

Small Business Loans to Offer Relief from COVID-19 Economic Crisis

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Congress has responded to the economic crisis brought on by the COVID-19 virus by passing economic stimulus packages to help small and mid-sized businesses. Congress included in these packages \$349 billion in Paycheck Protection Loans that will be forgiven so long as the loan funds are spent on certain specified costs and the business does not decrease the number of employees or cut employee wages by more than 25%. Congress also expanded the existing SBA Economic Injury Disaster Loan program to make it easier to obtain COVID-19 related disaster loans.

The purpose of this article is to provide information on the following:

- Paycheck Protection Loans (which are forgivable)
<https://www.sba.gov/funding-programs/loans/paycheck-protection-program>; and
- Economic Injury Disaster Loans (which are not forgivable)
<https://covid19relief.sba.gov/#/>.

I. Background

The Paycheck Protection Loans and Economic Injury Disaster Loans ("EIDLs") are Small Business Administration ("SBA") programs. SBA is a federal government agency that supports small businesses by increasing access to capital, offering business counseling, and helping small businesses win government contracts.

The SBA has both grant and loan programs. The SBA does not lend money itself - it sets standards that approved SBA lenders must follow, and the SBA guarantees a portion of those loans. Those guarantees are meant to encourage lenders to lend to eligible small businesses.

Most SBA loans are offered by private lenders to eligible small businesses under a program for general small business loans, known as "7(a)" loans.[1] The Paycheck Protection Loans are "7(a)" loans. The SBA also separately authorizes disaster loans including EIDLs.[2]

II. Paycheck Protection Loans

Eligibility. Any business with up to 500 employees is eligible for a Paycheck Protection Loan.[3] Also eligible are the following:

- Sole proprietors, independent contractors and self-employed workers;
- A business with not more than the size standard in number of employees established by the SBA for the industry (if the size standard is greater than 500 employees);
- A business designated as "accommodation and food services" under NAICS Sector 72 may obtain a loan for each location that employs up to 500 employees.

For purposes of counting the number of employees, an "employee" includes each individual employee whether full time or part time.

A loan applicant must certify in good faith that:

- The uncertainty of current economic conditions makes the loan request necessary to support the ongoing operations of the business;
- That funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments; and
- The borrower has not applied for or received a duplicative Paycheck Protection Loan.[4]

Unlike traditional SBA loans, there is no requirement that the applicant show that it is unable to obtain credit elsewhere.[5] There also is no collateral or personal guaranty required.[6]

Loan Amount. The maximum loan amount for each business is based on that business's payroll. The loan amount is calculated as follows:[7]

- The average monthly payment for "payroll costs" during the 1-year period before the date on which the loan is made (or for a seasonal business, the average total monthly payments for payroll for 12-week period beginning on either February 15, 2019 or March 1, 2019).
- Multiplied by 2.5.

If a business obtains an EIDL during the period beginning on January 31, 2020 and ending on the date on which Paycheck Protection Loans are available, a business can add the outstanding amount of the EIDL to the Paycheck Protection Loan amount.

The term "payroll costs" means-

- The sum of payments of any compensation with respect to employees 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;
- Payment of state or local tax assessed on the compensation of employees; and
- The sum of payments of any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, or similar compensation.

The term "payroll costs" does not include-

- Compensation of an individual employee in excess of an annual salary of \$100,000, as prorated between February 15, 2020 June 30, 2020;^[8]
- Taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code of 1986 between February 15, 2020 June 30, 2020;
- Any compensation of an employee whose principal place of residence is outside of the U.S.;
- Qualified sick leave wages for which a credit is allowed under section 7001 of the Families First Coronavirus Response Act (Public Law 116-127); or
- Qualified family leave wages for which a credit is allowed under section 7003 of the Families First Coronavirus Response Act (Public Law 116-127).

Permitted Uses of Paycheck Protection Loan Funds. The proceeds from a Paycheck Protection Loan can be used only for the following:

- Payroll costs;
- Costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- Employee salaries, commissions, or similar compensations;
- Payments of interest on any mortgage obligation (which cannot include any prepayment of or payment of principal on a mortgage);
- Rent (including rent under a lease agreement);

- Utilities; and
- Interest on any other debt obligations that were incurred before February 15, 2020.

As long as loan proceeds are used for one of these permitted purposes, the SBA will not have recourse for nonpayment of the loan against any individual shareholder, member, or partner of the borrower.[9]

Loan Forgiveness. Even though loan proceeds can be used for any of the permitted purposes listed above, only amounts spent on the following are eligible for loan forgiveness:

- Payroll costs;
- Mortgage interest payments for a mortgage on real or personal property that was incurred before February 15, 2020 (not including prepayment of or payment of principal);
- Rent payments for any lease agreement in force before February 15, 2020; and
- Utility payments for electricity, gas, water, transportation, telephone or internet for which service began before Feb. 15, 2020.[10]

The loan forgiveness amount cannot exceed the principal amount of the loan.[11] The loan forgiveness amount will be reduced if the borrower decreases the number of employees or cuts any employee's wages by more than 25%.

To determine the reduction of the loan forgiveness amount, a borrower must multiply the loan forgiveness amount by the quotient obtained by dividing:

- The average number of full-time equivalent employees per month for the 8-week period beginning on the date of the loan origination; by either
- The average number of full-time equivalent employees per month during the period beginning February 15, 2019 and ending on June 30, 2019, or at the election of the borrower, the average number of full-time equivalent employees per month during the period beginning January 1, 2020 and ending on February 29, 2019.

In addition, a borrower must reduce the loan forgiveness amount by the amount of any reduction in total salary or wage of any employee by more than 25% during the 8-week period beginning on the date of the loan origination. This does not apply to a salary reduction for any employee with an annualized salary of more than \$100,000.[12]

Forgiven loan amounts are excluded from gross income for federal tax purposes.[13]

Payments and Interest Rate. A lender must allow a borrower to delay payments of principal, interest and fees for at least six months and up to a year. The maximum

interest rate on the loan is 4% per year with a maximum maturity of 10 years from the date on which the borrower applies for loan forgiveness[14] (this would apply only to loan amounts that are not forgiven).[15]

How to Apply for a Paycheck Protection Loan. The application is not yet available and the current number of lenders authorized to make SBA loans is somewhat limited.[16] The CARES Act instructs the SBA and U.S. Treasury Department to increase the number of lenders authorized to make Paycheck Protection Loans, in an effort to deploy these funds quickly.[17]

III. Economic Injury Disaster Loans

Eligibility. Any business with up to 500 employees is eligible for an EIDL related to the COVID-19 emergency. Any individual who operates under a sole proprietorship, with or without employees, or as an independent contractor also is eligible.[18]

The SBA requires an applicant be creditworthy to assure the loans are sound as to reasonably assure repayment. The SBA considers the following:

- Character, reputation, and credit history of the applicant (and the operating company, if applicable), its associates, and guarantors;
- Experience and depth of management;
- Strength of the business;
- Past earnings, projected cash flow, and future prospects;
- Ability to repay the loan with earnings from the business;
- Sufficient invested equity to operate on a sound financial basis;
- Potential for long-term success;
- Nature and value of collateral (although inadequate collateral will not be the sole reason for denial of a loan request); and
- The effect any affiliates may have on the ultimate repayment ability of the applicant.[19]

The SBA will not require a borrower of an EIDL to pledge collateral if the loan is \$25,000 or less.[20]

For EIDLs in connection with COVID-19, the SBA will waive the personal guaranty requirement for loans of up to \$200,000. The SBA also will waive the requirement that an applicant must be in business for the 1-year period before the disaster, except applicant must have been in business as of January 31, 2020. Finally, the SBA will waive the requirement that the applicant must be unable to obtain credit elsewhere.[21]

Although an EIDL applicant must show an ability to repay the loan, the SBA may approve

an applicant based solely on the credit score of the applicant and cannot require an applicant to submit a tax return or a tax return transcript for loan approval.[22]

Loan Amount. An EIDL can provide up to \$2 million of financial assistance, although actual loan amounts are based on amount of economic injury.[23]

Permitted Uses of EIDL Funds. When the SBA approves an EIDL, the loan approval specifies the permitted use of loan proceeds. If a borrower wrongfully misapplies the proceeds, the borrower will be liable to SBA for one and one-half times the proceeds disbursed to the borrower as of the date SBA learns of the wrongful misapplication. Wrongful misapplication means the willful use of any loan proceeds without SBA approval contrary to the loan authorization. If a borrower fails to use loan proceeds for authorized purposes or fails to use the funds within 60 days or more after receiving a loan disbursement check, such non-use also is considered a wrongful misapplication of the proceeds. The SBA also may pursue criminal or civil charges.[24]

Loan Forgiveness. There is no loan forgiveness for an EIDL. However, repayment is not required for up to \$10,000 in the form of an Emergency EIDL Grant, discussed below.

Payments and Interest Rate. The interest rate is 3.7% for small businesses. Terms are available up to 30 years, determined on a case-by-case basis based upon each borrower's ability to repay. [25]

How to Apply for an EIDL. The application is available at <https://covid19relief.sba.gov/#/business-info>.

COVID-19 Emergency EIDL Grant of up to \$10,000. An applicant for an EIDL may ask the SBA for an advance of up to \$10,000 within 3 days after the SBA receives the loan application. An Emergency EIDL Grant must be used to pay for the following:

- Providing paid sick leave to employees unable to work due to the direct effect of COVID-19;
- Maintaining payroll to retain employees during business disruptions or substantial slowdowns;
- Meeting increased costs to obtain materials unavailable from the applicant's original source due to interrupted supply chains;
- Making rent or mortgage payments; and
- Repaying obligations that cannot be met due to revenue losses.

To obtain an emergency grant, an applicant can self-certify that the entity has no more than 500 employees.[26]

An applicant will not be required to repay the Emergency EIDL Grant even if subsequently denied an EIDL loan. [27] If an applicant receives an Emergency EIDL Grant and is approved for a Paycheck Protection Loan, the amount of Emergency EIDL Grant is

reduced from the loan forgiveness amount for the payroll costs for the Payroll Protection Loan.[28]

[1] 15 U.S.C. § 636(a).

[2] 16 U.S.C. § 636(b).

[3] CARES Act § 1102(a)(2)(D).

[4] CARES Act § 1102(a)(2)(G).

[5] CARES Act § 1102(a)(2)(I).

[6] CARES Act § 1102(a)(2)(J).

[7] CARES Act § 1102(a)(2)(E).

[8] It is unclear whether this means that for employees with annual salaries in excess of \$100,000, all compensation is excluded from the calculation or if the calculation includes the non-salary aspects of "payroll costs," such as payment for vacation, health care benefits, retirement benefits, certain taxes, and other items listed above.

[9] CARES Act § 1102(a)(2)(F).

[10] CARES Act § 1106(a) and (b).

[11] CARES Act § 1106(d).

[12] CARES Act § 1106(d).

[13] CARES Act § 1106(i).

[14] CARES Act § 1101 (a)(2)(K).

[15] CARES Act § 1102 (a)(2)(K) and (L).

[16] <https://www.sba.gov/funding-programs/loans/lender-match>

[17] CARES Act § 1109(b).

[18] CARES Act § 1110(a) and (b).

[19] 13 C.F.R § 120.150.

[20] 13 C.F.R § 123.11.

[21] CARES Act § 1110(c).

[22] CARES Act § 1110(d).

[23] 13 C.F.R. § 123.19.

[24] 13 C.F.R § 123.9.

[25] <https://www.sba.gov/disaster-assistance/coronavirus-COVID-19>

[26] CARES Act § 1110(e).

[27] CARES Act § 1110(e)(5).

[28] CARES Act § 1110(e)(6).

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