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Historic US Disaster Relief Legislation in Response to COVID-19 Crisis Will Have a Significant Impact on Companies and Their Employees Through Changes in the Tax Code and Related Provisions

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The novel coronavirus referred to as SARS-CoV-2 and the disease that the virus causes ("COVID-19") has created significant challenges for companies and employees across the United States as quarantine, self-isolation, and travel restrictions have been implemented globally. The United States government has responded by enacting three separate pieces of legislation: the first involved appropriations and emergency funding for federal agencies to respond to the coronavirus outbreak; the second legislation, the Families First Coronavirus Response Act (the "Response Act"), becomes effective on April 1, 2020 and relates to the paid sick leave and family leave certain employers are required to provide (please see our separate guidance here regarding this legislation); and the third legislation, the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), enacted on March 27, 2020, provides economic relief to companies, small businesses, individuals, and severely distressed industries.

Summary of Key Points

- The 80% of taxable income limitation on the deductibility of net operating losses ("NOLs") introduced by Pub. L. No. 115-97 (commonly known as the Tax Cuts and Jobs Act and referred to herein as the "TCJA") is temporarily suspended. Taxpayers may use the full amount of NOLs to offset taxable income in 2018, 2019, and 2020.
- NOLs arising in 2018, 2019, or 2020 generally can be carried back five years, subject to certain special rules. A technical correction to the TCJA allows NOLs arising in a taxable year beginning in 2017 and ending in 2018 to be carried back for two years.
- For purposes of calculating the limitation on deductions for interest expense in Section 163(j) of the Internal Revenue Code of 1986, as amended (the "Code"),[1] for 2020, taxpayers can elect to use their 2019 adjusted

[1] Unless otherwise noted, "Section" references are references to sections of the Code.

taxable income (rather than their 2020 adjusted taxable income). Given the potentially significantly lower adjusted taxable income of a taxpayer in 2020, this may materially increase the taxpayer's interest expense deductions for 2020 and after-tax available cash.

- The Section 163(j) limitation generally is increased from 30% to 50% of adjusted taxable income for taxable years that begin in 2019 or 2020. In the case of a partnership, for taxable years that begin in 2019 the partnership's net business interest expense deduction would remain limited to 30% of its adjusted taxable income, but each partner of the partnership would be able to deduct half of its allocable share of the partnership's excess business interest expense without limitation in the partner's first taxable year beginning in 2020.
- Although an early draft of the CARES Act would have reinstated Section 958(b)(4), which was previously repealed by the TCJA, such that downward attribution generally would no longer apply in determining whether a non-US corporation qualifies as a controlled foreign corporation ("CFC"), this important provision was left out of the final legislation. Accordingly, downward attribution continues to apply and may cause non-US corporations to be treated as CFCs despite the absence of actual US ownership, with the result being that many forms of transaction structures once considered market standard must continue to be reevaluated.
- As widely publicized, many Americans will be entitled to payments aimed to provide disaster relief of $1,200 per person with an additional $500 per child in the form of tax credits or rebates.
- To encourage donations, the charitable deduction limitations are increased or eliminated for contributions of *cash* and *food inventory* made to qualified charities in 2020.
- If air carriers or other larger distressed companies take loans under the CARES Act, they will be subject to compensation and severance limits for employees who were paid more than $425,000 in 2019 and additional limits for employees paid more than $3,000,000 in 2019. There are also limits on the ability to reduce the workforce by more than 10%.
- Eligible small businesses may receive forgivable loans to cover up to eight weeks of compensation and certain other expenses. These loans may be forgiven up to 100% of the principal of the loan; however, the amount of eligible forgiveness will be reduced to reflect reductions in workforce and 25% or greater reductions in compensation.
- The CARES Act expands eligibility to receive Economic Injury Disaster Loans to businesses with 500 or fewer employees. These loans are not forgivable; however, receiving a loan under this program does not disqualify the business from the employee retention tax credits or the delay of social security payroll taxes provided for in the CARES Act.
- Generally, non-US citizens and companies are ineligible for loan relief and certain other benefits. A business needs to be created or organized in the United States and have significant operations and a majority of its employees based in the United States in order to receive a loan under the air carriers and other larger distressed companies relief programs created by the CARES Act.
- Most employers may delay social security payroll tax payments until 2021 and 2022. Additionally, business affected by COVID-19 may receive an employee retention tax credit of up to 50% of qualified wages per employee in a calendar quarter (up to $5,000 of credit per employee per impacted quarter). Neither the payroll tax deferral nor the retention tax credit will apply if the business utilizes the small business loan forgiveness program.
- Individuals will have expanded and increased unemployment benefits protections. Additionally, individuals may take distributions or loans from eligible retirement savings to deal with COVID-19-related expenses.

Significant Changes to Tax Rules for Net Operating Losses, Interest Deductibility, and Other Matters

Net Operating Losses

The CARES Act modifies certain limitations imposed by the TCJA on a taxpayer's ability to deduct NOLs. Under the TCJA, the deductibility of NOLs arising in taxable years beginning after December 31, 2017 generally is limited to 80% of the taxpayer's taxable income (determined without taking into account the NOL deduction); further, a taxpayer is not allowed to carry back NOLs arising in such taxable years to prior taxable years, but may carry forward such NOLs indefinitely to future taxable years.

The CARES Act relaxes the taxable income limitation and carryback limitation on a taxpayer's use of NOLs. Under the CARES Act, the taxable income limitation is temporarily suspended with retroactive effect, allowing NOLs (whether arising in or carried forward to taxable years beginning in 2018, 2019, or 2020) to fully offset the taxpayer's taxable income for taxable years beginning before January 1, 2021. Additionally, the CARES Act provides that NOLs arising in a taxable year beginning after December 31, 2017 and before January 1, 2021 generally may be carried back five years – special rules would apply to real estate investment trusts and life insurance companies. Under the CARES Act, a US shareholder of certain specified foreign corporations may not carry back net operating losses to offset any additional amount includible in its gross income by reason of Section 965(a), a transition tax provision added by the TCJA. The taxpayer may elect, however, to exclude the taxable year in which such amounts are includible in its gross income from the five-year carryback period.

The CARES Act also contains a retroactive technical correction to the TCJA, providing that the carryback limitation under the TCJA shall apply to taxable years beginning after December 31, 2017 (rather than taxable years ending after December 31, 2017). This correction would allow NOLs arising in a taxable year beginning in 2017 and ending in 2018 to be carried back for two years.

***Observation**:* In non-public acquisition transactions, there are often covenants in the transaction agreement relating to the buyer's obligation to pay to the sellers pre-closing tax refunds and the value of other tax benefits arising as a result of the transaction (often referred to as transaction tax benefits). These changes to the NOL rules may impact those obligations, so parties to such transaction agreements should consider reviewing the relevant provisions to determine whether additional rights or obligations will accrue as a result of passage of the CARES Act.

Taxpayers should also consider the potential impact of the carryback of NOLs on any deductions or credits previously claimed. For example, certain taxpayers are entitled to the 50% deduction relating to its "global intangible low-taxed income" ("GILTI") or the 37.5% deduction relating to its "foreign-derived intangible income" ("FDII") allowed under Section 250 (collectively, the "Section 250 Deductions"). Section 250 Deductions, however, will be reduced in the event the sum of the taxpayer's GILTI and FDII exceeds its taxable income (which would be calculated after taking into account NOLs). Therefore, while taxpayers may expect to carry back NOLs to reduce their taxable income for prior years and receive a full refund, carrying back NOLs to 2018 or 2019 may potentially reduce or eliminate any previously-claimed Section 250 Deductions in such years for these taxpayers (especially US multinationals), resulting in refunds of amounts lower than expected.

Modification of Section 163(j) limitation on business interest expense for 2019 and 2020

Section 163(j) limits a taxpayer's deduction for net business interest expense to 30% of the taxpayer's "adjusted taxable income" or "ATI" for the taxable year (which is approximately equal to EBITDA for taxable years beginning before January 1, 2022). The CARES Act makes two temporary changes to Section 163(j) that should materially increase the amount of deductions available to taxpayers with indebtedness and significantly increase their available after-tax cash.

Election to use 2019 ATI for 2020. Because taxpayers may have significantly reduced ATI in 2020, the CARES Act allows taxpayers (at their election) to use their ATI for their last taxable year beginning in 2019 for purposes of computing the Section 163(j) interest expense limitation for their first taxable year beginning in 2020, which may dramatically increase the amount of interest expense deductions available to the taxpayer. In the case of a

partnership, this election is made at the level of the partnership (rather than at the partner level). For a taxpayer who makes this election and whose first taxable year beginning in 2020 is a short taxable year, the taxpayer's 2019 ATI must be reduced pro rata based on the number of months in the short taxable year for purposes of computing the taxpayer's 2020 Section 163(j) limitation.

Increase in limitation to 50% of ATI. The CARES Act generally increases the Section 163(j) limitation from 30% to 50% of ATI for taxable years that begin in 2019 and 2020. Taxpayers may elect out of the increase in limitation for any taxable year, but the election is irrevocable. In the case of a partnership, a special rule applies for taxable years that begin in 2019 (discussed below), and the election out of this increase to the Section 163(j) limit for taxable years that begin in 2020 is made by the partnership (rather than its partners).

Under existing law, partnerships are generally subject to the Section 163(j) limitation at the partnership level; any disallowed business interest expense of the partnership is allocated to the partners and must be carried forward until the partner is allocated either excess ATI or excess business interest income from the partnership. For taxable years that begin in 2019, although a partnership's net business interest expense deduction would remain limited to 30% of its ATI, each partner of the partnership would be able to deduct half of its allocable share of the partnership's excess business interest expense without limitation in the partner's first taxable year beginning in 2020 (the other half of the partner's allocable share of excess business interest expense would be subject to the general rule and be carried forward until the partnership produces excess ATI or excess business interest income). A partner could elect not to apply this special rule with respect to its allocable share of excess business interest expense, in which case the ordinary limitation on its ability to deduct excess business interest expense would apply.

Observation: While these modifications to the interest expense limitation generally would be expected to provide a substantial benefit to most taxpayers, the election out of the increase may be beneficial in some circumstances. Taxpayers (US multinationals in particular) should carefully consider their specific circumstances in determining whether a greater interest deduction for 2019 and 2020 would be desirable (for example, whether the additional interest expense deductions may have adverse consequences relating to the base erosion and anti-abuse tax under Section 59A or GILTI).

Acceleration of refund for prior year minimum tax liability of corporations

The CARES Act accelerates the refundable "alternative minimum tax" or "AMT" credit recovery schedule for corporate taxpayers and provides that the remaining balance of a corporate taxpayer's unused AMT credits may be fully recovered by a refund claim either with respect to its taxable year beginning in 2019 or (at the taxpayer's election) with respect to its taxable year beginning in 2018.

As background, although the corporate AMT was repealed by the TCJA, a corporate taxpayer is permitted to apply its AMT credits with respect to prior taxable years against its taxable income. These unused corporate AMT credits are available as refundable credits that, prior to the CARES Act were, recoverable over several years ending in the taxable year beginning in 2021. The CARES Act accelerates the recovery of these refundable credits.

Bonus depreciation for "qualified improvement property"

The CARES Act amends Section 168(e) to provide that qualified improvement property ("QIP"), which is an improvement to the interior of a nonresidential building that is placed in service after the building was placed in service, has a 15-year recovery period under the accelerated cost recovery system, which would cause it to be eligible for "bonus depreciation" under Section 168(k). This change applies retroactively to property placed in service after December 31, 2017.

The TCJA expanded the "bonus depreciation" regime of Section 168(k) to permit taxpayers to expense 100% of the basis of certain property in the taxable year the property is placed in service. The legislative history of the TCJA indicated that lawmakers anticipated assigning QIP a recovery period of 20 years or less to make it eligible for bonus depreciation. The final legislation, however, failed to classify QIP as 15-year property, and it consequently was subject to the 39-year recovery period that generally applies to nonresidential real property and

therefore was ineligible for bonus depreciation. The CARES Act fixes this technical glitch and allow QIP to be eligible for bonus depreciation.

No Repeal of Downward Attribution

Background. Prior to the TCJA, Section 958(b)(4) provided that the downward attribution rules contained in subparagraphs (A), (B) and (C) of Section 318(a)(3) did not apply to treat a US person as owning stock which was owned by a non-US person for purposes of determining whether a non-US corporation qualifies as a CFC. The TCJA repealed Section 958(b)(4). While it received little attention at the time of the TCJA's drafting amidst the broader changes made to the Code's international tax framework, the repeal was soon seen by tax practitioners as having significant unintended consequences in several contexts due to the resulting increase in the number of CFCs found in investment structures.

The effect of the repeal in creating more CFCs can be seen in two main scenarios:

The first, what we call the "vertical chain", is where a parent non-US entity ("Parent") owns 100% of an intermediate non-US corporation ("Non-US Direct Sub") which in turn owns 50% or more of an underlying US corporation ("US Indirect Sub"). Under Section 318(a)(3)(C), all of Parent's shares in Non-US Direct Sub are downward attributed to US Indirect Sub, such that US Indirect Sub is treated as owning 100% of the shares of its parent, Non-US Direct Sub, potentially causing Non-US Direct Sub to be treated as a CFC despite having no actual US ownership.

The second scenario, what we call the "horizontal chain", is where a parent non-US entity ("Parent") directly owns more than 50% of a non-US corporation ("Non-US Sub") and 50% or more of a US corporation ("US Sub"). Under Section 318(a)(3)(C), all of Parent's shares in Non-US Sub are downward attributed to US Sub, such that US Sub is treated as owning more than 50% of the shares in Non-US Sub, causing Non-US Sub to become a CFC, despite, again, having no actual US ownership.

Importantly, there is a 50% ownership threshold (by value) under Section 318(a)(3)(C), meaning that in each of the above scenarios, Parent must own 50% or more in value, directly or indirectly, in the US entity in order for downward attribution to apply. If such threshold is met, then the US entity will be treated as owning all of Parent's shares in the non-US entity.

While opinions vary, many practitioners do not treat the vertical chain scenario as resulting in Non-US Direct Sub being a CFC due to Treas. Reg. §1.318-1(b)(1), which provides that an entity cannot be treated as owning its own stock as a result of downward attribution. Under this view, US Indirect Sub cannot be treated as owning the stock of its parent, Non-US Direct Sub, as this would result in US Indirect Sub indirectly owning its own stock. However, there is no similar authority that would mitigate the result in the horizontal chain scenario.

The repeal of Section 958(b)(4) and resulting application of the downward attribution rules to Subpart F of the Code has created a multitude of CFCs that did not exist prior to the TJCA, impacting new and existing investment structures in unanticipated ways. An early draft of the CARES Act would have reinstated Section 958(b)(4) and resolved these issues. This fix was removed from the legislation, however, at the request of the ranking Democratic member of the Senate Finance Committee. This may be viewed as a sign that Congress does not intend a fix or simply that this was not the right time. In any event, we are left with downward attribution in Subpart F, at least for now, and the following illustrates several ways in which this technical glitch adversely impacts customary transactions and provides justification for Congress to act quickly to repeal or significantly limit downward attribution.

Portfolio Interest. Subject to several requirements being satisfied under Sections 871(h) and 881(c), the portfolio interest exemption exempts US source interest paid to non-US persons from withholding tax. This exemption is often relied upon by non-US investors making investments in the United States through leveraged blockers. The US blocker would be capitalized with a mix of debt and equity, with interest payments on the debt generating interest deductions to the blocker and being paid to its non-US investors free of withholding tax. One of the requirements to qualify for the portfolio interest exemption, however, is that a non-US lender cannot be a CFC that is treated as owning more than 50% of the vote or value of the borrower. Thus, in the horizontal chain scenario described above, if a foreign parent has even a single US subsidiary in the structure, there is a risk that all of its

non-US corporate subsidiaries (other than possibly those in a vertical chain with such US subsidiary) will become CFCs and will not be able to avail themselves of the portfolio interest exemption in one of the more common inbound investment structures.

Increased Number of CFCs and 10% US Shareholders Subject to Additional Income Inclusion. A US shareholder who owns 10% or more (measured by value or voting power) of the CFC ("10% US Shareholder") may be required to include in gross income amounts under Sections 951 ("Subpart F Inclusion Amount") and 951A ("GILTI Inclusion Amount"). As a result of the repeal of Section 958(b)(4), a non-US corporation that otherwise would not be classified as a CFC may become a CFC if the non-US shareholders of the foreign corporation hold sufficient equity interests in a US corporation or US partnership. Consequently, the repeal of Section 958(b)(4) has caused an increased number of CFCs and 10% US shareholders required to include in gross income the Subpart F Inclusion Amount and GILTI Inclusion Amount as a result of, for example, investments made by a non-US corporation's non-US shareholders.

In light of the unintended consequences resulting from the repeal of Section 958(b)(4), the Treasury Department and the Internal Revenue Service have been working on providing certain relief to taxpayers. For example, recognizing taxpayers' limited ability to determine whether a non-US corporation is a CFC and to obtain the information necessary to accurately determine the Subpart F Inclusion Amount and GILTI Inclusion Amount, the Internal Revenue Service issued Revenue Procedure 2019-40, which provides a safe harbor on which US shareholders of certain non-US corporations may rely to conclude that such corporation is not a CFC. Various requirements, however, must be satisfied for US shareholders to rely on this safe harbor. Therefore, absent a reinstatement of Section 958(b)(4), non-US corporations and their US shareholders may continue to face uncertainties caused by the downward attribution rules and may need to carry the burden of complying with additional requirements under current or future regulatory or administrative guidance to avoid these unintended adverse consequences.

Disaster-Relief Payments for Individuals

To put more cash in consumers' hands, the CARES Act provides for payments of $1,200 per individual taxpayer ($2,400 for joint filers) plus $500 per qualifying child, subject to phase-out at the rate of 5% for income in excess of $75,000 ($112,500 for heads of household and $150,000 for joint filers). These payments will generally take the form of credits against tax payable or refunds of federal tax previously paid for the 2018 or 2019 tax years and are in addition to the previously announced extension of the time to file and pay 2019 individual income tax returns and taxes from April 15 to July 15. The CARES Act also allows an eligible individual to exclude from his or her 2020 income up to $5,250 in student loan repayments made by an employer, further freeing up liquidity.

Enhanced Charitable Giving Incentives

Prior to the CARES Act, individual taxpayers who itemize deductions were limited to a deduction equal to 60% of their federal adjusted gross income (AGI) for cash contributions made to qualified charities. The CARES Act provides additional incentives for charitable giving and creates an attractive temporary income tax planning tool by permitting taxpayers to elect to completely suspend this limitation for *cash* contributions made to qualified charities during 2020. The CARES Act does *not* change the existing deduction limitations, however, for non-cash contributions and cash contributions to non-qualified charities such as donor-advised funds, most private non-operating foundations, and Section 509(a)(3) supporting organizations.

Corporations can similarly elect to increase their deduction limitation for such contributions from 10% to 25% of the corporation's taxable income.

In addition, for charitable contributions of food inventory from a taxpayer's trade or business made during 2020, the charitable deduction limitation is increased from 15% to 25% of the taxpayer's applicable income.

For individual taxpayers who do not itemize deductions, the CARES Act creates a new and seemingly permanent *above the line* deduction of up to $300 (in addition to the standard deduction) for cash contributions made to qualifying charities.

States (including New York) may have their own charitable deduction limitations which operate differently.

Employment, Compensation, and Benefits

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

Loans and Loan Guarantees. The CARES Act intends to provide liquidity in the form of loans or loan guarantees to eligible businesses related to losses incurred as a direct result of COVID-19. Eligible businesses are (a) air carriers; or (b) a United States business that has not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the CARES Act.

Loans, loan guarantees, and other investments will be made as follows: (1) up to $25 billion will be made available to make loans and loan guarantees for passenger air carriers and eligible businesses certified to perform inspection, repair, replace, or overhaul airline services, and airline ticket agents; (2) up to $4 billion will be made available to make loans and loan guarantees for cargo air carriers; (3) up to $17 billion will be available to make loans and loan guarantees for businesses critical to maintaining national security; and (4) up to $454 billion will be available for programs or facilities established by the Federal Reserve System for the purpose of providing liquidity to the financial system that supports lending to eligible businesses, States, or municipalities.

1. Conditions on Receipt of Such Loans

The CARES Act contains terms and conditions for entering into a loan or loan guarantee agreement, including a requirement that eligible businesses maintain the same number of employees that were employed as of March 24, 2020 until September 30, 2020, to the extent practicable, and in any case, will not reduce their employment levels by more than 10% from the levels established on March 24, 2020.

In addition, the following terms and conditions will also apply:

(a) Until a year after the date of the loan or loan guarantee is no longer outstanding, neither the eligible business nor any affiliate, may purchase an equity security of the eligible business or any parent company that is listed on a national securities exchange except to the extent required under contractual obligations existing prior to the enactment of the CARES Act;

(b) Until a year after the date of the loan or loan guarantee is no longer outstanding, the eligible business will not pay dividends or other capital distributions with respect to its common stock;

(c) Loan agreement must certify that the eligible business is created and organized in the United States, has significant operations in the United States, and has a majority of its employees based in the United States; and

(d) The eligible business must have incurred or is expected to incur covered losses such that continued operation of the business is jeopardized.

Furthermore, neither the Secretary of the Treasury (the “Secretary”), nor any other actor or agency of the federal government, may condition the issuance of a loan or loan guarantee on the implementation by an air carrier or other eligible business of measures to enter into negotiations with the certified bargaining representative of a class of employees of the air carrier or eligible business regarding pay or other terms and conditions of employment.

Observation: In order for an air carrier or a distressed business to receive a loan under these provisions, it must be created or organized in the United States or under the laws of the United States and have significant operations in and a majority of its employees based in the United States. This restriction could prevent cruise lines and others that receive favorable tax treatment due to offshore parent entities from receiving a loan under these provisions. The CARES Act is unclear whether foreign-parented companies could apply for aid through a US subsidiary that otherwise satisfies the requirements.

2. Limit on Increase in Compensation for Highly Compensated Officers and Employees

In addition to the restrictions above, including not reducing its workforce by more than 10%, the eligible business must comply with the Compensation Restrictions (as defined below).

As a condition of receipt of these loans, eligible businesses must enter into an agreement that, during the period beginning on the date on which the agreement is executed, and ending on the date that is one year after the date on which the loan or loan guarantee is no longer outstanding, no officer or employee whose total compensation exceeded $425,000 in calendar year 2019 may receive salary, bonuses, equity awards, and other financial benefits which exceed, during any 12 consecutive months of the applicable period, the total compensation received by the officer or employee from the eligible business in 2019. In addition, for employees whose compensation exceeded $3,000,000 in 2019, their total compensation will be reduced so that the employee may not receive during any 12 consecutive months of such period, total compensation in excess of the sum of (A) $3,000,000 and (B) 50% of the excess over $3,000,000 of the total compensation received by the officer or employee in 2019 (collectively, the "Compensation Restrictions"). Employees subject to a collective bargaining agreement entered into prior to March 1, 2020 are not subject to the Compensation Restrictions.

We note that these Compensation Restrictions are less restrictive than those created under the guidelines for financial institutions who participated in the Troubled Asset Relief Program ("TARP") (the "2009 TARP Guidelines") authorized under the Emergency Economic Stabilization Act of 2008, which limited executive salaries to $500,000 and imposed other restrictions.

3. Limits on Severance Benefits for Highly Compensated Officers and Employees

In addition, eligible business who enter into a loan agreement will be limited in the amount of severance it can provide for the during the period beginning on the date on which the agreement is executed, and ending on the date that is one year after the date on which the loan or loan guarantee is no longer outstanding. In particular, eligible businesses may not grant those employees whose total compensation exceeded $425,000 in 2019 termination and severance benefits in excess of two times (2x) the total compensation received by the officer or employee from the eligible business in 2019 (the "Severance Limits").The Severance Limits similarly exclude employees whose compensation is determined through an existing collective bargaining agreement entered into prior to March 1, 2020.

The Severance Limits are much less restrictive than those under the 2009 TARP Guidelines, which generally limited severance pay and golden parachute payments to one times (1x) the executive's compensation.

Air Carrier Worker Support

In order to preserve aviation jobs and compensate air carrier industry workers, the CARES Act would provide financial assistance to be used exclusively for the continuation of payment of employee wages, salaries, and benefits to: (a) passenger air carriers in an amount up to $25 billion; (b) cargo air carriers in an amount up to $4 billion; and (c) contractors, under contract with a passenger air carrier, in an amount up to $3 billion.

In order to receive a payment, air carriers or contractors must comply with the Compensation Restrictions and Severance Limits discussed above. In addition, the air carrier or contractor must (i) refrain from conducting involuntary furloughs or reducing pay rates and benefits until September 30, 2020; (ii) through September 30, 2020, ensure that neither the air carrier or contractor or their respective affiliates, purchase an equity security of the air carrier or contractor or of its relevant parent company that is listed on a national securities exchange; and (iii) through September 30, 2020, ensure that the air carrier or contractor does not pay dividends or other capital distributions with respect to its common stock.

The CARES Act limits the financial assistance available to an air carrier or contractor to an amount equal to the wages, salaries and benefits and other compensation reported by the air carrier or the contractor for the period from April 1, 2019, through September 30, 2019.

The CARES Act provides that not later than 10 days after the enactment of the CARES Act, the Secretary would make initial payments to air carriers and contractors that submit requests for financial assistance approved by the Secretary.

Assistance for Mid-Sized Businesses

In addition, as part of the $454 billion made available for programs or facilities established by the Federal Reserve System, the Secretary will implement a program to assist mid-size businesses. Under this program, assistance to mid-sized businesses would be provided by providing financing to banks and other lenders that make direct loans to eligible businesses with between 500 and 10,000 employees (including nonprofit organizations). Such loans will be subject to an annualized interest rate that is not higher than 2% per annum and no principal or interest shall be due and payable for the first six (6) months a direct loan is made, or for a longer period as determined by the Secretary in its discretion.

An eligible mid-size business applying for a direct loan under this program will be required to make good faith certifications that (1) the funds it receives will be used to retain at least 90% of the borrower's workforce, at full compensation and benefits, until September 30, 2020; and (2) 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 its workers no later than four (4) months after the termination date of the public health emergency declared in response to COVID-19. In addition, the borrower will be required to comply with the same Compensation Restrictions and Severance Limits discussed above.

The mid-size borrower will be required to satisfy that it (i) is domiciled in the United States with significant operations and employees located in the United States; (ii) is not a debtor in a bankruptcy proceeding; (iii) is created and organized in the United Stated, has significant operations in the United States, and has a majority of its employees based in the United States; (iv) will not pay dividends with respect to common stock, or repurchase an equity security the borrower or any parent company of the borrower while the direct loan is outstanding; (v) will not outsource or offshore jobs for the term of the loan and two (2) years after completing repayment of the loan; (vi) will not abrogate the existing collective bargaining agreement for the term of the loan and two (2) years after completing repayment of the loan; and (vii) will remain neutral in any union organizing effort for the term of the loan.

Small Business Loans

Under the CARES Act, any business or nonprofit organization that employs less than 500 employees (unless the covered industry's Small Business Administration ("SBA") size standard allows more than 500 employees) is eligible to receive a covered loan under the Paycheck Protection Program (the "PPP"). In addition, any business that employs 500 employees or fewer per physical location of the business and that is assigned a North American Industry Classification System ("NAICS") code beginning with 72 (Accommodations and Food Services) will be eligible to receive a covered loan. A portion of these loans may be eligible for loan forgiveness under the CARES Act (as described below).

For purposes of the affiliation rules, unless one of the foregoing exceptions apply, a business that is controlled by a private equity sponsor would be deemed an affiliate of other businesses controlled by that private equity sponsor, impacting each portfolio companies' eligibility for a loan under the PPP.

Employees of affiliated entities will be aggregated for purposes of determining the number of employees, unless (1) the business is assigned an NAICS code beginning with 72, (2) is operating as a franchise that is approved on SBA's Franchise Directory or (3) a business receiving financing from Small Business Investment Companies.

Small businesses may use the loans to cover (a) payroll costs; (b) costs related to the continuation of health care benefits during periods of paid sick, medical, or family leave, and insurance premiums; (c) employee salaries, commissions, or similar compensation; (c) mortgage interest payments; (d) rent; (e) utilities; and (f) interest on any other debt obligations that were incurred before the eight (8)-week period beginning on the date of the origination of the loan (the "Covered Period"). In addition, there would be no prepayment penalties for any payment made on a covered loan.

The maximum loan amount available is the *lesser* of (i) the sum of (A) the product obtained by multiplying (x) the average total monthly payments of the borrower for payroll costs during the 1-year period before the data on which the loan is made by (y) 2.5 and (B) the outstanding amount of a previous small business loan that was

made during the period beginning January 31, 2020 and ending on the date on which the covered loans are available to be refinanced under the covered loan; or (ii) $10,000,000.[2]

Small businesses should be aware that borrowing under this section of the CARES Act disqualifies a business from taking advantage of the employee retention tax credits, as described below. In addition, if the employer's loans are forgiven (as described in detail below), an employer is also disqualified from deferring the employer's share of social security taxes, as detailed below.

1. Borrower Requirements

An eligible borrower will be required to certify that: (i) the uncertainty of current economic conditions makes necessary to the loan request to support the ongoing operations of the eligible borrower; (ii) the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, or utility payments; (iii) it does not have a dual loan application pending under the CARES Act; and (iv) it has not already received a loan under the CARES Act for the same purpose as under its current application.

2. Small Business Loan Forgiveness

In general, a small business borrower would be eligible for loan forgiveness in an amount equal to the sum of the following costs incurred during the 8 week period beginning on the date of the origination of the loan (the "Covered Period"): (a) payroll costs; (b) payments of interest on any covered mortgage obligation; (c) payments on any covered rent obligation; and (d) covered utility payments. The loan forgiveness amount shall not exceed the principal amount of the financing made available under the applicable covered loan.

"Payroll costs" as defined in this section of the CARES Act, includes (a) salary, wage, commission, or similar compensation; (b) payment of cash tip or equivalent; (c) payment for vacation, parental, family, medical or sick leave; (d) allowance for dismissal or separation; (e) payment required for the provision of health care benefits; (f) payment of retirement benefits; (g) State or local taxes on compensation; (f) payments of any compensation to or income of a sole proprietor or independent contractor (not more than $100,000 in one year, as prorated for the Covered Period.

"Payroll costs" as defined, excludes (a) the compensation of an individual employee in excess of an annual salary of $100,0000 as prorated during the Covered Period; (b) taxes imposed or withheld under chapters 21, 22, or 24 of the Code (Federal Insurance Contributions Act; Railroad Retirement Tax Act; and Collection of Income Tax at Source on Wages respectively) during the Covered Period; (c) any compensation of an employee whose principal place of residence is outside the United States; (d) qualified sick leave wages for which a credit is allowed under section 7001 of the Families First Coronavirus Response Act; or (e) qualified family leave wages for which a credit is allowed under section 7003 of the Families First Coronavirus Response Act.

Not later than 15 days after the date on which the Small Business Administration receives a report of the expected forgiveness amount on a covered loan, the Small Business Administration will purchase the expected forgiveness amount with respect to each covered loan to which the report relates.

The CARES Act also provides for reductions in the amount of eligible loan forgiveness based on both (a) reductions in the number of employees in the workforce and (b) any reduction in compensation in excess of 25% for individuals making less than $100,000 per year.

(a) Loan Forgiveness Reduced by the Reductions in Number of Employees

The amount of loan forgiveness under this section would be reduced, but not increased, by multiplying the eligible loan forgiveness amount by the quotient obtained by dividing (i) the average number of full-time equivalent employees per month employed during the Covered Period; by (ii) at the election of the borrower either (aa) the average number of full-time equivalent employee per month employed during the period beginning February 15,

[2] There are different calculations to determine the maximum available loan amounts for seasonal employers and for eligible business that were not in business during the period beginning on February 15, 2019 and ending on June 30, 2019.

2019 and ending on June 30, 2019; or (bb) the average number of full-time equivalent employees per month employed during the period beginning on January 1, 2020 and ending on February 29, 2020.

In other words, the loan forgiveness amount will be reduced by the percentage of the reduction in work force from either of the two periods described above.

(b) Loan Forgiveness Reduced by Reductions in Compensation

The amount of loan forgiveness would also be reduced by the amount of any reduction in compensation during the Covered Period in excess of 25% of the compensation of an employee from the most recent full quarter during which the employee was employed before the Covered Period. This reduction would only apply to reductions in compensation for those employees who did not receive during 2019 an annualized rate of pay greater than $100,000.

Therefore, in general, eligible businesses receiving loans under this program will therefore be incentivized to not excessively reduce compensation (i.e. by more than 25%) for those employees making less than $100,000 annually.

(c) Exemption for Re-Hires

Reductions in workforce or compensation occurring during the period beginning on February 15, 2020 and ending 30 days after the date of the enactment of the CARES Act will not be considered in calculating the reduced amount of loan forgiveness if not later than June 30, 2020, the eligible employer has re-hired the number of full-time employees or reversed the reductions in salary or wages of such employees.

Economic Injury Disaster Loans

There is an SBA loan program currently open in which small businesses may apply for an Economic Injury Disaster Loan ("EIDL"). The CARES Act expends eligibility for an EIDL to businesses with 500 or fewer employees. The amount of an EIDL can be up to $2 million to help overcome the temporary loss of revenue borrowers are experiencing as a result of COVID-19. An EIDL may be used to pay fixed debts, accounts payable, payroll, and other bills that cannot be paid because of the impact of COVID-19.

Unlike the PPP discussed above, receiving an EIDL may still permit a borrower to apply for the employee retention tax credits available under the CARES Act, as detailed below.

The CARES Act provides that eligible businesses may receive an advance of up to $10,000 on an EIDL that may be used for (a) providing paid sick leave to employees unable to work due to COVID-19; (b) maintaining payroll to retain employees during business disruptions or slowdowns; (c) meeting increased costs to obtain materials due to interrupted supply chains; (d) making rent or mortgage payments; and (e) repaying obligations that cannot be met due to revenue losses. If the eligible business receives an advance, the business is not required to repay any amounts of the advance, even if subsequently denied an EIDL loan. However, if an eligible small business also receives a loan under the PPP as discussed above, the EIDL advance amount will be reduced from the eligible loan forgiveness amount under the PPP.

Employee Retention Tax Credit for Employers Subject to Closure due to COVID-19

The CARES Act also creates an employee retention tax credit for employers negatively affected by the coronavirus pandemic. Specifically, eligible employers are allowed a credit against applicable employment taxes for each calendar quarter in an amount equal to 50% of qualified wages (up to $10,000 in wages) for each employee (i.e., not more than $5,000 of credit per employee per quarter). This credit is up to an amount equal to the applicable employment taxes for the calendar quarter (reduced by any credits allowed for paid family leave or paid sick leave under the Response Act) on the wages paid for all employees during the calendar quarter. If the credit amount would exceed this limitation for any calendar quarter, the excess will be treated as an overpayment that will be refunded to the employer. Employers who receive a loan (whether or not forgiven) under the PPP will not be eligible to benefit from the employee retention tax credit.

Employers eligible for a tax credit include any employer who: (i) carries on a trade or business during calendar year 2020, and (ii) suffers with respect to any calendar quarter in either of the following ways: (x) the operation of that trade or business is fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19, or (y) gross receipts for the calendar quarter (beginning with the first calendar quarter after December 31, 2019) are less than 50% of gross receipts for the same calendar quarter in the prior year (until gross receipts exceed 80% of gross receipts for the same calendar quarter in the prior year).

For employers with more than 100 full-time employees during 2019 on average, qualified wages eligible for the credit are wages that the employer pays to employees who are not providing services due to the suspension of the business or drop in gross receipts. For employers with 100 or fewer full-time employees during 2019 on average, all wages paid qualify for the credit. In neither case, regardless of employee count, will qualified wages include wages taken into account for the purposes of payroll tax credits corresponding to paid family leave or paid sick leave under the Response Act (as detailed below). Additionally, qualified wages include qualified health plan expenses incurred by the eligible employer (to the extent such amounts are excluded from the gross income of employees). The employee retention credit is effective for wages paid after March 12, 2020, and before January 1, 2021.

Penalties for failing to make a tax deposit of applicable employment taxes will be waived if the Secretary determines that any such failure is due to a reasonable anticipation of the retention tax credit.

Employer Payroll Tax Payment Deferrals

The CARES Act permits all employers (except those employers who have loans forgiven pursuant to the PPP) to defer a share of the employer portion of social security tax payments that they would otherwise be required to pay during the tax deferral period, which begins on the date of enactment of the CARES Act and ends before January 1, 2021. The deferred payroll taxes will become due as follows: (i) 50% of such taxes will be due on December 31, 2021, and (ii) 50% of the applicable employer payroll taxes will become due on December 31, 2022.

Revisions to Paid Family Leave and Paid Sick Leave Provisions in the Families First Coronavirus Response Act

Under the recently signed Response Act, certain covered employers are required to provide paid family leave and paid sick leave to certain eligible employees impacted by COVID-19. To qualify for leave, employee eligibility requirements include, but are not limited to, the following: (i) for paid family leave under the Response Act, the employee must have worked for a covered employer for at least 30 days, and (ii) for paid sick leave under the Response Act, the employee is automatically eligible regardless of tenure. Additional information on the Response Act is available here.

The CARES Act maintains the paid family leave and paid sick leave requirements imposed on employers by the Response Act, with some cleanup revisions to the legislative text, including:

With regard to paid family leave, the CARES Act clarifies that “eligible employee” not only means all employees who worked for a covered employer for at least 30 calendar days, but that “employed for a least 30 calendar days” includes an employee who was laid off by that employer not earlier than March 1, 2020, had worked for the employer for not less than 30 of the last 60 calendar days prior to the employee’s layoff, and was rehired by the employer.

With regard to paid sick leave, the CARES Act enables the Secretary of Labor or his designee to investigate and gather data to ensure compliance with the Response Act.

In addition, with regard to the offsetting employer-side payroll tax credit for paid family leave and paid sick leave, the CARES Act provides that, in anticipation of the credit, including the refundable portion, the payroll tax credit may be advanced to employers, according to forms and instructions provided by the Secretary (subject to the calculations and limits as set forth in the Response Act), calculated through the end of the most recent payroll period in the quarter. Additionally, penalties for failing to make a tax deposit will be waived if the Secretary

determines that any such failure is due to the anticipation of payroll tax credits for required paid family leave or paid sick leave.

Single-Employer Plan Funding Changes

The CARES Act delays the payment by single-employer defined benefit plan sponsors of minimum required contributions that would otherwise be due (including quarterly contributions) until January 1, 2021 (increased for interest at the plan's interest rate).

Additionally, in determining whether a plan is less than 80% funded and subject to restrictions, including benefit restrictions, a plan sponsor may elect to treat the plan's adjusted funding target attainment percentage for the 2019 plan year as the adjusted funding target attainment percentage for the 2020 plan year.

Department of Labor May Postpone Certain ERISA Filing Deadlines in the Event of a Public Health Emergency

The CARES Act amends Section 518 of the Employee Retirement Income Security Act of 1974 ("ERISA") to permit the Secretary of Labor to provide extensions of certain ERISA filing deadlines by up to one (1) year in the event of "a public health emergency" (as declared by the Secretary of Health and Human Services). Such filing extensions are akin to those extensions authorized by the Department of Labor ("DOL") in response to presidentially declared disasters. As the Secretary of Health and Human Services in fact declared a "public health emergency" on January 31, 2020, the DOL may issue filing deadline relief pursuant to this amended ERISA Section 518.

Use of Retirement Funds

The CARES Act allows eligible participants in certain defined contribution retirement plans (including IRAs) to take up to $100,000 in coronavirus-related distributions without incurring the 10% early distribution tax penalty that would otherwise generally apply to payments made prior to age 59-1/2. The distribution may occur between January 1, 2020 and December 31, 2020. An eligible participant means an individual who: (i) is diagnosed with the virus SARS-CoV-2 or COVID-19 by an approved test; (ii) has a spouse or dependent diagnosed with such virus by an approved test; or (iii) experiences adverse financial consequences resulting from being laid off, quarantined, or furloughed; a reduction in work hours or the closing or reduced hours of a business owned or operated by the individual; or an inability to work due to lack of childcare; in any such instance due to the virus (or other factors as determined by the Secretary). Plan administrators can rely on a certification from an employee that the distribution was a coronavirus-related distribution.

An eligible participant may repay the distribution to an eligible retirement plan within three (3) years of taking the distribution and the repayment would be treated as a rollover contribution to the eligible retirement plan. Any gross income inclusion attributable to the distributions will be subject to tax ratably over a three- (3-) year period (unless the taxpayer elects not to have this provision apply).

The CARES Act also temporarily increases the maximum amount that an eligible participant may borrow from his or her plan account balance to $100,000 (from $50,000), from the date the CARES Act is enacted and ending 180 days later. An eligible participant may also borrow up to the lesser of $10,000 or 100% of their account balance, rather than 50% of his or her account balance as permitted under current regulations. The CARES Act provides a one- (1-) year extension for repayment of a plan loan if the due date occurs between the date the CARES Act is enacted and December 31, 2020.

Additionally, the CARES Act waives required minimum distribution rules for certain retirement plans in calendar year 2020.

Unemployment Insurance Benefits

The CARES Act expands and increases unemployment insurance ("UI") for a broad range of workers, providing a $600 per week increase to existing benefits for the first four (4) months of unemployment and federal funding of UI

benefits to those not otherwise eligible for UI benefits, such as self-employed workers and other nontraditional workers.

In order to receive these expanded UI benefits, an individual must: (i) not be eligible for regular compensation or extended benefits under state or federal law, and (ii) certify that either (x) he or she is otherwise able to work and available for work within the meaning of applicable state law, except the individual is unemployed, partially unemployed, or unable or unavailable to work due to a wide range of COVID-19 related reasons, or (y) he or she meets other self-employment, part-time employment, or other nontraditional work requirements. For clarity, the covered individual cannot be able to telework with pay or be currently receiving paid sick leave or other paid leave benefits, regardless of other qualifying criteria.

The expanded UI coverage is available due to applicable unemployment from January 27, 2020 through December 31, 2020, up to a maximum of 39 weeks (which is an extension from the 26 weeks available in most states). The UI benefit amount is tied to the applicable state's regular unemployment compensation rate plus the additional $600 weekly increase (with such $600 increase applying only for weeks of unemployment ending on or before July 31, 2020).

The CARES Act also incentivizes states to repeal any "waiting week" provisions that prevent unemployed workers from receiving benefits as soon as they are laid off by fully funding the first week of UI benefits for those states that suspend such waiting periods.

Conclusion

The CARES Act is the largest economic relief bill in modern history and will have a significant impact on companies and employees as detailed above. The aid the CARES Act provides to various businesses, individuals, and sectors of the economy is meant to assist in weathering the economic effects of COVID-19, to improve cash flow and liquidity for businesses and individuals, and to incentivize businesses to maintain their workforces and salaries. For questions or concerns, please contact any member of the White & Case Tax team, Employment, Compensation and Benefits team, or Private Wealth & Family Offices team.

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