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CLIENT ALERT BUSINESS/CORPORATE/TAX

Forgivable Loans Under the Paycheck Protection Program

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The Paycheck Protection Program sounds too good to be true. For some, it will be as advertised, and will provide invaluable assistance. For others, not so much. In some respects, we simply do not know and time will tell.

We have done some digging, beyond what members of Congress have been saying, what commentators have reported, and what many of you have heard from the "experts."

What's the Paycheck Protection Program? The CARES Act established a $349 billion loan program, designated the "Paycheck Protection Program." The stated purpose of the Paycheck Protection Program is to get cash into the hands of as many businesses as possible in order to minimize layoffs and maximize continued employment.

The gargantuan carrot that the Program dangles in front of potential business borrowers that might otherwise close their doors is that if they use the loan to pay employees and stay open, the loans are subject to forgiveness – *they can become nontaxable grants.*

Should you apply? There will be a huge demand – some speak of a stampede – to obtain Paycheck Protection Program loans. If you need the money and there is a reasonable chance that you will satisfy the criteria for forgiveness, explained below, you should apply. Even if you do not satisfy the criteria, the terms remain favorable, particularly the fact that personal guaranties and collateral are not required.

The Paycheck Protection Program forms and procedures have not yet been provided by the SBA to the lenders, and it will probably be weeks before that takes shape. *Nevertheless, especially if you are an existing customer or have a relationship with an SBA lender, and if you are interested in obtaining a loan, we strongly advise you to work with your professional advisors to submit a request for the loan, along with the financial information typically required in a loan application and the information required by the Paycheck Protection Program requirements, and to do so ASAP.* This may get you toward the front of what is likely to be a very long line.

We can assist you in this effort.

How do I apply? What are the eligibility requirements? Virtually all businesses are eligible, including for-profit businesses, 501(c)(3) nonprofit organizations, certain self-employed individuals, independent contractors, and sole proprietorships. You will need to apply through an SBA-approved lender. The eligibility criteria are minimal.

The CARES Act authorizes SBA lenders to approve the loans so long as the applicant was in operation on February 15, 2020, and so long as the applicant paid employees and payroll taxes or paid independent contractors since that time. You will also have to certify that the loan is necessary and will be used to "retain workers and maintain payroll or make mortgage payments, lease payment and utility payments," and that you are not applying for and have not received loans for the same purpose.

Applicants must have 500 or fewer employees (full-time and part-time). Banks will review affiliates, such as whether the applicant is owned by another company, in determining if this requirement is satisfied.

Will you get the loan? To get as much cash as possible into the hands of operating businesses, the qualification criteria is minimal and does not consider the borrower's ability to repay the loan (see below). To make it easy for lenders to loan the money, the federal government has guaranteed repayment to the lenders.

So why *wouldn't* you get a Paycheck Protection Loan?

If you have an existing relationship with an SBA-approved lender who knows your business and believes that it presents an acceptable risk, you should have no problem at all.

But what if you do not have that kind of relationship? Lenders want to take care of their existing customers first. If they have the processing capacity, they may consider other businesses with a track record and favorable financials, but you will likely be at the back of the queue. In any case, you should be able to find a lender, but for a fee. Lenders will make money by making these loans, and they will be seeking out attractive borrowers.

What if your business does not have a great track record, or is burdened by existing debt? According to the Act, you qualify merely by being in business since February 15 (see below). It should not make a difference to the lender because, again, the federal government is guarantying that the lender will get paid.

Nevertheless, we have learned that lenders may be reluctant to make these loans to risky borrowers, despite the federal guaranty, for at least two reasons.

First, the federal guaranty is not a panacea for a lender who makes a loan to a borrower who defaults. The bank will still have to chase the borrower before it can apply for the guaranty, and even then it will take time and effort to obtain the money from the government.

Second, like any legislation of this scope and, in view of how quickly it was put together, the language is often vague, and lenders cannot be sure if the federal government will erect unforeseen hurdles in the path of their ability to collect on the guaranty if and when they try to do so. Vagueness breeds uncertainty which breeds caution.

How much can you borrow? Loans are available for the *lesser* of your "average monthly payroll costs" (a carefully defined term under the Act) times 2.5 (plus the amount of any Economic Injury Disaster Loans received after January 31, 2020 that you choose to refinance under this program); or $10 million.

- **"Average monthly payroll costs"** are calculated based on the one-year period prior to the loan disbursal date, with certain exceptions for seasonal employers and new employers not in business between February 15, 2019 and July 30, 2019.

- **Payroll costs include**: employee salary, wages, and commissions; payment of cash tips; payment of vacation; parental, family, medical, or sick leave; allowance for dismissal or separation; payment required for group health benefits (including insurance premiums); payment of retirement benefits; or payment of state or local tax assessed on employee compensation; and sole proprietor income or independent contractor compensation not in excess of $100,000.
- **Payroll costs exclude**: compensation of an individual person in excess of $100,000 (as prorated for March 1, 2020 through June 30, 2020); federal employment taxes imposed or withheld; compensation to an employee whose principal residence is outside of the U.S.; qualified sick leave or family leave for which a payroll tax credit is allowed under the Families First Coronavirus Response Act.

What can you use the money for? You can spend the loan for the following purposes:

- Employee compensation (but not for wages in excess of $100,000 annually, prorated for the period of March 1, 2020 to June 30, 2020) and payroll support (including paid sick, medical, or family leave, and costs related to the continuation of group health care benefits during those periods of leave);
- Continuation of health care benefits;
- Mortgage interest obligations, rent and utilities; and
- Interest on debt incurred before the "covered period" – January 31, 2020 and December 31, 2020.

Terms are *very* favorable.

- Paycheck Protection Loans do not require personal guaranties or collateral. That is a *very* significant difference between these loans and other SBA loans.
- The term of the loans will be a maximum of 10 years at a maximum 4 percent interest rate, with six months (and up to one year) deferral of principal and interest payments.
- The usual SBA requirement that you prove that you cannot obtain funds elsewhere is waived.
- No SBA fees (you may still have to pay lender processing fees).
- No prepayment fee.

The elephant in the room … *what about the loan forgiveness*? The amount forgiven is the amount actually paid for payroll costs, mortgage interest, rent and utilities.

- *But*, the forgiveness amount will be reduced pro rata by (a) the reduction of the number of full-time equivalent employees and (b) the reduction in pay of an individual employee in excess of 25 percent.
- *However*, workforce reductions or reductions in pay that occur from February 15, 2020 to April 26, 2020 will be disregarded so long as the reductions are eliminated by June 30, 2020.

You must apply to your lender for forgiveness. Any portion of the loan that is forgiven will be excluded from gross income. You will need documentation for forgiveness – including proof of the number of employees, payroll tax filings (including federal, state, and unemployment filings), receipts/cancelled checks for mortgage interest, leases, etc.

Some of the details of the Paycheck Protection Program remain unclear; there will be adjustments and clarifications, and exactly how the Program will function in practice remains to be seen. We will keep you updated.

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The Wisler Pearlstine team of business attorneys is ready to address your COVID-19 questions and concerns. Please contact any of us at 610.825.8400 you have concerns about the impact of COVID-19 in the workplace.

This article represents our best effort to assemble accurate information on an accelerated basis. However, the subject is complex, and many details have been summarized or omitted in the interest of focusing on key points. In addition, the law and the guidance issued by the government is constantly changing. You should not rely on the accuracy or completeness of this information for your business and personal decisions but, rather, should seek updated, personalized legal advice as needed.

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