ALSTON & BIRD

Analysis of Funding Streams in the CARES Act

Funding Stream 1: $659 Billion for Small Business Administration (UPDATED June 5, 2020)

Who oversees small business loans?

- The Small Business Administration (SBA) is the primary federal agency that supports small businesses and entrepreneurs.

What types of loans are currently available through the SBA?

- The SBA works with lenders to provide loans to small businesses. The agency does not lend money directly to small business owners. Instead, it sets guidelines for loans made by its partnering lenders, community development organizations, and micro-lending institutions.
- There are three common financial assistance programs overseen by SBA – the "7(a) loan program", the "7(b) loan program" and the Small Business Investment Company (SBIC) financial assistance program.
- The 7(a) loan program is SBA's primary program for providing financial assistance – in the form of loans – to small businesses. In order for a small business to be eligible, the business must, in addition to other requirements:
    - Be registered as a for-profit business;
    - Not employ more than a certain number of employees or exceed stated revenue thresholds; and
    - Be physically based in the US.
- Section 7(b) of the Small Business Act includes the Economic Injury Disaster Loan (EIDL) program, which distributes loans in amounts up to $2 million for certain small businesses and non-profits facing economic injury as a result of declared emergencies like the coronavirus (COVID-19).
- The SBIC program allows licensed privately-operated investment funds to provide financing to eligible small businesses in the form of loans, debt securities, equity securities, guarantees or purchase of securities in a small business.

What is new for small businesses under the latest stimulus bill?

- The Coronavirus Aid, Relief, and Economic Security (CARES) Act creates a new 7(a) loan program, known as the Paycheck Protection Program (PPP). Congress initially is appropriating $349 billion of funding for this new program.
- The legislation also modifies and increases funding for the existing EIDL program under Section 7(b).
- The legislation relaxes participation requirements, meaning more business will be deemed "small" and eligible for economic assistance.
- The legislation provides funding for deferments of loans in place.
- The legislation establishes a program to provide training and resources to small businesses affected by coronavirus.

What is the PPP Loan?

- The PPP Loan provides to recipients up to the lesser of (i) 2.5x the average total monthly payroll costs during *the year preceding application* plus any amounts loaned to the recipient under the EIDL program this year, or (ii) $10 million.
  - "Payroll costs" include salaries, wages, commissions, cash tips, payment for vacation, parental or sick leave, allowance for dismissal or separation, payment of group healthcare benefits, payment of retirement benefits, and payment of state and local tax assessed on compensation.
  - "Payroll costs" exclude compensation (i.e. salary, wages, commissions or cash tips) in excess of $100,000 on an annualized basis for each employee, taxes imposed or withheld under Chapters 21, 22 or 24 of the Internal Revenue Code during the period from February 15, 2020 to June 30, 2020, compensation for non-U.S. domiciled employees, amounts paid to an independent contractor, and family or sick leave wages for which a credit has been received under the Families First Coronavirus Response Act.
  - NOTE: SBA has been inconsistent in interpreting the phrase "the year preceding application." The SBA guidance has interpreted this phrase as both (x) the twelve months preceding application and (y) "the preceding calendar year" (i.e., calendar year 2019). Consult the application form provided by your PPP lender for further guidance.
- PPP Loan Terms:
  - Complete payment deferral (including principal, interest and fees) until the date on which the amount of forgiveness is remitted to the lender; however, interest will continue to accrue over this period.
  - Maturity: For loans originated on or after June 5, 2020, a minimum of 5 years and a maximum of 10 years, in each case, after the funding of the loan. For loans originated prior to June 5, 2020, the existing maturity date may be modified by mutual agreement of the lender and the borrower to extend the maturity date to no less than 5 years and no more than 10 years.
  - Interest Rate: 1.00% fixed rate
  - Prepayment: The loan may be prepaid at any time with no penalties, premiums or fees
  - Collateral: None
  - Personal Guarantees: None; however, using the proceeds for fraudulent purposes will subject the applicant to criminal liability
- If an employer receives a PPP Loan, the employer will not be eligible for the employee payroll retention tax credit under Section 2301 of the CARES Act.

What are the permitted uses of the PPP Loans?

- The proceeds of the PPP Loans may be used for:
  - Payroll costs (subject to the limitations on "payroll costs" set forth above);
  - Interest related to mortgage obligations incurred prior to February 15, 2020;
  - Rent under lease agreement in force prior to February 15, 2020; and
  - Utilities costs, for which service began prior to February 15, 2020.

- If a borrower uses any portion of the PPP Loans for unauthorized purposes, SBA will direct the borrower to repay that portion of the PPP Loans.
    - The knowing use of funds for unauthorized purposes will subject the borrower to additional liability such as charges for fraud (including against any shareholder, member or partner of the borrower that uses such funds for unauthorized purposes).

Will the PPP Loans be forgiven?

- Applicants can receive loan forgiveness in an amount not to exceed the principal amount of indebtedness related to the PPP Loans, equal to the sum of the applicant's payroll (subject to the limitations on "payroll costs" set forth above), rent, mortgage interest and utility costs incurred and payments made during the 24-week period following the origination of the loan (but no later than December 31, 2020) (the "covered period") if they maintain the same number of FTEs during such covered period as compared to the FTE count during either (x) February 15, 2019 to June 30, 2019 or (y) January 1, 2020 to February 29, 2020; the loan forgiveness is scaled down proportionally with any decrease in FTEs during such covered period or if any FTE salaries of employees making less than $100,000 annually are decreased by more than 25%.
    - Applicants that received PPP loans prior to June 5, 2020 may elect for the covered period applicable to their PPP loans to end after 8 weeks
- NOTE: At least 60% of the PPP loan shall be used for payroll costs and no more than 40% of the PPP loan may be used for non-payroll costs.
- Re-Hiring: For purposes of the loan forgiveness calculation, applicants have until December 31, 2020 to restore their full-time employment and salary levels for any changes made between February 15, 2020 and April 26, 2020.
- The loan forgiveness amount will not be reduced proportional to the reduction in the number of FTE employees, if the applicant, in good faith: (A) is able to document an inability to rehire employees on or before December 31, 2020; or (B) is able to document an inability to return to the same level of business activity as the business was operating at before February 15, 2020 due to compliance with requirements or guidance issued by HHS, CDC, or OSHA during the period of March 1, 2020 to December 31, 2020 (e.g., related to sanitation standards, social distancing, or any other worker or customer safety requirement related to COVID-19).
- In order to request loan forgiveness, applicants must submit a request to the lender that is servicing the loan. The request will include documents that verify the number of full-time equivalent employees and pay rates, as well as the payments on eligible mortgage, lease, and utility obligations.
- If an applicant fails to apply for forgiveness within 10 months after the last day of the covered period (the earlier of (x) 24 weeks after loan origination and (y) December 31, 2020), the applicant will make principal, interest and fee payments on the covered loan beginning not earlier than 10 months after the last day of the covered period.
- The lender must make a decision on loan forgiveness within 60 days.
- Loans that are forgiven will not constitute cancellation of indebtedness income, and thus will not be taxable, to the borrower.

Do I qualify for the PPP Loan?

- In addition to traditional small businesses under SBA rules (eligibility criteria can be found here), eligible entities include any business (including nonprofits, veterans organizations and Tribal businesses) that employs 500 or fewer employees whose principal place of residence is in the U.S. (unless the applicant's primary industry is subject to a higher employee-based size standard, in which case the applicant must be "small" under that higher standard). Certain self-employed workers and independent contractors are eligible, too.

- Example: Applicant A's primary industry is subject to a 250-employee size standard but actually employs 350 employees. Applicant B's primary industry is subject to a 1,000-employee size standard but actually employs only 750 employees. Both applicants would qualify under the CARES Act paycheck protection assistance:
  - Applicant A qualifies because, even though it otherwise would not be "small" under its NAICS code for traditional SBA financial assistance, it is "small" for purposes of the CARES Act because it employs no more than 500 employees whose principal place of residence is in the U.S.
  - Applicant B qualifies because, even though it employs more than the 500-employee limit established in the CARES Act, it operates in an industry with a higher employee-based size standard and it qualifies as "small" under that standard.
- Additionally, a business is eligible for PPP loans as a small business concern if it met both tests in SBA's "alternative size standard" as of March 27, 2020: (1) maximum tangible net worth of the business is not more than $15 million; and (2) the average net income after Federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than $5 million.
- For purposes of determining the employee count, businesses may use their average employment over the previous 12 months or calendar year 2019 to determine their number of employees. Alternatively, businesses may elect to use the average number of employees per pay period in the 12 completed calendar months prior to the date of the loan application (or the average number of employees for each of the pay periods that the business has been operational, if it has not been operational for 12 months).

- Congress has also provided that businesses in the hospitality, food and beverage industry with more than one business location qualify ***provided*** that no single location has more than 500 employees.
- In addition, the SBA's usual "affiliation" rules are waived for (x) businesses primarily engaged in the hospitality, food and beverage industry employing not more than 500 employees, (y) registered franchises, and (z) businesses receiving financial assistance from a licensed SBIC.
- Affiliation rules: Affiliated companies are counted for purposes of determining whether a business satisfies the requirement of having 500 or fewer employees (or the traditional applicable size standard). More information on how SBA determines "affiliation" can be found at Section 121.103 of 13 CFR.
- Furthermore, eligibility for borrowers requires:
  - that the business was in operation on February 15, 2020; and
  - the business has paid employees or paid independent contractors and payroll taxes.
- NOTE: Borrowers are required to make the certification that the "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the [Borrower]." SBA has issued guidance that "Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business." Borrowers should be prepared to demonstrate to SBA, upon demand, the basis for this certification.

What is the modified EIDL Program?

- The legislation modifies the existing disaster relief program to respond to the economic impact of COVID-19.
- SBA will waive certain requirements, including that an applicant needs to have been in business for a 1-year period before the disaster (so long as it has been in business since at least January 31, 2020) or the $200,000 personal guarantee on advances and loans, and the obligation to first seek credit elsewhere before applying for funds provided under the program.
- **Note:** this program does not include the employee-by-location allowance offered in the PPP Loan for hospitality and food and beverage franchisees.
- Underwriting requirements are relaxed.
- EIDL loans must be paid back (other than any advance "emergency grant," not to exceed $10,000, applied for within 3 days after SBA receives the application).

Can I access both programs?

- Possibly. Businesses that receive a PPP Loan cannot receive an EIDL loan for the same purpose. However, businesses that have incurred an EIDL loan in 2020 may be able to refinance that loan into the PPP Loan, which becomes forgivable if the business has sufficient qualifying salary, utility and rent/mortgage expenses.
- NOTE: If a business used an EIDL loan for payroll costs and then incurs a PPP Loan, the business must use the PPP Loan to refinance its EIDL loan. Proceeds from any advance up to $10,000 on the EIDL loan will be deducted from the loan forgiveness amount on the PPP Loan.

Should I apply for PPP or EIDL Loans?

- It depends on your circumstances, but the PPP Loans will be beneficial in many cases if you anticipate that the funds will allow you to maintain your current payroll, especially because all or a portion of the PPP Loan may be forgivable; however, it is a temporary program and only covers expenses through December 31, 2020. Funds borrowed under the EIDL existing loan program must be repaid, but terms are flexible and it covers injuries through the end of the year.

When will these programs become available?

- The EIDL program is currently available.
- The PPP loan program is currently available.

How long will the PPP last?

- The program is open until December 31, 2020, but we are encouraging borrowers to apply as quickly as possible since the PPP Loans are "first come, first served" and lenders will need time to process the loans.
- NOTE: A borrower can only apply for one PPP Loan, so borrowers should apply for the maximum amount available.

What can I do now?

- For PPP Loans: Reach out to your existing relationship depository bank immediately to determine if they are an existing SBA 7(a) lender. Most banks only offer PPP Loans to their existing customers. To the extent a borrower does not have a relationship with an existing SBA 7(a) lender, a list of the top 100 most active SBA 7(a) lenders can be found here.
- For EIDL Loans: Go to the SBA website to apply.
- Complete the relevant Application Form (current as of June 5, 2020):
  - For PPP Loans: https://www.sba.gov/sites/default/files/2020-06/PPP-Borrower-Application-Form-Fillable-508.pdf
  - For EIDL Loans: 7(b) Loan Application (SBA Form 5): https://www.sba.gov/sites/default/files/files/serv_da_all_loanapp_2_0_0_3.pdf
- Other items to be submitted with your application:
  - Payroll Documentation (including any of the following: payroll processor records, payroll tax filings, or, if the borrower doesn't have such records, any other supporting documentation, such as bank records, sufficient to demonstrate the qualifying payroll amount)
  - Business tax returns (previous three years)
- NOTE: E-signatures and e-consents are permitted.

Additional Information Regarding the PPP (current as of June 5, 2020):

- An overview of the program can be found here.
- A Borrower Information Fact Sheet can be found here.
- A Lender Information Sheet can be found here.
- An FAQ can be found here.
- SBA Interim Final Rules can be found here, here and here.

Funding Stream 2: Tax Credits and Other Potentially Beneficial Tax Considerations

The CARES Act includes a number of potentially beneficial tax provisions for businesses, some of which apply generally across industries, while others are targeted to benefit specific industries (e.g., hospitality).

Section 2301 – Employee retention credit for employers subject to closure due to COVID-19.

- Provides a refundable payroll tax credit to qualifying employers on a dollar-for-dollar basis equal to 50% of qualifying wages paid by such employers to employees during the COVID-19 crisis, resulting in a maximum potential net credit of $5,000 per employee.
- The credit is available to employers whose (i) operations were fully or partially suspended due to a COVID-19-related government shutdown order (and only during periods in which its operations are fully or partially suspended), or (ii) gross receipts for a given quarter beginning after December 31, 2019 declined by more than 50 percent when compared to the same quarter in the prior year.
- The credit is based on qualified wages paid to the employee. Qualified wages include an allocable share of health benefits paid by an employer on behalf of the employee.
- Any family or sick leave wages for which a credit has been received under the Families First Coronavirus Response Act do not count as qualified wages for purposes of this credit.
- For employers who had an average of more than 100 FTEs during 2019, qualified wages are wages paid to employees when those employees are not providing services to the employer due to the COVID-19-related circumstances described above (i.e. (i) and (ii) in the second bullet).
- For eligible employers who had an average of 100 or fewer FTEs during 2019, all employee wages qualify for the credit, whether the employer is open for business or subject to a shut-down order.
- The credit is provided for wages paid or incurred from March 13, 2020 through December 31, 2020.

Section 2302 – Delay of payment of employer payroll taxes.

- Allows employers and self-employed individuals to defer payment of the employer share of the Social Security tax they otherwise are responsible for paying to the federal government with respect to their employees.
- As a general matter, employers are responsible for paying a 6.2-percent Social Security tax on employee wages.
- Section 2302 provides that employers can defer the tax due from the date of enactment of the Act through December 31, 2020.
- The provision requires that the deferred employment tax be paid over the following two years, with half of the amount required to be paid by December 31, 2021 and the other half by December 31, 2022.

Section 2307 – Technical amendment regarding qualified improvement property.

- Enables businesses to take an immediate deduction for costs associated with improving facilities instead of having to depreciate those improvements over the 39-year life of the building.
- The provision, which corrects an error in the Tax Cuts and Jobs Act, not only increases companies' access to cash flow by allowing them to amend a prior year return, but also incentivizes them to continue to invest in improvements as the country recovers from the COVID-19 emergency.