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Insights

Summary of the Coronavirus Aid, Relief, and Economic Security (CARES) Act

Overview

On March 27, 2020, the U.S. federal government enacted the Coronavirus Aid, Relief, and Economic Security Act (Pub. L. No. 116-136, the "CARES Act" or the "Act"), establishing a package of federal assistance and legislation to address growing economic and other concerns arising from the COVID-19 pandemic.[1] This third phase of congressional action is aimed at providing relief for both individuals and business—small and large—that have been and will continue to be negatively impacted by the coronavirus pandemic. Providing more than $2 trillion in expected economic investment, the relief package is the largest in modern American history.

Set out below is a summary of the key portions of the CARES Act, broken down by tax-related changes, and by benefit to large businesses, small businesses, individuals, and other forms of relief.

Please note that the enabling regulations defining program eligibility requirements and procedures for accessing financial relief set out in the CARES Act are being completed by the federal government. We are available to discuss the applicability of the new law and the enabling regulations and procedures to particular companies and situations.

Tax-Related Changes

Summary: The CARES Act includes a number of tax related changes. Unless otherwise noted, the tax changes impacting businesses are applicable to all businesses, regardless of size.

i. *Employee Retention Tax Credit* – The CARES Act provides an Employee Retention Tax Credit for 50% of wages paid by employers to employees during the COVID-19 crisis.[2] The credit is provided for wages paid or incurred from Mar. 13, 2020 through Dec. 31, 2020. The credit is available to employers (i) whose operations were fully or partially suspended due to a COVID-19-related shutdown order; or (ii) whose gross receipts declined by more than 50% when compared to the same quarter in the prior year. The credit is capped at the first $10,000 of compensation, including health benefits, paid to any eligible employee (i.e. a per employee credit of up to $5,000).

  (a) For employers with more than 100 full-time employees, qualified wages are those paid to employees when they are not providing services due to COVID-19 circumstances. For employers with 100 or fewer employees, all wages qualify for the credit, whether or not the employees are providing services. Employers may not claim the same wages for an

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1 Prior to the CARES Act, Congress passed two laws directly addressing the COVID-19 crisis – the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 (Pub. L. No. 116-123) and the Families First Coronavirus Response Act (Pub. L. No. 116-127).

2 On March 31, 2020, the Treasury Department and the Internal Revenue Service launched the Employee Retention Tax Credit program.

employee under this credit and also under the employer credit for extended Family and Medical Leave.

(b) Importantly, an aggregation rule applies to the payroll tax credit, which treats certain related parties as a single employer.[3]

ii. *Deferral of Certain Employment Taxes* – Payment of an employer's share of Social Security tax for the period Mar. 27, 2020, through Dec. 31, 2020, is deferred. Half of any deferred payroll taxes are required to be paid by Dec. 31, 2021 and the other half by Dec. 31, 2022.

iii. *Net Operating Losses* – The Tax Cuts and Jobs Act ("TCJA") eliminated the ability to carry back net operating losses ("NOLs") and limited the use of NOLs carried forward to 80% of taxable income. The CARES Act eliminates the 80% limitation for tax years prior to 2021 and allows NOLs generated in taxable years beginning during 2018, 2019 and 2020, to be carried back for up to five years. These changes should provide substantial refunds to many companies, especially historically profitable companies that generate losses in 2020 as a result of the COVID-19 pandemic.

iv. *Deductibility of Interest* – The TCJA imposed significant limitations on the deductibility of business interest, generally limiting such deductions for a given year to 30% of "adjusted taxable income," with any limited interest carried forward to subsequent years. The CARES Act temporarily increases the amount of deductible business interest for any taxable year beginning in 2019 or 2020 to 50% of adjusted taxable income. A taxpayer can elect to calculate the 50% limitation fro 2020 based upon 2019 adjusted taxable income instead of 2020 adjustable taxable income. Similar to the NOL change noted above, this change is expected to result in tax refunds for many businesses that are able to further reduce taxable income in 2019 or 2020, or through an increase in an NOL for 2019 or 2020, which may be carried back pursuant to the five year carryback described above.

v. *Charitable Contributions* – The CARES Act increases the limitation on a C Corporation's ability to deduct cash charitable contributions made during the calendar year 2020 from 10% of adjusted gross income under existing law to 25% of taxable income.

vi. *Excess Business Losses* – The TCJA imposed significant limitations on the deductibility of excess business losses (business losses in excess of business income). The CARES Act eliminates the TCJA limitations with respect to excess business losses generated in taxable years beginning before Jan. 1, 2021. This change should allow individuals owning an interest in a business conducted through a partnership or disregarded entity to utilize any net business losses against the individual's investment income.

vii. *Alternative Minimum Tax Credits* – The corporate alternative minimum tax ("AMT") was repealed as part of the TCJA. Corporate AMT credits existing at the time of repeal could be claimed as a refundable credit from 2018 to 2021. The CARES Act accelerates the refund of AMT credits, permitting companies to claim their entire AMT credit in either 2018 or 2019 by filing a claim for refund, providing additional cash flow during the COVID-19 emergency.

Large Businesses and Corporations

<u>Summary</u>: The CARES Act provides for a range of relief to assist larger businesses in the face of the ongoing COVID-19 pandemic.[4] The Act provides assistance to large companies by (i) allocating $454 billion to the Treasury's Exchange Stabilization Fund for loans, guarantees, and investments in support of facilities established by the Federal Reserve to support lending to eligible businesses, states, and municipalities, (ii) allocating $46 billion to the Treasury's Exchange Stabilization Fund for loans and

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3 *See* the CARES Act § 2301(d), citing the rules applied under §§ 52(a)-(b) and 414(m), (o) of the Internal Revenue Code of 1986.

4 With the exception of the mid-sized lending program, the following programs and provisions are also generally available to small businesses.

guarantees to air carriers and businesses critical to maintaining national security, and (iii) instituting various tax deferments and tax code modifications as described above. Under any of the loan or investment programs created herein, the President, Vice President, members of the Cabinet, and members of Congress (as well as their spouses, children, sons- and daughters-in-law) are barred from benefitting from the money carved out for corporations.

The Act also designates a Special Inspector General, along with a special committee, to oversee all loans and other uses of taxpayer dollars under these provisions. The Special Inspector General will be Presidentially-appointed and Senate-confirmed, and is tasked with conducting, supervising, and coordinating audits of the making, purchasing, management, and sale of the loans or other investments made by the Treasury Secretary under the Act. The Inspector General will operate for a five-year term with a $25 million budget, and must file quarterly reports with Congress, providing details of all loans.

Direct Loan Programs: The Federal Reserve has implemented a number of initiatives in response to the COVID-19 pandemic, including several direct lending programs undertaken pursuant to Section 13(3) of the Federal Reserve Act. The Federal Reserve was granted separate authority under the CARES Act to create programs backed by first-loss equity investments by the Department of the Treasury, but it has not yet announced what those programs will be.

Mid-Size Business Loans: The CARES Act instructs the Treasury Secretary to "seek the implementation" of a program to support banks and other private lenders who make direct loans to mid-size businesses and non-profits with between 500-10,000 employees. Importantly the Act notes that debtors in bankruptcy as of the time they are seeking to become a borrower under such program will not be eligible.

Bankruptcy Provisions

viii. National Emergencies Act payments for COVID-19-related issues by the President are exempted from "current monthly income" and "disposable income" when determining the power of courts to approve debtor bankruptcy plans rejected by trustees or claim-holders.

ix. Debtors in bankruptcy that have experienced material financial hardship due to COVID-19 can modify a plan confirmed prior to enactment of the CARES Act, if approved by a court after notice and hearing. This provision applies only if the bankruptcy plan does not provide payments more than seven years after the first payment was due under the original plan, and follows requirements of the Act §§ 1322(a)-(c), 1325(a). This modification sunsets Mar. 26, 2021.

Other Provisions

i. The Act importantly allows financial institutions to elect to suspend requirements under U.S. Generally Accepted Accounting Principles ("GAAP") for loan modifications related to the COVID-19 crisis, and suspend any such determination regarding loans modified as a result of the effects of the crisis. Federal banking agencies must defer to a financial institution to make a suspension. Such elections may begin on Mar. 1, 2020, and last for up to 60 days after the lifting of the COVID-19 national health emergency by the President.

Aviation Industry and National Security

i. The Act takes special care to provide assistance to air carriers and businesses critical to maintaining national security suffering from the economic crisis resulting from COVID-19, with the total value of assistance estimated to be $78 billion.

ii. On March 30, Treasury posted two high-level documents meant to help air carriers and other eligible businesses prepare to apply for the loan programs created by the CARES Act. These are not the final proposed regulations, but they do provide helpful insight into the information needed for the application.[5]

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[5] Loans & Loan Guarantees: https://home.treasury.gov/system/files/136/Procedures%20and%20Minimum%20Requirements%20for%20Loans.pdf.

iii. A portion of the money is earmarked exclusively for employee wages, salaries, and benefits, which the Treasury can choose to be secured by warrants, equity, or senior debt instruments, per the following breakdown:

(a) $25 billion for passenger air carriers;

(b) $4 billion for cargo air carriers; and

(c) $3 billion for airline contractors (this includes servicers providing catering functions and airport property functions such as maintenance, repair, overhaul, security, ticketing, and cleaning).

iv. Loans, guarantees, and other investments made to the airlines or other national security-important businesses must be secured by warrants, equity, or senior debt instruments of the borrower:

(a) $25 billion for passenger air carriers;

(b) $4 billion for cargo air carriers; and

(c) $17 billion for businesses critical to maintaining national security.

v. Air carriers availing themselves of this assistance under the Act must maintain scheduled air transportation service where deemed necessary by the Secretary of Transportation.

vi. Federal Excise Taxes collected in relation to commercial aviation are repealed by the Act between Mar. 28, 2020 and Jan. 1, 2021.

Small Businesses

Summary: The Act provides roughly $377 billion in assistance for qualifying businesses, i.e., generally those with 500 or fewer employees or deemed small businesses based on industry-specific standards. Key features of these assistance programs include emergency grants and forgivable loans, in addition to alterations of expense/deduction rules, meant to make it more feasible for small businesses to keep employees on their payrolls.

Paycheck Protection Loan Program

i. The Act allocates $349 billion to the SBA to provide loans of up to $10 million per business, under the Paycheck Protection Loan Program. The amount a small business may receive under the loan program is tied to its payroll costs[6] and the U.S. Department of Treasury, the Farm Credit Administration, and other federal financial regulatory agencies have authority to authorize bank and non-bank lenders to participate.

ii. Qualifying U.S. businesses consist of the following:[7]

(a) A small business concern as defined in section 3 of the Small Business Act (15 U.S.C. 632);

Air Carrier Payroll Support: https://home.treasury.gov/system/files/136/Guidelines%20and%20Procedures%20for%20Payroll%20Support%20to%20Air%20Carriers%20and%20Contractors.pdf.

6 The maximum loan amount is the lesser of the average total monthly payroll costs incurred by the borrower during the 1-year period before the date on which the loan is made, multiplied by 2.5, or $10 million.

7 SBA affiliation rules provide that a small business must aggregate its employees or annual receipts with those of any entities determined to be affiliates under the applicable rules of affiliation. It is the responsibility of the borrower to determine which entities (if any) are its affiliates, and to determine the employee count or average annual receipts of the borrower and affiliates. The lenders are permitted to rely on the borrower's certifications. Please see Milbank's client alert on applicable affiliation rules. *See also* https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequenty-Asked-Questions.pdf.

(b) A business concern with 500 or fewer employees whose principal place of residence is in the United States;

(c) A business concern that meets applicable SBA size standards for its industry, as defined by the North American Industry Classification System ("NAICS") code;[8]

(d) A business concern that, as of Mar. 27, 2020, had maximum tangible net worth of not more than $15 million, **and** average net income after Federal income taxes (excluding carry-over losses) for the two full fiscal years before application of not more than $5 million;[9] and

(e) Sole proprietors, independent contractors, and other self-employed individuals.

iii. The Act instructs lenders to consider whether prospective borrowers were operational on Feb. 15, 2020, and had employees for whom salaries and payroll taxes were required, in order to determine program eligibility. Importantly, these provisions waive the SBA's typical requirements: (i) of personal guarantees for loans up to $200,000; (ii) that the applicant must be in business for a year; and (iii) use of the "credit elsewhere" test. Once eligibility is determined, borrowers must make a good faith certification of necessity due to the uncertainty of economic conditions caused by COVID-19; that funds will be used to retain workers and payroll, lease, or utility payments; and they are not receiving duplicative funds for the same uses under other SBA programs.

iv. All current and new lenders under the program have "delegated authority" to determine borrower eligibility and creditworthiness.

v. Lenders will also receive compensation fees, per the following rules:

(a) 5% fee for loans of $350,000 or less;

(b) 3% fees for loans greater than $350,000, but less than $2 million; and

(c) 1% fee for loans of $2 million or more.

vi. Any portion of a loan received under this program which is used for the following purposes during an **8-week** period after the origination date, may be forgiven in full if the same number of employees stay employed through the end of Jun. 2020 (and reduced proportionately if the number of employees during the covered period decreases):

(a) Payroll Maintenance;[10]

(b) Rent;

(c) Mortgage interest; or

(d) Covered utility payments.

Eligible recipients seeking loan forgiveness must submit an application for forgiveness to the lender that is servicing the loan demonstrating that certain criteria have been met. If the eligible recipient demonstrates that the loan forgiveness criteria have been met, then the lender may not take enforcement action against the eligible participant (the so-called "nonrecourse loans").

vii. The amounts forgiven under the program may not exceed the principal of the loan. Amounts forgiven will be reduced (i) proportionally by any decrease in employees retained compared to the prior year, and (ii) by the amount of any reduction in pay of any employee beyond 25% of their

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8 In addition to for-profit businesses, tax-exempt nonprofit organizations described in section 501(c)(3) of the Internal Revenue Code (IRC), tax-exempt veterans' organizations described in section 501(c)(19) of the IRC, Tribal business concerns described in section 31(b)(2)(C) of the Small Business Act, and any other business concerns are eligible for PPP loans if they have 500 or fewer employees whose principal place of residence is in the United States, or meet the SBA size standards for the industry in which they operate.

9 *See* https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequenty-Asked-Questions.pdf.

10 Eligible payroll costs may not include portions of compensation to any individual employee above $100,000 annually. *See* https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.

prior year's compensation. Borrowers are able to eliminate the foregoing reductions by rehiring laid off workers and rescinding pay cuts by Jun. 30, 2020.

viii. Loans forgiven pursuant to the program are excluded from taxable income.

ix. Additionally, the Act allocates $17 billion to cover six months of payments for small businesses with existing SBA loans.

Economic Injury Disaster Loans and Emergency Grants: The Act allocates an additional $10 billion in Emergency Economic Injury Disaster Loans ("EIDL") of up to $2 million each[11] for small businesses to cover immediate operating costs.[12] Participants may request a forgivable advance of up to $10,000 that is intended to be delivered within 3 days after completion of an EIDL application.[13] For the period between Jan. 31 to Dec. 31, 2020, EIDL eligibility is expanded to include any business with 500 or fewer employees, operating under a sole proprietorship or as an independent contractor, and any cooperative, employee stock ownership plan ("ESOP"),[14] and tribal small business concern with 500 or fewer employees.

Caps on Paid Sick Leave and Extended Family and Medical Leave

i. Under the Act, employers will not be required to pay more than $511 per day and $5,110 in the aggregate for each employee who takes emergency paid sick leave because he or she is quarantined or experiencing Covid-19 symptoms and seeking a medical diagnosis, or more than $200 per day and $2,000 in the aggregate for each employee who takes paid leave to care for a quarantined individual or child.

ii. Employers will further not be required to pay more than $200 per day and $10,000 in the aggregate of paid family leave for each employee.

Bankruptcy Provisions

i. The Act amends the Small Business Reorganization Act to increase the eligibility threshold to file under subchapter V of chapter 11 of the U.S. Bankruptcy Code to businesses with not more than $7.5 million in debt.[15] This increase will sunset after one year and return to the previous amount of $2,725,625. Notably, the following groups are excluded from this change:

    (a) Any members of a group of affiliated debtors with aggregate, noncontingent, liquidated, secured and unsecured debts over $7.5 million (excluding debt owed to affiliates or insiders);

    (b) Corporations subject to reporting requirements in the Securities Exchange Act of 1934; and

    (c) Affiliates of an issuer under the Securities Exchange Act of 1934.

ii. National Emergencies Act payments by the President for COVID-19-related issues are exempted from "current monthly income" and "disposable income" when determining the power of courts to approve debtor plans rejected by trustees or claim-holders.[16] These modifications sunset on Mar. 26, 2021.

iii. Debtors that have experienced material financial hardship due to COVID-19 can modify a plan confirmed prior to enactment of the CARES Act, if approved after notice and hearing. This provision applies if the plan does not provide payments more than seven years after the first

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11 *See* https://www.sba.gov/sites/default/files/articles/EIDL_and_P3_4.1.2020_FINAL_2pm.pdf.

12 The Act also allows for an additional $562 million to be appropriated to the "Disaster Loans Program Account" authorized by section 7(b) of the Small Business Act. *Note*, Phase I allocated $20 million for administrative expenses relating to this program.

13 *See* the CARES Act § 1110(e)(4)(A)-(E) for allowable uses of any advance received under this program.

14 *See* the Small Business Act § 3 for the relevant definition of ESOP.

15 *See* 11 U.S.C. § 1182(1).

16 *See* 11 U.S.C. §§ 101(10A) and 1325(b).

payment was due under the original plan, and follows requirements of §§ 1322(a)-(c), 1325(a). This modification sunsets on Mar. 26, 2021.

Other Provisions

i. Federal grant funds appropriated to support the State Trade Expansion Program ("STEP") in FY 2018 and FY 2019 may remain available for use through FY 2021.

ii. The Act importantly allows financial institutions to elect to suspend requirements under U.S. Generally Accepted Accounting Principles ("GAAP") for loan modifications related to the COVID-19 crisis that would otherwise be categorized as a troubled debt restructuring, and it suspends any such determination regarding loans modified as a result of the effects of the crisis as being a trouble debt restructuring, including impairment for accounting purposes. Federal banking agencies must defer to a financial institution to make a suspension. Such elections may begin on Mar. 1, 2020, and last for up to 60 days after the lifting of the COVID-19 national health emergency.

Individuals

Summary: The CARES Act takes several approaches to assisting the economy on an individual-by-individual level, with an estimated $550 billion of assistance. The relevant provisions include cash disbursements directly to eligible individuals and families, expanded unemployment benefits, an extension to the 2019 tax filing deadline, and alterations to permissible retirement contributions. Individuals eligible for the Paycheck Protection Loan Program, described in the section covering Small Businesses, *supra*; such individuals include sole proprietors, independent contractors, and self-employed persons. The Secretary of Labor has the ability to issue further operating instructions and guidance, as necessary.

Cash Disbursements: estimated to total $300 billion, with amounts allocated under various qualifying rules based on an individual's 2018 or 2019 tax filings. Specifically, Americans making $75,000 or less ($150,000 in the case of joint returns, and $112,500 for heads of households) will receive $1,200 and $500 for each child.[17]

Unemployment Benefits

i. The Act's unemployment assistance increases available benefits and expands eligibility requirements.[18] The key provision adds $600 per week from the federal government in unemployment benefits, on top of whatever an individual may receive from his/her state. This provision is currently set to end on or before Jul. 31, 2020.

ii. Unemployment benefits are extended 13 weeks beyond state eligibility periods through Dec. 31, 2020.[19]

Certain Other Provisions

i. Employers may provide up to $5,250 in tax-free student loan repayment benefits.[20]

ii. All private insurance plans must cover COVID-19 vaccinations and tests.

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17 The Internal Revenue Service ("IRS") continues to publish updates and implementing information regarding direct payments to individuals under the CARES Act. *See* https://www.irs.gov/newsroom/economic-impact-payments-what-you-need-to-know.

18 Notably, the Act allows self-employed individuals and certain individuals who would not typically qualify for unemployment under state and federal law to be eligible for the additional programs. *See* § 2102(a)(3)(A)(ii)(II) of the CARES Act.

19 Most states provide a 26-week period of unemployment assistance; therefore, the Act will provide up to 39 weeks of unemployment insurance for the average American.

20 Section 2206 of the CARES Act passes into law the Employer in Participation Repayment Act by amending § 127(c)(1) of the Internal Revenue Code of 1986 to increase the limit on tax-free student loan repayment benefits.

iii. A borrower of a federally-backed mortgage loan experiencing a financial hardship due to the COVID-19 crisis may request forbearance on the loan, which shall be granted for up to 18 days and shall be extended for an additional 180 days at the request of the borrower provided that either the initial or extended period may be shortened. Except for vacant or abandoned property, a servicer of a federally-backed mortgage may not initiate a foreclosure for 60 days beginning on Mar. 18, 2020.

Related Government Actions

i. On March 21, 2020, the IRS announced that the deadline for filing 2019 tax returns filing was extended from April 15, 2020 to July 15, 2020.

Other Aid

Public Health Initiatives: Phase III provides over $140 billion in appropriations to support the U.S. healthcare system. The majority of this allocation will go directly to hospitals, while the rest is dedicated to providing personal and protective equipment, testing supplies, developing the workforce, accelerating Medicare payments, and supporting the CDC. As noted in the section covering individuals, supra, testing and vaccines for COVID-19 will be covered under private health plans.

Aid to State and Local Governments: Governments at the state, local, and tribal levels will receive $150 billion under the CARES Act, with specific dollar amounts earmarked for state and educational institutions, disaster relief, and transit programs. Generally, each of the 50 states shall receive an amount equal to the relative population proportion determined for the state.[21] A state, tribal government, or unit of local government may use the funds for necessary expenditures incurred between Mar. 1 and Dec. 30, 2020 due to the pandemic, if such expenditures were not accounted for in the budget most recently approved.

Aid to the Agricultural Sector: The CARES Act provides $14 billion in reimbursement of the net realized losses of the Commodity Credit Corporation not previously reimbursed, as reflected by the Jun. 2020 report of its financial condition. This is a reimbursement of funds already spent and not a direct appropriation for new spending or the creation of new programs.

For additional insights related to business and legal implications as a result of COVID-19, please visit our **Knowledge Center**.

[21] A payment thereunder may not be less than $1.25 billion and may be adjusted by the Secretary.

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