



Senate Unanimously Passes Coronavirus Aid, Relief, and Economic Security Act (CARES Act) Providing \$349 Billion in Forgivable SBA Loans to Small Businesses

By Dustin Alonzo and Amanda Lack of Fishman Haygood Published March 27, 2020

Late on Wednesday night, March 25, 2020, the United States Senate passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) by a vote of 96-0. This federal stimulus bill appropriates \$349 billion in loans to small businesses through the newly created Paycheck Protection Program under amendments to Section 7(a) of the Small Business Act (SBA). The House of Representatives likewise passed the CARES Act on Friday, March 27, 2020, and President Trump signed it immediately upon House passage.

This article focuses primarily on the assistance to small businesses provided by the Paycheck Protection Program and tax relief and incentives under the CARES Act. As widely reported, the CARES Act is an enormous piece of legislation with far-reaching consequences. Other provisions of the bill not discussed in this memo include the expansion of unemployment insurance, \$500 billion in loans or other aid to businesses, states, and municipalities, mortgage relief to consumers and certain owners of multifamily properties, and the provision of rebate checks directly to individuals. Please let us know if you have questions on any topics covered under the CARES Act or related to the ongoing COVID-19 pandemic.

PAYCHECK PROTECTION PROGRAM

The CARES Act amends Section 7(a) of the SBA to create the Paycheck Protection Program, which authorizes lenders to make Paycheck Protection Loans (PPL) to eligible small businesses until June 30, 2020. PPLs will be fully guaranteed by the federal government. As further described below, the portion of the PPL used to cover payroll, mortgage interest, rent, or utility costs from February 15, 2020 to June 30, 2020 are eligible for loan forgiveness, which is nontaxable.

Small Business Eligibility for a Paycheck Protection Loan

The Paycheck Protection Program greatly expands those businesses eligible for a PPL. Generally, a business is eligible if it has 500 or fewer employees, was in operation on February 15, 2020, and had employees for whom it paid salaries and payroll taxes. Both full-time and part-time employees are counted in the eligibility determination. If the small business did not have any employees, it would still be eligible if it paid independent contractors and reported such payment on a Form 1099-MISC.

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In addition to “small business concerns” under the SBA, the following businesses are eligible to obtain a PPL, provided they have 500 or fewer employees: (1) Any business concern; (2) 501(c)(3) nonprofit organizations; (3) Veterans organizations under 501(c)(19) of the Internal Revenue Code; (4) Tribal business concerns; and (5) Individuals who operate under a sole proprietorship, as an independent contractor, and certain self-employed individuals.

Existing rules under the SBA generally aggregate the employees of different companies that are under common control for purposes of determining eligible borrowers. As a result, portfolio companies of private equity sponsors and other kinds of investment firms may not be eligible for a PPL. However, the CARES Act creates a waiver of these affiliation rules for hotels and the food service businesses with no more than 500 employees, businesses operating as franchises, and businesses that receive funding from small business investment companies.

In addition, for hotels and food service businesses, the number of employees is not counted company wide. Instead, each individual property is considered its own business. Therefore, if a hotelier owns 10 properties with thousands of employees, he would be eligible to obtain PPLs for the properties that employ 500 or fewer people. This exception applies broadly to those in the “accommodations and food service” industry, including casino hotels, bed and breakfast inns, RV parks, restaurant franchisees, caterers, mobile food services, and bars.

Underwriting standards for PPLs are relaxed. Generally, lenders will only require proof of paid salaries and payroll costs/taxes. Lenders should not review the business’s ability to repay. That said, businesses will be required to make a good faith certification indicating that, among other things: (1) the uncertainty of current economic conditions makes the loan necessary to support the ongoing operations of the business; (2) the PPL proceeds would be used to retain workers and maintain payroll or make mortgage, lease, and utility payments; and (3) the business has not applied for or received proceeds from another PPL.

Paycheck Protection Loan Terms and Structure

Eligible borrowers may obtain a PPL up to a maximum amount of \$10 million – twice the amount of a typical SBA 7(a) loan. However, the amount available to each business will be based on a multiplier of the business’s average monthly Payroll Costs (as defined under the CARES Act).

The maximum interest rate for PPLs is 4% per year, origination fees are waived, and there is no prepayment penalty. Unlike typical Section 7(a) loans, lenders may not require a personal guarantee or any collateral as a condition for extending the PPL, and the requirement that the business is unable to obtain credit elsewhere does not apply to PPLs. In addition, the loans are non-recourse, except to the extent that the business misuses the PPLs loan proceeds (see discussion below). Finally, lenders must provide

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complete payment deferment relief, including payment of principal, interest, and fees, for a period of six months to one year.

Permitted Uses of Paycheck Protection Loan Proceeds

Businesses may only apply the proceeds of the PPLs to the following activities: (1) Payroll Costs; (2) costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums; (3) employee salaries, commissions, or similar compensations; (4) payments of interest (not principal) on any mortgage obligation; (5) rent; (6) utilities; and (7) interest on any other debt obligations incurred before February 15, 2020.

If the business obtained an Economic Injury Disaster Loan (EIDL) between January 31, 2020 and the date on which the PPLs were made available, the business could also use the PPL proceeds to refinance the EIDL. The CARES Act expressly states that a business may obtain both an EIDL and a PPL.

FORGIVENESS OF LOANS UNDER THE PAYCHECK PROTECTION PROGRAM

Small businesses who obtain PPLs and meet certain criteria may also be eligible for forgiveness of all or a portion of the indebtedness on the PPL, not to exceed the principal amount of the PPL. In order to qualify for loan forgiveness, the business must submit to the lender servicing the PPL an application that includes detailed information on the employees on payroll, its IRS payroll tax filings, its state income, payroll, and unemployment insurance filings, and any documentation of additional amounts for which the business intends to seek forgiveness. As such, businesses must keep detailed records of all costs and expenses during this time so that it can fully recover the cost of the PPL.

The amount of loan forgiveness is calculated by adding the following costs incurred and payments made during the eight weeks immediately following the origination of the PPL: (1) Payroll Costs; (2) mortgage interest payments incurred prior to February 15, 2020; (3) rent payments under a lease in force before February 15, 2020; and (4) utility payments, including transportation and internet access, for which service began before February 15, 2020.

The loan forgiveness provisions are drafted to induce businesses to retain employees or rehire employees who were laid off, and the loan forgiveness amount will be reduced for businesses who lay-off workers or reduce compensation. The CARES Act provides a specific formula that factors in the number of workers retained or rehired.

If the PPL has a remaining balance after the loan forgiveness (i.e., partial forgiveness), the PPL will have a maximum maturity of 10 years from the date on which the business applied for loan forgiveness.

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Amounts that are forgiven will be considered canceled indebtedness and will be excluded from gross income for purposes of federal taxes.

SBA Express Loans

In addition to the newly created PPLs, the SBA also increased the maximum for its Express Loans to \$1 million (from \$350,000) until December 31, 2020.

HOW TO APPLY FOR YOUR PAYCHECK PROTECTION LOAN

- 1) **Monitor.** We will continue to monitor the progress of the CARES Act through the House and across the President's desk. Once signed, we should get information on when lenders will begin offering PPLs.
- 2) **Communicate.** Businesses should contact their lender to determine if it will offer PPLs. It likely will if it has offered any SBA Loan products in the past. If your lender is not making PPLs, call around to find a bank or credit union that is. The SBA indicates that it will also on-board new lenders.
- 3) **Apply.** The application deadline is June 30, 2020, but we recommend applying as soon as possible. The Paycheck Protection Program, like the Section 7(a) loan program, is a partnership between private financial lenders which issue the loans, and the SBA which guarantees them. As such, the PPLs are obtained directly through lenders, not the SBA.
- 4) **Get Funded.** The Treasury Secretary has indicated that PPLs will be made and disbursed on the same day. The PPLs are administered through the SBA's existing Section 7(a) loan program, and funds will be distributed using the existing framework of this program.
- 5) **Keep Records.** Businesses should keep detailed records to submit documentation with any loan forgiveness application.

EMERGENCY ECONOMIC INJURY DISASTER LOAN GRANTS

The CARES Act also authorizes funds in the amount of \$10 billion to provide EIDLs for small businesses. Businesses are eligible for up to \$10,000, and the funds can be used for providing paid sick leave to employees unable to work, maintaining payroll to retain employees, meeting increased costs of materials, making rent or mortgage payments, and repaying obligations that cannot be met due to loss of revenue. Any EIDL will be completely forgiven. The deadline for obtaining an EIDL grant is on December 31, 2020.

The following businesses are eligible for an EIDL: (1) a business, cooperative, or ESOP with less than 500 employees; (2) an individual who operates under a sole proprietorship or an independent contractor; or (3) a Tribal small business concern. For EIDLs made in response to COVID-19, the CARES Act waives the following: (1) personal

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guarantee requirements; (2) requirement to be in business for a one-year period before the disaster; and (3) the requirement that the applicant be unable to obtain credit elsewhere. No tax return is required, and the approval may be based solely on the applicant's credit score.

TAX PROVISIONS FOR BUSINESSES AND INDIVIDUALS

In addition to the several grants and loans provided for in the CARES Act, the Act also provides for tax incentives for businesses and individuals. Among those tax incentives are temporary modifications to current law, higher deductions, as well as ways to spread out losses over a period of time.

Employee Retention Credit for Employers Subject to Closure Due to COVID-19

The CARES Act provides for an employee retention credit for eligible employers against applicable employment taxes for each calendar quarter. The amount of the credit is equal to 50% of the qualified wages with respect to each employee but is limited to (1) \$10,000 per employee, per quarter, and (2) employment taxes. After these two limitations, it is refundable. Employers who take a small business interruption loan are ineligible for this credit.

Modifications for Net Operating Losses

This section temporarily repeals and amends the taxable income limitation in the Internal Revenue Code for the taxable years 2020 and 2021. For the year 2020, net operating losses may fully offset income, without taxable income limitations. In 2021 and future years, the taxable income limitations are relaxed. The new language relaxes the limitations by allowing businesses to carry back losses for five years. Additionally, this section removes the taxable income limitation for carry forwards.

Modifications of Limitation on Business Interest

The prior limitation on deduction of business expenses was 30% of the business's adjusted taxable income, but the bill relaxed the limit by increasing it to 50% for 2019 and 2020, subject to special rules for partnerships. Additionally, it allows a taxpayer to use its taxable income from 2019 to determine its deductible expense in 2020, which allows for a higher tax deduction.

Delay of Payment of Employer Payroll Taxes

This section provides for a deferral for the payment of applicable payroll taxes paid by employers and those self-employed. The payment of taxes would be deferred until December 31, 2021 with respect to 50% of the amounts owed, and December 31, 2022 with respect to the remaining 50%. The deferral does not apply to a taxpayer that has had indebtedness forgiven under this act.

Technical Amendments Regarding Qualified Improvement Property

Under this section, taxpayers can immediately use improvements they have made as a tax write off all at once, instead of slowly depreciating the improvements.

Modification of Limitation on Losses for Taxpayers Other Than Corporations

For taxpayers other than a corporation, this section modifies the limitation on losses. For any taxable year after December 31, 2020 and before January 1, 2026, any excess business loss of the taxpayer for the taxable year shall not be allowed. This gives them the ability to claim refunds and/or reduce their tax payments.

Modification of Credit for Prior Year Minimum Tax Liability of Corporations

This modification, which applies to taxable years beginning after December 31, 2017, allows a taxpayer to file an application for a tentative refund of any amount from prior years to recover certain corporation alternative minimum taxes as refundable credit.

Unemployment Insurance Provisions

Unemployment assistance shall be available to covered individuals who lost their job because of COVID-19 beginning on or after January 27, 2020 and ending on or before December 31, 2020. Assistance is limited to 39 weeks. A person is considered a covered individual if the individual is eligible for regular compensation under state or federal law but is able to work but cannot due to COVID-19. It also provides funding for 100% of the costs to employers for “short-time compensation” in which employers reduce working hours for employees instead of laying them off. It also eliminates the waiting period of seven days for railroad unemployment benefits.

Rebates and Other Individual Provisions

Eligible individuals may recover a credit for the first taxable year beginning in 2020 of \$1,200 (\$2,400 for married couples filing jointly), plus \$500 for each qualifying child. The amount of the credit is reduced by 5% if the taxpayer’s adjusted gross income is more than \$150,000 for joint returns, \$112,500 for a head of household, and \$75,000 for any other taxpayer. An individual with a qualified retirement plan may withdraw up to \$100,000 early without the 10% penalty, and the income of that withdrawal will be subject to tax over a three taxable year period instead of all at once. Additionally, there is a temporary waiver of required minimum distribution rules for certain retirement plans and accounts. The bill relaxed the amount individuals and companies can claim as qualified charitable deductions. Lastly, employers can make student loan payments for employees tax-free, as long as they are made before January 1, 2021.

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Temporary Exception from Excise Tax for Alcohol Used to Produce Hand Sanitizer

Temporarily suspends the requirement of an excise tax for alcohol used to produce hand sanitizer.

This is a high-level summary of the CARES Act, as passed by the Senate on March 25, and focuses on the assistance to small businesses provided by the Paycheck Protection Program and tax relief and incentives. It is subject to update and correction. If you need any more information about the CARES Act, please reach out to your attorney at Fishman Haygood or contact any of the attorneys listed below.

New Orleans	201 St. Charles Avenue, Suite 4600 New Orleans, Louisiana 70170
John Werner	jwerner@fishmanhaygood.com
Scott Willis	swillis@fishmanhaygood.com
Maureen Gershanik	mgershanik@fishmanhaygood.com
Sharonda Williams	swilliams@fishmanhaygood.com
Baton Rouge	100 North Street, Suite 800 Baton Rouge, Louisiana 70802
Charles Landry	clandry@fishmanhaygood.com
Louis Quinn, Jr.	lquinn@fishmanhaygood.com
Scott Chenevert	schenevert@fishmanhaygood.com

www.fishmanhaygood.com