

# CARES Act – Consideration for Portfolio Companies of Private Equity Sponsors

**April 3, 2020**

While much of the attention has been focused on the loan programs in respect of the Paycheck Protection Program ("PPP") and Economic Injury Disaster Loans ("EIDL") for small businesses found in Title I of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") and the Coronavirus Economic Stabilization Act of 2020 for eligible businesses, including midsize and larger companies, and States and municipalities found in Title IV of the CARES Act, the CARES Act and a number of existing laws provide additional benefits to allow portfolio companies of private equity sponsors to manage cash flow and provide further liquidity to the businesses.

## **1. CARES Act Tax Related Considerations**

### **(a) NOLs; Excess Business Losses.**

(i) A corporation's losses from 2018, 2019, and 2020 can be carried back for five years, and corporate NOLs can fully reduce taxable income (rather than only 80% of taxable income under current law). However, a REIT is not permitted to carry back losses, and the CARES Act prevents the use of NOL carrybacks to offset amounts deemed repatriated under section 965 (which are subject to a one-time tax of 8% or 15.5%, generally payable in installments over 8 years), effectively preserving the NOLs to offset income taxed at the ordinary rate (21%).

(ii) The CARES Act allows corporate taxpayers that may be able to carryback losses a 120-day period to make certain important elections, including the election to forego the carryback.

(iii) The CARES Act retroactively suspends the excess business loss provision of section 461(l)(1) (which disallows business losses in excess of \$250,000 for a single taxpayer and \$500,000 for a married couple filing jointly) for 2018 through 2020.

(b) Limits on Business Interest Expense Deduction Increased From 30% to 50%.

(i) The CARES Act retroactively increases the section 163(j) limitation on business interest expense deductions from 30% to 50% for 2019 and 2020.

(ii) Taxpayers may elect to use their 2019 adjusted taxable income for purposes of calculating their section 163(j) limitation for 2020.

(iii) Taxpayers may also elect out of the increase (for example, to defer the deduction and avoid generating or increasing a net operating loss which, under the CARES Act, are again usable only to the extent of 80% of taxable income beginning in 2021; or to minimize the amount of interest subject to the base erosion and anti-abuse tax or the "BEAT").

(iv) Increase in the limitation applies to partners in partnerships only in 2020 (and not in 2019) but, for partners that do not elect out of the provision, 50% of the business interest of a partner that is accrued in 2019 is deemed to accrue in 2020 and is not subject to any limitation in 2020.

(c) Employee Retention Credit for Employers Closed Due to Covid-19.

(i) An employer is allowed a refundable payroll tax credit equal to 50% of certain "qualified wages" (including certain health plan expenses) paid to its employees beginning March 13, 2020 through December 31, 2020 if:

(1) the employer is engaged in a trade or business in 2020, and

(2) the wages are paid:

(A) while operation of that trade or business is fully or partially suspended due to a governmental order related to COVID-19; or

(B) during the period beginning in the first quarter in which gross receipts for that trade or business are less than 50% of gross receipts for the same calendar quarter of 2019 and ending at the end of the first subsequent quarter in which gross receipts are more than 80% for the same calendar quarter of 2019.

(ii) For employers with more than 100 employees, the credit is available only with respect to wages paid to an employee who is not providing services due to the circumstances described in (c)(i)(2)(A) or (c)(i)(2)(B) above.

(iii) The credit is capped at \$5,000 (50% of \$10,000 qualified wages) per employee for all calendar quarters.

(iv) Section 501(c) organizations are eligible for the credit, but governmental entities and companies receiving PPP loans are not.

(d) Employer Payroll Tax Payment Extensions and Filings.

(i) Employers and self-employed individuals (other than taxpayers who have indebtedness forgiven under the PPP) may delay payment of the 6.2% employer share of the Social Security tax (but not the employer's share of FUTA or the 1.45% employer share of the Medicare tax) from the date of enactment through the end of 2020. The tax is payable over the following two years with half due by December 31, 2021 and the other half by December 31, 2022. These provisions are available to everyone, regardless of income.

(ii) The CARES Act does not extend the tax return filing date or due date for estimated tax. The Treasury and the IRS have issued guidance that extends the due dates for the first quarter (but not, for now, second quarter) estimated tax payments and the April 15 filing date to July 15, 2020.

(e) Immediate Expensing of Capex Costs. The CARES Act corrects an error in the Tax Cuts and Jobs Act (the "TCJA") that prevented businesses from expensing certain costs for improvements to "qualified improvement property", and required the costs to be depreciated over the 39-year life of the building. Qualified improvement property is any improvement to the interior of a nonresidential building that is placed in service after the building is first placed in service. Qualified improvement property does not include improvements that are attributable to the enlargement of the building, elevators or escalators, or the internal structural framework of the building. The change is retroactive to the date of enactment of the TCJA.

(f) Acceleration of Alternative Minimum Tax (AMT) Credits. The CARES Act allows corporations with outstanding AMT credits to claim their credits immediately. Previously, the TCJA repealed the corporate AMT and allowed corporations to claim corporate AMT credits over several years until 2021.

(g) Small Business Loan Forgiveness Does Not Give Rise To Cancellation of Indebtedness Income. Any cancellation of debt income under the PPP is tax-free (i.e., excluded from income), and does not result in a loss of tax attributes.

(h) Tax Treatment of Economic Stabilization Investments. Any loans made or guaranteed by the Treasury under Title IV of the CARES Act are treated for tax purposes as debt issued at par, and stated interest on these loans is treated as qualified stated interest. As a result, loans issued or guaranteed under the program are not treated as issued with original issue discount for tax purposes, and cash basis taxpayers are not permitted to deduct interest on the loans until that interest is paid.

## **II. CARES Act Employee Benefits Related Considerations**

(a) Waiver of Required Minimum Distributions ("RMDs"). The CARES Act allows a temporary waiver for defined contribution plan RMDs that would otherwise have to be paid for calendar year 2020. The delay is available for section 401(a), 403(a), 403(b), and governmental 457(b) plans (in each case defined contribution only) and IRAs. A plan sponsor could adopt this change immediately, but it will need to adopt plan amendments to reflect the changes before December 31, 2022 (or, for non-calendar year plans, the end of the plan year that starts in 2022).

(b) Single-Employer Defined Benefit Funding Relief. The CARES Act allows sponsors of single employer defined benefit plans to delay payment of minimum required contributions for calendar year 2020. Delayed contributions must be made with interest by January 1, 2021. A plan sponsor also has the option under the CARES Act to use the plan's adjusted funding target attainment percentage for the last plan year ending before January 1, 2020 as the percentage for plan years which include calendar year 2020.

(c) Relief for Participants in Defined Contribution Plans. Relief is optional and will require plan amendments.

(i) Special CARES Act Distributions. Plans may allow "qualified individuals" to take "coronavirus-related distributions" of up to \$100,000 (from all plans in the controlled group combined). These distributions:

(A) may be taken while still employed (or after employment);

(B) may be included in income over three years (to spread the tax liability);

(C) are not subject to the 10% additional tax on distributions before age 59½; and

(D) may be repaid to the plan (like a rollover) within three years.

To qualify, the distribution must be taken before December 31, 2020, and the participant must (x) have been diagnosed or have a spouse or dependent who was diagnosed by an approved test with SARS-CoV-2 or COVID-19, or (y) have experienced "adverse financial consequences" as a result of being quarantined, furloughed, laid off, unable to work due to lack of child care, experiencing a closing or reduction of hours of a business owned by the individual, or other factors determined by the Secretary of Treasury.

(ii) Loan Relief. Until September 23, 2020, plans may increase the limit on plan loans for "qualified individuals" from \$50,000 (or, if lower 50% of the vested account balance) to \$100,000 (or, if lower, 100% of the vested account balance). In addition, the CARES Act delays by one year the deadline for qualified individuals to make loan repayments that are otherwise due between the date of enactment and December 31, 2020. Unlike suspension of payments for other leaves, a suspension under the CARES Act will extend the maximum permitted term of the loan (five years for non-residence loans).

(d) Health Plans. Plans must now cover COVID-19 diagnosis without cost sharing (same rules apply for in-network preventive care). In addition, the CARES Act allows over the counter drugs and menstrual products to be reimbursed by flexible spending accounts, health reimbursement arrangements, and health savings accounts, even without a prescription for over the counter drugs; and the CARES Act adds flexibility for HSA-qualified high deductible health plans to cover COVID-19 treatment and telehealth (even if not related to COVID-19) without imposing the deductible. The telehealth provision will sunset at the end of 2021.

### III. Existing Federal Legislation Considerations

(a) Emergency Paid Sick Leave Act. Under the Families First Coronavirus Response Act (the "FFCRA"), employers with fewer than 500 employees<sup>[1]</sup> must provide full-time employees with 80 hours of paid sick leave (less for part-time employees) if the employees are unable to work (or telework) for certain reasons related to COVID-19.

(i) Leave is fully paid, or paid at a rate of 2/3 of the regular rate, depending on the reason for taking leave.

(ii) Leave is capped at \$511 per day and \$5,110 in the aggregate; or \$200 per day and \$2,000 in the aggregate, depending on the reason for taking leave.

(iii) Employers may not require employees to use other paid leave first.

(iv) These requirements apply to leave taken between April 1, 2020 and December 31, 2020.

(b) Emergency Family & Medical Leave Expansion Act. Under the FFCRA, employers with fewer than 500 employees must also provide 12 weeks of leave to employees who are unable to work (or telework) because of a need to care for a child whose school/day care is closed or whose childcare provider is unavailable, in each case due to a public health emergency (leave counts towards 12 weeks of leave available under the existing Family & Medical Leave Act).

(i) First 10 days may be unpaid; after which employees must be paid 2/3 of their regular rate.

(1) Employees can substitute other leave for the 10 days of unpaid leave, including Emergency Paid Sick Leave.

(2) Pay is capped at \$200 per day; \$10,000 in total.

(ii) Employees must be employed for 30 days to be eligible.

(iii) These requirements apply to leave taken between April 1, 2020 and December 31, 2020.

(c) Tax Credits for Paid Sick and Paid Family and Medical Leave. Employers that are required to provide paid leave under the FFRCA are entitled to refundable payroll tax credits that reimburse them, dollar for dollar, for the cost of providing these benefits. The credits can be claimed each quarter. The credits are not available for employers receiving a credit for paid family and medical leave under the TCJA. The credits are also available as an advanced refund.

(d) Compensation Reduction, Layoff, Furlough, and Leave of Absence Considerations. Any of the following actions may trigger severance/separation from service obligations, employment agreements, plans, policies and arrangements should be reviewed.

(i) Reducing Compensation.

(1) Keep pay above the state and federal minimum wage.

(2) For exempt employees, consider the salary basis and minimum salary rules.

(A) Deductions from predetermined pay occasioned by day-to-day or week-to-week determinations of the operating requirements of the business may be impermissible.

(3) Notice may be required under state and local laws.

(4) If coupled with a bonus or restoration opportunity, a salary reduction can be treated as a deferral that violates Section 409A requirements.

(ii) Furloughs and Layoffs.

(1) Notice may be required to comply with federal and state WARN laws.

(A) Federal laws require 60 days' notice of a mass layoff or plant closure.[\[2\]](#)

(B) New York laws require 90 days' notice of a mass layoff or plant closure.[\[3\]](#)

(C) Some jurisdiction have an exception for unforeseeable business circumstances and/or faltering companies.

(D) Some jurisdictions do not apply to temporary layoffs for a period of less than six months.

(2) Furloughed employees are generally not entitled to federal paid leave, but may be eligible for state unemployment insurance benefits.

(A) Consider whether participants may continue to vest during a furlough under any equity plans.

(3) Large layoffs may trigger an obligation to vest retirement benefits. In addition, portfolio companies that have defined benefit pension plans could have reporting or funding obligations to the Pension Benefit Guaranty Corporation.

(4) Employers may consider voluntary resignation incentive programs.

(A) Consider appropriate benefits and eligibility requirements for participants.

(B) Age related considerations.

#### **IV. Non Legislative Compensation Related Considerations / Recommendations**

(a) Equity Plans. Equity plans should be reviewed. Consider:

(i) the potential for unintended dilution (e.g., contractual obligations to deliver a number of shares based on an absolute/fixed dollar value, without a maximum number of shares, that can be delivered may result in excessive dilution); or

(ii) suspending grants of stock options, stock appreciation rights, and profits interests, and possibly employee stock purchase plans. Existing valuations may no longer be reliable, and short-term drops in share or unit value affect the program's burn rate and may result in excess compensation in a recovery.

(b) Performance Goals.

(i) Performance goals for awards granted prior to the COVID-19 pandemic should be reviewed to evaluate the extent to which mid-stream adjustment is permitted.



(ii) If performance goals or granted performance-based awards are not yet set, consider waiting until there is more certainty in the market to set performance goals or grant awards. At a minimum, new awards should provide for flexibility to adjust metrics and payout amounts.

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[\[1\] Note:](#) In determining the threshold of 500 employees, include (i) full-time and part time employees within the U.S. (including D.C. and U.S. territories), (ii) employees on leave, (iii) temporary employees jointly employed by the employer (regardless of who maintains payroll), (iv) day laborers supplied by a temp agency, (v) common employees under the FLSA joint employer test, and (vi) employees of all entities making up the integrated employer under the FMLA integrated employer test. It does not include independent contractors.

[\[2\] Note:](#) Federal WARN Trigger: (i) 50 over 30/90 day period (and at least 33% of workforce for mass layoff), or (ii) if the minimum affected employees is 500 employees.

[\[3\] Note:](#) New York WARN Trigger: (i) 25 over 30/90 day period (and at least 33% of workforce for mass layoff or relocation), or (ii) if the minimum affected employees is 250 employees.

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**Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. We will continue to evaluate the CARES Act, related regulations and any subsequent legislation to provide our clients guidance in real time. Please visit our [Coronavirus Resource Center](#) for guidance on risk management measures, practical steps businesses can take and resources to help manage ongoing operations.**

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