CARES Act Small Business Forgivable Loans

Small Business Interruption Loans under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)

The federal government is allocating funds to the Small Business Administration (SBA) to guarantee loans to small businesses; referred to as "7(a) loans" because they are authorized by that section of the laws governing the SBA.

Who is eligible?

Any business with 500 or fewer employees.

The business does not have to be shut down completely or partially. Any business that applies is presumed to need the loan and will get it. The only underwriting standards are the company was in business on February 15, 2020 and had employees for whom it paid salaries and payroll taxes.

The self-employed and independent contractors are also eligible for these loans.

These loans are non-recourse, meaning no personal guarantees or liens on business assets.

How much are the loans for?

The maximum loan you can receive will be equal to 2.5 times your average "payroll costs" during the 1-year period before the loan is taken. "Payroll costs" include:

- ✓ Employee salaries, wages, commissions, etc. up to $100,000 per year, $8,333.33 per month
- ✓ Payment for vacation, parental, family, medical or sick leave
- ✓ Severance payments
- ✓ Group health insurance
- ✓ Retirement plan contributions
- ✓ State and local taxes assessed on such compensation

Not included:

- ✓ Federal tax withholdings
- ✓ Compensation for non-US residents
- ✓ Sick leave and family leave provided by the new Families First Coronavirus Response Act for which there are already tax credits

What can the money be used for?

The loan proceeds can be used for more overhead expenses than what went into calculating the amount of the loan, including:

- ✓ Payroll costs
- ✓ Interest (not principal) payments on mortgages
- ✓ Rent
- ✓ Utilities
- ✓ Interest (not principal) on any debts that were incurred before February 15, 2020

How much of the money is forgiven?

You do not have to pay back the principal portion of the following for 8-weeks following the origination date of your loan.

- ✓ Payroll costs
- ✓ Interest (not principal) on any business debts that were incurred prior to February 15, 2020
- ✓ Rent
- ✓ Utilities, including electricity, gas, water, transportation, telephone and internet

The amount forgiven cannot exceed the original principal amount of the loan.

The purpose is to encourage employers to keep everyone employed. The amount of loan forgiveness will be reduced proportionally by the reduction in employees during the "covered period" of February 15, 2020 – June 30, 2020 compared to February 15, 2019 – June 30, 2019. So, if you employed 10 people in 2019 and 5 now, the forgiveness will be reduced by half. It will be further reduced to the extent that employees are being retained but are having to take pay cuts of more than 25%.

The CARES Act encourages employers to rehire workers and/or restore the pay of employees who were kept but took big pay cuts. If, by June 30, 2020, you rehire the laid off employees and/or restore the salaries of the employees who took pay cuts, then your loan forgiveness will not be reduced.

••Note: A large pay cut to a highly paid employee won't proportionately reduce your loan forgiveness. If you have a highly paid associate who is barely working, and you can drop their pay to $8,333.33/mo. That will be fully covered by loan forgiveness and you will not have your loan forgiveness proportionately reduced. (On the other hand, if someone earning less than $100,000/yr suffers a greater than 25% pay cut, say 30%, then your loan forgiveness will be reduced by that 5% excess amount.)

How does a small business apply?

The SBA is guaranteeing these loans, and businesses will need to apply through banks and credit unions. The bank at which you've set up your business banking account will be where applications are submitted. Specifics may vary from bank to bank but you should be prepared to provide the following:

- ✓ Current financial statement
- ✓ 2019 & 2020 Payroll Records
- ✓ State Unemployment Tax returns, and possible withholding returns
- ✓ Health insurance and retirement documentation may be required
- ✓ Transcript for tax return (4506T)
- ✓ Personal financial statement (Form 413)
- ✓ SBA 1919 Application *NOTE: This form will be updated for the CARES Act forgiveness loan.
- ✓ 2017 and 2018 tax returns for the business, or 2018 and 2019
- ✓ Loan amount calculations
- ✓ Current insurance policies and endorsements
- ✓ List of current shareholders, members, or partners, with each person's ownership %, SSN, Physical address, Date of birth, and Copy of driver's license
- ✓ Current Good Standing Certificate from the Secretary of State's office
- ✓ **LLCs:** Certificate of Organization, Operating Agreement and any amendments
- ✓ **Partnerships:** Partnership Agreement and any amendments
- ✓ **Corporations:** Articles of Incorporation, Bylaws and any amendments

Borrowers will also need to make a "good faith certification" that the uncertainty of the current environment makes the loan request necessary, that you intend to use the funds to retain workers and maintain payroll <u>OR</u> make mortgage payments, lease payments and utility payments, and that you haven't applied for another Section 7(a) loan. Your financial institution may require further specifics.

••Note that you are not required to retain employees to get the loan. If you have laid off or furloughed your staff so they can get unemployment, you can still get the 7(a) loan, but the amount of loan forgiveness will be reduced to the extent that staff is laid off or their pay is dramatically reduced.

What is required to have the loan forgiven?

A separate loan application may be required to have the loan forgiven and the borrower must show evidence that it actually spent money on the things that are eligible for loan forgiveness by submitting an application to the bank that includes:

- ✓ Documentation verifying the number of employees on payroll during the 8-week period of eligible loan forgiveness, including payroll records and tax filings reported to the IRS as well as state income, payroll and unemployment insurance filings
- ✓ Documentation, including cancelled checks, payment receipts, accounting reports, etc. verifying payments on business debts, rent and utility payments
- ✓ A certification from an officer or owner of the borrower that the information being submitted is true and that the amount for which forgiveness is being requested was used to retain employees, and make interest payments on business debts, lease payments and utilities.

This will take some effort, but it must be done. There will be no debt forgiveness without it.

Will taxes have to be paid on the money that is forgiven?

Even though this is debt cancellation income, which is normally taxable, in this case, the cancelled debt will be excluded from income.

What happens to the money that is NOT forgiven?

The remaining balance will continue to be guaranteed by the SBA, have a maximum maturity of 10 years and bear interest at the rate of 4% or less.

Is it better lay off my employees, or keep them and get a 7(a) loan?

Depending on your situation, there are a couple of options that you can take. The first is more conservative and less disruptive and the second more aggressive but probably better for most.

Option #1

If you have not already let your staff go and think that doing so will be difficult in terms of employee morale, then consider taking the 7(a) loan at the beginning of the loan application process, as early as the first week of April; but no later than April 15th. The benefit of this is essentially free money used to pay 8 weeks' worth of your payroll costs, rent, interest on your debt service and utility bills.

Option #2

The best way to handle this for many businesses will be a two-part approach that takes advantage of unemployment benefits and the 7(a) loans. This is more disruptive to the business as it requires furloughing or laying off the employees.

If your business is shut down or largely shut down, then furlough staff and have them apply for unemployment. Thanks to the CARES ACT, they will get traditional unemployment benefits plus $600 per week from the federal funds. This will replace all or most of their normal pay, and in some cases give them a raise.

When you are ready to reopen your business, rehire your staff then, and obtain the 7(a) loan then. Just do this by June 30. You can use the money to pay your overhead when the business reopens. You should get the benefit of loan forgiveness for the 8-weeks following the date you take your loan (so into July and August). And, so long as the employees are rehired by June 30, the loan forgiveness will not be reduced. In this way, you are taking advantage of unemployment insurance to cover your employees' wages during the shutdown period and getting the tax benefits of the 7(a) loan once your business reopens.

Other Considerations

Organizations with large rent or exiting debt may find value in getting a loan right away, versus waiting. Independent contractors without employees who have had loss of revenue should consider applying for unemployment