April 3, 2020

UPDATE ON COVID-19 ECONOMIC RELIEF & INCENTIVES FOR SMALL BUSINESS OWNERS

Introduction and Note About Sources

First and foremost: I know every business owner is anxious about this. Take a few deep breaths. Yes, everyone wants to get their hands on these loans and incentives, but this is an instance where slowing down a step and being deliberate will be less expensive in the long run.

No lenders have figured this out. Not a single one. Anyone who tells you otherwise is blowing smoke. Anyone that claims to have "taken your application" just means that it is sitting in a stack. No applications are being "processed" yet. You're not "missing out" on anything yet.

Okay, now that you've taken a couple of deep breaths—read on.

President Trump signed the CARES Act into law on the afternoon of Friday, March 27th. That same afternoon, Bill, a long-time friend and mentor of mine, had arranged a virtual Zoom meeting with his long-time friend and colleague who is the president of one of the largest private SBA lenders (as in *all that they do is SBA loans*). Our guest was late to the meeting because he was literally "in the room where it happened" (*Hamilton* reference) watching President Trump sign the bill into law. Many of my lending-industry comments are coming one-step removed from the president of this private SBA lender.

Over the past week, I've spent hours on numerous meetings with other business and tax lawyers from around the country parsing through the new laws and how they apply. Meanwhile, new information and regulations have been coming daily, sometimes multiple times per day, to further clarify these rules.

I'm also a member of an organization that has over 400 law firms across the nation as members. This organization is now in twice-daily direct communication with the same president of the major SBA-lending association and is providing us regular updates from an "insider's perspective" as to what is really going on at the SBA.

Frankly, this has all become a mess. The CARES Act was thrown together so quickly and with an order for the SBA to start taking applications starting April 3, 2020, that it left little time for the SBA to issue the further guidance and clarification needed. Further, this program is on a scale far larger than anything the SBA has handled historically. The SBA is used to responding to isolated economic disasters arising from natural disasters like hurricanes, earthquakes, fires, and similar. But this pandemic has impacted the entire country all at once. (Note: For sole proprietors and independent contractors, the application start date is supposed to be April 10, 2020.)

The latest word, as of 2am on April 3, 2020, is that lenders are not ready to start accepting applications. It's unclear when they will be ready but it may still be a few days, possibly weeks as further negotiations and refinements to the rules and process are needed. (And if you want to understand the problems that have arisen on the lending side of things, and why this is currently stalled out, I've included that at the end.)

In the meantime, here are some updates about the different programs:

SBA Emergency EIDL Grants & Traditional EIDL Loans

The Emergency EIDL is the $10,000 immediate grant that we wrote about previously. Sources were previously reporting that applicants were supposed to receive their funds within 3 days of applying. This has since been updated: *Applicants will receive their funds within 3 days of <u>approval</u> but the processing of the application may still take 2-3 weeks.* [Source: SBA representative.]

Another important distinct that has been missed by many: EIDL stands for *Economic Injury Disaster Loan*. Many business owners rushed to apply for this grant viewing it as "free money." However, to be approved for the program, you must be able to certify that you have been economically injured due to the pandemic or have reasonable expectation of such. There are some businesses that are still thriving—if you're one of them, then the EIDL program may not be right for you unless we can show some form of economic injury.

Forgivable SBA 7a Paycheck Protection Program (PPP)

This is the program that many business owners are eager to jump on and the applications were supposed to start being processed on April 3, 2020, though that's now looking unlikely. On the evening of April 2, 2020, the SBA released an Interim Final Rule that clarifies various parts of the program as originally set forth in the CARES Act.

However, as reported directly from our SBA private lender at 2am on April 3, 2020, the Interim Final Rule: *"While this document is a good step in the right direction, it is still insufficient to most in the lending community. We truly hope that SBA will provide the necessary guidance we need very shortly, so we can begin processing loan applications, perhaps in a matter of hours* *thereafter."* (Again, if you want to understand the issues from the lenders perspective, see the end of this memo).

Between digging through the CARES Act and the Interim Final Rule here are a few clarifications worth noting:

- Unlike the EIDLs, the PPP loans do not require economic injury or expectation thereof.
- Small business owners will <u>*not*</u> be able to include 1099 independent contractors in their payroll cost calculations [because the independent contractors can apply on their own and this would potentially result in 'double dipping'.]
- Sole proprietors and independent contractors must apply for their own loans. The application start date is set for April 10, 2020 barring any delays.
- If you're a household employer that employs a nanny, housekeeper, or similar, you do not qualify for this program.
- If you received an EIDL loan between January 31, 2020 and April , 2020 this will be added to your maximum loan amount under the PPP, less any 'advance' that will be forgiven (i.e., the $10,000 mentioned above grant). Note that this is for purposes of qualifying the maximum loan amount. It does not necessarily mean that the EIDL portion of the loan will be eligible for the PPP loan forgiveness program. I think the reasoning for this is that EIDLs are direct with the SBA and I think they want to get these loans pushed out the private lenders and the secondary markets rather than the SBA having to hold and administer them, so they're using this as a way to 'refinance' the EIDLs into the PPP loans which are being handled by private lenders.
- If you have had to pay qualified sick leave or family leave under the Families First Coronavirus Act, then these payments do *not* count towards your 'payroll cost' for purposes of calculating your PPP loan amount—that's because these amounts are already offset by a corresponding payroll tax credit so you would be effectively 'double dipping' if you got to include these payments in your PPP calculations.
- The interest rate on the PPP loans has been changed to 1% (from .5%). Now, of course, the spirit of this program is to help small businesses keep people employed and if the funds are used for approved purposes then up to 100% of the loan will be forgiven. However, if any portion of the loan does not qualify for forgiveness, the PPP loans come with incredibly attractive terms for those needing working capital. The original CARES Act indicated that the PPP loans could be for up to a maximum term of 10 years, but the SBA Final Interim Rule has set the maximum loan term at 2 years. Borrowers under PPP will not have to pay any payments for 6 months following the date funds are disbursed to the borrower.

Qualifying for Loan Forgiveness under PPP

This is where it's going to be important to keep your eye on the ball. Right now, everyone is focused on how to ***get*** the PPP loans, but once funds are received, business owners are going to have to be extremely careful with their expenditures and tracking in order to qualify for the loan forgiveness. Note that the PPP and EIDL have different rules for how the funds can be used (which may become especially confusing if the EIDL gets 'refinanced' into the PPP).

We expect that further updates and guidance on this will also be forthcoming, so for the sake of brevity, we'll focus more on the loan forgiveness aspect in future updates.

Employee Retention Credit

If you opt for the PPP loan, then the Employee Retention Credit may not apply. The Employee Retention Credit allows for up to a $10,000 credit per employee against payroll taxes that is refundable. In other words, once you submit the appropriate forms, the government will send you a refund. For most small business owners, the PPP will make more sense. However, for some employers the Employee Retention Credit may be the better option. For example, someone that had a really low headcount and payroll cost in 2019 and now has a higher headcount may find the Employer Retention Credit to be the better option.

Double-Dipping Unlikely

All of these loan programs and tax incentives were enacted quickly, leaving some potential overlap between them. The consensus seems to be that further regulations will come out from the SBA, IRS, etc. that will effectively bar 'double-dipping' between the different loan forgiveness programs and tax incentives.

Insight Into What's Going On "Behind the Scenes"

To understand why this is rapidly evolving into a circus, it helps to understand how the banking and lending industry works.

Contrary to what many may believe, the Federal Reserve is NOT a government agency. It was created in 1913 as the central banking system for the U.S. The Treasury Department manages Federal finances by collecting taxes, paying bills, and managing our currency, government accounts and public debt.

When you go to a bank and borrow money, most banks make money by borrowing the money at a lower interest rate from the Federal Reserve (for example, 3%) and then loaning it to you at a higher interest rate (for example, 5%). First, they make some money off of the loan origination fees. Then the banks package these loans up into groups and sell them on the secondary market at an intermediate interest rate (let's say 4%). So not only does the bank make money on the origination fees, but the bank also pockets the 1% difference between the Federal Reserves interest rate (3%) and the interest rate they sell it at on the secondary market (4%). The purchaser on the secondary market also makes money on the difference between what they paid the original bank (4%) and what you, the borrower, pay (5%).

So here's what happened: the CARES Act, which included the PPP was passed without any actual instructions to the SBA for how to administer it. Initially, the SBA announced that the interest rate on the PPP loans would be 0.5%.

The major banks that purchase these loan packages on the secondary market then told the Federal Reserve, Treasury Department, and the SBA that they would not be interested in buying these loan packages on the secondary market if the interest rate is only 0.5%.

Second, the original laws and regulations, placed the burdens on the lenders to verify applicants information, including verifying the application information, eligibility for the loan, and that the applicant wasn't engaging in money laundering or similar illegal activities. This left most banks afraid that they were walking into a future liability trap for being accused of aiding in potential abuse of the PPP from fraudulent claims, money laundering, and similar. So in addition to balking at the interest rates, the banks are also asking the SBA to limit their liability for processing these loans before they will start processing applications.

Third, is the actual mechanics for processing the applications and issuing the promissory notes. As things currently stand, the loan applications will be submitted by the lenders through the SBA's E-Tran system. This system is not ready to handle the volume of applications anticipated and many are expecting that it will crash shortly after opening. To put this in perspective:

In 2019, the SBA loaned $28 billion on 63,000 loans. Under the PPP, the SBA is now expected to lend $350 billion on *millions* of loans.

And as if that weren't enough, they're also still trying to figure out what the promissory notes will actually say. There's a second software program that most lenders use called LaserPro that issues the actual promissory notes. The current promissory notes in the LaserPro system are standardized and the lenders may not have the ability to edit them, but verbiage needs to be added to these promissory notes to address the "forgiveness" portion of the PPP program.

We're Here to Help with Applications and Applying for Loan Forgiveness

We actively in the process of getting set up to help submit loans through the same private SBA lender that I mentioned at the start of this memo. This lender was been on the inside through the entire process of while the CARES Act was being written, when it was signed into law, and the subsequent negotiations that have been taking place between the SBA and the banking industry. All this lender does is handle SBA loans. And while many banks are still scrambling to figure this out, this company has been gearing up for this for *weeks* and already has agents ready to start processing applications once they get the green light.

Even if you've already submitted paperwork with another bank, you can still submit through the private SBA lender and wait and see which one gets processed faster.

If you'd like our office to assist with the loan processing, there is no direct fee to you. The SBA lender is permitted to pay an agent's fee for assistance with processing the application (similar to closing costs). These fees are being paid by the government and you get 100% of your loan amount.

Now, if you're wondering how an *estate planning* firm has gotten involved in all of this: (1) We have a lot of clients that are small business owners, sole proprietors, and independent contractors that need this assistance and (2) our firm has been handling applications for various government benefits for years and we also regularly work with the tax code. *In short: this is right in our wheelhouse and we're ready and able to assist.*

Further, as mentioned, the real issue is going to be qualifying for the PPP loan forgiveness and other economic incentives. We're gearing up to help local business owners make sure they qualify for the maximum loans and tax incentives that they're entitled to AND we're making sure that they have all their "ducks in a row" for getting maximum loan forgiveness.

To be blunt, the banks have no vested interest in making sure that you get your loan forgiven. As we don't yet know the full details of what will be involve din the loan forgiveness process, we don't know how the fees will work just yet other than to say this: we're doing this because we want to help our local community and business owners. We do need to cover our costs, but we're not looking for this to be a 'profit center' for the firm. Depending on the need, we may even be in a position to do some hiring to help process these loans and give work to people that have been furloughed or laid off for their jobs.

For those that are interested in our assistance, please add your name to our list and we will follow up with you as soon as we have more details about the next steps. And in the meantime, see the attached checklist for the documents we recommend that you begin gathering to support your applications.

SBA Loan Documentation List

Lenders are still waiting final guidance from the SBA regarding what documentation to gather, but here's what we would recommend having available:

Loan Application & Business Organization Documents

- ☐ Completed PPP Application Form
- ☐ Business Organization Documents (e.g., Articles of Incorporation or Articles of Organization)
- ☐ Business By-Laws or Operating Agreement
- ☐ Certificate of Beneficial Ownership Form
- ☐ A list of Affiliated Businesses (all entities owned by any 20% or more owner of the business)

Business Income Documentation

- ☐ 2019 Business Tax Returns or Year-End Financial Statements as of 12/31/2019 if you haven't filed taxes yet
- ☐ Trailing 12-month profit and loss statement
- ☐ Trailing 12-month general ledger

For Sole Proprietors & Independent Contractors

- ☐ Form 1040, Schedule C
- ☐ Trailing 12-month profit and loss statement including all gross income and expenses and net income per month

Payroll Information

- ☐ Documentation to support payroll costs:
    - List of employees with salary, wage, commission, or similar compensation
    - Payment of cash tips or equivalent
    - Payments for vacation, parental, family, medical, or sick leave
    - Payment for dismissal or separation (e.g., severance payments)
    - Payments for health care benefits including invoices
    - Payments for retirement benefits (e.g., contribution reports for 401k, SIMPLE IRA, SEP IRA, or similar)
    - Payment of state or local taxes assessed on employee compensation (e.g., unemployment taxes)
- ☐ Federal and State Payroll Tax Filings

    - IRS Form 941 Filings for 2020 and 2019
    - IRS Form 940 for 2019
    - North Carolina Department of Revenue NC-3 Filings
- ☐ Forms W-2 for all employees for 2019

Other

- ☐ Drivers License or State Photo ID for all applicants/signers
- ☐ Any secondary form of government identification