




Preserving Businesses During the COVID-19 Recession: Understanding the Business and Tax Impact of the CARES Act

Green & Sklarz LLC
One Audubon Street, Third Floor
NewHaven, CT 06511
(203) 285-8545
www.gs-lawfirm.com

1

Speakers

		
Jason A. Marsh, Esq. jmarsh@gs-lawfirm.com	Shelby L. Wilson, Esq. swilson@gs-lawfirm.com	Mark G. Sklarz, Esq. msklarz@gs-lawfirm.com

GREEN & SKLARZ LLC 2

2

Speakers



Eric L. Green, Esq.
egreen@gs-lawfirm.com



Jeffrey M. Sklarz, Esq.
jsklarz@gs-lawfirm.com

**GREEN &
SKLARZ** LLC

3

3

CPE/CE

- For Enrolled Agents and CPAs, there will be 8 attendance check words.
- We will give you the 8 words.
- Please write them down
- A link will be emailed to you after this program, click the link, put in your information and the eight words and you will automatically receive your certificate

**GREEN &
SKLARZ** LLC

4

4

Handouts and Q&A

- The handouts are in the Handouts tab in your control panel
- You may want to print the slides and the attendance check word form
- We will do Q&A at the end

5

- On Thursday, March 19th Senate Republicans introduced the *Coronavirus Aid, Relief, and Economic Security Act* ("CARES Act")
- Following several days of negotiation, on Wednesday, March 25th, the Senate approved (96-0) the CARES Act, H.R. 748, which was then approved by the House on March 27th. The President signed the \$2.2 trillion stimulus package into law later that day.
- The Treasury Department, SBA, IRS, and Federal Reserve are the agencies that will have the most substantial role in implementing the legislation. Private lenders, particularly SBA lenders, have a major role too.
- How they perform their tasks will largely determine the economic fate of the nation over the coming months.

6

Summary of Provisions

- Title I: Small Business (Forgivable) Loan Program
- Title II: Individual and Small Business Protections
 - Unemployment Insurance Enhancements
 - Direct Stipends to Individuals
 - Tax Credits for Businesses
- Title III: Health Care Related Provisions
- Title IV: Corporate Bail-Outs and Loan Programs
- Title V: Relief Fund for State, Local, and Tribal Governments
- Title VI: Misc. Provisions

**GREEN &
SKLARZ** LLC

7

7

Small Business Provisions

**GREEN &
SKLARZ** LLC

8

8

Small Business “Payroll Protection Loans”

- 500 or fewer employees (exception: NFPs that are Medicaid funded are still eligible even if they have more than 500 employees)
 - For the hospitality industry (NAICS Code 72, Accommodation and Food Services) the 500 employee cap applied *per location*, so large companies that own hotels or restaurants with multiple locations may still qualify as small businesses if each location has less than 500 employees.
 - Franchises qualify as well.
 - The terms “employee” is defined broadly and includes full and part-time.
- **Loan Amount:** 2.5x the average total monthly payments for payroll; capped at \$10 million.
- Loan guarantees by government, but funded through private lenders.
- Independent contractors and sole proprietors may apply.

GREEN &
SKLARZ LLC

9

9

Small Business “Payroll Protection Loans”

- Loan proceeds can be used for: “payroll costs” (a defined term under the Act), mortgage interest, rent, utilities, and other debt obligations incurred before the covered period. Tipped employees payroll can be included.
- Payroll amount is capped at \$100,000 per employee pro rated for the covered period (February 15 – June 30, 2020).
- Ex patriot workers are excluded.
- It appears (but is not 100% clear) that self-employed owners who receive a K-1 have their compensation included in the calculation (up to \$100,000).

GREEN &
SKLARZ LLC

10

10

Small Business “Payroll Protection Loans”

Nature of Loan

- Nonrecourse (unless used for unauthorized purposes)
- No personal guarantee of borrower’s owners
- No collateral requirement
- Borrower’s certification:
 - The uncertainty of the economic climate necessitates the loan
 - Funds will be used for “covered expenses”
 - No other similar loan applications
 - Between February 15, 2020 and December 31, 2020 recipient has not received and will not receive other similar loans

Small Business “Payroll Protection Loans”

Additional Elements

- No requirement to seek credit elsewhere
- Maximum maturity of 10 years
- Interest rate not to exceed 4%
- At least 6 months deferral of P&I (up to 1 year)
 - SBA to write rules to specify mechanism
- No prepayment penalties

Small Business “Payroll Protection Loans”

Underwriting Criteria:

- Treasury to make rules
- But, only real factors are: (i) the business was in operation on 3/1/2020 and (ii) had employees
- Business that received SBA disaster assistance loans for COVID-19 to support payroll cannot also get a CARE loan for the same purpose [this will need clarification]
- Businesses that apply for loans are presumed to qualify
- In his press conference, Sec. Mnuchin stated that he expected the program to be open within 10 days and for applicants to receive cash the same day they applied for the loan

Loan Forgiveness

- Covered businesses who receive CARE loans may seek forgiveness of the portion of the loan that relates to payroll expense, mortgage payments, rent, and utilities.
 - Mortgage debt or lease obligation must have been incurred before February 15, 2020
 - Act references a “mortgage” on “personal property,” which is unclear
- Expected Loan Forgiveness:
 - Payroll costs, rent/mortgage obligations, and utilities.
 - The term “Payroll Costs” means: “salary, wage, commission, or similar compensation,” certain fringe benefits, termination pay, health/insurance benefits, retirement benefits, state and local tax on compensation, self-employment income for sole-proprietors and independent contractors; all capped at \$100,000 per employee.

How to Obtain Loan Forgiveness

- Borrower must affirmatively seek loan forgiveness by filing an application
- Lender to make decision on loan forgiveness with 60 days
- Forgiveness will be reduced if employees are terminated during the “covered period” meaning between February 15th and June 30th
 - The comparison will be to the level of employment between February 15th and 30 days after enactment and the level of employment on June 30th
 - The process for comparison will need further clarification as the Act is unclear.
- Forgiveness will also be reduced if worker salaries are reduced

How to Obtain Loan Forgiveness

Application for Loan Forgiveness

- Payroll tax filings with IRS (Form 941)
- State income, payroll, and unemployment insurance filings
- Cancelled checks, payment receipts, etc. verifying actual payment of covered expenses
- Certification under oath that (a) the information provided is true and accurate and (b) the loan was used to retain employees and pay covered expenses
- Such other requirements imposed by the SBA

Limits of Amounts of Forgiveness Section 1106(d)

Reductions Based on Number of Employees

The amount of loan forgiveness equal

Amount of loan

Multiplied by Quotient of

Average # of FTE (f/t equivalent EE's per month) for one month of covered period

Divided by Either (at the election of the employer/borrower)

Average #FFTE/month employed from 2/15/2019 – 6/30/2019; or
Average #FFTE/month employed from 1/1/2020 – 2/29/2020; or

if seasonal employees

Average #FFTE/month employed from 2/15/2019 – 6/30/2019

Calculating the Eligible Loan Amount

Example

- Eric's Café applies for a paycheck protection loan.
- The business had \$2,000,000 in payroll costs for the 1-year period, for a monthly average of \$166,667.00.
- Eric's Café is entitled to loan equal to the lesser of (a) \$416,667.50 (\$166,667 in average payroll costs * 2.5), or (b) \$10 million.

Loan Forgiveness for Covered Expenses

Loan Forgiveness

- If the \$416,667.50 is used for “covered expenses,” the loan is forgivable, and the COD will not be income. Forgiveness amount will be reduced (see next slide) if employer either reduces workforce or employer cuts salary by more than 25% for those making less than \$100,000.
- There is potential for employer to correct and still be eligible for loan forgiveness if in allotted time period by employer rehires or increases employee's pay.
- The portion of the loan that is used for non-covered expenses (i.e. office supplies) is not forgiven but can be deferred for six months.

**GREEN &
SKLARZ** LLC

19

19

Calculating Loan Forgiveness Reduction

Example 1: Basic

- “Covered Period” mean February 15 – June 30, 2020
- Assume Eric's Café had 10 full time equivalent employees (FTE) on average each month between February 15 – June 30, 2019
- Assume Eric's Café has 7 FTEs during the covered period

$$\text{Thus: } \$416,667.50 \times \frac{7}{10} = \$291,667.30 \text{ [disallowed amount]} \\ \rightarrow \underline{\underline{\$125,000.25 \text{ [amount forgiven]}}}$$

**We believe there may be a technical error that needs correction. The Act seems to have it backwards. Why is there a 70% forgiveness reduction for a 30% workforce reduction? Further, Senate guidance indicates that the loan will be forgiven in proportion to the employees not retained.

**GREEN &
SKLARZ** LLC

20

20

Example 2: Loan not used entirely for covered expenses

- Instead of using the entire loan for covered expenses, Eric's uses \$50,000 to purchase equipment or supplies.
- Then, only \$366,667.50 is subject to forgiveness. The \$50,000 must be repaid over not more than 10 years, but the first payment is not due until between 6-12 months after the loan is advanced.
- Also, payments of salary in excess of \$100,000 are not covered expenses. Thus, while a business can borrow based on salaries in excess of \$100,000, it cannot seek forgiveness on such amounts.
- *Practice Tip:* If loan will not be forgivable consider applying for EIDL loans as the business can borrow up to \$2 million

Example 3: Borrowing based on compensation greater than \$100,000

- Eric's has 4 workers:
 - Eric, owner: K-1, \$200,000 guaranteed payment in 2019)
 - Dena, silent partner: K-1, received \$300,000 in distributions in 2019
 - Jeff, the scone pusher: 1099, paid a commission, received \$110,000 last year
 - Jay, W-2: \$50,000/year
 - Amanda, W-2: \$125,000/year

What is the maximum amount of the loan?

Likely exclude Dena's distribution, but include Eric's guaranteed payment, thus average of \$29,167/month X 2.5 = \$72,917.50.

What is the maximum amount of forgiveness allowed?

Cap compensation at \$100,000 for Eric, Jeff, and Amanda; thus: \$29,167/month X 2.5 = \$72,917.50, if used for covered costs. If payments go to compensation in excess of the \$100,000 cap, Eric, Jeff, or Amanda receive more than \$8,333 per month during the covered period, the balance must be repaid over not more than 10 years, but there is a 6-12 month payment deferral.

Limits of Amounts of Forgiveness Section 1106(d)

Reductions in Wages

- If employer reduced salary/wages in excess of 25% during covered period and did not cure the reduction by June 30, 2020, then reduce forgiveness of loan by the amount of the salary/wage reduction in excess of 25%.
- Use employee's salary/wages for most recent full quarter of employment when calculating whether reduction is in excess of 25%.

Example

- Eric reduces Amanda's salary from \$50,000 to \$30,000, a 40% reduction.
- This exceeds the 25% floor. $25\% \text{ of } \$50,000 = \$37,500$
- Thus, loan forgiveness is reduced by \$7,500

Rehiring Employees

- If employees were laid off between February 15th and 30 days after enactment of the Act, so long as they are rehired by June 30th
- These provisions are unclear and will require rule making

Additional Matters

- If a business has received an EIDL loan, it may refinance it with a paycheck protection loan.
- Businesses may not receive multiple paycheck protection loans.
- All currently approved SBA lenders may offer paycheck protection loans, but the SBA still needs to write rules to facilitate this.
- On Sunday, March 29th on *This Week with George Stephanopoulos*, and other shows, Larry Kudlow's, the chair of the President's council of economic advisors, indicated that the loans would be available the week of March 30th.

Entrepreneurial and Minority Business Assistance Centers

- SBA can provide grants for certain organizations that assist small businesses, including:
 - small business development centers
 - women's business centers
 - minority business centers
- No matching grants from states or other organizations required
- Organizations can assist small businesses with various loan programs and provide business counsel, at no charge to the business

27

Emergency EIDL Grants

- \$10,000 grant disbursed while an entity is waiting on whether it will receive an SBA loan
- Disbursed within 3 days
- May be used for COVID-19 related sick pay, payroll, certain operational expenses, rent/mortgage, other debt obligations
- Applicant must be eligible to receive a covered loan

28

Checklist for Seeking a Payroll Protection Loan

- Proof of existence (i.e. 2019 tax return) as of March 1, 2020
- Payroll journal, W-2s, K-1s, 1099s, and other proof of compensation for the 1 year prior to the loan
 - Health insurance contract, and proof of premium payments
 - Exclusions: compensation in excess of \$100,000, federal payroll taxes, *ex patriate* compensation, qualified sick pay compensated under
- Mortgage statements and proof of payment
- Lease agreements and proof of payment
- Utility bills

Small Business Bankruptcy Provisions (Title 11, Chapter 11, Subchapter V)

- Recently Congress enacted an optional fast track procedure for “small business debtors”
- The Act increases the debt limit to access the procedures to \$7.5 million (from \$2,725,625)
- This may provide a solution for companies hard hit by a short but extreme loss of revenue.
- Important to work with lawyer and financial adviser/accountant to model any bankruptcy

Business Tax Provisions

31

Small Business Tax Provisions

- The CARES Act clearly attempted to help businesses by allowing deductions to be accelerated or carried back and payments to be deferred.
- How much it will help is yet to be seen.
- Employee Retention Tax Credits (Title II, Subtitle C) are not in the small business section of the Act.

32

Employee Retention Credit

- The act creates refundable payroll tax credit for 50% of qualified wages paid from 3/13/2020 through 12/31/2020 for employers whose
 - a. operations were fully or partially suspended due to a COVID-19 related shut-down order, or
 - b. gross receipts declined by more than 50% when compared to the same quarter in the prior year.
- The credit is capped at the first \$10K of compensation (including health benefits) paid to employees. (§2301)

Delay of payment of employer payroll taxes

- Employers and self-employed individuals can defer payment of the employer's share (6.2%) of the Social Security payroll tax
- Amounts deferred must be repaid over two years: 50% must be repaid in 2021 and the balance in 2022.
- Any agent that defers payment of the trust funds taxes during the deferral period (2020) will be non-responsible if they do so at the owner's direction
- The owner would be solely responsible for the trust fund portion of the employment taxes deferred during 2020

Net Operating Losses

- NOLs arising in tax years 2018, 2019, or 2020 may be carried back 5 years. (significant tax savings because allows carrybacks to pre-TCJA years when the top corporate tax rate was 35%)
- It removes the 80% of taxable income limitation, retroactively, so that NOLs can fully offset taxable income in 2018, 2019, and 2020, regardless of the year in which they arose (80% rule goes back into effect for 2021)
- The bill does not change the rules for capital losses, which can be carried back 3 years and forward 5 years.

35

§461(I) excess business loss rules

- Repeals the excess business loss ("EBL") limitation for tax years 2018 through 2020
- Allows pass-through businesses and sole proprietors to utilize losses sooner

36

Refunds for AMT Credits

- Since the repeal of the corporate AMT, carryover AMT credits currently are refundable over several years, with the balance fully refundable in 2021.
- This provision accelerates the recovery time, enabling C corporation to obtain a refund of 50% in 2018 and the balance in 2019, unless the taxpayer elects to claim the entire refundable credit in 2018

Modification of §163(j) interest deduction limitation

- This provision increases taxpayer's permitted interest deduction by increasing the 30%-of-ATI limitation to 50% (with adjustments) for 2019 and 2020.
- Taxpayers generally can elect out of the 50% rule, can elect to use their 2019 ATI in the 2020 tax year, and there are certain limitations applicable to partnerships.

Technical amendment regarding qualified improvement property

- Qualified improvement property (QIP) has a recovery period of 15 years for general depreciation, and is eligible for bonus depreciation.
- If the alternative depreciation system (ADS) is used, because the real property business elected out of § 163(j), for example, then QIP has a 20-year recovery period and is not eligible for bonus depreciation.
- The bill fixes this retroactively so that businesses, especially in the hospitality industry, will be able to utilize bonus depreciation and write off immediately costs associated with improving facilities instead of having to depreciate them over a 39-year period

Excise tax for alcohol used to produce hand sanitizer

The provision waives in calendar year 2020 the federal excise tax on any distilled spirits used for or contained in certain FDA-compliant hand sanitizers.

**Shout out to Connecticut's own Litchfield Distillery. Good bourbon and clearly good folks.



Individual Tax Provisions

41

Individual tax credit/rebate

- All US residents with a valid Social Security number, are eligible for a \$1,200 rebate (\$2,400 for married couples).
- Additional rebate of \$500 per child.
- The rebate phases out beginning at AGI of \$75,000 for single taxpayers, \$150,000 for married taxpayers, and \$112,500 for head of household taxpayers. The reduction is \$5 for each \$100 of (AGI) over the relevant threshold.
- Payments will be based on 2019 tax returns if filed, or 2018 tax returns if 2019 is not filed yet. This should create an incentive for taxpayers to file 2019, even if they have no technical requirement to file.

42

Expanded Unemployment Benefits to Cover Self-Employed Individuals

GREEN &
SKLARZ LLC

43

43

- Unemployment compensation expanded and increased
- Extra \$600/week
- Extended to 39 weeks (from a typical 26 weeks)
- No waiting requirement
- Payable retroactive to January 27, 2020
- If you have to leave your job due to taking care of someone with COVID-19, you can collect

GREEN &
SKLARZ LLC

44

44

- Self-employed and independent contractors may receive unemployment.
- If you can tele-commute, and do your job, BUT elect not to, you cannot collect.
- If you are sick due to COVID-19 or are ordered to self-quarantine, you can collect.
- Each state will have to modify its unemployment application to allow for self-employed and independent contractors to properly file, but they are now covered.

Consumer Provisions

- 60 day moratorium on foreclosures of federally backed mortgages
- Up to 180 forbearance on foreclosure of federally backed mortgages
- Borrower must request forbearance
- Owners of multi-family homes can also request forbearance so long as they agree not to evict tenants (or issue late charges, etc.)
- 120 day moratorium on evictions from property that are financed by federally backed mortgages

IRS Enforcement Update

IRS/Treasury Update

1. The Treasury/IRS has granted a 90-day deferral to file and pay income taxes due on April 15th;
2. The taxes covered are income taxes, including self-employment taxes reported on a 1040. No other types of taxes are covered, so gift taxes, payroll taxes, etc. remain due on April 15, 2020;
3. Interest and penalties begin to accrue on July 16, 2020 if the taxes are not paid before July 15, 2020; and
4. First quarter estimated taxes are also deferred to July 15, 2020.

Tax Update

- Collections is standing down regarding issuing new liens and levies
- IA and OIC payments are also deferred
- Refunds will not be delayed (\$3 Trillion vs \$50 billion)
- Paper filings all done at campuses – one case of Covid-19 and the whole works shut down
- If client circumstances have changed, now is a great time to modify existing agreements or consider an OIC

Corporate Bailouts & Loans to Large/Mid-Sized Businesses

GREEN &
SKLARZ LLC

51

51

Loans and Loan Guarantees to “eligible businesses, States and Municipalities”, up to \$500 Billion.

Government will provide up to \$500 billion in loans and loan guarantees for:

- \$25 Billion - Passenger Air Carriers
- \$5 Billion - Cargo Air Carriers
- \$17 Billion - businesses critical for national security
- \$454 Billion (plus unused amounts under 1-3) programs and facilities to provide liquidity to the financial system that supports lending to eligible businesses, states and municipalities by
 - purchasing interests /obligations from the issuers
 - purchasing interests/obligations on secondary market
 - making loans, including loans secured by collateral

GREEN &
SKLARZ LLC

52

52

Loan Criteria

1. Borrower is an “eligible business” (meaning a business that it not otherwise entitled to receive economic relief, such a small business);
2. Credit is not reasonably available at the time of the transaction;
3. The obligation is “prudently incurred; and
4. The loan is sufficiently secured OR made at a rate that:
 - Reflects the risk and, if possible,
 - at a rate not less than prevailing rates prior to COVID-19 outbreak
5. Loan durations no longer than 5 years

Federal Reserve Program

Authorizes direct loans (not part of syndicated loan or originated by a financial institution or a securities offering) by Fed, provided

- borrower agrees to 1-year restriction on stock repurchase (unless required by contract existing as of Act date)
- borrower agrees to 1-year restriction on dividends to common stockholders
- borrower agrees to comply with compensation limitation

Federal Reserve Program (cont)

- Statutory requirements (e.g. 12 U.S.C. 343(3)) for collateralization, taxpayer protection, borrower solvency, shall apply
- Only for businesses created or organized in U.S. under U.S. law AND that have significant operations and a majority of employees in U.S.

Mid-Size Business Provisions

- Businesses with 500-10,000 employees
- Treasury Department directed to establish a program focused on such businesses, which will include:
 - Direct loan from Treasury
 - Interest rates will be no higher than 2%
 - First 6 months - no principal or interest due

Mid-Size Businesses (cont)

Borrower must make good faith certification that:

- uncertainty of economic conditions make loan necessary to support ongoing operations
- funds will be used to retain at least 90% of the workforce until 9/30/20 at full comp.
- will restore workforce to 90% of Feb 1, 2020 workforce at full comp within 4 months after end of the public health emergency
- Business is domiciled in the U.S.
- Business is not a debtor in bankruptcy
- Must have "significant operations" and majority of workforce in U.S.
- Recipient will not pay dividends on common stock or repurchase equity (publicly traded) except to the extent required by contract existing at time of the act

**GREEN &
SKLARZ** LLC

57

57

Mid-Size Businesses (cont)

- Recipient will not outsource or offshore jobs for the term of the loan +2 years after repayment
- Recipient to remain neutral in union organization efforts
- Establishment of "Main Street" lending programs by Federal Reserve to support small and mid-sized businesses not prohibited

**GREEN &
SKLARZ** LLC

58

58

Mid-Size Businesses (cont)

"Main Street Lending Program"

- Fed may create its own lending program for mid-sized businesses

Financial Protections for Government for Air Carrier and Security Industry loans (categories 1, 2 and 3 of Sub section (b))

- Borrower must be publicly traded stock company
- Secretary must receive a stock warrant or equity interest in the business
- If not publicly traded, Secretary must receive, in discretion of Secretary, warrant, equity or senior debt instrument
- Secretary may use up to \$100 million of the \$500 Billion for administrative costs

Limitations on certain Compensation

- 1-year limited on comp for employees that received Total comp exceeding \$425k in 2019 - those employees cannot receive a greater amount for 1 year from the loan date, or severance greater than 2x the annual amount
- For those that made in excess of \$3million, the 1-year limitation is \$3 million plus 50% of the excess they received over \$3million
- Total comp includes salary, bonuses, stock awards and other financial benefits

Taxpayer Protections

- One (1) year moratorium on stock repurchase (except to extent required under pre-existing (as of date of Act) contractual obligation) until loan is repaid, plus 1 year
- Businesses must maintain employment levels (within 10%) until 9/30/2020
- Limitations on dividends until loan is repaid
- Requires airlines to maintain a mandated flight schedule
- Prohibits landlords from evicting tenants who receive a bailout
- Limits executive compensation
- Special inspector general – President has stated he can ignore the Congressional reporting requirements
- Congressional oversight panel

- Members of congress and the Administration (or close family members, including sons-in-law [this means you Jared]) cannot receive funds.
- Monthly reporting to Congress of recipients of loans

63

Continuation of Certain Service

- Air carriers and qualified security service companies may be required by Sec. of Trans. To require borrowing air carriers to continue regular service
- Aviation Excise Taxes are suspended

64

Leases and Contracts

65

Force Majeure Provisions

- **Applicability:**

1. Event qualifies as Force Majeure under the contract (if addressed);
2. The risk was unforeseeable and unmitigable; and
3. Performance is truly impossible.

66

Force Majeure Provisions

- **Key Considerations**

- Is it truly impossible to perform, or just more economically difficult?
- The relevant standard differs from jurisdiction to jurisdiction.
- What does the relevant contract provide?

Force Majeure Provisions

- **Contracts with Majeure Provisions**

- Specificity is key – clauses that are silent on pandemics, epidemics or other viral outbreaks are likely to be insufficient for a force majeure defense.
- If the contract covers COVID-19, still need to demonstrate mitigation and impossibility.
- Recent governmental action may make it easier to invoke (e.g., executive orders closing restaurants, bars and other social gathering venues).

Force Majeure Provisions

- **Review.** Review the contract closely and determine whether the contract has a force majeure provision.
- **Analyze.** Analyze whether pandemic might constitute a force majeure event under the terms of the specific provision and then what effect this has on contractual obligations.
- **Communicate Early and Effectively.** Determine what notice is required under the force majeure provision.

Force Majeure Provisions

What should I do if I receive a force majeure notice?

- Carefully examine the notice to determine:
 - Whether it falls within the scope of the force majeure provision or applicable law.
 - Whether the form and timing of the notice was proper.
 - The availability and impact of applicable laws and facts.
 - When and how to respond, whether your performance or payment is excused, and whether to terminate the contract in response to the notice.

Force Majeure Provisions

- **Consider Downstream Impact.**
 - Do you need to provide a copy of the notice to other parties?
- **Has the party claiming force majeure fulfilled its other obligations under the contract?**
 - Ex. Did the party have an obligation to implement a business continuity plan or otherwise try to find a work-around to the situation?
- **Duty to Mitigate.**
 - In most states, an injured party has an obligation to mitigate its damages even if the force majeure claim is not proper and the non-performing party is in breach of contract.

Force Majeure Provisions

- **Contracts without Force Majeure Provisions**
 - Common law doctrine of impossibility/impracticability may apply.
 - Performance may be excused if:
 1. Unexpected intervening event;
 2. Agreement assumed such event would not occur;
 3. The event made performance impossible or impracticable.

Force Majeure Provisions

- **Impossible vs. Impracticable**

- True impossibility (e.g., New York).
- Performance would require excessive or unreasonable expense (e.g., California).
- Given the widespread and potentially devastating financial impact of COVID-19, the bounds of each standard will be tested in the courts.

Force Majeure Provisions

- **Frustration of Purpose**

- Similar to impossibility/impracticability, but focuses on whether the purpose of the contract has been obviated rather than whether performance remains viable.
- Example: Deal to purchase apartment building, which is condemned by local authorities in the interim between contract and closing.

Force Majeure Provisions

Interpretation by the Courts

- Relatively few cases have interpreted the impact of pandemic on force majeure clauses.
- Economic hardship or increase in expenses, without more, does not constitute a force majeure event.
- Avoidance difficult merely because customer demand has decreased.
- Courts split whether intervening governmental acts (change in regulations, emergency declarations, etc.) will excuse performance under contract.

Force Majeure Provisions

Increased Performance Costs and Pricing Concerns

- The mere occurrence of unfavorable economic conditions or market shifts may not qualify as force majeure or other events that excuse performance.¹
- Difficulties in performance due to circumstances outside of a party's control may not lead to recoverable damages.²

1. *OWBR LLC v. Clear Channel Communications, Inc.*, 256 F.Supp.2d 1214, 1222; Restatement (Second) of Contracts § (market shifts are always basic assumption on which contracts are made)

2. See, e.g., *Friedco of Wilmington, Del. Ltd. v. Farmers Bank of the State of Del.*, 529 F.Supp. 822, 827(D. Del. 1981) ("the parties to any contract to be performed over a term normally assume that the cost of performance may fluctuate during the term, and, as a result, courts ordinarily do not conclude that an increase in the cost of performance is an event the non-occurrence of which was a basic assumption of the contract.")

Force Majeure Provisions

Increased Performance Costs and Pricing Concerns

- Courts have found no commercial impracticability where one party's wheat shipment was forced to be re-routed due to the closing of the Suez Canal.³
- The Court of Appeals held no basis for relief because contract was not rendered legally impossible and it could be presumed that the shipping party accepted "some degree of abnormal risk".

3. *Transatlantic Financing Corp., v. U.S.*, 259 F.Supp. 725, 728 (D.D.C. 1965)

**GREEN &
SKLARZ** LLC

77

77

Force Majeure Provisions

Increased Performance Costs and Pricing Concerns

- Some precedent that a party's continued performance may be excused on grounds of impracticability where there is a substantial difference in the expected versus actual cost of performance due to an extraordinary intervening event.⁴

4. See, e.g., *Aluminum Co. of America v. Essex Group, Inc.*, 499 F. Supp. 53, 70-71 (W.D. Pa. 1980) (holding that under Indiana law seller was entitled to reformation of contract under doctrines of impracticability and frustration of purpose where price provision formula in contract dramatically increased seller's cost of performance to due OPEC actions to increase oil prices and unanticipated pollution control costs).

**GREEN &
SKLARZ** LLC

78

78

Force Majeure Provisions

COVID-19 Considerations

- Examine agreements to determine the increased cost impact from COVID-19 and, if significant, discuss adjustments to account for fact that performance costs no longer reflect the intentions or expectations.
- Buyers faced with notification of a material or indefinite delay that substantially impairs the value of the whole contract may be able to terminate and discharge any unexecuted portions of the contract or modify the contract by agreeing to a substituted performance.⁵

5. U.C.C. § 2-616; 30 Williston on Contracts § 77:22(4th ed). Analysis under UCC will focus on foreseeability, reasonableness, good faith, and the availability of alternative ways to perform.

Force Majeure Provisions

COVID-19 Considerations

- **Representations and Warranties**
 - Material Adverse Effect
 - Material Adverse Change
 - Default or “events which, with the passage of time...”
- **Indemnities**
 - Scrutinize closely; pay attention to limits, baskets, scrapes, etc.

Business Interruption Insurance

- Business Interruption covers losses from direct interruptions to a business's operations
- Loss of revenue
- Fixed expenses (e.g., rent and utilities)
- Contingent Business Interruption covers lost profits and costs resulting from supply-chain disruptions.
- Losses due to illness are *not* typically covered.
- As the N.Y. Dept. of Insurance instructs:

It is unlikely that a current business interruption policy has contemplated the coronavirus specifically. However, you should check to see if your policy has an exclusion that would disable coverage for an incident triggered by an epidemic or pandemic, which might apply as the COVID-19 situation evolves. Also, any claim would still need to be related to your property damage for coverage to be triggered.

81

- Check policies closely.
- Comply meticulously with all notice requirements.
- Apply for coverage – even if rejected, can be shown as good-faith efforts of mitigation.
- Make a claim even if payment unlikely.

82

Additional Considerations

- **Items to Compile in Anticipation of Filing a BI Claim**

- Historical and current annual financial statements
- Federal and state annual tax returns
- Monthly profit and loss statements
- Budgets, forecasts, or projections done prior to and after the event
- Monthly bank statements
- Inventory reports
- Payroll records
- Invoices and purchase orders
- General ledger accounts established to account for any expenses related to the loss such as additional payroll, shipping, temporary facilities, etc.
- Documentation to support extra expenses including receipts, invoices, time sheets, advertising costs, etc.

Pending Legislation

- Various states have explored retroactively nullifying exclusions to BI coverage for COVID-19.
- Even if passed – despite strong opposition from insurance industry – it is unclear how such laws could be applied retroactively.

Pending Litigation

- French Laundry (California)
- Oceana Grill (Louisiana)
- Actions seeking coverage under “all risk” policies

Retirement Provisions and Charitable Giving

Tax-Favored Withdrawals from Retirement Plans

- An eligible individual may receive a “coronavirus-related distribution” up to One Hundred Thousand Dollars (\$100,000) before December 31, 2020 from a qualified retirement plan or individual retirement account prior to age 59-1/2 without liability for a 10% premature distribution penalty tax.

Tax-Favored Withdrawals from Retirement Plans

- A distribution is a coronavirus-related distribution if made after January 1, 2020 and before December 31, 2020 to an individual:
 - Who is diagnosed with virus SARS-CoV-2 or COVID-19 by a test approved by the Centers for Disease Control and Prevention (“CDC”); or
 - Whose spouse or a dependent (for IRC Section 152 purposes) is so diagnosed by a CDC test; or
 - Who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off or having work hours reduced due to such virus or disease, being unable to work due to lack of child care due to such virus or disease, closing or reducing hours of a business owned or operated by the individual due to such virus or disease or other factors determined by the Secretary of the Treasury (or the Secretary’s delegate).

Tax-Favored Withdrawals from Retirement Plans

- Unless the recipient elects otherwise, to the extent the corona-virus distribution is required to be included in gross income, it will be included and taxed ratably over the 3-taxable-year period beginning with the taxable year of distribution.

Tax-Favored Withdrawals from Retirement Plans

- However, at any time during the 3-year period beginning on the date after the coronavirus-related distribution was received, the recipient may make one or more contributions not to exceed the amount of such distribution to an eligible retirement plan of which the individual is a beneficiary and the contributions will be considered as rollover contributions by the IRS and therefore not subject to income tax. Such contributions will not affect amount of otherwise permitted contribution to plans by an individual in those years.

Tax-Favored Withdrawals from Retirement Plans

- As long as distribution from an employer's plan would not violate any provision of the IRC without the coronavirus-related distribution, such distribution will not be considered a violation of the plan, providing such coronavirus-related distributions in the aggregate do not exceed \$100,000 to an individual.

Tax-Favored Withdrawals from Retirement Plans

- A plan administrator may rely upon an employee's certification that the employee satisfies the conditions for determining whether a distribution is a coronavirus-related distribution.
- Coronavirus-related distributions shall not be subject to withholding tax rules.

Loans from Qualified Plans

- During a one hundred eighty (180) day period beginning on the day following enactment of CARES (March 27, 2020) the amount a qualified individual may borrow from a qualified employer plan is increased from the lesser of Fifty Thousand Dollars (\$50,000) or one-half ($\frac{1}{2}$) of the individual's present value of non-forfeitable accrued benefit to the lesser of One Hundred Thousand (\$100,000) or the full present value of the individual's non-forfeitable accrued benefit.

Loans from Qualified Plans

- If the due date of any repayment of a loan to a qualified individual from a qualified plan occurs during the period beginning on the enactment of the Act and ends on December 31, 2020, such due date shall be delayed for one (1) year and subsequent payments shall be adjusted to reflect the one (1) year delay.
- For a loan advance under the Act, the period described from the date following the enactment of the Act through December 31, 2020 shall be disregarded [i.e. appears to allow payment over six (6) years but unclear].

Loans from Qualified Plans

- As long as a plan is amended to comply with provisions of Act (or any regulations issued by the Secretary of Treasury or Labor) on or before the first plan year beginning on or after January 1, 2022 and has been operated prior to the amendment as if the amendment were in effect, the plan shall be deemed to be amended retroactively and operated in accordance with the terms of the plan.

Temporary Waiver of Required Minimum Distribution (“RMD”) Rules

- RMD rules are not applicable for calendar year 2020 with respect to:
 - a defined contribution plan defined in IRC Sections 403(a) or 403(b); or
 - a defined contribution plan which is an eligible deferred compensation plan under IRC Section 457(b) and maintained as described in Section 457(e)(1)(A); or
 - an Individual Retirement Account (“IRA”).

Temporary Waiver of Required Minimum Distribution (“RMD”) Rules

- If required beginning date was in 2019 and such distribution was not made before January 1, 2020, RMD is waived for 2020
- RMDs already taken in 2020 can be eligible to be rolled over if:
 - they are within 60 days of taking the RMD
 - there must not have been an IRA-to-IRA or Roth IRA to Roth IRA rollover in the 12 months preceding the receipt of the 2020 RMD
 - non-spouse beneficiaries cannot undo RMDs already taken

Temporary Waiver of Required Minimum Distribution (“RMD”) Rules

- For beneficiaries of an inherited IRA in 2015 or later that is subject to the 5-year payout rule (i.e. through estate or trust that did not qualify as a designated beneficiary), the beneficiaries are now subject to a 6-year rule since they do not need to take RMDs in 2020.

Increased Charitable Deductions & Suspension of Income Limitations

- Above line charitable cash distribution of \$300- permanent for taxable years beginning January 1,2020 but must be to a Section 170 charity and not to a private foundation or for a donor advised fund.
- Modification of itemized deductions for individuals- suspension of AGI limitation of cash contributions for 2020 and carryover of excess contributions.

Increased Charitable Deductions & Suspension of Income Limitations

- Corporations: increase to 25% of taxable income and carryover for cash contributions to qualified charities.

Estate Planning

101

Estate Planning in a Volatile Market and Low Interest Environment

- Review estate plans with clients to be certain documents remain consistent with client objectives.
- Review and amend healthcare/end of life documents.
 - Prior language may preclude client from gaining to ventilators and other life-sustaining measures.
 - Clear language should allow health care agents/proxies latitude in executing instructions remotely (i.e. email, phone, video conferencing- FaceTime, Skype, Zoom).
- Clients should consider adding provisions to powers of attorney allowing for access to digital assets, and to exercise powers remotely.

102

Estate Planning in a Volatile Market and Low Interest Environment

- Potential decrease of federal and state estate and gift tax/exemptions – explore using remaining exemptions for wealthy clients as soon as possible
- Low AFRs
 - Mid-term AFR for April 2020: 0.99%
 - Long-term AFR for May 2020: 1.43%
- Low §7520 rate
 - 1.2% for transfers made in April 2020
 - Likely to decrease further in following months
- Potential for additional leveraged gifting – use of exemptions while still possible

Estate Planning in a Volatile Market and Low Interest Environment

- Consider intra-Family loans and restructuring current intra-family loans (i.e. IDGTs)
- Grantor trust status and considerations for new/existing trusts
- GRATS – short term and long term
- Late GST Allocations
- Low (relative) valuations of closely-held businesses

Potential Leveraged Gifting Proposal #1: Grantor Retained Annuity Trust (GRAT)

1. Grantor transfers real estate, and investment account or other asset to a 2-year GRAT
2. Annuity amounts (based on initial gift to the GRAT) are paid to Grantor for 2 years
3. Balance ("winnings") pass to an irrevocable "grantor" trust at end of GRAT term

Client transfers asset

-predicted to grow significantly during GRAT term
-examples: investment account, single position in stock, tangibles, real property

2 year GRAT

-\$7520 interest rate is 1.2% for April 2020

Year 1 = 46,298.43%* annuity to Grantor

Year 2 = 55,558.11%* annuity to Grantor

*based on 1.2% § 7520 rate

Irrevocable Grantor Trust

Established for benefit of children and younger family members

At end of GRAT term

GREEN & SKLARZ LLC

105

105

Potential Leveraged Gifting Proposal #2: Sale to Intentionally Defective Grantor Trust (IDGT)

Client sells asset with sufficient cash flow for a term

Client makes a seed gift of at least 10% of the value as of date of sale

Assets gifted and sold to IDGT Trust ("IDGT" assets)

Promissory note to client at approximately 0.99% for 7 years (interest only with a balloon payment at end of 7 years)

IDGT assets

Grantor Family Trust f/b/o younger generation family members

*Client pays all income tax during term of trust.
*Client does not incur income tax on the note interest paid to himself/herself.

GREEN & SKLARZ LLC

106

106

Questions?



**GREEN &
SKLARZ** LLC

107