of employees of an applicant. For example, business concerns and

other persons (entities or individuals) are affiliates of each other when one controls or has the power to control the other, or a third party (or parties) controls, or has the power to control, both.¹

- Control of a business concern may be established by, for example, ownership or control, or the power to control 50% or more of such party's voting stock, or a block of such party's voting stock that is large compared to all other outstanding blocks of voting stock.²
 - Control of a business concern may also be established through, amongst others, a party's ability, under the concern's charter, by-laws, or shareholders agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders of the business concern.
- The CARES Act provides that this regulation is waived only with respect to eligibility for a Paycheck Protection loan for:
 - any business concern with not more than 500 employees that is in the accommodation and food services industry (NAICS 72);
 - any business concern operating as a franchise that is assigned a franchise identifier code by the SBA; and
 - any business concern that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958 (SBICs).

How Paycheck Protection Loans Work with SBA Economic Injury Disaster Loan:

- A recipient of an SBA EID Loan made between January 31, 2020 and the date loans are available under the CARES Act for a purpose other than paying payroll costs and other Paycheck Protection loan purposes described below is **still eligible for a Paycheck Protection loan**.
- Applicants of Paycheck Protection loans may refinance EID Loans made between January 31, 2020, and the date on which loans are made available under the CARES Act.
- Section 1110 of the CARES Act provides that SBA EID Loans, as modified by the CARES Act, will be available until December 31, 2020. (Note that the "covered period" for the Section 7(a) loans described above runs only until June 30, 2020.)
- The CARES Act similarly changes the definition of "small business," for the purposes of an EID Loan, to include a company with no more than 500 employees, but does not waive the affiliation rules.
- Notably, the **CARES Act also waives the personal guaranty requirement for EID Loans and the requirement for applicants to demonstrate that they are unable to obtain credit from other sources.**
- The CARES Act provides for a \$10,000 emergency advance (within three days of submitting an application) while an applicant's loan application is pending, which SBA will *not* require to be repaid. Notably, the CARES Act contemplates that an applicant may receive this advance while **still applying for a Paycheck Protection loan** and that, if the applicant later receives a Paycheck Protection loan, the amount of the advance will "be reduced from the loan forgiveness amount for a loan for payroll costs."

¹ 13 CFR § 121.103(a)

² 13 CFR § 121.103(c)

Use of Loan Proceeds: The CARES Act provides that proceeds of **Paycheck Protection loans may be used for:** payroll costs; continuation of group health care benefits during periods of paid sick, medical, or family leave, or insurance premiums; salaries or commissions or similar compensation; interest on mortgage obligations; rent; utilities; and interest on other outstanding debt.

Maximum Loan Amount:

- **If an applicant was in business from February 15, 2019 to June 30, 2019**, the maximum loan amount is the lesser of: (1) (a) the average total monthly payments by the applicant for payroll costs (as defined below) incurred during the one-year period before the date the loan is made, multiplied by (b) 2.5; and (2) \$10 million.
- **If an applicant was not in business from February 15, 2019 to June 30, 2019**, the maximum loan amount is the lesser of: (1) (a) the average total monthly payments by the applicant for payroll costs incurred from January 1, 2020 to February 29, 2020 multiplied by (b) 2.5; and (2) \$10 million.
- **“Payroll Costs” are defined to include:** (i) payments for salary, wage, commission, or similar compensation; (ii) payments for cash tip or equivalent; (iii) payments for vacation, parental, family, medical, or sick leave; (iv) allowance for dismissal or separation; payment required for the provisions of group health care benefits; (v) payment of any retirement benefit; (vi) payment of state or local tax assessed on the compensation of employees; and (vii) payments of any compensation or income of a sole proprietor or independent contractor that is an amount not more than \$100,000 in one year, as prorated for the period February 15, 2020 through June 30, 2020.
 - **“Payroll costs” do not include:** (i) the compensation of an individual employee in excess of an annual salary of \$100,000, as pro-rated for the period February 15, 2020 through June 30, 2020; (ii) taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code; (iii) compensation of an employee whose principal place of residence is outside of the United States; and (iv) qualified sick leave wages or qualified family leave wages for which a credit is already allowed under the *Families First Coronavirus Response Act*.
- **Annual salary in excess of \$100,000 should not be included** in determining the maximum loan amount, as discussed above.
- **Seasonal Employees:** For seasonal employers, the applicable payments to include in the maximum loan amount calculation are the average total monthly payments for payroll during the 12-week period beginning February 15, 2019, or at the election of the recipient, March 1, 2019, and ending June 30, 2019.

No Collateral or Personal Guaranty: **No collateral or personal guarantee** is required for a Paycheck Protection loan. Unlike traditional SBA 7(a) loans, no personal guarantee will be required to receive funds and no collateral needs to be pledged. The SBA has no recourse against any borrower for non-payment of the loan, except where the borrower has used the loan proceeds for a non-allowable purpose.

No Need to Show that a Borrower Cannot Obtain Credit Elsewhere: **The CARES Act waives the requirement that a business show that it cannot obtain credit elsewhere.** In lieu of these requirements, borrowers must certify that the loan is necessary due to the uncertainty of current economic conditions; that they will use the funds to retain workers, maintain payroll, or make

lease, mortgage, and utility payments; and that they are not receiving duplicative funds for the same uses.

Loan Forgiveness: Borrowers will be eligible for loan forgiveness if the loan proceeds were used as set forth below:

- **The loan forgiveness amount is equal to** the amount spent by the borrower during the 8-week period beginning on the date of the origination of a Paycheck Protection loan for the following items:
 - Payroll costs (not to exceed \$100,000 of annualized compensation per employee);
 - Payments of interest on any mortgage loan incurred prior to February 15, 2020;
 - Payment of rent on any lease in force prior to February 15, 2020; and
 - Payment on any utility for which service began before February 15, 2020.
- **The amount of loan forgiveness will be subject to reduction if** there is a workforce reduction or a reduction in the salary or wages of employees.
 - **Workforce Reduction:** The amount of loan forgiveness will be reduced by multiplying (1) the forgivable costs by (2) the quotient obtained by dividing (a) the average number of full-time equivalent employees per month during the eight week period beginning on the date of the origination of a Paycheck Protection loan, by (b) at the election of the borrower, (i) the average number of full-time equivalent employees per month from February 15, 2019 to June 30, 2019 or (ii) the average number of full-time equivalent employees per month from January 1, 2020 to February 29, 2020.
 - **Salary/Wage Reduction:** The amount of loan forgiveness will also be reduced by the amount of any reduction in total salary or wages of any employee (who did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount of more than \$100,000) during the eight week period beginning on the date of the origination of a Paycheck Protection loan that is in excess of 25% of the total salary or wages during the most recent full quarter during which the employee was employed before the covered period.
 - **There are exceptions for these reductions.** Reductions in workforce and salaries or wages that occur from February 15, 2020 to April 26, 2020 will be disregarded for purposes of reducing the amount of the loan forgiveness so long as the reductions are eliminated no later than June 30, 2020.
- The loan forgiveness amount is **excluded from taxable gross income.**
- **Borrowers must apply for loan forgiveness with the lender servicing the loan.** Lenders have 60 days to review and make a determination with respect to loan forgiveness.
- Existing 7(a) loans are also eligible for loan forgiveness under the CARES Act.

Terms of Loan After Forgiveness: If a Paycheck Protection loan has a remaining balance after the forgiveness described above, it will have a **maximum maturity of 10 years and an interest rate not exceeding 4%.**

- Lenders must defer payments of principal, interest, and fees for at least six months and up to one year.
- The SBA will not collect any annual or guarantee fees for the loan.

- All prepayment penalties are waived.

Please contact us if you have any questions about the CARES Act or the loan program application process. Businesses are encouraged to reach out to their banks to determine whether such banks are SBA-approved lenders. Croke Fairchild can help with finding an SBA-approved bank partner. We look forward to your questions and calls.



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