Understanding the CARES Act and Paycheck Protection Program
by Rick Parmelee and Joseph Feehan

On March 27, Congress passed and the President signed into law the CARES Act including the Paycheck Protection Program. The CARES ACT contains a number of important tax provisions, while the Paycheck Protection Program provision of the CARES Act offers businesses immediate access to liquidity through a new loan program tied to prior year payroll. We have highlighted key details of both below.

Highlights of the CARES Act

- Tax relief for individuals and businesses and direct cash payments for qualifying individuals.
- Temporarily reverses or limits the revenue raising provisions of the Tax Cuts and Jobs Act (the TCJA) and makes several technical corrections to the TCJA.
- $500 billion lending program providing loans, loan guarantees and investments.
- Increases unemployment benefits, including "Gig" workers and the self-employed.
- Funding to support public health programs, hospitals, medical providers and suppliers.
- Protections against certain foreclosures and eviction (and relief for delayed payments).
- Funding for the Emergency Food Assistance Program, SNAP and CNP.

Individual Tax Provisions

Cash Payments

- All U.S. residents with adjusted gross income up to $75,000 ($150,000 married), who are not a dependent of another taxpayer and have a work eligible social security number, are eligible for the full $1,200 ($2,400 married) rebate. Plus $500 per child payment for those eligible.
- Phased-out completely for single filers with incomes exceeding $99,000, $146,500 for head of household filers with one child, and $198,000 for joint filers with no children.
- IRS will use taxpayer's 2019 tax return if filed, or their 2018 return to determine eligibility.

Relaxation of restrictions on use of retirement funds

- Consistent with previous disaster-related relief, the provision waives the 10 percent early withdrawal penalty for distributions up to $100,000 from qualified retirement accounts for coronavirus-related purposes made on or after January 1, 2020.
- Income attributable to such distributions are subject to tax over three years, and the taxpayer may recontribute the funds to an eligible retirement plan within three years without regard to that year's cap on contributions.

Waives the required minimum distribution rules for certain defined contribution plans and IRAs for calendar year 2020.

Provides for a $300 deduction for charitable contributions for all taxpayers and modifies limitations on charitable contributions made during 2020

Exclusion for certain employer payments of student loans

- The provision enables employers to provide a student loan repayment benefit to employees on a tax-free basis.

__**Business Tax Provisions**__

Employee retention credit for employers subject to closure due to COVID-19

- The provision provides a refundable payroll tax credit for 50 percent of wages paid by employers to employees during the COVID-19 crisis. The credit is available to employers whose (1) operations were fully or partially suspended, due to a COVID-19-related shutdown order, or (2) gross receipts declined by more than 50 percent when compared to the same quarter in the prior year.
- The credit is based on qualified wages paid to the employee.
- For employers with greater than 100 full-time employees, qualified wages are wages paid to employees when they are not providing services due to the COVID-19-related circumstances described above.
- For eligible employers with 100 or fewer full-time employees, all employee wages qualify for the credit, whether the employer is open for business or subject to a shut-down order.

Delay of payment of employer payroll taxes

- The provision allows employers and self-employed individuals to defer payment of the employer share of the Social Security tax.
- The provision requires that the deferred employment tax be paid over the following two years, half due on December 31, 2021 and the other half by December 31, 2022.

Modifications for net operating losses

- Provides for the 5-year carryback of Net Operating Losses arising in 2018, 2019 and 2020.

Modification of limitation on losses for taxpayers other than corporations

- Modifies the loss limitation applicable to pass-through businesses and sole proprietors.

Modification of credit for prior year minimum tax liability of corporations

- Accelerates the ability to recover AMT.

Modification of limitation on business interest

- Increases from limitation from 30 percent to 50 percent of taxable income for 2019 and 2020.

Technical amendment regarding qualified improvement property

- Allows the immediate write-off of costs associated with improving facilities instead of having to depreciate those improvements over a 39-year life.

Temporary exception from excise tax for alcohol used to produce hand sanitizer

- Waives the federal excise tax on any distilled spirits used for or contained in hand sanitizer that is produced and distributed in a manner consistent with guidance issued by the Food and Drug Administration and is effective for calendar year 2020.

We will continue to keep you apprised as additional information and guidance is provided.

Paycheck Protection Program

The Paycheck Protection Program provision of the CARES Act offers businesses immediate access to liquidity through a new loan program tied to prior year payroll. Loans made under the Paycheck Protection Program are backed 100% by the federal government. Eligible borrowers will find the lending requirements under the Paycheck Protection Program to be significantly less onerous than provisions found in the SBA's Disaster Loan program.

Eligibility

Businesses in operation on February 15, 2020, that had had employees or paid independent contractors on that date are eligible for the Paycheck Protection Program. Small Business Administration (SBA) loans are typically governed by borrower size constraints. These constraints frequently limit a business's access to SBA loans. The size constraints are typically tied to revenue and employment levels. Each of these constraints has been relaxed in the CARES Act that President Trump signed into law on March 27, 2020. The CARES Act provides that businesses with (a) 500 or fewer full-time, part-time or other employees or (b) if higher, the maximum number specified for the type of business in the SBA's Table of Small Business Size Standards are eligible to participate. The calculation of employees will be very important for businesses near 500 total employees. Consideration of this issue is beyond the scope of this article.

Exceptions and Special Rules

Special rules exist for businesses with fewer than 500 employees in one location, categorized with a 72 NAICS Code (hospitality/food service industries). A waiver of the affiliation rules exists for businesses operating as a franchise, where the franchise has been assigned an identifier code by the SBA. The SBA franchise directory can be **accessed here**. Businesses operating franchises not included in this directory, who can benefit from this waiver, should consider requesting the franchisor become listed.

Loan Terms

An eligible business may borrow the lesser of $10 million or 2.5 times the average monthly payments by the applicant for payroll costs. If over the last 12 months your average monthly payroll was $1 million, your business could borrow $2.5 million ($1m x 2.5). The CARES Act does not require collateral or personal guarantees for a covered loan. The loan term is a maximum of 10 years at a maximum interest rate of 4%. Loan payments will be deferred for the first 6-12 months.

Loan Forgiveness

The act allows for covered loan forgiveness if the borrower meets certain criteria. The loan forgiveness is equal to payroll costs (including healthcare benefits) + mortgage costs + rent

+ utilities during the covered period. The covered period begins on the origination date of the loan and ends eight weeks later.
The loan forgiveness is reduced if the borrower:

1. reduces the average number of full-time equivalent employees per month during the covered period, below the lesser of
    - the average number of full-time equivalent employees per month from February 15, 2019 to June 30, 2019 or
    - the average number of full-time equivalent employees per month from January 1, 2020 to February 29, 2020 or
2. reduces the salary or wages of any employee in excess of 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed prior to the covered period.

There is no reduction if a borrower re-hires employees who were terminated.
Forgiven amounts are excluded from taxable income.

Conclusion
The Payroll Protection Program included in the CARES Act represents a unique opportunity for businesses to borrow money on very favorable terms. The loan forgiveness aspect of the CARES Act represents a rare opportunity for business to recapitalize on a tax-free basis. We expect there to be significant demand for loans under this program.

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