ThompsonKnight

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CARES ACT: SUPPORT FOR MID-SIZE TO LARGE BUSINESSES

This Client Alert discusses the impact of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") on mid-size and large businesses. Appendix A to this Client Alert summarizes the economic relief provided to small businesses under the CARES Act, which was described in more detail in a previous Client Alert.[1]

Am I a "mid-size business?" The CARES Act provides relief to mid-size employers (those with between 500 and 10,000 employees) by providing $500 billion to the Secretary of Treasury for loans, loan guarantees, and investments in eligible businesses under Title IV of the CARES Act, or the Coronavirus Economic Stabilization Act of 2020 ("Title IV"). With these funds, it is possible for a mid-size business to be eligible for loans under the Emergency Relief and Taxpayer protections portion of the CARES Act. Note that, as discussed further in Appendix A, certain businesses with more than 500 employees may still be deemed to be a "small business."

What if I am considered neither a small nor mid-size business? While Title IV focuses on certain types of businesses (as discussed below), larger companies that do not fall into any of those categories may still be eligible for Title IV loans once further programs pursuant to Title IV are rolled out and further guidance is issued. Additionally, there are various tax relief provisions under the CARES Act that could benefit large businesses as described below.

ELIGIBILITY FOR AND RESTRICTIONS ON RELIEF UNDER TITLE IV

Am I eligible for a Title IV loan? Title IV appropriates $500 billion to the Secretary of Treasury for loans, loan guarantees, and investments in "eligible businesses," including mid-size and large businesses, the aviation industry, and businesses "critical to maintaining national security."[2] The definition of "eligible business" under Title IV is very broad, and includes any U.S. business that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the CARES Act. Up to $46 billion of these funds are appropriated for loans to businesses in the aviation industry and businesses that are "critical to maintaining national security." The Secretary of the Treasury is directed to use up to $454 billion (plus any of the $46 billion described above that is not used) to make loans and loan guarantees to, and other investments in, programs or facilities for the purpose of providing

[1] There is mounting bipartisan political pressure to modify the affiliation rules so that more private equity-backed companies will qualify as a small business and therefore be able to take advantage of certain programs targeted to small businesses in the CARES Act. As the law is currently written, a company owned by a private equity firm must count not only its own employees, but also the employees of the private equity firm's other portfolio companies. We are monitoring developments and anticipate that this Appendix and its analysis with respect to what is considered a small business may change.

[2] What constitutes a business "critical to maintaining national security" has not yet been defined.

liquidity to the financial system that supports lending to "eligible businesses." Title IV also suggests that the Federal Reserve System may establish a Main Street Lending Program or other similar program or facility that supports lending to small and mid-size businesses. This includes the Mid-Size Business Program referenced and detailed in the CARES Act, and further explained below. The interest rate on any loan made to an eligible mid-size business is not permitted to exceed two percent per annum. In addition, no interest or principal payments will be required on any such loan for the first six months, or longer as determined by the Secretary of the Treasury. Other terms and conditions will be established by the Secretary of the Treasury and the Federal Reserve.

But there are strings attached… It is important to note that the loans offered under Title IV come with significant restrictive conditions. While some of the restrictions apply to all Title IV loans, some are specific to certain sections of Title IV (*e.g.*, the section addressing the aviation industry and the section addressing nonprofits and mid-size businesses). For example, businesses that receive Title IV loans may not increase salaries for officers and employees whose compensation exceeded $425,000 in 2019 or offer those employees severance pay or other benefits upon termination of more than twice their maximum total compensation for the year. These restrictions apply during the course of the loan and for one year thereafter. However, these restrictions do not apply to employees whose compensation is determined through an existing collective bargaining agreement that was entered into prior to March 1, 2020. Further, officers or employees of the eligible business whose total compensation exceeded $3 million in 2019 are prohibited from earning more than $3 million plus 50 percent of any amount of their compensation that exceeded $3 million in 2019. For example, if an employee earned $20 million in 2019, such employee would be prohibited from earning more than $11.5 million annually. These restrictions would apply from the time the federal support began to one year after it ended.

I'm a mid-size business receiving a loan under the Mid-Size Business Program. What restrictions apply to my loan? Mid-size businesses (including non-profit organizations) that seek loans under Title IV are subject to additional conditions as part of the Mid-Size Business Program, including requirements relating to use of funds, employment levels, outsourcing jobs, union organizing efforts, and highly compensated employees. For a business to receive this type of loan, it must make a "good-faith certification" that it will comply with the following restrictions listed in Title IV:

- *Funds Must Be Used To Retain Employees*. At least 90 percent of the government loan must be paid to the employer's workforce, at full compensation and benefits, until September 30, 2020.

- *Current Employment Levels Must Be Maintained*. The employer must retain at least 90 percent of its employees as of the time the loan is received at full pay through September 30, 2020. The employer also must sign a good faith certification that it intends to restore not less than 90 percent of its employees that existed as of February 1, 2020, and to restore all compensation and benefits to its employees, no later than four months after the Federal public health emergency declaration ends.

- *Domiciled or Organized in the United States*. The employer must be an entity or business domiciled, organized, or created in the United States with significant operations and employees located in the United States.

- *No Bankruptcy*. The employer must not be a debtor in a bankruptcy proceeding.

- *No Dividends or Repurchasing of Securities*. The employer must not pay dividends with respect to the common stock of its business or repurchase an equity security that is listed on a national securities exchange of the business or any parent company while the loan is outstanding, except to the extent that is required under a contractual obligation in effect as of the date of enactment of the CARES Act.

- *No Outsourcing and No Abrogation of CBAs*. The employer must not outsource or offshore any jobs or abrogate any existing collective bargaining for the term of the loan and for two years after completion of repaying the loan.

- *Employer Must Remain Neutral*. The employer must agree to remain neutral in any union organizing effort throughout the term of the loan.

I'm an airline business. What restrictions apply to my loan? To receive a direct loan under Title IV, an airline or other eligible aviation business must agree to maintain current employment levels as of March 24, 2020, to the extent practicable, and, in any event, not reduce staffing by more than 10 percent before September 30, 2020. Further, businesses receiving a direct loan must agree to not buy back stock or pay dividends for a period of time that extends one year beyond the term of the loan. Additionally, during the life of the loan, the borrower can only invest in, or loan to, U.S. businesses.

TAX CHANGES AND BENEFITS SPECIFICALLY FOR LARGE BUSINESSES

In a previous Client Alert, we explained the tax issues and implications associated with the CARES Act; this section of this Client Alert expands on how these tax changes could benefit large businesses. Specifically, there are eight provisions under subtitle C of Title II of the CARES Act, or the Assistance For American Workers, Families, and Businesses Act ("Title II"), that offer tax relief to larger businesses.

- *Employee Retention Credit.* Eligible employers, including tax-exempt organizations but not governmental entities, are allowed a refundable credit against applicable employment taxes, including Social Security and Railroad Retirement, equal to 50 percent of the first $10,000 in wages per employee, including value of health plan expenses that are properly allocable to such wages. An eligible employer means an employer who carried on a trade or business during calendar year 2020 and whose (1) operations were fully or partially suspended, due to a COVID-19 related shutdown order, or (2) gross receipts declined by more than 50 percent when compared to the same quarter in the prior year. If an employer is eligible for the credit due to a drop in gross receipts, the availability of the credit continues each quarter until the employer's gross receipts exceed 80 percent of the gross receipts for the corresponding quarter in 2019. This credit is effective for wages paid after March 13, 2020 and before January 1, 2021. However, it is important to note that this tax credit is not available if the employer is a borrower under the Paycheck Protection Program (described in Appendix A). Further, for employers with more than 100 full-time employees, only employees who are currently not providing services for the employer due to (1) and (2) above are eligible for the credit.

- *Delay of Employer Payroll Taxes*. While employers are responsible for paying a 6.2 percent Social Security tax on employee wages, from March 27, 2020 (the date of enactment of the CARES Act) through December 31, 2020, employers are allowed to defer depositing the employer's share of Social Security taxes. Half of this deferred amount will be due on December 31, 2021, and the other half by December 31, 2022. Please note that this deferral is not available if the employer has had indebtedness forgiven under the Paycheck Protection Program (described in Appendix A).

- *Modifications for Net Operating Losses*. The Tax Cut and Jobs Act (the "TCJA"), enacted in 2017, eliminated net operating loss ("NOL") carrybacks for certain years. Under the TCJA, NOLs arising after 2017 could be carried forward indefinitely, but were limited to 80 percent of taxable income in the relevant carryforward period. The CARES Act provides that NOLs arising in a tax year beginning in 2018, 2019, or 2020 can be carried back five years. Additionally, the NOLs can be used to offset the entire taxable income of a corporation and are no longer limited to 80 percent.

- *Modification of Limitation on Losses for Non-Corporations*. Limitations on excess business losses applicable to non-corporate businesses, such as pass-through entities and sole proprietorships, are removed for tax years ending before January 1, 2021. This change may increase a non-corporate taxpayer's NOLs that can be carried back under the above-discussed NOL provisions.

- *Prior-Year Corporate AMT Credit Acceleration*. Companies are now able to claim refundable Alternative Minimum Tax ("AMT") credits and obtain additional cash flow. The TCJA allowed taxpayers to claim refundable AMT credits over the period of 2018-2021. Under the CARES Act, the allowance of refundable AMT credits is accelerated to tax years 2018-2019 and companies can take advantage of expedited refund procedures.

- *Business Interest Expense Limitation Modification*. The TJCA limits business interest expense deductions to the sum of 30 percent of adjusted taxable income (calculated similarly to EBIDTA) plus business interest income. The CARES Act increases the limitation to 50 percent for taxable years beginning in 2019 and 2020. Another change allows the limitation for taxable years beginning in 2020 to be calculated with respect to adjusted taxable income from 2019. This change benefits taxpayers whose 2019 income exceeds their 2020 income. Separate rules apply to interest expense of partnerships to generate a similar outcome. This may be a significant benefit to some taxpayers and may create additional NOLs that could be carried back to previous tax years under the modifications for NOLs explained above.

- *Technical Correction to Treatment of Qualified Improvement Property*. A drafting error in the TCJA prohibits certain qualified improvement property from being eligible for 100 percent bonus depreciation. The CARES Act retroactively fixes this mistake and allows restaurateurs, retailers, and others to claim bonus depreciation. Amended returns for 2018 could generate cash tax

refunds, and taxpayers may have a larger 2019 tax refund due to the availability of bonus depreciation.

- *Exception from Excise Tax for Alcohol Used for Hand Sanitizer Production*. For 2020, the federal excise tax is waived on any distilled spirits used in hand sanitizer that is produced and distributed in a manner consistent with guidance from the FDA.

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

CONTACTS:

Anna Marie Dempsey
713.653.8760
AnnaMarie.Dempsey@tklaw.com

Mitchell L. Griffith
214.969.1731
Mitchell.Griffith@tklaw.com

Jeremiah M. Mayfield
214.969.1744
Jeremiah.Mayfield@tklaw.com

Cassandra G. Mott
713.951.5803
Cassandra.Mott@tklaw.com

Michael C. Titens
214.969.1437
Michael.Titens@tklaw.com

Wesley P. Williams
214.969.1324
Wesley.Williams@tklaw.com

Susan Fisher
214.969.1158
Susan.Fisher@tklaw.com

Maddie Giese
214.969.1189
Maddie.Giese@tklaw.com

Angela Herrington
214.969.1547
Angela.Herrington@tklaw.com

Austin M. Jacobs
713.951.5859
Austin.Jacobs@tklaw.com

APPENDIX A

Who is a "small business." To qualify for the loans made under Title I of the CARES Act, or the Keeping American Workers Paid and Employed Act ("Title I"), an employer must qualify as a small business under the existing Small Business Administration ("SBA") rules for "small business concerns." The interim guidelines published by the SBA on April 2, 2020 (the "Interim Guidelines") clarify which employers are eligible for a loan under Title I, which are referred to as Paycheck Protection Program loans ("PPP loans"). An employer is eligible for a PPP loan if it: (i) has 500 or fewer employees whose principal place of residence is in the United States, or is a business that operates in a certain industry and meets the applicable SBA employee-based size standards for that industry (which standard may be higher than 500 employees); (ii) is (A) a small business concern and subject to SBA's affiliation rules, unless specifically waived by the CARES Act or (B) a 501(c)(3) tax-exempt non-profit organization, a 501(c)(19) tax-exempt veterans organization, a Tribal business concern defined in the Small Business Act, or any other business; and (iii) was in operation on February 15, 2020 and either had employees for whom it paid salaries and payroll taxes or paid independent contractors as of such date.

Effect of "affiliates" on classification. The "affiliation rules," which may cause the employees of your business to be aggregated with those of other businesses that are affiliated with yours, apply to employers under Title I. These rules are complex and provide for a number of waivers. In addition, it is anticipated that additional guidance will be forthcoming interpreting these rules, including potential expansion of the waivers. The Interim Guidelines do not clarify the application of the "affiliation rules" but do mention that the SBA intends to promptly issue additional guidance with regard to the applicability of those rules to PPP loans.

ELIGIBILITY FOR AND RESTRICTIONS ON RELIEF UNDER TITLE I

Loans made under Title I to small businesses (known as the Paycheck Protection Program) may be used to cover both wages owed to employees and payments owed to independent contractors (excluding certain highly compensated employees or contractors and employees whose principal place of residence is outside the United States). The Interim Guidelines require that at least 75 percent of PPP loan proceeds must be used for payroll costs. Funds under this program can also be used to cover payment for group health benefits, including insurance premiums and the cost of continuing group health coverage during periods of qualifying paid sick, medical, or family leave under the Families First Coronavirus Response Act (FFCRA), and payment for any retirement benefits or applicable state and local wage taxes. Funds can also be used to pay certain business expenses, including rent, utility, and mortgage interest payments. These loans include complete payment deferment relief (including payment of principal, interest and fees) for a period of not less than six months and not more than one year and are eligible for forgiveness of certain amounts used for payroll, mortgage/rent payments, and utility payments during the eight-week period beginning on the date of the origination of the loan if the business was in operation on February 15, 2020.

Are the SBA's affiliation rules waived for my business? The SBA size standards define whether a business qualifies as "small." In determining whether a particular business meets such size standards, the SBA's affiliation rules require an employer to aggregate its employees with the employees

of its affiliates. Under the CARES Act, the affiliation rules are waived for (i) NAICS Code 72 businesses (*i.e.*, hospitality businesses and restaurants) that employ 500 employees or fewer, (ii) franchises, or (iii) businesses that receive financial assistance from a small venture investment company licensed under the SBA. The CARES Act also allows NAICS Code 72 businesses that employ not more than 500 employees "per physical location" to be eligible for a loan. For example, hospitality businesses and restaurants are eligible for a loan as long as they employ 500 employees or fewer "per physical location." Further, a restaurant franchisee with 5,000 employees (but no more than 500 employees at any one location) could qualify for the loans.

But there are strings attached… It is important to note, however, that both the loans and the forgiveness program come with certain labor and employment conditions, including restrictions on payments made to highly compensated employees and requirements that the current employment levels and salaries be maintained. For example, if loan proceeds are used to pay employees at a rate of more than $100,000 annually, the portion of the payments in excess of $100,000 annually (as prorated for the period of February 15, 2020 through June 30, 2020) will not be eligible for forgiveness. Further, in order to be eligible for the full amount of the loan forgiveness, employers must not reduce salaries or wages in excess of 25%, except for employees who earn wages or salaries that exceed $100,000. Additionally, the amount of loan forgiveness, which can be up to 100% of the principal balance, will be reduced by a proportional amount if the employer (i) terminates the employment of employees and/or (ii) decreases employee salaries or wages in excess of 25% (as compared to the prior year). Employers that re-hire (prior to June 30, 2020) workers previously laid off will not be penalized for having a reduced payroll at the beginning of the period.

This Client Alert is sent for the information of our clients and friends. It is not intended as legal advice or an opinion on specific circumstances. Furthermore, due to the rapidly evolving nature of the COVID-19 pandemic, you should consult with counsel for the latest developments and updated guidance.