Understanding the Paycheck Protection Program

Relief for Small Businesses Included in the Phase III COVID-19 Relief Bill

What is the Paycheck Protection Program?

Title 1 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act is the *Keeping American Workers Paid and Employed Act*, which provides relief for small businesses and their employees who are adversely affected by the outbreak of COVID-19. The cornerstone provision is the "**Paycheck Protection Program**," an emergency lending facility, administered by the Small Business Administration (SBA) under its 7(a) lending program, to provide small business loans on favorable terms to borrowers impacted by the current state of economic uncertainty.

At$349 billion in new lending capacity, it accounts for the vast majority of the small business assistance provided in the Phase III legislation and is one of the most important — if somewhat overlooked — aspects of the Congressional response to the pandemic thus far.

Congress intended the Paycheck Protection Program to accomplish two fundamental goals: 1) help small businesses cover their near-term operating expenses during the worst of the crisis, and 2) provide a strong incentive for employers to retain their employees. In short, <u>it is intended as a partial revenue replacement program to allow deeply affected businesses to hibernate through a period of severe disruption without making drastic changes to their footprint</u>.

How does it work?

The program generally targets businesses, nonprofits, Tribal businesses, and veteran's organizations with 500 employees or less as eligible for federally insured, partially forgivable loans that can be used to cover short-term operating expenses during the economic crisis. The maximum loan size is equivalent to 250 percent of the employer's average monthly payroll costs (e.g., roughly 10 weeks of payroll expenses) or $10 million, whichever is less. Payroll costs are defined broadly to include wages, salaries, retirement contributions, healthcare benefits, covered leave, and other expenses.

The program includes several generous features for borrowers, including six months to one year of deferred repayment, fee waivers, and streamlined application requirements. <u>Most importantly, borrowers are eligible for loan forgiveness equivalent to the sum spent on covered expenses during the eight-week period after the loan is originated.</u> Those covered expenses include the bulk of a typical business's fixed operating costs: payroll, rent, utilities, and mortgage interest obligations. The forgivable nature of these loans in effect turns them into grants, meaning that qualifying businesses will not see a significant increase in their debt burdens. But to qualify for forgiveness, employers must maintain their pre-crisis level of full-time equivalent employees or face a reduction in forgiveness proportional to the reduction in headcount. Since many businesses have already been forced to make staffing reductions in response to vanishing customers and lost revenues, the legislation includes a clause allowing them to qualify for loan forgiveness if they have re-hired back to pre-crisis levels by June 30, 2020.

Congress made the terms generous and the barriers to entry low to ensure resources would be made available as quickly as possible to needy businesses. Borrowers do not need to demonstrate actual economic harm to qualify. Instead, they simply need to make a series of good faith certifications, principally that current economic conditions necessitate the loan to support ongoing business operations, and that the funds will be used to maintain payroll and address other covered expenses. <u>W hile this streamlined approach will certainly make it easier for vulnerable businesses to receive support on an expedited basis, it may also lead some otherwise healthy businesses to take advantage of the program at the expense of those whose survival depends upon it.</u>

Why is this needed?

The U.S. small business sector is facing an unprecedented crisis as a result of the pandemic. Already, a wave of businesses have closed their doors, helping fuel a record number of new unemployment claims. Many others have seen their revenues dry up, making it impossible to keep up with basic operating costs for much longer. These businesses need immediate access to capital that can replace their lost revenue and help them weather the crisis until normal operations can resume. The more small businesses that survive the crisis, the stronger the recovery we can expect once it is over.

Will it be enough?

Probably not. Economists Michael Strain of the American Enterprise Institute and Glenn Hubbard of Columbia Business School estimates the cost of replacing lost revenue for affected firms for three months to be $1.2 trillion. The initial $349 billion in new lending will no doubt help many businesses survive a short-term crisis, but mass closures have already begun, and many more will follow if Congress is slow to extend additional lending capacity. <u>Indeed, the amount currently allocated may not even be enough to meet demand during a short-term crisis;</u> it will almost certainly not be adequate for helping small businesses survive the plausible scenario of a protracted crisis followed by a slow return to normal.

What happens next?

The Paycheck Protection Program is a critically-needed lifeline for American small businesses. However, Congress may need to consider an extension of the program so that new lending is made available before the current resources are exhausted.

CHANGES IN THE CARES ACT AND RETIREMENT PLANS

The Coronavirus, Aid, Relief and Economic Security (CARES) Act has bassed. The Act contains several provisions affecting retirement plans.

EMPLOYEE 401(k) CONTRIBUTIONS - Any employee may stop 401(k) elections at any time. Please be sure that they complete a deferral election form or go online to the recordkeeper website instructing you to stop withholding 401(k). Have your employees use the form of change (paper or website) that you typically utilize;

SAFE HARBOR CONTRIBUTIONS - These contributions are mandatory, however, you may delay funding these contributions until later in the plan year or even into next year before filing your 2020 tax return. You may also stop these contributions with a 30-day notice to your employees and an amendment that reinstates discrimination testing. Contact your Plan Analyst if you are wanting to stop these contributions at this time;

PROFIT SHARING CONTRIBUTIONS - Profit Sharing contributions are always discretionary and not mandatory so you may make the decision to fund later; and

EMPLOYEE RELIEF - If any of your employees need a hardship distribution or a loan from their retirement account, please have them contact Cat Houchins in our office, loansdistnotify@rpsi.us.com or (919) 792-3186. There are still certain criteria and rules, but we will work with the participants to see what options are available for them. We have summarized below the current rules as well as the changes contained in legislation that has just been passed.

CURRENT RULES

Availability of Hardships: As March 26, a hardship under FEMA for the Coronavirus would be available to residents of North Carolina (and other states listed at https://www.fema.gov/coronavirus) as it has been declared a federal disaster area. Until passage of the CARES Act, however, hardships for this reason would be under the normal rules and might be subject to the 10% early withdrawal penalty tax.

LOANS: Many employers have already begun to furlough employees rather than terminate them. Under IRS regulations, employees with plan loans who are placed on unpaid leave of absence may forego making loan payments during the leave of absence without triggering taxation of the loan as long as the following requirements are met:

1. The furlough period must not exceed one year.

2. The loan must be repaid by the end of the original term of the loan.

HARDSHIP DISTRIBUTIONS: The CARES Act waives the 10% early withdrawal penalty tax under Internal Revenue Code on early withdrawals up to $100,000 from a retirement plan or IRA for an individual:

- who is diagnosed with COVID-19;

- whose spouse or dependent is diagnosed with COVID-19;

• who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, having work hours reduced, being unable to work due to lack of child care due to COVID-19, closing or reducing hours of a business owned or operated by the individual due to COVID-19; or

• other factors as determined by the Treasury Secretary.

The legislation also permits those individuals to pay tax on the income from the distribution ratably over a three-year period and allows individuals to repay that amount into the plan over the next three years (presumably filing for a tax deduction on the taxes they will have paid as a result of the premature distribution). Those repayments would not be subject to the retirement plan contribution limits.

PLAN LOANS: The CARES Act doubles the current retirement plan loan limits to the lesser of $100,000 or 100% of the participant's vested account balance in the plan. Individuals with an outstanding loan from their plan with a repayment due from the date of enactment of the CARES Act through Dec. 31, 2020, can delay their loan repayment(s) for up to one year. The maximum loan repayment period continues to be five years.

PLAN AMENDMENTS: The legislation further permits retirement plans to adopt these rules immediately, even if the plan does not currently allow for hardship distributions or loans, provided the plan is amended on or before the last day of the first plan year beginning on or after Jan. 1, 2022, or later if prescribed by the Treasury Secretary.

TEMPORARY WAIVER OF REQUIRED MINIMUM DISTRIBUTION RULES: The CARES Act waives RMDs for calendar year 2020 for 401(k), 403(b), 457(b) and IRA plans, allowing individuals to keep funds in their retirement plans. Under current law, individuals generally at age 72 must take an RMD from their plans and IRAs. The legislation also includes special rules regarding the waiver period to, in essence, hold harmless those individuals (and plans) who took advantage of the RMD waiver for 2020.

Expansion of DOL Authority to Postpone Certain Deadlines: The CARES Act provides the Department of Labor with expanded authority to postpone certain deadlines under ERISA. We will keep you informed as these occur.

Below we've outlined the key elements of the program as well as an industry breakdown of firms with fewer than 500 employees.

Paycheck Protection Program Overview	
Covered Loan Period	Retroactive to February 15, 2020, through June 30, 2020
Eligible Businesses	Small businesses, nonprofits, Tribal business concerns, and veteran's organizations that: • Have less than 500 employees or the applicable size standard for the industry as provided by SBA • Are sole proprietors, self-employed individuals, or independent contractors • Were in business on Feb. 15, 2020
Maximum Loan Amount	The lesser of: • 2.5X average monthly payroll costs during the 1-year period* before the date on which the loan is made • $10 million • *For new businesses, the measurement period would be Jan. 1 to Feb. 29, 2020 • The legislation also temporarily increases the maximum amount for an SBA Express loan from $350,000 to $1 million through December 31, 2020
Guarantees	• Increases the government guarantee of 7(a) loans to 100 percent through December 31, 2020
Allowable Uses	• Payroll costs • Health care benefits (including paid sick or medical leave, and insurance premiums) • Mortgage interest obligations • Rent obligations • Utility payments • Interest on other debt obligations incurred previous to Feb. 15, 2020
Eligible Lenders	• SBA and the Department of the Treasury are granted authority to determine additional lenders to administer the Payment Protection Program loans
Maturity Schedule	• Maximum 2-year maturity after application for loan forgiveness
Interest Rate	• Not to exceed 1 percent during the covered period
Payment Deferral	• Not less than 6 months and not more than 1 year (including payment of principal, interest, and fees)
Terms of Loan Forgiveness (Sec. 1106)	• Loan recipients will be eligible for loan forgiveness for an 8-week period after the loan's origination date in the amount equal to the sum of the following costs incurred during that period: • Payroll costs (compensation above $100,000 excluded) • Payment of interest on the mortgage obligation • Rent obligations • Utility payments • The amount forgiven cannot exceed the amount borrowed. • Loan forgiveness will be proportionally reduced if the average number of employees is reduced during the covered period as compared to the same period in 2019. The amount of loan forgiveness will be reduced by the amount of any reduction in total employee salary or wages during the covered period that is over 25 percent of the total salary or wages. • Payroll documentation and documentation of expenses are required to receive forgiveness, to ensure the forgiveness was used to retain employees and pay expenses. • Borrowers that rehire laid-off workers by June 30 won't be penalized for having a smaller workforce at the beginning of the period. • Borrowers with tipped workers may receive loan forgiveness for the additional wages paid to those employees. • Lenders have 60 days to issue a decision on the application. • The canceled loan amount will not count towards gross income for tax purposes
Waivers	• Borrower and lender fees are waived • Prepayment fees are waived
Borrower Requirements	• Good faith certification that the loan is necessary because of economic uncertainty caused by COVID-19 and will be applied to maintain payroll and make required payments. • Borrower must also certify that they are not receiving this assistance and duplicative funds for the same uses from another SBA program. • No collateral or personal guarantee is required.
Nonbinding Guidance	Lenders should prioritize small businesses, entities in underserved and rural markets, veterans and members of the military community, small business concerns owned by socially and economically disadvantaged individuals, women, and businesses in operation for less than 2 years.
Lender Reimbursements	Lenders will be reimbursed at the following rates based on the balance of the financing outstanding at the time of loan disbursement: • 5 percent for loans up to $350,000 • 3 percent for loans between $350,000 and $2,000,000 • 1 percent for loans above $2,000,000
Appropriated Amounts for Program	• $349 billion

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US Small Business Share of Firms and Employment by Industry

NAICS Code	NAICS Description	Total Number of Firms	Total Number Small Firms*	Small Firms* as % of Total	Total Employment	Total Employment at Small Firms*	Small Firm* Employment as % of Total
	Total	5,996,900	5,976,761	99.7%	128,591,812	60,556,081	47.1%
11	Agriculture, Forestry, Fishing and Hunting	22,641	22,535	9.5%	164,046	136,591	83.3%
21	Mining, Quarrying, Oil and Gas Extraction	19,080	18,720	98.1%	578,098	244,367	42.3%
22	Utilities	5,957	5,752	96.6%	644,703	111,747	17.3%
23	Construction	701,477	700,393	99.8%	6,533,061	5,373,702	82.3%
31-33	Manufacturing	248,039	244,098	98.4%	11,721,785	503,972	43.0%
42	Wholesale Trade	298,127	294,909	98.9%	6,115,476	3,413,157	55.8%
44-45	Retail Trade	647,927	645,685	99.7%	15,705,808	5,526,296	35.2%
48-49	Transportation and Warehousing	185,028	182,688	98.7%	4,866,282	1,685,388	34.6%
51	Information	79,662	78,430	98.5%	3,507,966	984,379	28.1%
52	Finance and Insurance	238,408	236,657	99.3%	6,408,168	1,909,933	29.8%
53	Real Estate and Rental an Leasing	309,369	308,106	99.6%	2,148,006	1,524,546	67.6%
54	Professional, Scientific, and Technical Services	811,320	807,932	99.6%	8,905,549	5,190,980	58.3%
55	Management of Companies and Enterprises	26,959	19,134	71.0%	3,462,498	423,295	12.2%
56	Administrative, Support, Waste Management and Remediation	347,829	343,791	98.8%	11,897,056	3,754,463	31.6%
61	Educational Services	93,500	92,147	96.6%	3,688,541	1,645,262	44.6%
62	Health Care and Social Assistance	655,069	650,689	99.3%	20,241,438	8,984,159	44.4%
71	Arts, Entertainment and Recreation	130,107	129,287	99.4%	2,368,928	1,428,531	60.3%
72	Accommodation and Food Services	539,886	537,443	99.5%	14,088,211	8,542,661	60.6%
81	Other Services (Except Public Administration)	696,668	695,268	99.8%	5,534,978	4,697,878	84.9%

*Small Firm is <500 Employees
Source: Census Bureau's Statistics of U.S Businesses 2017