

Small Business Administration Loans Summary Under the CARES Act

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This article was authored by Carlton Fields associate Daniel Badovinac.

Keeping American Workers Paid and Employed Act (Payroll Protection Program)

The Payroll Protection Program creates a \$349 billion federally guaranteed loan program for small businesses and nonprofits that employ up to 500 workers to apply through qualifying banks for loans backed by the Small Business Administration (SBA). The loans would be available during an emergency period starting February 15, 2020, and ending June 30, 2020. If at least 75% of the grant is used for payroll (and the remaining amounts for mortgage interest, rent, or utilities), then the loans would convert into exempt grants with grant amounts reduced if workers are laid off.

Considerations for Eligibility

- The business was in operation on February 15, 2020; and
- It had employees for whom the borrower paid salaries and payroll taxes.
- Companies are eligible to apply if they employ the greater of no more than 500 employees or, if applicable, the size standard of employees established by the North American Industry Classification System for that particular industry.
- Sole proprietors, independent contractors, and self-employed individuals are eligible for application.

Definition of a Small Business Concern

Title I of the CARES Act provides that a small business concern is one that employs no more than the greater of 500 employees (full-time, part-time) or, if applicable, the size standard of employees established by the North American Industry Classification System, and followed by the SBA, for the industry in which the entity operates.

The SBA determines whether an entity qualifies as a small business concern by counting its receipts and employees or by assessing other measures to determine affiliation with existing businesses.

Affiliation Issues Under the CARES Act

The SBA regulations establish that affiliation with another business is based on the power to control that business, regardless of whether such power is exercised. The power to control exists when an external party has an ownership interest of 50% or more. It may also exist with an ownership interest of considerably less than 50% by contractual arrangement, economic dependency, or when looking at comparative shares. Additionally, if there is common management between the entities, or if there is an identity of interest between individuals (such as family members), there is likely affiliation under the act.

In addition to the foregoing, the SBA may apply a totality of the circumstances test to determine whether an affiliation exists. Affiliation through the totality of the circumstances means that if there is not sufficient evidence to show affiliation by a single independent factor, the SBA may still find that the businesses are affiliated where the interactions between the businesses are so suggestive of reliance as to render them affiliates.

The CARES Act, however, waives the affiliation regulations if the company:

- Falls under category 72 of the North American Industry Classification System (e.g., restaurants, hotels, motels);
- Is a franchise with an SBA franchisor identifier code; or
- Receives financial assistance from a company licensed under section 301 of the Small Business Act.

Allowable Uses of Covered Loans and Borrower Requirements

The CARES Act waives the requirement that a business prove that it cannot obtain credit elsewhere. In lieu of this requirement, borrowers must certify that the loan is necessary due to the uncertainty

of current economic conditions; that the business will use the funds to retain workers, maintain payroll, or make lease, mortgage, and utility payments; and that the business is not receiving duplicative funds for the same uses by certifying that it does not have a pending loan application with the SBA. The interim final rule issued by the SBA set the interest rates at 100 basis points or 1%, and the maturity of the loan for two years. The covered loan period is from February 15, 2020, through June 30, 2020.

The act expressly states that the allowable uses of funds do not include:

- Compensation of more than \$100,000 for any employee;
- Taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code; or
- Compensation of an employee whose principal place of residence is outside the United States.

Waiver of Personal Guarantee Requirement and Prepayment Penalties

- No personal guarantee or collateral shall be required for the covered loan.
- No prepayment penalty will be assessed for any prepayment made on a covered loan.

Loan Amount and Formula

The loan amount is calculated according to the following formula:

- The average monthly amount paid by the applicant for payroll incurred during the one-year period before the loan is made multiplied by 2.5 plus the advance received under the Economic Injury Disaster Loan. For companies that have not been in business at least one year, the average payroll payments from January 1, 2020, through February 29, 2020, multiplied by 2.5; or
- A maximum of \$10 million

Loan Forgiveness

- Under the CARES Act, loan proceeds that small businesses use to cover payroll expenses, rent, interest on mortgage obligations, and utilities will be forgiven and exempt from repayment. Currently, at least 75% of the forgiven amount must be used for payroll in order to qualify for forgiveness. The remaining 25% can be allocated for rent, interest on mortgage obligations, and utilities. Any prepayment of mortgage obligations will not be exempt from forgiveness.

- Loan forgiveness will be reduced by a decrease in salaries and wages of more than 25% for any employee who made less than \$100,000 annualized in 2019.
- These forgiven amounts shall not exceed the principal and will be considered canceled indebtedness by a lender. In addition, even though the cancellation of debt is generally taxable to the borrower, these forgiven loan amounts are not included in the borrower's income for federal income tax purposes.

Loan Procedure

The U.S. Department of the Treasury has already issued a sample form and accompanying procedures for submitting SBA applications for the Payroll Protection Program found at www.treasury.gov. The Economic Injury Disaster Loan application procedure can be found at www.sba.gov. The federal government has indicated that it will make the loans available by April 3, 2020, for small businesses and sole proprietors and April 10, 2020, for independent contractors and self-employed individuals. Application can be made through any existing SBA 7(a) lender or through any federally insured depository institution or participating federally insured credit union. We are closely monitoring the development of the guidelines for the application process.

SBA's Economic Injury Disaster Loan Program

The SBA's Economic Injury Disaster Loan (EIDL) program provides small businesses with working capital loans of up to \$2 million as vital economic support to help overcome the temporary loss of revenue they are experiencing.

Generally, a declaration from the SBA is needed to trigger eligibility. Once a declaration is made, the information on the application process for EIDL assistance is made available to affected small businesses within the state. Currently, all states have been declared disaster zones, and all small businesses across the nation are eligible to apply to the EIDL program.

For a business to qualify for EIDL assistance, it has to meet either the North American Industry Classification System gross receipts or the employee numbers standard used by the SBA. The interest rate is 3.75% for small businesses. The term can be extended to a maximum of 30 years. Terms are determined on a case-by-case basis upon the borrower's repayment ability.

Midsize Business Loans Under the CARES ACT

Title IV of the CARES Act gives the treasury secretary the authority to make up to \$500 billion worth of loans or loan guarantees to states, municipalities, and eligible businesses. Approximately \$45

billion will be available to airlines, cargo carriers, and the national security industries. The remaining \$455 billion will be used to assist eligible businesses, states, and municipalities.

Title IV of the CARES Act directs the treasury secretary to seek the implementation of a program to provide low-interest loans for midsize businesses with between 500–10,000 employees. Unlike the Payroll Protection Program loans, these loans will not be forgiven. Under the act, an applicant for the midsize business loan must meet the following criteria:

- The loan applicant will maintain at least 90% of its employee workforce in its payroll with full compensation and benefits from February 1, 2020.
- The loan applicant will not pay dividends or redeem stock in the company.
- The company must have been created in the United States and have the majority of its employees in the United States to be eligible.
- The company must not outsource or offshore jobs for a period of the term of the loan plus two years.
- The company must remain neutral regarding employee “unionizing” and must not repeal any existing union agreements.

The act imposes a compensation cap on employees for companies receiving loans. Any employee who received \$425,000 or more in total compensation during 2019 will have his or her future compensation capped at that amount for the subsequent year and for the term of the loan, as well as a year after the loan is not outstanding. This cap also applies to severance payments.

- Employees whose total compensation exceeded \$3 million in 2019, however, may receive compensation of up to \$3 million plus 50% of the excess of that amount of the total 2019 compensation.

Authored By



[Kenneth A. Tinkler](#)



[Daniel A. Badovinac](#)



[Patricia M. Carreiro](#)



[Benjamin E. Stearns](#)

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