

What Should Businesses and Individuals Know About the Coronavirus Aid, Relief, and Economic Security Act?

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On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) into law. The CARES Act is a sweeping piece of legislation aimed at bolstering the American economy and providing additional assistance to the American healthcare system in response to the COVID-19 crisis. This whitepaper will address the main economic components of the CARES Act:

- Keeping American Workers Paid and Employed Act
- Relief for Workers Affected by Coronavirus Act
- Recovery Rebates and Use of Retirement Funds
- Business Payroll Tax Credits and Delay of Payroll Tax Payments
- Coronavirus Economic Stabilization Act of 2020

Keeping American Workers Paid and Employed Act

Overview

One of the key features of the CARES Act is a massive temporary expansion of the Small Business Administration’s (“SBA”) 7(a) Small Business Loan Program. Under Title I of the CARES Act, the government guarantee of loans made for the Payment Protection Program under section 7(a) of the Small Business Act is increased to 100% through December 31, 2020. A “covered loan” means any loan made during the period between February 15, 2020 and June 30, 2020 (the “Covered Period”).

Businesses with 500 or less employees are eligible to receive a covered loan. Individuals who operate a sole proprietorship, independent contractors, and certain self-employed individuals are also eligible for the covered loans, but they must submit documentation (as necessary) verifying their eligibility (*e.g.*, payroll tax filings, Forms 1099-MISC, and income and expenses from the sole proprietorship).

The maximum amount of a covered loan is the lesser of: (1) \$10,000,000.00; or (2) one of the two formulas detailed below:

- (i) The average total monthly payments for by the Applicant for payroll costs X 2.5 + The outstanding amount of a loan under subsection (b)(2) that was made during the period beginning on January 31, 2020 and ending on the

incurred during the 1-year period before the date on which the loan is made

date on which covered loans are made available to be refinanced

- (ii) The average total monthly payments made by the applicant for payroll costs incurred during the period beginning on January 1, 2020 and ending February 29, 2020 X 2.5 + The outstanding amount of a loan under subsection (b)(2) that was made during the period beginning on January 31, 2020 and ending on the date on which covered loans are made available to be refinanced.

Information for Borrowers and Lenders

Covered loans may be used for payroll costs, costs related to the continuation of group health care benefits, employee salaries and compensation, payment of interest on any mortgage obligation, rent, utilities, and interest on any other debt obligations that were incurred before February 15, 2020.

When applying for a covered loan, a borrower must make a good faith certification. The items that a borrower must certify include, among other things, the following: (1) that the uncertainty of current economic conditions has made the borrower's loan request necessary in order to support its ongoing operations; and (2) the funds received will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments.

Under the CARES Act, lenders previously approved to make 7(a) loans are deemed to have been delegated authority by the SBA. Additionally, the authority to make covered loans is extended to additional lenders who have the necessary qualifications to process, close, disburse, and service loans made with the guarantee of the SBA.

When evaluating a borrower's eligibility for a covered loan, lenders are only to consider two factors: (1) whether the borrower was in operation on February 15, 2020; and (2) whether the borrower had employees for whom it paid salaries and payroll taxes or paid independent contractors.

The SBA has waived collection of any fees between February 15, 2020 and June 30, 2020. Several other waivers are contained in the CARES Act. For example, the requirement that a borrower be unable to obtain credit elsewhere is waived for covered loans. In addition, the SBA has waived the personal guarantee and collateral requirements for covered loans. The Act specifically indicates that the SBA will have no recourse against an individual shareholder, member, or partner of a recipient of a covered loan for nonpayment of the loan unless the recipient uses the covered loan proceeds for an unauthorized purpose.

The interest rate for covered loans is capped at 4%. There is no prepayment penalty for any payments made on a covered loan. Between February 15, 2020 and June 30, 2020, the SBA is requiring lenders to provide complete deferment of all principal, interest, and fees. The

deferment period must be at least 6 months, but it cannot exceed 1 year. The SBA will provide guidance to lenders regarding the deferment process no later than 30 days after the CARES Act's date of enactment.

Covered loans are eligible to be sold in secondary markets, and the SBA cannot collect any fee for any guarantee sold into the secondary market. If, during the covered period, a covered loan is sold on the secondary market and an investor declines to approve a deferral requested by a lender, the SBA will exercise its authority to purchase the loan so that the borrower can receive a deferral, as detailed above.

With respect to the appropriate Federal banking agencies or the National Credit Union Administration Board respective risk-based capital requirements, a covered loan must receive a risk weight of 0%.

Any loans made under the SBA's Economic Injury Disaster Program (Section 7(b)(2) loans) during the period beginning on January 31, 2020 and ending on the date on which covered loans are made available may be refinanced as part of a covered loan.

The SBA will reimburse a lender authorized to make a covered loan. The reimbursement will be at a rate, based on the balance of the financing outstanding at the time of disbursement of the covered loans, of:

- (i) 5% for loans of \$350,000.00 or less;
- (ii) 3% percent for loans in excess of \$350,000.00 but less than \$2,000,000.00; and
- (iii) 1% for loans of \$2,000,000.00 or more.

Reimbursements will be made no later than 5 days after the disbursement of a covered loan.

The SBA will be establishing limits that an agent assisting a borrower can collect for the preparation of an application for a covered loan.

Loan Forgiveness

In general, a borrower of a covered loan is eligible for loan forgiveness equal to the amount of payroll costs, payment on interest of a mortgage obligation, payment of a rent obligation, and utility payment incurred and paid during the Covered Period. Amounts forgiven will be treated as cancelled indebtedness to the lender for purposes of the loan program, but borrowers will not be required to include this forgiveness in their gross income.

The amount of forgiveness cannot exceed the principal amount of the financing made available under the covered loan. In addition, if the borrower lays off employees, the amount of the loan will be reduced by the quotient obtained by dividing:

The average number of full-time equivalent employees per month employed by the borrower during the Covered Period by either:

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| (a) The average number of full-time equivalent or employees per month employed by the borrower during the period beginning February 15, 2019 and ending on June 30, 2019 | (b) The average number of full-time equivalent employees per month employed by the borrower during the period beginning on January 1, 2020 and ending on February 29, 2020 |
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Similarly, the amount of loan forgiveness will be reduced by the amount of any reduction in total salary or wages of any employee during the Covered Period that is in excess of 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the Covered Period. Importantly, an employee is defined as any person who did not receive wages or salary during any single pay period during 2019 that would, if extrapolated to a full year, exceed \$100,000. This provision allows an employer to reduce the salaries of highly paid employees without triggering this reduction.

The CARES Act contains an exemption for re-hires. Under this exemption, the amount of loan forgiveness will not be reduced for layoffs or pay cuts (as discussed above) that occur between February 15, 2020 and April 26, 2020, if the borrower has eliminated the reduction in the number of full-time equivalent employees laid off and/or the reduction in the pay of employees by June 30, 2020. The SBA and Secretary of Treasury may also prescribe regulations that will grant *de minimis* exemptions from loan forgiveness reductions prescribed by the CARES Act.

A borrower seeking loan forgiveness must submit to the lender specific documentation verifying the number of full-time equivalent employees on payroll and pay rates for the applicable periods of time. Within 60 days after the lender receives an application for loan forgiveness from a borrower, the lender must issue a decision on the application. Within 90 days after the date on which the amount of forgiveness is determined, the SBA will remit the amount of forgiveness, plus any interest accrued through the date of payment, to the lender. If the lender has received the required documentation, the SBA will refrain from levying penalties or initiating enforcement actions against the lender.

The SBA will be issuing guidance and regulations regarding loan forgiveness within 30 days of the CARES Act's enactment.

In addition to the loans described above, a business will be eligible for an emergency injury disaster loan under section 7(b)(2) of the Small Business Act. If this loan is made in response to COVID-19 during the period beginning on January 31, 2020 and ending on December 31, 2020, the SBA will waive the following: (1) any rules related to the personal guarantee on advances and loans of \$200,000.00 or less; (2) the requirement that the borrower needs to be in business for the 1-year period before the disaster (unless the business was not in operation on January 31, 2020); and (3) the requirement that the borrower be unable to obtain credit elsewhere.

Additionally, if a loan made under section 7(b)(2) is made in response to COVID-19 during the period beginning on January 31, 2020 and ending on December 31, 2020, the SBA may approve a borrower based solely on its credit score (and not require the borrower to submit a tax return or a tax return transcript for approval), or use alternative appropriate methods to determine the borrower's ability to repay.

Between January 31, 2020 and December 31, 2020, any entity eligible for a 7(b)(2) loan will also be eligible for an emergency grant. Eligible borrowers may, in response to COVID-19, request an advance of up to \$10,000 from the SBA. The funds will then be provided within three days after the SBA's receipt of the application. Borrower will simply need to file a self-certification in which the borrower attests, under penalty of perjury, that it is eligible for the advance. Funds advanced by the SBA can be used for any of the following reasons: (1) to provide paid sick leave to employees unable to work due to the direct effect of COVID-19; (2) maintaining payroll to retain employees during business disruptions or substantial shutdowns; (3) meeting increased costs to obtain materials unavailable from the borrower's original source to due to interrupted supply chains; (4) making rent or mortgage payments; and (5) repaying obligations that cannot be met due to revenue losses. A borrower will not be required to repay any amounts of an advance even if it is subsequently denied a section 7(b)(2) loan. If a borrower who receives an advance transfers into or is approved for a section 7(a) loan, the advance amount will be reduced from any allowed loan forgiveness under the 7(a) loan program.

Relief for Workers Affected By Coronavirus Act

The Relief for Workers Affected by Coronavirus Act, another component of the CARES Act, provides an estimated \$250 billion in federal funding to expand unemployment insurance benefits for workers affected by the COVID-19 pandemic. The Act expands these benefits in three major ways: including individuals not previously eligible for assistance; increasing the amount of money that an individual can receive; and extending the length of time the benefit can be received.

First, the CARES Act significantly expands the number of individuals who are eligible for unemployment benefits through the creation of the Pandemic Unemployment Assistance Program. This program allows individuals who are not eligible for regular unemployment compensation under state law, or those who have already exhausted regular unemployment compensation, to receive benefits. The individual must self-certify that he or she is unemployed, partially employed, or unable to work as a direct result of specified COVID-19 related reasons. Such qualifying reasons are as follows:

1. The individual is diagnosed with COVID-19 or experiencing symptoms and seeking a COVID-19 diagnosis;
2. A member of the individual's household has been diagnosed with COVID-19;
3. The individual is providing care for a family member or member of household diagnosed with COVID-19;
4. The individual is the primary caregiver of a child or other person in the household that is unable to attend school or another facility due to a COVID-19 closure;
5. The individual is unable to reach the place of employment because of a COVID-19 imposed quarantine;
6. The individual is unable to reach the place of employment because of self-quarantine advised by a health care provider due to COVID-19 concerns;
7. The individual was scheduled to commence employment and does not have a job or is unable to reach the job due to COVID-19;
8. The individual has become major support for the household because the head of household died as a result of COVID-19;
9. The individual has to quit his or her job as a direct result of COVID-19; or
10. The individual's place of employment is closed due to the COVID-19 public health emergency.

Unlike regular unemployment compensation, the CARES Act also extends such benefits to individuals who are self-employed, seeking part-time employment, or do not have the sufficient work history needed to qualify for regular unemployment compensation, assuming such individuals are unemployed, partially unemployed, or unable to work due to one of the above COVID-19 related reasons. However, individuals that are able to telework with pay or are receiving paid sick leave or other paid benefits are not covered under the Pandemic Unemployment Assistance Program, regardless of whether the individual meets any of the other qualifying requirements.

Second, the CARES Act provides increased unemployment compensation payments. Individuals covered under the Pandemic Unemployment Assistance Program and individuals eligible for regular unemployment compensation are entitled to receive the amount payable under the unemployment compensation law of their state of employment and an additional Federal Pandemic Unemployment Compensation payment of \$600 per week. The additional weekly payment is available until July 31, 2020, and it shall not be considered income for purposes of the Medicaid and CHIP programs.

States may elect to send both amounts in one payment or in separate payments, but such payments must be sent on a weekly basis. In addition, the CARES Act provides for immediate payments upon qualifying unemployment, thereby eliminating the one-week waiting period often imposed under state unemployment compensation laws.

Third, the CARES Act extends the benefits period by 13 weeks beyond the benefit period under the otherwise applicable state law for individuals until December 31, 2020, up to a total of 39 weeks. The 39 week period may also be increased by the number of weeks, if any, that the benefits are extended after enactment of the CARES Act.

Finally, the CARES Act provides federal funding to support state-enacted “short-time compensation” programs in which employers reduce employee’s hours instead of laying off the employees, and the employees with reduced hours receive a pro-rated unemployment benefit. In addition, similar enhanced unemployment compensation benefits under the Railroad Unemployment Insurance Act are also addressed by the CARES Act.

Recovery Rebates and Use of Retirement Funds

The CARES Act also authorizes the direct payment of funds to individuals, labeled as “recovery rebates,” and also allows for penalty free withdrawal from qualifying retirement accounts.

Recovery Rebates

One of the biggest items of interest within the CARES Act to which numerous individuals and news organizations are directing their attention is the individual stimulus payment of the Act. While the stimulus payment is called a recovery rebate, it is essentially a refund or credit against previous tax filings (it may be referred to in this document as a credit, refund or rebate, depending on context). The CARES Act tasks the IRS with effectuating these payments by looking to 2019 tax returns, or, if the taxpayer has not filed 2019 returns yet, the IRS will look to 2018 instead.

Payments to qualifying individuals will be \$1,200, or \$2,400 if married filing jointly, plus \$500 per qualifying child. Earlier versions of the CARES Act bill built in certain requirements for minimum or qualifying income, which did not survive to make its way into the final Act. The only restriction that is income-related is that there is a phase-out of the credit in the amount of 5% of the excess amount the taxpayer’s Adjusted Gross Income (“AGI”) is above:

- \$150,000 in the case of a joint return;
- \$112,500 in the case of filing as head of household; and
- \$75,000 in the case of a taxpayer not filing a joint return or head of household.

For example, if a family of four has an AGI of \$170,000 in 2019 and filed jointly, the base credit would be \$3,400 ($\$2,400 + \$500 + \500) and the phase-out would be \$1,000 ($\$170,000 - \$150,000 = \$20,000 * 5\% = \$1,000$); thus, the family would receive \$2,400 ($\$3,400$ base - $\$1,000$ phase-out). Our theoretical family would not have their entire credit phased out until they reached an AGI of \$218,000.

Payments are to be made “as rapidly as possible” according to the Act; before December 31, 2020. Unfortunately, there is no guidance beyond this in the Act as to how quickly taxpayers can expect their payments. The payments will be made to any account to which the taxpayer authorized electronic payment on or after January 1, 2018. Therefore, if the taxpayer authorized the IRS to electronically transfer your refund from last year to his or her bank account, the rebate will be electronically transferred to the same bank account.

Exception to 10% Penalty from Retirement Fund Distribution

An item that did not garner much attention, but will still likely effect many, is the exception to the 10% penalty for distributions from retirement funds. Generally, when the owner of a retirement plan takes a distribution from a qualified retirement plan before the age of 59 ½, income tax and a 10% penalty is due on the distribution. This CARES Act exception allows a distribution up to \$100,000 in the year 2020, penalty free. It is important to note, however, that income tax on this distribution will still be owed in 2020. Theoretically, though this income tax assessment could be mitigated because if a person is dipping into their retirement to pay bills due to a layoff or furlough, they may be in a lower tax bracket from the lost income. Even though the taxpayer has to pay income tax on the qualifying distribution, said income may be spread over a threeyear period. Additionally, the taxpayer can avoid income recognition by repaying the distribution to the retirement plan within three years of receiving it.

There are a few qualifications in order for a taxpayer to take this exception. First, the distribution must be from a qualified retirement plan, as defined in the Internal Revenue Code. In general, 401(k)s, 403(b)s, and IRAs will qualify. Additionally, the distribution must be a “coronavirus-related distribution.” This seems to be a very broad definition and allows self-certification. Additionally, the administrator of an eligible retirement plan may rely on the employee’s certification that the employee satisfies the test of “coronavirus-related distribution.” The “coronavirus-related distribution” is allowed to an individual:

- who is diagnosed with SARS-CoV-2 or COVID-19 by a test approved by the CDC;
- whose spouse or dependent is diagnosed with one of those two diseases; or
- who experiences adverse financial consequences as a result of being quarantined, furloughed or laid off or having work hours reduced, due to such virus or disease, being unable to work due to lack of child care due to such virus or disease, closing or reducing hours of a business owned or operated by the individual due to such virus or disease, or other factors as determined by the Secretary of the Treasury.

Employer Payroll Tax Credits and Delay of Payroll Tax Payments

Payroll Tax Credits

The CARES Act also provides relief in the form of a payroll tax credit to businesses and nonprofits who retain employees through the COVID-19 emergency. These tax credits allow employers to offset up to 50% of employee wages against their social security payroll tax liability.

In order to take advantage of the tax credits during a particular calendar quarter, an employer must either (a) have had to fully or partially suspend its operations by order of an appropriate government authority due to the onset of COVID-19 or (b) incur a loss of gross revenue of at least 50% in a calendar quarter compared to the same calendar quarter in the prior year.

The tax credits are applied differently based on the employer's size. Employers having an average of more than 100 employees during the 2019 calendar year may receive a credit of 50% of qualified wages paid to employees during a period where they are not actually providing services to the employer. Employers having an average of 100 or less employees during the 2019 calendar year may receive a credit of 50% of qualified wages paid to all of its employees during the covered period. For these smaller employers, there is no requirement that the employees must be not providing services to the employer in order to claim the credit.

Employers may continue to claim the tax credit through any calendar quarter during which it was required to fully or partially suspend its operations or until the next calendar quarter in which its gross receipts are greater than 80% of the gross receipts for the same calendar quarter in the prior year.

The Act includes the employer's share of the employee's health insurance premium as "qualified wages" but limits qualified wages to \$10,000 per employee per calendar quarter. Therefore the tax credit will never be more than \$5,000 per employee during a given quarter. The Act also prohibits employers from claiming a payroll tax credit if the employer has claimed a credit for the same wages under the provisions of the Families First Coronavirus Response Act. An employer can utilize both credits with respect to a given employee, but it cannot double dip on the same specific wages.

It is also important to note that employers who obtain an SBA Small Business Interruption Loan under the CARES Act are ineligible for the payroll tax credit described here. So employers will need to choose which program is more advantageous to them.

Delay of Payroll Tax Payments

Employers may also delay payment of the employer share of social security payroll taxes due between the date that the CARES Act was enacted and the end of calendar year 2020. Employers electing to do so must make payment of 50% of the delayed payroll taxes on or before December 31, 2021 and must pay the remainder by December 31, 2022. As with the payroll tax credits, this option is unavailable to employers that obtain an SBA Small Business Interruption Loan.

Coronavirus Economic Stabilization Act of 2020

The Coronavirus Economic Stabilization Act is the piece of the CARES Act legislation devoted to larger businesses and systemic risk to the economy. It appropriates a total of \$500 billion for lending, loan guarantees and investments from the US Treasury Department and the Federal Reserve.

Under the Act, Treasury Department is authorized to lend \$25 billion directly to passenger air carriers, certified repair businesses, and ticket agents; \$4 billion to cargo air carriers; and \$17 billion to businesses deemed important to maintaining national security. The remaining \$454 billion is allocated to support the Federal Reserve in making loans under its emergency lending powers to businesses, states, and municipalities.

In order to obtain financing from either Treasury or the Federal Reserve, a business must be able to show that alternative financing is not reasonably available. The Act requires that the loan term must be as short as possible, and in no case longer than five years. Until September 30, 2020, recipients must maintain employment at a level as close to its employment levels as of March 24, 2020. In any case, the recipient must retain at least 90% of its employees through September 30, 2020. Recipients will not be permitted to engage in stock buybacks until twelve (12) months after the loan or guarantee is satisfied, and they may not issue dividends or make any distributions on equity until twelve (12) months after the loan or guarantee is satisfied.

The Act also directs the Treasury Secretary to implement a program under the Federal Reserve's emergency lending powers that is specifically intended to support businesses employing between 500 and 10,000 workers. This "mid-size business lending program" will be administered by providing funds to banks to provide financing to mid-size businesses. Recipients under this program will be required to retain at least 90% of their workforce, with full compensation and benefits, through September 30, 2020. The loans shall carry interest rates no higher than 2% annually and will not require any interest or principal payments for a period of six months. To obtain these loans, recipients must certify that the uncertainty of economic conditions make the loan request necessary to support ongoing operations. The recipient also must agree (1) not to pay dividends or make any distributions on equity while the financing is outstanding; (2) not to outsource or offshore any jobs until two years after the loan is fully paid; (3) not to abrogate any collective bargaining agreement to which it is subject until two years after the loan is paid off; and (4) to remain neutral in any union organizing effort for the term of the loan.

There are additional restrictions on all loans under these programs. Employees or officers whose total compensation is more than \$425,000 per year may not receive a pay increase until a year after the loan or guarantee is satisfied. Any severance pay package for such an employee is also capped at double the employee's annual compensation. Officers or employees whose compensation exceeds \$3 million per year would see their salaries cut by half of the amount of their salaries that exceed \$3 million.

These programs will also be subject to additional oversight. The Act establishes an Inspector General to oversee the funds and provide quarterly reports to Congress. In addition, Congress will name a five member committee with additional oversight authority. This committee will report to Congress every thirty days on the administration of the funds.

Consumer Protection Provisions

The CARES Act also provides several key new consumer protections. Entities that furnish credit reports will be required to report obligations as "current" if those obligations are under a forbearance agreement to which the debtor is not in default. Previously, these credit facilities would be deemed past due. This mandate is in effect for any forbearance agreements entered into starting on January 31, 2020 and it shall remain in effect until 120 days after the Secretary of Health and Human Services terminates the order declaring a state of public health emergency.

Additionally, the Act places a moratorium on any foreclosure proceedings on any federally backed residential real estate mortgage. The Act defines “federally backed” as any loan insured by FHA, HUD, VA or the US Department of Agriculture; any loan made directly by the US Department of Agriculture; or any loan purchased by Fannie Mae or Freddie Mac. The moratorium is in place for a period of sixty days beginning on March 18, 2020.

Finally, the Act places a moratorium on residential eviction proceedings at any property that is secured by a federally backed loan. The definition of a federally backed loan is the same here as it is for purposes of the mortgage foreclosure moratorium. For a period of 120 days from the date of enactment, landlords can take no eviction action against tenants occupying these properties.

We’re Here to Help Guide You Through this Storm

The sudden onset of the COVID-19 crisis has shaken our nation and our region to its core. The turbulence and uncertainty that it has introduced to public health and our economy is near unprecedented. We’re closely tracking COVID-19 related events and legislation and are ready to assist you and your business in navigating the vast constellation of assistance that is now available. We believe that it is vitally important to help our businesses, our families, and our communities rise above the circumstances in which we find ourselves. We are available to assist over the telephone or video teleconference. You may contact us at 814.235.2222 or via email at contact@mqlaw.com.



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