

The CARES Act:

Primer on SBA

Paycheck Protection Loans and Loan Forgiveness

Disclaimer:

This primer was created by JustMoney.org as teaching material covering legislation passed on March 27, 2020.

While JM makes an effort to ensure the information is accurate, it is not guaranteed to be correct, complete, or up-to-date.

The document is not intended as legal, financial, accounting, or any other professional advice.



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The Big Picture

- **Forgiveness.** The loans are intended to be forgiven, so most loans will become grants (no need for repayment). Principal can be forgiven in full. We're still trying to confirm whether interest can be forgiven as well. We'll post an update on this point.
- **Conditions for full forgiveness.** Generally, (1) employment numbers cannot drop (at all), and (2) wages cannot drop by more than 25%. There's some flexibility around temporary declines.
- **Partial forgiveness.** Even when these conditions are not met, there are proportional adjustments, and most of the principal can still be forgiven (you're not walking on eggshells).

- **Broad eligibility.** Small businesses are eligible to borrow, but also many others, including "eligible self-employed" (under the 2020 Families First Act), independent contractors, sole proprietors, and non-profits.
- **Loan size.** You can borrow up to 2.5 times your average monthly payroll costs (capped at \$1 million). Streamlined procedures are available for loans under \$1 million.
- **Loan Terms.** Interest rate is capped at 4%. The term is 10 years (apparently amortized). No prepayment penalty.
- **Waived SBA requirements.** No collateral or personal guarantees required (loans are 100% gov. guaranteed). The SBA does not require you to show you cannot obtain credit elsewhere.

- **Allowable uses.** You can use the loan for payroll costs, but also for additional specified uses: mortgage interest, rent, utilities, and other preexisting debt. Loan proceeds cannot be used for non-specified purposes.
- **You can use it without forgiveness.** If you use the loan for the additional specified uses (those other than meeting payroll costs), you will not receive forgiveness. But you still get a loan on pretty convenient terms.

Additional sources:

- **SBA Guidelines.** Will hopefully be issued this week, providing greater detail [[URL](#)].
- **COVID Small Business Legal Clinic.** An initiative by Lawyers for Good Government [[URL](#)].
- **Senate Small Business Committee.** Guide to the CARES Act [[URL](#)]; .
- **The 2020 CARES Act.** Full text [[URL](#)]. Sections 1102, 1106.

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A. What are the basics I need to know?

1. Am I eligible to borrow?

Eligible borrowers include:

1. **Small businesses concerns.** Generally, businesses under 500 employees. But for specifics, consult SBA's [size standards](#) on maximum number of employees and revenue in your subsector;
2. **Eligible self-employed** (defined in the Families First Act). As well as sole proprietors and independent contractors;
3. **Civil society.** non-profits, veterans organizations and Tribal business concerns, generally, if they employ no more than 500 employees;
4. **Hoteling Food etc.** greater flexibility around size limitations;
5. **Franchises.** ditto.

2. Where will I get the loan?

Unlike the EIDL (Economy Injury Disaster Loans), your direct interface for paycheck protection loans will be with private banks approved by SBA.

The banks originate the loan on the frontend.

And the banks will process your application for forgiveness on the backend.

3. What are the loan terms and requirements?

1. **Rates:** capped at 4%;
2. **Term:** 10 years;
3. **Time flexibility:** deferment for at least six months;
4. **Prepayment penalties:** waived; :
5. **Personal guarantees:** waived;
6. **Collateral requirements:** waived;
7. **SBA fees:** waived (but lender may require fees);
8. **Requirement SBA borrowers cannot obtain "credit elsewhere":** waived.

3. What are the key documents I'll need?

Apparently, the usual documentation for SBA 7(a) loans is required (guidelines may provide further information later this week).

For self-employed etc. You'll need payroll tax filing to IRS; (2) Forms 1099-MISC; (3) Income and expense for sole proprietorship;

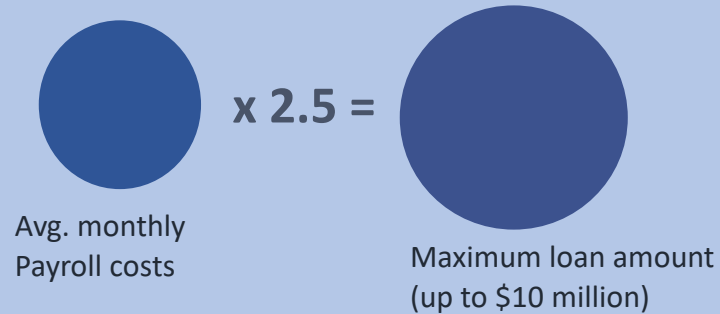
In the application for forgiveness. You'll need payroll tax filing to IRS; (2) State income; (3) Payroll and unemployment insurance filings; (4) Documentation regarding payments on mortgages, lease and utility obligations.

Certifications. Borrowers needs to make general statements agreeing to comply with the provisions of the program and assuring the lack of emergency borrowing for duplicate purposes.

B. How much can I borrow?

5. How much can I borrow?

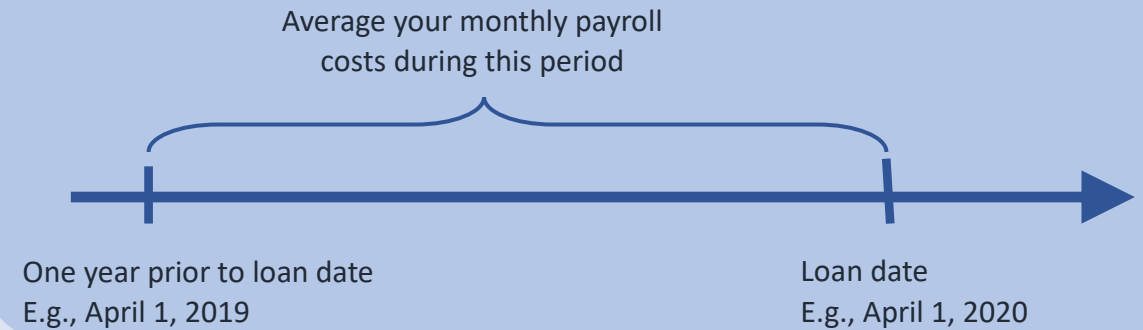
To find out how much you can borrow, take your average monthly “payroll costs” and multiply it by 2.5. This amount is capped at \$10 million. Borrowing under \$1 million will expedite the process.



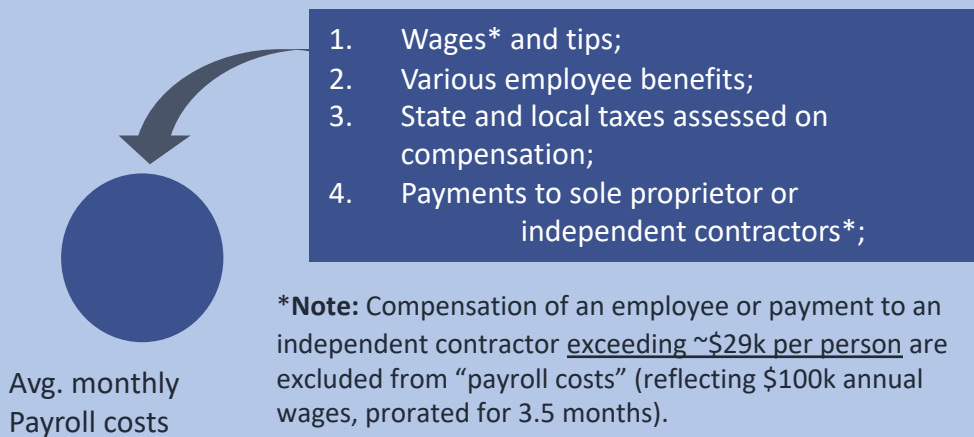
Note: borrowers who took SBA disaster loans (EIDL) for Covid can add those amounts, and refinance

7. What period should I use for payroll costs?

Take the one year period prior to the loan date. Special rules apply to those recognized as seasonal employers.



6. What is included in “payroll costs”?



C. What can I do with the proceeds?

8. What can I do with the proceeds?

While payroll costs are used to determine the maximum loan amount, you may also use loan proceeds for a number of additional, but specified uses.



9. What are the additional specified uses?

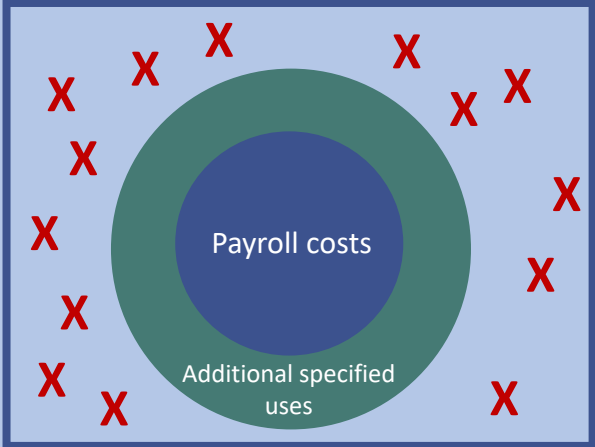
1. Costs related to continued health benefits;
2. Payment of interest on mortgage obligations (but no principal or prepayment);
3. Rent;
4. Utilities;
5. Interest on other pre-existing debt;



10. Can I use the proceeds for non-specified purposes?

You may not. Even if these purposes are somehow Covid related, loan proceeds could only be used for payroll costs, and the other specified purposes.

When taking the loan, you will need to certify (i.e., to state in writing) that you will comply with this condition.



D. How much of my loan will be forgiven?

11. How much forgiveness can I get?

Assuming all proceeds were used for allowable purposes: **payroll costs**, and **the other specified uses**, you could get forgiveness up to the full principal amount. There are, however, potential downward adjustments you should be aware of, and we discuss below.

Will interest owed on principal that is forgiven be forgiven as well? Good question. We find the language of Section 1106(d)(1) on this point confusing. We're trying to find official answer, and will post an update as soon as we get one. At any rate, recall interest is capped at 4%.



12. What are the potential downward adjustments?

There are two different types of downward adjustments:

1. For a reduction in employment;
2. For a reduction in wages.

Broadly speaking, as long as the number of employees did not drop, and as long as wages did not drop by more than 25%, the loan principal should still be forgiven in full (no downward adjustments). More specifics, below.

Note that even with downward adjustments, a substantial portion of the principal could still be forgiven. There is no threshold that triggers absolute denial of forgiveness, so you are not walking on eggshells.

13. What are the tax implications of loan forgiveness?

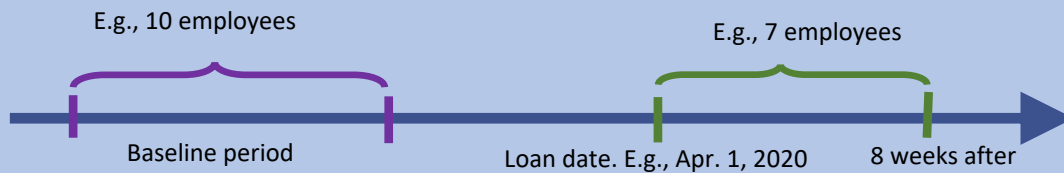
We are not tax experts. But the CARES Act does specify that loan forgiveness amounts will not be included in the borrower's gross income for federal tax purposes.

D. How much of my loan will be forgiven? (Cont'd)

14. How does the adjustment for number of employees work?

This downward adjustment is based on a decline in the average number of employees between some **baseline period**, and the **8-week period** following the loan date.

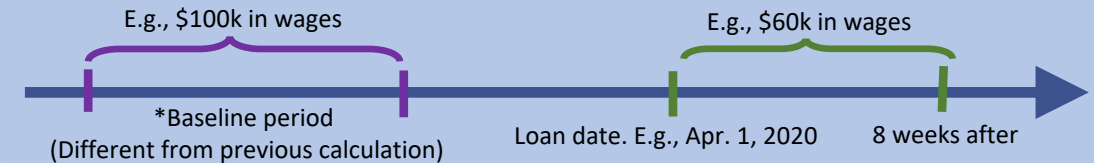
For example, if you had **10 employees** in the baseline period, and **7 employees** in the 8-week period, downward adjustment would be 30% ($=\frac{10-7}{10}$). If your initial principal was \$100k, \$70k will be forgiven, and \$30k ($=30%*\$100k$) will remain to be paid.



15. How does the adjustment for wages work?

This downward adjustment is based on the difference in wages between wages in some **baseline period***, multiplied by 75%, and wages in the 8-week period following the date you took the loan. This means wages can drop by up to 25% without triggering a downward adjustment in forgiveness. This 25% cashflow will then be available for the other allowable loan uses: mortgage interest, rent, utilities, etc.

For example, if wages amounted to **\$100k** in the baseline period, and dropped to **\$60k** in the 8-week period, the difference will be: $\$100k*0.75 - \$60k = \$15k$. If your initial principal was \$100k, \$85k will be forgiven, and \$15k will remain to be paid.



14. (Cont'd)- A little more on calculations...

- **What dates should I use for the baseline period?** Employers can generally choose between two different alternative periods. By choosing the one with a lower number of employees, you can reduce the downward adjustment, and increase the amount of forgiveness. The two alternatives are (1) Feb 15, 2019-June 30, 2019 and (2) Jan 1, 2020-Feb 29, 2020.
- **Seasonal employers** (as recognized by the SBA) must choose alternative #1.
- **How do I calculate the number of employees?** For this calculation, you use the number of equivalent full-time employees (EFT), the average it across the various pay periods falling within the period for which you are doing the calculation.

15. (Cont'd)- A little more on calculations...

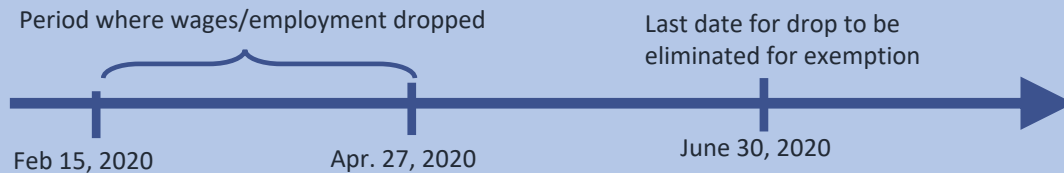
- **What dates should I use for the baseline period here?** For this calculation, the baseline period is the most recent quarter before you took the loan.
- **Limitation up to 100k annualized:** wages in either period do not include those of employees who received income during any period in 2019 which, if annualized, is greater than \$100k.
- **Tipped Workers:** employers can receive additional forgiveness by increasing wages to tipped employees (replacing lost tip income) under special rules.

D. How much of my loan will be forgiven? (Cont'd)

16. Is there flexibility with downward adjustments?

There is an exemption to downward adjustments (both number of employees and wages). Forgiveness amount will not be reduced where:

- The number of employees or wages dropped between Feb. 15, and Apr. 27, 2020 (=Mar. 27, +30 days from the date legislation was passed);
- The reduction in employment and wages was “eliminated” no later than June 30, 2020
- In our view, the language of this provision raises some important questions. Hopefully those will be addressed in SBA’s guidelines later this week.



THE END.
GOOD LUCK,
YOU GOT THIS!