

CARES Act Small Business Interruption Loans*

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Small Business Interruption Loans under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)

What is this Program?

Under the Senate bill (which the House has passed but has not been signed into law as of the original posting of this document on 3/27/20), the federal government will be allocating \$349 billion to the Small Business Administration to guarantee loans to small businesses.

These are referred to "7(a) loans" because they are authorized by that section of the laws governing the SBA.

Who Can Apply?

Any business with 500 or fewer employees.

The business does not have to be shut down completely or partially. Any business that applies is presumed to need the loan and will get it. The only underwriting standards are the company was in business on February 15, 2020 and had employees for whom it paid salaries and payroll taxes.

The self-employed and independent contractors are also eligible for these loans.

These loans are non-recourse, meaning no personal guarantees or liens on practice assets.

What is the Maximum Loan Amount?

The maximum loan you can receive will equal 2.5 times your average "payroll costs" during the 1-year period before the loan is taken.

(In the unlikely event you took a separate SBA "disaster loan" on or after January 31, 2020, then your 7(a) loan amount can be increased to include a refinancing of this disaster loan.)

"Payroll costs" are defined very broadly and include:

- (A) Employee salaries, wages, commissions, etc. up to \$100,000 per year, \$8,333.33 per month
- (B) Payment for vacation, parental, family, medical or sick leave
- (C) Severance payments
- (D) Group health insurance
- (E) Retirement plan contributions
- (F) State and local taxes assessed on such compensation

CARES Act Small Business Interruption Loans*

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Payroll costs do not include:

- (A) Compensation over \$100,000/yr, \$8,333.33/mo
- (B) Federal tax withholdings
- (C) Compensation for non-US residents
- (D) Sick leave and family leave provided by the new Families First Coronavirus Response Act for which there are already tax credits

How Do You Apply?

The SBA is guaranteeing these loans, and businesses will need to apply through banks and credit unions. Approximately 1,800 lenders are already approved to issue 7(a) loans. The bank at which you've set up your business banking account will be a great place to start.

Since the maximum loan amount will equal 2.5 x your average monthly payroll costs during the 12 month period preceding the loan, you will need to submit an application that includes a sizeable amount of documentation, including:

- (A) Employee wages for the last 12 months, including you, your family and associate doctors – contact your payroll provider for the report
- (B) This report must also show paid time off, vacation, sick pay, family medical pay, etc. All of this is eligible to be included. The more you can show the better, as this will increase the loan amount
- (C) Withholding for state and local taxes on employee compensation
- (D) 1099s paid to independent contractor doctors
- (E) Documentation showing how much you, the employer, paid in employee group health insurance premiums for the past 12 months. Your insurance company should be able to provide this
- (F) Documentation showing the amount of retirement plan funding the employer made for employees over the past 12 months (profit sharing 401(k) plans, cash balance plans, SIMPLE and SEP IRAs). If your 2019 plan administration has been completed, you should use this as the basis for these figures. (Employees' own 401(k) salary deferrals won't count for these purposes.)

This will take some time and effort, so use the next few days to start assembling these materials. Be prepared to apply for and get the loan as soon as they are available.

Borrowers will also need to make a "good faith certification" that the uncertainty of the current environment makes the loan request necessary, that you intend to use the funds to retain workers and maintain payroll OR make mortgage payments, lease payments and utility payments, and that you haven't applied for another Section 7(a) loan.

CARES Act Small Business Interruption Loans*

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Note that you are not required to retain employees to get the loan. If you have laid off or furloughed your staff so they can get unemployment, you can still get the 7(a) loan, but as we will see, the amount of loan forgiveness will be reduced to the extent that staff is laid off or their pay is dramatically reduced.

There will be no fee to obtain the loan – another example of how the feds are doing what they can to get this money circulating in the economy. Nor are you required to first look elsewhere to get the money.

How Long Will it Take to Get the Money?

Treasury Secretary Mnuchin has indicated that he expects them to be ready (the loans disbursed) by the end of next week (April 3). If so, that is amazingly fast. The Treasury Department will be fast-tracking this.

What Can the Loan Proceeds be Used For?

The loan proceeds can be used for more overhead expenses than what went into calculating the amount of the loan, including:

- (A) Payroll costs (see definition above)
- (B) Interest (not principal) payments on mortgages
- (C) Rent
- (D) Utilities
- (E) Interest (not principal) on any debts that were incurred before February 15, 2020

How Long Can We Defer Repayment on the 7(a) Loan?

Borrowers can completely defer repayment of principal and interest for at least six months but not more than one year. Apparently, the particular deferment period will be up to the discretion of the bank that issues the loan.

What Portion of the Loan Will be Forgiven?

The amount of loan forgiveness will equal the sum of the employer's:

- (A) Payroll costs (as broadly defined above)
- (B) Interest (not principal) on any business debts that were incurred prior to February 15, 2020
- (C) Rent
- (D) Utilities, including electricity, gas, water, transportation, telephone and internet access . . .

CARES Act Small Business Interruption Loans*

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Which are incurred during the 8 week period that begins on the origination date of the 7(a) loan. Hopefully, the country will have returned to work well before these 8 weeks elapse.

The amount forgiven cannot exceed the original principal amount of the loan.

The loan forgiveness concept encourages employers to keep everyone employed. The amount of loan forgiveness will be reduced proportionally by the reduction in employees during the “covered period” of February 15, 2020 – June 30, 2020 compared to February 15, 2019 – June 30, 2019. So, if you employed 15 people in 2019 and 10 now, the forgiveness will be reduced by one-third. It will be further reduced to the extent that employees are being retained but are having to take pay cuts of more than 25%.

The CARES Act encourages employers to rehire workers and/or restore the pay of employees who were kept but took big pay cuts. If, by June 30, 2020, you rehire the laid off employees and/or restore the salaries of the employees who took pay cuts, then your loan forgiveness will not be reduced.

Note that a large pay cut to a highly paid employee won't proportionately reduce your loan forgiveness. Say you have a highly paid associate who is barely working and you can drop their pay to \$8,333.33/mo. That will be fully covered by loan forgiveness and you will not have your loan forgiveness proportionately reduced. (On the other hand, if someone earning less than \$100,000/yr suffers a greater than 25% pay cut, say 30%, then your loan forgiveness will be reduced by that 5% excess amount.)

What Must Be Done To Get the Loan Forgiveness?

The borrower has to show evidence that it actually spent money on the things that are eligible for loan forgiveness by submitting an application to the bank that includes:

- (A) Documentation verifying the number of employees on payroll during the 8-week period of eligible loan forgiveness, including payroll tax filings reported to the IRS as well as state income, payroll and unemployment insurance filings
- (B) Documentation, including cancelled checks, payment receipts, accounting reports, etc. verifying payments on business debts, rent and utility payments
- (C) A certification from an officer or owner of the borrower that the information being submitted is true and that the amount for which forgiveness is being requested was used to retain employees, and make interest payments on business debts, lease payments and utilities.

This will take some effort, but it has to be done. There will be no debt forgiveness without it.

What Will the Tax Treatment be on the Forgiven Debt?

Even though this is debt cancellation income, which is normally taxable, in this case, the cancelled debt will be excluded from income.

CARES Act Small Business Interruption Loans*

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What Happens to the Portion of the Loan that is Not Forgiven?

The remaining balance will continue to be guaranteed by the SBA, have a maximum maturity of 10 years and bear interest at the rate of 4% or less.

Will There be Prepayment Penalties on 7(a) Loans?

No.

Is it Preferable to Lay Off or Furlough Staff and Send Them to Unemployment or Keep Them on the Payroll and Get a 7(a) Loan?

There are two viable approaches that you can take. The first is more conservative and less disruptive and the second more aggressive but probably better for most.

Approach #1

If you have not already let your staff go and think that doing so will be difficult in terms of employee morale, then consider taking the 7(a) loan at the beginning of the loan application process, as early as the end of next week (April 3). The benefit of this loan is a tax-free gift, via loan forgiveness, to pay 8 weeks worth of your payroll costs, rent, interest on your debt service and utility bills.

\$349 billion has been allocated to this program, and it's conceivable that this money will be depleted before the last day these loans are authorized to be made. If that happens, Congress will likely authorize another round of funding, but that is never guaranteed.

Approach #2

The best way to handle this for most practices will be a two-part approach that takes advantage of unemployment benefits and the 7(a) loans. This is more disruptive to the practice as it requires furloughing or laying off the employees. However, if you've already done this, then that is a non-issue:

1. If your practice is shut down or largely shut down, then furlough staff and have them apply for unemployment. Thanks to the CARES ACT, they will get traditional unemployment benefits plus a \$600 kicker. This will replace all or most of their normal pay, and in some cases give them a raise.
2. When you are ready to reopen your practice, rehire your staff then, and obtain the 7(a) loan then. Just do this by the June 30 deadline -- better yet, a couple weeks before then in order to give yourself a cushion. You will use the loan proceeds to pay your overhead when the practice reopens. You should get the benefit of loan forgiveness for the 8 weeks following the date you take your loan (so into July and August). And, so long as the employees are rehired by June 30, the loan forgiveness will not be reduced. In this way, you are taking advantage of

CARES Act Small Business Interruption Loans*

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unemployment insurance to cover your employees' wages during the shutdown period and also getting the tax benefits of the 7(a) loan once your practice reopens.