Legal Update

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BREAKING NEWS: CARES ACT RELIEF FOR SMALL BUSINESSES AND INDIVIDUALS

By Jon Vegosen, Peter T. Berk, Cecilia M. Suh, and Paul M. King

INTRODUCTION

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). This $2 trillion package will provide relief in the face of the coronavirus (COVID-19) pandemic and its devastating effects on millions of people and businesses. This newsletter provides an overview of the CARES Act, which is 880 pages, and focuses on some of the ways that this unprecedented legislation will affect American businesses and employees. The newsletter follows the organization of the CARES Act.

DIVISION A: KEEPING WORKERS PAID AND EMPLOYED, HEALTH CARE SYSTEM ENHANCEMENTS AND ECONOMIC STABILIZATION

Title I: Keeping American Workers Paid and Employed Act

Business Loan Program: The CARES Act amends the Small Business Act (the "SBA") for a business loan program called the Paycheck Protection Program (the "Program"). It provides loans for certain expenses described below that an eligible small business incurs between February 15 and June 30, 2020. The Program is designed to assist not only small business concerns as defined under the SBA, but also the following:

(a) covered businesses employing not more than 500 employees (with potentially higher thresholds in certain industries);

(b) sole proprietors, independent contractors, and self-employed individuals with proper documentation; and

(c) any business concern that employs not more than 500 employees per physical location in certain industries (particularly food and accommodation businesses that provide customers with lodging and/or prepare meals, snacks, and beverages for immediate consumption).

The term "employee" includes individuals employed on a full-time, part-time, or other basis.

Maximum Loan Amount: The maximum potential loan amount is $10 million, and, for the particular business, is generally limited to the sum of the following:

- 250% of the average total monthly payments by the borrower for payroll costs incurred during the one-year period before the date the loan is made (subject to special rules for seasonal employers); <u>plus</u>

- the outstanding amount of a loan made to the borrower under the SBA's Disaster Loan Program during the period beginning January 31, 2020 and ending on the date on which covered loans are made available to be refinanced under the covered loan.

Payroll costs **include** (a) salary, wages, commissions, or similar compensation; (b) payment of cash tips or their equivalent; (c) paid leave; (d) allowance for dismissal or separation; (e) group health care benefits, including insurance premiums; (f) retirement benefits; (g) state or local payroll taxes; and compensation to or income of sole proprietors or independent contractors, including commission compensation, that is not more than $100,000 per worker in one year, as pro-rated for the covered period.

Payroll costs **exclude** (a) the compensation of an individual employee in excess of an annual salary of $100,000, as pro-rated for the covered period; (b) various federal taxes; (c) compensation of an employee whose principal place of residence is outside the U.S.; and (d) qualified sick leave and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act ("FFCRA").

Allowable Uses of Covered Loans: In addition to uses already permitted under the SBA's Business Loan Program, a borrower may use the proceeds of the covered loan for:

(a) payroll costs;

(b) group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums;

(c) employee salaries, commissions, or similar compensations;

(d) payments of interest on any mortgage obligation (but not prepayment or payment of principal on a mortgage obligation);

(e) rent (including rent under a lease agreement);

(f) utilities; and

(g) interest on any other debt obligations that were incurred before the covered period.

Certification: An eligible borrower applying for a covered loan must make a good faith certification:

(a) that the uncertainty of current economic conditions makes the loan request necessary to support its ongoing operations;

(b) acknowledging that funds will be used to retain workers and maintain payroll or make mortgage, lease, and utility payments;

(c) that the borrower does not have an application pending for a loan for the same purpose and duplicative of amounts applied for or received under a covered loan; and

(d) during the period of February 15 - December 31, 2020, that the borrower has not received amounts for the same purpose and duplicative of amounts applied for and received under a covered loan.

Interest / Guarantees / Collateral: The interest rate on a covered loan must not exceed 4%. No personal guarantee and no collateral are to be required for a covered loan.

Loan Forgiveness: A borrower will be eligible for forgiveness of indebtedness on a covered loan in an amount equal to the sum of the following costs incurred and payments made during the eight-week period beginning on the date of loan origination:

(a) payroll costs;

(b) any payment of interest on any covered mortgage obligations (which shall not include any prepayment of or payment of principal on a covered mortgage obligation);

(c) any payment of any covered rent obligation; and

(d) any covered utility payments.

The loan forgiveness amount must not exceed the principal amount of the covered loan.

Loan forgiveness is conditioned upon a borrower retaining its employees and maintaining payroll levels during the covered period. The CARES Act contains a reduction formula if there are fewer employees. It also contains a reduction formula if wages are reduced. There is, however, an exemption from the reductions for employers who, by June 30, 2020, eliminate the reductions in the (i) number of full-time equivalent employees and (ii) the salaries or wages of employees. Employers may want to be mindful of this exemption.

Documentation: The Act contains certain documentation requirements that a borrower must satisfy in order to receive loan forgiveness:

(a) verification of the number of full-time equivalent employees on payroll and their pay rates, including payroll tax filings reported to the IRS and state income, payroll, and unemployment insurance filings;

(b) verification of payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments;

(c) certification the documents presented are accurate and the requested amount to be forgiven 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

(d) any other documentation the SBA Administrator determines necessary.

Taxability: Forgiveness amounts are excluded from taxable income.

Grants for Entrepreneurial Development and Education and Training: Title I also provides for grants to promote entrepreneurial development programs and to provide education, training, and advice to covered small businesses and their employees. There are grants for (a) small business development centers; (b) women's business centers; (c) associations that represent resource partners in a number of languages besides English; and (d) minority business centers.

Emergency Economic Injury Disaster Loan ("EIDL") Grants: The CARES Act expands the SBA's disaster loan program. An eligible entity, including a (i) sole proprietorship, or (ii) a business, cooperative, or an ESOP with not more than 500 employees, that applies for an emergency EIDL grant in response to COVID-19 may request that an advance of not more than $10,000 be made within three days. An advance may be used, among other things, to: (a) provide paid sick leave to employees unable to work due to the direct effect of COVID-19; (b) maintain payroll to retain employees during business disruptions or substantial slowdowns; (c) meet increased costs to obtain materials unavailable from the applicant's original source due to interrupted supply chains; (d) make rent/mortgage payments; and (e) repay obligations that are not met due to revenue losses.

An applicant will not be required to repay the advance even if it is subsequently denied a Program loan.

Bankruptcy: Title I temporarily increases, from $2,750,625 to $7,500,000, the debt threshold for covered small businesses that seek bankruptcy protection during the year following enactment of the CARES Act.

Emergency Rulemaking Authority: The SBA Administrator is to issue rules to carry out Title I within 15 days following its enactment. The usual notice requirement for the rulemaking process is waived.

Assistance with SBA Loans: For assistance with applying or submitting documentation for SBA loans, or any other questions, please contact your legal, financial, or banking advisors.

Title II: Assistance for American Workers, Families and Businesses

Title II is divided into three sections: (a) changes to unemployment; (b) individual benefits, including the "stimulus checks" and retirement plan changes; and (c) tax benefits for employers.

A. Changes to Unemployment

Eligibility for Benefits Extended: The CARES Act extends unemployment benefits to certain individuals who are otherwise not eligible for unemployment benefits or who have exhausted their unemployment benefits so long as the reason they cannot currently work is related to COVID-19. This includes being diagnosed with COVID-19, caring for someone diagnosed with COVID-19, medical advice to self-quarantine, closure of a child's school due to COVID-19, and the person's place of employment being closed due to COVID-19.

Extended Benefits Timing: The extended unemployment benefits mentioned above apply from January 27, 2020 through December 31, 2020. They are authorized to last "as long as the covered individual's unemployment, partial unemployment, or inability to work caused by COVID-19 continues," up to a maximum of 39 weeks (unless subsequent law extends the duration).

Waiting Periods: The benefits under the CARES Act are available without any waiting period, regardless of any state law requiring one.

Increase in Unemployment Benefits: The CARES Act allows states to enter into agreements with the federal government to provide an additional $600 per week in benefits.

First Week of Unemployment: States that do not require a one-week waiting period may also enter into agreements with the federal government for the federal government to pay for the individual's first week of unemployment benefits. Illinois has waived this waiting period.

Short Time Compensation Programs: The CARES Act provides states with reimbursement (in whole or in part) for "short time compensation programs," which allow employers to reduce employee hours rather than conducting layoffs, and allow the employees to receive pro rata unemployment payments.

B. Individual Benefits

Amount of Payment: Eligible individuals that are entitled to a full payment (see below for reductions) will receive $1,200 (joint filers will receive $2,400), plus $500 for each child.

Reduction Based on Gross Income: The payment amount described above is reduced by $5 for every $100 dollars that one's taxable gross income exceeds:

(1) $150,000 for those filing jointly;
(2) $112,500 for those filing as head of household; or
(3) $75,000 for all other taxpayers.

Thus, the entire payment is eliminated for single filers with incomes exceeding $99,000, $146,500 for head of household filers with one child, and $198,000 for joint filers with no children. For a typical family of four, the amount is completely phased out for those with adjusted gross incomes exceeding $218,000.

Relevant Year: For those that have filed 2019 returns, the IRS will use the information in that return. For those that have not yet filed, the IRS will use information from the 2018 tax return.

Early Distributions From Retirement Plans Without Penalty: The CARES Act waives early distribution penalties for up to $100,000 in distributions from qualified retirement accounts for "coronavirus-related distributions" (defined in detail in the Act). The Act also provides certain tax relief and re-contribution rules for those distributions.

Loan Limit Increase: The limitation on loans from qualified retirement plans that are not treated as distributions is raised from $50,000 to $100,000 for 180 days after the enactment of the CARES Act.

Repayment of Loans: Loan repayments due between the enactment date and December 31, 2020 are delayed for one year, and subsequent payments and interest are recalculated accordingly.

Waiver of Minimum Distributions: The CARES Act allows individuals to waive distributions that would otherwise be required during 2020, allowing individuals to leave such funds in qualified retirement accounts if they wish.

Charitable Donations: The rules and limits for charitable donations for taxpayers who itemize as well as those who do not itemize deductions are altered to encourage more charitable giving.

Employer Student Loan Repayment: Repayment of student loan amounts (whether principal or interest) can be provided as a benefit by employers without a resultant tax on the employee for payments made prior to January 1, 2021.

C. Tax Benefits for Employers

The CARES Act also provides a number of tax benefits for employers. Below are some (but not all) of the key changes. You should consult your legal and tax advisors regarding how these and other tax provisions apply to your business.

Employee Retention Credit: Private employers negatively impacted by COVID-19 may receive a credit against payroll taxes. The credit is limited to 50% of the first $10,000 in "qualified wages" per employee, or the total employment taxes owed, for the period of March 12 through December 31, 2020.

The credit is available to employers for each quarter that they are required to completely or partially close under a COVID-19 related government order until such order is lifted. The credit is also available to employers for each quarter that their gross receipts have declined by more than 50% compared to the same quarter in the prior year until a subsequent quarter in which the employer has gross receipts totaling over 80% of that same quarter in the prior year. Importantly, these provisions also apply to organizations that are tax exempt under the provisions of section 501(c) of the Internal Revenue Code.

For larger organizations (with over 100 employees), the credit is limited to payments for those employees who are not providing services due to the COVID-19 closures or losses described above.

SBA Loan Limitation: A business that has received an SBA Program loan is not eligible for the Employee Retention Credit.

Payroll Tax Payment Delay: Employers and self-employed individuals are allowed to defer payment of the employer's share of certain employment taxes. Half of the deferred payment will be due by December 31, 2021, and the other half will be due by December 31, 2022.

Other Business Tax Provisions: The CARES Act also changes the limits and carryover and carryback rules for net operating losses, loss limitations applicable to pass-through entities and sole proprietorships, the minimum tax liability for corporations, and the rules for business interest expense deductions, among other items.

Certain Exemptions From Excise Taxes: The excise tax for distilled spirits is waived if they are used to make hand sanitizer in accordance with FDA guidance.

Title III: Supporting America's Health Care System in the Fight Against the Coronavirus

Title III includes broad changes to, and support for, the national health care and medical systems in response to COVID-19. It also provides clarification regarding the new paid leaves of absence from work available under the recently passed Families First Coronavirus Response Act ("FFCRA") as well as relief for certain student loan borrowers as part of the education-related provisions of Title III. For more information about the FFCRA paid leave entitlements, please see our recent newsletter here. Some of the key provisions of Title III are as follows:

Changes to the U.S. Health Care and Medical Systems: The CARES Act provisions modifying the U.S. health care and medical systems are aimed at addressing issues such as the anticipated shortages in the U.S. supply chain for medical products, potential shortages of drugs, and insurance coverage for COVID-19 related services.

Clarifications About the New Paid Leaves Available under the FFCRA: Title III also provides various clarifications regarding the recently-enacted FFCRA, including:

(a) **Cap on Emergency Paid FMLA Leave:** Clarifies the limitation on Emergency Paid FMLA Leave under the Emergency FMLA Expansion Act, making it explicit that an employer shall not be required to pay more than $200 per day and $10,000 in the aggregate for each employee.

(b) **Cap on Emergency Paid Sick Leave:** Clarifies the limitation on Emergency Paid Sick Leave under the Emergency Paid Sick Leave Act, making it explicit that an employer shall not be required to pay more than $511 per day and $5,110 in the aggregate for sick leave or more than $200 per day and $2,000 in the aggregate to care for a quarantined individual or child for each employee.

(c) **Advance Payment of Tax Credits:** Allows employers to receive an advance tax credit instead of having to be reimbursed on the back end for payments under the Emergency FMLA Expansion Act and Emergency Paid Sick Leave Act. Regulations and guidance, as well as forms and instructions, for receiving tax credit advances, instead of seeking refundable credits, are expected to be issued in the near future.

(d) **Changes to Employee Eligibility Requirements for Emergency FMLA Leave:**

  i. Limits eligible employees to employees who have been employed for at least 30 calendar days by the employer.

  ii. Protects employees who were laid off beginning March 1, 2020, or later by giving them access to paid leave under certain instances if they are rehired and worked for the employer at least 30 days of the last 60 days prior to being laid off.

(e) **Unemployment Insurance:** Provides that states must make their application process for unemployment compensation benefits and assistance accessible, and available in at least two of the following methods: in person, by phone, or online.

Changes to Education and for Student Loan Borrowers under the COVID-19 Pandemic Education Relief Act of 2020:

The Title III provisions related to education under the COVID-19 Pandemic Education Relief Act of 2020 are generally designed to provide greater flexibility and use of funds under existing federal education programs in order to help students, student loan borrowers, and educational institutions affected by COVID-19. The Senate Health, Education, Labor and Pensions Committee estimates that Title III will provide relief for over 95% of student loan borrowers. In addition to other education-related changes, Title III:

(a) suspends all payments due for federal student loans for six months, through September 30, 2020, without penalty to the borrower for all federally owned loans;

(b) requires reporting of these federal student loan payments that have been suspended to consumer reporting agencies to be treated as if they were regularly scheduled payments made by the borrower;

(c) counts each month during which a federal student loan payment is suspended toward payments made for the purpose of loan forgiveness or loan rehabilitation programs;

(d) suspends most collection efforts related to federal student loan payments (e.g., wage garnishments);

(e) provides that affected student loan borrowers must be notified, within 15 days after Title III is enacted, about the temporary relief available under Title III and their options, such as continuing to make payments toward principal;

(f) waives the institutional matching requirement for campus-based aid programs and allows institutions to award additional funds and emergency financial aid grants for unexpected expenses to students impacted by COVID-19;

(g) allows institutions to still issue federal work-study payments to students who are unable to work due to COVID-19;

(h) provides various forms of relief for students who have dropped out of school as a result of COVID-19, including relief under Pell Grants or federal student loans; and

(i) modifies service requirements for teachers who could not finish their year of teaching service as a result of COVID-19 by allowing them to count their partial year of service as a full year of service toward TEACH grant obligations or teacher loan forgiveness and waiving the requirement that teachers must serve consecutive years of teaching service for teacher loan forgiveness eligibility if a teacher's service is not consecutive as a result of COVID-19.

Title IV: Economic Stabilization & Assistance to Severely Distressed Sectors of the U.S. Economy

Title IV includes the Coronavirus Economic Stabilization Act of 2020, which provides funding to support eligible businesses, states, and municipalities. Specifically, it provides $500 billion for making loans, loan guarantees, or other investments related to losses incurred as a result of the coronavirus. To be eligible, a business must (a) be created or organized in the U.S. or under U.S. law, (b) conduct a significant amount of its operations in the U.S., and (c) have a majority of its employees in the U.S. Businesses that receive a loan, loan guarantee, or investment are subject to several prohibitions. For example, stock buybacks and dividends/capital distributions are strictly prohibited for the duration of the loan plus 12 months.

The Secretary of the Treasury will publish procedures to apply for funds under this title within 10 days of the enactment of the CARES Act. The Secretary will also report all transactions entered into under the CARES Act on its website and be subject to oversight by a new inspector general's office.

Title V: Coronavirus Relief Funds

Title V establishes the Coronavirus Relief Fund, which provides $150 billion to states, tribal governments, and units of local government, to use for expenditures incurred due to the public health emergency caused by COVID-19, allocated by population.

Title VI: Miscellaneous Provisions

Title VI provides an additional $10 billion of borrowing authority for the United States Postal Service to respond to the effects of COVID-19.

DIVISION B - EMERGENCY APPROPRIATIONS FOR CORONAVIRUS HEALTH RESPONSE AND AGENCY OPERATIONS

Division B of the CARES Act provides $340 billion in emergency funding for various government programs, including the Department of Agriculture, the United States Federal Emergency Management Agency, and the United States Centers for Disease Control and Prevention. Some of these funds may be available for businesses.

CONCLUSION

While this newsletter does not cover every aspect of the CARES Act, it should provide readers with a good sense of what the CARES Act addresses. For the full text of the legislation, click here. For a section-by-section summary of the CARES Act that the Chairman of the Senate Health, Education, Labor and Pensions Committee released, click here. Although the CARES Act is the third piece of legislation passed to address the tremendous adverse effects of COVID-19, there will likely be a need for additional legislation to deal with the health and economic aspects of the pandemic.

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