March 27, 2020

Client Alert – Phase 3 Federal Stimulus Package Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") COVID-19 (Coronavirus)

Below you will find our summary of most business-relevant provisions of the CARES Act (as well as a brief summary of some of the provisions relevant to individuals) which was enacted early on Friday afternoon, March 27, 2020. While the law gives us general guidelines on the stimulus package, the real work related to these items will come in their administration, which will be an ever-evolving process.

$349B Small Business Lending – The Paycheck Protection Program

The Paycheck Protection Program, which will be the most talked-about (and difficult to administer) section of the new law, provides funding for small businesses to survive during this crisis, as well as an incentive to maintain current employment levels. The intention of this program is to maintain the employment of as many individuals as possible so that businesses will be in a better position to rebound once the COVID-19 crisis has stabilized. It carries with it approximately $349B in authorized funding through December 31, 2020. The other particulars of this program are outlined below.

- Streamlined Application Process. The Paycheck Protection Program will be administered by the Small Business Administration under its existing Section 7(a) lending program. This means applicants will deal directly with their financial institutions who will receive the benefit of SBA's backing. With the passage of this new law, the government will be waiving many requirements normally associated with Section 7(a) loans, including all borrower and lender fees and all collateral and personal guarantee requirements, in order to provide small businesses relief as quickly as possible. Unlike the existing loan application process, applicants will not be required to demonstrate any specific hardship; they will only be required to make a good faith certification of the loan's necessity and that it will be used to retain workers. Further, the CARES Act replaces the standard "ability to pay" requirement for loan eligibility with a determination of whether a business (i) was operational on Feb. 15, 2020 and (ii) had employees for whom it paid salaries and payroll taxes or paid independent contractors. Loans under this program must be made by June 30, 2020 and carry a maximum interest rate of 4% and maturity term of 10 years.

- Eligibility Expanded. Most businesses (including sole proprietors) and 501(c)(3) organizations are eligible for these loans if they have fewer than 500 employees or they already meet existing SBA small business criteria. Even individual locations of hotel and restaurant chains are eligible to borrow under the program. Those businesses who have received an economic injury disaster loan ("EIDL" loans, discussed below) between February 15, 2020 and March 31, 2020 are also eligible to receive assistance under this program.

- Increased SBA Loan Amounts. The Paycheck Protection Program raises the maximum loan amount for any given borrower to the lesser of (i) $10MM and (ii) that amount which is equal to 2.5 times the borrower's average payroll for the prior year. Payroll, for these purposes, is defined as consisting of: (1) salary, wage, commission, or similar compensation; (2) cash tip or equivalent; (3) payment for vacation, parental, family, medical, or sick leave; (4) dismissal or separation pay; (5) health care or retirement benefits; (6) state and local payroll taxes; and (7) payments to sole proprietors and independent contractors that are a wage, commission, income or otherwise net earnings from self-employment. The calculation of payroll costs excludes compensation to employees exceeding $100,000 on an annualized basis, federal payroll taxes, compensation to employees residing outside the United States, and leave for which the employer is receiving a tax credit under the "Phase II" coronavirus response (detailed in prior VW Client Alerts). SBA Express loan amount ceilings are also raised, from $350,000 to $1MM through the end of the year. SBA Express loans are generally processed on an expedited basis.

- Permitted Uses of Loan Funds. While your loan amount is calculated based on payroll costs, the loan itself can be used for a variety of essential business expenses including payroll, rent, mortgage interest, interest on debts, and utilities.

- Existing Loan Payment Deferment. This program provides for complete deferment of loan payments on existing Section 7(a) loans for 6-12 months, starting with the next payment due under the loan. SBA is required to provide guidance to lenders on this deferment process within 30 days of the act's passage.

- Loan Forgiveness Offered. One of the most attractive aspects of this program is some of the amounts borrowed will be eligible for loan forgiveness. Borrowers will be eligible for loan forgiveness on an amount equal to the total amount the borrower spent on payroll (excluding annualized compensation over $100,000,) mortgage interest, rent, and utilities in the eight weeks following their loan's origination. Employers are additionally allowed to make extra payments to tipped employees (such as wait staff) to account for their loss of tips. Forgiven expenses are generally restricted to obligations undertaken before February 15 of this year. Loan forgiveness will be reduced proportionally by any reduction in employees retained compared to the prior year and by the reduction in pay of any employee beyond 25% of their prior year compensation. Borrowers that re-hire workers previously laid-off will not be penalized for having reduced payroll at the beginning of the period. Importantly, cancelled indebtedness resulting from this loan forgiveness program will not be included in the business's taxable income.

- Loan Forgiveness Calculation and Procedure. In order to calculate the portion of the borrower's covered costs that will be forgiven, participants should multiply their eligible operating costs by the quotient of: (a) their average monthly number of full-time-equivalent (FTE) employees during the eight-week period; and (b) the borrower's average monthly number of FTE's during their choice of two periods—February 15, 2019-June 30, 2019 or January 1, 2020-February 29, 2020. In order to receive loan forgiveness, a borrower will submit to their lender documents including: (1) state or federal payroll documents; (2) documentation of mortgage interest, rent, or payroll expenses; (3) certification that the information is true; and (4) any other documentation that SBA determines is appropriate. The lender will then have 60 days to determine the appropriate level of forgiveness, at which point SBA would purchase and forgive the relevant amount of the initial loan.

Expansion of Emergency EIDL Loans & Grants

In addition to the Payroll Protection Program, the CARES Act authorizes $10B to be appropriated to SBA for the purpose of expanding the existing emergency economic injury disaster loans (EIDLs) program to eligible entities and even provides for advance funding (cash now) independent of SBA's ultimate decision to lend under the program.

- Eligibility. Startups, cooperatives, and ESOPs with fewer than 500 employees, or any individual operating as a sole proprietor or an independent contractor will be eligible for an EIDL.

- Immediate Cash. The new law establishes an emergency grant program to allow an eligible entity that has applied for an EIDL to request an advance on that loan of not more than $10,000 which the SBA must distribute within three days. This can be a very useful tool for small businesses at the precipice of collapse.

- Conditions on Advance Payment. In advance of disbursing the advance payment, the SBA must verify that the entity has applied for an EIDL loan. Then, the advance payment may be used for providing paid sick leave to employees, maintaining payroll, meeting increased costs to obtain materials, making rent or mortgage payments, and repaying obligations that cannot be met due to revenue losses.

- No Repayment Required. EIDL applicants will not be required to repay advance payments even if they are subsequently denied for an EIDL loan.

- Waiver of Certain Loan Requirements. For any EIDL loans made in response to COVID-19 before the end of the year, the SBA will waive: (i) any personal guarantee on advances and loans below $200,000, (ii) the requirement that an applicant needs to have been in business for the 1-year period before the disaster, and (iii) the "credit elsewhere" requirement.

Unemployment Insurance ("UI") Coverage Increased

The CARES Act creates a temporary Pandemic Unemployment Assistance program through the end of the year which will provide for the following changes in UI coverage:

- Expanded Eligibility. The new law provides payments to individuals who have not traditionally been eligible for unemployment benefits (self-employed, independent contractors, those with limited work history, and others), if they are unable to work as a direct result of COVID-19.

- Increased Benefits. Individuals eligible for unemployment benefits will receive an additional $600 per week for up to four months.

- Extended Term. In addition to increasing UI benefit amounts, the new law provides up to an additional 13 weeks of unemployment benefits, through the end of the year, to help those who remain unemployed after state unemployment benefits are no longer available.

Other Provisions Relevant to Businesses

The CARES Act provides several other benefits to businesses, including:

- Payroll Tax Payment Delay. Employers and self-employed individuals are permitted to defer payment of the 6.2% employer share of the Social Security tax they otherwise are responsible for paying to the federal government with respect to their employees. The provision requires that the deferred employment tax be paid over the following two years with half of the amount required to be paid by December 31, 2021 and the other half by December 31, 2022.

- Payroll Tax Credit. Employers will be allowed to claim a refundable payroll tax credit equal to 50% of wages (maximum of $10,000 in wages per employee) paid to employees during the crisis. The credit is restricted to employers who see a full or partial suspension of operations due to a shutdown/shelter-in-place order or who see gross receipts decline by more than 50% relative to the same quarter in the previous year. For employers with more than 100 full-time employees, the credit is restricted to wages paid to employees who, due to COVID-19, are not working; however, for employers with fewer than 100 full-time employees, it is applicable to all wages.

- Net Operating Loss ("NOL") Limitation Removal. NOLs are currently subject to a taxable income limitation, and they cannot be carried back to reduce income in a prior tax year. This legislation provides that a loss from 2018, 2019, or 2020 can be carried back five years, and it also temporarily removes the taxable income limitation to allow an NOL to fully offset income. These changes will allow companies to utilize losses and amend prior years returns, which will provide critical cash flow and liquidity during the COVID-19 emergency.

- Loss Limitation Lifted for Pass-Throughs and Sole Proprietors. Partnerships, S corporations, and sole proprietors will have the limitations on losses taken on their tax returns temporarily lifted with the intention of allowing them to utilize excess losses to provide necessary cashflow.

- Corporate Alternative Minimum Tax ("AMT") Credits Accelerated. The corporate AMT was repealed as part of the Tax Cuts and Jobs Act, but corporate AMT credits were made available as refundable credits over several years, ending in 2021. The new law accelerates the ability of companies to recover those AMT credits and obtain additional cash flow in the short term.

- Business Interest Deduction Limitations Lifted. The act temporarily increases the amount of interest expense businesses are allowed to deduct on their tax returns by increasing the 30% limitation to 50% of the taxable income (with adjustments) for 2019 and 2020.

- Technical Amendment to Qualified Improvement Property. The legislation also enables businesses, especially in the hospitality industry, to write off immediately costs associated with improving facilities instead of having to depreciate those improvements over the 39-year life of the building.

Paid Leave Limitations

- Prior Legislative and Administrative Actions. Last week, as detailed in previous VW Client Alerts, Congress passed laws requiring companies to provide limited paid sick and family leave to employees impacted by the COVID-19 outbreak. Two days later, the Treasury Department, Internal Revenue Service, and Department of Labor outlined their intention to implement the legislation expeditiously. Both benefits are limited to individuals directly affected by COVID-19, whether caring for themselves or others, and are only in effect through the end of the year. The provisions apply to employers with fewer than 500 employees, and the Department of Labor can exempt certain small businesses with fewer than 50 employees as well as health care workers and emergency responders.

- Paid Leave Payroll Tax Credit. Employers may claim 100% of wages paid to employees in connection with the COVID-19-related leave requirements as a refundable credit against payroll taxes. In case those credits do not account for the cost of the leave, employers can seek an expedited advance from the IRS through a forthcoming claims process.

Other Provisions Relevant to Individuals

In addition to the stimulus provisions applicable to businesses, the CARES Act also provides for direct payments and other benefits to individuals, some of which are summarized below:

- Recovery Rebates. Recovery checks (though the delivery of these amounts may be electronic in nature) of $1,200 will be delivered to all individual (single-filers) with adjusted gross income of $75,000 or less (or $112,500 or less, in the case of those who file their taxes as head of household). All married couples, with adjusted gross income up to $150,000 and who file a joint return are eligible for $2,400. Each of those amounts increase by $500 for every child. The IRS will base these amounts on the taxpayer's 2019 tax return if filed, but if the taxpayer has not yet filed, the rebate will be based on the taxpayer's 2018 filed return. The rebate amount is reduced by $5 for each $100 a taxpayer's income exceeds the phase-out threshold. The amount is completely phased-out for single filers with incomes exceeding $99,000, $136,500 for head of household filers and $198,000 for joint filers.

- Retirement Fund Withdrawals. The 10% early withdrawal penalty on distributions from retirement accounts will be waived for distributions up to $100,000 from qualified retirement accounts made on or after January 1, 2020 if the withdrawals are for coronavirus-related purposes.

- Charitable Giving Encouraged. The new law contains a one-time, above-the-line deduction for cash contributions of up to $300 made to certain qualifying charities. All taxpayers would be eligible to take the deduction, including those filers who use the standard deduction. The new deduction would not apply to non-cash gifts or to gifts contributed to donor-advised funds. In addition, for individual taxpayers who itemize their deductions, the new law suspends (for 2020, only) the normal limit on deductions for contributions to charities. For corporations, the limit on deductions for contributions, ordinarily 10% of adjusted gross income ("AGI"), is elevated to 25% for 2020.

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