

Relief for small businesses

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In March 2020, three important pieces of legislation were signed into law in response to the novel coronavirus pandemic. The ACG has previously published summaries of the bills. This paper will now delve into details of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) and the Families First Coronavirus Response Act (“Families First Act”), focusing on the provisions that affect small businesses. This paper does not address every provision in these Acts. Individuals and businesses should consult with their trusted advisors to determine how these pieces of legislation impact them.

The terms and conditions of these new programs are rapidly changing. The information provided in this paper is current as of April 7, 2020. Clients should consult their legal advisor for up-to-the minute changes.

The Paycheck Protection Program

Section 1102 of the CARES Act

The Paycheck Protection Program provides for expedited federally guaranteed Small Business Administration (“SBA”) loans to qualifying businesses in a simplified, streamlined process. Once the business is approved for a loan, it may receive the loan proceeds as early as the next day in some cases.

For a loan application: sba.gov/document/sba-form--paycheck-protection-program-borrower-application-form

To find an approved lender: sba.gov/paycheckprotection/find

For more information: sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program-ppp#section-header-0

and

uschamber.com/co/small-business-coronavirus

Who can qualify?

The business must have been operating on February 15, 2020, and the loan must be needed to support ongoing operations during this period of economic uncertainty. No collateral or personal guarantees are required. While the application is short, businesses will have to supply the reason for the loan, information about the owners, as well as documentation of employee headcount and payroll costs. All employees are included, regardless of full-time or part-time status. (It is possible that agricultural workers in the U.S. on an H2-A visa are not included.) The following types of entities may qualify:

- Businesses, including farms, ranches, cooperatives, nonprofits, tribal business concerns, and veterans' organizations with fewer than 500 employees and certain businesses (generally accommodation and food services sector) with fewer than 500 employees per physical location;
- Individuals who are self-employed, sole proprietors, and independent contractors;
- Certain franchises; and
- Certain businesses that receive funding from an approved Small Business Investment Company.

Paycheck protection loans may be denied:

- If the business or an owner has been suspended, prohibited from participating, or otherwise excluded from the program by any federal department or agency;
- If the business or an owner is currently in bankruptcy;
- If the business or an owner is delinquent on or has defaulted on an SBA or federal loan within the last seven years; or
- If the business has already gotten a Paycheck Protection loan.

How much is the loan?

The maximum amount the business may borrow is the lesser of 2.5 times average monthly payroll cost or \$10 million. The loans can be used for costs incurred between February 15, 2020 and June 30, 2020.

Average monthly payroll cost includes:

- Salary, wages, commissions, cash tip payment, and other compensation;
- Earnings up to \$100,000 annually for sole proprietors, independent contractors, and self-employed individuals;
- Vacation, parental, family, medical or sick leave payments;
- Separation payments;
- Group health benefit payments;
- Retirement benefit payments; and
- State and local taxes on employee compensation.

Average monthly payroll cost *excludes*:

- Annual employee compensation exceeding \$100,000 per employee;
- Payroll taxes, Railroad Retirement taxes, and income taxes (although subsequent guidance indicates that gross pay may be included);
- Compensation to non-United States residents, such as agricultural workers in the U.S. on an H2-A visa; and
- Qualified sick or family leave wages for which a credit is available under the Families First Act, discussed later.

Required uses

Since the loan's uses are limited to the costs of ongoing operations, the proceeds must be used for the following expenditures only:

- Payroll (as defined and capped in the maximum loan provisions);
- Continuing group health benefits during employee absences and continuing health insurance premiums;

- Current mortgage interest;
- Rent;
- Utilities (electricity, gas, water, transportation, telephone, or internet); and
- Interest on other debt incurred before the Paycheck Protection loan.

Note that whether requirements are met to qualify as payroll costs or permitted uses should be analyzed together with a client's tax advisor to determine the appropriate steps to take in any circumstance.

Loan terms and lenders

The Treasury initially set the interest rate at .5%, although the SBA later issued an Interim Final Rule increasing the rate to 1%. The rate could increase up to 4% under the CARES Act. The first payment is due six months after the business receives the funds, and the full loan is due after two years. The CARES Act provides for a maximum maturity of 10 years, but currently the loans uniformly have a two-year term. There are no loan fees or prepayment fees.

Businesses can apply through any participating lender, so it may be practical to start with their own lending institution. The SBA is maintaining a list of approved lenders on its website.

Businesses may receive a Paycheck Protection loan if they receive funds from another SBA loan, including the additional loan programs the CARES Act allows; however, they must use proceeds from multiple loans for different purposes. Businesses borrowing through the Economic Injury Disaster Loan program between January 31 and April 3, 2020 may refinance that loan into a Paycheck Protection loan. Businesses do not need to look for funds elsewhere before they apply for a Paycheck Protection loan. Businesses receiving the Paycheck Protection loan are not eligible for the Employee Retention Credit discussed later.

Loan forgiveness

Section 1106 of the CARES Act

One of the most attractive features of Paycheck Protection loans is that they may be forgiven and essentially transformed into a grant. Subject to limitations, a borrower is eligible for federal income tax-free debt forgiveness on the Paycheck Protection loan for loan proceeds used for the following expenditures during the eight-week period starting on the loan origination date:

- Payroll (as previously defined and capped). Subsequent guidance indicates that while gross

pay may be considered for the amount borrowed, any amounts used for payroll taxes, income taxes and Railroad Retirement taxes may not be forgiven);

- Mortgage interest;
- Rent; and
- Utilities.

No more than 25% of the amount forgiven may be for non-payroll costs. A borrower will not be forgiven for 100% of the Paycheck Protection loan if the number of employees is reduced or total wages paid to employees is reduced by more than 25%. However, the borrower will not lose loan forgiveness if, by June 30, 2020, it restores any reduction in the number of employees or the amount of wages that were paid between February 15, 2020 and April 26, 2020.

Debt relief for other SBA loans

Section 1112 of the CARES Act

sba.gov/funding-programs/loans/coronavirus-relief-options/sba-debt-relief

Debt relief may be available for other SBA loans. For existing and new borrowers who take out 7(a), 504, or microloans within six months of the CARES Act's enactment, the SBA covers all payments, including principal, interest and fees for six months. The same borrowers may also take a Paycheck Protection loan for another purpose, but debt relief under this section does not apply to Paycheck Protection loans.

Each of the three programs has different requirements and different factors to determine eligibility. They all require the ability to repay and a sound business purpose. These loans also apply limits on the business's size. Generally, 7(a) loans provide up to \$5 million for short and long-term working capital needs. 504 loans are typically long-term fixed rate loans for businesses to acquire fixed assets to expand or modernize. Microloans are usually used to help certain small businesses and nonprofit childcare centers start up or expand and don't exceed \$50,000.

Emergency lending for larger businesses

Sections 4003 and 4004 of the CARES Act

The CARES Act allocates \$46 billion to lending in

specific business sectors: air travel, air cargo, and national security. More importantly for other types of U.S. domiciled businesses that are not eligible for the Paycheck Protection Program, an additional \$454 billion is set aside for an "Emergency Fund" allowing the Treasury to make direct loans or guarantee Federal Reserve loans to help businesses, states, and municipalities dealing with the pandemic. The Treasury's ability to guarantee Federal Reserve loans significantly leverages the amount the Federal Reserve can lend to affected businesses, which the Treasury estimates to be about 10 times the \$454 billion allocated.

The loans require collateral or an interest rate reflecting its risk. Additionally, the loans should be short-term, with a five-year maximum maturity. To be eligible, the business must certify the loan is needed to support ongoing business operations due to the economic uncertainty caused by Covid-19. For mid-sized businesses with 500-10,000 employees, the interest rate is capped at 2%, and the first payment is not due until six months after the loan is taken. While larger businesses may qualify for loans, the terms will be based on risk and market conditions.

The CARES Act places some restrictions on the \$454 billion direct emergency loans. There are limits on executive compensation, outsourcing, stock buybacks, dividends, and changes to existing collective bargaining and union activities. Furthermore, the borrower must retain no less than 90% of its employees until September 30, 2020.

Loans made under this provision of the CARES Act cannot be forgiven. The borrower must also show it is not insolvent and is not able to obtain adequate financing elsewhere. Information about the application process should be forthcoming from the Federal Reserve.

Emergency Economic Injury Disaster Loan Grants

Sec. 1110 of the CARES Act

The CARES Act expands the SBA's Economic Injury Disaster Loan ("EIDL") program by providing an advance of up to \$10,000 to any employer that applies for an EIDL from the SBA. Employers that are eligible to apply for the advance include not only corporations and LLCs, but also sole proprietors, independent contractors, and private nonprofit organizations with less than 500 employees. Additionally, certain

businesses with more than 500 employees that meet the SBA's size standards for a "small business" may obtain an EIDL and the \$10,000 advance payment. This advance, or grant, is to be paid to the business within three days of applying for an EIDL. These emergency advances are available through December 31, 2020 and do not ever need to be repaid.

Note that agricultural enterprises have never been eligible for EIDLs; however, wineries may be eligible due to the manufacturing nature of the business.

To apply for an EIDL and the advance payment, go to sba.gov/page/disaster-loan-applications.

Refundable tax credits and penalty-free deferral of payroll tax deposits

Secs. 2301 and 2302 of the CARES Act
Secs. 7001-7005 of the Families First Act
IRS Notice 2020-22

The Families First Act, signed into law on March 18, 2020, provides tax credits for employers required to provide up to 80 hours of paid sick leave to employees unable to work due to COVID-19 and, under an expansion of the Family and Medical Leave Act ("FMLA"), tax credits for wages paid to employees entitled to an additional 10 weeks of family leave. Businesses and tax-exempt organizations with fewer than 500 employees can receive fully refundable tax credits to cover the cost of the leave plus the employer's share of the Medicare tax on those wages, within certain limits. Self-employed individuals are eligible for equivalent credits based on similar circumstances in which the individual is unable to work. (Wages paid under these programs are referred to as "Qualified Leave Wages.")

Paid sick leave

Tax credits are available if sick leave wages are paid to an employee who is unable to work (including telework) for any of the following reasons:

- The employee is under a Federal, State, or local quarantine or isolation order;
- The employee has been advised by a health care provider to self-quarantine;
- The employee is experiencing symptoms of COVID-19 and seeking a medical diagnosis;
- The employee is caring for an individual who is subject to the quarantine or isolation order, or has

been advised by a health care provider to self-quarantine;

- The employee is caring for the employee's child if the school or place of care has been closed, or the child care provider is unavailable due to COVID-19 precautions; or
- The employee is experiencing any other substantially similar condition specified by the U. S. Department of Health and Human Services.

Expanded FMLA

In addition to the reasons stated above, an employee who is unable to work (including telework) to care for a child whose school or place of care is closed, or whose child care provider is unavailable due to COVID-19 is entitled to wages equal to two-thirds of his/her normal wages (up to certain limits), and tax credits are available to employers who pay such wages.

Employee retention tax credit

Tax credits are also available to employers whose gross receipts declined to less than 50% of gross receipts for the same calendar quarter in the prior year, or whose business is fully or partially suspended due to COVID-19, and who continue to pay employees' wages during that time. These wages are referred to as "Qualified Retention Wages." The amount of wages per employee that can be included in calculating the tax credits is limited. There are also limits on the amount of tax credits to which an employer is entitled, depending on how many full-time employees were employed by the business in 2019. These credits are available to businesses regardless of size; however, a business that participates in the Paycheck Protection Program is not eligible for the retention tax credits.

Deferring payroll deposits

An employer that pays Qualified Leave Wages and/or Qualified Retention Wages can apply to receive tax credits that are applied to the employer's portion of the Social Security taxes (and certain Medicare taxes) that are due on such wages paid (up to stated limits) between March 27, 2020 and December 31, 2020. This allows the employer to use (Social Security) tax dollars to pay wages currently. The statutes provide further relief by allowing employers to delay the payment of the employer's share of Social Security taxes without incurring a penalty for failing to deposit such taxes on time. The employee's share of payroll taxes must be deposited on time. Self-employed taxpayers that pay Social Security taxes under the Self-Employment Contribution Act ("SECA") will be able to defer the payment of one-half the Social Security tax that

would otherwise be due. These taxes are not waived; the payment of them is merely delayed without penalty: 50% of the delayed payment must be paid by December 31, 2021 and the remaining 50% by December 31, 2022.

Example: An employer paid \$5,000 in qualified sick leave wages and qualified family leave wages (and allocable health plan expenses and the employer's share of Medicare tax on the qualified leave wages) and is otherwise required to deposit \$8,000 in federal employment taxes, including taxes withheld from all of its employees, for wage payments made during the same quarter as the \$5,000 in qualified leave wages. The employer may keep up to \$5,000 of the \$8,000 of taxes it was going to deposit, and it will not owe a penalty for keeping the \$5,000. The employer is then only required to deposit the remaining \$3,000 on its required deposit date. The employer will later account for the \$5,000 it retained when it files Form 941, Employer's Quarterly Federal Tax Return, for the quarter.

Employers that obtain loan forgiveness under the Paycheck Protection Program are not eligible to defer payroll taxes as described above.

For additional details on what records must be kept and how to apply for these tax credits, go to irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs#how_to_claim

Bankruptcy

Section 1113 of the Cares Act

The CARES Act amends subchapter V of Chapter 11 of the U.S. Bankruptcy Code, otherwise known as the Small Business Reorganization Act ("SBRA"). The SBRA gives businesses with debts under a certain threshold a faster and less expensive option for reorganizing the business under Chapter 11. The CARES Act raises the debt limit from \$2,725,625 to \$7.5 million, meaning that more debtors may seek bankruptcy protection under the SBRA. This higher debt limit applies to bankruptcy cases filed between March 27, 2020 (the date the CARES Act became effective) and March 27, 2021. Filing for protection under the SBRA is more advantageous to debtors seeking to stay in business without the complexities and expense of filing for reorganization under other sections of Chapter 11.

The CARES Act amends the definition of income for chapters 7 (liquidation) and 13 (reorganization for individuals) to exclude coronavirus-related payments from the Federal government. It also allows individuals who are currently in a Chapter 13 bankruptcy proceeding to seek a payment plan modification if they are experiencing a material financial hardship due to the coronavirus, including extending their payments for up to seven years after their initial plan payment. These provisions will be in effect until March 27, 2021.

Net operating losses

Section 2303 of the CARES Act

The Tax Cuts and Jobs Act of 2017 ("TCJA") eliminated a business's ability to carryback operating losses and limited the deduction of losses to 80% of taxable income. The CARES Act provides that net operating losses (NOL) arising in a tax year beginning after December 31, 2017 and before January 1, 2021 can be carried back five years, and it also removes the 80% limit so that NOLs can fully offset income through 2020. These changes may allow businesses to file amended tax returns to take advantage of carrying back NOLs and receive expedited refunds. For example, a company was profitable in 2018 and 2019 and paid taxes on those earnings. In 2020, the company had a large loss. The company can carry back NOLs in 2020 to recoup all or a portion of taxes paid in 2018 and 2019.

Acceleration of recovery of AMT refundable credits

Section 2305 of the CARES Act

TCJA repealed the corporation alternative minimum tax ("AMT") but allowed a credit of AMT paid in prior tax years to be used against a corporation's normal tax liability from 2018 through 2021 and to treat 50% of the credit as refundable in taxable years 2018-2020 and 100% beginning in 2021. The CARES Act amends this provision by allowing 100% of an AMT credit to be treated as refundable for taxable years beginning in 2019. In addition, the CARES Act provides a special election to take the entire refundable credit amount in 2018 and to file a tentative refund claim no later than December 31, 2020.

Note that the recovery of AMT credits and the new provisions regarding NOL carrybacks should be

analyzed together by a client's tax advisor to determine the appropriate steps to take in any particular circumstance.

Deductibility of interest expense

Section 2306 of the CARES Act

TCJA limited a business's ability to deduct interest expense to 30% of adjusted taxable income ("ATI")

with any excess interest expense carried forward. The CARES Act temporarily and retroactively increases the limitation on the deductibility of interest expense to 50% of ATI for tax years beginning in 2019 and 2020. In addition, the business may use 2019 income to determine the deduction limit for 2020. For example, if a business had ATI of \$10 million in 2019 but a negative ATI in 2020, it could elect to deduct \$5 million of interest expense in 2020 (50% of \$10 million), generate a bigger loss, and then use the favorable NOL provisions to carry back the loss to 2019 and recover taxes paid in that year.¹



¹ Nitti, T., Congress Reaches Agreement on a Coronavirus Relief Package: Tax Aspects of The CARES Act, Forbes, March 25, 2020

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