

Client Alert

April 2020

SBA Loans Available under the CARES Act (Updated April 4, 2020)

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), which is a \$2.2 trillion aid package designed to provide financial relief for the American people and American business in response to the impact of the COVID-19 pandemic. Among the key aspects of the CARES Act is a \$349 billion Small Business Administration (“SBA”) loan guarantee program, the Paycheck Protection Program (“PPP”), designed to help small businesses keep employees on the payroll and meet other necessary expenses. The CARES Act also expands the list of borrowers eligible to apply for an emergency Economic Injury Disaster Loan (“EIDL”) that was made available pursuant to the Coronavirus Preparedness and Response Supplemental Appropriations Act, enacted on March 6, 2020. On April 2, 2020, the SBA issued an interim final rule to facilitate the implementation of the PPP and loan forgiveness program under the CARES Act.

The summary below discusses key provisions of the CARES Act, including:

- The PPP;
- Loan Forgiveness; and
- The EIDL Program.

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This client alert provides additional details to the executive summary PowerPoint presentation and the FAQs that our Firm previously published, which can be found [here](#).

Paycheck Protection Program

The SBA will guaranty 100% of the amount advanced by participating lenders to eligible borrowers under the PPP (“covered loans”) during the period beginning on February 15, 2020 and ending on June 30, 2020 (“covered period”). The CARES Act provides that the annual interest rate on a covered loan will not exceed 4%. Pursuant to the interim final rule, the SBA has set the annual interest rate at 1%. As of April 3, 2020, more than 1,100 lenders, including many community banks, began accepting loan applications and processed over 17,000 loans valued at \$5.4 billion.

Eligibility

Eligible borrowers under the PPP include:

Any business concern with no more than 500 employees whose principal place of residence is in the United States;

- Any business concern, nonprofit organization, veteran's organization and Tribal business concern that meets the size standards in number of employees (if higher than 500) established by the SBA;
- Sole proprietors, independent contractors and other self-employed individuals; and
- Any business concerns with more than one physical location and with not more than 500 employees at each physical location and that is assigned a North American Industry Classification System ("NAICS") code beginning with 72 (the accommodation and food services sector) at the time of disbursement.

Pursuant to the interim final rule, **ineligible** borrowers under the PPP include:

- Financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (with a limited exception for pawn shops);
- Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds;
- Life insurance companies;
- Businesses located in a foreign country;
- Pyramid sale distribution plans;
- Businesses deriving more than one-third of gross annual revenue from legal gambling activities;
- Businesses engaged in any illegal activity;
- Private clubs and businesses which limit the number of memberships for reasons other than capacity;
- Government-owned entities (with the exception of businesses owned or controlled by Native American tribes);
- Businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting;
- Loan packagers earning more than one third of their gross annual revenue from packaging SBA loans;
- Businesses with an associate (i.e., officer, director, owner of more than 20% equity, or key employee) who is incarcerated, on probation, on parole, or has been indicted for a felony or a crime of moral turpitude;
- Business in which the lender or any of its associates owns an equity interest;

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- Businesses which present live performances of a prurient nature or derive more than *de minimis* gross revenue through the sale of products or services, or the presentation of any depictions or displays, of a prurient sexual nature;
- Businesses that have previously defaulted on a federal loan or federally assisted financing, resulting in a loss to the federal government or agency (unless waived by the SBA for good cause);
- Businesses primarily engaged in political or lobbying activities; and
- Speculative businesses (such as oil wildcatting).

Under the CARES Act, the SBA affiliation rules are waived during the covered period with respect to eligibility for a covered loan for: (i) any business concern with no more than 500 employees under the NAICS code beginning with 72 (the accommodation and food services sector); (ii) any business concern operating as a franchise and assigned a franchise identifier code by the SBA; and (iii) any business concern that receives financial assistance from a licensed “small business investment company.”

For eligibility purposes, lenders are required to determine whether a business was operational on February 15, 2020 and had employees for whom it paid salaries and payroll taxes, or paid independent contractors.

Allowable Uses

An eligible borrower may receive one covered loan, which the borrower may use for:

- Payroll costs (defined below);
- 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 shall not include any prepayment of or payment of principal on a mortgage obligation);
- Rent (including rent under a lease agreement);
- Utilities;
- Interest on any other debt obligations that were incurred before the covered period; and
- Refinancing of an EIDL loan made between January 31, 2020 and April 3, 2020.

The interim final rule clarifies that if a borrower received an EIDL between January 31, 2020 and April 3, 2020, the borrower can apply for a loan under the PPP (a covered loan). If the EIDL is not used for payroll costs, it does not affect the borrower’s eligibility for a covered loan. If an EIDL is used for payroll costs, the covered loan must be used to refinance the EIDL. Proceeds

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from an advance up to \$10,000 on the EIDL will be deducted from the loan forgiveness amount on the covered loan.

The interim final rule specifies that at least 75% of the loan proceeds are to be used for payroll costs. Accordingly, not more than 25% of the forgiven amount may be used for non-payroll costs, such as payments for mortgage interest, rent, or utilities.

Maximum Loan Amount

The maximum loan amount available to a borrower, which is subject to a \$10 million cap, is an amount equal to the product of: (i) the average total monthly payments by the borrower for “payroll costs” incurred during the one-year period before the date on which the loan is made, multiplied by (ii) 2.5. This formula is subject to adjustment for (i) borrowers that are seasonal employers, (ii) borrowers that were not in business during the period from February 15, 2019 through June 30, 2019 and (iii) borrowers with certain SBA loans made during the period beginning on January 31, 2020, and ending on the date on which covered loans are made available to be refinanced under the covered loan.

Note that the interim final rule and the revised loan application, published on April 2, 2020, conflict on which one-year period to use. As provided in the CARES Act, the interim final rule uses the one-year period ending on the loan origination date (which seems impractical). In contrast, the revised application looks to calendar year 2019.

The term “payroll costs” consists of (i) salary, wage, commission or similar compensation; (ii) payment of cash tip or equivalent; (iii) payment for vacation, parental, family, medical or sick leave; (iv) allowance for dismissal or separation; (v) payment required for the provisions of group health care benefits, including insurance premiums; (vi) payment of any retirement benefit; and (vii) payment of state or local tax assessed on the compensation of employees. Payroll costs are subject to a \$100,000 cap of annual salary per employee (pro-rated for the covered period) and are subject to certain exclusions, including: (i) any compensation for an employee whose principal residence is outside the United States and (ii) sick leave or family leave wages for which the Borrower can receive a credit under the Families First Coronavirus Response Act.

The interim final rule clarifies that independent contractors are NOT employees for purposes of a covered loan amount calculation or loan forgiveness. Independent contractors have the ability to apply for a PPP loan on their own.

The PPP operates on a first come, first served basis.

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Non-recourse

The SBA has no recourse against any individual shareholder, member or partner of a borrower for nonpayment of a covered loan, except to the extent such shareholder, member or partner uses the covered loan proceeds for an unauthorized purpose.

No Guarantee or Collateral Requirements

The CARES Act does not require collateral or personal guarantees for a covered loan.

Certification Required

Borrowers are required to provide a good faith certification that:

- The uncertainty of current economic conditions makes the loan request necessary to support ongoing operations;
- The borrower will use the loan proceeds to retain workers and maintain payroll or make mortgage, lease and utility payments;
- Borrower does not have an application pending for a loan duplicative of the purpose and amounts for which they are applying; and
- From Feb. 15, 2020 to Dec. 31, 2020, the borrower has not received a loan duplicative of the purpose and amounts for which they are applying.

Payment Deferment Relief

The CARES Act provides that during the covered period, the SBA will require lenders to: (i) consider each eligible recipient that applies for a covered loan to be an “impacted borrower” (defined below) and (ii) provide complete payment deferment relief for impacted borrowers with covered loans for a period of not less than six months and no more than one year, including payment of principal, interest and fees. The term “impacted borrower” means a borrower in operation on February 15, 2020 that has an application for a covered loan that is approved or pending approval on or after the enactment of the PPP. The interim final rule limits the deferment period to six months.

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Fees

Borrower and lender fees for participation in the PPP are waived. The SBA will reimburse the lender for processing the covered loan. There are no pre-payment penalties for loans under the PPP.

Maturity

A covered loan that has a remaining balance after reduction based on loan forgiveness under the CARES Act (described below) has a maximum maturity of ten years from the date on which the borrower applies for loan

forgiveness. The SBA guarantee for that portion of the covered loan that is not forgiven will remain intact. Under current SBA guidance, the covered loan will have a maturity of two years and an annual interest rate of 1%.

Application

The SBA has published [SBA Form 2483](#) for borrowers interested in applying for the PPP.

Note: Borrowers that receive a covered loan under this program cannot claim an Employee Retention Credit if otherwise eligible.

Loan Forgiveness on SBA Loans

Under the CARES Act, borrowers that receive a loan through the PPP are eligible for loan forgiveness for various payroll and operating costs incurred during the eight-week period beginning on the date that the loan is originated. Any amount of indebtedness forgiven under this program is considered a cancellation and is excluded from that borrower's gross income for tax purposes. Within 90 days after the amount of forgiveness on a covered loan is determined, the SBA will remit payments to the applicable lender for the total amount of forgiveness plus interest accrued through the date of payment. The SBA will issue guidance and regulations implementing this section within 30 days of the enactment of the CARES Act.

Loan Forgiveness Covered Period

The covered period for loan forgiveness is eight weeks beginning on the date of loan origination.

Payroll and Operating Costs Eligible for Forgiveness

For the eight-week covered period, the SBA will forgive a borrower's indebtedness for the following payroll and operating costs: (i) payroll costs subject to the exclusions under PPP described above; (ii) interest payments on mortgages incurred before February 15, 2020; (iii) rent payments under lease agreements in effect before February 15, 2020; and (iv) utility payments for which service began before February 15, 2020. The interim final rule clarifies that not more than 25% of the forgiven amount may be used for non-payroll costs.

Limitations on Amounts of Forgiveness

The amount of forgiveness will not exceed the principal amount of financing made available under the covered loan. Also, as noted above, payroll costs are subject to the limitations under the PPP, including a \$100,000 cap of annual salary per employee that is pro-rated for the eight-week covered period for loan forgiveness. In addition, the total amount of forgiveness is also reduced

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for any decreases in the number of employees and amount of wages or salaries as summarized below.

Reduction Based on Decreases in the Number of Employees

The amount of loan forgiveness will be reduced for decreases in the number of employees during the covered period. To calculate the amount of reduction, the CARES Act provides the following formula:

- Multiply the total amount of loan forgiveness by a quotient obtained by dividing:
- The average of number of full-time equivalent employees per month during the eight-week covered period by (borrower chooses one):
 - The average number of full-time equivalent employees per month from February 15, 2019 through June 30, 2019; **OR**
 - The average number of full-time equivalent employees per month from January 1, 2020 through February 29, 2020.

Certain adjustments to this formula are available for borrowers that are seasonal employers.

Reduction Based on Decreases in Salaries or Wages

The amount of available loan forgiveness will be reduced by the amount of any reduction in total salary or wages of any employee during the eight-week covered period in excess of 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the eight-week covered period. For purposes of this calculation, “employee” refers only to any employee who did not receive, during any single pay period during 2019, wages or salary at an annualized rate exceeding \$100,000.

Exemptions for Re-Hires and Elimination of Salary Reductions

The CARES Act provides that reductions in full-time equivalent employees, or reduction in salary or wages that occur during the period beginning on February 15, 2020, and ending 30 days after enactment of the CARES Act (as compared to February 15, 2020), will not reduce the amount of loan forgiveness **IF** by June 30, 2020, the borrower eliminates the reduction in full-time equivalent employees or reduction in salary or wages.

Expansion of the Economic Injury Disaster Loan Program

The SBA’s EIDL program provides working capital loans of up to \$2 million to small businesses experiencing substantial economic injury as a result of disasters. On March 12, 2020, the SBA Administrator announced that pursuant to the Coronavirus Preparedness and Response Supplemental Appropriations Act, the SBA would make the EIDL program available to small businesses and private nonprofit organizations in designated areas

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impacted by COVID-19. All U.S. states and territories have been so designated. The CARES Act expands on the EIDL program by: (i) broadening the list of eligible borrowers; (ii) providing for emergency grants; and (iii) appropriating \$10 million to carry out the program.

Covered Period for EIDL Program Expansion

The covered period for this program is January 31, 2020 through December 31, 2020.

Eligible Borrowers

The expanded list of eligible borrowers includes businesses (including tribal business concerns), cooperatives with fewer than 500 employees, and Employee Stock Ownership Plans with fewer than 500 employees; sole proprietorships, with or without employees; and independent contractors.

Approval and Waivers

During the covered period, the SBA is authorized to approve applicants for an EIDL based on credit score and can use alternative appropriate methods to determine an applicant's ability to repay the loan. Applicants are not required to submit a tax return or tax return transcript.

In addition, the SBA will waive certain rules and requirements for eligible borrowers, including: (i) any personal guarantees for advances and loans of \$200,000 or less; (ii) the requirement that a business must have been in operation for a one-year period before the disaster; and (iii) the requirement that an applicant be unable to obtain credit elsewhere. However, businesses not in operation on January 31, 2020 will not receive a waiver under this section.

Emergency Grants

During the covered period, an applicant that applies for an EIDL may request an advance from the SBA of up to \$10,000 to pay for certain payroll and operating costs. To receive an advance under this program, an applicant must submit a self-certification under penalty of perjury certifying that it is eligible for an EIDL. Upon receiving an application, the SBA will disburse the advance within three days. An applicant is not required to repay any amount advanced under this program, even if denied an EIDL.

Eligible Uses for Advances

Applicants are allowed to use an advance disbursed under this program to pay for the following payroll and operating costs: (i) paid sick leave for employees unable to work due to COVID-19; (ii) maintenance of payroll to retain employees during business disruptions or substantial slowdowns; (iii) increased costs to obtain materials unavailable due to supply chain

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interruptions; (iv) rent or mortgage obligations; and (v) other obligations that cannot be paid due to revenue losses.

Overview of SBA's Affiliation Rules

As noted above, the CARES Act broadens the pool of applicants eligible for a loan under the Payment Protection Program and the EIDL program. A business that qualifies as a "small business" under established SBA standards is among the applicants eligible for both loans. The SBA employs a two-prong, fact-sensitive test to determine whether a business qualifies as a "small business":

- *First*, the SBA determines the size of a business according to one of two values: (i) number of employees **OR** (ii) annual receipts. The NAICS code assigned to the business determines which of the two values the SBA should consider, as well as the maximum number of employees or amount of annual receipts the business should have.
- *Second*, the SBA aggregates all of the affiliates of the business to calculate the total number of employees or annual receipts (whichever is applicable), subject to the NAICS Code 72 exception.

To be eligible as a "small business" under these standards, a business (including its affiliates) must not exceed the maximum number of employees or amount of annual receipts pursuant to the NAICS code assigned to the business. Under established SBA standards, entities are affiliates when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. Control may exist or arise through ownership, management and contractual relationships, among other things. Also, whether control is exercised is irrelevant as long as the power to control exists.

Under the SBA standards, affiliation may also arise under the following specific circumstances:

- *Stock ownership*, where (i) a person (including individuals and entities) controls 50% or more of the business's voting stock; (ii) two or more persons each control less than 50% of a business's voting stock but such holdings are large compared with other stock holdings; or (iii) the business's voting stock is widely held, in which case the Board of Directors, CEO or President may be deemed to have the power to control the business;
- *Stock options, convertible securities, and agreements to merge*, as they contain certain rights that the SBA deems has a present effect on the power to control a business;
- *Common management*, where one or more officers, directors, managing members, or partners of the business also controls the board of directors or management of one or more other entities;
- *Identity of interest*, where individuals or firms have identical or substantially identical interests (e.g., family members, individuals or

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- firms with common investments, or firms that are economically dependent through contractual or other relationships); and
- *Newly organized businesses*, where the former officers, directors, principal stockholders, managing members of key employees of one business organize a new business in the same or related industry or field of operation.

Olshan lawyers from multiple practice groups are working together with clients to address COVID-19-related matters, including the CARES Act stimulus programs (i.e., the PPP and EIDL) and other corporate matters, including contractual analysis and financing, tax, restructuring, employee benefits and employment practices, insurance coverage and litigation. Click [here](#) to access additional materials addressing issues raised by COVID-19.

Please contact the Olshan attorney with whom you regularly work or one of attorneys listed below if you would like to discuss this client alert or have questions about its content.

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