

# Small Business Owners: What you Need to Know about the Paycheck Protection Program's Forgivable Loan

Articles, COVID 19: Answers to Business Challenges March 30, 2020

The "Coronavirus Aid, Relief, and Economic Security Act" or the "CARES Act" has officially been signed into law. The 880 page document creates and funds many programs designed to combat the economic disaster brought on by the COVID-19 Pandemic. This entry will focus on one important section: the Paycheck Protection Program of the CARES Act. This part of the Act is designed to keep small business employees employed by offering forgivable loans to certain businesses and this article is to designed answer some of the many questions that borrowers and lenders may have about the Program.

## What is a Covered Loan?

A covered loan is a loan made pursuant to the Paycheck Protection Program, (15 U.S.C. 636(a)(36)), during the covered period of February 15, 2020 through June 30, 2020.

## What Banks Can Issue Covered Loans under the Paycheck Protection Program?

Most banks will be able to issue such loans. While the CARES Act explicitly delegates authority to lenders authorized under Section 7(a) of the Small Business Act (hereinafter referred to as "Bank") to make the above-described loans, the Administrator of the Small Business Administration ("Administrator") and the Secretary of the Treasury may extend authority to additional lenders they deem to have the necessary qualifications to process, close and disburse loans.

## How Much Money Can a Bank Loan?

Generally, 2.5 times borrower's monthly payroll costs. Specifically, the Maximum Loan Amount is the lesser of: 1) \$10,000,000; and 2) average monthly payments for payroll costs for the year before the loan is made (or 12-week period for seasonal employment) multiplied by 2.5 plus the outstanding amount of a subsection (b)(2) (Economic Injury Disaster Relief) loan that was made after January 31, 2020.

For new businesses, if the borrower was not in business from February 15, 2019 and ending on June 30, 2019, borrower can chose to calculate monthly from January 1, 2020 through February 29, 2020 instead of a whole year.

## When Will Banks Start Accepting Applications?

Soon. Some Banks are accepting preliminary applications, but loans will most likely be processed after the Administration issues regulations and guidelines later this week.

## What are the Eligibility Requirements for Borrowers?

Borrowers that employ not more than 500 employees or other standard established by the Administration for a particular business or industry, including non-profits. In addition, individuals who operate under sole proprietorships, independent contractors and other self-employed individuals are eligible to receive a covered loan.

In addition, when submitting their application, these borrowers must make a good faith certification: 1. that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible

recipient; 2. acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments; 3. that he/she/it does not have an application pending for a loan under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan; and 4. that during the period beginning on February 15, 2020 and ending on December 31, 2020, he/she/it has not received amounts under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan.

### **Are Borrowers with Multiple Locations Eligible?**

Possibly. The Act was designed to protect business entities like franchises even though, in total, they may employ more than 500 individuals. Under the Act, a borrower that employs not more than 500 employees per physical location and that is assigned a North American Industry Classification System code beginning with 72 (Accommodation and Food Services) at the time of disbursement is eligible to receive a covered loan.

Moreover, the regulations applicable to affiliations are waived for: 1) businesses with less than 500 employees and is assigned an NAICS Code beginning with 72 (Accommodation and Food Services); 2) businesses operating as a franchise that is assigned a franchise identifier code by the Administration; and 3) any business that receives financial assistance from the Small Business Investment Act.

### **What are Some Other Unique Features to Covered Loans?**

During the covered period, with respect to a covered loan the inability to obtain credit elsewhere not required; no personal guarantee is required; no collateral is required and there is no prepayment penalty for any payment made on a covered loan.

The waiver of the personal guarantee and collateral requirements is important because, prior to the CARES Act, for loans greater than \$350,000, the SBA would typically require that the Bank collateralize the loan as much as possible (up to the loan amount) which could include a requirement that the borrower secure the loan with personal assets.

### **Can Existing Loans be Refinanced as Covered Loans?**

Yes. Some loans made pursuant to subsection (b)(2) (Economic Injury Disaster Loan) after January 31, 2020 may be refinanced as a covered loan.

### **What Other Factors Will the Bank Consider?**

In evaluating the eligibility of a borrower, the Bank shall consider whether the borrower: 1) was in operation on February 15, 2020; and 2a) had employees for whom the borrower paid salaries and payroll taxes; or 2b) paid independent contractors.

In addition, Congress inserted a provision stating that the Administration should issue guidance to lenders prioritizing small business concerns and entities in underserved and rural markets, including veterans and members of the military community, small business concerns owned and controlled by socially and economically disadvantaged individuals, women, and businesses in operation for less than 2 years.

### **What is the Maximum Interest Rate for Covered Loans?**

Four percent (4%) during the covered period. Loan terms will still be negotiated between borrowers and Banks and will be product of the prime rate, plus the LIBOR rate. Previously, fixed rate loans were capped at 6 percent. After the covered period, loans may bear interest at typical SBA rates.

### **When do Borrowers Begin Making Payments on the Covered Loans?**

Lenders are required to defer payment obligations for a period between six months and one year on all principal and interest. Loans may have a maximum maturity date, which is 10 years after the borrower submits its application.

### **Will the Administration Charge Any Fees?**

No. All annual and/or guarantee fees for the loan and all prepayment penalties are waived. Prior to the CARES Act, the SBA typically levied fees ranging from 2 to 3.75 percent of the guaranteed portion of a loan.

### **What and How Do Banks Get Paid?**

Administrator shall reimburse a Bank for processing a loan at the following rates :1) 5 percent for loans of not more than \$350,000; 2) 3 percent for loans of more than \$350,000 and less than \$2,000,000; and 3) 1 percent for loans of not less than \$2,000,000.

Banks shall be reimbursed by the Administrator no later than 5 days after the disbursement of the covered loan.

### **What Fees Can be Charged by Agents of the Borrower?**

These amounts will be set by the Administrator.

### **What if an Economic Injury Disaster Loan (Subsection (b)(2) of the Small Business Act) was Already Issued to the Borrower?**

A recipient of an economic injury disaster loan that is for a purpose other than paying payroll costs and other obligations may still receive assistance.

### **How Much Money is Available under this Program?**

\$349,000,000,000. Commenters have noted that this amount is about half of what would be required to cover 2½ months of payrolls for every business in America with fewer than 500 employees, which are the program's main targets. Accordingly, since these loans are first-come, first-served, the cash will run out before every eligible business receives a loan.

### **Can the Covered Loans be Forgiven?**

Yes, Section 1106(b) of the CARES Act provides that amounts paid to cover payroll, mortgage interest, rent and utility payments shall be forgiven.

### **Can the Amount of Forgiveness be Reduced?**

Yes, covered loans can be forgiven (i.e., not repaid). This is a departure from other SBA loans which typically required repayment in full. Under the CARES Act, the amount of forgiveness cannot exceed the principal amount of financing.

The amount of forgiveness can be reduced based on the reduction of the number of employees (per an equation set forth in Section 1106(d)(2)(A) of the Act) and based on a reduction in salaries and wages. A borrower will need to calculate its average number of full-time employees in both 2019 and between Jan. 1, 2020 and Feb. 29, 2020 to determine the most favorable result. Generally, if a borrower's workforce is 75% of the workforce during the applicable comparison period, then 75% of the loan.

Employers should be aware that the Administrator and Secretary of Treasury may prescribe regulations granting *de minimus* exceptions to the requirements of this subsection.

### **How Does a Borrower Apply for Forgiveness?**

The borrower must submit an application to the Bank that serviced the covered loan that must include the following: • documentation verifying the number of full-time equivalent employees on payroll and pay rates for the relevant time period; • documentation verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments; • a certification that: 1) the documentation presented is true and correct; and 2) the amount for which forgiveness is requested was used for permitted purposes (pay employees, mortgage interests, rent, utility payments, etc.). • any other documentation the Administrator determines necessary (In other words, look for future guidance).

### **Is the Amount Forgiven Taxable?**

No. As set forth in the Act, “any amount which (but for this subsection) would be includible in gross income of the eligible recipient by reason of forgiveness described in subsection (b) shall be excluded from gross income.”

### **How Long Does the Bank have to Make a Decision on the Application?**

60 days.

### **Is the Bank Protected if It Forgives a Loan in Good Faith?**

Yes, if the Bank receives the Required Documentation from the borrower who attests that the borrower has accurately verified the payments for payroll costs, payments on covered mortgage obligations, payments on covered lease obligations, or covered utility payments during covered period, then the Administrator is unlikely to pursue any claims against the Bank.

### **Will There Be Additional Guidance on Forgiveness?**

Yes. The Administrator is obligated to issue guidance and regulations implementing the CARES Act within 30 days of its passage. Indications are that they will be issued later this week or early next week.

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