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CARES ACT AND SBA LOANS

Introduction

On March 27, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), an economic stimulus package estimated at \$2.1 trillion. Included in the CARES Act is \$349 billion in small business loans through the Small Business Administration (“SBA”). Loans will be made in accordance with three programs: (1) the Paycheck Protection Program (“PPP”), (2) the Small Business Debt Relief Program, and (3) Disaster Assistance. There are also several tax changes in the CARES Act, of which businesses may take advantage. Useful links can be found at the end of this document.

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PAYCHECK PROTECTION PROGRAM

The CARES Act has temporarily added a new product called the “Paycheck Protection Program” to the SBA’s 7(a) Loan Program. The purpose of PPP loans is to help small businesses pay for payroll and certain operating expenses, to keep businesses open, and to keep employees on the payroll. Borrowers may only receive one PPP loan and should consider applying for the maximum amount.

Eligibility

Businesses that have fewer than 500 employees, including affiliated businesses (see section immediately below), or the employee size standard under the NAICS Code (see [NAICS Identification Tools](#) to search codes), if larger, are eligible for this relief. If the foregoing size requirement is satisfied, the following businesses meet eligibility requirements:

- Any business operating on February 15, 2020 that paid salaries and payroll taxes
- Sole proprietorships, independent contractors, and self-employed individuals
- Businesses of any revenue size; there is no test for total revenues
- Nonprofit businesses, specifically 501(c)(3) organizations
- 501(c)(19) veterans’ organizations
- Tribal business concerns described in Section 31(b)(2)(C) of the Small Business Act

The following exceptions to the size requirement apply to:

- Accommodation (hospitality) and food service businesses with NAICS codes beginning with “72”
- Franchises, where the SBA assigns a franchise identifier code
- Any business receiving financial assistance from a small business investment company (SBIC)

Affiliated Businesses

The SBA considers entities “affiliates” of one another when one controls or has the power to control the other, or a third-party controls or has the power to control both. Importantly, the SBA’s conceptions of affiliation and control are more expansive than they are in the corporate context and in other legal regimes. For example, minority stockholders of a company are routinely deemed to “control” a company for SBA purposes (and, accordingly, each company “controlled” by the same minority stockholder would have to aggregate all employees across each other, even if otherwise unrelated).

While there are several ways companies can be affiliated, the most common is through stock ownership:

- A majority owner of the company’s voting equity is an affiliate

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- A minority owner is considered an affiliate if it can either:
 - Prevent a quorum of the board of the company's directors or stockholders, or
 - Veto day-to-day operational (as distinguished from extraordinary) decisions of the company, including encumbering or selling assets (short of all or substantially all assets), amending or terminating lease agreements, purchasing equipment, officer or employee compensation decisions, hiring and firing officers and executives, incurring debt, paying distributions or dividends, bringing or defending a lawsuit, approving or changing the budget, changes in strategic direction (aside from entering into a substantially different line of business), or establishing or amending an incentive or employee stock ownership plan.

Many private equity ("PE") and venture capital ("VC") deals include some of these operational covenants and, as such, affiliation can be especially problematic for VC- and PE-backed companies. Where an investor is considered an affiliate of the PPP loan applicant, and the same investor also "controls" other entities (e.g., portfolio companies), those relationships would result in the aggregation of employee head counts across multiple, otherwise separate businesses, potentially putting the applicant itself over the PPP employee threshold.

Important Dates

Borrowers must apply by June 30, 2020. Early application is encouraged, as the program is expected to be oversubscribed and run out of money much sooner than that date.

Application acceptance begins:

- April 3, 2020, for small businesses and sole proprietorships
- April 10, 2020, for independent contractors and self-employed individuals

Borrowing Limit

PPP loans will be capped at \$10 million. The following methodology will allow businesses to calculate maximum loan amounts:

- (1) Aggregate payroll costs from the last twelve months for employees. Payroll costs consist of:
 - Compensation to employees (whose principal place of residence is the United States) in the form of salary, wages, commissions, or similar compensation
 - Cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips)
 - Payment for vacation, parental, family, medical, or sick leave
 - Payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums and retirement
 - Payment of state and local taxes assessed on compensation of employees
 - For an independent contractor or sole proprietor, wage, commissions, income, or net earnings from self-employment or similar compensation

Payroll costs exclude:

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- Payments to independent contractors: independent contractors have the ability to apply for a PPP loan on their own and do not count for purposes of a borrower's PPP loan calculation
 - Any compensation of an employee whose principal place of residence is outside of the United States
 - The compensation of an individual employee in excess of an annual salary of \$100,000, prorated as necessary
 - Federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including the employee's and employer's share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees
 - Qualified sick and family leave wages for which a credit is allowed under Sections 7001 and 7003 of the Families First Coronavirus Response Act
- (2) Subtract any compensation paid to an employee in excess of an annual salary of \$100,000 and/or any amounts paid to an independent contractor or sole proprietor in excess of \$100,000 per year
 - (3) Calculate average monthly payroll costs (divide the amount from Step 2 by 12)
 - (4) Multiply the average monthly payroll costs from Step 3 by 2.5
 - (5) Add the outstanding amount of an Economic Injury Disaster Loan ("EIDL") made between January 31, 2020 and April 3, 2020, less the amount of any "advance" under an EIDL COVID-19 loan (because it does not have to be repaid)

Loan Terms

All loans under the PPP are identical in structure and shall be made in accordance with the following terms:

- Loan maturity is 2 years
- Interest rate is 1.0%
- First 6 months' payments (principal and interest) are automatically deferred, though interest will continue to accrue during this deferment
- Administrators are authorized to defer loan payments for up to one year
- 100% guaranteed by the SBA (due to this provision, lenders are not expected to perform credit analyses)
- No borrower or lender fees payable to SBA
- No collateral
- No personal guarantees

A PPP loan may be sold on the secondary market after the loan is fully disbursed. A PPP loan may be sold on the secondary market at a premium or a discount to par value. SBA will issue guidance regarding any advance purchase for loans sold in the secondary market.

Forgiveness

PPP loans may be forgiven. In general, borrowers are eligible for loan forgiveness equal to the amount of certain expenses spent during the 8 weeks immediately following the date of loan origination. No more than 25% of a loan can be forgiven for non-payroll costs. Forgiveness may not exceed loan principal amount.

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The percentage of employee retention is related to loan forgiveness. The amount forgiven would be reduced proportionally by any reduction in employees retained compared to the prior year, and by the reduction in pay of any employee in excess of 25% of that employee's prior-year compensation. However, to encourage employers to rehire any employees who have already been laid off, businesses that rehire previously laid-off workers by June 30, 2020 would still qualify and not be penalized for having a reduced payroll during the loan period.

Any debt forgiven is not included in taxable income for the year.

Borrowers should keep the following in order to qualify for forgiveness:

- Documentation verifying the number of employees on payroll and pay rates, including IRS payroll tax filings and State income, payroll, and unemployment insurance filings
- Documentation verifying payments on covered mortgage obligations, lease obligations, and utilities
- Certification from a representative of the business or organization that is authorized to certify that the documentation provided is true and that the amount that is being forgiven was used in accordance with the program's guidelines for use

Permitted Uses

PPP loans can be used for the following:

- Payroll costs, including salary, commission, or similar compensation (up to an annual rate of pay of \$100,000 per employee)
- Employee group healthcare benefits, including insurance premiums
- Employee benefits including costs for vacation, parental, family, medical or sick leave
- Allowance for dismissal
- Payment for any retirement benefit
- Covered leave from February 15, 2020 to June 30, 2020
- Payments of interest on mortgages incurred before February 15, 2020
- Interest on any other debt incurred prior to February 15, 2020
- Rent, under lease agreements in force before February 15, 2020
- Utilities, for which service began before February 15, 2020

Prohibited Uses

Businesses may not use PPP loans for the following:

- Employee or owner compensation over \$100,000
- Taxes imposed or withheld under Chapters 21, 22, and 24 of the Internal Revenue Code
- Compensation of employees whose principal place of residence is outside the United States

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- Qualified sick and family leave for which a credit is allowed under Sections 7001 and 7003 of the Families First Coronavirus Response Act (which requires certain employers to provide their employees with paid sick leave or expanded family and medical leave for specified reasons related to COVID-19)

If a business uses PPP funds for unauthorized purposes, the SBA will direct that business to repay those amounts. If a business knowingly uses the funds for unauthorized purposes, it will be subject to liability, such as charges for fraud. If a shareholder, member, or partner of the business uses PPP funds for unauthorized purposes, the SBA will have recourse against the shareholder, member, or partner.

Lenders

Loan applications should be made through SBA-approved banks, not the SBA. All current SBA 7(a) lenders are eligible lenders for PPP. The Department of the Treasury will also authorize new lenders, including non-bank lenders, to help meet the needs of small business owners. The following types of lenders have been determined to meet the criteria and are eligible to make PPP loans unless they are currently designated in Troubled Condition by their primary federal regulator or are subject to a formal enforcement action with their primary federal regulator that addresses unsafe or unsound lending practices:

- Any federally insured depository institution or any federally insured credit union
- Any Farm Credit System institution (other than the Federal Agricultural Mortgage Corporation) as defined in 12 U.S.C. 2002(a) that applies to the requirements under the Bank Secrecy Act (“BSA”) and its implementing regulations
- Any depository or non-depository financing provider that originates, maintains, and services business loans or other commercial financial receivables and participation interests; has a formalized compliance program; applies the requirements under the BSA as a federally regulated financial institution, or the BSA requirements of an equivalent federally regulated financial institution; has been operating since at least February 15, 2019 and has originated, maintained, and serviced more than \$50 million in business loans or other commercial financial receivables during a consecutive 12 month period in the past 36 months; or is a service provider to any insured depository institution that has a contract to support such institution’s lending activities in accordance with 12 U.S.C. § 1867(c) and is in good standing with the appropriate Federal banking agency

SBA will pay lenders fees for processing PPP loans in the following amounts:

- 5% for loans of not more than \$350,000
- 3% for loans of not more than \$350,000 and less than \$2,000,000
- 1% for loans of at least \$2,000,000

The government a search tool dedicated to helping borrowers find lenders: www.sba.gov/lendermatch *

*Note that as of April 3, 2020, this link goes directly to the PPP information page.

Loan Applications

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The applicant must submit SBA Form 2483 (Paycheck Protection Program Application Form) and payroll documentation. The lender must submit SBA Form 2484 (Paycheck Protection Program Lender's Application for 7(a) Loan Guaranty) electronically in accordance with program requirements and maintain the forms and supporting documentation in its files.

Agent fees will be paid by the lender out of the fees the lender receives from the SBA. Agents may not collect fees from the borrower or be paid out of the PPP loan proceeds. The total amount that an agent may collect from the lender for assistance in preparing an application for a PPP loan (including referral to the lender) may not exceed:

- 1% for loans of not more than \$350,000
- 0.5% for loans of more than \$350,000 and less than \$2,000,000
- 0.25% for loans of at least \$2 million

Lenders must:

- Confirm receipt of borrower certifications contained in PPP Application form
- Confirm receipt of information demonstrating that a borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020
- Confirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application
- Follow applicable BSA requirements

Borrower Documentation

Because additional guidance needs to be issued before the application process begins and in anticipation of a high volume of requests, borrowers should prepare and organize the following documents:

- Payroll information from 2019
- Projected payroll costs for May and June 2020
- Building lease agreements outlining monthly rent requirements and/or mortgage interest (if the building is owned/financed)
- Utility bills (electric, gas, water, transportation, telephone, internet, etc.)
- Financial statements and tax returns, including:
 - Interim 2020 income statement and balance sheet
 - Fiscal year-end 2019 income statement and balance sheet
 - 3 years of tax returns
- Up-to-date bylaws, articles, operating agreements, and/or similar corporate documents
- Proof of liability insurance

PPP and other SBA Assistance

Borrowers may apply for PPP loans and other SBA financial assistance, including Economic Injury Disaster Loans (EIDLs), 7(a) loans, 504 loans, and microloans, and receive investment capital from Small Business

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Investment Corporations (SBICs). However, a business cannot use a PPP loan for the same purpose as other SBA loans(s). For example, if an employer uses a PPP to cover payroll for the 8-week covered period, it cannot use a different SBA loan product for payroll for those same costs in that period, although it could use it for payroll not during that period or for different workers.

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SMALL BUSINESS DEBT RELIEF PROGRAM

The SBA Debt Relief Program gives immediate relief to borrowers with existing SBA 7(a) loans, 504 loans and microloans. For these existing borrowers, the SBA will cover all loan payments for the next six months. This includes principal, interest and fees. This relief is also available for businesses who take out new loans within six months of the CARES Act being enacted. This debt relief is automatic, but make sure to check with your lender to make sure. Businesses should check with a bank or lender to see if they offer these loans or contact SBA to find one.

For local SBA assistance, www.sba.gov/local-assistance/find/

Eligibility: 7(a) Loans, 504 Loans, Microloans

In general, businesses must meet size standards, be based in the U.S., be able to repay, and have a sound business purpose. Standards are determined by the 6-digit NAICS code and 3-year average revenue.

Use this tool to determine whether a business qualifies: www.sba.gov/size-standards/

7(a) Loans

7(a) loans are an affordable loan product of up to \$5 million for borrowers who lack credit elsewhere and need access to versatile financing, providing short-term or long-term working capital and to purchase an existing business, refinance current business debt, or purchase furniture, fixtures, and supplies. In the program, banks share a portion of the risk of the loan with SBA.

There are many different types of 7(a) loans, found here: www.sba.gov/partners/lenders/7a-loan-program/types-7a-loans

504 Loans

The 504 Loan Program provides loans of up to \$5.5 million to approved small businesses with long-term, fixed-rate financing used to acquire fixed assets for expansion or modernization. This is a good option if businesses need to purchase real estate, buildings, and machinery. Borrowers apply through a Certified Development Company, which is a nonprofit corporation that promotes economic development. Interest rates on 504 Loans are correlated with the current market rate for 5-year and 10-year U.S. Treasury issues. Loan maturities of 10 and 20 years are available. Fees may be financed with the loan.

The CARES Act introduced temporary refinancing rules for 504 Loans. Requirements of this time-limited program include:

- The debt to be refinanced is a commercial loan which was incurred not less than 2 years prior to the date of application, including any prior refinancing of the debt;
- Substantially all (85%) of the proceeds of the original debt being refinanced must have been used for 504 eligible purposes (acquisitions, construction or improvement of long-term fixed assets) and the remaining (15% or less) must have been incurred for the benefit of the small business;

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- The debt to be refinanced must be secured by eligible fixed assets;
- The project also may include using available equity to pay eligible business expenses;
- The small business must have been in operation for two years or more (no start-ups); and
- The debt refinancing must not involve expansion of the small business (however, this may be eligible under the regular 504 loan program).

SBA 504 Loan information: www.sba.gov/offices/headquarters/ofa/resources/4049

Microloans

The Microloan Program provides loans up to \$50,000 to help small businesses and certain not-for-profit childcare centers to start up and expand. The average microloan is about \$13,000. These loans are delivered through mission-based lenders who are also able to provide business counseling.

SBA Microloan information: www.sba.gov/loans-grants/see-what-sba-offers/sba-loan-programs/microloan-program%20

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DISASTER ASSISTANCE

Recipients of EIDLs and EEIGs may also apply for PPP loans, and any advance amount received in the grant would be subtracted from the amount forgiven from the PPP. EIDLs cannot be used for the same purpose(s) as the PPP. The SBA's disaster assistance page can be found here: www.sba.gov/funding-programs/disaster-assistance

Economic Injury Disaster Loan (“EIDL”)

EIDLs are loans of up to \$2 million, with principal and interest deferment at the Administrator's discretion, that are available to pay for expenses that could have been met had the disaster not occurred, including payroll and other operating expenses. Up to \$200,000 can be approved without a personal guarantee.

The interest rate is 3.75% for small businesses. The interest rate for nonprofits is 2.75%.

Businesses suffering substantial economic injury in all 50 states, D.C., and the territories may apply for an EIDL. The following businesses are eligible:

- Businesses with 500 or fewer employers
- Sole proprietorships, with or without employees
- Independent contractors
- Cooperatives and employee-owned businesses
- Tribal small business
- Private nonprofits with an effective ruling letter from the IRS, granting tax exemption under Sections 501(c), (d), or (e) of the Internal Revenue Code of 1954, or if the organization can provide satisfactory evidence from the State that the non-revenue producing organization or entity is a nonprofit one organized or doing business under State law

Emergency Economic Injury Grant (“EEIG”)

These grants provide an emergency advance of up to \$10,000 to small businesses and private nonprofits harmed by COVID-19 within three days of applying for an SBA Economic Injury Disaster Loan (EIDL). To access the advance, you first apply for the EIDL and then request the advance. The advance does not need to be repaid under any circumstance, and may be used to keep employees on the payroll, to pay for sick leave, meet increased production costs due to supply chain disruptions, or pay business obligations, including debts, rent and mortgage payments. If a PPP loan is secured, then this \$10,000 will be subtracted from forgiveness amount. EEIGs are available from January 31, 2020 to December 31, 2020.

The following businesses are eligible:

- Those businesses that have been in operation since January 31, 2020

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TAX PROVISIONS

The CARES Act brought several changes to tax provisions for which businesses may be able take advantage.

Business Losses

The CARES Act repeals the 80% income limitation on losses for tax years beginning before 2021 and allows 100% of loss carryforwards and carrybacks to be used for those years. In addition, the CARES Act permits taxpayers (other than REITs) to carryback for up to 5 years.

Net operating loss (“NOL”) carryback:

- Businesses permitted to offset losses in 2018, 2019, and 2020 against profits from the prior 5 years
- NOL carryback was previously eliminated by the Tax Cuts and Jobs Act (TCJA) in 2017
- Losses that are used to offset pre-TCJA profits, which were taxed at a higher rate, would be refunded at pre-TCJA tax rates, providing an additional boost
- For corporations, NOLs carried back to tax years before 2018 will be particularly valuable because the corporate income tax rate was 35%
- To qualify for a carryback adjustment, a taxpayer must file the application within 120 days of the enactment of the CARES Act.

Business Interest Deductions

The CARES Act relaxes the limitation on business interest expense deductions from 30% of adjusted taxable income (“ATI”) to 50% of ATI for tax years beginning in 2019 and 2020, with any excess carried forward to future tax years. ATI is defined generally as EBITDA for tax years beginning before 2022. In addition, the CARES Act allows taxpayers to elect to use their ATI from their 2019 tax year for purposes of their business interest deductions in their 2020 tax year. This election will allow businesses that were more profitable in 2019 than 2020 to have a higher limit on deductible business interest than they otherwise would, which will provide a large benefit to businesses that will be in loss positions for 2020.

For tax partnerships (which include many LLCs), the increased limit from 30% to 50% applies for tax years beginning in 2020 (but not 2019). For excess business interest in tax years beginning in 2019, partners can elect to have 50% of that excess business interest treated as business interest paid in 2020 that is not subject to the business interest deduction limitation, and the remaining 50% of that excess business interest subject to the 30% business interest expense limitation can be carried forward. For tax partnerships, the election to use ATI from the 2019 tax year for purposes of business interest deductions in the 2020 tax year is made by the partnership. The increase in the business interest expense deduction (in addition to the expanded ability to use losses, as discussed above) may permit tax partnerships to reduce their outlays of cash for tax distributions to their partners.

Bonus Depreciation

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The 2017 TCJA generally permits taxpayers to take 100% bonus depreciation on property with a recovery period of 20 years or less if that property is placed in service before 2023. In what is commonly called the “retail glitch,” the 2017 TCJA mistakenly excluded from 100% bonus depreciation business expenses for improvements to an interior portion of an existing nonresidential building (“qualified improvement property” or “QIP”). The CARES Act fixes this error by extending 100% bonus depreciation to QIP and by permitting taxpayers to retroactively claim 100% bonus depreciation on QIP placed in service in 2018 and 2019. Qualifying taxpayers should consider filing amended returns to take advantage of this benefit.

Deferral of Social Security Payroll Tax Payments

The CARES Act allows employers (including self-employed individuals) to defer payment of the employer’s share of Social Security taxes on wages that accrue from the date of enactment of the CARES Act until the end of 2020 (the “Deferral Period”). 50% of the deferred amount must be paid by the end of 2021, and the other 50% must be paid by the end of 2022. In the case of self-employed individuals, the payroll tax that may be deferred is the 6.2% “employer portion” of the Social Security taxes in the Deferral Period.

Excess Business Loss Limitations on Noncorporate Taxpayers

For noncorporate taxpayers, an individual’s ability to use business losses arising to offset nonbusiness income is limited to \$250,000 for individuals (\$500,000 for joint return filers) prior to 2026, and such losses that are disallowed as “excess business losses” are carried forward and treated as NOLs in future tax years. The CARES Act suspends these excess business loss limitations for tax years beginning in 2018, 2019 and 2020. Qualifying taxpayers should take advantage of these additional deductions to reduce taxes for 2019 and 2020, and should consider filing amended returns for excess business losses that arose in 2018.

Expedited Refunds for AMT Credits

Before the 2017 TCJA, certain corporations paid a 20% alternative minimum tax (“AMT”) and that paid AMT generated a tax credit that could be carried forward and used to offset regular income tax paid by those corporations in future tax years. The CARES Act provides that a corporation can claim a full refund of these AMT credits in its 2018 and 2019 tax years. To take advantage of this immediate refund, corporations must apply by the end of 2020 and the IRS will process the application within 90 days.

Employee Retention Credit

The employee retention credit is designed to encourage businesses to keep employees on their payroll by providing a refundable tax credit of 50% of up to \$10,000 in wages paid by an eligible employer whose business has been impacted by COVID-19.

To be eligible, an employer’s:

- Operations must be fully or partially suspended during the COVID-19 crisis period due to a COVID-19-related shut-down order; or
- gross receipts must have declined by 50% or more when compared to the same quarter in 2019. For employers with more than 100 full-time employees in 2019, “qualified wages” are wages paid to

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employees that are not providing services due to the COVID-19 crisis. For eligible employers with 100 or fewer full-time employees in 2019, all employee wages are “qualified wages.”

Credit provided through December 31, 2020.

Qualified Family Leave Credit

The Families First Coronavirus Response Act requires employers with fewer than 500 employees to provide public health emergency leave under the Family and Medical Leave Act, P.L. 103-3, when an employee is unable to work or telework due to a need for leave to care for a son or daughter under age 18 because the school or place of care has been closed, or the child care provider is unavailable, due to a public health emergency related to COVID-19 (employers with fewer than 50 employees can be exempted from the requirement). Subject to certain limitations, an employer receives a payroll tax credit equal to 100% of the qualified family leave wages paid by the employer. Self-employed individuals can get the credit as well but cannot use Form 7200 to obtain it.

Qualified Paid Sick Leave Credit

The Families First Coronavirus Response Act also requires employers with fewer than 500 employees to provide up to 80 hours of paid sick time through the end of this year if an employee is unable to work due to being quarantined or self-quarantined or having COVID-19 or because the employee is caring for someone who is quarantined or self-quarantined or has COVID-19 or if the employee is caring for children whose school has been closed because of COVID-19 precautions. (Employers with fewer than 50 employees can be exempted from the requirement.) Subject to certain limitations, an employer can receive a payroll tax credit equal to 100% of the qualified sick leave wages paid by the employer. Self-employed individuals are also permitted to receive this credit.

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USEFUL LINKS

NAICS Code search tool: www.naics.com/search

SBA 7(a) Loans: www.sba.gov/partners/lenders/7a-loan-program/types-7a-loans

SBA 504 Loans: [/www.sba.gov/offices/headquarters/ofa/resources/4049](http://www.sba.gov/offices/headquarters/ofa/resources/4049)

SBA Disaster Assistance: www.sba.gov/funding-programs/disaster-assistance

SBA Lender Match*: www.sba.gov/lendermatch *

*Note that as of April 3, 2020, this link goes directly to the PPP information page.

SBA Local Assistance: www.sba.gov/local-assistance/find/

SBA Microloan Program: www.sba.gov/loans-grants/sec-what-sba-offers/sba-loan-programs/microloan-program%20

SBA PPP: www.sba.gov/funding-programs/loans/paycheck-protection-program-ppp

SBA Size Standards Check: www.sba.gov/size-standards/