

The CARES Act Webinar

April 2, 2020

Presented by
Kaufman & Canoles

Overview of topics:

- New leave entitlements, unemployment expansion, and other remedies to help your employees survive
- Impact on Retirement Plans and Other Employee Benefits
- Delay of Employer Payroll Taxes
- Modification of Net Operating Loss Rules

Overview of topics:

- Maximizing your opportunity under the stimulus package
- Managing risk in the new business landscape
- Negotiating M&A deals through a pandemic
- Tax Rebate Checks
- Delayed Deadlines
- Employee Retention Tax Credit

Disclaimer

This material is for general informational purposes only and does not represent our advice as to any particular set of facts, nor does it represent any undertaking to keep recipients advised of all legal developments.

Additional guidance documents may be forthcoming and may change our interpretations and recommendations.

If you have any specific questions please reach out to any of our attorneys or visit our COVID-19 Legal Resource Center at <https://www.kaufcan.com/covid-19-legal-resources/>.

Congress Passed the Third Phase of Covid-19 Pandemic Relief Last Week

The Federal government has provided a variety of programs to support the businesses.

•Phase
1

•Phase
2

•Phase
3

•Coronavirus Preparedness and Response Supplemental Appropriations Act

- Became law: 6 March 2020
- Estimated cost: \$8.3bn
- Focus: Primarily increased funding for the Department of Health and Human Services to respond to the outbreak

•Families First Coronavirus Response Act

- Became law: 18 March 2020
- Estimated cost: \$105bn
- Focus: Paid sick leave, unemployment insurance, free testing

•Coronavirus Aid, Relief, and Economic Security Act

- Became law: 27 March 2020
- Estimated cost: \$2.3tn
- Focus: **Relief package** to support smaller businesses and several industries weather the Covid-19 pandemic

Emergency Paid Sick Leave

- Applies to all employers with fewer than 500 employees
- A new benefit of two weeks (80 hours) leave
- Paid by the employer
- Employer receives tax credit
- Broad categories of eligibility

Emergency Paid Sick Leave

1. The employee is subject to a **formal** state, federal, or local quarantine or isolation order;
2. The employee has been advised by a **health care provider to quarantine;**
3. The employee is experiencing **symptoms** of COVID-19 and is **seeking a medical diagnosis;**
4. The employee is **caring** for someone subject to a formal quarantine or isolation order or someone who has been advised to quarantine by a health-care provider;
5. The employee is **caring for a minor son or daughter** who is at home due to a school or daycare closure; or
6. The employee is suffering from an “**substantially similar condition**” designated by the Secretary of HHS.

Emergency Paid Sick Leave

- Does not cover:
 - Employees who are frightened to come to work
 - Employees who are “self-quarantined” by order of their employer
 - Employees who have just returned from some exotic “hot spot” – like New Rochelle, NY

FMLA Expansion

- Applies to all employers (not just those with more than fifty employees)
- Is employer-paid (other FMLA leave is not paid); first two weeks can be unpaid or employee can use existing leave, employee choice; tax credit reimburses employer
- Only for child care for minor son or daughter who is unable to go to school or child care due to COVID-19 restrictions

“Health Care Provider” exemption – very broad

- The Act allows an employer who employs “health care providers” to exempt them from Expanded FMLA or the Emergency Paid Medical Leave
- Act uses FMLA definition of HCP
- Guidance and regs issued by DOL is far broader: can exempt essentially anyone who works in a hospital, medical office, or medical supplier! 29 CFR 826.3 (proposed)

Small Business Exemption

- New proposed regulation 29 CFR 826.40:
- Fewer than 50 employees exempt from both types of new leave if “the imposition of such requirements would jeopardize the viability of the business as a going concern.” **STRICT!**
 - Leave causes business to cease operating // \$\$
 - Absence of particular employee pose substantial risk because of their specialized skills, knowledge or responsibilities
 - Insufficient number of able, willing, and qualified workers left

What can I ask my employees?

- Can I take employee's temperature?
- Can I inquire about fever, cough, resp.?
- Can I send sick employees home?
- Can I ask returning travelers to stay home?
- Can I require telework for those who can?
- Can I require sanitary practices?
- Can I require applicants to test negative?
- Can I withdraw a job offer if test positive?

What can I ask my employees?

- The answer to each of the preceding questions is, “**YES!**”
- EEOC Guidance, revised March 19, 2020
- OSHA General Duty Clause Guidance on COVID-19: “**Prompt identification and isolation of potentially infectious individuals is a critical step in protecting workers, customers, visitors, and others at a worksite.**”

Do not ask employees:

- “Do you have an underlying condition that could increase your vulnerability to COVID-19, such as uncontrolled diabetes, asthma, or a compromised immune system?”
- “Hey, you look Asian! Are you Chinese?”

Impact on Retirement Plans and Other Employee Benefits

Benefits Items

- New CARES Act rules
 - New tax-favored retirement plan distributions
 - Increased limits and flexibility for plan loans
 - Waiver of 2020 RMDs
 - Other benefits items
- Other impacts on retirement plans
- Other impacts on group health plans/COBRA

Retirement Plan Distributions

- New “coronavirus-related distribution” up to \$100,000 between 1/1/20 – 12/31/20
- Essentially anyone affected by virus based only on self-certification; optional for plan
- Early withdrawal 10% penalty does not apply
- Taxed over three years
- No mandatory 20% tax withholding
- Can be re-contributed within three years

Retirement Plan Loans

- Increased maximum limits on new loans taken within 180 days of 3/27/20
- Lesser of \$100,000 / 100% of vested balance
- New or existing loans get one-year delay for repayments due from 3/27/20 – 12/31/20
- Re-amortized with accrued interest and can extend beyond five-year period
- Max limit optional; payment deferral unclear

2020 RMD Waiver

- Required minimum distributions due in 2020 may be waived
- Includes participants already taking RMDs and those taking 2019 RMD by 4/1/20
- Will likely be optional for plan
- Expect rules much like 2009 RMD waiver

Other Benefits Changes

- Tax-free employer student loan repayments
 - Direct student loan repayments
 - Limited by existing rules in Section 127
 - Payments made 3/27/20 – 12/31/20
- HSAs may again be used for OTC items
 - Reverses ACA provision; permanent change
- Several contribution, funding, and other retirement plan deadlines extended

Other Retirement Plan Impacts

- “Furlough” vs. “Termination”
- Partial plan termination
- Reduction of employer contributions
 - Discretionary
 - Fixed
 - Safe harbor

Other Insurance Impacts

- “Furlough” vs. “Termination”
- Active coverage vs. COBRA
- “Actively at work” requirement; waivers
- Premium payments
- Premium grace periods
- Special enrollment periods
- Heavily dependent on insurer – check!

Payroll Protection Program

This relief package is designed to help keep smaller businesses going throughout the crisis.

Small Business Loans & Payroll Subsidies		
\$377bn (1.8% of GDP)		
Eligibility	Program	Terms & Process
<ul style="list-style-type: none"> - Small businesses < 500 employees (< 500 per physical location for accomm. and food services sector) - Sole proprietors, contractors, self-employed individuals - Businesses operational, with employees on payroll, on Feb. 15 	<ul style="list-style-type: none"> - Small business obtains loan for, per application, 2.5x monthly payroll up to \$10M - Loan forgiven when used for employee pay, rent or mortgage interest, and utility payments 	<ul style="list-style-type: none"> - Business eligible if operational and having employees on Feb 15 (repayment ability not considered) - Amount forgiven prorated to account for layoffs and pay decreases - Government guarantee at 100% rate (vs. 75% for traditional SBA loans) - Banks earn fee up to 5% for originating loan - Payments deferred up to 1 year - Banks hold loans on balance sheet with zero risk rating

CARES Act Additional Programs

This relief package provides payments to individuals and expands unemployment insurance.

Payments to Individuals		
\$269bn (1.3% of GDP)		
Eligibility	Program	Terms & Process
<ul style="list-style-type: none"> - Taxpayers with incomes up to \$99,000 (or \$198,000 joint) based on 2019 tax return (2018 if not available) 	<ul style="list-style-type: none"> - Tax rebate of \$1,200 (or \$2,400 for a joint tax return) - Additional \$500 rebate per child 	<ul style="list-style-type: none"> - Rebate phases out gradually for incomes greater than \$75,000 (\$150,000 joint) - Rebates sent "as rapidly as possible" targeted for early April
Increased Unemployment Insurance		
\$250bn (1.2% of GDP)		
Eligibility	Program	Terms & Process
<ul style="list-style-type: none"> - Individuals qualifying for standard unemployment compensation - Individuals not previously qualifying for unemployment compensation, such as contractors and the self-employed 	<ul style="list-style-type: none"> - Provides standard unemployment compensation (roughly 50%) for 39 weeks, vs standard 26 weeks - Additional \$600 pay per week through July 31 (4 months), even if unemployment compensation exceeds previous wage level 	<ul style="list-style-type: none"> - Pay is immediate, vs. standard one-week waiting period

CARES Act Additional Programs

This relief program also provides support to several industries.

Relief for Specific Distressed Sectors		
\$46bn (0.2% of GDP)		
Eligibility	Program	Terms & Process
- Airlines, air cargo, and national security/aerospace sectors	<ul style="list-style-type: none">- Direct lending: airlines (\$25bn), air cargo (\$4bn), and national security/aerospace (\$17bn)- Grants to pay wages, salaries and benefits: airlines (\$25bn), air cargo (\$4bn), airline contractors (\$3bn)	<ul style="list-style-type: none">- Alternative financing not available- Short loan duration, < 5 years- Stock buybacks and dividend payments prohibited until 1 year after date of loan repayment- Exec comp restrictions- Must retain 90% of employment level as of March 24- Majority of employees must be based in US

The Paycheck Protection Program

This program is an expansion of the Small Business Association's 7(a) small business loan guaranty program. The money is being made available to cover payroll costs, utilities, rents, and certain existing debt service.

Loan Components

- **Forgivable loan**
- Loan is capped at **2 times the average monthly payroll, plus 25% of that amount** or \$10 million. Example: Avg. monthly payroll is \$100k, max loan is \$250K.
- Payroll is calculated as **salary, wages, commissions, or tips** (capped at \$100k for each employee. Example: Employee makes \$150k, \$100k counts towards payroll)
- Payroll costs also includes employee benefits including vacation costs, parental, family, medical, or sick leave; allowance for separation; payments for healthcare benefits including insurance; and payment of any retirement benefits; but excludes FICA.

Terms and Forgiveness Requirements

- Interest rate is fixed at 1.0%, which is **substantially lower** than the Act's maximum interest rate
- Payments deferred for 6 months and converts to a 2 year loan, versus the Act's 10 year loan. There is no prepayment penalty
- No collateral or personal guaranty is required
- Will have to certify, among other things, **that current economic uncertainty** makes this loan request **necessary to support the ongoing operations** of the business, that the funds will be used for payroll, rent, utilities, and other permissible uses, and that payroll accounts for 75% of it.
- **The full amount will be forgiven** if you **use the money for payroll or other permitted expenses**—75% of the proceeds should be used for payroll
- Forgiveness amount will be adjusted if you do not maintain staff and payroll
- If you do reduce staff, you have **until June 30, 2020** to restore full time employment and salary levels

The EIDL Program

The CARES Act also expands the SBA's Economic Injury Disaster Loan (EIDL) program by relaxing the eligibility requirements and increasing the available funding. The loans have a **max value of \$2 million** and **are not forgivable**. The interest rate is 3.75% for small businesses or 2.75% for nonprofits affected by Covid-19.

EIDL Eligibility

- Private, profits, nonprofits
- Small agricultural cooperatives
- Sole proprietorships, with or without employees
- Any business, cooperative, employee stock ownership plan or Tribal small business with fewer than 500 employees, or companies that have more than 500 employees but are still “small” using the convoluted SBA test regarding “size of entity.”
- Business must have been in existence on January 31, 2020

Waived Requirements

- **Personal guaranty of loans \$200k or less**
- Business in operation for at least a year prior to Covid-19 outbreak
- That the business or its affiliates be unable to obtain credit elsewhere

Use of proceeds

- Prior to CARES Act must be used for working capital necessary until the normal business operations resumed and expenditures necessary to alleviate economic injury
- **CARES Act expands these uses** to include **paying sick leave** to employees unable to work due to the direct effect of COVID-19; **maintaining payroll** to retain employees; **meeting increased costs to obtain materials unavailable** from the business's original source because of supply chain issues, **rent or mortgage payments**; and repaying certain obligations that cannot be met due to revenue losses.

EIDL Grants

- **Grants of \$10,000** payable within 3 days of application, **does not need to be repaid**

The Paycheck Protection Program Versus EIDL Program

Each program offers benefits and drawbacks. It is important for every business to assess each program and to determine which is the best fit.

	PPP	EIDL	Comments
Eligibility			<ul style="list-style-type: none"> Businesses, nonprofits with 500 or fewer employees or businesses that have more than 500 employees but are still “small” using the convoluted SBA test regarding “size of entity” are eligible under both programs
Use funds for payroll			<ul style="list-style-type: none"> PPP is intended to fund payroll; the CARES Act expands EIDL, allowing those funds to be used for payroll as well
Use funds for rent, utilities, mortgage interest			<ul style="list-style-type: none"> Both loan programs permit funds to be used for rent, utilities, and mortgage interest
Use funds for ops			<ul style="list-style-type: none"> PPP permits the use funds for payroll and a limited set of other permitted uses, the EIDL program permits the use of funds for some business operations needs
Will be forgiven			<ul style="list-style-type: none"> The PPP protection loans will be forgiven so long as the funds are used for payroll and other permitted uses; EIDL loans are not forgiven



Unfavorable



Neutral



Favorable

Contract Issues: Force Majeure

Forces beyond one's control may trigger a force majeure clause. Parties need to analyze the specific terms of the contract in question.

- A **force majeure** clause may excuse a party from performing a contractual obligation in light of an unexpected event beyond its control in specified circumstances
 - The language varies considerably from contract to contract
 - The applicable governing law of the contract has a significant impact on interpretation and therefore the scope and operation of the clause



The contract's language and terms will determine outcome

Contract Issues: Common Law Doctrines

In addition to Force Majeure, several Common law doctrines may apply

■ The Doctrine of Impossibility

- Generally excuses performance when a supervening event that the parties assumed would not occur destroys the subject matter of the contract or the means of performance, effectively **making performance objectively impossible**

■ The Doctrine of Impracticability

- Generally excuses performance when a supervening event that the parties assumed would not occur **renders performance impracticable**
- Impracticable: A fact or circumstance that excuses a party from performing an act, esp. a contractual duty, because (though possible) it would cause extreme and unreasonable difficulty. • For performance to be truly impracticable, the duty must become much more difficult or much more expensive to perform, and this difficulty or expense must have been unanticipated. (Black's Law Dictionary)

■ The Doctrine of Frustration of Purpose

- Generally excuses performance when a supervening event that the parties assumed would not occur **substantially frustrates a party's principal purpose** under the contract

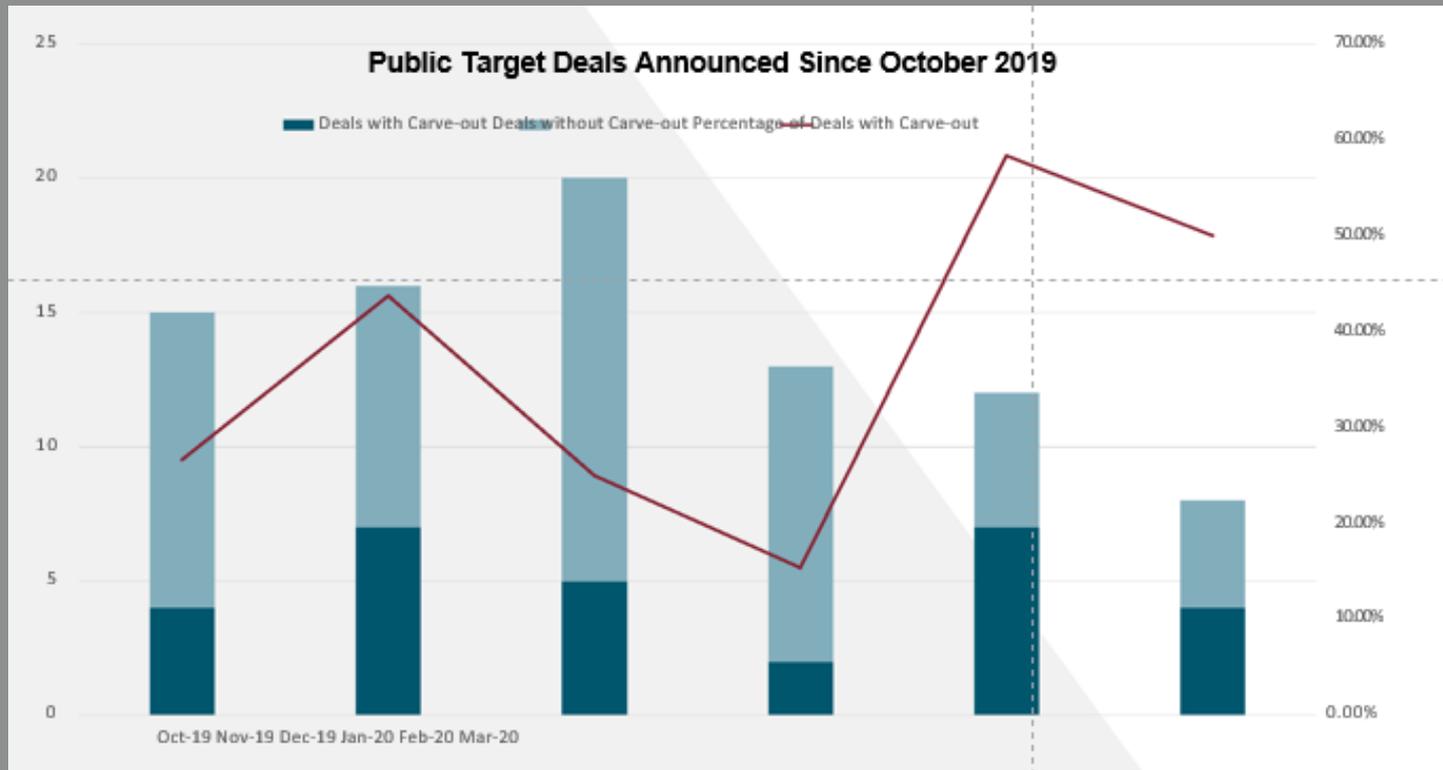
Contract Issues: Recurring Issues

The applicability of force majeure clauses and the three common law doctrines excusing performance often raise similar issues, regarding

- Unforeseeability of the supervening event
- Causation (by an external event beyond the party's control)
- Avoidability (without fault and exercising due diligence or reasonable efforts)
- Allocation of the risk by the parties
- Notice

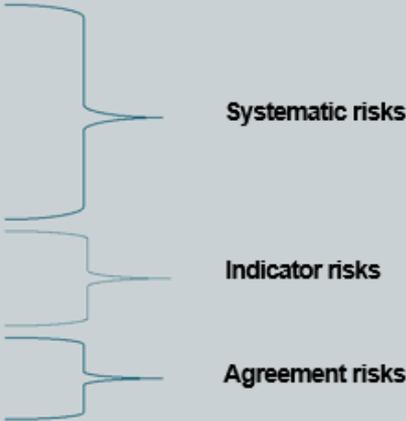
M&A: Impact of Covid-19 on Pending Deals

Although it is early in the Covid-19 Pandemic, deals being negotiated may be negatively affected



M&A: Keeping deals on track

Deals that are already signed are likely to close given the high threshold required to trigger Material Adverse Effect Clauses which allow for termination of the purchase agreement

<p>Element 1:</p> <p>What is an MAE?</p>	<p>An event that has had [or [would/could] reasonably be expected to have] a material adverse effect on:</p> <ul style="list-style-type: none">• Business-related items:<ul style="list-style-type: none">• Business (current or prospects for the future)• Financial condition• Results of operations• Others?• Ability of target to perform its obligations
<p>Element 2:</p> <p>Exclusions</p>	<ul style="list-style-type: none">• Changes in economy• Changes in industry• Acts of war or terrorism• Natural disasters• Changes in law• Changes in GAAP• Failure to meet projections• Credit rating downgrade• Declines in stock price• Pendency of transaction• Actions taken at request of buyer  <ul style="list-style-type: none">Systematic risksIndicator risksAgreement risks

Exclusions are not MAEs but exclusions which disproportionately affect a party to the Purchase Agreement compared to other companies within the industry may still qualify as MAE

M&A: Keeping deals on track

For transactions still being negotiated the contract should shift risk allocation to other sections of the contract

MAE Provisions:	<ul style="list-style-type: none">• Not a great mechanism for allocating specific COVID-related risks
Other Possibilities:	<ul style="list-style-type: none">• Earnout provisions• Closing conditions• Representations and warranties• Financing provisions / reverse termination fees

CARES Act Tax Relief

- Tax Rebate Checks
- Delayed Deadlines
- Delay of Employer Payroll Taxes
- Employee Retention Tax Credit
- Modification of Net Operating Loss Rules
- Modification to Limitation on Business Interest Expense

Tax Rebate Checks

- Act provides “recovery rebate” checks treated as advance refunds of a 2020 tax credit to taxpayers.
- Tax credit of \$1,200 for individuals (\$2,400 for joint filers) plus \$500 for each qualifying child.
- Phase out begins for taxpayers with AGI over \$75,000 for individuals, \$112,500 for heads of household, and \$150,000 for joint filers.
- Credit is not available for non-resident aliens, individuals who can be claimed as a dependent by another taxpayer, and estates and trusts.
- Rebate is based on 2019 tax return (or 2018 return if 2019 return not filed yet).

Delayed Deadlines

- Federal:
 - Filing and payment deadlines for all taxpayers who file and pay their Federal income taxes on April 15, 2020 are automatically extended until July 15, 2020.
- Virginia:
 - Income Tax: Delayed deadline for payments from May 1, 2020 to June 1, 2020. Filing deadline (May 1, 2020) has not been extended.
 - Sales Tax: Businesses can request a 30-day extension for filing and payment of February 2020 sales tax due March 20, 2020.

Delay of Payroll Taxes

- Employers can defer remittance of employer's share of the Social Security payroll tax (6.2% up to \$137,700 wage base) that would have been deposited between the date of the CARES Act's enactment and December 31, 2020.
- Delay of 50% of 2020 employer payroll taxes until December 31, 2021; the other 50% will be due December 31, 2022.
- Employers that are granted loan forgiveness under the Paycheck Protection Program are not eligible for this deferral.

Employee Retention Tax Credit

- Eligible employers are allowed a refundable payroll tax credit equal to 50% of wages paid to employees during COVID-19. Credit is provided for the first \$10,000 in wages (including health care expenses) for each eligible employee.
- Applies to wages paid after March 12, 2020 and before January 1, 2021.
- Eligible employers (including non-profits):
 - Employers that suffer a full or partial suspension of the operation of their business due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to the COVID-19 outbreak.
 - Employers that have gross receipts less than 50% of their gross receipts for the same quarter in the prior year are also eligible, until their gross receipts exceed 80% of their gross receipts for the same calendar quarter in the prior year.

Modification of Net Operating Loss Rules

- TCJA: eliminated carryback of NOLs, indefinite carryforward, 80% of income limitation.
- CARES Act temporarily repeals the 80% income limitation for NOL deductions for years beginning before 2021, allowing companies to fully offset taxable income by such carrybacks / carryforwards.
- For losses arising in 2018, 2019, and 2020, a five-year carryback is allowed (taxpayers can elect to forgo the carryback).

Modifications to Limitation on Business Interest Expense

- TCJA limited business interest expense deduction to 30% of adjusted taxable income (EBITDA) for tax years through 2021.
- CARES Act temporarily modifies the 30% of ATI limitation to 50%. Taxpayers can elect to use 30% limit.
- Businesses can elect to use their 2019 ATI to calculate their 50% of ATI limitation for 2020.
- Partnerships:
 - 50% of excess business interest allocated to partners in 2019 is deductible in 2020 and not subject to limitation.
 - Increase in limitation from 30% to 50% ATI goes into effect in 2020 for partnerships.



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Questions?

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