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KPMG report: Lending programs under CARES Act, including interactions with tax provisions (COVID-19)

The “Coronavirus Aid, Relief, and Economic Security Act” (CARES Act) (Pub. L. No. 116-136) signed into law on March 27, 2020—in addition to its numerous tax provisions—establishes two important lending programs:

- The Small Business Administration-administered “paycheck protection program” (PPP)
- The Treasury Department’s economic stabilization fund

Together, these two programs provide nearly \$900 billion to support lending to both small and large businesses. The following discussion outlines the requirements for the paycheck protection program, the economic stabilization fund, and the interaction of those programs with the tax provisions of the CARES Act.

Small business provisions

A provision for small businesses in the CARES Act is the appropriation of \$349 billion to expand the guaranteed lending program under Section 7(a) of the Small Business Act. The new PPP is the major part of this expansion.

Read a [Treasury information sheet](#) [PDF 223 KB] regarding the PPP.

Eligible borrowers

Eligible borrowers under the PPP include almost all small businesses—as well as individuals who are sole proprietors and independent contractors—and nonprofit organizations. The requirement to qualify as a “small business” is:

- 500 or fewer employees, or

- Meeting the definition of “small business” for purposes of its industry (as defined under existing Small Business Administration (SBA) standards)

There are exceptions to the general eligibility rules:

- For certain categories of businesses that have multiple locations but 500 or fewer employees in each location (e.g., restaurant or hospitality)
- For franchise businesses (by waiving SBA affiliation rules); for businesses already receiving funding from small business investment companies (SBICs); for businesses with over 500 employees that are assigned NAICS codes beginning with “72.”

Loans under the PPP can be for amounts up to 2.5 times a business’s average monthly payroll costs, but capped at \$10 million.

The definition of “payroll costs” includes more than just salary (it can include tips, benefits, insurance, and retirement benefits) but generally excludes compensation for highly paid employees (\$100,000+ per year) and non-U.S. employees.

Availability and terms of loans

- Loans are available under the PPP on a “streamlined basis” through June 30, 2020.
- Eligible borrowers only need to make good-faith attestations that the loan is required due to the current economic uncertainty and that the proceeds will be used to pay workers and cover overhead costs.
- Loan proceeds may be used for payroll, rent or mortgage payments, utilities, and interest payments on existing debt.
- Existing SBA lenders have been automatically delegated by the CARES Act to approve and make loans under the PPP. Additional lenders are expected to be authorized once the SBA publishes regulations (mandated by the CARES Act within 15 days of the date of enactment). Lenders may make loans to any eligible borrower that was in business as of February 15, 2020, and had employees for which they paid payroll taxes.
- The maximum interest rate on these PPP loans is 4%.
- No fees, collateral, or personal guarantees are required, and the loans are nonrecourse to the borrowers (except if there is a later finding of misuse or abuse).
- The loans will be guaranteed by the SBA.
- Lenders will be required to defer payments on PPP loans for up to a year based on guidance that the SBA is required to issue within 30 days.

Loan forgiveness

A key feature of the PPP is that loan proceeds used by borrowers to pay certain expenses during the eight-week period following origination of the loan (the covered period) are eligible to be forgiven.

- Forgiveness is available to the extent proceeds are used to pay payroll, rent or mortgages, and utilities during the covered period.

- In addition, the CARES Act provides that any amounts forgiven pursuant to this rule are not taxable (i.e., no cancellation of debt income for the borrower).
- The amount of loan forgiveness available to the borrower is reduced if the borrower does not retain its employees or cuts their salaries by more than 25% (not including salaries of highly paid employees).
- A reduction in workforce is measured by comparing the average number of full-time employee equivalents (FTEEs) during the period following the loan to a prior equivalent period in either 2019 or early “pre-COVID 2019 period” in 2020.
- Loan forgiveness is reduced by the same percentage the FTEEs are found to have been reduced. A borrower that rehires employees or reverses salary reductions by June 30, 2020, can generally avoid having its loan forgiveness amount reduced.

Other small business provisions and programs

The CARES Act authorizes the SBA to increase the limit on its “express loan program” to \$1 million (from the current \$350,000).

The CARES Act also expands the SBA’s “economic injury disaster loan program” by streamlining certain requirements and expanding the categories of businesses who are eligible to apply. For existing borrowers with SBA-backed loans that are not delinquent, the CARES Act requires the SBA to step in and make the borrowers’ payments for a six-month period, with the borrower having no obligation to repay such amounts.

Treasury Department Stabilization Programs

The CARES Act includes a \$500 billion authorization for the Treasury Department to make loans, guarantees, and provide other financial support to eligible businesses as well as state and local governments.

- Of the \$500 billion, \$46 billion is specifically allocated to support passenger airlines, cargo airlines, and certain businesses that are deemed critical to national security. The support to be provided under those industry-specific programs has its own terms—some but not all of which overlap with the terms of the general programs briefly described below. For example, the requirement that Treasury be given equity stakes in companies that borrow under these programs only applies to passenger airlines, cargo airlines, and certain businesses that are deemed critical to national security.
- The remaining \$454 billion is broadly intended to provide financial assistance through programs or facilities established by the Federal Reserve.

The Treasury Department is authorized to publish regulations to fill in the details on rules and requirements of the various programs that it will administer.

The following discussion outlines the general rules and requirements.

Eligible borrowers

There are a variety of programs under Treasury’s purview as part of the CARES Act, but in all cases, it appears that assistance will only be available to U.S. businesses organized under state or federal law that have significant U.S. operations and a majority of their employees in the U.S.

In addition, loans will not be made to insolvent entities or those intending to lend to insolvent entities.

Terms of financial assistance

It appears that the Secretary of the Treasury has discretion to set the terms and conditions of the assistance to be provided under these programs. In terms of loans:

- Interest rates are supposed to be based on generally prevailing rates prior to the COVID-19 crisis.
- Loans must be fully secured, and there can be no loan forgiveness of debt extended under the Treasury programs.

To the extent Treasury provides assistance to a program or Federal Reserve facility that makes direct loans to eligible businesses, borrowers must agree that during the term of the loan and for an additional 12 months thereafter, there will be:

- No dividends or other capital distributions paid on common stock
- No stock buybacks
- Caps on raises for highly compensated employees and officers' compensation

There is no requirement that businesses receiving indirect support from Treasury under any of these programs maintain employment levels.

Medium-sized business provisions

The CARES Act provides that the Secretary of the Treasury is to "endeavor to" have the Federal Reserve implement a program to help provide financing to eligible businesses with between 500 and 10,000 employees. The aspirational nature of this language makes predicting the timing and scope of this program difficult, but there are additional terms and conditions.

- Interest rates on loans under such a program would be capped at 2%.
- Borrowers would be required to certify in good faith the following:
 - Retention of 90% of workforce at full compensation and benefits through September 30, 2020
 - Restoration of workforce to 90% of February 1, 2020 workforce within four months of the end of the current COVID-19 emergency
 - No outsourcing or offshoring of jobs for two years after repayment of loan
 - No payment of dividends and no stock buy backs during term of loan
 - The borrower is U.S. domiciled

Lenders and logistics

In addition to the programs that will be administered through the Federal Reserve and its existing networks, the CARES Act authorizes the Treasury Department to designate financial institutions to act as its agents for purposes of fulfilling the mandates of the new law.

The Treasury Department is also required to publish regulations or guidance regarding this program under the new law within 10 days.

Interaction with the tax provisions of the CARES Act

In addition to the eligibility requirements of the lending provisions outlined above, there are important interactions with the tax provisions of the CARES Act that need to be considered.

The CARES Act creates a new "employee retention tax credit," which very generally provides a tax credit for wages paid by certain employers affected by the coronavirus crisis. This new credit is, however, not available to employers who also receive a loan under the PPP loan program. Thus, eligible taxpayers may claim the employee retention tax credit or an SBA loan, but not both.

Read [KPMG's report](#) [PDF 3.1 MB] on the tax provisions in the CARES Act.

A similar rule applies with regard to the payroll tax deferral provision of the CARES Act. That provision generally allows an employer to delay payment of the employer portion of payroll tax until 2021 and 2022.

This payroll tax deferral also has a limitation based on the SBA program, although it is not identical to the limitation for the employee retention tax credit. The CARES Act provides that taxpayers who receive a PPP loan and also apply for the loan forgiveness feature of that program, are ineligible for the payroll tax payment deferral.

In conclusion, the interaction of these payroll-related tax provisions with the loan program need to be considered by taxpayers in determining whether and how to claim benefits under the CARES Act.

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