10 April 2020 Noreen Weiss

Key Features of the CARES Act

The "Coronavirus Aid, Relief, and Economic Security Act" (CARES Act) was enacted by Congress on March 25, 2020 to provide "emergency assistance and health care response for individuals, families and businesses affected by the 2020 coronavirus pandemic." One key feature is the creation of a $349 billion loan program for small businesses, including 501(c)(3) non-profits and physician practices. These loans can be forgiven through a process that incentivizes companies to retain employees.

- Forgivable Loan, and Emergency Loan, Programs
- Income Tax and Payroll Tax relief

Loan Programs: PPP and EIDL

Paycheck Protection Program or "PPP"

The "Paycheck Protection Program" or "PPP" is a loan, that is forgivable in whole or in part, as explained below. The PPP loans will be made through participating commercial lenders between February 15, 2020, and June 30, 2020 (the covered period), to eligible borrowers (see below). These PPP loans are fully guaranteed by the Small Business Administration ("SBA"). If you are interested in this type of financing, you should check with your bank to determine if it is a lender in this program, or visit www.sba.gov for a list of SBA lenders.

Eligibility:

A business is eligible if it meets all the following criteria:

- It employs not more than the greater of 500 employees (see below as to how to calculate this number),
- It has been in operation on February 15, 2020, and
- It can certify that
  - The uncertainty of current economic conditions makes the loan request necessary to support the ongoing operations of the applicant;
  - Funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments or utility payments;
  - The business does not have an application pending for an SBA business 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 applicant has not received another SBA business loan for the same purpose and duplicative of PPP amounts applied for or received.

Please refer to our companion article "Are Foreign-Owned Small Businesses Eligible for "PPP" Subsidies under the CARES Act?" for the eligibility of foreign-owned businesses.[1]

Counting employees

When counting employees, the business will count its own US employees (including anyone employed on a full-time, part-time or other basis) *and* employees of its "affiliates" (see below), and the applicant is required to certify that the payroll calculation is for only employees with a principal residence in the United States; additionally the calculations exclude independent contractors.

The SBA considers entities to be "affiliates" of one another when one controls or has the power to control the other, or a third party controls or has the power to control both. The SBA's conceptions of affiliation and control are more expansive than they are in the corporate context, and minority stockholders of a company are routinely deemed to "control" a company for SBA purposes (and, accordingly, each company "controlled" by the same minority stockholder would need to aggregate all employees across each other, even if otherwise unrelated). A majority owner of the company's voting equity is an affiliate. A minority owner is considered an affiliate if it can either:

- Prevent a quorum of the board of the company's directors or stockholders, or
- Veto day-to-day operational (as distinguished from extraordinary) decisions of the company, including encumbering or selling assets (short of all or substantially all assets), amending or terminating lease agreements, purchasing equipment, officer or employee compensation decisions, hiring and firing officers and executives, incurring debt, paying distributions or dividends, bringing or defending a lawsuit, approving or changing the budget, changes in strategic direction (aside from entering into a substantially different line of business), or establishing or amending an incentive or employee stock ownership plan.

Consequently, typically the applicant counts all employees of all enterprises of any shareholder who meets a test above.

The access to credit elsewhere" exception has been waived for a PPP loan.

The PPP waives the ordinary requirement that the applicant be unable to obtain credit elsewhere. Customarily the SBA requires that any 20%+ owner inject any liquid assets above a certain threshold into the business in order to reduce the amount of the loan; however, recent SBA guidance indicates that this typical requirement is included in the waived "credit elsewhere" requirement noted above, but the guidance is not yet definitive.

Other favorable terms.

PPP loans require no personal guarantee, and no collateral. The loans are fee-free, and payments of principal and interest are deferred for at least six months and up to a year.

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[1] By Robert MacDonald, Partner, MacDonald Weiss PLLC.

Loan Amount – based on payroll, but proceeds may be used for many other expenses

The loan can be for an amount required to cover up to two months of the business's average monthly payroll costs from the last year plus an additional 25% of that amount. The PPP loans may not exceed 250% of the business's average monthly "payroll costs" (see below) from (generally) the year prior to the loan, up to a total maximum of $10 million.

"Payroll costs" include the total amount of any compensation to (1) employees in the form of salaries, wages, commissions and cash tips (capped at $100,000 on an annualized basis for each employee), payments for leave, severance, group health care benefits, retirement benefits, or state or local taxes assessed on employee compensation. Effectively this means that for any employee whose salary is $100,000 or more, only $8,333 per month can be included in the calculation of average monthly payroll costs, in addition to that employee's cost of health and retirement benefits and state and local taxes prorated for the covered period. Independent contractors (those who receive a Form 1099) do *not* count toward the total payroll costs in the calculation of the loan amounts as independent contractors have the ability to apply for the loan on their own.

Permitted use of loan proceeds

During the period from February 15, 2020, to June 30, 2020 (the covered period), the loans can be used for payroll costs, health care benefits, mortgage interest, rent, utilities and interest on any other debt obligation that was incurred before February 15, 2020. However, no more than 25% of the loan amount can be used for non-payroll costs.

PPP Loan Forgiveness

Recipients can apply for and receive forgiveness of all or a portion of a PPP loan. The Act allows for a maximum forgiveness of the aggregate value of the loan used for payroll, mortgage interest, rent and utilities that the business can document that it paid in the eight weeks following origination of the loan.

The remainder of the loan will not be forgiven; also, amounts of the loan used to pay interest on other obligations (not mortgage) will not be forgiven, nor will amounts paid outside of the covered period of the loan. Any remaining balance on the loan that is not forgiven will remain fully guaranteed by the SBA, will accrue interest at 1.0%, and will be due in 2 years but there are no pre-payment penalties; also, the onset of payment is deferred for 6 months (but interest will still accrue during that time).

The amount of the loan actually forgiven by the SBA may also be reduced if the business reduced its workforce or instituted wage or salary cuts (for employees who made less than $100,000 in 2019), and the reduction is calculated by comparing full-time headcount and salary amounts during the eight-week period after the loan was originated to headcount and salary amounts during prior designated time periods. A portion of these reductions will not apply if the company rehires or eliminates the salary reductions by June 30, 2020.

How to apply for a PPP loan

Applicants must submit SBA form 2483 as well all relevant payroll documentation, through a private bank or other lending institution.

Economic Injury Disaster Loans (EIDL) program

The CARES Act likewise expands access to SBA's economic injury disaster loans (EIDL) program to businesses with fewer than 500 employees, which grants emergency loans for businesses suffering an immediate economic injury. The same affiliate issues described above apply. Eligible businesses that suffer substantial economic injury as a result of a disaster or emergency, which now includes COVID-19, can apply for a loan under this program between January 31, 2020, and December 31, 2020.

Loan size and payment terms

Unlike PPP, moneys under the EIDL are loans. Qualifying businesses can obtain a loan of up to $2,000,000 depending on the size and type of business. The interest rate is 3.75% for for-profit businesses and 2.75% for non-profit businesses, with a maximum term of 30 years. No payment is due for one year. While interest accrues during the deferment period, there is no prepayment penalty.

What constitutes Substantial Economic Injury

To establish a qualifying economic injury, the business must demonstrate an inability to meet its obligations as they mature or pay its ordinary and necessary operating expenses as a result of COVID-19. This can be shown by comparing financial information from the prior year with the current year, with the difference associated with COVID-19

Guarantees and Collateral Requirements

Collateral is required for loans above $25,000. No personal guarantee is required for EIDLs under $200,000, and the loan can be made solely upon the applicant's credit score. An owner of more than 20% of the borrower may have to provide a personal guarantee for loans over $200,000. Initial advances of up to $10,000 can be issued within three days and will be subtracted from the final loan amount. The loan will bear a low rate of interest; however, unlike PPP loans, the act does not provide for forgiveness for EIDLs. Businesses may receive both PPP loans and EIDLs, so long as both loans are not used for the same purpose or otherwise duplicative.

Use of Proceeds

The loan funds can be used to pay fixed debts, payroll, accounts payable and other operating expenses that could have been paid if the disaster had not occurred.

Tax Relief

Employee Retention Credit for Employers Affected by COVID-19

The Act provides eligible employers that experience full or partial suspension of operations caused by a shutdown order due to COVID-19, or significant decline in gross receipts, with a refundable employment tax credit for 50% of qualified wages paid to employees. This credit is not available to employers that receive a loan under the PPP. Applies to wages paid after March 12, 2020 and before January 1, 2021. Qualified wages are limited to $10,000 per employee.

Delay of Payment of Employer Payroll Taxes

The Act allows employers to defer payment of the employer share of Social Security taxes that otherwise would be due between the date of enactment of the CARES Act and December 31, 2020. A similar deferral is available to self-employed individuals. Fifty percent of such deferred taxes are due December 31, 2021. The remaining 50% are due December 31, 2022. This benefit is not available to employers that have had loans forgiven under the PPP.

For further information please contact Noreen Weiss, weiss@macdw.com, +1-646-513-3284.

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