Payroll Loans and Loan Forgiveness: New Relief Opportunities for Small Businesses under the CARES Act's Paycheck Protection Program

Hinckley Allen Corporate & Business

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Overview

This afternoon the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), a nearly $2 trillion stimulus package to help address the economic impact of the recent COVID-19 pandemic was signed into law. Included in the CARES Act is a Paycheck Protection Loan Program, proposed as a revision to the U.S. Small Business Administration's ("SBA") existing 7(a) loan program (the "Paycheck Protection Program"). Key features are summarized below.

Important Takeaways for Employers

- A small business impacted by the COVID-19 pandemic may be eligible for a loan in an amount up to 2.5 times its average payroll costs (up to $10 million) for use in the payment of certain expenses (including payment of employee salaries and wages as well as specific mortgage interest, rent and utilities obligations).
- If the small business uses the loan proceeds for approved expenses under the CARES Act and maintains its average full-time workforce without a reduction in compensation over the covered period, the principal of the loan will be forgiven, meaning the company will only need to pay back the interest accrued. In the event the small business lays off employees or reduces compensation during the covered period, it may be eligible for partial loan forgiveness.
- Interest rates for loans made under the CARES Act are capped at 4% and there is a minimum 6-month repayment deferral.

Who Is Eligible?

Businesses eligible for loans under the Paycheck Protection Program include small business concerns (as defined under the Small Business Act), as well as any business concerns, nonprofit organizations, or veterans organizations that employ not more than the greater of 500 employees or, if applicable, the size standard in number of employees established by the SBA for the industry in which the business operates. There is no requirement that an applicant is unable to obtain credit elsewhere, nor is there any evaluation of the creditworthiness of the applicant in determining eligibility for these loans. Recipients of loans under the SBA's economic injury disaster program may be eligible to refinance those loans under the Paycheck Protection Program.

How Much Is the Loan Amount and What Are the Terms?

A borrower is eligible for a loan in an amount not to exceed the lesser of (1) $10,000,000, or (2) 2.5 multiplied by average total monthly payments for *payroll costs* (as defined below) during the 1-year period before the date on which the loan is made. In the event that a borrower has received a loan under the SBA's economic injury disaster loan program, the borrower may be eligible to refinance all or a portion of that amount under the Paycheck Protection Program. A covered loan's interest rate will not exceed four percent (4%) and it will be subject to complete payment-deferral relief for at least six months.

Payroll costs generally include the sum of payments of any compensation that is a salary, wage, commission, or similar compensation; payment of cash tip or equivalent; payment for vacation, parental, family, medical, or sick leave; allowance for dismissal or separation; payment required for the provisions of group health care benefits, including insurance premiums; payment of any retirement benefit; or payment of state or local tax assessed on the compensation of employees. However, "payroll costs" do not include employee compensation in excess of $100,000 annually or compensation of employees whose principal place of residence is outside of the United States. The CARES Act also includes other exclusions from the definition of "payroll costs", including certain types of taxes and leave wages for which credit is allowed under the Families First Coronavirus Response Act.

The interest rates for loans under the Paycheck Protection Program will not exceed four percent (4%) and the loans will be subject to complete payment deferral relief for at least six months. Loans under the Paycheck Protection Program do not require collateral or personal guarantees. The CARES Act appropriates approximately $349 billion towards these loans.

How to Use the Loan?

A borrower may use loan proceeds for "payroll costs" (as defined above); costs related to continuation of group health care benefits during periods of paid sick, medical, or family leave; insurance minimums; employee salaries, commissions, and similar compensations; payments of interest on any mortgage obligation (which shall not include any prepayment or payment of principal on a mortgage obligation); rent (including rent under a lease agreement); utilities; and certain other debt obligations. In each case, the covered period is from February 15, 2020 through June 30, 2020.

Will the Loan Be Forgiven?

A borrower is eligible for forgiveness of the portion of the loan (which could be up to the entire principal amount of the loan) that is used to pay the following costs that are incurred and paid during the 8-week period following the origination of the loan: payroll costs (as defined above), interest on certain mortgage obligations, certain rent obligations, and certain utility payments. The amount of the loan eligible for forgiveness can be reduced proportionally in the event the borrower makes reductions in employment levels or compensation levels beyond certain thresholds. However, in the event a borrower has made or makes reductions in employment levels or compensation levels beyond the threshold amounts between February 15, 2020 and 30 days after the enactment of the CARES Act, the provisions of the CARES Act that might otherwise lead to a reduction in the loan forgiveness amount as a result thereof will be disregarded if the borrower re-hires the equivalent number of employees or raises compensation to prior levels (as applicable) prior to June 30, 2020.

Loans under the Paycheck Protection Program do not require collateral or personal guarantees. Any forgiven debt (canceled indebtedness) is excluded from gross income for federal tax purposes.

Disclaimer.

This summary does not include or address every provision of Paycheck Protection Program under the CARES Act, which should be read in its entirety. Furthermore, pursuant to the CARES Act, the SBA is required to promulgate regulations for the implementation of the Paycheck Protection Program within fifteen (15) days of passage and, as such, there is still uncertainty relating to details of implementation.

We are here to help answer specific questions and offer advice on your options. Feel free to contact any member of our Corporate & Business Group.

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