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CARES Act of March 27, 2020

Summary of "Phase 3" Provisions Affecting Cash Flow and Finances
Revised 4-3-2020; important changes are highlighted

I. Basic Terms of SBA Paycheck Protection Program (PPP). This loan program is generally available only for businesses with less than 500 employees (or more for certain industries) – for businesses that are close to this number, or affiliated with other businesses that could exceed this number of employees if combined, please contact your SSEG attorney for assistance. The loans are also available to sole proprietors, self-employed and independent contractors, and certain non-profits. You would apply for this loan with an SBA-approved lender, which can be your current bank. The SBA is directed to provide rules for standard operating procedures that lenders must follow within 30 days.

A. Minimum Information Needed for Loan Application.

1. Total payroll for 1-1-2019 through 3-31-2020, including:
   a. Salary, wages, commission and tips
   b. Bonus
   c. Health insurance premiums plus other payments related to group health insurance
   d. State and local taxes paid (not federal taxes or withholdings)
   e. Separation payments
   f. Retirement contributions by the employer
   g. NOT payments to 1099 independent contractors (clarified 4-2-20)

It remains unclear whether the supporting payroll documentation to be submitted with the application is to be for calendar year 2019, or the 12-month period ending March 31, 2020. Lending banks are seeking guidance on this issue, but for applicants the prudent measure would be to prepare to provide IRS payroll records, retirement plan contributions, health insurance premiums and other payroll costs for both of the possible periods of measurement.

2. When determining payroll costs, which will drive the amount available to be borrowed, you will exclude any portion of an employee's annual salary, commission and bonus compensation over $100,000 as annualized – this excess is excluded because only the $100k annual rate is eligible for the loan.

3. Organizational documents, such as articles of incorporation/formation, LLC Operating Agreements or corporate bylaws.

4. Name, address and affiliation of owners of 20% or more.

5. Documentation Needed for Forgiveness of Loan:

   a. documentation verifying the number of full-time equivalent employees on payroll and pay rates for at least the one-year period prior to the application and then moving forward through at least 6-30-2020, including:

      (i) payroll tax filings reported to the Internal Revenue Service; and
      (ii) State income, payroll, and unemployment insurance filings.

   b. documentation, including cancelled checks, payment receipts, transcripts of accounts, or other documents verifying payments on business mortgage obligations (loan in place on 2-15-20), payments on lease obligations for leases in place on 2-15-20, and utility payments;

6. Certifications: The bank's application form will contain several required certifications from an authorized representative of the applicant. These certifications must be true because if found to be untrue down the road, it will be considered fraud. Besides background check type information, note the following:

   (i) the documentation presented is true and correct; and
   (ii) the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation, or make covered utility payments; and
   (iii) that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient (*note: this certification appears to be the only hardship-related requirement for this loan program, but it is so general that it is likely true for every business*).

B. Loan Amount; Use of Proceeds.

1. The maximum loan amount is generally 250% of your adjusted annual monthly payroll costs, but is subject to an overall cap of $10 million.

2. The proceeds may be used to pay for:

   a. Payroll Costs – must constitute at least 75% of the PPP loan proceeds. "Payroll costs" are defined broadly as: compensation to employees (whose principal place of residence is the United States) in the form of salary, wages, commissions, or similar compensation; tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips); payment for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums, and retirement; payment of state and local taxes assessed on compensation of employee. salary, wages, commissions, or similar compensation are subject to a $100,000 per year cap for purposes of using proceeds for this loan.

b. Rent for leases in existence at 2-15-2020
c. Utilities for services in existence at 2-15-2020
d. Interest on pre-existing debt (as of 2-15-2020), including mortgage interest (note: for purposes of forgiveness, only mortgage interest is counted)
e. Other typical Section 7(a) loan purposes, like general working capital or real estate, BUT proceeds used for these purposes will not be forgivable.

Although there are no regulations on compliance yet, we suggest you keep the forgivable loan proceeds segregated from general accounts and then apply them (with proper documentation) only to the permitted use of proceeds. This will ensure obtaining the maximum forgiveness without undue complications arising from questioning of use of funds.

C. Loan Terms and Conditions.

1. No personal guaranties, and non-recourse to business owners (note: this is a departure from normal SBA requirements).
2. No collateral required.
3. Subject to forgiveness upon meeting certain conditions (see item D below), making it "free" money.
4. To the extent not forgiven, the loan will have a 2-year term with interest at 1%; payments to be deferred for 6 months.
5. Lender has 60 days to make a decision on loan, although it is not clear what credit underwriting, if any, is to be done. Under certain circumstances, borrowers can obtain an emergency advance of up to $10,000 within 3 days of an application being submitted (this is done EID loan discussed below). Current knowledge indicates funding will be made immediately when the application is complete, and certainly within a few days.

D. Loan Forgiveness.

1. All loan principal that is used for the eligible use of proceeds within 8 weeks of the loan can be forgiven, subject to reductions below.
2. Both principal and interest on the loan is forgiven.
3. The amount of the loan to be forgiven is reduced pro rata by the percentage reduction in FTEs from 2-15-20 through 6-30-20 vs. the "comparison period". The comparison period is either (at borrower's option) 2-15-19 through 6-30-19 or 1-1-20 through 2-29-20.
4. The amount of the loan to be forgiven is reduced by any reduction of over 25% in compensation to a covered employees from 2-15-20 through 6-30-20 vs. the average in 4th quarter 2019 (it appears this reduction does not apply if compensation is reduced for employees receiving over $100k on an annualized basis – i.e., the loan will not include compensation of over $100k on an annualized basis, so the borrower is not penalized on the forgiveness side).
5. The forgiveness reductions will not factor in jobs or compensation cut between 2-15-20 and 4-30-20 if the cuts are "cured" by 6-30-2020. For this purpose, a "cure" means employees rehired or payroll restored.

6. The amount forgiven must be at least 75% expended toward "payroll costs."

E. Tax Effect of Forgiveness. Normally, the amount of any forgiven loan is treated as taxable ordinary income, but for this loan its forgiveness amount is not taxable income.

F. Clarity (?). Remember, this loan program is different (and better for small businesses) than the previously announced SBA Economic Injury Disaster loans (see item IV below). Applicants may add to a PPP loan the amount of any Economic Injury Disaster (EID) loan MADE between 1/31/20-4/3/20; but doing so will require some specialized tracking of use of proceeds to ensure forgiveness. This process is tough to summarize in this format, and requires individual attention. Unfortunately, current guidance from the SBA itself does not clarify if it is permissible to receive both an EID loan and PPP loan that does not fit this limited circumstance (i.e., refinancing a previously received EID loan into the PPP program). On this issue, our advice has been (i) we are not aware of anything official that expressly prohibits receiving both loans, so long as the proceeds are applied to different permitted uses, (ii) Senate Committee guidance contemplates use of both loan programs, (iii) the new SBA application form contains changes that confirm that the PPP loan and EID loan programs are separate and are not mutually exclusive as long the funds are not used to pay the same covered expense, and (iv) PPP applicants should disclose prior EID applications to their lender, just in case the lender is taking the position that it will not allow both. As is clear by now, however, this entire situation is fluid and this particular issue could be clarified either way in the future, so applicants for both loan programs should be certain to discuss it with the PPP lender.

II. SBA 7(a) Loan Subsidy. For any already-outstanding SBA 7(a) loans, the government will now make the next 6 months of payments at no cost to the borrower. This does not include new PPP loans described above. This loan does not require a showing of hardship, as all businesses with SBA 7(a) loans currently outstanding are eligible.

III. Payroll Tax Provisions. The Act contains two provisions for payroll tax relief, but these are only available if the business does not use a PPP forgivable loan.

A. Employee Retention Credit. This tax credit only applies to businesses that are fully or partially suspended or closed due to a government order and can demonstrate substantial revenue losses. The credit applies against employer-paid payroll taxes and is 50% of qualified wages (wages that count for this purpose are limited to $10,000 per employee, per quarter) paid from March 12, 2020 through December 31, 2020. If the credit exceeds employment taxes, the excess will be paid to the employer as a tax refund.

B. Payroll Tax Deferral. Provides a deferral of the employer's share of payroll taxes until 12-31-2021 (half the deferred amount) and 12-31-2022 (the other half).

IV. SBA EID Loans. While not covered by the CARES Act, it is important to remember that since the COVID situation has been declared a disaster in Ohio (and all other states), the SBA will make available Economic Injury Disaster loans to qualified small business borrowers.

A. SBA's Economic Injury Disaster Loans offer up to $2 million in assistance and can provide support to small businesses to help overcome the temporary loss of revenue they are experiencing.

B. These loans may be used to pay fixed debts, payroll, accounts payable and other bills that can't be paid because of the disaster's impact.

C. The interest rate is 3.75%, 2.75% for certain non-profits.

D. The loans have long-term repayments in order to keep payments affordable, up to a maximum of 30 years. Terms are determined on a case-by-case basis, based upon each borrower's ability to repay.

E. Unlike the CARES Act PPP loans, these EID loans will typically require personal guaranties and a pledge of assets.

F. Loan applications are made directly with the SBA via it on-line process, not via a bank.

G. Application review should take 2-3 weeks, with 5 additional days to fund after approval.

H. You may be able to have this loan subordinated to existing credit facilities, if the senior lender will allow it – this is something to discuss with your existing lender.

V. Existing Loans. Many lenders are providing accommodations on existing loan facilities, which is consistent with the expectations laid out in the CARES Act. As part of your cash flow planning, make sure you ask existing lenders about payment deferrals or other accommodations that may be available.

VI. CAVEATS. The CARES Act was, by necessity, hastily drafted and therefor may be subject to correction or modification moving forward, and guidance updates have changed some of the terms and conditions as indicated above. In addition, we are still waiting final regulations and other guidance to be issued for the loan programs, FMLA changes, etc. Finally, we have seen numerous summaries and statements about the contents of the CARES Act that appear to vary from the actual text, so if you have any questions feel free to contact SSEG for clarification.