



KTA COVID-19 ALERT

CONGRESS PASSES CARES ACT – PROVIDES SBA LENDING AND \$2 TRILLION STIMULUS PACKAGE

-- CONSIDERATIONS FOR SMALL BUSINESSES --

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security (the “CARES Act”) was signed into law, providing approximately \$2 trillion in financial stimulus. The CARES Act provides for, among other things, loans (some of which need not be repaid) and other relief for small businesses facing financial distress during the COVID-19 crisis. We highlight some of the key provisions impacting small businesses.^{[11](#)}

1. Paycheck Protection Program

Under the Paycheck Protection Program (26 U.S.C. §1102), the Small Business Administration (the “SBA”) is authorized to lend up to an aggregate \$349 billion to qualifying small businesses (500 employees or fewer), ESOPs, not-for-profit organizations, veterans’ organizations and tribal concerns to assist them during the coronavirus emergency. The CARES Act vastly expands the businesses that are eligible for SBA loans. These loans are to cover payroll, mortgage interest, rent and utilities (with certain limitations). They carry up to 4% interest and, under certain conditions (discussed below), these loans need not be repaid. Franchises, lodging and food service businesses may have more than 500 employees, although not at one location, and still qualify.

These loans have no fees and are fully non-recourse to shareholders, officers, directors, partners, etc. as they do not require personal guaranty(ies) as is typically the case for an SBA loan.

An eligible borrower/business may borrow up to 2.5 times its average monthly payroll costs for the one-year period prior to the date of such an SBA loan, up to a maximum of \$10 million per business. Payroll costs include employee compensation (salaries, wages and commissions) up to \$100,000 per year for eligible employees, employee benefits (such as group health insurance), retirement benefit payments and state and local payroll taxes. There are additional complexities and we recommend that you reach out to counsel to understand how your business may utilize and access these loans.

Lenders are required to defer payments for between six months and a year. However, the particulars of these rules will not be certain until the SBA issues its regulations setting forth the deferral period; these regulations are expected to be promulgated on or about April 27, 2020.

To incentivize companies to retain employees, the principal of these loans may be partially or completely forgiven, depending on a ratio comparing a company's average number of employees between Feb. 15, 2019-June 30, 2019 or Jan. 1, 2020-Feb. 29, 2020 and the 8-week period after taking the loan. The loan forgiveness would also be reduced by any reduction in total salary or wages of **any** covered employee (any employee making less than \$100,000 per year) during the covered period that exceeds 25% of that employee's total salary or wages during their most recent full quarter of employment. The law has provisions to provide additional flexibility to eliminate reductions in the number of full-time employees or wage reductions that occurred between February 15, 2020 and April 26, 2020. These calculations include additional complexities that are best addressed by reaching out to counsel. Businesses with tipped employees may receive forgiveness for additional wages paid to those employees.

Businesses will be required to submit payroll records and proof of mortgage, rent and utility payments to qualify for forgiveness. Ordinarily, forgiven loans result in taxable income; these SBA loans do not.

2. Emergency Economic Injury Disaster Loan (EIDL)

In addition to a Paycheck Protection Loan, qualifying small businesses/organizations may also apply to the SBA for an Emergency EIDL Loan (26 U.S.C. § 1110).

Under an Emergency EIDL Loan, a qualifying borrower may apply for a loan of up to \$2,000,000. If the loan is for less than \$200,000, it will not require an owner's personal guarantee. In addition, borrowers do not need to prove that they are unable to obtain credit elsewhere.

At the time a borrower applies for an EIDL Loan, it may request a \$10,000 advance. That advance is to be paid within three days of the application, to cover (a) payroll, (b) paid sick leave, (c) rent and/or mortgage payments, (d) increased supply costs due to supply chain disruptions and (e) obligations that cannot be met due to reduced revenues. This amount is not required to be repaid, even if the EIDL is denied.

During the covered period described above, a borrower may obtain an EIDL Loan based solely on a credit score and will not be required to submit tax returns; the SBA administrator will also be empowered to use alternate means to determine ability to repay.

Under 15 U.S.C. § 636(a)(4)(C), these loans have a minimum term of 15 years, have a fixed interest rate and have prepayment penalties for the first three years of the loan. If a borrower prepays more than 25% in the first year after disbursement, the penalty is 5% of the prepayment; 3% during the second year; and 1% during the third year.

3. Employee Retention Credit (Does Not Apply to Companies Receiving Paycheck Protection Loans)

Companies not taking Paycheck Protection Loans may be eligible for a refundable tax credit against their share of Social Security and Railroad Retirement taxes. The credit is equal to 50% of the first \$10,000 in wages (including the value of health plan benefits) paid during the covered period per employee, for a maximum credit of \$5,000 per employee.

To qualify, employers must either (a) have business operations fully or partially suspended due to governmental limits on commerce, travel, or group meetings, or (b) have a year-over-year drop in quarterly revenue in 2020 (i.e., when compared to the same quarter in 2019) of at least 50%. For firms with fewer than 100 full-time employees, the credit may be claimed for all qualifying employee wages. For firms with more than one hundred full-time employees, only employees who are currently not providing services for the employer due to COVID-19 causes are eligible for the credit.

The employee retention credit is effective for wages paid after March 12, 2020, and before January 1, 2021.

4. Paid Sick Leave Provisions

Qualifying organizations (under 500 employees) are required to provide employees who are unable to work or tele-work due to coronavirus-related circumstances with paid sick leave or expanded family medical leave. These rules apply to all employees, except that only employees employed for at least 30 calendar days are entitled to the paid expanded family and medical leave described in Section C below.

- **A. If the employee is quarantined or experiencing symptoms.** If an employee is unable to work or tele-work because he or she is quarantined (pursuant to Federal, State or local government order or on advice of a health care provider) and/or is experiencing COVID-19 symptoms and seeking a medical diagnosis, he or she is entitled to two weeks' pay at the higher of minimum wage or his or her regular rate, up to a maximum of \$511 per day and \$5,110 in the aggregate.
- **B. If the employee is caring for someone quarantined or experiencing symptoms.** If an employee is unable to work or tele-work because he or she needs to care for an individual subject to quarantine (as described above), he or she is entitled to two weeks' pay at the higher of 2/3 of his or her minimum wage or 2/3 of his or her regular rate, up to a maximum of \$200 per day and \$2,000 in the aggregate.
- **C. If the employee is unable to work for childcare reasons.** If the employee is unable to work or tele-work because he or she needs to care for a child under age 18 whose school or child care provider is closed or unavailable for reasons related to COVID-19, he or she is entitled to (a) two weeks' pay at the higher of 2/3 of his or her minimum wage or 2/3 of his or her regular rate, **plus** (b) if the employee has been employed for at least 30 calendar days, an additional ten weeks of paid expanded family and medical leave at the higher of 2/3 of his or her minimum wage or 2/3 of his or her regular rate. This employee is entitled, under (a) and (b) combined, to a maximum of \$200 per day and \$10,000 in the aggregate.
- **D. Part-Time Employees.** Part-time employees or employees who work an irregular schedule are entitled to be paid based on the average number of hours he or she worked for the six months prior to taking Emergency FMLA. Employees who have worked for less than six months prior to leave are entitled to their reasonable expectation at hiring of the average number of hours the employee would normally be scheduled to work.

5. Payroll Tax Deferral

Notwithstanding 26 U.S.C. § 6302, an employer may defer paying its share of the 6.2% Social Security tax for the year ending December 31, 2020 until December 31, 2021 (as to 50% of the 2020 obligation) and December 31, 2022 (for the remaining 50%). This applies to obligations beginning on March 27, 2020 and ending December 31, 2020.

This deferral does **not** change employer obligations with respect to the 6.2% withheld from an employee's paycheck. We note that "responsible persons" are still personally liable for a failure to pay those payroll taxes if a company does not do so by the deadlines.

Self-employed taxpayers may defer 50% of their obligations, with 25% due on or before December 31, 2021 and 25% due on or before December 31, 2022.

6. Small Business Reorganization Act Changes

The CARES Act also amends the recently enacted Small Business Reorganization Act of 2019 ("SBRA"), which provides a streamlined chapter 11 process for eligible small businesses (i.e., business debtors with "noncontingent liquidated secured and unsecured debts" less than \$2,725,625). The CARES Act increases the debt limit to \$7.5 million for one year to enable more small businesses to take advantage of the law.

Under the SBRA's streamlined procedure, there is no creditors' committee, and only the debtor may file a reorganization plan. In addition, administrative expenses can be stretched out through the life of the plan, and the requirement that business owners provide "new

value” as part of a reorganization process is eliminated. Although the SBRA is new, for struggling businesses with less than \$7.5 million in debt, it creates another option for a company and its counsel to consider.

7. Net Operating Losses

To allow companies to utilize greater losses, a company may apply, for the 2018-2020 tax years, all of their net operating loss (NOL) carryforwards to their entire current year’s income, rather than being limited to 80% (as per the Tax Cuts and Jobs Act).

By way of example, assume a company had \$100,000 in NOL carryforwards from prior years and then \$100,000 in taxable income in 2019. Under the Tax Cuts and Jobs Act, the taxpayer could only use \$80,000 of the NOLs in 2019, with the balance carried forward. The CARES Act would allow the taxpayer to use the entire NOL in 2019, resulting in no income.

Companies may also carry back NOLs arising in 2018, 2019 and 2020 five years. In other words, a company could amend its 2016 return to utilize NOLs from 2019.

8. Increased Interest Deduction

For 2019 and 2020, business may now deduct interest equal to 50% of EBITDA, rather than 30%.

9. Retirement Plans

The CARES Act also waives the ten (10%) percent penalty for early withdrawals from retirement plans and IRAs for coronavirus-related hardship withdrawals (i.e., if the participant, his or her spouse and/or his or her dependent child has been diagnosed with coronavirus; or if the participant has suffered adverse financial consequences due to quarantine), up to a maximum of \$100,000. These withdrawals may be repaid at any time within three years after the withdrawal.

“Corona-virus related hardship” includes: (1) if the participant, his or her spouse and/or his or her dependent child has been diagnosed with COVID-19; (2) if the participant suffers adverse financial consequences as a result of being quarantined, furloughed or having been laid off or had his or her hours reduced due to COVID-19; (3) being unable to work due to a lack of child care due to COVID-19; or (4) if his or her business has had to close or reduce its hours due to COVID-19.

The Act also increases the dollar amount available for loans from qualified plans from \$50,000 to \$100,000 and allows a participant to borrow the entire amount of his account, rather than the current 50% (up to \$100,000). Loan repayment may be deferred for an additional one year from the original due date (usually, five years from the date of the loan). The participant may also spread the income from the withdrawals over three years, rather than declaring it all in one year.

[1] Nothing in this alert should be taken as legal advice. Given the rapidity in the changes in law, Federal and State executive orders, regulations and the like, and the complexity of these new laws, and that we are reviewing and digesting them immediately after their enactment, we urge you to contact legal counsel before taking action or making decision based the information herein.

We understand that at this time of crises these additional requirements may prove difficult for many employers. They also may be the springboard for litigation and problems down the road. Our team stands ready to help. For further assistance, do not hesitate to call any member of our team:

Gary Trachten (212) 868-5721 (o); (914) 420-5435 (c);
email: gtrachten@kudmanlaw.com

Paul Aloe (212) 868-1888 (o); (516) 816-8000 (c);
email: paloe@kudmanlaw.com

Barry Posner (212) 868-0174 (o); (914) 420-5555 (c);
email: bposner@kudmanlaw.com

David Saponara (212) 868-1887 (o); (914) 220-2885 (c);
email: dsaponara@kudmanlaw.com

Francis Curran (212) 868-0871 (o); (727) 215-7507 (c);
email: fcurran@kudmanlaw.com

Alex Slichko (212) 244-2586 (o); (518) 867-7916 (c);
email: aslichko@kudmanlaw.com

CONNECT WITH US!

