

Coppersmith Briefs

CARES ACT LOAN AID FOR SMALL AND MEDIUM-SIZED BUSINESSES

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April 9, 2020

The \$2.2 trillion Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) became effective on March 27, 2020. It includes several provisions to help small and medium-sized businesses weather the economic hardships caused by the novel coronavirus pandemic (COVID-19), including a broad lending program, tax credits, and payment deferrals.

Small Business Provisions

1. Paycheck Protection Program

The CARES Act expands the Small Business Act (“SBA”) to create a new loan category for small businesses, called the Paycheck Protection Program (“PPP”).

Who is Eligible?

Any employer, including nonprofit 501(c)(3) organizations, veterans organizations, and tribal business concerns, is eligible to participate in the PPP, so long as it employs fewer than 500 individuals (including those employed on a full-time, part-time or other basis). Employers in the hospitality industry (including restaurants) may receive a loan so long as they employ less than 500 individuals per location. Sole proprietors, independent contractors and eligible self-employed individuals (as defined in the Families First Coronavirus Response Act (FFCRA) are also eligible for a loan, but are subject to a different application date.

To obtain a loan, employers must certify that: (1) the uncertainty of current economic conditions make it necessary to obtain the loan to support the ongoing operations of the business; (2) the loan will be used to retain workers or make mortgage, lease or utility payments; and (3) the business has not submitted a duplicative application for the same purposes.

Amount of PPP Loan

The PPP allows the SBA to provide to eligible employers the lesser of: (1) the sum of the employer’s average monthly payroll during the prior 12 months (a different time period is used for seasonal employers; some lenders may allow borrowers to use data from the 2019 calendar year) multiplied by 2.5, and the amount outstanding on any pre-existing emergency loan; or (2) \$10 million.

For purposes of the PPP, “payroll costs” for a borrower (other than an independent contractor) include:

- Salary, wage, commission, or other similar compensation (not in excess of \$100,000, prorated, and excluding any employee whose principal place of residence is outside of the U.S.);
- Cash tips or equivalent (not with respect to any employee whose principal place of residence is outside of the U.S.);
- Payment for vacation, parental, family, medical, or sick leave (other than for qualifying leave taken under the FFCRA – reimbursement for those payments is through the tax credit process included within the FFCRA);
- Allowance for dismissal or separation (e.g., severance pay);
- Payment of group health care benefits and insurance premiums (generally, medical, dental, vision and health flexible spending account benefits);
- Payment of retirement benefits; and
- Payment of state or local tax assessed on employee compensation, and federal taxes and withholding.

In general, payroll costs for calculating the loan amount are calculated on a gross basis and need not be reduced by the employees’ share of federal taxes and employee withholding (payroll costs do not include the employer’s share of payroll tax). Note, however, that those same federal taxes and withholding amounts must be excluded from payroll costs for purposes of loan use and loan forgiveness.

Use of Funds

PPP loans may be used to pay the following types of expenses incurred by the business between February 15, 2020 and June 30, 2020:

- Payroll costs (as defined above);
- Costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums;

- Rent, or mortgage interest (but not principal);
- Utilities; and
- Interest on any other debt obligations incurred before the covered period.

Subsequent guidance issued by the Treasury Department clarifies that the loans may also be used to pay rent, mortgage, and utilities obligations incurred before February 15, 2020.

Loan Forgiveness

Perhaps the most attractive feature of the PPP is its forgiveness provision. The amount eligible for forgiveness is the lesser of (i) the amount the borrower spent on eligible expenses identified in the “Use of Funds” section above during the eight-week period following origination of the loan, or (ii) the principal amount of the loan.

That base amount is reduced by multiplying the eligible amount by this quotient: the average number of full-time equivalent employees (“FTEs”) employed per month during the eight-week period, divided by either (at the borrower’s election) that same average for the time period February 15, 2019 through June 30, 2019, or that same average for the time period January 1, 2020 through February 29, 2020. For example, if the employer employs an average of 20 FTEs during the eight-week period, and employed an average of 25 FTEs from 1/1/20 through 2/29/20, the quotient is 0.8. Therefore, the employer is eligible for forgiveness of 80% of the total eligible amount.

The amount of forgiveness may be further lessened if, during the period February 15, 2020 through April 26, 2020, the borrower reduces the number of employees, or reduces by more than 25% the salaries and wages of employees with annual salaries of \$100,000 or less. This forgiveness penalty will not apply if the borrower restores its workforce count and salaries/wages by June 30, 2020.

The Treasury Department has since clarified that in addition to the above guidelines, at least 75% of the forgiven amount must be used for payroll costs.

For those loan amounts that are not forgiven, payments are automatically deferred for six months, though interest will continue to accrue during this time. Although the CARES Act specifies that loans accrue .50% interest, the Treasury Department has since issued an Interim Final Rule setting the interest rate at 1.0% in response to concerns by banks that the lower rate would not cover their costs. All loans come due two years after they are made.

Application Process

Businesses may apply for a loan through an existing SBA lender or through any federally insured depository institution, federally insured credit union, and Farm Credit System institution that is participating. A list of approved lenders is available at www.sba.gov. The SBA anticipates adding other regulated lenders to the program over the coming weeks. This may help ease some of the crunch being caused by banks restricting applications to existing business customers and, in at least one instance, capping the number of applications accepted.

Borrowers must submit verifying documentation and certifications to the lender servicing their loan in order to qualify for loan forgiveness. This documentation will verify the number of full-time equivalent employees and pay rates, as well as the payments on eligible mortgage, lease, and utility obligations. Borrowers must also certify that the documents are true and that they used the forgiveness amount to keep employees or make eligible mortgage interest, rent and utility payments. Lenders have 60 days to decide whether to forgive a loan.

The application period for small businesses and sole proprietorships is now open, while independent contractors and self-employed individuals can apply starting on April 10, 2020.

2. Economic Injury Disaster Loan (EIDL)

The CARES Act also expands the SBA's long-standing Economic Injury Disaster Loan ("EIDL") Program, which was created to assist businesses, renters and homeowners located in regions affected by declared disasters. Any business (including independent contractors, sole proprietors, tribal concerns and nonprofits) with fewer than 500 employees that was in existence on January 31, 2020 and is suffering or has suffered substantial economic injury caused by COVID-19 is eligible to apply for an EIDL.

The maximum EIDL is \$2 million. The loans have standard interest rates – 3.75% for businesses and 2.75% for non-profits – and up to a 30-year term, though payments of Coronavirus EIDLs are deferred for one year. No collateral is required for loans of \$25,000 or less. For larger loans, the collateral is a general security interest in business assets. Personal guarantees may also be required for loans greater than \$200,000.

Importantly, the CARES Act explains that applicants for an EIDL are eligible to receive a \$10,000 emergency grant within three days of submitting an EIDL application. These grants do not need to be repaid, regardless of whether the EIDL application is approved, so long as the funds are used for:

- Paid sick leave to employees unable to work due to COVID-19;
- Maintaining payroll to retain employees during business disruptions or substantial slowdowns;

- Meeting increased costs to obtain materials because of a disrupted supply chain;
- Making rent or mortgage payments; and
- Repaying obligations that cannot be met due to revenue losses.

Though eligible businesses may apply for loans under both the PPP and the EIDL programs so long as the loans are not used for the same purpose, the amount of a PPP loan that is forgiven is reduced by the \$10,000 grant. An EIDL may also be refinanced into a PPP loan.

3. Employee Retention Credit

The CARES Act also offers a tax credit for certain eligible employers' employment taxes. The tax credit equals 50% of qualified wages, including qualified health plan expenses, paid to an employee between March 13, 2020 and December 31, 2020. The credit equals 50% of the first \$10,000 paid to each employee, meaning that the maximum tax credit per employee is \$5,000.

“Eligible employers” include those that were in business during the 2020 calendar year and that either: (1) fully or partially suspended their operations due to orders from a governmental authority because of COVID-19, or (2) had at least a 50% decline in gross receipts from the previous year. For employers with more than 100 full-time employees in 2019, the credit is based only on qualified wages paid to employees during the suspension of the business because of COVID-19. Nonprofit 501(c)(3) organizations may take advantage of the tax credit, though governmental divisions, agencies and instrumentalities may not.

4. Delay of Employer Taxes

The CARES Act allows employers to defer paying the employer portion of Social Security taxes from March 27, 2020 through December 31, 2020. Half of this deferred amount will be due on December 31, 2021 and the other half will be due by December 31, 2022.

Medium-Sized Business Provisions

Title IV of the CARES Act provides for up to \$454 billion in loans, loan guarantees and investments to be used by the Treasury Department to support medium-sized businesses, defined in the Act as those having between 500 and 10,000 employees.

Under the CARES Act, the Treasury Secretary is authorized to implement a credit program or facility to support banks and other private lenders that make direct loans to mid-size businesses. Such a program may coexist and

supplement other programs developed to encourage lending to mid-sized businesses, including a “Main Street Lending Program” that the Federal Reserve will administer.

Only those businesses that are domiciled in the U.S., have significant operations in the U.S., have a majority of employees in the U.S., and are not in bankruptcy, are eligible for such loans. Businesses also must certify that the loan is necessary for operations moving forward because of COVID-19.

The Treasury Department is expected to issue guidance in the coming weeks on how the program will be implemented. However, we do know that any loan provided to a business under the program will come with at least the following terms and restrictions, including several that implicate labor relations:

- The funds must be applied to retain at least 90 percent of the borrower’s current workforce (including full compensation and benefits) through at least September 30, 2020;
- The borrower must commit to restoring at least 90 percent of the workforce that was employed as of February 1, 2020 (including full compensation and benefits) within four (4) months after the termination of the COVID-19 public health emergency;
- Funds cannot be used for stock repurchases or to pay dividends while the loan is outstanding;
- The borrower must agree not to outsource or offshore jobs while the loan is outstanding and for two years thereafter;
- The borrower may not abrogate existing collective bargaining agreements while the loan is outstanding and for at least two years thereafter; and
- The borrower must agree to remain neutral in any union-organizing effort while the loan is outstanding.

In addition, the loans will come with restrictions on executive compensation. For the period until one year after the date the loan is no longer outstanding, (1) any officer or employee with 2019 total compensation of over \$425,000 cannot receive increased compensation for any 12-month period or receive severance pay or other termination benefits of more than twice the officer’s 2019 total compensation, and (2) any officer or employee whose 2019 total compensation was more than \$3,000,000 cannot receive compensation greater than \$3,000,000 plus 50% of the amount by which his or her 2019 total compensation exceeded \$3,000,000.

The maximum annual interest rate on loans made to mid-sized businesses is 2%. Unlike PPP loans, these loans are not eligible for forgiveness, but no principal or interest will be due for the first six months.

The logo for Coppersmith Brockelman Lawyers is centered at the top of the page. It features the name "COPPERSMITH" in a large, white, sans-serif font, with a thin horizontal line underneath. Below the line is the name "BROCKELMAN" in the same font and size. Underneath "BROCKELMAN" is the word "LAWYERS" in a smaller, white, sans-serif font. The background of the logo is a dark blue image of a city skyline at night.

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Jill Chasson focuses on helping businesses of all sizes in a variety of industries with their employment law needs. She provides practical advice to employers regarding compliance with the many federal and state laws that govern the workplace and regularly provides training for supervisors and human resource professionals. When disputes arise, Jill represents employers before administrative agencies, in arbitration proceedings, and in litigation in federal and state courts regarding a variety of employment-related claims.

Kent Brockelman represents employers in a wide variety of employment matters and serves as principal outside employment counsel for a number of employers headquartered or with substantial operations in Arizona. His regular work includes complex employment litigation in state and federal courts and other sorts of employment related dispute resolution, including arbitrations and administrative proceedings, drafting employment contracts and policies, and daily counseling about employment law issues as they arise in the workplace. He also regularly advises companies about business disputes and serves as lead counsel in related litigation.

Vidula Patki is a litigator who assists clients in complex commercial disputes, appeals, eminent domain claims, and bankruptcy matters. In a previous life, she also practiced environmental litigation, assisting clients with evaluating and mitigating compliance risks under federal, state, and local environmental laws, including CERCLA and UMTRCA. She has represented clients at both the trial court and appellate level.

Marvin Ruth is a partner with substantial experience representing clients in complex commercial litigation in state and federal courts in Arizona and Nevada. His practice primarily focuses on business disputes and litigation, including partnership disputes, real estate litigation, business torts, and fraud claims.