

WEBINAR

Implications of Certain Provisions of the Federal Stimulus Package to Private Equity Funds and their Portfolio Companies

April 1, 2020

Agenda

1. Introductions
2. Title I of the CARES Act: SBA Paycheck Protection Program Loans
3. Title IV of the CARES Act: Economic Stabilization and Assistance to Severely Distressed Sectors of the U.S. Economy
4. Workforce Matters: Families First Coronavirus Response Act & the CARES Act
5. Tax Ramifications
6. Closing Remarks

Title I of the CARES Act: SBA Paycheck Protection Program Loans

SBA Paycheck Protection Program Loans

What businesses are eligible for PPP loans?

- A business is eligible if:
 - its employee count is lower than the greater of (i) 500 employees and (ii) the applicable NAICS code size standard; OR
 - it falls within NAICS code 72 (accommodations and food services) and has no more than 500 employees per location; OR
 - it meets (i) the applicable NAICS code size standard or (ii) the net worth and average net income thresholds

SBA Paycheck Protection Program Loans

- Employees of a business’ “**Affiliates**” must also be counted. A determination of affiliation can be based on:
 - ownership of a control stake
 - board control
 - veto rights (e.g., minority rights) or ability to block a quorum
 - economic dependence
 - other factors showing common control
- Most portfolio companies of a private equity fund would be treated as affiliates of one another. Subject to the limited exceptions on the next slide, ***it’s unlikely that a PE fund’s majority-owned portfolio companies can obtain PPP loans***
- Minority investments will require detailed analysis

SBA Paycheck Protection Program Loans

Are there exceptions to the affiliation requirements?

- Businesses within NAICS code 72 (accommodations and food services) that have no more than 500 employees
- Franchises with codes assigned by the SBA
- SBIC portfolio companies (i.e., companies with SBIC investors)

SBA Paycheck Protection Program Loans

What is the maximum loan amount?

- The maximum loan amount is the lesser of:
 - The sum of 2.5x TTM average monthly payroll costs and
 - \$10 million
- Payroll costs:
 - Exclude compensation above \$100k/year for any employee
 - Exclude compensation of employees residing outside the U.S.

SBA Paycheck Protection Program Loans

What can a business use the loan proceeds for?

- Use of the loan proceeds is limited to:
 - Payroll costs (which excludes any comp above \$100K for any employee)
 - Group healthcare benefit costs and insurance premiums
 - Mortgage interest and rent payments
 - Certain utilities
 - Interest (but not principal) on debt that existed as of February 15, 2020
 - Additional wages paid to tipped employees

SBA Paycheck Protection Program Loans

Can PPP loans be forgiven?

- Loans are forgiven to the extent used for permitted expenses incurred or paid within 8 weeks after loan
 - Forgiveness amount reduced proportionately if average FTE employee count for the 8 weeks after loan is lower than specified pre-crisis period
 - Forgiveness amount reduced dollar for dollar if an employee's comp for the 8 weeks after loan is more than 25% below prior quarter
 - Reduction is disregarded if FTE employees or comp are restored to pre-crisis levels by June 30

SBA Paycheck Protection Program Loans

What are the other terms and conditions of PPP loans?

- Other loan terms and rates
- Process for obtaining loans

Title IV of the CARES Act: Economic Stabilization and Assistance to Severely Distressed Sectors of the U.S. Economy

Title IV of the CARES Act

- Title IV of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) authorizes \$500B of loans, loan guarantees, and other investments for eligible businesses, states, and municipalities
- Secretary of Treasury to publish application procedures and other requirements/guidelines by April 6, 2020

Title IV of the CARES Act

Who qualifies?

- Eligible businesses, including air carriers and U.S. businesses that have not otherwise received adequate economic relief under the CARES Act
- States and municipalities

Title IV of the CARES Act

What aid is available?

- \$500B of loans, loan guarantees, and other investments for eligible businesses, states, and municipalities, as follows:
 - up to \$25B for passenger air carriers and related businesses
 - up to \$4B for cargo air carriers
 - up to \$17B for businesses critical to maintaining national security
 - up to \$454B for programs or facilities established by the Federal Reserve System to provide liquidity to the financial system that supports lending to eligible businesses, states, and municipalities

Title IV of the CARES Act

What are the terms and conditions?

- Terms for carriers and businesses critical to maintaining national security
- Terms for direct loans by the Secretary
- Terms for loans to mid-sized businesses
- Authorization of a Main Street Lending Program by the Federal Reserve

Title IV of the CARES Act

Financial Protection of the Government

- For loans made to passenger air carriers, cargo air carriers, and businesses critical to maintaining national security, the Secretary must receive a warrant or other equity security (or, in the case of private companies, a senior debt instrument) to provide equity appreciation (or a reasonable interest rate premium) to taxpayers
- Equity securities will not have voting rights
- Securities will not be subject to restrictions on transferability

Workforce Matters: Families First Coronavirus Response Act & the CARES Act

Overview

Families First Coronavirus Response Act: Key Employer Provisions

- Emergency Paid Sick Leave Act
- Emergency Family and Medical Leave Expansion Act

CARES Act: Key Employer Provisions

- Unemployment insurance
- Fringe benefits/payroll taxes
- Executive compensation and workforce constraints
- Small business loans (Payroll Protection Program)
- Financial assistance under Title IV of the CARES Act
- Retirement plan benefits
- Health & welfare benefits

Options for Employers

- Deferred compensation
- Reduction in hours or pay
- Temporary furlough
- Total workplace closure

FFCRA: Overview of Emergency Paid Sick Leave Act

- **Effective Date?** April 1, 2020
- **Which employers must offer this job-protected paid leave?**
 - Employers with fewer than 500 employees
 - Aggregation?
 - Potential Exception: The U.S. Secretary of Labor has the authority to issue regulations exempting businesses with fewer than 50 employees
- **Which employees?**
 - Employees who cannot work/telework because they:
 1. are subject to a federal, state, or local quarantine or isolation order related to COVID-19;
 2. have been advised by a health care provider to self-quarantine due to concerns related to COVID-19;
 3. are experiencing symptoms of COVID-19 and seeking a medical diagnosis;
 4. are caring for an individual who is subject to an order described in (1) or has been advised as described in (2);
 5. are caring for a son or daughter if the school or place of care for such child has been closed, or the child care provider of such child is unavailable due to COVID-19; or
 6. are experiencing any other substantially similar condition specified by the Secretary of Health and Human Services in consultation with the Secretary of Treasury and the Secretary of Labor
 - Potential Exception: Employers of health care providers or emergency responders may elect to exclude such employees from the Emergency Paid Sick Leave Act

FFCRA: Overview of Emergency Paid Sick Leave Act

- What benefit must be provided to eligible employees?
- What amount is paid?
- What tax credit is given?

FFCRA: Overview of Emergency Family and Medical Leave Expansion Act

- **Effective Date?** April 1, 2020
- **Which employers must offer this job-protected paid leave?**
 - Employers with fewer than 500 employees
 - Aggregation?
 - Potential Exception: The U.S. Secretary of Labor has the authority to issue regulations exempting businesses with fewer than 50 employees and excluding healthcare providers and emergency responders from the definition of “eligible employee”
- **Which employees?**
 - Employees who cannot work (or telework) because they are caring for a son or daughter under the age of 18 if the school or place of care has been closed, or the child care provider of such child is unavailable due to a public health emergency
 - Potential Exception: Employers of healthcare providers or emergency responders may elect to exclude such employees from the Emergency Family and Medical Leave Extension Act

FFCRA: Overview of Emergency Family and Medical Leave Expansion Act

- What benefit must be provided to eligible employees?
- What amount is paid?
- What tax credit is given?

CARES Act: Basics

- The Coronavirus Aid, Relief, and Economic Security Act (H.R. 748) (“CARES Act”)
- Sometimes referred to as “Phase 3” of coronavirus economic relief
- Enacted on March 27, 2020
- Extension of unemployment benefits
- Student loan payments
- Payment relief for employment taxes
- Payroll tax deferral

CARES Act: Business Loans

- Title IV – The CARES Act imposes certain limits on businesses that receive loans, loan assistance, or other financial assistance under Title IV of the CARES Act. These limits do not apply to companies seeking relief under the CARES Act’s Paycheck Protection Program
 - Workforce change constraints
 - Executive compensation limits
- Title I – Paycheck Protection Program (small business loans)

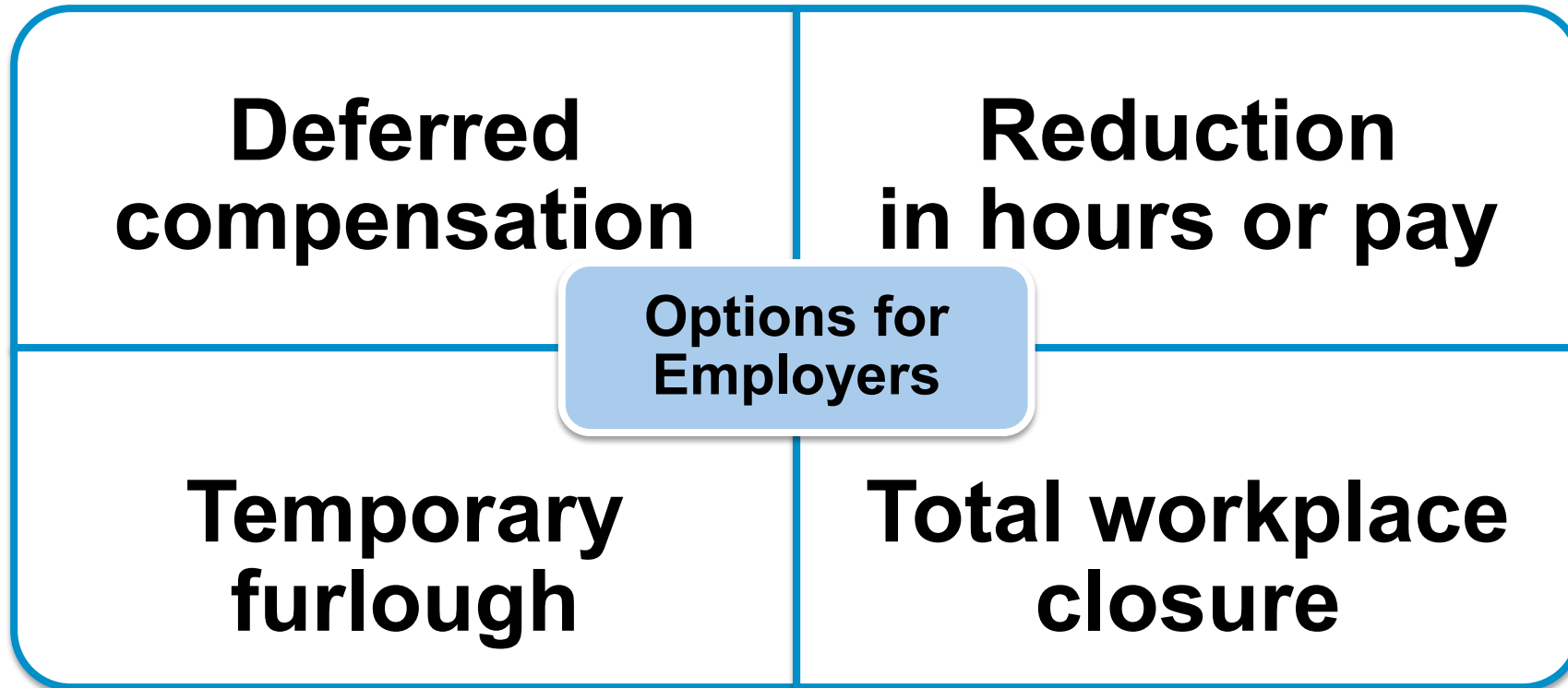
CARES Act: Retirement Benefit Plans

- Penalty-free coronavirus-related distributions of up to \$100k in 2020
- Repayment of coronavirus-related distributions within 3 years
- Income inclusion over 3 years for coronavirus-related distributions
- Plan loan dollar limits temporarily increased to \$100k
- 1-year extension of time to repay a plan loan, if due date is 3/27/2020 – 12/31/2020
- Suspension of required minimum distributions in 2020
- Plans must be amended to reflect new rules by the last day of plan year beginning 1/1/2022
- Single-employer defined benefit plan funding relief

CARES Act: Health & Welfare Benefits

- COVID-19 diagnostic testing
- COVID-19-related preventive services
- Telehealth
- Over-the-counter products and medications

Options for Employers



Tax Ramifications

Selected Tax Provisions of CARES Act

- Payroll tax credit
- Payroll tax deferral
- NOL carrybacks (and relaxation of carryforward limitation)
- More liberal interest expense deduction limitations in 2019 and 2020 (and interplay with NOL carrybacks)
- Expensing of qualified improvement property (technical correction of a provision of 2017 tax reform)

Payroll Tax Credit and Deferral

- Refundable tax credit for employer portion of Social Security payroll taxes
 - 50% of wages paid in 2020 up to \$10,000 per employee per quarter
 - Does not apply to employers who receive a covered loan under the Paycheck Protection Program of the CARES Act
- Applies to “eligible employer”
 - Full or partial shutdown; or
 - Significant decline in gross receipts
 - 50% of the gross receipts of the corresponding quarter in 2019
 - Until recovery in quarter where gross receipts are greater than 80% of corresponding quarter

Payroll Tax Credit and Deferral

- Tax credit applies to “qualified wages”
 - If no more than 100 employees, all wages
 - If more than 100 employees, only wages paid to employees who can’t work
 - Aggregation rule may impact portfolio companies
- Payroll tax deferral
 - Social Security payroll taxes deferred for remainder of 2020
 - 50% until December 31, 2021
 - 50% until December 31, 2022
 - Only exception is if small business loans forgiven under CARES Act

Net Operating Losses

- CARES Act defers application of 80% taxable income limitation on NOL utilization until 2021
- 5-year NOL carryback period for 2018-2020 NOLs
 - Refund check typically within 90 days
 - Refunds for 2020 NOLs not until after 2020 returns filed
- Need to check 2018-2020 acquisition agreements and whether refunds may contractually have to be paid to sellers

Interest Expense Deduction Limitation

- Interest expense deduction limitation increased to 50% of adjusted taxable income (from 30%)
 - EBITDA is a good approximation
- Adjusted taxable income calculation for 2020 can use 2019 results
 - Will maximize interest expense deductions and NOL carrybacks

Qualified Improvement Property

- Tax reform included a 100% deduction for capital expenditures on property with depreciable life of up to 15 years (expensing)
- Mistake made in drafting and interior improvements to buildings were not included (“retail glitch”)
- Retail glitch fixed retroactive to 2018
- Taxpayer can amend 2018 returns (and 2019 if already filed) and get refunds

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