

## COVID-19 Relief Loans for Small Businesses

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Small businesses adversely affected by COVID-19 may apply for special loans provided or guaranteed by the U.S. government. The program provided \$349 billion available for two types of loans, both of which are now available through the Small Business Administration (the “SBA”):

1. Paycheck Protection Program loans (the “PPP Loans”) through lenders enrolled in the SBA’s Section 7(a) loan program and other lenders approved by the SBA, pursuant to the Paycheck Protection Program under the Keeping American Workers Employed and Paid Act (the “Act”), which is part of the Corona Aid, Relief, and Economic Security Act (the “CARES Act”) enacted on March 27, 2020 (*click on [link](#) for the enacted legislation*). The PPL Loans are made by lenders authorized by the SBA and guaranteed by the U.S. government. Information about PPP Loans, including applications, can be found on the SBA website (*click on [link](#) for information on the PPP Loans*).
2. Economic Injury Disaster Loans (“EIDL Loans”) directly from the SBA (*click on [link](#) for information on the EIDL Loans*).

Other types of loans are also available directly through lenders authorized by the SBA under the existing provisions of Section 7(a) of the Small Business Administration Act (the “SBA Act”). *For more information on these loans, please click on the following [link](#).*

Before applying for one of these loans, a company should confirm whether such loan would be permitted by the indebtedness and financial covenants under its existing debt arrangements and whether a waiver or amendment may be obtained.

Foley Hoag LLP will update this summary as needed in the coming days and weeks, including to address regulations that are expected to be issued by the SBA with regard to these programs.

### Paycheck Protection Program under Keep American Workers Employed and Paid Act

Starting as early as April 3, 2020, small businesses may apply for loans to cover adverse effects on its business from COVID-19. A sample application is available through the SBA website (*click on [link](#) for a sample PPP Loan application form*). The PPP Loans do not prevent a company from receiving EIDL Loans to cover obligations for payroll, rent, utilities and interest on debt to the extent not covered by PPP Loans. A company may apply through June 30, 2020 for the adverse effects of COVID-19 during the covered period of February 15 through June 30, 2020.

Note that the SBA has not yet implemented final coordination with lending banks or issued the form of definitive documentation for PPP Loans. These steps are expected to be completed soon.

#### Eligibility for PPP Loans

A company is eligible for a PPP Loan if it is (i) a “small business concern” under the Act and (ii) has suffered problems such as supply chain shortages, staffing difficulties, business closures, or reduced sales as a result of COVID-19. The company must certify that the PPP Loan is necessary for its ongoing operations as a result of the COVID-19 pandemic. Prior to incurring a PPP Loan, the company’s board should make a specific determination with respect to the need for the PPP Loan proceeds.

“Small business concern” in the new Act is broader than the SBA definition and includes the following:

- Any business that employs not more than 500 employees (excluding employees not resident in the US and independent

contractors) or, if greater, the SBA's size standard for its applicable industry (by NAICS code);

- A sole proprietorship, independent contractor or self-employed person; or
- Accommodation and food service business concerns (NAICS code 72) with multiple locations that employ not more than 500 persons per location, franchises that are listed on the SBA's Franchise Directory (*click on [link](#) for the directory*) and small businesses that receive financing through the SBIC program.

For purposes of the small business concern test, the number of the applicant's employees will be combined with the number of employees of its affiliates, primarily other companies controlled by or under common control with the applicant. The SBA's affiliation rules include any majority shareholder, as well as any minority shareholder who (together with its obvious affiliates, such as family members or family investment vehicles in the case of an individual or funds with the same investment advisor) has the ability to prevent a quorum or to block action by the applicant's board of directors or shareholders, except with respect to certain unusual or extraordinary items.

The type of unusual or extraordinary items for which an investor may have blocking rights without having being deemed to have control under prior SBA decisions include:

- Sale of all or substantially all the business or a merger or change of control
- Issuing additional share
- Amending the charter
- Placing a lien on all company assets
- Filing for bankruptcy

The type of ordinary or day-to-day items for which an investor with blocking rights has been deemed to have control under prior SBA decisions include:

- Paying dividends
- Approval of company's budget
- Incurring loans
- Hiring and firing officers and executives
- Determining employee compensation
- Establishing an employee option or other stock plan
- Entering into contracts or joint ventures
- Initiating or defending a lawsuit

If a minority shareholder irrevocably waives or relinquishes the right to block these ordinary or day-to-day items, the shareholder will no longer be an affiliate of the applicant.

For purposes of determining percentage ownership, the SBA uses a fully diluted basis, giving effect to the exercise or conversion of all outstanding options, warrants and convertible debt unless satisfaction of the conditions to exercise or conversion is extremely remote.

The determination of control by the SBA is based on a totality of circumstances and is very fact-specific. Companies should consult with counsel regarding the application of these rules and the latest updates.

These affiliation rules do not apply to companies in the accommodation and restaurant industries (NAICS code 72), franchises that are listed on the SBA's Franchise Directory and small businesses that receive financing through the SBIC program.

For purposes of the 500 employee test used to determine small business status, the SBA permits applicants to choose whether to count average number of employees during 2019 or for the 12 months ended prior to the date of the application.

#### *Terms of PPP Loans*

All PPP Loans are expected to be made on the same terms for all companies. The principal terms are:

1. *Principal Amount:* Lesser of \$10,000,000 or:

**if** the company was in business from February 15 to June 30, 2019 (the “Covered Period”), 2.5 times the average monthly payments for payroll (excluding (a) compensation for employees not resident in the US and for independent contractors and (b) the excess over \$100,000 in total annual cash compensation (but not benefits) for any domestic employee) for the previous year (or, for a seasonal business, the period from either February 15, 2019 or March 1, 2019 through June 2019, at such company’s discretion), minus any EIDL Loans for the same purpose (other than payroll) or being refinanced; or

**if** the company was not in business during the Covered Period, 2.5 times average monthly payroll from January 1, 2020 through February 29, 2020, minus any EIDL Loans for the same purpose (other than payroll) or being refinanced.

“Payroll” for this purpose includes salary, wage, commission, tips, paid leave for illness, family or vacation, severance pay, health care and retirement benefits and state or local taxes based on employee compensation, but excludes federal tax credits for sick and family leave or federal withholding taxes.

2. *Interest Rate:* 1.0% per annum, with no payments due for six months after the loan is incurred.
3. *Maturity:* Two years, with no prepayment penalties.
4. *Guarantees and Collateral:* None.
5. *Fees:* None payable by borrower. (Lender will earn fees payable by the SBA.)
6. *Use of Proceeds:* Payroll, rent, utilities and interest on debt that was incurred prior to February 15, 2020, with at least 75% of the loan proceeds applied to payroll.
7. *Other Covenants:* None, except to the extent feasible borrower will purchase only American-made equipment and products.
8. *Shareholder Information:* The PPP Loan application requires the borrower to provide information about each 20% shareholder, including name, address, taxpayer identification number, percentage of shares owned and whether such shareholder is a 20% owner or manager of another business.

#### *Forgiveness of PPP Loans*

A company may obtain forgiveness of a portion of its PPP Loans (including accrued interest on the forgiven portion of the loan), as follows:

1. The maximum amount of the loan to be forgiven will be equal to the amount spent on payroll, rent, utilities and interest on mortgages during the eight-week period following incurrence of the loan (the “initial loan period”).
2. The amount of the loan to be forgiven will be reduced (i) proportionally by the quotient of (a) the company’s average number of domestic employees during the initial loan period divided by (b) at the company’s election, either (1) its average number of domestic employees from February 15, 2019 through June 30, 2019 or (2) its average number of domestic employees from January 1, 2020 through February 29, 2020.
3. The amount of the loan to be forgiven will also be reduced by the dollar amount that the compensation of domestic employees earning less than \$100,000 in salary for 2019 was reduced during the initial loan period by at least 25% of the employee’s average compensation during the quarter ended March 31, 2020.
4. The company may reverse these reductions (A) to the extent resulting from employees laid off between February 15, 2020 and April 26, 2020 if the employees are rehired by June 30, 2020 or (B) to the extent resulting from a compensation reduction if the compensation is restored by June 30, 2020.
5. The amount of the loan to be forgiven in respect of rent, utilities and interest on mortgages will be capped at 25% of the forgiven amount, with the remaining forgiven amount allocated for payroll costs.
6. To obtain loan forgiveness the company must submit appropriate receipts and documentary evidence to its lender.
7. Cancelled indebtedness as a result of loan forgiveness will not be taxable as gross income.

#### *Loss of CARES Act Tax Relief*

A company that obtains a PPP Loan is not eligible for the refundable payroll tax credit and a company that obtains forgiveness of its PPP Loan is not eligible for the employer payroll tax deferral, in each case as otherwise available under the CARES Act. See Foley Hoag’s [“The](#)

[CARES Act: Tax Relief Provisions](#)". Consult your legal counsel and financial adviser about the relative benefits of PPP Loans and these tax relief programs.

Small business owners in all U.S. states and territories may apply ([click on link for application](#)) for up to \$2 million in EIDL Loans with an annual fixed interest rate of 3.75% and a maximum maturity of 30 years. These loans may be used for working capital and to cover payroll and sick leave that cannot be paid due to the impact of COVID-19. The EIDL Loans cannot be used to refinance long-term debt.

### Eligibility

To be eligible for these loans, a company must: (i) be located in a designated disaster area ([click on link for designated disaster areas](#)); (ii) show that it has suffered substantial economic injury as a result of COVID-19; and (iii) be a "small business" under SBA guidelines.

Whether a company is a "small business" for these purposes is defined by SBA size standards ([click on link for size standards](#)). The size of a small business varies by industry, and is calculated based on average annual receipts or average number of employees. To qualify, (i) the size of the company, excluding its affiliates, must not exceed the size standard designated for the industry in which the company is primarily engaged, and (ii) the size of the company, combined with its affiliates, must not exceed the size standard designated for either the primary industry of the company alone or the primary industry of the company and its affiliates collectively, whichever is greater. The definition of "affiliate" ([click on link for definition](#)) is very broad, as described above for PPP Loans.

### Other Requirements

In addition to satisfying the eligibility standards, the company must provide additional documents, including:

1. Credit history;
2. Demonstrated ability to repay the loan;
3. Collateral for loans over \$25,000. The SBA requires real estate collateral when available. Although the SBA will not decline a loan for lack of collateral, the SBA will require the company to pledge all available collateral; and
4. Unlimited personal guarantees from any 20% shareholder for loans over \$200,000 (see below).

The SBA may require the company to maintain insurance. Flood insurance is required if the company has property in a special flood hazard area.

### Modifications under the Act

Under the Act, the EIDL program terms have been modified to provide for:

1. An advance of \$10,000 to a company that applies for an EIDL Loan, within three days of SBA's receipt of the application, even if the company is subsequently denied the EIDL Loan, so long as the company: (a) is a small business; (b) was in operation on January 31, 2020; and (c) submits a self-certification that the company is an eligible entity; such advance will not need to be paid back, but will be deducted from any amount forgiven under the PPP Loan;
2. Waiver of personal guarantees for loans less than \$200,000;
3. Waiver of the requirement that the borrower demonstrate inability to obtain financing from alternate sources (the "credit elsewhere" test); and
4. Authorization of loans based solely on credit score.

**Foley Hoag has formed a firm-wide, multi-disciplinary [task force](#) dedicated to client matters related to the novel coronavirus (COVID-19). For more guidance on your COVID-19 issues, visit our [Resource Page](#) or contact your Foley Hoag attorney.**

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- [Life Sciences](#)
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- Business Counseling
  - COVID-19 Task Force
  - Debt Finance
  - Emerging Company and Venture Capital
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