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The CARES Act: How <500 Employee Small Businesses Can Stay Afloat Via The Paycheck Protection Loan Program

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In this guide, we will help you determine if a PPP loan is the right option for your business and how to prepare for the application process while we await application guidance from the SBA.

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). Included in the CARES Act is the Paycheck Protection Loan Program ("PPP"), a new $349 billion forgivable business loan program under the Small Business Administration's ("SBA") existing Section 7(a) loan framework. The PPP was established to help small businesses affected by economic conditions resulting from COVID-19.

PPP loans are capped at the *lesser* of either: $10 million or 2.5x the business's average monthly payroll costs during the year prior to the loan date. SBA-approved lenders can make PPP loans and must offer a 6 to 12 month deferment on payment of principal, interest, and fees to borrowers. To the extent not forgiven, PPP loans carry a maximum loan term of 10 years and are capped at an interest rate of 4%. PPP loans are also free certain fees and prepayment penalties. Further, PPP loans do not require any personal guarantee or collateral.

First: What Will Lenders Require from Businesses Applying for PPP Loans?

Full details on application requirements have yet to be defined by the SBA. At this point, we do not know how long the application process will take or how long it will take for an approved loan to fund. Treasury Secretary Steven Mnuchin has indicated that the system will be set up for same-day evaluation. This is an unprecedented program and it is possible that funding will vary based on the size of the loan, size of the institution, volume of applicants, and anti-fraud measures.

However, at this point we know that lenders will ask eligible businesses for a good faith certification that:

- Due to the uncertainty of current economic conditions, the loan is necessary to support the business's ongoing operations;
- The business will use the loan to retain its workers and maintain payroll or make its mortgage,

lease, and utility payments;
- The business does not have an application pending for a loan duplicative of the purpose and amounts applied for in the current application;
- From Feb. 15, 2020 to Dec. 31, 2020, the borrower has not received a loan duplicative of the purpose and amounts. (Note that under the CARES Act, there is an opportunity to fold the emergency loans discussed below made between Jan. 31, 2020 and March 27, 2020 into a new loan).

Independent contractors, sole proprietors and self-employed individuals should be prepared to provide additional documentation. The documentation has not been announced yet, but may include payroll tax filings, Forms 1099-MISC, and income and expenses. If your business qualifies, it would be prudent to begin gathering such documents now.

Second: How Does the Business Calculate “Payroll Costs?” to Determine the Loan Amount

Under the CARES Act, payroll costs are different for employers and sole proprietors.

- For employers, payroll costs include the sum of any of the following compensation paid to an employee:
    - salary, wage, commission, or similar compensation;
    - payment of cash tip or equivalent;
    - payment for vacation, parental, family, medical, or sick leave;
    - allowance for dismissal or separation;
    - payment required for the provisions of group health care benefits, including insurance premiums;
    - payment of any retirement benefit; and
    - payment of state or local tax assessed on the compensation of the employee

- For sole proprietors, payroll costs include the sum of any wage, commission, income, net earnings from self-employment, or similar compensation and that is in an amount that is not more than $100,000 in one year, as pro-rated for the covered period.

- The following are <u>not</u> considered payroll costs for PPP purposes:
    - Compensation of an individual employee in excess of an annual salary of $100,000, as prorated for the covered period of February 15, 2020 to June 30, 2020;
    - Payroll taxes, railroad retirement taxes, and income taxes;
    - Any compensation of an employee whose principal place of residence is outside of the United States;
    - Qualified sick leave wages or qualified family leave wages for which a credit is allowed under the Families First Coronavirus Response Act Section 7001 and 7003

Third: Will the Loan Be Forgiven?

Businesses that receive a PPP loan are eligible for loan forgiveness equal to the amount spent on the following expenses during the 8-week period beginning on the date of loan origination:

- Payroll costs (as defined above)

- Mortgage interest incurred in the ordinary course of business;
- Rent on a leasing agreement;
- Payments for the business's utilities (electricity, gas, water, transportation, telephone, or internet); and
- And for businesses with tipped employees, additional wages paid to those employees

The business must apply to its lender for forgiveness. The forgiveness will not exceed the loan principal.

Fourth: How Could My Loan Forgiveness Be Reduced?

PPP loan forgiveness could be reduced if the business does not maintain its number of employees or reduces wages paid to employees by more than 25%. However, there is a grace period. If the business makes such a reduction between February 15, 2020 and April 26, 2020, but restores it by June 30, 2020, the amount of PPP loan forgiveness will not be reduced.

Fifth: Where Do I Get a PPP Loan?

FDIC lending institutions, credit unions and other SBA-approved lenders, will be authorized to start making PPP loans to eligible businesses on April 3, 2020. There is a network of approximately 1,800 approved lenders. Applications should be submitted directly to the approved lender. Loans will be available through June 30, 2020.

However, applicants be advised that there could be delays in the accessibility of these loans while lenders interpret the CARES Act, develop an application process and determine how many of these loans to put on their books.

Sixth: What if the PPP Loan Does Not Cover My Business Needs? What are My Options under the CARES Act?

In addition to a PPP loan, small businesses may consider applying for a low-interest Economic Injury Disaster Loan ("EIDL") or Emergency Economic Injury Grant. The SBA's existing EIDL program was expanded by the CARES Act to cover the period of January 31, 2020 to December 31, 2020. The EIDLs:

- Cover a broader base of business uses that would have been met had the COVID-19 pandemic not occurred, including but not limited to costs for payroll and supply chain interruptions.
- To qualify under the CARES Act, the business must have suffered "substantial economic injury" from COVID-19.
- Loans are based on actual economic injury to the business in an amount up to $2 million.
- Applications are submitted directly to the SBA and the SBA determines the amount of the injury.
- The loan terms are longer – up to 30 years – and some loans require personal guarantees.
- Loans can be made quickly, sometimes with as little as a borrower's credit score.

While PPP and EIDL loans are distinct, there is some overlap. For example, EIDL can be refinanced into a PPP loan. Further, the CARES Act permits EIDL applicants to request an advance of $10,000 to pay certain working capital needs, also called an Emergency Economic Injury Grant. Grants are available for businesses in operation on or before January 31, 2020. The CARES Act does not require the grant to be repaid, even if the EIDL applicant is denied. However, the amount of the advance must be deducted from any loan forgiveness amounts under a PPP loan, if a PPP loan is obtained.

Finally, under the Small Business Debt Relief Program, the SBA will cover all loan payments including principal, interest, and fees, for six months on existing non-emergency SBA loans and non-emergency SBA loans obtained in the six months following the March 27, 2020 enactment of the CARES Act.

Click here to read *Womble Bond Dickinson's Overview of the CARES Act's Paycheck Protection Loan Program* including whether your business qualifies as a small business under the CARES Act.

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