

Payroll Protection Loans Under the CARES Act: FAQs for Companies Seeking Assistance

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By Wendy A. Lisman, Caitlin B. Houlton Kuntz, Erin M. Byom and Levi J. Smith

The Coronavirus Aid, Relief and Economic Security Act (CARES Act) recently passed by the U.S. Senate and House and signed by the President creates a specific loan program through the Small Business Administration to help small businesses retain employees and pay critical expenses in this challenging time. Under the so-called “Paycheck Protection Program”, the SBA’s current 7(a) loan guaranty program would be expanded and modified to provide up to \$349 billion of federally-guaranteed loans for small businesses. These loans would be issued by qualified SBA lenders and available to an expanded group of eligible borrowers during the period beginning February 15, 2020, through June 30, 2020. The maximum loan amount is \$10 million. The loan provisions under the CARES Act are designed to keep small businesses, and their employees, at work.

Some frequently asked questions for potential borrowers relating to payroll protection loans are below. A separate list of frequently asked questions for lenders will be forthcoming.

Are the SBA 7(a) loans under the CARES Act and the SBA Economic Injury Disaster Loans (EIDL) the same?

No. The SBA loans offered under the CARES Act and the SBA EIDL differ in eligibility requirements and terms. This Q&A addresses the loans that are available under the pending CARES Act. Please note that if you receive an SBA loan under the CARES Act for assistance with employee salaries, payroll support, mortgage payments, etc., you may not be able to receive an SBA EIDL if the proceeds are used for the same purpose.

For information specific to SBA EIDLs, please see Fredrikson & Byron’s article “SBA Economic Injury Disaster Loans Due to COVID-19 FAQs.”

How much money could a borrower receive through an SBA 7(a) loan under the proposed CARES Act?

The maximum loan amount is \$10 million. A borrower would be eligible for the lesser of:

- 2.5 times the borrower’s average total monthly payroll expenses that were incurred in the prior 12 months before the loan is made; plus
- The outstanding amount of a loan that was made under the SBA’s disaster loan program during the period beginning on January 31, 2020, and ending on the date which the covered loan may be refinanced as part of this new loan program;
- or
- \$10 million.

If the borrower’s business was not in existence from February 15, 2019 – June 30, 2019, the borrower is eligible for the lesser of:

- 2.5 times the borrower’s average total monthly payroll expenses incurred from January 1, 2020 – February 29, 2020; plus
- The outstanding amount of a loan that was made under the SBA’s disaster loan program during the period beginning on January 31, 2020 and ending on the date which the covered loan may be refinanced as part of this new loan program;
- or
- \$10 million.

What is the interest rate for an SBA 7(a) loan under the proposed CARES Act?

Capped at 4 percent.

Who is eligible to obtain 7(a) loan?

During the covered period (February 15, 2020 through June 30, 2020), the Act would expand 7(a) loan eligibility to include certain small businesses and other organizations meeting an employee size requirement.

Eligible businesses would include:

- “Small business concerns” (defined in section 3 of the Small Business Act).
- Any business, 501(c)(3) nonprofit organization, 501(c)(19) veteran’s organization, or tribal business concern (as described in section 31(b)(2)(c) of the Small Business Act) with 500 employees or fewer (or, if applicable, the SBA’s size standards for its industry, whichever is greater).
- Businesses in the “Accommodation and Food Services” sector (Sector 72 of NAICS) with 500 or fewer employees per physical location. Sector 72 generally applies to establishments that provide their customers with lodging and/or meals, snacks or beverages for immediate consumption (such as hotels, motels, restaurants).
- Sole proprietors, independent contractors, and eligible self-employed individuals (as defined in the Families First Coronavirus Response Act (Families First Act)) that submit the necessary supporting documentation to the SBA.

Who is considered an “employee” for purposes of the eligibility requirements?

Under the current proposal, the term “employees” would include those employed on a full-time, part-time or other basis.

Would the SBA’s affiliation rules apply for the purposes of eligibility?

Generally, yes, although they would be waived for certain businesses.

Those businesses would include:

- Businesses in the accommodation and food services sector (Sector 72 of NAICS) with 500 or fewer employees;
- Franchises that have been assigned SBA franchisor identifier codes, and
- Businesses that receive financial assistance from a Small Business Investment Company.

Otherwise, it appears that the SBA’s affiliation rules would continue to apply. The proposal notes that the SBA’s affiliation rules would apply to 501(c)(3) nonprofit organizations and 501(c)(19) veterans’ organizations in the same manner as a small business concern. We expect additional guidance from the SBA on how these provisions will be interpreted for purposes of this program.

How could 7(a) loan proceeds be used?

Since the program is designed to help keep employees at work, proceeds from a 7(a) loan may only be used for certain purposes. Permitted uses include:

- “Payroll costs” (as defined in the Act);
- Costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance proceeds;
- Employee salaries, commissions, or similar compensation;
- Interest payments on any mortgage obligation (excluding prepayments of or principal payments on a mortgage obligation)
- Rent (including rent under a lease agreement);
- Utilities; and
- Interest on any other debt obligations incurred before the covered period (which would begin on February 15, 2020).

What kinds of expenses would qualify as “payroll costs”?

“Payroll costs” would mean the sum of:

- Employee compensation (e.g., salary, wages, commissions, cash or equivalents);

- Payment for vacation, parental, family, medical or sick leave;
- Allowance for dismissal or separation;
- Payment for group health benefits, including insurance premiums;
- Payment for any retirement benefit;
- State and local payroll taxes; and
- The sum of any compensation paid to a sole proprietor or independent contractor (i) that is a wage, commission, income net earnings from self-employment or similar compensation and (ii) that does not exceed \$100,000 in one year, prorated for the covered period.

Payroll costs would not include: individual employee compensation above \$100,000 per year (prorated for the covered period); certain federal taxes; compensation to employees whose principal place of residence is outside of the US; and sick and family leave wages for which credit is allowed under the Families First Coronavirus Response Act.

Would a borrower have to start making payments right away?

Possibly not. If the borrower's business was in operation on February 15, 2020, and has a pending or approved loan on or after the date the CARES Act is enacted, then the business is presumed to be eligible to defer payments for at least six months or up to one year. The SBA is expected to issue additional guidance on deferrals within 30 days of the enactment of the CARES Act.

Would these loans be eligible for forgiveness?

Yes. The amount of the loan eligible for forgiveness would be equal to the sum of payments made for specific expenses:

- Payments made toward mortgage interest.
- Payments made toward covered rent.
- Payments made toward covered payroll costs.
- Payments made toward covered utility expenses.

Note that the amount forgiven could not exceed the principal amount of the loan.

What if the borrower cut back on staff or wages? Is the borrower's loan still eligible for forgiveness?

Possibly. The forgiveness amount could be reduced if a borrower reduces staff or salaries within certain thresholds.

If a borrower reduces full time employees, the forgiveness amount would be reduced by an amount determined by the following equation:

- The total forgiveness amount, **multiplied by:**
- The average number of full-time employees of borrower per month during the covered period, **divided by:**
 - At borrower's option, (1) the average number full-time employees of borrower per month between February 15, 2019, and June 30, 2019, or (2) the average number of full-time employees of borrower per month between January 1, 2020, and February 29, 2020; or
 - If the borrower is a "seasonal employer" (as determined by the SBA), the average number of full-time employees per month between February 15, 2019, and June 30, 2019.

If a borrower reduces salaries or wages, the forgiveness amount would be reduced by the total amount of reductions in salaries or wages during the covered period in excess of 25 percent of the employee's total salary or wages during most recent full quarter the employee was employed before the covered period (note that for purposes of this equation, "employees" include only those who, for any pay period in 2019, were paid at an annualized rate of \$100,000 or less).

While the above calculations can only be used to reduce the forgiveness amount, not increase it, a borrower who employs "tipped employees" (as defined by Fair Labor Standards Act) could also receive forgiveness for additional wages paid to such employees.

What if the borrower rehires its employees and raises salaries once things improve?

The forgiveness reduction penalties would not apply if, for employees or salaries reduced between February 15, 2020, and 30 days after the enactment of the CARES Act, the borrower rehires employees or raises salaries (or both, if the situation demands) back to their previous levels by June 30, 2020. (Note that regulations prescribed by the SBA may make de minimis exceptions to these requirements.)

What will be the process for loan forgiveness?

A borrower would need to apply for loan forgiveness to the appropriate lender. While additional details and forms have not yet been developed, the application would require, at a minimum, the following:

- Documentation of the number of full-time employees and salaries or wages paid during the relevant periods, including federal payroll filings and state payroll, income and unemployment insurance filings;
- Documentation of qualifying expenses;
- Certification by an eligible representative of borrower that (1) the documentation submitted is true and correct and (2) the forgiveness amount was indeed used for qualifying expenses; and
- Any other documentation determined necessary by SBA.

After an application is submitted, the lender has 60 days to make determination. Lenders will then work with the SBA to be reimbursed for the forgiven amount.

How would a borrower apply for an SBA 7(a) loan under the CARES Act?

There are borrower requirements that an applicant would have to meet when applying for an SBA 7(a) loan under the CARES Act.

- The borrower must make good faith certifications that:
 - The loan is necessary to keep their business running due to the impacts of COVID-19;
 - The funds received from the loan will be used for payroll expenses and retention of employees, or for mortgage payments, lease payments, and utility payments;
 - The borrower does not already have an application pending for this type of loan for the same purpose; and
 - During the covered period, the borrower has not received a loan for the same purpose







The SBA is currently revising the current 7(a) loan forms for borrowers and lenders. More information will be provided as it becomes available.

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