March 27, 2020

Congress Passes CARES Act

Earlier today, the House of Representatives passed the largest economic stimulus bill in U.S. history. The Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") provides $2 trillion in emergency relief. The bill was approved by the Senate late Wednesday night and is widely expected to be signed into law by the President shortly. Nearly 900 pages in length, the bill provides for many forms of relief to broad segments of the nation. The following is an overview of the key provisions.

Title I – Keeping American Workers Paid and Employed Act

Paycheck Protection Program

- The Act amends the Small Business Act (the "SBA") 7(a) loan program to include a new guaranteed, unsecured loan program (the "Paycheck Protection Program") to help fund operational costs of eligible businesses, organizations and self-employed persons during the COVID-19 pandemic.
- Congress appropriated $349 billion for guaranteed, low-interest, no-fee loans under the Program, with repayment deferred for at least six months.
- The Program also permits loan forgiveness up to 100% of the loan principal amount, subject to employment-number and compensation-level requirements.
- Further details about the Paycheck Protection Program:
    - Applicability: The loan program covers businesses, nonprofits and veterans' organizations and tribal business concerns with up to 500 employees (unless the applicable industry has a higher size standard under SBA rules).
    - The employee count can include full-time, part-time or other hires.
    - In certain industries (accommodation and food services), businesses with more than 500 employees and one physical location are eligible for the loan program, provided that they do not have more than 500 employees per physical location.

- The loan program also covers individuals operating under sole proprietorships, independent contractors and self-employed individuals (subject to certain additional documentation requirements).

- Covered Period for Loans: February 15, 2020 through June 30, 2020.

- Amount: The maximum loan amount is $10 million.

- The formula for determining the size of the loan for a particular borrower is tied to payroll costs (broadly defined) incurred by the business.

- Uses: Allowable uses of the loan funds include payroll costs; continuation of healthcare benefits during paid sick, medical or family leave; insurance premiums; mortgage interest payments, rent and utility payments; and interest on other existing debt obligations.

- Borrower Requirements:

  - Certification – Borrowers must make a good-faith certification that (i) the loan is necessary due to the current economic conditions caused by COVID-19, (ii) they will use the funds to retain workers and maintain payroll, lease and utility payments and (iii) they are not receiving duplicative funds for the same uses under another SBA program.

  - Employment Level – Borrowers must maintain an average monthly number of full-time equivalent employees during the covered period that is not less than the average monthly number during a specified period prior to the COVID-19 pandemic.

- Guaranteed loans: The government will guarantee 100% of the loans through December 31, 2020. After that date, the guarantee percentage will return to 75% for loans over $150,000 and 85% for loans under $150,000.

- Deferments: Lenders must provide complete payment deferment for at least six months and up to 12 months.

- There is a limited safe harbor for lenders participating in the loan program.

- Loan Forgiveness: Paycheck Protection Program loans may be forgiven.
    - Coverage: Borrowers will be eligible for loan forgiveness equal to the amount they spend during the eight-week period after the loan origination date on payroll costs, interest payments or mortgages incurred prior to February 15, 2020, payment of rent on any lease in force prior to February 15, 2020 and payment on any utility for services that began prior to February 15, 2020.
    - Restrictions: Restrictions on loan forgiveness include:
        - the amount forgiven may not exceed the loan principal amount; and
        - payroll costs for compensation above $100,000 in wages are not eligible for loan forgiveness.
    - Reductions: The amount forgiven will be reduced proportionally by any reduction in employees retained compared to the prior year and reduced by the reduction in pay of any employee beyond 25% of their prior year compensation.
    - To encourage rehiring, this forgiveness reduction will not apply if the borrower eliminates any reduction in employee number and employee salaries/wages by June 30, 2020.
    - SBA remittance: The SBA will reimburse the lender for the amount of forgiveness (plus accrued interest).
    - Federal tax effect: Forgiven loan amounts (cancelled indebtedness) are excluded from gross income for tax purposes.
- Loan maturity: Any loan, or portion of a loan, that is not forgiven will have a maturity of 10 years or less, and a maximum interest rate of 4%. There will be no prepayment fees.

Emergency Economic Injury Grants

- The Act creates a new $10 billion grant program under the SBA's Office of Disaster Assistance, designed to provide quick relief while applicants await processing of SBA Economic Injury Disaster Loans ("EIDLs"). EIDLs are loans of up to $2 million with interest rates of 3.75% for companies and

2.75% for nonprofits, and have interest and principal deferment for up to four years.

- Loan applicants may request grants of up to $10,000 to cover immediate payroll, mortgage, rent and other specified operating expenses.

- The grant does not have to be repaid, even if the loan application is denied.

- Covered entities: Covered entities include businesses, nonprofits, agricultural cooperatives and tribal business concerns with less than 500 employees, independent contractors and the self-employed.

- Covered period: Beginning January 31, 2020 and ending December 31, 2020.

- A business that receives an EIDL during the covered period as a result of the COVID-19 disaster declaration can also apply for or refinance their EIDL into a Paycheck Protection Program loan.

SBA Borrower Principal/Interest Relief under Existing SBA Loans

- Deferments: During the COVID-19 emergency period, lenders on existing SBA-backed loans are encouraged to provide payment deferments and extend the loan maturity to avoid balloon payments or other requirements that would increase the debt payments as a result of the deferments.

- SBA Payments: The SBA will pay lenders the deferred principal and interest payment amounts (and associated fees) that are owed during the covered period for a six-month period, relieving the borrowers of that obligation.

- Coordination with banking agencies: The SBA will encourage federal and state banking agencies to not require lenders to increase reserves due to deferment and receipt of SBA payment.

Title II – Assistance for American Workers, Families and Businesses

Income Tax Relief for Businesses

- The Act will enhance near-term liquidity of business taxpayers by temporarily liberalizing rules enacted in 2017 relating to net operating

losses, interest expense deductions, alternative minimum tax credits and trade or business losses of non-corporate taxpayers.

- The changes create significant opportunities for taxpayers to claim refunds or reduce upcoming tax payments.
- Taxpayers, especially those with losses, interest expense or alternative minimum tax credits, should evaluate the Act's impact on the availability of refunds and on upcoming tax obligations.
- Most significantly, the Act temporarily lifts two restrictions on the use of net operating losses.
    - The Act permits losses incurred in 2018, 2019 and 2020 to be carried back five years.
        - Previously, losses could only be carried forward, not carried back.
        - For example, under the Act, if a taxpayer had $100 of taxable income in 2018 and $100 of taxable income in 2019 and incurs a $200 loss in 2020, the taxpayer can carry the $200 loss back to 2018 and 2019 and claim a refund.
        - The five-year carryback period could be especially valuable for taxpayers with capacity to carry back losses to 2017 (or a prior year) as such losses would reduce taxable income that was generally taxed at a 35% rate (rather than the current 21% rate).
        - The Act does not, however, permit loss carrybacks to reduce the 2017 one-time "transition tax" on offshore income.
    - The Act permits loss carryovers and carrybacks to eliminate 100% of taxable income for carryovers and carrybacks to 2018, 2019 and 2020, rather than only 80% of taxable income under pre-Act law.
        - Thus, if a taxpayer incurs a loss of $100 in 2018 and has taxable income of $100 in 2019, the taxpayer can use all $100 of the 2018 loss against all $100 of the 2019 taxable income.
        - Previously, the taxpayer would have had to pay tax on $20 for 2019.

- The Act temporarily loosens restrictions on interest expense deductions.
    - Previously, interest deductions were limited to 30% of "adjusted taxable income."
    - The Act changes the limit to 50% for 2019 and 2020 (with special rules for partnerships for 2019).
    - Under the Act, for 2020, taxpayers may use 2019 adjusted taxable income to calculate the limit.
    - Any interest expense in excess of the limit is, as before, carried forward.
- The Act accelerates the ability to claim a refund for taxes paid under the alternative minimum tax credit system that was repealed in 2017 and provides for expedited procedures for claiming such a refund.
- The Act defers limitations on trade or business loss deductions of non-corporate taxpayers, applying them beginning in 2021, rather than 2018.
- The Act fixes a technical error in the Internal Revenue Code to permit immediate expensing of 100% of the costs associated with improving the interior portion of any non-residential real property.
- The Act loosens restrictions on deductions for certain charitable contributions made in cash (or food inventory) in 2020.

<u>Unemployment Insurance</u>

- The Act includes significant enhancements to protections for the unemployed, including:
    - assistance for various individuals not covered by traditional unemployment insurance;
    - reimbursements to state and local governments for expenses associated with providing enhanced unemployment insurance (including up to an additional $600 per week, through July 31, 2020); and

  - extended benefits through the end of 2020 (up to a maximum of 39 weeks) for various categories of employees whose regular unemployment insurance benefits have previously expired.

- The enhanced benefits are generally available to individuals who would otherwise be ready and available for work but for specified consequences of the COVID-19 crisis.

Individual Tax Credit

- The Act provides a tax credit for 2020 of $1,200 ($2,400 for joint filers) and $500 per child under the age of 17, subject to phase-out for taxpayers with adjusted gross incomes in excess of $75,000 (or $112,500 for heads of households and $150,000 for joint filers).

Flexibility under Certain Retirement Plans

- The Act relaxes various restrictions applicable to eligible tax-qualified, defined contribution retirement plans, such as 401(k) plans:

  - participants affected by the crisis may withdraw up to $100,000 without penalty (with a three-year period for recognition of associated taxes or for return of the funds to the plan account);

  - the maximum loan amount is increased to the lesser of $100,000 and 100% of the participant's vested account balance (an increase from the lesser of $50,000 and 50% of the participant's vested account balance); and

  - participants may delay receipt of minimum distributions that otherwise would be required to be made in 2020.

Employee Retention Credit

- The Act provides a credit against employer payroll taxes to certain businesses that experience full or partial shutdowns or significant revenue reductions for 50% of up to $10,000 of qualified wages (including health plan expenses) per employee payable from March 13, 2020 through December 31, 2020.

- The credit applies for any calendar quarter (i) during which the company's operations were fully or partially suspended by a governmental authority or

(ii) that falls during the period beginning with the first calendar quarter in 2020 for which the company's gross receipts were less than 50% of those in the same quarter in the prior year and ending with the calendar quarter after the quarter for which such employer's gross receipts are in excess of 80% of gross receipts for the same quarter in the prior year.

- For companies with more than 100 employees, qualified wages are limited to wages paid to employees who were not providing services due to the impact of the COVID-19 crisis.

Deferral of Employer Payroll Taxes

- The Act allows employers to defer payment of 2020 employer payroll taxes (from the date of enactment through the end of the year), with 50% due on December 31, 2021 and 50% due on December 31, 2022.

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

Emergency Preparedness

- The Act requires the national stockpile to include personal protective equipment, diagnostic tests and other supplies, and provides for expedited review of certain drug applications.

- Manufacturers of certain critical drugs or medical devices must develop risk management plans and must notify the government in advance of anticipated shutdowns or interruptions.

- Government procurement restrictions are eased for the duration of the emergency.

Coverage for Coronavirus Testing and Vaccines

- The Act modifies the Families First Coronavirus Response Act to broaden the definition of qualifying coronavirus tests that health insurers must cover without any cost sharing.

- It sets reimbursement rates at which healthcare providers are to be paid by health insurers for testing services and requires that healthcare providers post their testing prices online.

- It requires health insurers and Medicare Part B to cover certain coronavirus vaccines and qualifying preventative measures without cost sharing.

Support for Healthcare Providers and Community Programs

- The Act limits the liability faced by volunteer healthcare professionals, loosens restrictions on telehealth services, allows nurse practitioners to perform certain medical tasks, and requires Medicare drug plans to allow up to three-month refills for the duration of the crisis.

- It awards multiple grants to healthcare and community organizations and creates and/or funds research initiatives and community and public health programs.

Education

- The Act suspends all payments of principal and interest for certain federal student loans, and requires that, for the purpose of consumer credit reporting agencies, the suspended payments be treated as if they had been made.

- It waives or modifies requirements for the receipt of federal education grants, allows deviations to the use and/or distribution of federal education grants, modifies limits placed on student loans and Pell grants, and makes provisions for students who withdraw or relocate due to the crisis.

Paid leave

- The Act clarifies the maximum amounts to be paid by employers, extends eligibility under the Family Leave Medical Act to rehired employees, and provides for the advance refunding of payroll credits.

- It also allows federal agencies to fund paid leave for employees of certain federal contractors.

Title IV – Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy

Loans, Loan Guarantees and Other Investments

- The Treasury Secretary is authorized to make loans, loan guarantees and other investments in support of eligible businesses, states and municipalities up to an aggregate amount of $500 billion, including:
    - up to $25 billion to passenger air carriers,
    - up to $4 billion to cargo air carriers,
    - up to $17 billion to businesses critical to maintaining national security, and
    - up to $454 billion (and any remaining amounts) to Federal Reserve-established programs to provide liquidity to the financial system that supports lending to eligible businesses, states or municipalities.
- "Eligible business" includes an air carrier or a U.S. business that has not otherwise received adequate economic relief in the form of loans or loan guarantees under the Act.
- Financial assistance is limited to U.S. businesses (businesses created or organized in the United States and that have significant operations in and a majority of whose employees are based in the United States).
- Loan duration is limited to five years.
- The interest rate is not to be less than prevailing market rates prior to the coronavirus outbreak.
- The loans are treated as debt for tax purposes. The Treasury Secretary is authorized to issue regulations providing that the acquisition of equity does not result in an "ownership change" for tax purposes. An "ownership change" could limit a taxpayer's ability to use net operating losses.

Restrictions on Stock Repurchases, Dividends and Employment Levels

- Business recipients must agree:

  - not to repurchase exchange-listed securities of the business or its parent company for the duration of the loan/loan guarantee and 12 months thereafter;
  - not to issue dividends or make distributions on any common stock of the business for the duration of the loan/loan guarantee and 12 months thereafter; and
  - to maintain employment levels as of March 24, 2020, to the extent practicable, but in no event reduce such levels more than 10%.

- Similar restrictions on repurchases and dividends apply to loans, loan guarantees or other investments by Treasury as part of a Federal Reserve-established program or facility.

Executive Compensation Restrictions

- To receive financial assistance (in the case of air carriers and contractors), or loans and loan guarantees (in the case of other eligible businesses), a company must agree to the following limitations on annual compensation and severance during the relevant period for each officer and other employee (other than a unionized employee) whose "total compensation" exceeded $425,000 in 2019:
  - Total compensation during any 12 consecutive months cannot exceed the lesser of:
    - the total compensation received by the individual in 2019; and
    - the sum of (i) $3,000,000; and (ii) 50% of the amount that the individual's total compensation in 2019 exceeded $3,000,000.
  - Severance pay or other benefits upon termination of employment cannot exceed two times the maximum total compensation received by the individual in calendar year 2019.

- "Total compensation" includes salary, bonuses, awards of stock, and other financial benefits provided by an eligible business to an officer or employee of the eligible business.

- The relevant period is, (x) in the case of air carriers or contractors, the two-year period ending March 24, 2022, and (y) in the case of other eligible

businesses, the period from entry into the loan or loan guarantee agreement through the first anniversary of the date that the loan or loan guarantee is no longer outstanding.

- Companies that participate in the program will need to navigate legal and administrative challenges with respect to the compensation restrictions.
    - For example, participating companies may need to obtain waivers from officers and employees who have contractual rights to compensation or severance in excess of the prescribed limits.
- The compensation limitation provisions also present numerous interpretive questions, including how various components of compensation should be identified and valued, when compensation is deemed "received" (particularly as applied to equity awards or deferred compensation), and the scope of "other benefits upon termination" (which we presume does not apply to vested deferred compensation).
    - We expect Treasury regulations to be promulgated addressing these and other interpretive issues.
- Warrants, Other Equity Interests or Senior Debt Instruments Required – The Treasury Secretary may not issue a loan/loan guarantee to an eligible business unless a warrant or equity interest in, or senior debt instrument of, the eligible business is received.
- The Treasury Secretary may sell, exercise or surrender a warrant or senior debt instrument but may not exercise any voting power with respect to any acquired common stock.
- Midsize Businesses or Nonprofit Organization Program or Facility – The Treasury Secretary will seek implementation of a Federal Reserve-established program or facility to provide financing to banks and other lenders that make direct loans to eligible businesses and nonprofit organizations (to the extent practicable) with between 500 and 10,000 employees.
    - Loan terms would include an annualized interest rate of 2% or less and no interest or principal due on such loans for the first six months (or for such longer period as the Treasury Secretary determines).

- Borrower certification and restrictions include, in addition to agreeing to the above restrictions on dividends and stock repurchases and U.S. company requirements, that:
  - the funds would be used to retain at least 90% of the borrower's workforce at full compensation and benefits until September 30, 2020;
  - the borrower intends to restore not less than 90% of its workforce that existed as of February 1, 2020 and to restore all compensation and benefits to workers by not less than four months after the termination of the coronavirus health emergency declaration;
  - the borrower will not outsource or offshore jobs or abrogate existing collective bargaining agreements during the term and for two years after the repayment of the loan; and
  - the borrower will remain neutral in any union organizing efforts.

- Main Street Lending Program or Facility – The Act encourages the Federal Reserve to establish a facility or program that supports lending to small and midsize businesses.

- State and Municipality Program or Facility – Treasury Secretary will seek implementation of a Federal Reserve-established program to provide liquidity to the financial system that supports states and municipalities.

Support of Financial Institutions

- FDIC Institution Debt Guarantee Program – The FDIC is authorized to establish a program to guarantee the debt obligations of solvent insured depository institutions and their affiliates, including deposit accounts, through December 31, 2020.

- Temporary Deposit/Share Account Insurance Increase – The FDIC and NCUA are authorized to increase the insurance coverage on any noninterest-bearing transaction accounts through December 31, 2020.

- Temporary Lending Limit Relief – The OCC is authorized to waive single borrower lending limits for national banks and federal savings associations

until the earlier of the termination date of the coronavirus emergency declaration and December 31, 2020.

- Temporary Community Bank Leverage Ratio Relief – The federal banking agencies must adopt an interim rule, effective until the earlier of the termination of the coronavirus emergency declaration and December 31, 2020, to:
    - reduce the minimum community bank leverage ratio from 9% to 8% percent; and
    - give a community bank a "reasonable grace period" to satisfy such ratio if it falls out of compliance.
- Temporary Relief from Troubled Debt Restructuring Requirements – Financial institutions are permitted to suspend requirements under GAAP for loan modifications relating to the COVID-19 pandemic that would otherwise be characterized as troubled debt restructuring if:
    - the loan modification is made between March 1, 2020 and the earlier of December 31, 2020 or 60 days after the end of the coronavirus emergency declaration; and
    - the applicable loan was not more than 30 days past due as of December 31, 2019.
- Temporary Relief from CECL – All insured depository institutions, bank holding companies or affiliates thereof are exempted from complying with the Current Expected Credit Losses methodology, until the earlier of the termination of the coronavirus emergency declaration and December 31, 2020.
- Money Market Guarantee Program – The Treasury is permitted to establish a guarantee program for the U.S. money market mutual fund industry, although any such guarantee must terminate by December 31, 2020.

Accountability and Transparency Provisions

- An Office of the Special Inspector General for Pandemic Recovery is established in the Treasury to manage audits and investigations of the making and management of loans, loan guarantees and other investments pursuant to the Act.

- A Congressional Oversight Commission is established to oversee the implementation of the economic stabilization measures by the Treasury, the Federal Reserve and other federal government entities.

- Entities controlled by the President, Vice President, the head of an executive department, a member of Congress and their spouses, children, and sons-in-law or daughters-in-law are ineligible to receive loans and loan guarantees under the Act.

- The Treasury must post on its website a report on each loan/loan guarantee/investment transaction within 72 hours of the transaction and on each contract in connection with the administration of any loan or loan guarantee within 24 hours.

- The Treasury and the Federal Reserve must report regularly to specified congressional committees on transactions and new facilities and the Treasury Secretary, and the Federal Reserve Chairman must testify before such committees on a quarterly basis.

- GAO Study and reporting are required.

Relief for Individuals

- Credit Reporting Protection – From January 31, 2020 through the later of the date of enactment of the Act or the expiration of the national emergency declaration, reports to credit reporting agencies must show accounts as current even when there has been an account forbearance or agreement to defer or modify payments of a customer affected by the coronavirus pandemic.

- 1-4 Family Mortgage Loan Forbearance and Foreclosure Moratorium– The Act provides that a borrower with a federally backed 1-4 family mortgage loan who is experiencing financial hardship due to the coronavirus emergency may submit a forbearance request and the lender must grant such forbearance on the loan, regardless of delinquency status and without penalties, fees, or interest, for a period of up to 180 days and subject to a 180-day extension upon the borrower's request.

- The loan servicer may not initiate a foreclosure process or take foreclosure action for the 60-day period beginning on March 18, 2020, except for vacant or abandoned property.

- Multifamily mortgage loan forbearance and eviction protection – A multifamily borrower with a federally backed multifamily mortgage loan that was current on its payments as of February 1, 2020 may also request (written or verbal) a forbearance and the lender must grant such forbearance for up to 30 days, subject to two additional 30-day periods upon the borrower's request.

- During the forbearance period, multifamily borrowers receiving forbearance may not evict or charge penalties or fees to tenants solely for non-repayment of rents.

- Other Evictions Moratorium – During the 120-day period beginning from the enactment of the Act, the landlord of property assisted by certain federal programs may not initiate legal action to recover possession of the property for nonpayment of rent or charge fees or penalties for the nonpayment of rent.

Relief for Airline Workers

- The Act directs the Treasury Secretary to provide financial assistance, to be used exclusively for the payment of employee wages, salaries and benefits, to passenger air carriers in an aggregate amount up to $25 billion, to cargo air carriers in an aggregate amount up to $4 billion and to contractors in an aggregate amount up to $3 billion.

- The air carrier or contractor must, among other things, agree to:

    - refrain from conducting involuntary furloughs or reducing pay rates and benefits until September 30, 2020;

    - not purchase any equity securities of the carrier or contractor or its parent company that is listed on a national exchange through September 30, 2021;

    - not pay any dividends or capital distributions on common stock through September 30, 2021; and

    - impose the compensation caps discussed above, between March 24, 2020 and March 24, 2022.

Title V – Coronavirus Relief Fund

- This title appropriates $150 billion in payments for fiscal year 2020 to states, tribal governments and local governments.

Title VI – Miscellaneous Provisions

- This title provides for emergency borrowing authority for the U.S. Postal Service and a lengthy list of emergency appropriations for other governmental agencies and operations.

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