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UPDATED: Small Business Administration (SBA) Response to Coronavirus

NOTE: Recent updates are included to reflect recent guidance provided by Treasury and the Small Business Administration as of April 13, 2020.

This brief describes the process to apply for economic relief through the Small Business Administration's (SBA) low-interest loan and grant programs.

In response to the economic situation created by Covid-19 Congress has provided an increase of $384 billion to the SBA's loan programs. The goal of the law is to help small businesses retain employees, meet payroll and pay for business expenses like rent and utilities. The package provides funding for Economic Injury Disaster Loans (EIDL) and Emergency EIDL Grants, the newly created Paycheck Protection Program (PPP), and the small business loan forgiveness and debt relief programs. Below you will find a summary of each of these SBA programs.

Economic Injury Disaster Loans (EIDL) Program: SBA's EIDL loans offer up to $2 million in assistance for each affected small business. The loans are designed to provide economic relief due to an emergency or catastrophe. They can be used to pay fixed debts, payroll, accounts payable and/or other bills that can't be paid due to the epidemic's economic impact. The interest rate is 3.75% for small businesses and 2.75% for non-profits. SBA offers the option to establish long-term repayments, with up to a maximum of 30 years, and a one-year deferment on the first payment. Section 1110 of the CARES Act expands eligibility of EIDLs to include any individual as a sole proprietor or an independent contractor during the covered period (January 31, 2020 to December 31, 2020). Any EIDL made in response to the coronavirus outbreak before the covered period ends will waive any personal guarantee on advances and loans below $200,000 and will waive the requirement for an applicant to be in business for at least a year before the disaster.

- **Who is Eligible:**
    - The amount of sales ***or*** employees required to qualify as a small business varies by industry. Every type of small business has a size standard identified by a code under the North American Industry Classification (NAIC) System.
    - For most small businesses in the ***finance and insurance industry***, the SBA only considers the amount of sales and does not factor the number of employees. You will find more information on how the SBA defines a small business here and the industry size matched to the codes here.
    - For example, an entity dealing with portfolio management or investment advice is considered a small business if they have annual sales less than $41.5 million, regardless of the number of employees.

    - The SBA designation for small business insurance agencies or brokerages is $8 million or less in annual sales.
- In addition to meeting the numerical standards, your small business must:
    - Be a for-profit business of any legal structure
    - Be independently owned and operated
    - Not be nationally dominant in its field
    - Be physically located and operate in the U.S. or its territories
- Non-profit organizations of any size, including charitable organizations such as churches and private universities, organized under state law as such and registered with the IRS are eligible for SBA EIDLs. A non-profit organization is legally structured for goals other than profit. For example, the entity must be assembled as a charity for the advancement of religion; advancement of education or science; or the promotion of social welfare.

  How to apply: There are a few methods to apply for an SBA EIDL. You can apply through SBA's website here; or you can request an application via phone at (800) 659-2955 or TTY (800) 887-8339. To start your application, the SBA will do an initial credit check. You should expect an SBA loss verifier to estimate the total cost to support your operations.

  An SBA loan officer will review applications and will guide applicants through the process. If approved, the SBA will contact applicants to discuss the loan application. The application review can take anywhere from few days to a few weeks. A loan officer will then contact you to discuss the loan recommendations and your next steps. Once SBA receives your signed Loan Closing Documents, you should get an initial disbursement within five days of $25,000. A case manager will be assigned to you to help you with subsequent loan disbursements and to ensure you meet all loan conditions. It allows the SBA to approve credit based on the applicant's credit score or an alternative process for determining the small business' ability to repay the loan.

EIDLs are not eligible for loan forgiveness. However, a small business that takes an EIDL loan in response to the coronavirus crisis can refinance their EIDL loan under the PPP to take advantage of the PPP's loan forgiveness measures.

Note: Due to the oversubscription of the EIDL Program, expect SBA limiting the amount of an EILD loan you may receive.

Emergency EIDL Grants: Section 1110 of the CARES Act, establishes Emergency EIDL Grants to allow any eligible entity who has applied for an EIDL as a consequence of the coronavirus outbreak to request an advance on that loan. The amount of the advance of the loan shall not be more than $10,000, which the SBA must distribute within 3 days to maintain payroll. In other words, this is money the Federal government is giving to small businesses and other eligible entities without any strings attached. If the application is denied, the applicant is not required to repay the $10,000 advance. Emergency advance funds can be used for payroll costs, increased material costs, rent or mortgage payments, or for repaying obligations that cannot be met due to economic losses due to the coronavirus outbreak. The CARES Act provides $10 billion to support expansion of this EIDL Grant until December 31, 2020. As soon as you apply for EIDL, you will be asked if you want to receive an EIDL Grant.

High demand for the EIDL loans has limited the amount of the EIDL Grants. Due to this high demand, SBA has changed its policy to limit EIDL Grants to $1,000 per employee.

Note: Numerous government sources have stated the EIDL Program has seen an oversubscription of loans.

Small Business Debt Relief: The law requires the SBA to pay all principal, interest, and fees on all pre-existing SBA 7(a) loan products for six months to provide economic relief. The debt relief only applies to 7(a) loan recipients. Loans that are already on deferment will receive six months of payments by the SBA beginning with the first payment after the deferral period. The CARES Act provides $17 billion for these loan subsidies. Your lender should be able to process the debt relief. The PPP loans are not covered under this program.

Paycheck Protection Program (PPP): Section 1102 of the CARES Act provides $349 billion to support loans through the newly created PPP. The program is designed for small businesses to preserve employees' salaries. The size of the loans could equal up to 250 percent of an employer's average monthly total payroll costs incurred during the year prior to the loan date, with a cap of $10 million. The PPP assistance will be provided under the umbrella of the SBA's 7(a) loan program. Under the 7(a) programs the SBA guarantees the loan through an eligible SBA lender. There are thousands of banks that currently participate in the lending program, including numerous community banks. You will find a list of the 100 most active SBA 7(a) lenders here. The PPP is wholly guaranteed by the Federal government, but potential borrowers will have to work directly with the originating lenders to close and administer the loans. Treasury has indicated the loans will be disbursed on a first-come, first-served basis.
A small business can receive both a PPP loan and an EIDL, but they must be for different purposes. For example, if a small business acquires a PPP loan to cover payroll costs, they cannot apply for a separate EIDL to cover those same costs. However, the entity could apply for an EIDL to cover rent and utility expenses. If you have an existing EIDL loan, you could be eligible to refinance that loan into a PPP loan.

The PPP loan can function much like a grant given that it can be fully or partially forgivable. Prior to the CARES Act, in order to be eligible for a 7(a) loan a small business applicant had to establish that it was a for-profit operating business located in the U.S. that met the size requirements, as described above, and demonstrate a need for the credit. The new law modifies these general eligibility criteria, expanding them in several ways. The CARES Act now allows sole proprietors, non-profits, and independent contractors to qualify for PPP under the 7(a) program, and also indicates that a "business concern" is eligible. The SBA regulations governing small business loans define "business concern" as "a business entity organized for profit, with a place of business located in the U.S., and which operates primarily within the U.S. or which makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor." Per these regulations, a business concern can take the legal form of a proprietorship, partnership, LLC, corporation, joint venture, association, trust, or cooperative. If you are an independent contractor, sole proprietor, or self-employed individual, lenders will also be looking for certain documents such as payroll tax filings, Forms 1099-MISC, and income and expenses from the sole proprietorship.

A small business may also utilize PPP loans to purchase material, equipment, supplies, etc., but that portion of the loan will not be forgiven. In addition to payroll costs, the entity is also allowed to cover the costs for payments of interest on mortgages; rent (including rent under a lease agreement); utilities; and interest on any other debt obligations that were incurred before the covered period. New guidance from Treasury released on April 7, 2020, clarifies how to account for payroll costs. The guidance only limits cash compensation in excess of $100,000 annually per employee. The cap on cash compensation excludes non-cash compensation. The interpretation is that a business or independent contractor can surpass the $100,000 cap with non-cash compensation. Non-cash compensation includes the following:

- Employer contributions to defined-benefit benefit or defined-contribution retirement plans;
- payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums; and
- payment of state and local taxes assessed on compensation of employees.

For example, let’s say you’re an independent contractor whose compensation is $110,000 annually. On top of that, your health benefits and state and local taxes amount to $15,000 annually. In this case, the maximum amount eligible for payroll costs would be the following:

Max payroll costs = $110,000 - $10,000 (excess cash compensation) + $15,000 (non-cash compensation) = $115,000

Some other costs that are excluded from eligible payrolls costs is compensation for an employee whose principal place of residence is outside of the U.S.; and paid sick leave or paid family leave for which a credit is allowed under phase two of the coronavirus stimulus package. During the covered period, borrowers are not required to provide collateral security for the loans or cause owners or affiliates to guarantee the loans. The covered period runs from February15, 2020 to June 30, 2020. Under Treasury’s guidance, payroll costs are calculated on a gross basis without regard from federal taxes. For example, an employee who earned $4,000 per month in gross wages, from which $500 in federal taxes was withheld, would count as $4,000 in payroll costs. The employee would receive $3,500, and $500 would be paid to the federal government. However, the employer-side federal payroll taxes imposed on the $4,000 in wages are excluded from payroll costs under the statute. As a result, payroll costs include taxes on an employee and required to be withheld by the employer, but not

Recent guidance from Treasury and SBA sets the interest rate at 1% and a maturity of 2 years for PPP Loans. Lenders are required to provide complete payment deferment on the loan for at least six months and a maximum one year.

The SBA’s 7(a) program also provides SBA Express Loans**.** Under section 1102, the maximum loan for an SBA Express loan is increased from $350,000 to $1 million through December 31, 2020. The maturity for this type shall be no longer than seven years, with an option to revolve the loan. The SBA program features an accelerated turnaround time for SBA review. Talk to your lender of choice to discuss your applications for this program. If you receive the SBA

Express Loan, your small business will be ineligible for the employee retention credit and the payroll tax deferment under the CARES Act.

- **Requirements to apply:**
    - PPP requires borrowers to certify that the loan is necessary due to the economic conditions of the coronavirus and it was operational as of February 15, 2020;
    - Borrowers need to verify that the funds will be used to retain workers and maintain payroll costs, lease, and utility payments;
    - Borrowers must confirm that they are not receiving alternative loans for the same uses from another SBA program from February 15, 2020 to December 31, 2020.
    - You can also see the application here.

- **Who is eligible:**
- Small employers with 500 employees or fewer, as well as those that meet the current SBA designation for a small business as described above.
- Sole proprietors and independent contractors.
- Certain non-profits, including 501(c)(3) organizations and 501(c)(19) veteran organizations, and tribal businesses with under 500 employees.
- The small business must be located in the U.S.

However, in the regulations defining the general rules for all SBA loan programs (see 13 C.F.R. sec. 120.110), there are a number of businesses that are excluded from participation.

These potentially excluded businesses are: (a) 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); (b) passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except for Eligible Passive Companies under 13 CFR section 120.111); (c) life insurance companies [**Note**: this does not include agents or brokers]; (d) businesses located in a foreign country (businesses in the U.S. owned by aliens may qualify); (e) pyramid sale distribution plans; (f) businesses deriving more than one-third of gross annual revenue from legal gambling activities; (g) businesses engaged in any illegal activity; (h) private clubs and businesses which limit the number of memberships for reasons other than capacity; (i) government-owned entities (except for businesses owned or controlled by a Native American tribe); (j) businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting; (k) loan packagers earning more than one third of their gross annual revenue from packaging SBA loans; (l) businesses with an associate who is incarcerated, on probation, on parole, or has been indicted for a felony or a crime of moral turpitude; (m) businesses in which the SBA lender (or certain related parties) owns an equity interest;(n) businesses which: (1) present live performances of a prurient sexual nature; or (2) 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; (o) unless waived by SBA for good cause, businesses that have previously defaulted on a Federal loan or Federally assisted financing, resulting in the Federal government or any of its agencies or Departments sustaining a loss in any of its programs, and certain businesses related to such a business (e.g., a successor business); (p) businesses primarily engaged in political or lobbying activities; and (q) speculative businesses (such as oil wildcatting).

As noted, while passive businesses are generally ineligible for 7(a) loans, certain passive businesses qualify. Under the applicable regulations, an "Eligible Passive Company" is "a small entity or trust which does not engage in regular and continuous business activity, which leases real or personal property to an Operating Company for use in the Operating Company's business. For these purposes, an "Operating Company" is "an eligible small business actively involved in conducting business operations now or about to be located on real property owned by an Eligible Passive Company, or using or about to use in its business operations personal property owned by an Eligible Passive Company."

In terms of other rules relating to eligibility for the PPP, certain industries are exempt for purposes of the 500-employee rule from an "affiliation" rule that could aggregate independently owned/operated franchises.

Employers receiving the employee retention tax credit under the package are not eligible for PPP loans. The employee retention tax credit was enacted under section 2301 of the CARES Act. This employee retention tax credit provides for a refundable credit of up to $5,000 per employee against employment taxes for employers who keep their workers during the coronavirus crisis. The credit is available to employers whose (1) operations were fully or partially suspended, due to a crisis related shut-down order, or (2) gross receipts declined by more than 50 % when compared to the same quarter in the prior year. The credit is based on qualified wages paid to the employee. For employers with more than 100 full-time employees, qualified wages are wages paid to employees when they are not providing services due to the coronavirus-related circumstances described above. For employers with 100 or fewer full-time employees, all employee wages qualify for the credit, it doesn't matter if the business is open for business or subject to a shut-down order. The credit is provided for the first $10,000 of compensation, including health benefits. The credit is provided for wages paid or incurred from March 13, 2020 to December 31, 2020.

The PPP loan program was made available on April 3, 2020, for businesses. The PPP loan program will open to independent contractors and self-employed individuals on April 10, 2020. We recommend you contact your lender of choice to begin your application as soon as possible. Applicants are eligible to apply for the PPP loan until June 30th, 2020.

Small Business Loan Forgiveness: Section 1106 of the CARES Act mandates that the borrower of PPP can apply for forgiveness of a portion of its loan, which will be forgiven as long as the amount is less than the principal amount of the loan. The maximum eligible amount for full loan forgiveness (along with interest) is the sum of the costs paid during the eight-week period. The eight-week period starts from the date the loan disbursement is made. The eligible costs include: total payroll costs, as described above; any interest on any covered mortgage obligation; and any payment on any covered rent (or leasing) and utility obligations for services that began before February 15, 2020.

- **Formula for Reduction of Loan Forgiveness:** The forgiven amount may be reduced by multiplying the sum of the payroll costs by the result of a fraction. The numerator of this fraction is the average number of full-time employees per month during the eight-week period following the loan; the denominator is at the discretion of the borrower with two sets of criteria: (1) the average number of full-time employees per month between February 15, 2019, and June 30, 2019; or (2) the average number of full-time employees per month between January 1, 2020 and February 29, 2020. ***Note:*** The reduction in eligible loan forgiveness only applies if the entity reduces the amount of workers employed during the eight-week period compared to the two sets of criteria described above.

  Example: a small business has $1000 of eligible costs for the eight-week period, and during this period the owner had an average of six employees per month. The entity had an average of ten employees for the two sets of criteria, making this number the denominator. Given the numbers provided above, the small business illustrated in the example only would be eligible to forgive $600 of its loans. In essence, the small business could rehire four employees to keep the average of ten employees and acquire the maximum amount of loan forgiveness. Employers that terminated workers between February 15, 2020 and April 26, 2020, have until June 30, 2020 to qualify for the full benefit as long as they have rehired and fully paid employees. Payroll costs that were not taken into account for the initial loan cannot be considered as part of the loan forgiveness. Further, the amount of potential forgiveness is reduced (dollar-for-dollar) by the amount of wage decreases implemented during the eight-week period for employees who make an annualized amount of $100,000 or less that exceed 25 percent of the employee's salary for the most recent quarter before the eight-week period. Thus, if an employee's wages are cut by 30 percent, the forgivable amount would be reduced, dollar-for-dollar by the value of 5 percent of that employee's wages for the eight-week period. The EIDL grant award of up to $10,000 would be taken out from the amount forgiven under the PPP.

- **How to apply for loan forgiveness:**
  - Documentation with respect to its full-time equivalent employees and payroll tax filings;
  - Documentation with respect to payments of amounts that are forgivable under the program (e.g., rent, utility payments, etc.); and
  - A certification that the documentation is accurate and that the requested amount of forgiveness was used to retain employees and make forgivable payments.

A PPP lender has 60 days from its receipt of a loan forgiveness application to make a decision with respect to the approval process. If the full principal of the PPP loan is forgiven, the borrower is not responsible for the interest accrued in the 8-week covered period. The remainder of the loan that is not forgiven will operate according to the loan terms agreed upon by you and the lender. Recent guidance from Treasury and SBA limits loan forgiveness to 25% for non-payroll expenses, and leaves the remaining 75% for only payroll expenses.

The amount of the loan forgiven will not be included as federal taxable income. <u>If any amount of the loan is forgiven, the borrower is not allowed to defer its payroll tax under the CARES Act</u>. Section 2302 of the CARES Act provides for a payroll tax deferral mechanism for the employer portion of any Social Security taxes for the period beginning on March 27, 2020 and ending before January 1, 2020 (this is the payroll tax deferral period). If a balance remains after the borrower receives loan forgiveness, the outstanding loan will have a maximum maturity date of 10 years after the application for loan forgiveness. Loans that are granted forgiveness are still deductible for tax purposes, and there seems to be no limit with respects to the deduction under section 11c. Your lender of choice should be able to process the loan forgiveness.

Please keep in mind the process and requirements to apply for a PPP loan may vary by lending institution. The PPP loan program is a brand new federal government program, and lenders are still refining their own internal processes for PPP loan applications. This brief is meant to help you navigate the different SBA programs during the pandemic crisis. We will do our best to update this brief as we get new guidance and updates from the federal government.

This brief was prepared by Alex Cisneros and your AALU/GAMA Government Affairs Team. Please contact Alex with any questions.