MUNSCH HARDT

COVID-19
CARES ACT

CARES Act Authorizes Loans and Loan Forgiveness for Small to Mid-Sized Businesses Hit by COVID-19 Crisis

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was enacted on March 27, 2020. Considered the largest fiscal stimulus in American history, the CARES Act is expected to provide more than $2 trillion in economic stimulus and financial assistance to employers and individuals affected by the COVID-19 pandemic.

This bulletin focuses on the new Small Business Administration ("SBA") loan facility known as the Paycheck Protection Program ("PPP"), codified in Title I of the CARES Act. The purpose of the PPP is to provide cash-flow assistance to small to mid-sized businesses that maintain their payroll during the COVID-19 crisis.

A key feature of the PPP loan program is loan forgiveness. If a business obtains a PPP loan and maintains its payroll during an eight week period after the loan is originated, then the portion of the loan used for covered payroll costs, healthcare expenses, interest on mortgage obligations, rent, and utilities will be forgiven without producing taxable income.

We have endeavored to keep this summary of the PPP loan rules as brief as possible and therefore have omitted several details. The following is not intended as legal advice. *Please contact your relationship attorney with the firm if you have questions on how the PPP loan and loan forgiveness apply to your situation. We would appreciate it if you could submit your questions in writing, which would help us understand your questions more clearly and enable us to more quickly and efficiently answer them.*

- **Lenders.**

  PPP loans will be made by banks and other financial institutions eligible to make loans backstopped by SBA loan guarantees. The CARES Act also grants authority to the Department of the Treasury to establish criteria for additional private sector lenders to gain authority to offer PPP loans.

  - **Recommendations:**

    - **If you are interested in a PPP loan, contact your commercial banker. Lending institutions we have contacted are saying they will pay attention to requests from existing customers before responding to prospective customers.**

    - **If your existing bank is unable or unwilling to consider a PPP loan, please contact your relationship attorney at the firm. We will do our best to put you in touch with lenders participating in the PPP program.**

- **Eligible borrowers.**

  - PPP loans are available to "*small business concerns*" (as defined by SBA regulations, which can include businesses with more than 500 employees or businesses that satisfy a maximum annual receipts test) and certain other businesses and nonprofits in operation on February 15, 2020 that meet eligibility requirements. With appropriate documentation, sole proprietorships, individual contractors, and self-employed individuals, such as those participating in the "gig economy," are also eligible to receive a PPP loan.

  - If the applicant is not a "small business concern" as defined in SBA regulations, the CARES Act will nonetheless apply to a business or nonprofit employing not more than the greater of (a) 500 or fewer employees, or (b) if applicable, the size standard in number of employees currently established by the SBA for the applicant's designated industry. An employee includes individuals employed on a full-time, part-time, or "other basis." Here are some exceptions and nuances when applying the rule:

    - To determine whether a business satisfies the number of employees test, with some exceptions, the business must include the number of employees at affiliated businesses.

- Generally, businesses are affiliated if one business controls or has the power to control another business, or they are controlled by a common owner. Control may arise through ownership, management or other relationships.
- The SBA affiliation rules are complex. We are unsure how they will be applied to portfolio companies of private equity and venture capital firms that typically own controlling interests in many companies. The CARES Act did not adopt any exceptions for portfolio companies of private equity and venture capital firms, although we anticipate the SBA will issue further guidance in this area in the near future. *Therefore, stay in touch with your relationship attorney at the firm for more developments.*

- The CARES Act, in certain cases, expands the application of the number of employee limit:
  - Restaurants, hotels, motels, food service contractors (caterers) and other similar businesses falling within the "Accommodation and Food Service" industry code (NAICS Code 72) should apply the 500 employee test on a per physical location basis if the business has more than one physical location.
  - The CARES Act also waives the SBA affiliation rule for the following borrowers:
    - Restaurants, hotels, motels, food service contractors (caterers) and other similar businesses falling within the "Accommodation and Food Service" industry code (NAICS Code 72), if the employer entity has less than 500 employees,
    - Businesses operating as a franchise assigned a franchise identifier code by the SBA, and
    - Any business concern that receives financial assistance from a company licensed under the Small Business Investment Company Act.

❖ **Recommendation: We recommend you make an initial determination of whether your business would be an eligible borrower under the PPP loan program. Please contact your relationship attorney at the firm if you need our assistance in making the determination.**

- **Maximum loan amount.**

  The amount of the PPP loan is limited to the lesser of:

  ❖ $10 million, or

  ❖ 2.5 times average monthly payroll costs for the one-year period before the loan

  - Special calculation rules apply for seasonal employers and businesses that were not in existence from February 15, 2019 to June 30, 2019.

- **Interest rate.**

  Not to exceed 4% per annum. [1]

- **Credit support.**

  PPP loans require no collateral or personal guarantees, and there is no recourse against individual shareholders, members or partners for nonpayment unless proceeds are used for an unauthorized purpose. [2]

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[1] The CARES Act states that the 4% maximum interest rate applies to the "covered period," a defined term that means the period the period beginning on February 15, 2020 and ending on June 30, 2020. Borrowers should check their loan documentation carefully to ensure that the interest rate may not be increased after June 30, 2020.

[2] Note, the CARES Act states that the collateral waiver also applies to the "covered period." Borrowers should check their loan documentation carefully to ensure that there are no springing guarantee or collateral provisions that apply to periods after June 30.

- **Use of loan proceeds.**

  The loans are available only to cover certain expenses during the "covered period" (February 15, 2020 to June 30, 2020). These include:

  - "*Payroll costs*," broadly defined to include the sum of salaries, wages, vacation pay, paid leave, separation pay, payments for group health benefits, including health insurance premiums, payment of any retirement benefits, state employment taxes (or, with respect to sole proprietors and independent contractors, not more than $100,000 in income or net earnings for one year, prorated for the covered period), BUT
    - Excluding compensation to employees above $100,000 per year, prorated for the covered period,
    - Excluding sick leave wages and family leave wages for which a payroll tax credit is allowed under Families First Coronavirus Response Act,
    - Excluding taxes imposed or withheld for federal insurance contributions (Social Security, Medicare) and federal unemployment taxes, and
    - Excluding compensation to employees whose principal residence is outside the United States.
  - Costs related to the continuation of group healthcare benefits during periods of paid sick, medical, or family leave, and insurance premiums
  - Salaries, commissions, or similar compensations
  - Interest on mortgages secured by real or personal property
  - Rent (including lease payments)
  - Utilities
  - Interest on other debt entered into before February 15, 2020.

- **Loan repayment terms.**
  - Lenders must defer payments of principal and interest for at least 6 months, and may defer for up to one year, and
  - If the PPP loan has a remaining balance after loan forgiveness (see below), the balance has a maximum maturity of 10 years from the date when the borrower applies for loan forgiveness.

- **Borrower certifications.**
  - Borrower must certify in good faith that "the uncertainty of current economic conditions makes necessary the loan requests to support the ongoing operations of the borrower,"
  - Borrower must acknowledge that the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments and utility payments, and
  - Duplicative PPP applications and loans are prohibited.

- **Loan forgiveness.**

  An important incentive for businesses to consider a PPP loan is the opportunity to receive loan forgiveness, which results in the SBA making a payment to the lender for the amount forgiven. Here's a summary of the conditions and limitations on loan forgiveness:

  - The PPP loan proceeds may be used for the purposes described above, but *only the portions identified below incurred during the 8 week period following loan origination are eligible for loan forgiveness:*
    - payroll costs (defined and limited as provided above)
    - payments of interest on a secured loan entered into before February 15, 2020, and
    - payments on covered rent obligations, and
    - utility payments

- ❖ The amount of loan forgiveness is subject to reduction if the number of employees is reduced. The forgiveness amount is reduced by the proportion by which the average number of FTEs during the eight week period bears to the average number of FTEs between either February 15, 2019 - June 30, 2019 or January 1, 2020 - February 29, 2020, at the borrower's election.
- ❖ The forgiveness amount will also be reduced dollar-for-dollar for any wage or salary reduction of <u>an employee</u> by more than 25%, measured against the wage and salary for such employee during the most recent full quarter prior to loan origination. For purposes of this calculation, employees paid more than $100,000 in 2019 are not subject to the 25% limitation on salary decreases described above.
- ❖ A borrower may receive loan forgiveness for additional wages paid to certain tipped employees, such as those who work in the restaurant or hospitality industry.
- ❖ If an employer reduced its workforce or reduced wages during the period between February 15, 2020 and March 26, 2020, then:

  1) If by June 30, 2020 the employer restores <u>the number of employees</u> to the number that were employed as of February 15, 2020, then the employer will not be subject to the percentage reduction in the forgiveness amount.
  2) If by June 30, 2020, the employer restores <u>the wages paid to each of its employees</u> to the amount of the wages paid to each such employee as of February 15, 2020, then the employer will not be subject to the dollar-for-dollar reduction in the forgiveness amount.
- ❖ To qualify for loan forgiveness, the borrower is required to submit an application to the lender with verifying documentation required by the statute, including a certification that the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered secured loan, and make payments on covered rent obligations and utility payments.
- ❖ The amount of the loan that is forgiven is excluded from gross income for federal income tax purposes.

▪ **<u>SBA Guidance and Regulations</u>.**

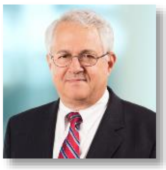
The statute requires the SBA to issue guidance and regulations by April 26, 2020 to implement the loan forgiveness provisions. We anticipate that this will help clarify uncertain or ambiguous application of the new law.

▪ **<u>Recommendations</u>.**

If a business is interested in applying for a PPP loan, it should gather the following information:

- ❖ Prepare a schedule of qualified monthly costs for which the business could use the PPP loan
- ❖ Assess whether PPP loan forgiveness limitations as a result of terminations or wage and salary reductions will apply. If so, then determine whether employees can be rehired and wages and salaries restored to facilitate loan forgiveness.
- ❖ Assemble tax returns and financial statements for last two years
- ❖ Prepare a summary of the economic impact of COVID-19 on your business, employment of your employees, and how you intend to use the loan proceeds to emerge from the crisis in support of the certification requirement that "the uncertainty of current economic conditions makes necessary the loan requests to support the ongoing operations of the borrower."

Munsch Hardt Kopf & Harr is continually monitoring for developments related to COVID-19 and will send out additional information as it becomes available. In the interim, please contact one of our Corporate or Finance attorneys below if you have any questions or need any additional information.



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