

Does My Business Qualify for Federal Funding under the CARES Act?

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What small business owners need to know

The Coronavirus Aid, Relief, and Economic Security Act (“CARES Act” or “Stimulus Act”), signed into law on March 27, 2020, includes a program administered through the Small Business Administration (SBA) that will assist small businesses, non-profits, and other concerns that have reduced staff, missed payroll, or are simply struggling to make payroll in response to COVID-19 (known as the Paycheck Protection Program).

Generally, the Stimulus Act will provide up to \$10 million in federal assistance to eligible businesses to pay for a wide range of business expenses incurred through June 30, 2020, without the usual collateral or personal guarantee requirements. For businesses that retain their employees and hold salaries steady during this time, the federal assistance may be forgiven in its entirety. Apply for this loan program through your local bank or credit union—most will be authorized to facilitate these loans.

Below are the questions that small business owners should consider when determining whether their business qualifies for federal assistance under the Stimulus Act, and a hypothetical applying the legislation as drafted. A more detailed list of the requirements of the Paycheck Protection Program as set forth in the Stimulus Act may be found [here](#).

Note: Federal agencies, such as the U.S. Treasury and the SBA, and local lenders are continuing to promulgate rules, regulations, and guidelines further refining and providing guidance on the Stimulus Act. Given the fluid and dynamic regulatory landscape at the time of publication, businesses should consult their counsel and local lenders for any additional rules or regulations that may impact their business decisions related to the Paycheck Protection Program. We hope that this article will help you craft an overall loan strategy.

1. Is my business eligible for federal assistance through the SBA loan program

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(administered by your local bank or credit union)?

For your business to be eligible for federal assistance through the SBA loan program, your business must be the right size and have been in operation at the right time.

Is my business the right size?

Otherwise eligible businesses that employ less than 500 employees and, as of February 15, 2020, was in existence and had employees will qualify.

Nonetheless, if a business has more than 500 employees, it may still qualify for federal assistance under the Stimulus Act as a “small business concern.” Specifically, the SBA determines whether a business is a “small business concern” using either its total number of employees or its annual receipts. These standards can vary by industry, so it is important to check the specific rule that applies to your business, but “[m]ost manufacturing companies with 500 employees or fewer, and most non-manufacturing businesses with average annual receipts under \$7.5 million, will qualify as a small business.”¹

Regardless, a business that employs less than 500 employees and was in operation with at least one employee as of February 15, 2020 is eligible to receive federal assistance under the Stimulus Act. Importantly, the business’s legal form can be a limited liability company, a sole proprietorship, partnership, corporation, non-profit, or tribal entity.

Alaska Native Corporations (ANCs) that are eligible under the SBA’s Section 8(a) business development program are eligible to receive federal assistance under the Stimulus Act. ANCs that are not Section 8(a) eligible – such as non-profits – may still be eligible if they employ no more than 500 employees or if they otherwise satisfy the requirements for a “small business concern.”

Notwithstanding the foregoing, a business concern (excluding non-profits) described under 13 CFR §120.110 remain ineligible. Such concerns include financial businesses primarily engaged in the business of lending, life insurance companies, businesses located in a foreign country (businesses in the U.S. owned by aliens may qualify), pyramid sale distribution plans, businesses engaged in any illegal activity among others.

Was my business in operation at the right time?

The business must have been in operation on February 15, 2020, and had employees for whom the business paid wages or salaries and payroll taxes or paid independent contractors as of that date.

2. How much federal assistance can I ask for?

The amount of federal assistance that your business may be eligible for is based on a calculation tied to your business’s payroll costs, and cannot exceed \$10 million. Generally, the SBA will average your payroll costs over the 12 month period before the

loan application is made and multiply that monthly average by 2.5. However, you do not need to borrow the maximum amount.

The intent of the Stimulus Act is to provide a loan that will cover your payroll expenses for about 8 weeks, but it can be used for other qualifying expenses (as further discussed below). To qualify for a loan, you will need to certify that your business needs financial assistance for ongoing operations in light of COVID-19 disruptions and acknowledge that the loan proceeds you receive from the Stimulus Act will be used to retain workers, maintain payroll or pay other permitted expenses.

What if my business ramps up during the summer tourist season?

If you are a seasonal employer (as determined by the SBA), the SBA will average your payroll from, at the election of the business, February 15, 2019 or March 1, 2019 and, in either case, ending June 30, 2019, and multiply that monthly average by 2.5.

If your business ramps up during the summer tourist season, you may want to elect to have the SBA use your March 1 through June 30, 2019, payroll numbers because it will likely result in a higher average, and thus a higher potential loan amount for your business.

3. Will I have to provide a personal guarantee or collateral for the federal assistance I receive?

No. A business seeking federal assistance through the SBA under the Stimulus Act will not have to provide a personal guarantee or collateral for the loan. This usual requirement for receiving loans through the SBA has been waived by the Stimulus Act.

Similarly, the usual SBA requirement that businesses demonstrate that they cannot obtain credit elsewhere before seeking a loan from the SBA and the application fee for seeking SBA assistance have been waived.

4. How can I use the federal assistance I receive?

You can use the Stimulus Act loan to pay for the following business expenses incurred from February 15, 2020, through June 30, 2020:

1. Payroll costs
2. Rent (including rent under a lease agreement)
3. Utilities
4. Payments of interest on any mortgage obligation (but this cannot be used toward the payment of any principal on a mortgage obligation)
5. Costs related to the continuation of group health care benefits, including insurance premiums and the costs of paid sick leave, medical leave, or family leave, and insurance premiums
6. Employee compensation (wages, salaries, commissions, or similar)
7. Interest on any other debt obligations incurred prior to February 15, 2020

If you cannot use the entirety of the loan for eligible expenses incurred on or before June 30, 2020 or if you do not use the loan for forgivable expenses (as further explained below), the remainder becomes a loan with a maximum maturity date of 10 years (unless shortened by additional rules or regulations promulgated by federal agencies) with an interest rate not to exceed 4%.² The Stimulus Act requires that payments on the principal, interest, and fees on the loan be made on a monthly basis but are deferred for at least 6 months, and up to 1 year, at the discretion of the lenders.

5. Will I have to pay back the federal assistance I receive?

It depends. The intent of the Stimulus Act is to forgive a portion or all of the loan where businesses have retained their employees and maintained wage levels. However, the loan forgiveness analysis and calculation is complicated.

My business has retained its employees and maintained wages – how much of my loan can be forgiven?

For businesses that have retained their employees and maintained wages, the loan – up to the principal amount – may be forgiven in the amount equal to certain business expenses incurred and paid in the eight weeks following the disbursement of the loan (the “Forgiveness Expenses Period”). Those qualifying business expenses are:

1. Payroll costs (including salaries, wages, commissions, or similar compensation)
2. Rent (obligated under a rental/leasing agreement in force before February 15, 2020)
3. Utilities for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which the service began before February 15, 2020
4. Interest on any mortgage obligation (obligated under a debt instrument for a mortgage on real or personal property incurred before February 15, 2020), but not the payment of any principal on a mortgage obligation

It is important to note that, although you are permitted to use the loan toward a variety of business expenses, only some of those expenses qualify for loan forgiveness. Therefore, there is a difference between eligible expenses and eligible forgivable expenses.

Another important distinction to note is that eligible forgivable expenses must be incurred and paid in the eight weeks following the disbursement of the loan. The loan can also be used toward eligible expenses that are incurred from February 15 through June 30 (rather than just the eight weeks following the disbursement of the loan); however, these expenses would not qualify for loan forgiveness.

My business has had to reduce the number of its employees – can my loan still be forgiven?

Yes. If your business laid off employees on or after February 15, 2020, the amount of your loan forgiveness may be reduced.

The SBA calculates whether you have reduced the number of your employees by

comparing:

1. **numerator:** the average number of full-time employees per month in your employment during the Forgiveness Expenses Period to
2. **denominator:** either (at your option): (a) the average number of full-time employees per month in your employment from January 1, 2020, to February 29, 2020, or (b) the average number of full-time employees per month in your employment from February 15, 2019, to June 30, 2019.

These numbers will form a fraction, which will then be multiplied by the amount of eligible expenses you have paid during the Forgiveness Expenses Period. In order to obtain the greatest loan forgiveness possible, you will want this fraction to be as close to 1 as possible.

For example, if you employ 90 full-time employees during the Forgiveness Expenses Period, but employed 100 full-time employees during the same period last year, your calculation should look like this:

90 full-time employees per month during Forgiveness	X	qualifying costs = 90% costs forgiven
100 full-time employees per month Feb. 15-June 30, 2019		

If, however, you employed fewer employees in the beginning of 2020 than you did from February to June last year, you would likely want to elect to use the number of employees you had at the beginning of 2020:

90 full-time employees per month during Forgiveness	X	qualifying costs = 94.7% costs forgiven
95 full-time employees per month Jan. 1-Feb. 29, 2020		

My business has had to reduce employee salaries – can my loan still be forgiven?

Yes. If your business has been unable to maintain the salaries of its employees from February 15, 2020, to June 30, 2020, the amount of your loan forgiveness may be reduced.

The amount of the loan forgiveness will be reduced by the amount of any reduction in

total salary or wages of any qualifying employee (under \$100,000 in annualized wages for any pay period in 2019) of more than 25% of the total salary or wages the employee received during the most recent full quarter during which the employee was employed before February 15, 2020 (presumably Q4 in 2019).

Can I rehire employees or raise salaries to have a greater percentage of my loan forgiven?

Yes. If, prior to June 30, 2020, you rehire your employees or raise salaries that were previously reduced, you can increase the amount of loan forgiveness.

The SBA will use the number of full-time employees or salaries of the employees your business employed on February 15, 2020, as a baseline. If you reduce or have reduced the number of full-time employees or salaries of employees between February 15, 2020, and April 26, 2020, you can rehire those employees or raise those salaries to their previous levels by June 30, 2020, without having that brief reduction impact your loan forgiveness calculation. For example, if you had 90 full-time employees on February 15, 2020, and had to let go 60 employees on March 12, 2020, you could rehire some or all of those 60 employees on or before June 30, 2020, without having the brief reduction in payroll negatively impact your loan forgiveness calculation (in other words, the rehired employees are considered to have worked during the Forgiveness Expenses Period so they are included in the “average monthly” employee count). As previously noted, however, only eligible forgivable expenses incurred and paid during the Forgiveness Expenses Period, may be utilized in the loan forgiveness calculation.

HYPOTHETICAL

ABC LLC had a monthly average of 300 employees for the look-back period chosen by the borrower and a monthly average payroll of \$1 million for the 12 month period prior to the loan application. On March 15, 2020, ABC LLC laid off 250 employees due to COVID-19.

ABC LLC could be eligible for a loan of up to \$2.5 million (2.5 x \$1 million monthly payroll average). ABC LLC applies for the full \$2.5 million loan, which is funded on May 1, 2020.

Scenario A: Full Forgiveness

ABC LLC applies all \$2.5 million toward eligible forgivable expenses incurred and paid from May 1 through June 30, 2020. These eligible forgivable expenses include \$2 million in payroll and \$500,000 in rent and utilities.

Because ABC LLC laid off its employees between February 15 and April 26, 2020, it is eligible for loan forgiveness calculated as though it had not laid off its employees if it rehires the employees before June 30, 2020.

Therefore, if ABC LLC hires back all of the employees before June 30, 2020, its entire

loan would be forgiven. This forgiveness calculation would be as follows:

300 (monthly avg. full-time employees during Forgiveness Expenses Period)	X	qualifying costs = 100% forgiven
300 (monthly avg. full-time employees Feb. 15-June 30, 2019)		

Because this fraction equals 1, the full loan amount would be forgiven based on the requirements set forth in the Stimulus Act.

Scenario B: Partial Forgiveness

During the Forgiveness Expenses Period commencing May 1, ABC LLC spends \$1 million of its \$2.5 million Stimulus Act loan toward eligible forgivable expenses (e.g., payroll costs, rent, and utilities) and \$500,000 toward other eligible (but not forgivable) expenses (e.g., utility expenses other than for electricity, gas, water, transportation, telephone or internet). Although ABC LLC received \$2.5 million under the Stimulus Act, it only had \$1.5 million in eligible expenses, leaving a remainder of \$1 million from the disbursement.

ABC LLC rehires only 85 of its laid-off employees effective on May 1, 2020 (perhaps because the remaining 165 laid-off employees would prefer to stay on the increased unemployment benefits). With these rehired employees, ABC LLC's monthly employee average is 135 (50 retain employees plus 85 rehired employees) because ABC LLC is eligible for loan forgiveness calculated as though it had not laid off those employees. The forgiveness calculation would be:

135 (monthly avg. full-time employees during Forgiveness Expenses Period)	X	qualifying costs = 45% forgiven
300 (monthly avg. full-time employees Feb. 15-June 30, 2019)		

Under these facts and the requirements set forth in the Stimulus Act, the \$1 million spent on forgivable expenses would be forgiven at 45% equaling \$450,000. The remaining

\$550,000 would not be forgiven. Additionally, the \$500,000 spent toward eligible but not forgivable expenses would not be forgiven.

Therefore, the \$1,050,000 in non-forgivable expenses (\$550,000 plus \$500,000) plus the remaining \$1,000,000 of the Stimulus Act disbursement, would become a loan for \$2,050,000. The loan would have a maximum maturity date of 10 years (unless shorted by federal agencies' additional rules or regulations) with an interest rate no higher than 4% interest rate and monthly payments becoming due only after the mandatory minimum 6 month deferral period (which could be extended up to a year at the discretion of the lender).

CONCLUSION

The small business relief provisions of the CARES Act provide small businesses with powerful tools to help them stay in business and maintain employee continuity. The loan and loan forgiveness programs of the Act, which are currently being refined by additional rules and regulations promulgated by federal agencies, are intended to keep local economies going by providing small businesses with access to low interest funding and potentially broad loan forgiveness provided the money is used for payroll expenses (for current or rehired employees) and other eligible forgivable expenses.

¹ Basic Requirements, U.S. Small Business Administration, <https://www.sba.gov/federal-contracting/contracting-guide/basic-requirements>.

² For example, the U.S. Treasury disseminated an [information sheet](#) for Paycheck Protection Program borrowers which indicates that the maturity of the loan will be 2 years at a fixed interest rate of 1.00%. However, at the time of publication of this article, it is unclear whether this guidance from the U.S. Treasury is final or will be further revised.