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The CARES Act

Understanding the tax implications for private equity



About Plante Moran

Plante Moran is one the nation's largest certified public accounting and business advisory firms providing tax, audit, transaction advisory, technology, operations, and strategy services.

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year founded

3,100+

professionals

25

offices

20,000+

clients

1,525+

private equity &
portfolio company
clients

10

affiliates, including
investment bank,
PMCF



Presenters



Jeremy Sikkema, Senior Manager, National Tax Office

Jeremy is a tax senior manager and a leader of Plante Moran's tax transaction advisory services. He has more than 12 years of public accounting experience, specializing in federal and state tax compliance and tax due diligence. He also has considerable experience with transaction structuring. Many of his clients are portfolio companies of private equity groups that have activity in mergers and acquisitions. He's a member in Plante Moran's private equity, manufacturing and distribution, and National Tax Office groups.



Don Stanovcak, Manager, National Tax Office

Don is an attorney and serves on the firm's National Tax Office. He provides tax consulting services to closely held owner-operated corporations, consolidated corporations, single and multitiered partnerships, and domestic, as well as multinational private equity funds and portfolio companies in manufacturing, distribution, and other service-related industries. His technical experience includes structuring sales and acquisitions, entity choice, and tax reform.



Shawn Dubinsky, Senior Manager, Restructuring & Transformation

Shawn is a senior manager on the firm's strategy and operations practice with more than 12 years of consulting and finance experience, specializing in advising management teams, equity investors, and creditors navigating change. In this role, he focuses on profitability improvement, capital planning and liquidity management and specializes in crisis management and creditor negotiation, as well as transaction advisory, business viability, and cash flow modeling.



Overview of today's discussion

- Background: How did we get here?
- Losses & how to use losses
- Business interest expense limitation changes
- Qualified improvement property & changes to depreciation
- Payroll credits and deferral of payroll tax credits
- SBA Paycheck Protection Program
- Main Street Lending Program
- Excess business losses
- Corporate AMT credits
- What should taxpayers be doing right now?



Background



Current developments

COVID-19 continues to impact individuals and businesses across the country, and recent legislation provides support.

Coronavirus Aid, Relief, and Economic Security Act (CARES Act)

- Substantial legislation that includes support for healthcare, individuals, and businesses
- Includes new small business loans, payroll tax credits and deferrals, and other income tax changes

Families First Coronavirus Response Act

- Expanded paid sick leave and paid family leave programs for certain employers and employees
- Provided payroll tax credits to employers



Implementing the CARES Act

Many provisions take effect immediately, but procedural guidance will be released over time.

State and local tax impact?



Polling question one

What are you finding most challenging about implementing the new law?

- A. SBA loan program
- B. Payroll tax credits
- C. Utilizing loss carrybacks
- D. Claiming bonus depreciation for qualified improvement property
- E. Applying the new business interest expense limitation



Net operating losses



Net operating loss rule changes

Pre-Tax Cuts and Jobs Act (TCJA) provisions

- Net operating losses (NOLs) were generally carried back two years and carried forward 20 years.
- NOLs could be created for both regular tax and alternative minimum tax purposes.

TCJA provisions

- For most taxpayers, NOLs arising in tax years ending after Dec. 31, 2017, could no longer be carried back to offset income in any prior tax year.
- NOLs arising in tax years beginning after Dec. 31, 2017, and carried over to another tax year are limited to offsetting 80% of a corporation's taxable income in such carryover year, computed without regard to NOL deduction.



Net operating loss rule changes

CARES Act: Restored carryback rules apply

- Taxpayers are permitted to carryback their NOLs arising in tax years beginning after Dec. 31, 2017, and before Jan. 1, 2021, to each of the five tax years preceding the tax year of the loss.
- Carryback provisions are impacted by short tax years since the carryback provisions reference tax years.
- State and local NOLs will need to be reviewed to determine whether they conform to the federal provisions.
- Refunds attributable to NOL carrybacks are generally timely filed if they're filed during the period ending three years after the due date (including extensions) for the tax year of the NOL.



Net operating loss rule changes

Portfolio company impact

- In general, it's advantageous to carryback NOLs, but there will be interactions with other tax provisions that could mitigate some or all of those benefits.
- To the extent it's disadvantageous to carryback NOLs, an irrevocable election can be made on the next timely filed return to forgo the carryback.
- NOL carryback refund claims are generally processed on a "first-in, first-out" basis.
- Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax, a company may obtain an expedited refund of overpaid estimated tax if its overpayment is at least \$500 and 10% of the expected tax liability.



Net operating loss rule changes

Transaction impact

- Purchase agreements from 2018 and 2019 should be reviewed to determine the appropriate recipient of any refunds generated from carrying back NOLs into those tax years.
- It's common for stock transactions to generate NOLs in the year of the transaction due to short periods and transaction costs being recognized inside the target while gain is recognized by sellers.



Business interest expense limitation changes



Business interest expense limitation: TCJA

The TCJA imposed a new limitation on annual interest expense deductions for certain taxpayers.

Business interest expense deductions were limited to:

- Business interest income.
- 30% of adjusted taxable income (ATI).
- Floor plan financing interest.

Special rules were applied to small businesses, real estate, farming businesses, and utilities.



What changed?

The annual limitation is generally increased to include 50% of ATI for 2019 and 2020.

- For 2020, taxpayers can also elect to use their 2019 ATI.

A special rule is applicable to partnerships:

- 2019: Partnerships still use the limitation based on 30% of ATI.
- 2020: Partnerships use the increased limitation based on 50% of ATI.
- 2020: Partners are able to deduct half of any suspended deductions (EBIE) allocated by the partnership in 2019; the remaining half of EBIE is subject to normal carryforward rules.



Business interest expense rule changes

Portfolio company impact

- Taxpayers may elect to use their ATI from 2019 on their 2020 tax returns for the purpose of determining the amount of deductible business interest expense.
- This will allow businesses that were more profitable during 2019 than 2020 to further increase their business interest expense deductions in 2020.
- Final and proposed regulations under Section 163(j) are expected to be issued shortly, which may be applicable to the 2019 tax return.



Business interest expense rule changes

Transaction impact

- When exiting from a partnership, the ability to deduct additional current year interest and 50% of EBIE in 2020 can change potential capital deductions into ordinary deductions.
- When exiting from a corporation, an increase in the limitation may reduce “lost” value in EBIE at close.



Qualified improvement property & changes to depreciation



Qualified improvement property (QIP)

- Prior to TCJA, certain “qualified improvement property” was eligible for bonus depreciation – TCJA changed this result (perhaps accidentally).
- CARES Act provisions rollback the law to pre-TCJA, retroactively to Jan. 1, 2018.
- Consider amended or superseding return opportunities for 2018/2019 to claim additional depreciation.
- Additional guidance is expected to come at some point.
- Consider accounting method changes as appropriate.
- Additional depreciation should be considered in conjunction with NOLs.



Qualified improvement property (QIP)

Portfolio company impact

- Utilizing 100% bonus depreciation on qualified improvement property will often generate sizable deductions, which may create NOLs.



Qualified improvement property (QIP)

Transaction impact

- Consider whether language should be added to purchase agreements outlining which party would receive the tax refunds for preclose periods that aren't amended until after closing.



Payroll credits & deferral of payroll tax payments



Employer payroll tax credits & deferral provisions

One new credit and a deferral provision supplement two credits introduced in Families First Coronavirus Response Act (FFCRA)

- The employee retention credit is new in the CARES Act.
- An employer payroll tax deferral provision is included in the CARES Act.
- The required paid sick leave credit was included as part of FFCRA.
- The required paid family medical leave credit was included as part of FFCRA.



Employer deferral of FICA taxes

Employer deferral provisions

- Employers may defer the payment of its 6.2% share of FICA taxes.
- Deferral amounts are determined after the employee retention credit.
- Half of the tax is due on Dec. 31, 2021, and the remaining half is due on Dec. 31, 2022.
- Employers aren't eligible if they receive loan forgiveness under the SBA Paycheck Protection Program (not just receive a loan that would make an employer ineligible for the employee retention credit).



Employer deferral of FICA taxes

Portfolio company impact

- Employers should work closely with their payroll tax providers to determine eligible deferral amounts.
- If a company reporting on a calendar year basis takes advantage of the full deferral period and doesn't pay any of the deferred portion of the payroll taxes until after Sept. 15, 2021, the company can't deduct the payroll taxes until the time of payment.



Employer deferral of FICA taxes

Transaction impact

- For transactions closing before Dec. 31, 2022, buyers and sellers may need to negotiate which party may be economically responsible to repay any deferred payroll tax liability.
- To the extent sellers in an asset sale take the deduction at close, it would be treated as an ordinary deduction that may offset ordinary income that may be triggered by the sale.
 - This could potentially impact payments that buyers are making for incremental taxes.
- Adjustments to EBITDA may be needed to the extent that the deferred payroll tax liability isn't expensed for book purposes because payroll taxes will be lower or higher than normal operations.



Employee retention credit

This is a refundable, quarterly credit in the amount of 50% of “qualified wages” up to \$10,000 per employee.

- The credit applies against the employer’s portion of the 6.2% FICA tax, but any excess is refundable.
- Any refundable amounts will offset other employment tax obligations for the quarter, including other employer tax obligations (1.45% Medicare) and remittances of employer withholdings.
- Employers may claim an advance credit refund on Form 7200.
- Businesses are ineligible if they have received a PPP loan through SBA.



Employee retention credit

Eligibility criteria

- Two criteria, either of which may entitle an employer to the credit during a quarter:
 - Suspension of operations due to governmental restriction
 - Significant decline in gross receipts
 - A reduction in gross receipts for any calendar quarter of > 50% relative to the same quarter of 2019.
 - Eligible through the calendar quarter in which gross receipts are restored to > 80% of the gross receipts of the same calendar quarter of 2019.



Employee retention credit

Businesses of all sizes are eligible, but the rules differ for employers with greater than 100 employees:

- Greater than 100 employees, only wages paid to employees who aren't performing services.
- 100 or fewer employees, includes all wages of the affected quarter (for first quarter, only wages going back to March 12, 2020 apply) for all employees.
 - Doesn't require that employees no longer performing services to qualify.
- The statute provides that aggregation rules (same rules as the Affordable Care Act for 2019) may apply to pull two employers together for purposes of determining whether an employer is a small employer.



Employee retention credit

Example 1

- ABC, Inc. operated a trade or business in 2020 and previous years.
- As a result of government orders in State X, which restricted travel, ABC suspended its operations from March 10, 2020 through April 30, 2020.
- Assuming all other eligibility requirements are met, ABC is eligible for the credit for wages paid during the first and second quarters of 2020. Note, however, that only wages paid after March 12, 2020, can qualify for the credit.



Employee retention credit

Example 2

- Assume the same facts in Example #1 and that ABC restores its business operations on May 1, 2020, after the state order is lifted.
- For Q1, Q2, and Q3 2020, ABC's gross receipts were 85%, 45%, and 90% of gross receipts received of 2019, respectively.
- Because gross receipts fell by more than 50% for the first time in Q2, ABC met the gross receipts test for Q2 of 2020.
- However, ABC was already an eligible employer for Q2 because of the state order.
- Meeting the gross receipts test for Q2 allows ABC to continue to be an eligible employer for Q3 even though there was no state order during Q3.
- Since gross receipts increased above the 80% threshold in the Q3, ABC isn't an eligible employer for wages paid after Q3.



Employee retention credit

Example 3

- Assume the same facts in Example #1 & 2, except Q3 gross receipts for 2020 are 60% of the gross receipts received for Q3 in 2019.
- Since an employer only loses eligibility under the gross receipts test after the quarter in which its gross receipts exceed 80%, ABC is still an eligible employer during Q3 and Q4.



Employee retention credit

Portfolio company impact

- It may be possible for the employer to retain any federal payroll taxes or withholdings up to the amount of the credit in order to gain immediate access and cash under existing guidance or future guidance.
- Employers without good data to calculate credits or that are at a high risk of becoming disqualified may also consider only taking advantage of the credit by requesting refunds on quarterly payroll tax filings to avoid the imposition of penalties.
- These employer tax credits should also be evaluated in conjunction with other credit opportunities that were created by the FFCRA.



Employee retention credit

CAUTION!

- Be careful when retaining employee withholdings! Trust fund liability may attach to those persons who have responsibility for directing payments to creditors of the business.
- If employee withholdings (both income and payroll tax, employee share) are being used to satisfy the credit, then businesses should make sure to get the credit. Otherwise, a responsible person (officer of the business or certain persons with check-signing authority) may be held personally responsible for the retained funds.



Employee retention credit

Transaction impact

- Additional payroll tax due diligence may be warranted to the extent sellers have taken these payroll tax credits to determine if there are any potential exposures relating to either qualifications or calculation of the credit.
- The tax credit is expected to be included in taxable income. Buyers might perceive this as phantom income if they didn't get the credit.



Polling question two

Which credit market relief program is your business considering? Select all that apply.

- A. Paycheck Protection Program
- B. Main Street Lending Program
- C. Existing loan relief (TDRs)
- D. Unsure
- E. Not applicable



SBA's 7(a) Paycheck Protection Program & Fed's Main Street Lending Program



SBA backstops forgivable loans

Frequently asked questions on the SBA 7(a) Paycheck Protection Program

- Is my business eligible?
- What is the affiliation rule?
- What are the loan terms?
- What is included in payroll costs?
- How does loan forgiveness work?



Size standard

The CARES Act expanded the definition of small business concern.

The SBA provided updated guidance that a business can qualify under the following circumstances:

- Business with 500 or fewer employees whose principal place of residence is in the United States
- Business meets the SBA employee or revenue size standard corresponding to its industry NAICS code
- Business can qualify if it meets both tests of the SBA's "alternative size standard" as of March 27, 2020



Alternate size standard

A business will qualify under the “alternative size standard” if as of March 27:

- I. Maximum tangible net worth of the business isn't more than \$15 million.
- II. And average net income after federal income taxes (excluding any carryover losses) for the two fiscal years before loan application isn't more than \$5 million.

Note: SBA defines “goodwill” as the only intangible element.

In determining size, the SBA counts the receipts, employees, or the alternate size standard (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates [eCFR Section 121.103(a)(6)]



Affiliation rule

Carefully consider the affiliation rule and seek guidance from counsel and/or lenders.

The SBA considers entities as “affiliates” when one controls or has the power to control the other, or a third party has the power to control both (*Interim Final Rule on Affiliation*)

- Ownership, management, negative, or affirmative controls under organizational documents, previous relationships with or ties to another concern, and contractual relationships all factor into the SBA’s determination.
- SBA issued a letter on April 4, 2020, that states private equity companies remain subject to the existing affiliation rules, except that the CARES Act removed the common-investment and economic-dependence rules.



SBIC affiliation waiver

Financial assistance from a Small Business Investment Company (SBIC) waives affiliation rule.

- (i) Regardless of the amount of investment from the SBIC
- (ii) Regardless of whether there are other non-SBIC investors
- (iii) Regardless of whether the financial assistance received from the SBIC is in the form of loans, debt with equity features, equity, guarantees, and/or securities purchased from an underwriter

Businesses can search the SBIC Directory at [SBA.gov](https://www.sba.gov) to determine if they're receiving funding from an SBIC.

Note: The PPP additionally waives the affiliation rule for industries with a NAICS code beginning with 72 and for franchises on the SBA directory.



Proceed with caution

There has been significant coverage in the media about program oversight.

- The SBA PPP loan application specifically states that most parts of the application will be subject *Freedom of Information Act (FOIA)* requests.
- The U.S. AG stated the DOJ would prioritize investigating wrongdoing “related to the current pandemic.”
- The DOJ stated that false certifications on an SBA loan application falls under the *False Claims Act (FCA)*.
 - The *FCA* is enforceable by the public (qui tam lawsuits) and whistleblowers are eligible to receive a portion of damages and penalties recovered by the government.

Dept. of Treasury and SBA continue to issue clarification and guidance that may impact eligibility and other considerations.



Main Street Lending Program

Federal Reserve releases details of the Main Street Lending Program as part of \$2.3 trillion stimulus.

- On April 9, the Fed provided a preliminary term sheet outlining the \$600 billion lending program.
- The program targets businesses with up to 10,000 employees or up to \$2.5 billion in 2019 revenues*.
- The program will utilize funds from Title IV of the CARES Act to form a two new special purpose vehicle to lend to U.S. financial institutions.
- Eligible loans under the program will contain the provisions defined in 4003(c)(3)(A)(ii) of the CARES Act.

** Note: Additional eligibility requirements*



Main Street at a glance

Main Street New Loan Facility

New unsecured term loans originated after April 8, 2020, with a maximum loan equal to the lesser of:

- \$25 million
- 4x 2019 EBITDA, less (i) existing outstanding bank debt, plus (ii) committed but undrawn bank debt

Main Street Expanded Loan Facility

Upsizing existing term loans originated before April 8, 2020, with a maximum upside tranche equal to the lesser of:

- \$150 million
- 30% of the sum of (i) outstanding bank debt, plus (ii) committed but undrawn bank debt
- 6x 2019 EBITDA, less (i) existing outstanding debt, plus (ii) committed but undrawn debt



Excess business losses



Excess business loss rule changes

Limitations on excess business loss rules change

- Prior to the TCJA, there were no specific limitations on excess business losses.
- TCJA imposed a \$250,000 net business loss rules (\$500,000 for married couples filing jointly) for all “excess business losses,” beginning with 2018.
- The CARES Act suspends the TCJA changes for tax years 2018, 2019, and 2020; the provision doesn’t take effect until 2021.
- This may create additional original and amended return opportunities to claim additional business losses for 2018 and 2019.



Excess business loss rule changes

Portfolio company impact

- Portfolio companies that operate as pass-through entities may have provided a tax loss that was subject to this limitation for the taxpayer's 2018 or 2019 tax year.
- The taxpayer will be required to amend that tax return in order to claim the excess business losses and make any other corresponding adjustments.



Corporate AMT credits



Corporate AMT changes

The alternative minimum tax (AMT) for corporations was eliminated for tax years after 2017 under the TCJA.

- Corporations could claim 50% of any unused AMT credit carryforwards as a refundable credit for 2018, 2019, and 2020, with any excess being fully refundable in 2021.
- The CARES Act amends this rule to allow for any excess credits to be fully refundable in 2019. In addition, corporations can elect to claim the full AMT credit refund in 2018.



Corporate AMT changes

Transaction impact

- Purchase agreements from 2018 and 2019 should be reviewed to determine the appropriate recipient of this benefit in the event a C corporation was sold with this attribute during those years.



**What should
taxpayers be
doing right now?**



What to do now

Evaluate loan and payroll credit options

- Need to determine program eligibility and potential benefits
- Conclude on the most beneficial options

Integrate changes into 2019 tax returns

- Will require decisions, such as whether to claim bonus depreciation on QIP
- Evaluate previously filed 2019 returns for amendment or superseding return opportunities

Identify opportunities for prior years

- Consider opportunities to amend prior year returns or to file accounting method changes to take advantage of new rules
- Evaluate impact of loss carryback rules and opportunities to maximize benefits

Continue to watch for additional guidance



Q&A



COVID-19 resources

- plantemoran.com/covid-19
 - Articles & insights
 - Webinars
 - Preparedness assessments
 - Access complimentary guidance from our COVID-19 task force
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Thank you for attending!



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