

Congress Passes CARES Act: Stimulus Package Includes \$349 Billion for SBA Guarantees of Forgivable Loans for Small and Medium Sized Businesses

Legal Alert
March 27, 2020

On March 27, 2020, Congress passed and the President signed the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). Below is a summary of the Paycheck Protection Program of the CARES Act, as it relates to U.S. Small Business Administration (“SBA”) loans. Specifically, the Paycheck Protection Program includes authorization of up to \$349 billion of guaranteed loans to qualifying small and medium sized businesses. Loan amounts can be up to 2.5 times a company’s annual average monthly payroll and may be partially forgiven if the business maintains its payroll through June 30, 2020.

We expect the U.S. Department of Treasury and the SBA to release guidance in the upcoming weeks that will provide further details on the Program’s administration. Please see this link to the SBA’s [Interim Final Rule](#). We expect further guidance, particularly with respect to the SBA affiliation rules, to be released.

As additional guidance is being released, please consult with a Foster Garvey attorney or other advisor prior to relying on this information.

Small Business Association Section 7(a) Loan Program

The Paycheck Protection Program modifies the SBA’s existing Section 7(a) loan program. Under the 7(a) loan program, the SBA partially guarantees loans made by participating banks to qualified borrowers. The Paycheck Protection Program amends the 7(a) loan program in three ways: (i) it expands the realm of eligible borrowers, (ii) it allows forgiveness of all or a portion of the loan if the company maintains payroll, as described below, and (iii) it modifies standard SBA loan terms, including the

Contact

Greg Duff

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elimination of security and guarantees.

Eligible Borrowers

Under the Paycheck Protection Program, the types of businesses and organizations eligible to receive an SBA loan (a “Paycheck Protection Loan”) is expanded for the covered period.

Generally, an eligible borrower includes:

- Any business, 501(c)(3) non-profit organization, veterans organization, and tribal business that employs not more than the greater of (i) 500 employees, or (ii) the size standard in number of employees as established by the SBA under 13 C.F.R. § 121.201. In each case, the number of employees a business has includes the employees of affiliates (except for the exclusions below).
- Sole proprietors, independent contractors, and self-employed individuals, provided they can submit certain documentation (such as payroll tax filings, Forms 199-MISC, and income/expenses for sole proprietors).
- Certain businesses in the hospitality and food service industry (i.e., those under a NAICS code that begins with “72”) with more than one physical location but no more than 500 employees at each location at the time the loan is dispersed.

The definition of employees includes all persons employed on either a part-time, full-time or temporary basis.

The requirement to include employees of affiliates, which is standard for SBA 7(a) loans, is waived for any:

- Hospitality and food service business in a NAICS code 72 industry, provided each location has no more than 500 employees at the time the loan is dispersed.
- Business operating as a franchise that is assigned a franchise identifier code by the SBA.
- Business that receives financial assistance under the SBA’s Small Business Investment Company program.

Priority will be given to businesses in underserved and rural markets, that are owned and controlled by economically and socially disadvantaged individuals, that are owned by women or that have been in operation for fewer than two years.

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Special attention should be made to the existing debt of borrowers to ensure that a Paycheck Protection loan is not prohibited under existing loan agreements. Also, special attention should be given to small businesses that receive private equity or VC funding, because such small businesses may not be eligible, due to the SBA affiliation rules. Under the affiliation rules, the employees of the fund, as well as employees of other portfolio companies, might be counted toward the employee threshold.

Forgiveness of Paycheck Protection Loans

Paycheck Protection Loans are eligible for forgiveness equal to the amount spent by the borrower during the eight-week period after the loan origination date on (i) payroll costs (which includes benefits), (ii) interest payment on any mortgage (provided that such instrument was entered into prior to February 15, 2020), (iii) payment of rent on any lease (provided that such instrument was entered into prior to February 15, 2020), and (iv) payment on any utility payments that began before February 15, 2020. Because this program is new to the SBA and lenders, we expect additional guidance on how businesses and lenders can better ensure their CARES Act Loans are eligible for forgiveness.

The loan amount eligible for forgiveness will be reduced proportionally by any reduction in employees during the covered period (eight weeks after the loan is disbursed) compared to either (at the option of the borrower) (i) the February 15, 2019 through June 30, 2019 period or (ii) the January 1, 2020 through February 29, 2020 period. In addition, the loan amount forgiveness will be reduced by the reduction in pay of certain employees in excess of 25 percent. No employee with an annual salary over \$100,000 shall be included in the forgiveness calculation.

To encourage employers to rehire any employees who have already been laid off, reduced or furloughed due to the economic crisis, companies that re-hire workers will not be penalized for having a reduced payroll at the beginning of the period. The payroll costs of any such employees are eligible for loan forgiveness.

Any loan amounts forgiven under the CARES Act will not be classified as taxable income under the Internal Revenue Code.

Loan Terms

Use of Proceeds. Paycheck Protection Loans may be used to pay payroll costs, group healthcare benefits, insurance premiums and interest on mortgage or other debt, and to make rent and utility payments.

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Loan Amount. Eligible borrowers are able to receive loans up to 2.5 times their monthly payroll costs, measured over the prior twelve months from the loan origination date, with a cap of \$10 million. Payroll costs for purposes of loan amount calculation includes salaries, certain employee benefits, state and local taxes and certain types of compensation to sole proprietors or independent contractors up to \$100,000. The current version of the CARES Act specifically excludes compensation of any employee in excess of \$100,000 annually, compensation of foreign employees and FICA and income tax withholdings.

Credit Elsewhere Requirement. The CARES Act waives the “credit available elsewhere” test that is normally applicable to SBA loans. This means that eligible borrowers are not required to seek other sources of capital.

Term; Prepayment. The loan amount that is not forgiven will have a term of up to two years and amortize with fixed monthly principal and interest payments. There will be no penalties for prepayment.

Deferral of Payment. The CARES Act allows automatic deferrals of principal and interest payments for at least six months and not more than one year for all borrowers.

Collateral and Personal Guarantees. Paycheck Protection Loans do not require collateral or personal guarantees.

Interest Rate. One percent.

Conclusion

The CARES Act will provide much-needed support to many small and medium sized businesses. The modifications to the existing SBA 7(a) loan program made under the CARES Act include many nuances and complexities. Foster Garvey has attorneys well-versed in commercial finance, corporate, tax and employment matters who can assist in navigating the CARES Act. Please contact a Foster Garvey attorney for assistance, including those listed to the right.