

## U.S. Insight: CARES Act Provisions for Small Businesses and Individuals

The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) was signed into law by President Trump on March 27, 2020. A brief summary of how the CARES Act may impact small businesses and individuals is provided below.

The CARES Act amends the Small Business Act (the “Small Business Act”) to create, among other things, a new paycheck protection program (the “Paycheck Protection Program”) to provide eligible businesses with 100% federally-backed loans, which ultimately may be forgiven in whole or in part, to help pay certain costs, such as payroll, rent, health benefits, insurance premiums, utilities, and more.

The CARES Act directs the Small Business Administration (the “SBA”) to issue implementing regulations within 15 days of its enactment. Since the enactment of the CARES Act, the SBA has published additional guidance on its website (the “SBA Guidance”), which states, among other things, that lenders may be able to start processing loan applications for small businesses as early as April 3, 2020 and for individuals as early as April 10, 2020. Additionally, the SBA has posted the interim final rule (the “Interim Final Rule”) in advance of publication in the Federal Register, which provides small businesses with additional guidance when determining loan eligibility and forgiveness. Please be aware that further guidance may be issued by the SBA and such guidance may include additional requirements than what is described herein.

### Paycheck Protection Program

The SBA allows its administrator (the “Administrator”) to provide loans directly or in cooperation with the private sector. The Administrator may guarantee covered loans under this program on the same terms, conditions, and processes as other loans made under 7(a) of the Small Business Act.

The CARES Act also provides that an “eligible entity” shall be eligible for an Economic Injury Disaster Loan (“EIDL”) made under 7(b)(2) of the Small Business Act (loan amounts are based on actual economic injury and financial needs, and can be up to \$2 million). During the covered period, an eligible entity that has applied for an EIDL may request an advance in an amount up to ten thousand dollars (\$10,000); *provided* such advance be used for permissible purposes only. An applicant shall not be required to repay any amounts of such advance, even if such applicant is subsequently denied a loan under 7(b)(2) of the Small Business Act; *provided, however*, that such advance shall be reduced from any loan forgiveness available if the applicant transfers into or is approved for a loan pursuant to 7(a) of the Small Business Act.

Any such loan that was made under the SBA’s Disaster Loan Program on or after January 31, 2020 may be refinanced as part of a covered loan under this new Paycheck

Protection Program as soon as loans are made available. The CARES Act specifically allows SBA Disaster Loan recipients with an EIDL that was made since January 31, 2020 for purposes *other than the permitted loan uses under this program* to receive assistance under this program.

### Borrower Eligibility Requirements

The CARES Act expressly specifies that the requisite number of employees and a good faith certification are required of a potential borrower in order for it to be eligible for a Paycheck Protection Program loan, as more fully described below. We note that there may be other requirements under existing SBA guidelines or by individual lenders.

#### *Number of Employees*

Pursuant to the Interim Final Rule, a borrower is eligible for a Paycheck Protection Program loan if such borrower has 500 or fewer employees whose principal place of residence is in the United States, or is a business that operates in a certain industry that meets the applicable SBA employee-based size standards for such industry, *and*

- (i) Such borrower is:
  - A. A small business concern as defined in section 3 of the Small Business Act, and subject to the SBA's affiliation rules under 13 CFR 121.301(f) unless specifically waived in the CARES Act; or<sup>1</sup>
  - B. A tax-exempt nonprofit organization described in section 501(c)(3) of the Internal Revenue Code ("IRC"), a tax-exempt veterans organization described in section 501(c)(19) of the IRC, Tribal business concern described in section 31(b)(2)(C) of the Small Business Act, or any other business; *and*
- (ii) Such borrower was in operation on February 15, 2020 and either had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC.

An individual who operates under a sole proprietorship or as an independent contractor or eligible self-employed individual will be eligible for a Paycheck Protection Program loan as long as such individual was in operation on February 15, 2020 and can provide supporting documentation.

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<sup>1</sup> While the Interim Final Rule omits the use of "or", it is apparent from guidance issued by the SBA that any business with 500 or fewer employees will be eligible for a loan under the Paycheck Protection Program and, as such, the use of "or" is appropriate.

Section 121.106 of the Code of Federal Regulations (the “CFR”) outlines the method for determining a business concern’s size. To calculate the number of employees of a business concern, such business concern should use the average number of employees of the business (including those of its domestic and foreign affiliates) based upon the number of employees for each of the pay periods for the preceding completed 12 calendar months.

The SBA considers “employees” of a business concern to be all individuals employed by such business concern (subject to the SBA’s affiliation rules) that work on a full-time, part-time, or other basis. This includes employees obtained from a temporary employee agency, professional employee organization, or leasing concern.

Please be aware that the SBA will consider the totality of the circumstances, including criteria used by the Internal Revenue Service (“IRS”) for federal income tax purposes, in determining whether individuals are employees of a business concern.

### *Affiliates*

In most cases, a borrower will be considered together with its affiliates for purposes of determining eligibility for a Paycheck Protection Program loan.

The SBA published an interim final rule on affiliation (the “Interim Final Affiliation Rule”) in advance of publication in the Federal Register in order to provide potential borrowers with additional guidance with respect to the SBA’s detailed affiliation standards. The Interim Final Affiliation Rule clarifies that while section 1102 of the CARES Act provides that the provisions applicable to affiliations under 13 CFR 121.103 apply with respect to nonprofit organizations and veterans organizations in the same manner as with respect to small business concerns, 13 CFR 121.103(a)(8) provides that applicants in SBA “Business Loan Programs”, which include the Paycheck Protection Program, are subject to the affiliation rule contained in 13 CFR 121.301.

13 CFR 121.301(f) provides four tests for affiliation based on control that apply to participants in the Paycheck Protection Program. For purposes of determining the applicable number of employees, an applicant is considered together with its affiliates.

Business concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists. Control may be affirmative or negative. 13 CFR 121.301(f) provides certain circumstances that are sufficient to establish affiliation for applicants of the Paycheck Protection Program. Such circumstances include:

- *Affiliation based on ownership.* A concern is an affiliate of an individual, concern, or entity that owns or has the power to control more than 50% of the concern’s voting equity. If no individual, concern, or entity is found to control,

then the SBA will deem the board of directors or president or chief executive officer (or other officers, managing members, or partners who control the management of the concern) to be in control of the concern. The SBA will deem a minority shareholder to be in control if such minority shareholder, whether individual or entity, has the ability, under the concern's charter, bylaws, or shareholders' agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

- *Affiliation arising under stock options, convertible securities, and agreements to merge.* The SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the power to control a concern. The SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised. The SBA will not give present effect to (i) agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date, (ii) options, convertible securities, and agreements that are subject to conditions precedent that are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, and/or (iii) individuals', concerns', or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation.
- *Affiliation based on management.* Affiliation arises where the chief executive officer or president of the applicant concern (or other officers, managing members, or partners who control the management of the concern) also controls the management of one or more other concerns. Affiliation also arises where (i) a single individual, concern, or entity that controls the board of directors or management of one concern also controls the board of directors or management of one or more other concerns, and/or (ii) a single individual, concern, or entity controls the management of the applicant concern through a management agreement.
- *Affiliation based on identity of interest.* Affiliation arises when there is an identity of interest between close relatives, as defined in 13 CFR 120.10, with identical or substantially identical business or economic interests. In the case where the SBA determines that interests should be aggregated, an individual or firm may rebut such determination with evidence showing that the interests are separate.

For religious institutions, the relationship of a faith-based organization to another organization is not considered an affiliation if the relationship is based on a religious teaching or belief or otherwise constitutes a part of the exercise of religion.

The CARES Act specifically waives affiliation rules for (i) businesses with not more than 500 employees that, on the date on which the loan is disbursed, is assigned an North

American Industry Classification System code beginning with 72, (ii) any business concern operating as a franchise that has been assigned an SBA franchisor identifier code, and (iii) any business that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958.

#### *Good Faith Certification Requirement*

Pursuant to the Interim Final Rule, the requirements to obtain a loan under the Paycheck Protection Program include a good-faith certification by an authorized representative of the applicant that:

1. The applicant was in operation on February 15, 2020 and had employees for whom it paid salaries and payroll taxes or paid independent contractors;
2. The uncertainty of current economic conditions makes the request for the loan necessary to support the ongoing operations of the applicant;
3. Funds will be used to retain workers and maintain payroll or make mortgage, lease and utility payments (this includes an acknowledgement that if funds are knowingly used for unauthorized purposes, the federal government may hold the applicant legally liable);
4. Documentation verifying the number of full-time equivalent employees on payroll, as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities for the eight-week period following the loan will be provided to the lender;
5. Loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities (but not more than 25% of the forgiven amount may be for non-payroll costs);
6. During the period beginning on February 15, 2020 and ending on December 31, 2020, the applicant has not received and will not receive another loan under this program;
7. The information provided in the application and the information provided in all supporting documents and forms is true and accurate in all material respects (this includes an acknowledgement that knowingly making a false statement to obtain a guaranteed loan from the SBA is punishable under law); and
8. The lender will confirm the eligible loan amount using tax documents submitted by the applicant (this includes an affirmation that such tax documents are identical to those submitted to the IRS and an acknowledgement that the lender can share such tax documents with the SBA's authorized representatives for purposes of compliance with loan program requirements and other SBA reviews).

As of the date of this summary, additional guidance on what documentation will be required to support the certification, if any, has not been published.

## Use of Proceeds

Businesses may use Paycheck Protection Program loan proceeds for:

1. Payroll costs (as defined below);
2. Costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums;
3. Payments of interest on mortgage obligations (which shall not include any repayment of principal);
4. Rent (including rent under a lease agreement);
5. Utilities;
6. Interest on other debt obligations incurred before February 15, 2020; and/or
7. Refinancing an SBA EIDL made between January 31, 2020 and April 3, 2020. (If an applicant received an SBA EIDL from January 31, 2020 through April 3, 2020 and such EIDL loan was used for payroll costs, then the proceeds of the Paycheck Protection Program loan must be used to refinance the EIDL. Proceeds from any advance up to \$10,000 on the EIDL will be deducted from the loan forgiveness amount of the Paycheck Protection Loan.)

While payroll costs expressly exclude non-US residents, the rent or utility obligations do not specifically exclude non-US obligations.

It is important to note that the SBA Guidance and then the Interim Final Rule added that *at least 75%* of the proceeds from a Paycheck Protection Program loan *shall be used for payroll costs*. For purposes of determining the percentage of use of the proceeds for payroll costs, the amount of any EIDL refinanced will be included. While the CARES Act provided that loan proceeds under the Paycheck Protection Program may be used for the purposes listed above and for other allowable uses described in Section 7(a) of the Small Business Act, the Administrator stated that finite appropriations and the structure of the CARES Act, along with Congress' overarching goal of keeping workers paid and employed, warranted a requirement that borrowers use a substantial portion of the proceeds for payroll costs. If a borrower uses Paycheck Protection Program loan proceeds for unauthorized purposes, then the SBA will direct such borrower to repay those amounts. However, if a borrower knowingly uses loan proceeds for unauthorized purposes, then such borrower will be subject to additional liability, such as charges for fraud. The Interim Final Rule also provides that the SBA will have recourse against any shareholder, member, or partner for any such person's unauthorized use of loan proceeds.

### Loan Amount

The maximum principal amount available to an eligible business concern is 2.5 times the average total monthly payments by the applicant for payroll costs incurred in the one-year period prior to the loan being made, plus any outstanding amount of a loan made under the SBA's Disaster Loan Program between January 31, 2020 and the date in which such loan may be refinanced as part of this new program, subject to a \$10 million cap.

In the case of an eligible business concern that was not in business during the period beginning on February 15, 2019 and ending on June 30, 2019, the maximum principal amount available is 2.5 times the average total monthly payments by the applicant for payroll costs incurred during the period beginning on January 1, 2020 and ending on February 29, 2020, plus any outstanding amount of a loan made under the SBA's Disaster Loan Program between January 31, 2020 and the date in which such loan may be refinanced as part of this new program, subject to a \$10 million cap.

### *Payroll costs*

Payroll costs mean, subject to the below limitations:

1. For business concerns, the sum of payments of the following with respect to employees whose principal place of residence is in the United States:
  - a) Salary, wage, commission, or similar compensation;
  - b) Payment of cash tip or equivalent;
  - c) Payment for vacation, parental, family, medical, or sick leave;
  - d) Allowance for dismissal or separation;
  - e) Payment required for the provisions of group health care benefits, including insurance premiums;
  - f) Payment of any retirement benefit; and
  - g) Payment of State or local tax assessed on the compensation of employees.
2. For an independent contractor or sole proprietor, the sum of payments of any compensation that is a wage, commission, income, net earnings from self-employment, or similar compensation and that is in an amount that is not more than \$100,000 in 1 year, as prorated for the applicable period (meaning if such compensation is greater than \$100,000, it should be included as compensation of \$100,000).

The Interim Final Rule clarifies that independent contractors have the ability to apply for a Paycheck Protection Program loan on their own, so they do not count for purposes

of a borrower's Paycheck Protection Program loan calculation (nor will they count for purposes of calculating a borrower's loan forgiveness amount).

Payroll costs **do not** include:

1. The compensation of an individual employee in excess of an annual salary of \$100,000, as prorated for the applicable period (meaning if an employee makes greater than \$100,000, they should be included as having a salary of \$100,000);
2. Withholding taxes imposed or withheld during the applicable period;
3. Any compensation of an employee whose principal place of residence is outside of the United States; or
4. Qualified sick leave or family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.

### Loan Forgiveness

Paycheck Protection Program loans are eligible for loan forgiveness up to the full principal amount of the loan and any accrued interest. The actual amount of loan forgiveness will generally be in an amount equal to the sum of the following costs and payments made during the 8-week period following the origination date of the program loan (the "Loan Period"):

1. Payroll costs;
2. Any payments of interest on covered mortgage obligations (which shall not include any repayment of principal);
3. Any payment of any covered rent obligation; and
4. Any covered utility payments (*i.e.*, payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which services began before February 15, 2020).

Pursuant to SBA Guidance and the Interim Final Rule, the SBA has added the further limitation that *at least 75%* of the forgiven amount must have been used for payroll costs.

As noted above, while payroll costs expressly exclude non-US residents, the rent or utility obligations do not specifically exclude non-US obligations.

An eligible business concern should also be aware that the list of items for which program loan proceeds may be used and forgiven is more restrictive than the list of items for which program loan proceeds may be used and, therefore, for certain borrowers the amounts eligible for forgiveness may be substantially less than amounts utilized for permitted use.



### *Reduction based on reduction in number of employees*

The amount of the loan to be forgiven will be reduced by multiplying the amount eligible for forgiveness by a fraction, the numerator of which is the average number of full-time equivalent employees per month during the Loan Period, and the denominator of which is (i) at the election of the borrower, (a) the average number of full-time equivalent employees per month employed from February 15, 2019 to June 30 2019, or (b) the average number of full-time equivalent employees per month employed from January 1, 2020 to February 29, 2020, or (ii) in the case of a seasonable employer, the average number of full-time equivalent employees per month employed by the eligible employer during the period beginning on February 15, 2019 and ending June 30, 2019.

### *Reduction relating to salary and wages*

The amount of the loan eligible to be forgiven will be reduced by the amount of any reduction in total salary or wages of any employee during the Loan Period that is in excess of 25% of any such employee's salary or wages during such employee's most recent full quarter of employment before the origination date of the covered loan. For purposes of this calculation only, an "employee" is limited to any employee who did not receive more than \$100,000 in salary or wages on an annualized basis during any pay period in 2019.

Although the CARES Act states that a Paycheck Protection Program loan is "eligible" for forgiveness, it is expected that, subject to the borrower's ability to demonstrate its use of proceeds, the applicable portion of a Paycheck Protection Program loan will be forgiven. The CARES Act directs the SBA to provide guidance on the implementation of Paycheck Protection Program loan forgiveness within 30 days of its enactment.

The US Department of Treasury has provided guidance that lenders must make a decision on loan forgiveness within 60 days.

### *Other Paycheck Protection Program Loan Terms*

- Lenders are required to provide complete payment deferment relief for "impacted borrowers" with covered loans for a period of not less than 6 months, including payment of principal, interest, and fees, and not more than 1 year. Interest will continue to accrue on covered loans during this 6-month deferment.
- During the period from February 15, 2020 to June 30, 2020, the Administrator shall consider each eligible recipient that applies for a covered loan to be an "impacted borrower".
- The CARES Act directs the SBA to provide guidance to lenders on the deferment process within 30 days of its enactment.

- ***Maturity.*** With respect to a covered loan that has a remaining balance after application of the loan forgiveness provisions, the covered loan shall have a maximum maturity of 10 years from the date on which the borrower applies for loan forgiveness. The SBA Guidance and Interim Final Rule clarify that the loans will have a maturity of 2 years.
- ***Interest.*** The Interim Final Rules provides that the interest rate on loans obtained through the Paycheck Protection Program will be 1%.
- ***Prepayment.*** There shall be no prepayment penalty for any payment made on a covered loan.
- ***Security, Etc.*** No collateral or personal guarantee is permitted to be required for a loan. Additionally, the SBA Administrator will have no recourse against any individual, shareholder, member, or partner of an eligible loan recipient for non-payment, unless the individual uses the loan proceeds for unauthorized purposes.
- ***Application.*** According to the SBA website, applicants may apply through any existing SBA 7(a) lender or through any federally insured depository institution, federally insured credit union, and Farm Credit System institution that is participating. Other regulated lenders will be available to make these loans once they are approved and enrolled in the program.

#### Other Incidental Benefits

The CARES Act also includes several tax provisions that may be of benefit to certain businesses that are not discussed in this summary. For a discussion of tax benefits, please see our prior client alert, titled “U.S. Insight: Summary of the Business Tax and Individual Tax Provisions of the CARES Act, a COVID-19 Relief Measure”, available [here](#).

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