HOW THE "CARES ACT" AFFECTS YOU
CORONAVIRUS AID, RELIEF AND ECONOMIC SECURITY ACT

On March 27, 2020, President Trump signed into law the CARES Act. It is designed to help American citizens and businesses through these difficult times. Our attorneys have familiarized themselves with this legislation, as well as various Acts and Orders passed/issued in Pennsylvania and New Jersey and also with proclamations applicable to Philadelphia County. This article concentrates on certain provisions of the CARES Act applicable to businesses with fewer than 500 employees.

Should you desire additional information on any of the state or federal programs, or have questions, please call us and we will help.

PAYMENT PROTECTION PROGRAMS (BUSINESS LOANS)

Paycheck Protection Program.

The CARES Act amends the Small Business Act (the "SBA") to create a new program category of federally-backed loans, up to a maximum as described in Section 3 below, to eligible businesses for operating costs such as payroll, rent, health benefits, insurance premiums and utilities. Subject to certain conditions described below, the loans, or portions thereof, may be eligible for forgiveness.

Loan Requirements.

1. Eligible Borrowers.

Generally speaking, any "small business concern" as currently defined under the SBA is eligible to receive a loan under this program if it employs less than 500 employees, including full and part-time workers and those engaged on other bases. Small business concerns include corporations, limited liability companies, partnerships, sole proprietors, independent contractors and certain self-employed individuals, subject to the other conditions for eligibility.

2. Application Deadline.

Applications for loans under the Paycheck Protection Program must be submitted prior to June 30, 2020.

3. Loan Amounts.

(a) The maximum loan amount is $10 million. The maximum loan for which a borrower will be eligible is the lesser of (i) $10 million, or (ii) the amount obtained by multiplying (A) the average total monthly payments for payroll costs during the 1-year period prior to the loan being made, or (B) if the borrower is a new business, the average monthly payroll costs during the period from January 1, 2020 – February 29, 2020, by **2.5**. Different calculations apply to seasonal businesses.

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(b) Payroll costs include compensation to employees such as salary, wages, commissions, cash tip or equivalent, paid leave, severance payments, group health care payments, retirement benefits, and state and local payroll taxes. Excluded from payroll costs are compensation of an individual employee in excess of $100,000, prorated for the period between February 15, 2020 and June 30, 2020, federal taxes imposed or withheld, compensation to employees residing outside the United States, and certain sick and family leave wages for which the employer is allowed credit under the Families First Act.

4. Eligible Uses for Funds.

Eligible uses for funds borrowed under the Paycheck Protection Program shall include payroll costs (as described in Section 3(b) above), group health insurance costs, payments of mortgage interest (but not principal), rent, utilities and interest on other debt incurred before February 15, 2020.

5. Loan Terms.

The following terms will apply to loans provided under the Paycheck Protection Program: (a) interest up to 4% per annum (initially deferred); (b) no collateral required; (c) no fees charged; (d) no personal guarantees required; (e) no pre-payment penalties assessed; and (f) the loans will be non-recourse to principals, provided that the loan funds are used for the specified purposes.

6. Loan Conditions.

(a) Eligible borrowers must have been in business on February 15, 2020 and must have had employees for whom the borrower paid salaries and payroll taxes, or paid independent contractors in the form of 1099 payments.

(b) Borrowers must certify that: (i) the uncertainty of current economic conditions makes the loan necessary to support ongoing operations of the business; and (ii) the funds will be used to retain workers and to make payments for eligible uses.

7. Payment Deferral.

Payments due from impacted borrowers will be permitted to be deferred for six (6) months to one (1) year. More guidance will be forthcoming on this deferral.

8. Loan Forgiveness.

(a) Paycheck Protection Loans may qualify for loan forgiveness under the SBA. Subject to the possible reductions described below relating to maintaining employment and pay, loans are forgiven in an amount, up to the principal amount of the loan, equal to the sum of payroll costs, interest payments on mortgages, rent and utility payments incurred and payments made during the eight (8) week period after the loan is made or originated.

(b) The amount of loan forgiveness is reduced if: (i) the number of full-time equivalent employees has been reduced as further described in the CARES Act; or (ii) the total salaries or wages of certain employees are reduced by more than 25% as further described in the CARES Act.

(c) Borrowers can eliminate or minimize potential reductions in forgiveness by rehiring employees or making up for wage reductions, in whole or in part, by June 30, 2020.

(d) Borrowers seeking forgiveness of amounts must submit to their lender certified supporting documentation regarding payroll, pay rates and other costs eligible for forgiveness.

(e) Any loan amount forgiven will be excluded from the borrower's federal taxable income.

(f) Any loan amount not forgiven at the end of one year will be due and payable with a maximum term of 10 years, with a maximum interest rate of 4%.

9. Expansion of SBA Disaster Loan Program.

The SBA will offer low interest (3.75% for small business and 2.75% for non-profits) long term(up to 30 years) federal disaster loans for working capital to small businesses suffering substantial economic injury from COVID-19. This is a separate program from the SBA Business Loan Program. Eligibility requirements have been expanded. Now businesses with 500 or fewer employees, sole proprietorships, co-ops with 500 or fewer employees, and ESOPs with 500 or fewer employees are eligible as borrowers. Loans in response to COVID-19 now do not require personal guarantees on loans up to $200,000, waive the one year in business prior to disaster requirement, waives the requirement that applicant cannot obtain credit elsewhere, and allows lenders to approve applicants based on credit scores. Applicants for the disaster loan can now obtain a $10,000 emergency advance for emergency capital which will be forgiven even if the application is denied. Such advances are to be awarded within three days of application and may be used for the existing SBA disaster loan program rules, but also for sick leave as a result of COVID-19, maintaining payroll, meeting increased supply chain costs, and making rent or mortgage payments and repaying debts that cannot be repaid due to the loss of revenue. The amount of the advance will reduce the payroll cost forgiveness amounts discussed above. Applications can be made on line to the SBA..

10. Loan Payment Subsidies for Certain SBA Loans.

These subsidies apply to loans under the SBA Business Loan Program (excluding the new payroll loan program). The program also applies to Title 5 loans under the Small Business Investment Act and loans made by an intermediary to a small business under the SBA's micro loan program. The Act encourages lenders to provide payment deferment and extend maturity so as to avoid balloon payments or increases in the debt payments of the borrower.

The borrower is to be relieved from paying principal, interest and associated fees owned for loans made before enactment of the CARES Act for the six month period beginning on the next payment date; for loans made before the CARES Act was enacted that were already on deferment for six months beginning with the next payment due date; and for loans within six months of enactment of the CARES Act for six months after the first payment was made. The SBA is encouraged to avoid pressuring lenders to increase the reserve and to waive statutory limits on maximum loan maturity for certain covered loans, and to extend lender site physical requirements to not more than 30 days following an adverse event, or not more than 90 days after a payment default.

11. Emergency Rule Making Authority for Small Business Administration.

The SBA is to issue regulations to carry out the CARES Act by April 11, 2020.

UNEMPLOYMENT COMPENSATION

The CARES Act extends unemployment insurance to workers who are not normally eligible for such benefits at the state level so long as their unemployment is connected to COVID-19. Those who will now be eligible include part-time employees, independent contractors, the self-employed, freelancers and gig workers. In addition, the federal government will provide $600/week to individuals who are eligible for unemployment insurance for up to four months, through July 31, 2020, which will complement existing state unemployment benefits. The CARES Act also extends state-level unemployment insurance by an additional 13 weeks (from 26 to 39 weeks in Pennsylvania) through December 31, 2020.

RETIREMENT PROVISIONS

1. Waiver of Ten Percent (10%) Penalty for Premature Distributions.

To discourage plan participants from spending their IRA or retirement plan assets prematurely, an additional 10% tax normally applies to distributions to a participant under the age of 59½. The CARES Act waives the 10% penalty under certain circumstances for withdrawals of up to $100,000.

The distribution itself will still be subject to income tax, but the CARES Act allows the income tax to be paid ratably over three years. Alternatively, instead paying the income tax, the participant may choose to repay the distribution within three years (to the same plan or a similar qualified plan), in which case it is treated as a tax-free rollover.

To qualify, the participant must certify either: (i) that the participant, his or her spouse, or his or her dependent was diagnosed with COVID-19 (substantiated by a CDC approved test), or (ii) that he or she suffered virus-related adverse financial consequences from being quarantined, laid off, a reduction in hours or child care issues.

2. Qualified Plan Loan Limits and Repayment Period are Increased.

A qualified retirement plan (but not IRAs) may provide for loans to its participants. Normally, a plan permitting loans must limit the amount of the loan to the lesser of $50,000 or 50% of the vested plan benefit. The CARES Act increases the limits to the lesser of $100,000 or 100% of the vested plan benefit.

The participant must provide the same certification required for the waiver of the premature distribution penalty described above.

In addition, any pension plan loan payment due between the CARES Act enactment date and December 31, 2020, may be skipped by the taxpayer. The term of a loan with a bypassed 2020 payment essentially is extended from five to six years, with a corresponding adjustment in the interest accruing during the delay.

3. One-Year Delay for Required Minimum Distributions (RMDs).

Under the CARES Act, a participant who is normally required to take a minimum distribution from his or her IRA or qualified retirement plan (other than a defined benefit plan) for 2020 may elect to delay the distribution by one year. This delay applies to 2020 RMDs as well as 2019 RMDs that were required to be taken by April 1, 2020.

These changes have a profound impact on those whose RMDs were to start in 2020.

For a participant who turned 70½ during 2019, he or she would have been required to take his or her first RMD before April 1, 2020. It appears that he or she can push out his or her first RMD as far as March 31, 2022 (the deadline for the 2021 calendar year RMD).

The SECURE Act enacted by Congress last Fall changed the mandatory age for taking RMDs to those turning 72 starting in 2020. For a participant who turns 72 this year, he or she also can delay the start of his or her RMDs until March 31, 2022 (for calendar year 2021).

4. IRA and Qualified Plan 2019 Contribution Deadline extended.

Under normal circumstances, April 15, 2020 would have been the latest a taxpayer could have made a contribution to his or her IRA or qualified plan and have it count as being made in 2019. The contribution deadline has been extended to July 15, 2020, but not technically by the CARES Act. The IRS issued Notice 2020-18, followed by FAQs on March 24th, addressing this extension, making its inclusion in the final version of the CARES Act unnecessary (earlier versions of the Act had provided for this extension).

5. 2020 Qualified Plan Minimum Funding Requirements are Delayed.

Employers who maintain defined benefit pension plans may delay their 2020 ERISA mandated minimum funding contributions, including quarterly contributions, until January 1,

2021. The employer opting to delay contributions must pay accrued interest from the original due date to the date of funding.

6. <u>ERISA Filing Deadlines may be Extended by the Secretary of Labor</u>.

The CARES Act allows the United States Secretary of Labor to extend certain qualified plan filing deadlines. Specific filings were not mentioned, such as the annual information returns (Form 5500). This will bear monitoring over the upcoming weeks to see which extensions, if any, will be authorized.

7. <u>Lenient Timeframe for Amending Plans to Comply with the CARES Act</u>.

While plan sponsors must immediately comply with the changes made by the CARES Act, actual amendments to plans themselves are not required for most plans until December 31, 2022.

SMALL BUSINESS TAX PROVISIONS

1. <u>Payroll Tax Credit for Eligible Employers</u>.

(a) During the COVID-19 crisis, this provision provides a refundable payroll tax credit for 50% of wages paid by eligible employers to certain employees.

(b) Employers are generally "eligible employers" to the extent that such employer conducted a trade or business during 2020 and whose

(1) operations were fully or partially suspended due to a COVID-19 related government order, or

(2) gross receipts declined by more than 50% when compared to the same calendar quarter in the prior year.

(c) Wages of employees who are furloughed or have reduced hours as a result of the employer's economic hardship are eligible for the payroll tax credit.

2. <u>Employee Retention Credit for Eligible Employers</u>.

(a) The CARES Act provides a refundable payroll tax credit for 50% of the "qualified wages" paid by eligible employers with respect to each employee during the COVID-19 crisis. ("Qualified wages" do not include sick leave wages or family leave wages paid pursuant to the Families First Coronavirus Response Act (H.R. 6201)).

(b) The credit is provided based on the first $10,000 of qualified wages (including health benefits) paid to an eligible employee, resulting in a maximum tax credit of $5,000 per employee.

(c) For eligible employers with 100 or fewer full-time employees, all employee wages qualify for the credit, regardless of whether an employee is furloughed.

(d) For eligible employers with more than 100 full-time employees, only employees who are not currently providing services for the employer due to COVID-19 causes are eligible for the credit.

(e) The employee retention credit is available for qualified wages paid or incurred after March 12, 2020, and before January 1, 2021.

(f) Note: The credit is not available to employers receiving Small Business Interruption Loans.

(g) The IRS is granted authority to advance payments to eligible employers and to waive penalties for employers who do not deposit applicable payroll taxes in anticipation of receiving the credit.

3. Delay of Payment of Employer Payroll Taxes.

(a) Employers are responsible for paying a 6.2% Social Security tax on employee wages.

(b) With the CARES Act, many employers will be able to defer paying their share of this Social Security tax (and deposits with respect to such taxes).

(c) The CARES Act requires that the deferred tax liability amounts be paid over the next two years, with half due by December 31, 2021, and the remainder due by December 31, 2022.

(d) The provisions of Act Section 2302 apply to the period beginning on March 27, 2020 and ending before January 1, 2021 (the "Payroll Tax Deferral Period").

(e) Note: employers that receive a loan under the Small Business Act that is forgiven pursuant to the CARES Act are ineligible for this credit.

CHARITABLE CONTRIBUTIONS

The CARES Act encourages charitable giving in tax year 2020 by allowing income tax deductions for qualified contributions to certain charitable organizations, such as churches, educational organizations, hospitals, and medical research organizations. Individuals may deduct qualified charitable cash contributions of up to $300 regardless of whether the taxpayer itemizes deductions. For individuals who itemize deductions, the 50% charitable deduction limitation is suspended for qualified charitable contributions of cash in 2020. For corporations, the deduction limitation on qualified charitable contributions of cash increases to 25% of the corporation's taxable income. The charitable deduction limitation for a corporation that donates food inventory to a charitable organization that will use it for the care of the ill, the needy, or infants increases to 25% of the corporation's taxable income. Donations (either by an individual or corporation) to a Section 509(a)(3) supporting organization or donor advised fund do not qualify as a qualified charitable contribution.

INDIVIDUAL TAX PROVISIONS

1. Refundable Tax Credits.

The CARES Act provides for payments that are similar to outright grants to taxpayers and their dependents. These payments are being distributed as a tax credit based upon the filing of a prior tax return. Individuals are allowed an income tax credit equal to the sum of $1,200 for individuals and $2,400 for married individuals filing joint tax returns. In addition, there is a credit of $500 for each qualifying child under age 17. As a refundable credit, this means that a check will be forthcoming from IRS. Individuals with no income or income from SSI are eligible for the credit. There is no limit on the number of children eligible for the credit. The credit begins to phase out once an individual has more than $75,000 of income and is completely phased out once adjusted gross income exceeds $99,000. For joint filers the phase out begins at $150,000 and is completely phased out at $198,000.

As a refundable credit, the payment is tied to an individual's 2019 tax return so that it can be paid immediately. Since many individuals have not yet filed their 2019 returns because of the extension given to file to July 15, 2020, the refundable credit will be based upon the available 2018 tax return of the taxpayer. If for some reason an individual was not eligible for a refund based upon 2019 tax information, the credit can be claim next year when filing a 2020 tax return.

2. Non-Income Payments by Employers for Students Expanded.

Section 127 of the Internal Revenue Code allowed employees to exclude from income an amount up to $5,250 for payments made by an employer to assist with the employee's education. Now under the CARES Act, those non-income payments can also include payments for eligible student loan repayments.

BUSINESS TAX PROVISIONS

1. Restored Deduction for Excess Business Losses.

For the period of time between December 31, 2017 and January 1, 2026, non-corporate taxpayers were denied a loss deduction for when business deduction exceeded business income plus $250,000. The CARES Act restores this deduction for years 2018, 2019 and 2020. There are additional changes that will impact businesses regarding interest expense deductions, delayed payment of estimated tax and alternative minimum tax.

2. <u>Delay of Estimated Tax Payments for Corporations</u>.

Installment payments that might be due as of the enactment date are not due until October 15, 2020.

3. <u>Alternative Minimum Tax Credits</u>.

The Act will allow corporations to claim credits in 2019 for 100% of the alternative minimum tax. The entire credit can be taken for 2018 as a tentative carryback refund claim.

4. <u>Interest Expense Deduction</u>.

For the years 2019 and 2020 the interest expense deduction under is increased from 30% to 50%. The rule will not apply to partnerships for 2019 but will apply in 2020. Partners need to consider the benefits of electing out of the increase and the impact on 2019 and 2020 returns.

CONCLUSION

We trust this information has been helpful and we encourage you to call us if you have questions or desire clarification. Early action in seeking relief is recommended, as there are limitations on the amount of funds available for some of the initiatives described above and practical limitations on the flood of paperwork that lenders will be equipped to process. Accordingly, acting promptly is important, especially as loans will not be processed or funded immediately, and a lag time should be anticipated.

We hope that you and your families, and your businesses will remain healthy during these trying times.

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