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The following is an update of our March 31, 2020 CARES Act summary. This update includes the Interim Final Rule published by the SBA on April 2, 2020 in connection with implementation of the Paycheck Protection Program (PPP) established under the CARES Act. Information underlined below reflects changes or clarifications set out in the SBA's Interim Final Rule.

THE CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY ACT (the "CARES Act")

Updated April 3, 2020 (includes the SBA Interim Final Rules issued on April 2, 2020)

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The CARES Act was enacted into law on March 27, 2020, as part of the federal effort to provide relief to small businesses affected by the ongoing COVID-19 pandemic, including a new Paycheck Protection Program (section I below), a subsidy for existing SBA loans (section II below), and expanding relief under the SBA's existing Economic Injury Disaster Loan ("EIDL") program, which was signed into law on March 6, 2020 (section III below). The CARES Act also provides certain tax relief and other tax benefits for employers (SCW has prepared a separate summary of these tax provisions).

I. THE PAYCHECK PROTECTION PROGRAM

A. Generally

- Section 1102 of the CARES Act permits the SBA to guarantee 100% of Section 7(a) loans under a new program titled the Paycheck Protection Program" (PPP).
- Section 1106 of the CARES Act provides forgiveness of up to the full principal amount of qualifying loans guaranteed under the PPP.
- $349 billion in federal funds have been appropriated to fund this new program.
- The intent of the PPP is to provide relief to small businesses by providing funds to cover up to 8 weeks of payroll expenses and other amounts paid during that period toward certain existing debt obligations.
- PPP loans will be made and serviced by SBA-certified lenders. The SBA will seek to expedite loans by giving SBA-approved lender delegated authority and streamlining application and approval processes. Lenders are allowed to rely on borrower certifications in the approved PPP Application Form and borrower documentation required to be submitted to determine eligibility and maximum loan amounts.

B. Eligible Businesses

- *Eligible borrowers* include the following small businesses that were in operation as of February 15, 2020 and had either employees for whom you paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC:

    1. Any business with no more than 500 employees whose principal place of residence is in the United States[1];

    2. Any other business that otherwise meets the SBA's size standards for the applicable North American Industry Classification System (NAICS) code, which are usually stated in the average number of employees (full-time, part-time, temporary, leased and affiliate employees) over the past 12 months or average annual receipts over the past 3 years[2];

    3. Sole proprietors, independent contractors, and self-employed individuals who regularly carry on any trade or business, including those in the gig-economy;

    4. Hospitality and food service businesses (those with NAICS code beginning with 72) if it has fewer than 500 employees per physical location;

    5. A tax-exempt non-profit entity under Section 501(c)(3) of the Internal Revenue Code which has no more than 500 employees;

    6. A tax-exempt veterans organization under Section 501(c)(19) of the Internal Revenue Code that meets the applicable SBA size standards; or

    7. A tribal concern described in Section 31(b)(2)(C) of the Small Business Act

- *Borrower Affiliates.* The 500 employee limit will typically include employees of the borrower's affiliated businesses. Generally a business controlled by or under common control with a borrower is deemed to be affiliated for purposes of determining the number of employees under the PPP. The SBA typically looks at common ownership, management, and contractual relationships and rights (e.g., blocking or veto rights).

- *Borrower Affiliation Waivers*. These affiliation requirements have been waived for the following:

    1. Accommodation and food service companies which have been assigned an NAICS code beginning with 72;

    2. A business operating as a franchise that has an SBA-assigned franchise identifier code; and

[1] Volunteers and independent contractors are not counted in the calculation of employees. Independent contractors have the ability to apply for PPP loans on their own.

[2] Language in the CARES Act suggests that NAICS size standards, to the extent applicable for PPP eligibility, will be determined as of the date the loan is disbursed.

3. Any entity that receives financial assistance from a company licensed under Section 301 of the Small Business Investment Act (SBIA), which typically does not affiliate businesses owned wholly or in substantial part by licensed small business investment companies or development companies qualifying under the SBIA.

- *Ineligible Borrowers*. Applicants who otherwise meet the foregoing requirements will be denied loans if any of the following apply:

    1. The applicant or ANY owner is presently suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in the loan transaction by any Federal department or agency;

    2. The applicant or ANY owner is presently involved in any bankruptcy;

    3. The applicant or ANY of its owners, or any business owned or controlled by them, has received a direct or guaranteed loan from the SBA or any other Federal agency that is currently delinquent or has defaulted in the last 7 years and caused a loss to the government;

    4. The applicant (if an individual) or any individual owning more than 20% of the applicant's equity subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction;

    5. The applicant (if an individual) or any individual owning more than 20% of the applicant's equity is presently incarcerated or on probation or parole;

    6. The applicant (if an individual) or <u>ANY of its owners (initial guidance had limited this to 20% owners)</u> has, within the <u>last 5 years (initial guidance had specified 7 years</u>), for any felony (<u>the Interim Rule deletes misdemeanors for a crime against a minor</u>), (a) been convicted; (b) pleaded guilty; (c) pleaded nolo contendere; (d) been placed on pretrial diversion; or (e) been placed on any form of parole or probation (including probation before judgment);

    7. The applicant was not in operation on February 15, 2020 <u>and did not have employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on Form(s) 1099-MISC</u>;

    8. The applicant does not need the PPP loan to support its ongoing operations due to the current economic uncertainty;

    9. The applicant does not intend to use the PPP loan funds to retain workers and maintain payroll or make qualified mortgage interest payments, lease payments, and utility payments;

    10. The borrower has received another PPP loan and will not receive another a PPP loan on or before December 31, 2020;

    11. <u>The borrower is engaged in any activity that is illegal under federal, state or local law;</u>

12. The borrower is a household employer (individuals who employ household employees such as nannies or housekeepers).

13. Financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances);

14. Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except Eligible Passive Companies under Small Business Act Section 120.111);

15. Life insurance companies;

16. Businesses located in a foreign country (businesses in the U.S. owned by aliens may qualify);

17. Pyramid sale distribution plans;

18. Businesses deriving more than one-third of gross annual revenue from legal gambling activities;

19. Businesses engaged in any illegal activity;

20. Private clubs and businesses which limit the number of memberships for reasons other than capacity;

21. Government-owned entities (except for businesses owned or controlled by a Native American tribe);

22. Businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting;

23. Loan packagers earning more than one third of their gross annual revenue from packaging SBA loans;

24. Businesses in which the SBA lender or CDC, or any of its Associates (as defined in 13 CFR Section 109.20) owns an equity interest;

25. Businesses which (a) present live performances of a prurient sexual nature; or (b) derive directly or indirectly more than *de minimis* gross revenue through the sale of products or services, or the presentation of any depictions or displays, of a prurient sexual nature;

26. Businesses primarily engaged in political or lobbying activities; and

27. Speculative businesses (such as oil wildcatting).

Initial Guidance indicated that PPP loans would not be available to entities with any foreign owner holding 20% or more of the applicant's equity. That limitation has been eliminated in the Interim Final Rule. Instead, applicants must certify that the United States is the principal place of residence for all employees included in the applicant's loan request.

PPP Loan Application Period

- Loan applications can be submitted beginning on April 3, 2020 for small businesses and sole proprietorships and April 10, 2020 for independent contractors and self-employed individuals.

- The loan application period ends on June 30, 2020.

C. Maximum PPP Loan Amount

- A PPP loan cannot exceed the lesser of:

  1. $10,000,000, **OR**

  2. (a) 2.5 x the average monthly Payroll Costs during the 1-year before the loan is taken, or (b) 2.5 x the average monthly Payroll Costs for March, April, May and June 2019 if the employer is seasonal, or
     (c) 2.5 x the average monthly Payroll Costs for January and February of 2020 if the employer has been in business for less than 12 months.

- *Payroll Costs*. For purposes of the PPP loan program, "Payroll Costs" include:

  1. Salaries, wages, commissions or similar compensation up to $100,000 per year ($8,333.33 per month) per employee (prorated for February 15, 2020 to June 30, 2020), for employees whose principal place of business is in the United States.

  2. Cash tips or the equivalent (based on employer records of part tips or, in the absence of such records, a reasonable, good faith employer estimate of such tips).

  3. Payments for vacation, parental, family, medical or sick leave (excluding any sick leave or family leave wages provided by the new Families First Coronavirus Response Act for which there are already tax credits under that law).

  4. Severance or dismissal payments.

  5. Group health insurance payments (including premiums).

  6. Retirement plan contributions.

  7. State and local taxes assessed on such compensation (but not federal withholdings, including FICA, Railroad Retirement Act taxes and income taxes required to be withheld from employees).

8. For an independent contractor or sole proprietor, wage, commissions, income, or net earnings from self-employment or similar compensation.

- *Recommended Methodology*:

Step 1: Aggregate "Payroll Costs" from the last 12 months for employees whose principal place of residence is in the United States.

Step 2: Subtract any compensation paid to an employee in excess of an annual salary of $100,000 and/or amounts paid to an independent contractor or sole proprietor in excess of $100,000 per year.

Step 3: Divide the amount from Step 2 by 12 (this is the applicant's average monthly Payroll Costs).

Step 4: Multiply the amount from Step 3 by 2.5.

Step 5: Add the outstanding amount of any Economic Injury Disaster Loan (EIDL) made between January 31, 2020 and April 3, 2020, less the amount of any "advance" under an EIDL COVID-19 loan (because it does not have to be repaid). The sum is the applicant's maximum PPP loan amount.

D. PPP Loan Terms

- Loan terms for PPP will be the same for all borrowers and include:

  - 100% guaranteed by the SBA (not 75% as with other 7(a) loans)
  - Non-recourse (no personal guarantees) (as long as loan is used for authorized purposes)
  - No collateral required
  - 1.00% interest rate (up from 0.5% in the initial guidance)[3]
  - 2 year maturity
  - No prepayment penalties
  - No "Credit Elsewhere Test"
  - No Section 7(a) annual fees
  - No up-front fees paid by the borrower
  - Principal and interest payments will be deferred for at 6 months (the Act had indicated that deferment could be up to 1 year, which is now not the case). Interest will continue to accrue on PPP loans during the 6-month deferment
  - Loans can be pre-paid at any time
  - Up to 100% of principal may be forgivable (see Section F below)
  - PPP Loans will be processed by SBA approved lenders

[3] The SBA, in consultation with the Treasury Secretary, determined that a 1% interest rate was appropriate because (a) it provided low cost funds to borrowers during the temporary period of economic dislocation caused by COVID-19; (b) for lenders, the 100 basis points offers an attractive interest rate relative to the cost of funding for comparable maturities. For example, the FDIC's weekly national average rate for a 24-month CD deposit product for the week of March 30, 2020, is 42 basis points for non-jumbo and 44 basis points for jumbo; and (c) the interest rate is higher than the yield on Treasury securities of comparable maturity. For example, the yield on the Treasury 2-year note is approximately 23 basis points. This higher yield combined with the fact that PPP loans are 100% guaranteed by the SBA and the fact that lenders will receive a substantial processing fee from the SBA provide ample inducement for lenders to participate..

- Eligible borrowers may only receive 1 PPP loan.

- E-signatures or e-consents can be used regardless of the number of owners.

- The PPP is "first-come, first-served"

E. Use of PPP Loan Proceeds

- The Interim Final Rule has confirmed that a PPP loan may be used for the following:

    1. "Payroll Costs" (at least 75% of PPP loan proceeds must be used for Payroll Costs[4]);

    2. *Interest* (not prepayments or principal payments) on mortgage obligations incurred before February 15, 2020;

    3. Rent payments under lease agreements in force before February 15, 2020;

    4. Utilities (e.g. electricity, water, gas, telephone, transportation, internet access, etc.) for which service began before February 15, 2020;

    5. Interest payments on any other debt obligations that were incurred before February 15, 2020; and/or

    6. Refinancing an SBA EIDL loan made between January 31, 2020 and April 3, 2020. If the applicant's EIDL loan was used for payroll costs, it does not affect eligibility for a PPP loan. If the EIDL loan was used for payroll costs, the PPP loan must be used to refinance the EIDL loan. Proceeds from any EIDL advance up to $10,000 will be deducted from the loan forgiveness amount of the PPP loan.

- The Interim Final Rule also states that PPP loan proceeds may be used for the purposes stated above **AND** for other allowable uses described in Section 7(a) of the Small Business Act (15 U.S.C. 636(a)), which includes plant acquisition, construction, conversion, or expansion, including the acquisition of land, material, supplies, equipment, and working capital.

- If PPP loan funds are used for unauthorized purposes, the borrower will be required to pay those amounts. If a borrower knowingly uses funds for unauthorized purposes, the borrower will be subject to additional liability such as charges for fraud.

F. PPP Loan Forgiveness

- *Forgivable Amount*. PPP loans will be eligible for forgiveness, up to the original principal amount of the loan, to the extent loan proceeds have been used for the following purposes during the 8-week period after the loan is made:

    1. Payroll Costs (as broadly defined above);

[4] For purposes of determining the percentage of use of proceeds for Payroll Costs, the amount of any EIDL refinanced will be included.

2. Interest (not principal) payments on mortgages that existed on February 15, 2020;
3. Rent payments; **PLUS**
4. Utility payments (e.g., electricity, gas, water, telephone, transportation, internet access, etc.).

- *Reductions.* The purpose of the PPP is to help businesses retain employees who make less than $100,000 per year ($8,333.33 per month) at their current base pay. Accordingly, the amount of loan forgiveness will be reduced under the following circumstances:

  Headcount is Reduced - If the number of full-time equivalent employees (FTEs) on June 30, 2020 is less than 25% of the borrower's FTEs on February 15, 2020, loan forgiveness with be reduced proportionately.

  Compensation is Reduced - If the borrower's total Payroll Costs for workers making less than $100,000 per year ($8,333.33 per month) decreases by more than 25%, loan forgiveness will be reduced by that amount.

  Re-Hiring - If the borrower rehires laid-off employees and/or restores salaries of employees who took pay cuts by June 30, 2020, the borrower will not experience forgiveness reduction for those matters.

- If the full principal of the PPP loan is forgiven, the borrower will not be responsible for the interest accrued during the 8-week covered period. The remainder of the loan that is not forgiven will operate according to the agreed loan terms.

- Forgiven amounts will NOT constitute cancellation of debt income for federal tax purposes.

- The SBA will reimburse the lender for the principal amount of any forgiven debt, which may encourage lenders to be open to loan forgiveness.

- In order to be considered for PPP loan forgiveness, the borrower must:

  1. Submit an application for loan forgiveness directly to the lender (the lender will have 60 days from receipt to make a determination).
  2. Provide documentation verifying the number of employees on payroll during the 8-week period of eligible loan forgiveness, including payroll tax filings reported to the IRS as well as state income, payroll, and unemployment insurance filings.
  3. Provide documentation, including canceled checks, payment receipts, accounting reports, etc. verifying payments on business debts, rent and utility payments.
  4. Provide a certification from an officer or owner of the borrower that the information being submitted is true and that the amount for which forgiveness is being requested was used to retain employees, make interest payments on business debts, lease payments, and/or utilities.

G. How to Apply for a PPP Loan

- The PPP loan application deadline is June 30, 2020. However, interested borrowers are encouraged to apply as soon as possible to avoid the expected volume of applications. Treasury Secretary Mnunchin has said that PPP loan applications might be available as early as April 3, 2020, although that seems optimistic given the need to develop regulations and coordinate with thousands of SBA lenders.

- Applications must be made through lending institutions that are approved to participate in the SBA's existing Section 7(a) program as well as other lenders approved by the Department of Treasury. We recommend that borrowers contact existing lenders to determine if they are PPP eligible. Otherwise, borrowers can contact their local SBA offices or visit the SBA website for a list of 7(a) approved lenders (https://www.sba.gov/funding-programs/loans/paycheck-protection-program for more information). Applications should NOT be submitted to the SBA.

- *Borrower Documentation*

  1. Submit a completed and signed SBA Paycheck Program Application Form 2483 (04./20) (e-signatures or e-consents can be used regardless of the number of owners but borrowers should be prepared to provide "wet signatures" in due course), any 20% owner of applicant must submit certifications as well;

  2. Documentation to confirm that the applicant was in existence on April 15, 2020, including, as applicable:
     - Articles of Incorporation/Organization
     - Bylaws/Operating Agreement
     - Good Standing Certificate
     - Governing documents for 501(c)(3), 501(c)(19) or 31(b)(2)(C) organizations)

  3. Documentation confirming the dollar amount of average monthly Payroll Costs for the preceding calendar year, including, as applicable::

     - Payroll summary report of payroll register
     - IRS Forms 940, 941, and 944, as applicable
     - For seasonal employees, a payroll summary report for the period February 15, 2019 through June 30, 2019
     - Other financial statements or reports to support Payroll Costs
     - IRS 1096 and/or 1099-MISC for independent contractors

II. SBA SUBSIDY OF EXISTING SMALL BUSINESS LOANS

Small businesses with existing SBA loans through the SBA Section 7(a), 504 and Microloan programs are also afforded relief under the CARES Act. The SBA will be subsidizing those loans, up to an estimated amount of $17 billion. Key details about this subsidy program include the following:

- The SBA will pay the principal, interest, and any associated fees that are owed on existing covered loans for a 6 month period, starting on the next payment due date;

- For covered existing loans that are already on deferment, the SBA will begin making these payments with the first payment after the deferral; and

- SBA loans that are made under these programs—not including the Paycheck Protection Program—within the next 6 months will also receive a full 6 months of loan payments by the SBA.

Small businesses with these existing covered loans should contact their lender directly for additional details regarding this SBA subsidy program.

III. SECTION 7(b) ECONOMIC INJURY DISASTER LOANS

The CARES Act also contains provisions related to the SBA's existing Economic Injury Disaster Loan ("EIDL") program, which was signed into law on March 6, 2020 as part of the Coronavirus Preparedness, and Response Supplemental Appropriations Act. The EIDL program operates under Section 7(b) of the Small Business Act and provides low-interest (3.75% for small businesses and 2.75% for nonprofits) long-term loans to small businesses located in areas that the SBA has declared to be geographic disaster zones. Small businesses can apply for up to $2 million in 7(b) EIDL loans if they are located within the geographic disaster zones identified on the SBA's website.

Key changes to this program based on the CARES Act include:

- Under the CARES Act, a borrower that receives a PPP loan would not be able to obtain an EIDL loan for the same purposes. However, an EIDL loan made on or after January 31, 2020 could be refinanced as part of a new PPP loan program.

- Section 1110 of the CARES Act provides that SBA EIDL 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 will be available only until June 30, 2020.)

- The CARES Act similarly changes the definition of "small business," for the purposes of an EIDL loan, to include a company with no more than 500 employees, but does not waive the affiliation rules for NAICS Sector 72 businesses.

- The CARES Act also (a) waives the personal guaranty requirement for EIDL loans under $200,000, (b) requires eligible businesses to be in operation since January 31, 2020 rather than 1 year, and (c) waives the requirement for borrower to demonstrate that they are unable to obtain credit from other sources.

- The CARES Act provides a $10,000 emergency advance (within 3 days of submitting an application) while applicant's loan application is pending, for any allowable purpose under the Section 7(b) program, including (a) providing paid sick leave to employees unable to work due to the direct effect of COVID-19, (b) maintaining payroll to retain employees during business disruptions or substantial slowdowns, (c) meeting increased costs to obtain materials unavailable from the applicant's original source due to interrupted supply chains, (d) making rent or mortgage payments, and (e) repaying obligations that cannot be met due to revenue losses. If the applicant receives an advance but is subsequently denied an EIDL loan, the advance need not be repaid. The CARES Act designates $10 billion for these immediate EIDL grants.

- An applicant may receive an EIDL advance while still applying for a Section 7(a) loan described above and that, if the applicant later receives a 7(a) PPP loan, the amount of the advance will "be reduced from the loan forgiveness amount for a loan for payroll costs."

As background on the Economic Injury Disaster Loan program, Section 7(b) EIDL loans may be used to pay fixed debts, payroll, accounts payable and other costs, but are not intended to replace lost sales or profits and cannot be used for certain purposes, including to refinance debt, make payments on loans owed by another federal agency, to pay tax penalty obligations, repair physical damages, or to pay dividends to stockholders. These EIDL loans also offer long-term repayments in order to keep payments affordable, up to a maximum of 30 years. Terms are determined on a case-by-case basis, based upon each borrower's ability to repay.

To be eligible, the applicant also must have an acceptable credit history, have the ability to repay the loan, be physically located in a declared disaster area, and have suffered working capital losses due to the declared disaster, not due to a downturn in the economy or other reasons.

Applicants may apply for an EIDL loan online at https://www.sba.gov/disaster/apply-for-disaster-loan/index.html and should expect to provide at least the following paperwork:

- Completed SBA loan application (SBA Form 5)
- Tax Information Authorization (IRS Form 4506T) for the applicant, principals and affiliates
- Complete copies of the most recent Federal Income Tax Return
- Schedule of Liabilities (SBA Form 2202)
- Personal Financial Statement (SBA Form 413)

Summers Compton Wells LLC will continue to monitor these programs and will be available to answer questions and work closely with our clients and their accountants to better understand these programs. Please contact one of our attorneys if we can assist.

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