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Understanding the “CARES Act” Loan Options: A Q&A for Business Owners

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act or commonly known as the “CARES Act.” The \$2.1 trillion aid package will apply to different areas of the U.S. economy to minimize the economic effect of the ongoing COVID-19 pandemic.

AlvaradoSmith transactional attorneys Tom Zeigler and Jerry Ruiz have prepared a Q&A to inform business owners of the available resources and new programs within the CARES Act that will help address the needs of small business owners and nonprofit institutions.

What types of loans are currently available through the Small Business Administration (“SBA”)?

- There are two distinct SBA loan programs – the “7(a) loan program” and the “7(b) loan program.”
- The 7(a) loan program is SBA’s primary program for providing financial assistance to small businesses. For a small business to be eligible, the business must, in addition to other requirements:
 - Be registered as a for-profit business;
 - Not exceed certain maximum employee or revenue thresholds on average for the past three years; and
 - Be physically based in the U.S.
- Section 7(b) of the Small Business Act includes the Economic Injury Disaster Loan (“EIDL”) loan program, which distributes loans in the amount of up to \$2 million to be given to certain small businesses and nonprofits facing economic injury as a result of the coronavirus (COVID-19).

What is new for small businesses under the CARES Act?

- The passage of the Coronavirus Aid, Relief, and Economic Security Act (“CARES”) Act created a new 7(a) loan program,

known as the Paycheck Protection Program Loan (“PPP”).

- The legislation also implements modifications to the existing EIDL program under Section 7(b).

What is the Paycheck Protection Program Loan?

- The PPP Loan is a **new program** under section 7(a) of the Small Business Act.
- Loans are up to \$10 million based on the following calculation:
 - 2.5x the average monthly “payroll” costs (defined below), measured over the 12 months preceding the loan origination date. Seasonal businesses may use the period February 15, 2019 – June 30, 2019, or March 1, 2019 – June 30, 2019, to calculate the average payroll.
 - If you took out an EIDL loan between February 15, 2020, and June 30, 2020, and you want to refinance that loan into a PPP loan, you would add the outstanding loan amount to the “payroll” sum.
 - Payroll includes salaries, commissions, tips, certain employee benefits (including health insurance and retirement benefits), state and local taxes and, certain types of compensation to sole proprietors or independent contractors. Payroll costs specifically exclude compensation of an individual employee over an annual salary of \$100,000, foreign employees, FICA and income tax withholdings.
- The business must have been in business as of March 1, 2020, with then active employees for whom they paid salaries and payroll taxes.
- PPP loans will have complete payment deferral (including principal, interest, and fees) for at least six months, with a maximum of 1 year.
- Applicants can receive loan forgiveness for their payroll costs and debt payments **IF** they maintain the same number of Full Time Employees (“FTEs”) during the covered period of February 15 – June 30, 2020 (the “Covered Period”); the loan forgiveness is scaled down proportionally with any decrease in FTEs during such covered period or if any salaries decrease

by more than 25%

Who Processes the Paycheck Protection Loan application and the EIDL loan application? How long will the loan application take to process?

- You can apply for the PPP Loan at any lending institution that is approved to participate in the program through the existing SBA 7(a) lending program and additional lenders approved by the Department of Treasury. This could be the bank you already use, or a nearby bank. You do not have to visit any government institution to apply for the program. You can call your bank to see if they participate in the program.
- Lenders can start processing applications for PPP loans as soon as April 3, 2020.
- EIDL loans are processed directly through the SBA and generally, take 2–3 weeks to process plus five days to fund.
- Due to demand, it is unknown how long it will take to process a loan application.

Does my business qualify for the PPP Loan?

- The loan is intended to cover the Covered Period.
- Congress has expanded eligibility for the 7(a) loan program. Eligible entities include businesses with less than 500 employees, nonprofits, veteran organizations, and self-employed workers.
- In addition, usual affiliation rules are suspended for (x) hospitality, food and beverage businesses with no more than 500 employees, (y) franchises, and (z) other businesses receiving financial assistance from the Small Business Investment Company.
- Congress has also provided that businesses in the NAICS 72 category (generally hospitality, food and beverage sector) qualify provided that no single location of such business has more than 500 employees.
- Furthermore, eligibility for borrowers includes:
 - The business was in operation on February 15, 2020; and

- Has paid employees or paid independent contractors and payroll taxes.

What can I use the PPP Loan funds for?

You must acknowledge that the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments. Funds you use for other purposes will not be eligible for forgiveness. The funds can be used for:

- Payroll and commission payments;
- Group health care benefits/insurance premiums;
- Mortgage, rent, and lease payments;
- Utilities; and
- Interest on any other debt obligations that were incurred before the covered period.

How is the PPP Loan different from the Economic Injury Disaster Loan (SECTION 7(B))?

- No personal or business collateral is required for a PPP Loan. The SBA EIDL loan may require collateral for loan amounts over \$25,000.
- It is permissible for you to also have access to credit elsewhere. To receive an SBA disaster loan, you generally need to have no other source of credit.
- The PPP Loan covers a more restrictive set of purposes (outlined above). The SBA EIDL loan can cover most operating expenses.
- Your PPP loan can be forgiven if you follow the terms. The SBA EIDL loan requires repayment.

What are the terms of the loan forgiveness?

This is an unprecedented program, so anticipate changes based on upcoming regulations.

- The amount of forgiveness cannot exceed the amount of the original loan.

- The forgiveness amount is equal to the amount spent over an 8-week period, from the date of loan origination which shall include: payroll costs, interest payments on any mortgage begun prior to February 15, 2020, rent payments on any leases in force prior to February 15, 2020, and payment of any utility in service prior to February 15, 2020.
- Compensation of individual salary above \$100,000 for one year, as prorated for the Covered Period, is not refunded/forgiven.
- The company does not in 2020 have a reduction in wages of those employees that is greater than 25% of that employee's last year's wages for any employee earning \$100K or less. Should the company have a reduction in wages of any employee beyond 25% of their prior-year compensation, the amounts forgiven will be reduced by the dollar amount of compensation reduction beyond 25%.
- The company must maintain the same number of employees that it employed during the prior year lookback period of February 15, 2019–June 30, 2019 (X). Should the company have less than that number of employees (Y), then the loan amount forgiven will be reduced proportionally (Y/X). Companies who re-hire workers at the beginning of the period who were previously laid off due to the COVID-19 crisis will not be penalized for re-hiring those workers.
- Any loan amount that is not forgiven at the end of one year is carried forward as an ongoing loan with terms of a max of 10 years, at a max 4% interest. The 100% loan guarantee of the federal government will remain for these loans through to their term.

How is the loan forgiven?

In the eight weeks following your loan signing date, all expenses related to the following can be forgiven:

- Payroll—salary, wage, vacation, parental, family, medical, or sick leave, health benefits
- Mortgage interest—as long as the mortgage was signed before February 15, 2020

- Rent—as long as the lease agreement was in effect before February 15, 2020
- Utilities—as long as service began before February 15, 2020

When submitting your application for loan forgiveness, current requirements state that you must provide the following documentation (no exceptions) (NOTE: This is subject to change as regulations are promulgated):

- documentation verifying the number of full-time equivalent employees on payroll and pay rates for the periods described above, including:
 - payroll tax filings reported to the IRS;
 - State income, payroll, and unemployment insurance filings
- documentation to prove your mortgage, lease, or utility payments
 - canceled checks
 - payment receipts
 - account statements
- a certification from a representative of the eligible recipient authorized to make such certifications that:
 - the documentation presented is true and correct; and
 - the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation, or make covered utility payments; and
 - any other documentation the Administrator determines necessary.

The lender must make a decision within 60 days of your forgiveness application submission.

What is the modified EIDL Program?

- The legislation modifies the existing disaster relief program to respond to the economic impact of COVID-19

- Provides loans to small businesses. As a general guide, a small business has less than 500 employees and \$35 million in revenue.
- Maximum loan size is \$2 million.
Loans will be 30-year loans and bear interest at the rate of 3.75% for businesses; 2.75% for nonprofits.
- First payments commence one year after the loan origination date; however, interest on the amount of the EIDL loan does accrue during the deferment period.
- The funds can be used to pay for financial obligations and operating expenses that could have been met had the disaster not occurred.
- SBA will waive certain requirements, including that an applicant needs to be in business for 1 year before the disaster (so long as it has been in business since at least January 31, 2020) or the \$200,000 personal guarantee on advances and loans, and the obligation to first seek credit elsewhere before applying for funds provided under the program.
- Underwriting requirements are relaxed, but the SBA will seek assets as collateral for the EIDL loan.
- Personal guarantees are required for owners of more than 20%. No liens will be taken against the real estate of the guarantor.
- EIDL loans must be paid back; **there is no loan forgiveness.**
- An eligible entity that applies for an EIDL loan can request an advance “emergency grant,” not to exceed \$10,000, within three days after SBA receives the application. Applicants are NOT required to pay back that portion of the grant, even if they are subsequently denied the full 7(b) loan. **NOTE – you can apply for the EIDL loan now through the SBA website. However, the SBA has not yet updated its application to provide for the emergency grant. One the emergency grant application is available; you will need to complete that application too.**

Can I access both the PPP and EIDL programs?

Possibly. Businesses that receive a PPP Loan cannot receive an EIDL loan for the same purpose. However, businesses that have an EIDL loan issued in 2020 in place may be able to refinance that loan into the PPP Loan, which becomes forgivable if the business has sufficient qualifying salary, utility, and rent/mortgage expenses.

Should I apply for PPP Loan or EIDL?

It depends on your circumstances, but the PPP will be beneficial in many cases if you anticipate that the funds will allow you to maintain your current payroll, especially as the loan is forgivable. It is a temporary program and only covers expenses through June 30, 2020. The EIDL existing loan program must be paid, but terms are flexible, and it covers injuries through the end of the year.

When will these programs become available?

- The statute requires implementing the regulations within 15 days of it being signed into law. President Trump signed the CARES Act on March 27, 2020.
- SBA has released [the PPP application form found here](#). On April 3, 2020, lenders can begin to process applications, so contact your lender ASAP to get the process started.
- The EIDL application is live on the SBA website. There is no obligation to accept the loan if you qualify. In fact, you have 60 days to reject the loan once approval is granted. Therefore, it is better to apply ASAP.

What can I do now?

- Familiarize yourself with the [SBA Website](#).
- Contact your lender to see if they are an approved SBA lender.
- Fill out the Paycheck Protection Program Application Form.
- Review the following forms that will need to be filled out once the application process is underway:
 - For 7(a) Loans: Borrower Information Form (SBA Form 1919)
 - For 7(b) Loans: 7(b) Loan Application (SBA Form 5)
- Other items to begin gathering:

- Business tax returns (previous three years)
- Business certificate or license
- Business leases
- Loan application history

As this is a fast moving topic, please note that this post is current as of April 1, 2020.

DISCLAIMER: The information contained herein is intended for informational purposes only and should not be construed as professional counsel or legal advice. Seek legal counsel for advice with respect to any legal matter. The information in this document may not reflect the most current developments as the subject matter is extremely fluid and may change daily. The content and interpretation of the issues addressed herein are subject to change.

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