

# Disaster/Emergency Legislation – Summary of Provisions Related to Loan Relief; Small Business and Bankruptcy

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## Overview

The disaster/emergency legislation enacted in late March is wide-ranging and far-sweeping in its attempt to provide economic relief to the damage caused by various federal and state “shut-downs” brought on by a widespread viral infection that originated in China in late 2019 and has spread to the United States. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) provides relief to small businesses and their employees, including farmers and ranchers, as well as to certain students. Some states have also acted to temporarily stop mortgage foreclosures.

I am grateful to Joe Peiffer of Ag and Business Legal Strategies located in Hiawatha, Iowa, for his input on some of the topics discussed below.

Recent disaster/emergency legislation related to loan relief, small business and bankruptcy – it’s the topic of today’s post.

## Deferral of Student Loan Payments

The CARES Act provides temporary relief for federal student loan borrowers by requiring the Secretary of Education to *defer* student loan payments, principal, and interest for six months, through September 30, 2020, without penalty to the borrower for all federally owned loans. This provides relief for over 95 percent of student loan borrowers.

## Bankruptcy Changes

The CARES Act makes the following changes to the bankruptcy Code:

- A one-year increase in the debt limit to \$7.5 million (from \$2.73 million) for small businesses that file Chapter 11 bankruptcy. For one year after date of enactment, following the bill’s enactment, the measure temporarily excludes federal payments related to COVID-19 from income calculations under Chapter 11 bankruptcy proceedings. It would also allow debtors experiencing hardship because of COVID-19 to modify existing bankruptcy reorganization plans. *CARES Act, §1113.*
- Individuals and families currently undergoing Chapter 13 bankruptcy may seek payment plan modifications if they are experiencing a material financial hardship due to the virus, including extending payments for up to seven years after the due date of the initial plan payment. This provision expires one year after date of enactment.
- “Income” for Chapter 7 and Chapter 13 debtors does not include virus-related payments from the federal government. This provision expires one year after date of enactment.
- For Chapter 13 debtors, “disposable income” for purposes of plan confirmation does not include virus-related payments. This is also a one-year provision.



## “Small Employer” Relief

The CARES Act provides qualified small businesses various options.

- **Immediate SBA Emergency Economic Injury Disaster Grants.** These \$10,000 grants (advances) are to be used for authorized costs such as providing paid sick leave; maintaining payroll to retain employees; meeting increased material costs; making rent or mortgage payments; and repaying obligations which cannot be met on account of revenue losses. The grants are processed directly through the Small Business Association (SBA), but the SBA may utilize lenders (that are an SBA authorized lender) for the processing and making of the grants. A grant applicant may request an expedited disbursement. If such a request is made, the funds are to be disbursed within three days of the request. The CARES Act also removes standard program requirements including that the borrower not be able to secure credit elsewhere or that the borrower has been in business for at least a year, as long as the business was in operation as of January 31, 2020. *CARES Act, §1110.*
- **Traditional SBA Economic Injury Disaster Loans (EIDL).** The CARES Act expands this existing program such that the SBA can provide up to \$2 million in loans to meet financial obligations and operating expenses that couldn't be met due to the virus such as fixed debts, payroll, accounts payable and other bills attributable to actual economic injury. The loans are available to businesses and organizations with less than 500 employees. The interest rate is presently 3.75 percent and cannot exceed 4 percent for small businesses that can receive credit elsewhere. Businesses with credit available elsewhere are ineligible. The interest rate for non-profits is 2.75%. The length of the loan can be for up to 30 years with loan terms determined on a case-by-case basis, based on the borrower's repayment ability. Applications will be accepted through December of this year.
- **Forgivable SBA 7(a) Loan Program Paycheck Protection Loans.** The Paycheck Protection Loan Program (PPP) is an extension of the existing SBA 7(a) loan program with many of the existing restrictions on 7(a) loans waived for a set timeframe including guarantee and collateral requirements and the requirements that the borrower cannot find credit elsewhere. In addition, a small business loan borrower is eligible for loan forgiveness on existing SBA 7(a) loans. The 7(a) loan program is the SBA's primary program for providing financial assistance to small businesses. For borrowers with an existing 7(a) loan, the SBA will pay principal, interest, and any associated loan fees for a six-month period starting on the loan's next payment due date. Payment on deferred loans start with the first payment after the deferment period. However, this relief does not apply to loans made under the PPP.

For purposes of the PPP, a “qualified small business” is defined as a business in existence as of February 15, 2020 paying employees or independent contractors that does not have more than 500 employees or the maximum number of employees specified in the current SBA size standards, whichever is greater; or if the business has more than one location *and* has more than 500



employees, does not have more than 500 employees at any one location and the business' primary NAICS code starts with "72" (Accommodation and Food Service – e.g., hotels, motels, restaurants, etc.); or is a franchisee holding a franchise listed on the SBA's registry of approved franchise agreements; or has received financing from a Small Business Investment Corporation. "Farming" is limited to 500 employees.

Sole proprietorships and self-employed individuals (i.e., independent contractors) may qualify under this program if the sole proprietor/self-employed person has a principal residence in the United States, and the individual filed or will file a Schedule C for 2019.

**Note:** While the SBA guidance on the issue only refers to Schedule C businesses, it seems that "Schedule F" should be able to be substituted. See SBA 2020-\_\_\_\_ (Apr. 14, 2020).

Additionally, certain I.R.C. §501(c)(3) organizations; qualified veterans' organizations; employee stock ownership plans; and certain Tribal businesses are also eligible. Ineligible businesses are those that have engaged in any illegal activity at the federal or state level; household employers; any business with a 20 percent or more owner that has a criminal history; any business with a presently delinquent SBA loan; banks; real estate landlords and developers; life insurance companies; and businesses located in foreign countries.

The terms and conditions, like the guaranty percentage and loan amount, may vary by the type of loan. The lender must be SBA-approved. The loan proceeds can be used for payroll; continuing group health care benefits; a mortgage or rent obligation; payment of utilities; and any other debt obligation incurred before the "covered period," plus compensation paid to an independent contractor of up to \$100,000 per year. Not included in the computation of payroll costs are Federal FICA and Medicare taxes and Federal income tax withholding; any compensation paid to an employee whose principal place of residence is outside the United States (e.g., H2A workers); qualified sick leave and family leave wages that receive a credit under the Families First Coronavirus Response Act. Agricultural commodity wages count as "payroll costs" as do group health plan costs and employer-paid retirement costs.

**Note:** For H2A workers, it is unclear whether they qualify as "employees" if they satisfy the "principal place of residence test, or if they are year-round workers (e.g., dairy workers). If qualified, it would appear that associated utility costs would also count as eligible expenses.

Under the PPP, the bank can lend up to 250 percent of the lesser of the borrower's average monthly payroll costs (before the virus outbreak) or \$10,000,000 (with some exclusions including compensation over \$100,000). For example, if the prior year's payroll was \$300,000, the maximum loan would be \$62,500 (total payroll of \$300,000 divided by 12 months = 25,000 x 2.5 = \$62,500). The SBA guarantee is 100 percent.

Self-employed taxpayers became eligible for loans on April 10, 2020. For a self-employed taxpayer, the loan amount is based on the taxpayer's net self-employment earnings, limited to \$100,000 of net self-employment income. The maximum loan to a self-employed taxpayer is set at 20.8333 percent of self-employment earnings (plus other payroll costs). For a Schedule C taxpayer, that amount can be determined from line 31 (net profit). If that amount is over \$100,000, the loan is limited to \$100,000. If line 31 is a loss, the loan amount would normally be zero, but one-half of employee payroll costs can be added in. For a 2019 Schedule F, the applicable line is line 34. A copy of the taxpayer's 2019 Schedule C (or Schedule F) must be provided to SBA.

**Note:** It is presently unknown whether income of a farmer reported on Form 4797 (as the result of an equipment trade, for example, qualifies. The farmer's Schedule F income might be a loss, but significant income on Form 4797 might be present (which is not subject to self-employment



tax). The question is whether such a farmer will be able to reconcile the Schedule F to include all equipment gains. Gains attributable to farmland and buildings will likely be excluded. It is also unknown whether rental income that is not reported Schedule F qualifies (such as that reported on either Schedule E or on Form 4835).

For partnerships, the law is unclear whether income is based on guaranteed payments to partners or partnership gross receipts. Filing is at the partnership level. This precludes each partner from getting a loan. Likewise, if a taxpayer has an interest in more than one partnership that are treated as self-employed entities, a question remains as to whether each entity can qualify for a loan. For instance, if a farmer is a partner in three partnerships and earns at least \$100,000 of net self-employment earnings in each partnership, can each partnership use the farmer's full \$100,000 compensation limit or must it be allocated among each partnership?

For an LLC that is taxed as a partnership, only the amount a partner receives as a guaranteed payment is taxed as self-employment income. For taxpayer's with interests in multiple single-member LLCs, a holding company can file for the entities under its ownership or each entity can file for a loan. What is not known is whether if only one entity is profitable whether a loan can be filed only for the profitable entity. Similarly, it is not known whether a taxpayer's compensation from each entity is allowed in full (if it doesn't exceed \$100,000/entity) even though total earnings exceeds \$100,000, or whether the taxpayer's compensation is limited to \$100,000.

The interest rate is set at one percent and cannot exceed 4 percent. Payments, including principal, interest and fees can be deferred anywhere from six to 12 months, and the SBA will reimburse lenders for loan original origination fees. A borrower can then apply for loan forgiveness to the extent the loan proceeds were used to cover payroll costs (at least 75 percent), mortgage interest, rent and utility payments during the eight-week period following loan disbursement.

The borrower must have been in business as of February 15, 2020 and employed employees and paid salaries and taxes or had independent contractors and filed Form 1099-MISC for them. Guarantee fees are waived, and the loans are non-recourse to the borrower, shareholders, members and partners of the borrower. There is no collateral that is required, and the borrower need not show an inability to secure financing elsewhere before qualifying for financing from the SBA.

The SBA will pay lenders for processing loans under the Payroll Protection Program in an amount of 5 percent of the loan up to \$350,000; 3 percent of the loan from \$350,000 to \$2 million; and 1 percent of loans of \$2 million or more. Lender fees are payable within five days of disbursement of the loan.

A borrower under the PPP can apply for loan forgiveness on amounts the borrower incurs after February 14, 2020, in the eight-week period after the loan origination date on the following items (not to exceed the original principal amount of the loan): payroll costs (not to exceed \$100,000 of annualized compensation per employee); payments of accrued interest on any mortgage loan incurred prior to February 15, 2020; payment of rent on any lease in force prior to February 15, 2020; fuel for business vehicles and, payment on any utility for which service began before February 15, 2020. The amount forgiven is *not* considered taxable income to the borrower. Documentation of all payment received under the PPP is necessary to receive forgiveness. Any amount that remains outstanding after the amount forgiven is to be repaid over a term not to exceed 10 years.

**Note:** For a sole proprietorship or self-employed individual, it is unclear whether the loan forgiveness amount is based on eight weeks of self-employment income in 2019 plus amounts spent on qualified amounts, or whether the amount forgiven is limited to eight weeks of self-employment income.

The amount forgiven will be reduced proportionally by any reduction in the number of employees retained as compared to the prior year. The proportional reduction in loan forgiveness also applies to reductions in the pay of any employee. The reduction in loan forgiveness applies when the reduction of employees or an employee's prior year's compensation exceeds 25 percent. It is increased for wages paid to employees that are paid tips. A borrower will not be penalized by a reduction in the amount forgiven for termination of an employee made between February 15, 2020 and April 26, 2020, as long as the employee is rehired by June 30, 2020.

**Note:** For both the loan calculation and the amount of forgiveness a taxpayer cannot include any owner's health insurance or retirement payments. Reference is to simply be made to Schedule C or Schedule F net income.

**Note:** As for loan forgiveness for the self-employed owner compensation, apparently Schedule C (of Schedule F) compensation shown on the 2019 return is used. This amount is then divided by 52 (weeks in the year) and multiplied by eight. The resulting amount is (apparently) forgiven.

A taxpayer that receives a PPP loan is ineligible for the Employee Retention Tax Credit. (discussed next), and is barred from applying for unemployment. *CARES Act, §1102.*

- **Employee Retention Credit.** If a government order requires an employer to partially or fully suspend operations due to the virus (there is no statutory definition of "partially" or "fully"), or if business gross receipts have declined by more than 50 percent as compared to the same quarter in the immediately prior year, the employer can receive a payroll tax credit equal to 50 percent of employee compensation ("qualified wages") up to \$10,000 (per employee) paid or incurred from March 13, 2020 and January 1, 2021. For employers with greater than 100 full-time employees, qualified wages are wages paid to employees when they are not providing services ("services" is undefined) due to the coronavirus-related circumstances described above. For eligible employers with 100 or fewer full-time employees, all employee wages qualify for the credit, whether the employer is open for business or subject to a shut-down order. Qualified wages must not "exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately preceding such period." As noted, the credit applies to the first \$10,000 of compensation, including health benefits, paid to an eligible employee. The credit is provided for wages paid or incurred from March 13, 2020 through December 31, 2020.

The credit is allowed in each calendar quarter against Medicare tax or the I.R.C. §3221(a) tax imposed on employers at the rate of 50 percent of wages paid to employees during the timeframe of the virus limited to the applicable employment taxes as reduced by any credits allowed under I.R.C. §§3111(e) and (f) as well as the tax credit against amounts for qualified sick leave wages and qualified family leave wages an employer pays for a calendar quarter to eligible employees under the FFCRA. Thus, "applicable employment taxes" are reduced by the I.R.C. §§3111(e)-(f) credits and those available under the FFCRA. Then, the resulting amount is reduced by the Employee Retention Credit. If a negative amount results, the negative amount is treated as an overpayment that will be refunded pursuant to I.R.C. §6402(a) and I.R.C. §6413(b). *CARES Act, §2301.*

- **Express Loan Program.** The SBA's Express Loan Program loan limit is increased to \$1 million (from \$350,000) until December 31, 2020. This program features an accelerated turnaround time for SBA review, with a response to applications within 36 hours. *CARES Act, §1102(c)*.
- **Forgiveness of Certain SBA-Guaranteed Loans.** Certain qualified small businesses are eligible for loan forgiveness of certain SBA loans. A "covered loan" is a loan added under new §7(a)(36) of the Small Business Act (15 U.S.C. §636(a)). The amount forgiven is equal to the sum of costs incurred and payment made during the eight-week period beginning on the covered loan's origination date. Forgiven amounts are excluded from gross income up to the principal amount of the loan. To be forgiven, loan proceeds must be used to cover rent paid under a lease agreement in force before February 15, 2020; a mortgage that was entered into in the ordinary course of business that is the borrower's liability, and is a mortgage on real or personal property incurred before February 15, 2020; or utilities (electricity, gas, water transportation, telephone or internet access) for which service began before February 15, 2020. The borrower must verify that the amount for which forgiveness is requested was used for the permissible purposes. The amount of loan forgiveness is subject to a reduction formula tied to employee layoffs. The numerator of the formula is the average number of full-time employees per month. The denominator is, at the borrower's election, the average number of full-time employees per month employed from Feb. 15, 2019 to Jun. 30, 2019 or the average number of full-time employees per month employed from Jan. 1, 2020 to Feb. 29, 2020. Employers with seasonal employees use a different formula to calculate payroll costs. A seasonal employer uses the average total monthly payments for payroll for the twelve-week period beginning Feb. 15, 2019; or, by election, Mar. 1, 2019 through Jun. 1, 2019.

There is also a reduction formula for employee salaries and wages, with the amount forgiven reduced by the amount of any reduction in salary or wages of any employee during the covered period. That is the excess of 25 percent of total salary and wages for the most recent quarter for that employee. For purposes of this formula, employees earning over \$100,000 are excluded. If an employer rehires the employees or raises salaries and wages back to their prior level by Jun. 30, 2020, the rehire is not considered for purposes of the formula. *CARES Act, §1106*.

**Note:** Expenses attributable to loan forgiveness (rent, mortgage, utilities, etc.) are not deductible.

- **Tax Credit to Fund Paid Sick Leave.** An employer with an employee that is paid sick-leave on account of the virus receives a FICA tax credit (employer share only) equal to the lesser of wages plus health care costs or \$511 per day for up to 10 days. An employer providing sick leave to an employee with a sick family member, the credit is \$200 per day, up to a maximum of \$10,000.

**Planning strategies.** For businesses with immediate cashflow needs, a \$10,000 EIDL grant can be applied for. Simultaneously, application can be made for PPL program loan. But, as noted, the basis for the separate loans and the costs being paid with each loan are different. An application can then be made seeking loan forgiveness. If this approach is inadequate, a traditional EIDL loan

can be applied for. Also, if the business has sufficient cashflow, one of the FICA/Medicare tax credit options can be considered. Also, for employers with employees impacted by the virus or are caring for affected family members, the sick leave credit or the employee retention credit can be utilized if business operations were suspended or if gross receipts declined substantially.

### Conclusion

The CARES Act contains many provisions that small employers can utilize to bridge the economic divide created by the government reaction to the virus. As the new programs are implemented rules will be developed that should address presently unanswered questions. The SBA has up to 30 days following the enactment of the CARES Act to issue regulations implementing and providing guidance on certain CARES Act provisions. In addition, the Treasury Department is required to issue regulations implementing and providing guidance under many CARES Act provisions. Issuance of regulations and guidance could delay loan approval and disbursement or modify/waive certain loan requirements.

The disaster/emergency legislation also made numerous tax changes. Those will be addressed in a future post.

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