

## Keeping Your Business Safe and Nimble During COVID-19: Part III

March 31, 2020

It has been a little over a week since we sent [Part II](#) of our advice. Since then, COVID-19 cases in the U.S and much of the rest of the world have grown exponentially. More than 3 billion people are now under some form of lockdown order, including thirty-two U.S. states, most of Europe and India. And even in U.S. states that haven't officially ordered a lockdown or shutdown of non-essential businesses or instructed people to work from home, cities and businesses are adopting their own directives.

Although the U.S. federal government is still playing catch-up (on both public health and avoiding an economic catastrophe), last week's enactment of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") is an important step in trying to blunt the disruption caused by COVID-19. We expect additional federal programs to be rolled out as the economic effects of numerous countries shuttering large amounts of commercial activity reverberate through the national and international economies.

We're providing Part III of our advice for three reasons: first, to let you know about the financial assistance available to small businesses under the CARES Act; second, to update you on similar laws and policies enacted by state and local governments; and third, to offer proactive steps that start-ups and small businesses can take as COVID-19 disruption continues. We hope this helps you to keep your business nimble and safe and helps you to deliver the best achievable outcome for all stakeholders.

### **I. Recent Developments**

#### *A. Congress Creates the Paycheck Protection Program*

Of the over \$2 trillion in economic relief contemplated by the CARES Act, Congress has allocated \$349 billion to lend to small businesses through the SBA under the Paycheck Protection Program. The CARES Act also grants businesses that do not borrow under the Paycheck Protection Program tax credits to retain their employees and allows businesses to delay payment of most payroll taxes. Our experience is that SBA loans can be time-consuming to apply for and can take weeks or longer to receive; even though underwriting standards are looser (i.e., effectively non-existent) for Paycheck Protection Program loans, companies may nevertheless want to engage their legal and accounting advisors to move the process forward.

#### *B. DOL Issues Guidance on the Families First Coronavirus Response Act*

The U.S. Department of Labor (DOL) issued [guidance for employers](#) and a Q&A on the previous stimulus bill, the Families First Coronavirus Response Act ("Coronavirus Response Act"). We recommend that you read this guidance together with [Part II of our advice](#). The DOL clarified that the paid leave provisions of

the Coronavirus Response Act become effective on April 1, 2020, and cover leave taken by employees between April 1, 2020, and December 31, 2020. Per the guidance, expanded leave provided under the Coronavirus Response Act will not be available after December 31, 2020.

The Wage & Hour Division of the DOL also stated that it will not bring enforcement actions against any employer for violations of the Coronavirus Response Act through April 17, 2020 so long as the employer has made “reasonable, good faith efforts” to comply with the Act. An employer will be found to have acted “reasonably” and in “good faith” if (i) it remedies any violations of the Coronavirus Response Act, (ii) any violations were not willful, and (iii) it agrees, in writing, to comply with the Act going forward. Businesses with under 500 employees should use this two-and-a-half-week grace period to consult with counsel before that date to make sure their plan complies with the Coronavirus Response Act.

### *C. States May Let Small Businesses Stop Paying Their Rent*

The New York State Legislature is considering allowing small business commercial tenants that have lost income or been forced to close their place of business as a result of COVID-19 to not pay rent for up to 90 days.<sup>1</sup> Suspended rent would be forgiven. A small business would qualify for relief if it: (i) is independently owned and operated; (ii) is not dominant in its field; and (iii) employs 100 or fewer people. This proposed small business protection would be in addition to New York Governor Andrew Cuomo’s 90-day moratorium on evictions and foreclosures for commercial tenants.<sup>2</sup>

California Governor Gavin Newsom has also banned evictions through May 31, 2020 for any commercial tenant who is unable to pay rent.<sup>3</sup> All a tenant needs to do to be protected is to declare in writing, within seven days after the rent due date, that its inability to pay rent is attributable, at least in part, to COVID-19.

Although several states, including New York and California, have issued orders requiring lenders to grant mortgage forbearance, none of these orders have addressed whether or not landlords who use this forbearance for rental properties must also permit their tenants to suspend paying rent. We nevertheless recommend that businesses facing a cash crunch that prevents them from paying rent contact their landlord and inquire whether it is eligible to forbear its mortgage payments and, if so, whether it will avail itself of this forbearance so that the tenant can likewise suspend rent payments.

## **II. CARES Act**

The CARES Act creates three programs that will provide help to most small and medium sized businesses: (1) the Paycheck Protection Program; (2) Advances on Economic Injury Disaster Loans; and (3) Tax Credits for Employee Retention.

### *A. Paycheck Protection Program*

The primary assistance provided to small businesses, sole proprietorships and the self-employed by the CARES Act is the Paycheck Protection Program, which is a \$349 billion pool that the SBA will administer and lend to eligible borrowers affected by COVID-19. Eligible businesses will be able to apply for

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<sup>1</sup> <https://www.nysenate.gov/legislation/bills/2019/s8125>; <https://www.nysenate.gov/legislation/bills/2019/a10224>

<sup>2</sup> <https://www.governor.ny.gov/news/no-2028-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency>

<sup>3</sup> <https://www.gov.ca.gov/2020/03/27/governor-newsom-takes-executive-action-to-establish-a-statewide-moratorium-on-evictions/>

Paycheck Protection Program loans from any lender authorized by the SBA that opts to participate in the program. Loans cannot be obtained directly from the SBA.

### 1. Eligibility

A small business is eligible for a Paycheck Protection Program loan if it employs fewer than 500 people and was in operation on February 15, 2020. There are no other underwriting standards and no requirement to post collateral. Sole proprietors and the self-employed are also eligible to apply for a Paycheck Protection Program loan, but they must submit additional documentation—such as payroll tax filings reported to the Internal Revenue Service, Forms 1099–MISC, and/or income and expenses from the sole proprietorship—to establish eligibility.

Borrowers need to comply with the SBA’s affiliation rules, which are especially relevant for venture-backed start-ups. These rules have historically limited the ability of venture-backed companies to qualify for an SBA loan because the SBA aggregates each business with its venture capital investors if those investors have “control” rights over the portfolio company, and also aggregates other companies similarly “controlled” by the venture fund. This often results in an employee count well over 500 for venture-backed applicants. Although the CARES Act waived the affiliation rules for restaurants, bars, hotels and in other limited circumstances, it has not done so for venture capital, nor has the SBA announced any intention to relax these rules. We recommend that venture-backed companies looking to borrow funds through the Paycheck Protection Program review their capital structure and governance arrangements with counsel and, if emergency funds are needed, consider approaching investors to waive “control” provisions that might otherwise prevent eligibility.

### 2. Loan Size and Terms

The maximum Paycheck Protection Program loan that a borrower can receive is the lesser of (i) \$10 million or (ii) 2.5 times the average total monthly payroll costs for employees residing in the United States during the one-year period before the loan is made plus the outstanding amount of any business loan obtained via the SBA on or after January 31, 2020. While the calculation of the applicable loan limit is based on payroll costs between February 15, 2019 and June 30, 2019, any early stage companies that were not in business at this time should use January 1, 2020 to February 29, 2020 to calculate their limit.

Employees’ annual salaries and base wages are capped at \$100,000 per year when calculating “payroll costs,” and paid sick and FMLA leave covered under the Corona Virus Response Act are excluded. The CARES Act does not appear to impose a similar limit on incentive-based compensation such as commissions and bonuses, although those amounts will be averaged out over 12 months for companies (and may not be included at all for companies using the shorter 2020 window to measure payroll costs).

Paycheck Protection Program loans will have a maximum maturity date of 10 years from the date on which the borrower applied for the loan, and the annual interest rate will be capped at 4%. Participating lenders are required to defer principal, interest and fee payments on loans for at least six months.

### 3. Use of Funds

Although the dollar limit for Paycheck Protection Program loans is calculated using payroll costs, borrowers can use the funds to cover other fixed costs too, namely: (i) payroll (i.e., employee compensation, payment for vacation, parental, family, medical or sick leave, dismissal or separation

payments, payment of retirement benefits, and payment of state and local taxes assessed on employee compensation), (ii) costs and insurance premiums for continuing group health care benefits for employees out on paid sick, medical, or family leave, (iii) mortgage interest, (iv) rent, (v) utilities, and (vi) interest on any funds borrowed before February 15, 2020.

Paycheck Protection loans cannot be used to pay more than the prorated equivalent of \$100,000 in annual salary or base wages per employee. Paid sick and FMLA leave provided for under the Corona Virus Response Act are again excluded. The CARES Act authorizes the payment of commissions and “similar compensation” but does not appear to address other incentive-based compensation such as bonuses. As a result, we recommend that companies with more bespoke compensation plans review their program with counsel and their HR consultant when deciding whether to take a Paycheck Protection Program loan.

#### 4. Loan Forgiveness

The federal government will forgive amounts borrowed under a Paycheck Protection loan that are used to cover documented payroll costs, mortgage interest payments, rent, and utilities. This forgiveness program has several legal and practical limitations, however. The first is that the CARES Act requires documentation for payments, such as payroll filings, financial statements and evidence of mortgage or lease obligations and utility payments. Borrowers must also certify that the documentation is correct and that the funds were used for a permitted purpose. Although the CARES Act does not specify penalties for making an inaccurate certification, our expectation is that the SBA will forgive unintentional errors, technical errors and similar situations where the borrower was acting in good faith.

Borrowers will effectively be penalized for laying off workers because the amount of any loan forgiveness will be reduced in proportion to any workforce reductions.<sup>4</sup> Borrowers can also be penalized if they reduce an employee’s pay by more than 25% if that employee earned less than \$100,000 in 2019 on an annualized basis. Penalties for laying off or reducing the salary of a covered employee can be negated for any employee who is re-hired or whose salary is restored before June 30, 2020.

##### *A. Economic Injury Disaster Loans*

Businesses that borrow under the Paycheck Protection Program can also apply for an SBA Economic Injury Disaster Loan so long as the loans are for different purposes and the use of funds is not duplicative. Our [previous memo](#) discussed the Economic Injury Disaster Loan program, which is a more traditional form of SBA lending that has its own underwriting process and can be used for payroll and to pay accounts payable and fixed debts. Companies that plan to borrow under both programs should carefully document the use and purpose of each set of funds in their internal records.

The CARES Act softened the underwriting standards for Economic Injury Disaster Loans by, among other items, (i) waiving personal guarantees on loans under \$200k, (ii) allowing any business in operation on January 31, 2020 to borrow, (iii) allowing companies to take an Economic Injury Disaster Loan even if they can obtain credit elsewhere, and (iv) authorizing the SBA to approve an applicant based solely on a

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<sup>4</sup> The comparison to be made to determine the size of the penalty is between the average number of workers during (i) February 15, 2020 to June 30, 2020 and, (ii) at the borrower’s election, either (a) February 15, 2019 and June 30, 2019, or (b) January 1, 2020 to February 29, 2020.

credit check. As a result, this kind of loan may be a good option for businesses that have sufficient cash to operate while completing the underwriting process.

The CARES Act also allows any small business that applies and certifies that it is eligible for an Economic Injury Disaster Loan to receive a cash advance of up to \$10,000 to cover payroll, paid sick leave, rent, mortgage payments, higher materials costs resulting from supply chain disruption and other obligations that have become harder to repay due to revenue loss. Any funds advanced are not required to be repaid, regardless of whether the recipient actually obtains an Economic Injury Disaster Loan.

### *B. Tax Credits for Employee Retention*

Businesses that do not borrow funds under the Paycheck Protection Program can take a tax credit of up to \$5,000 per employee against 50 percent of the “qualified wages” paid by the business if, due to COVID-19, the business (a) had its operations fully or partially suspended pursuant to a governmental order limiting commerce, travel, or group meetings, or (b) experienced a significant decline in gross receipts.<sup>5</sup> The tax credit covers qualified wages paid after March 12, 2020 through December 31, 2020.

“Qualified wages” generally covers all wages and other compensation provided to employees during the periods described above, up to \$10,000 per employee. For businesses with more than 100 full-time employees, “qualified wages” are limited to wages and other compensation paid to an employee who is not working due to a full or partial suspension of operations or a significant decline in gross receipts. Businesses can also include amounts paid or incurred to provide and maintain a group health plan (so long as these amounts are not included in an employee’s gross income). In light of their own funding mechanism, wages paid for any sick or FMLA leave covered under the Coronavirus Response Act are excluded.

Businesses can take early advantage of the CARES Act’s employee retention tax credit by simply not paying the payroll taxes for which they expect to receive a tax credit. But the mechanics for claiming the full credit can be complex, particularly if a company uses a third-party PEO for payroll, and we recommend that businesses which wish to benefit from the employee tax credit consult their counsel and accountant.

### *C. Deferred Payment of Social Security Taxes*

The CARES Act also defers payment of an employer’s portion of Social Security taxes through December 31, 2020 for any employers or self-employed individuals who do not take a loan under the Paycheck Protection Program. Half of the deferred amount is due by December 31, 2021, and the remaining amount is due by December 31, 2022.

## **III. Other Economic Assistance**

As discussed in [Part II of our advice](#), a number of state and local governments have developed financial assistance programs for small businesses affected by COVID-19.

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<sup>5</sup> A business will be considered to have experienced a significant decline in gross receipts if gross receipts for any 2020 calendar quarter are more than 50% lower than the equivalent 2019 calendar quarter. Businesses taking the employee retention credit because of a significant decline in gross receipts can continue to do so during 2020 until their quarterly gross receipts exceed 80 percent of their gross receipts for the equivalent 2019 calendar quarter.

The number of private entities offering financial relief to their customers continues to expand, with financial institutions chief among such entities. For example, some banks are offering to (i) waive late fees on loan payments and service charge fees, (ii) defer payments on small business loans, and (iii) refund overdraft fees for small businesses. Some banks also are making loans available to small businesses with the first payment not due until 90 days after the loan has been taken out. The American Bankers Association is maintaining [a list of the banking institutions that are offering relief](#) to businesses affected by Coronavirus, including details on the relief available at each institution. If your bank is not on the list, and even if it is, we suggest contacting your bank to see what options may be available to you.

Credit card issuers are likewise offering relief to their customers, such as waiving fees for late payments and allowing cardholders to skip payments without accruing interest. We recommend reaching out to your card issuer to discuss available options.

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We encourage you to contact us with any questions about how the issues discussed above may impact your company or your employees. We look forward to working with you as we all continue to navigate the impacts of COVID-19.

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