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White paper

$359 billion in funding for loans under the CARES Act

Paycheck Protection Program and Economic Injury Disaster Loan Program

Ryan Patton, JD, MBA
Consultant, Advanced Consulting Group

Support offered under the CARES Act for businesses

On March 27th, 2020 President Trump signed the Coronavirus Aid, Relief and Economic Security (the "CARES Act") Act into law. With the signing of the Act over $2 trillion dollars become available for the public in areas such as public health, support for small businesses, individual citizen aid and targeted efforts for hard-hit industries. The Act itself is like a new board game; we generally know what the game is and what the expected outcome should be. However, with this game we are missing the rules. This paper will cover what we know the CARES Act provides for small business owners seeking lending support with the caveat that rules are still coming on some provisions.

Under the CARES Act two provisions provide a substantial amount of relief to qualifying small business owners. One of the largest support efforts is the new Paycheck Protection Program (PPP).[1] PPP is tasked with preventing job loss and small business failure due to the COVID-19 pandemic. PPP was allotted $349 billion to make available to eligible small businesses, including non-profits, sole proprietors, tribal business concerns and veteran's organizations.[2] PPP also offers forgivable loans[3] to cover the cost of payroll and other essential business costs. Secondly, the CARES Act provides $10 billion in funds to the already existing Economic Injury Disaster Loan Program (EIDL)[4] in addition to expanding the program overall under the Small Business Administration (SBA).

While these two programs generally offer the largest benefit to small business owners and are what we will cover here, there are many other provisions under the CARES Act that offer support as well. Not all businesses will qualify for some of the provisions due to thresholds or other qualification criteria. Therefore, each business will need to separately evaluate the particular support programs offered by the CARES Act considering their industry and the applicable legal and financial requirements to determine if, and how, they may qualify.

Paycheck Protection Program

PPP is new under the CARES Act and is very attractive for small businesses as loans made under this program are 100% federally guaranteed.[5] Unlike most SBA loans, PPP loans are unsecured requiring zero collateral, no showing of credit availability elsewhere, and no personal guarantee. PPP loans are available through June 30, 2020[6] and allow for partial or total loan forgiveness for loans made to cover eligible business costs such as:

- Payroll (Employee compensation[salary/wages/tips/PTO, etc.] limitations apply to employees with salaries over $100,000. Other restrictions apply to employees based outside of the U.S.)
- Group health care benefits including related insurance premiums
- Rent and utilities
- Mortgage interest obligations (excluding principal payments)
- Interest on debt incurred by the business prior to the PPP loan[7]

Only companies that were in operation and paid salaries and payroll taxes on February 15, 2020 will be eligible for PPP loans.

While this listing does not cover all cost incurred by a business owner, it does cover a substantial amount of monthly expenses. This may be why the CARES Act limits the amount any one business can receive. The maximum PPP loan an eligible business can receive is equal to the lesser of: (a) $10,000,000 or (b) 2.5 x its average total monthly payroll cost, as defined in the Act.[8]

PPP loans are forgivable for certain amounts a business borrows and spends during the 8-week period after the origination date of the loan.[9] The forgivable amounts are subject to documentation and include: (1) mortgage interest, (2) rent, (3) defined payroll cost, (4) and utilities.[10] The total amount of PPP loan forgiveness may be reduced if the business reduces the number of employees or salaries/wages during the 8-week period following the loan origination.[11] Business owners are given some flexibility with this reduction as the penalty does not apply to businesses that restore their workforce count and salaries/wages no later than June 30, 2020.[12]

If a borrower does not receive forgiveness on the full amount of the PPP loan, the PPP loan amount not forgiven will then be subject to a maximum 10-year term at an interest rate not to exceed 4%.[13] Additionally, SBA-approved lenders must offer 6-12-month deferral of payment on principal, interest and fees.[14]

Businesses will be eligible for a PPP loan if they are able to meet one of the following criteria: (a) a small business concern under SBA regulations, or (b) a business concern, veterans' organization, nonprofit organization or tribal concern with 500 or fewer employees, with provisions for entities with more employees in certain industries.[15] Unique to PPP loans are exceptions to the 500 employee rule given to businesses that operate in the Accommodation and Food Services Industry. These businesses can avail themselves of the 500 employee rule, assuming that they operate multiple locations, if each location of operation has 500 or fewer employees per location.[16]

Another benefit passed down via the CARES Act is the waver of the SBA's affiliation rules for determining PPP eligibility for certain specific categories of business, including the accommodation and food services industry, businesses that receive financial assistance from a licensed Small Business Investment Company and franchises that are assigned a franchise identifier code in the SBA franchise directory.[17] This limited waiver, subject to some guidance anticipated from the SBA, leaves the remainder of eligible businesses still subject to the SBA's affiliation rules. Guidance on this topic may be forthcoming from the SBA and should help to clarify how the SBA will view the affiliation rules for PPP loan applicants.

Lastly, only companies that were in operation and paid salaries and payroll taxes on February 15, 2020 will be eligible for PPP loans. The borrower must also certify that the uncertainty of the current economic conditions makes it necessary for the requested loan to be issued to support the ongoing operations of the business. The borrower must also acknowledge that the funds will be used to retain workers and maintain payroll, make lease or mortgage payments, and use the funds for utility payments.[18]

Economic Injury Disaster Loan Program

The CARES Act also extended additional lending options to small businesses through the expansion of the existing EIDL SBA program. The EIDL program provides borrowers longer-term loans with favorable lending terms. Under EIDL, companies that have already applied for or received EIDL due to COVID-19 related economic injuries can seek to refinance their loans under PPP to take advantage of PPP's loan forgiveness provisions. Borrowers may in fact be eligible for both programs, however, the borrower is unable to recover under EIDL for the same costs that are covered by a PPP loan.

Unlike PPP, EIDL under the CARES Act has an expanded window of lending with the period running from January 31, 2020 through December 31, 2020.[19] Eligibility is limited to businesses with no more than 500 employees, sole proprietors or independent contractors, cooperatives, ESOPs or Tribal small business concerns.[20] Like PPP mentioned above, EIDL will also be subject to forthcoming guidance from the SBA on affiliation rules which will ultimately impact eligibility of borrowers. Businesses previously eligible to receive EIDL, which include private nonprofit organizations and even small agricultural cooperatives, those entities will remain eligible for EIDL and can benefit from the more favorable terms provided by the CARES Act.

Qualified borrowers under EIDL must show that they have suffered "substantial economic injury" from the COVID-19 pandemic. The determination by the SBA of the loan amount is based on each company's actual economic injury (less applicable recoveries on insurance proceeds) up to $2 million. EIDL funds can be used for payroll, costs incurred due to supply chain interruption, and paying on obligations that otherwise would be supported by revenues.[21] Terms for EIDL funds are favorable, albeit determined on a case by case basis, at an amortized 30-year term with rates fixed at 3.75% for small businesses and 2.75% for nonprofits.

The CARES Act also provides immediate funds, up to $10,000, for applicants that make a request for an advance to pay for working capital needs.[22] These funds are expected to be paid by the SBA within three days of the request. Since the funds are an advance, repayment of the funds is not required, even if the borrower's application is ultimately denied.[23] The funds will need to be appropriately deducted from any loans that are forgiven.

EIDL comes with a few additional commitments for borrowers seeking funds. Under the CARES Act, although EIDL borrowers are not required to personally guarantee loans if the loan is under $200,000, if the loan does exceed $200,000, a personal guarantee is required by owners who have a 20% or greater interest in the applying business.[24] This requirement can be waved if the borrower is able to demonstrate its inability to obtain credit elsewhere. Another area of potential conflict with current SBA rules is that, unless changed, the SBA requires collateral on all EIDL loans over $25,000. Unlike PPP loans, the SBA must review and make a determination on applications based on the borrowers' ultimate ability to repay the loans. The SBA can approve a loan based on a credit score or other means, not requiring the submission of tax returns, to determine the borrower's ability to repay.[25] The issuance of the loan under EIDL is therefore expedited but not guaranteed.

Additional items to consider

When considering lending options other provisions of the CARES Act should also be examined to determine what will result in the best outcome for the business. Importantly, business owners should review Employee Retention Credits[26] and Payroll Tax Deferral[27] as part of their overall planning efforts. Business owners who participate in PPP are not eligible to participate in either of these two programs. Therefore, careful consideration must be given to determine what provisions of the CARES Act will support their needs best.

Employers may be eligible for a refundable tax credit for their share (6.2%) of Social Security tax. This potential credit is available for 50% of the first $10,000 in qualified wages, including health plan expenses, paid to each employee starting on March 13th, 2020.[28] For an employer to be eligible to receive the credit an employer must (1) have had their operations either fully or partially suspended as part of the government's shutdown orders related to COVID-19 or (2) their gross receipts must have declined by more than 50% in a calendar quarter when compared to the same quarter for 2019.[29] Employers will remain eligible until the earlier of (i) the time their gross receipts exceed 80% relative to the same quarter of 2019, or (ii) December 31, 2020.[30] If an employer had more than 100 employees (based on 2019 employment levels), qualifying wages are limited to wages paid to employees who were not providing services due to COVID-19. The Employee Retention credit is not available to employers who receive loans from the SBA under PPP as described above.[31]

In addition to the above tax credit for Social Security taxes, the CARES Act also allows employers to defer the payment on the employer's share of the 6.2% Social Security tax on wages paid beginning March

27th, 2020 through December 31st, 2020. Deferral is also permitted for the equivalent portion of self-employment taxes. Amounts deferred under this provision are payable in two installments, 50% being due on December 31st, 2021 and the remainder being due December 31st, 2022.[32] The Payroll Tax Deferral credit is not available to employers who receive loans from the SBA under PPP as described above.

Given these provisions, it is critical to discuss with your tax professional which election makes the most sense based on your individual needs and foreseeable future state of revenue.

Summary

Under PPP and EIDL, borrowers are offered very favorable terms. Business owners that have been economically affected by the COVID-19 pandemic should discuss with their SBA-approved banker how these programs can help secure the future of their businesses. Borrowers seeking loans through EIDL should discuss their individual eligibility and requirements with their SBA representative.

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[1] Act section 1102
[2] Act section 1102 (a)(2)(D)(i)
[3] Act section 1106
[4] Act section 1107(6)
[5] Act section 1102(a)(1)(F)
[6] Act section 1102(a)(2)(A)(iii)
[7] Act section 1102(a)(2)(A)(viii)
[8] Act section 1102(a)(2)(E)
[9] Act section 1106(a)(3)
[10] Act section 1106(b)
[11] Act section 1106 (d)
[12] Act section 1106 (d)(2)
[13] Act section 1102 (a)(2)(K)
[14] Act section 1102 (a)(2)(M)
[15] Act section 1102 (a)(2)(D)(i)
[16] Act section 1102 (a)(2)(D)(iii)
[17] Act section 1102 (a)(2)(D)(iv)
[18] Act section 1109 (f)
[19] Act section 1110 (e)(8)
[20] Act section 1110 (a)(2)
[21] Act section 1110 (e)(4)
[22] Act section 1110 (e)(3)
[23] Act section 1110 (e)(5)
[24] Act section 1110(c)(1)
[25] Act section 1102 (d)
[26] Act section 2301
[27] Act section 2302
[28] Act section 2301(a) & Act section 2301 (b)
[29] Act section 2301(c)(2)(A)(ii)
[30] Act section 2301(c)(2)(B)
[31] Act section 2301(j)
[32] Act section 2302(d)(1)(3)

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