GERSTMANSCHWARTZ
ATTORNEYS AT LAW

GOTHAM
GOVERNMENT RELATIONS

www.gerstmanschwartz.com 516-880-8170 www.gothamgr.com

For more information please contact David Schwartz at dschwartz@gerstmanschwartz.com

Dear Clients, Friends and Colleagues:

We have received a lot of requests from our clients asking us to clarify the Small Business Association ("SBA") borrowing options available under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). While we wanted to keep our previous emails concise for the purpose of readability, we are using this as an opportunity to provide a more extensive overview of the CARES Act's two primary borrowing provisions; namely, **Paycheck Protection Program Loans** ("PPP") and **Economic Injury Disaster Loans** ("EIDL").

We would also like to clarify two important details. First, although the CARES Act has now been signed into law, we are still awaiting further guidance on how these benefits can actually be claimed and utilized. Second, there seems to be a lot of confusion around the "**Employee Retention Credit**" under the Section 2301 of the CARES Act. It is important to note that while this exemption might be an excellent option for certain businesses, any business that obtains an SBA PPP loan under the CARES Act is **NOT** eligible for the Employee Retention Credit (or the Delay of Employer Payroll Taxes). That said, a business that obtains an EIDL only might still be eligible for these credits.

BUSINESS LENDING & GRANTS

PAYCHECK PROTECTION LOANS

The CARES Act has expanded the existing SBA 7(a) loan programs adding a new category called Paycheck Protection Program Loans ("PPP" loans). This allows the SBA to provide 100% federally guaranteed loans to eligible businesses to assist with operational costs such as payroll, rent, health benefits, insurance premiums and utilities. A portion of these loan amounts are

<u>forgiven</u>, subject to certain conditions, which we will discuss in more detail below. *Additionally, PPP loans are expected to have a "rapid" turnaround of 1-3 days*.

The Covered Loan Period

A "covered loan" is a PPP loan that is made during the period of February 15, 2020 to June 30, 2020.

Who Is Eligible?

The CARES Act has made these loans available to most businesses and has reduced the requirements for obtaining a loan. The businesses that are eligible for the new program are "small business concerns" (defined as a for-profit business located primarily in the U.S. or that makes a significant contribution to the American tax system), any business concern (so long as they meet the criteria below), nonprofit organizations, veterans' organizations, and Tribunal businesses, each of which **MUST** meet the following requirements:

- Employ 500 or fewer employees; or
- If applicable, the size standard in number of employees established by the Administration for the industry in which the entity operates.

Sole proprietors, independent contractors and eligible self-employed individuals (as defined in the Families First Coronavirus Response Act ("Families First Act") *are also eligible to receive PPP loans*, subject to certain documentary requirements.

How Much Can You Borrow?

The maximum loan amount (capped at $10 million) is the lesser of:

- 2.5 times the total monthly payroll costs incurred in the one-year period before the loan is made; <u>OR</u>
- For businesses that did not exist during the period from February 15, 2019 to June 30, 2019:
    - 2.5 times the average total monthly payroll payments from January 1, 2020 to February 29, 2020; <u>OR</u>
- $10 million.

Businesses are permitted to use the loan proceeds for:

- *Payroll costs;*
- *Rent/lease payments;*
- *Mortgage interest payments;*
- *Utilities;*
- *Interest (excluding principal) on any other debt obligations incurred before the covered period;*

Borrowers who use the loan for non-permissible purposes risk changing their recourse obligations under the loan.

Payroll Costs

Payroll costs are defined as:

- *Employee compensation including salary, wage, commission and cash;*
- *Severance payments;*
- *Group health care benefits during periods of paid sick, medical or family leave, vacation, and insurance premiums;*
- *Retirement benefits;*
- *State and local payroll taxes; and*
- *Compensation to sole proprietors or interdependent contractors (including commission-based compensation).*

Payroll costs ***exclude*** compensation of individual employees with an annual salary in excess of $100,000.

Loan Terms and Deferment

The loans have a *maximum repayment term of* **<u>10 years</u>** *and a maximum interest rate of* **<u>4%</u>**. The loans also qualify for *complete payment deferment* for a period of **<u>six months to one-year</u>** and lenders are required to provide such relief. A portion of the loan will also be **<u>forgiven</u>** during the *first eight weeks* of the loan (as described in further detail below).

Loan Forgiveness

One of the most talked about and appealing aspects of this program is that borrowers qualify for ***loan forgiveness***. The loan forgiveness will NOT be considered taxable income and is excluded from calculations of gross income. The loan proceeds that are used within the first eight weeks of the origination of the loan are eligible for forgiveness, so long as:

- *The loan proceeds are used only for permissible purposes (except for non-mortgage debt interest);*
- *The borrower maintains a certain salary level for staff, subject to limits;*
- *The loan borrower maintains a certain number of full-time equivalent employees*

How Is Loan Forgiveness Calculated?

The following costs incurred and payments made during the first **eight weeks** of the loan origination are **forgiven**:

- *Payroll costs* (excluding employees whose income exceeded $100,000);
- *Mortgage interest payments* that were in place prior to February 15, 2020;
- *Lease or rent payments* that were in place prior to February 15, 2020;
- *Utility payments* that were in place prior to February 15, 2020, for the following:
  - *Electricity*
  - *Gas*
  - *Water*
  - *Transportation*
  - *Telephone*
  - *Internet access*

The Limits Of Forgiveness

The amount forgiven is reduced in proportion to any reduction in the number of Full Time Equivalent Employees ("FTEEs," which are currently undefined) and/or in wages.

The formula for a reduction in employees is:

1. The maximum available forgiveness under the rules described above **multiplied by**:
2. The average number of FTEEs per month (based on the average number of FTEEs for each pay period falling within a month) during the covered period **divided by**:

3. Either (at the election of the borrower):
    - The average number of FTEEs per month employed from February 15, 2019 to June 30, 2019; or
    - The average number of FTEEs per month employed from January 1, 2020 until February 29, 2020.

The employee reduction formula will be used only to reduce forgiveness amounts but cannot be used to increase these amounts.

The formula for a reduction in the number of salaries and wages is a straight reduction by the amount in pay of any employee during the covered period that is in excess of 25% of the employee's salary/wages during the employee's most recent full quarter of employment before the covered period.

- For example, if an employee's wages are reduced by 10% there is no reduction; however, if an employee's wages are reduced by 30%, the forgiveness amount will be reduced by 5% (30% - 25%).

Any employee whose annual salary is over $100,000 is excluded from these reductions.

A borrower can avoid these reductions entirely by rehiring workers previously laid off and/or making up for wage reductions by **June 30, 2020**. Specifically, in the following circumstances, the forgiveness reduction rules above will not apply to an employer who, between **February 15, 2020 and April 27, 2020**:

- Reduces the number of FTEEs in this period and, by June 30, 2020, the employer has eliminated the reduction in FTEEs; or
- There was a salary reduction, as compared to February 15, 2020, during this period for one or more employees, but the reduction is subsequently eliminated by June 30, 2020.

Applying For Loan Forgiveness

Although the applications have not yet been released, there are some required processes to apply for loan forgiveness. Borrowers seeking forgiveness of amounts must submit to their lender:

- Documentation verifying FTEEs on payroll and their pay rates;
- Documentation on covered costs/payments (*e.g.*, documents verifying mortgage, rent, and utility payments);
- Certification from a business representative that the documentation is true and correct and that the forgiveness amounts requested were used to retain employees and make other forgiveness-eligible payments; and

- Any other documentation the Administrator may require.

The Application Process and Considerations

The PPP loans will typically be available at your regular banking institution. The application is not yet available, but is expected to be fairly simple and straightforward. Lenders are required to issue a determination on forgiveness within 60 days of the application.

To qualify, the borrower must:

- Have been operational on February 15, 2020;
- Have employees whom the business paid salaries and payroll taxes, or paid independent contractors; and
- Have been substantially impacted by public health restrictions related to COVID-19.

Eligible borrowers are required to make a good faith certification that they have been affected by COVID-19 and will use the funds to retain workers and maintain payroll and other debt obligations.

Unlike other SBA programs, there is no requirement to evaluate the borrowers' ability to repay the covered loan or that the borrower not be able to find credit elsewhere. Additionally, there is no personal guarantee or collateral required.

Relationship To Other CARES Act Provisions

It is important to remember that recipients of PPP loans under the CARES Act are NOT eligible for either the Employee Retention Credit or the Delay of Employer Payroll Taxes.

ECONOMIC INJURY DISASTER LOANS

The CARES Act has also expanded the Economic Injury Disaster Loan ("EIDL") program. *The anticipated turnaround time on these loans is between 21 to 45 days*.

Qualifications

The covered period for this section is January 31, 2020 - December 31, 2020. In addition to current eligible entities, the following may receive SBA disaster loans:

- A business with 500 or fewer employees;
- *Sole proprietorships, with or without employees, and independent contractors*;
- Cooperatives with 500 or fewer employees;
- ESOPs with 500 or fewer employees; and
- Tribal small business concerns.

Changes To The SBA Disaster Loan Program

- Waives rules related to personal guarantees on advances and loans of $200,000 or less for all applicants;
- Waives the "1 year in business prior to the disaster" requirement (except the business must have been in operation on January 31, 2020);
- Waives the requirement that an applicant be unable to find credit elsewhere; and
- Allows lenders to approve applicants based solely on credit scores (no tax return submission required) or "alternative appropriate methods to determine an applicant's ability to repay."

The SBA will still assess the borrower's ability to repay.

Cash Advances (Forgiven)

The program also allows for an emergency advance up to $10,000, which does **NOT** have to be repaid even if the recipient is subsequently denied an EIDL. The grants are issued through a self-certification and will be provided within **<u>three days</u>** of the application. Any cash advance received under this program will be deducted from any amount of Loan Forgiveness on a PPP loan.

Relationship Between PPL Loans and EIDL Loans

A business **CANNOT** apply for both a PPP and an EIDL ***for the same purposes***. Businesses must therefore be cautious in how they choose to use the respective loan proceeds. For example, an *EIDL can cover expenses not covered by PPP Loans including*:

- *Increased supply chain costs*
- *Accounts payable and bills*
- *Repaying debts that cannot otherwise be repaid*

A prudent business strategy might therefore be to apply for an EIDL and an emergency grant, *to cover the above expense only*, and to subsequently apply for a PPP loan—when it becomes available—to cover *other expenses*. It is also worth noting that a loan made under the EIDL program, on or after January 31, 2020, may be refinanced as part of a covered loan under the PPP loan program.