

COVID-19 LEGISLATIVE RESPONSES: IMPACT FOR SMALL BUSINESS

INTRODUCTION

As the novel coronavirus (COVID-19) pandemic shuts down the United States, Congress has undertaken a flurry of legislative actions intended to combat the outbreak and mitigate its impact on the U.S. economy. Several of these efforts would have significant impacts for small businesses who have been disproportionately impacted by the outbreak. Most notably, small businesses should be aware of four policy developments:

- **Forgivable Loans for Small Businesses.** Recently passed “Phase III” response legislation — the Coronavirus Aid, Relief, and Economic Security (CARES) Act — would provide forgivable loans incentivizing small businesses to keep employees on payroll.
- **Emergency Grants.** The same “Phase III” bill provides affected small businesses with emergency grants of up to \$10,000.
- **Tax Incentives.** “Phase III” provides several tax incentives that could be valuable for small businesses, including an employee retention tax credit.
- **Paid Leave.** The recently enacted “Phase II” legislation — The Families First Coronavirus Response Act — requires paid sick and family leave for affected employees, while providing tax credits to compensate employers.

As this memo is based on a constantly changing situation, it is subject to further updates. This memo should not be considered legal advice.

PAYCHECK PROTECTION PROGRAM

A key provision in Senate Majority Leader Mitch McConnell’s (R-KY) CARES Act would establish a \$349 billion “Paycheck Protection Program.” In effect through June 30, this program provides eligible small businesses with government-backed interruption loans, which could then be forgiven based on the borrower keeping its employees on payroll. The following analysis is based on the legislative text, as well as agency guidance published on March 31.

The Paycheck Protection Program provides funding for small businesses to maintain operations during these troubled times, as well as an incentive to maintain employment levels. The benefits of this program include:

- **A Flexible Loan to Cover Operating Expenses.** The program would provide a loan equal to 10 weeks of a company's payroll, up to \$10 million. This could be used to pay the payroll, rent, and utilities that allow a small business to keep its doors open.
- **Loan Forgiveness.** Borrowers could have eight weeks of payroll, rent, mortgage payments, and utilities forgiven if they maintain their workforce. Loan forgiveness is reduced proportional to any layoffs or salary reductions.
- **Incentives to Rehire.** While reductions in workforce usually result in a reduction in loan forgiveness, the legislation allows companies that already laid off workers to rehire them while still benefitting from full loan forgiveness.
- **Broadened Eligibility.** Participation in the program is open to all businesses and 501(c)3 nonprofits with fewer than 500 employees or that meet the Small Business Administration's (SBA) small business criteria, as well as independent contractors. In order to account for COVID-19's disproportionate impact on the restaurant and hospitality sectors, individual locations of companies in those sectors will also be eligible.
- **Streamlined Application Process.** The program operates directly through financial institutions, with the government waiving many requirements normally associated with such loans in order to provide small businesses relief as fast as possible. Applicants are not required to demonstrate any specific hardship, only make a good faith certification of the loan's necessity and that it will be used to retain workers.

Below is a list of Frequently Asked Questions (FAQs) to walk small business stakeholders through this process.

How does this program work?

The Paycheck Protection Program operates via SBA's existing 7(a) lending program, through which SBA offers guarantees on loans made by participating financial institutions. Applicants apply for a 7(a) guarantee directly through a participating financial institution, and, if approved, receive an SBA guarantee on their loan.

The CARES Act takes several steps to expedite the rollout of Paycheck Protection loans relative to the general 7(a) program including:

- Waiving application fees.
- Reimbursing financial institutions for processing applications.
- Extending participation to additional lenders.
- Waiving the requirement that an applicant cannot find credit elsewhere.
- Waiving requirements for collateral and personal guarantees.

How do I determine if my business is eligible?

Participation in the Paycheck Protection Program is open to businesses, 501(c)3 nonprofits, and veterans' organizations that have fewer than 500 employees or meet one of SBA's industry-specific small business thresholds – found [here](#). Sole proprietors, independent contractors, and some other self-employed individuals are also eligible.

Additionally, restaurants and hospitality businesses with multiple locations are eligible, so long as they have fewer than 500 employees per location. Affiliation rules are waived for restaurants and hospitality locations with fewer than 500 employees, franchises, and businesses financed by small business investment companies.

How do I participate in the program?

Financial institutions are directly delegated the authority to process loan and forgiveness applications. Applicants for the Paycheck Protection Program apply directly through an existing SBA lender or any other federally insured depository institution, credit union, or Farm Credit System institution. Additional lenders are expected to be added.

To apply, borrowers will submit a brief, four-page form to their lender. That application can be found [here](#) and consists of a simple good faith certification that the borrower needs the loan to support their ongoing operations, as well as other information—for instance criminal history—providing eligibility for government loans.

Applicants should also expect to submit tax documentation of payroll numbers confirming their eligibility to participate in the program and allowing the calculation of their maximum loan amount. Additionally, the legislation explicitly requires contractors and sole proprietors to establish their eligibility with payroll tax filings, Form 1099-MISC, and documentation of income and expenses.

When will assistance be available?

Eligible small businesses and sole proprietorships will be able apply for Paycheck Protection loans through existing SBA lenders starting April 3. Independent contractors and self-employed individuals can apply for loans starting April 10. Newly approved lenders will be able to make loans as soon as they are approved and enrolled in the program.

As funds are limited and will be granted on a first come first-served basis, businesses should not hesitate to seek a loan as promptly as possible.

What expenses are covered?

SBA will offer a 100 percent guarantee on a loan amounting to the recipient's average monthly payroll costs over the previous year, times 2.5. In other words, this loan amounts to two and a half months of payroll costs. The maximum loan amount is \$10 million.

Seasonal employers may opt to have their loan amount calculated based on their payroll during the analogous period last year (either February 15 or March 1 to June 30). Employers who were not in

business in during this period of February 15-June 30, 2019 can use employment figures for January 1-February 29 of this year.

For the purposes of loan amount and forgiveness (see below), payroll is defined as consisting of: (1) salary, wage, commission, or similar compensation; (2) cash tip or equivalent; (3) payment for vacation, parental, family, medical, or sick leave; (4) dismissal or separation pay; (5) health care or retirement benefits; (6) state and local payroll taxes; and (7) payments to sole proprietors and independent contractors that are a wage, commission, income or otherwise net earnings from self-employment. The calculation of payroll costs excludes compensation to employees exceeding \$100,000 on an annualized basis, federal payroll taxes, compensation to employees residing outside the United States, and leave for which the employer is receiving a tax credit under the “Phase II” COVID-19 response bill.

While loan amount is calculated based on payroll costs, the loan itself can be used for a variety of essential business expenses including payroll, rent, mortgage interest, interest on debts, and utilities.

How can my loan be forgiven?

Loans made under the program can be forgiven for the total amount that the borrower spent on payroll (capped at \$100,000 for each employee on an annualized basis) mortgage interest, rent, and utilities in the eight weeks following their loan’s origination. Additionally, employers are allowed to make extra payments to tipped employees to account for their loss of tips. Forgiven expenses are generally restricted to obligations undertaken before Feb. 15 of this year.

While the CARES Act allows forgiveness for all covered expenses, the federal government has indicated that due to limited funding, applicants should expect that no more than 25 percent of their amount forgiven will be for non-payroll costs.

Importantly, the forgiven debt is not counted in taxable income. Any portion of the loan not forgiven will remain guaranteed by SBA and have a 2-year maturity and .5 percent interest rate. Lenders will be required to defer payment of that loan for six months.

How is my forgiveness calculated?

The amount of forgiveness is reduced proportionally to any reduction in the borrower’s workforce, as well as any reduction in employee salary beyond 25 percent. Borrowers that have already taken action to reduce their workforce and eliminate any reduction in staff or salary by June 30, however, will not be penalized. The SBA is additionally able to issue *de minimis* exemptions from any reduction in forgiveness.

To calculate the portion of the borrower’s covered costs that will be forgiven, participants should multiply their eligible operating costs by the quotient of:

- Their average monthly number of full-time-equivalent (FTE) employees during the eight-week period, and;

- The borrower's average monthly number of FTE's during their choice of two periods—Feb. 15, 2019-June 30, 2019 or Jan. 1, 2020-Feb. 29, 2020.

How do I apply for forgiveness?

To achieve forgiveness, a borrower must submit to their lender documents including: (1) state or federal payroll documents; (2) documentation of mortgage interest, rent, or payroll expenses; (3) certification that the information is true; and (4) any other documentation that SBA determines is appropriate. The lender will then have 60 days to determine the appropriate level of forgiveness, at which point SBA would purchase and forgive the relevant amount of the initial loan.

In general, borrowers should bear in mind that this is a very new program and should err on the side of caution in maintaining records that demonstrate the eligibility of their expenses to be forgiven.

How does this program interact with SBA's Economic Injury Disaster Loans (EIDL)?

Borrowers who have received a COVID-19-related EIDL loan are allowed to apply for a Paycheck Protection loan or refinance their EIDL into a Paycheck Protection loan. However, EIDL loans and Paycheck Protection loans generally cannot be used towards the same expenses, with an employer for instance able to use a Paycheck Protection loan towards payroll and an EIDL towards rent and utilities if necessary. Any EIDL grant award provided under the bill (outlined in the following section of this memo) is subtracted from a borrower's loan forgiveness.

EIDL LOANS AND GRANTS

In addition to the Paycheck Protection Program, the CARES Act provides relief to small businesses via an expansion of SBA's Economic Injury Disaster Loan (EIDL) program, which provides operational liquidity of up to \$2 million to small businesses in designated disaster areas. The application to apply for an EIDL directly from SBA can be found [here](#).

Most notably, the CARES Act would change EIDL to provide emergency \$10,000 grants to eligible businesses. These changes are in effect through the end of the year.

Who is eligible for the program?

EIDL loans will be available to businesses, private nonprofits, and cooperatives with fewer than 500 employees, as well as small businesses currently recognized by SBA. Independent contractors and sole proprietors are also eligible. The bill broadly expands EIDL's scope to better account for the COVID-19 outbreak by treating emergency declarations under the Stafford Act (which President Trump has already invoked) as a trigger for EIDL eligibility. During this or a similar crisis, the SBA Administrator could then, at their discretion, designate what states or subdivisions have suffered sufficient economic damage to justify EIDL loans for small businesses in these areas.

Is this a grant or a loan?

While EIDL is traditionally a loan program, the CARES Act would provide \$10 billion for SBA to temporarily offer grants through the program. When applying for an EIDL loan, any eligible applicant

could request an advance on that loan of up to \$10,000, which SBA would be obligated to fulfill within three days. While this payment is technically an advance, it explicitly does not need to be repaid, even if the applicant is denied for their loan. It is, for all intents and purposes, a grant.

How do I apply?

In order to receive a grant, eligible businesses must first apply for an EIDL loan, self-certify their eligibility under penalty of perjury, and request an advance on their loan.

To streamline the disbursement of grants, the CARES Act waives several items normally required for the EIDL application process, including: (1) a personal guarantee on advances and loans over \$200,000; (2) the requirement that applicants have been in business for more than one year; and (3) the requirement that applicants cannot find credit elsewhere. The process is further expedited by allowing applicants to apply solely with a credit score, rather than tax documentation.

What can my grant be used for?

EIDL grants can be used for: (1) providing paid sick leave to employees unable to work due to COVID-19; (2) maintaining payroll during business disruptions; (3) meeting increased costs arising from supply chain disruption; (4) making rent or mortgage payments; and (5) repaying obligations that cannot be met due to revenue loss.

How does this grant interact with the Paycheck Protection Program?

A grant received under this program would be counted against any forgiveness an applicant receives under the Paycheck Protection Program.

TAX INCENTIVES

The CARES Act includes several tax incentives that could be valuable to small businesses attempting to navigate the crisis:

- **Employee Retention Tax Credit.** This provision would allow employers to claim a refundable payroll tax credit equal to 50 percent of wages (maximum of \$10,000 in wages per employee) paid to employees during the crisis. The credit is restricted to employers who see a full or partial suspension of operations due to a shutdown order, or who see gross receipts decline by more than 50 percent relative to the same quarter the previous year. For employers with more than 100 full-time employees, the credit is restricted to wages paid to employees not providing service due to COVID-19. For employers with fewer than 100 full-time employees, it is applicable to all wages.
- **Delay of Payroll Taxes.** This provision would allow employers to defer payment on the employer contribution of Social Security payroll taxes through the end of the year. Half of this deferred amount would be due to be paid on Dec. 31, 2021 and the other half by Dec. 31, 2022.

- **Modification of Net Operating Losses (NOL).** This provision would allow NOLs from 2018, 2019, and 2020 to be carried back five years and allow NOLs to fully offset income. This change is intended to allow businesses to use losses and amend prior year returns to provide liquidity during the outbreak.
- **Modification on Limitation of Losses for Sole Proprietors and Pass-Throughs.** This provision temporarily lifts the loss limitation for sole proprietors and pass-throughs with the intention of allowing them to utilize excess losses to provide necessary cashflow.
- **Increase to Interest Expense Deduction.** This provision would raise (from 30 to 50 percent of taxable income) the limitation on interest that businesses are allowed to deduct from their 2019 and 2020 taxes.
- **Technical Amendment Regarding Qualified Improvement Property (QIP).** This provision would correct an error in the 2017 Tax Cuts and Jobs Act preventing businesses, particularly in the hospitality industry, from writing off facility improvement costs immediately rather than over 39 years.

PAID LEAVE

On March 18, 2020, President Trump signed into law a bill requiring companies to provide limited paid sick and family leave to employees impacted by the COVID-19 outbreak. Two days later, the Treasury Department, Internal Revenue Service, and Department of Labor [outlined](#) their intention to implement the legislation expeditiously. The Department of Labor has additionally offered a comprehensive [FAQ](#) assisting employers in meeting their obligations under this law.

Both benefits are limited to individuals directly affected by COVID-19, whether caring for themselves or others and are only in effect through the end of the year. The provisions apply to employers with fewer than 500 employees, and the Department of Labor can exempt certain small businesses with fewer than 50 employees, as well as health care workers and emergency responders.

Employers may claim 100 percent of wages paid to employees in connection with the COVID-19-related leave requirements as a refundable credit against payroll taxes. In the case that those credits do not account for the cost of the leave, employers can seek an expedited advance from the IRS through a forthcoming claims process.

In general, employers are required to provide 10 days of paid sick leave and 10 weeks of paid family leave. The specific timeframes that employers are required to provide leave, at what percent of normal compensation it should be provided, and the maximum dollar amount of compensation that can be required are detailed in the chart below.

Max Benefits per Employee by Income

Annual Employee Income (40 Hours per Week, 52 Weeks per Year)		Sick Leave Benefit (10-Day Max)		Family Leave Benefit (10-Week Max)	Max per Employee
		Self — 100 Percent Wages (\$511 Daily Cap)	Caregiver — 2/3 Wages (\$200 Daily Cap)	2/3 Wages (\$200 Daily Cap)	
Federal Minimum Wage	\$15,080	\$580	\$387	\$1,933	\$2,513
Poverty Level (Family of Four)	\$26,200	\$1,008	\$672	\$3,359	\$4,367
Median Income for Full-Time Workers	\$48,672	\$1,872	\$1,248	\$6,240	\$8,112
Income for Max Sick Leave for Caregiving and Family Leave	\$77,997	\$3,000	\$2,000	\$10,000	\$13,000
Income for Max Sick Leave for Self	\$132,900	\$5,110	\$2,000	\$10,000	\$15,110