

CARES Act: Key Provisions Affecting the Hospitality Industry

March 27, 2020

As of Friday, March 27th, the US Senate and the House have approved the Coronavirus Aid, Relief, and Economic Security (CARES) Act (H.R. 748). The bill, which remains subject to signature by President Trump, would provide significant financial relief for eligible businesses affected by the COVID-19 pandemic, including those in the hospitality space. The President is expected to sign the bill into law imminently.

Highlighted below are key provisions of the bill relevant to hotel and other hospitality businesses, though the legislation covers a much broader array of programs designed to alleviate the effects of this pandemic.

We note that in addition to understanding the details of the new legislation (not all of which are described below), one must review any potential consents or other actions required by existing documentation and in particular, any existing loan documentation.

SBA 7(a) Loans (Paycheck Protection Program)

The CARES Act expands the Small Business Administration's (SBA) existing 7(a) loan program to help eligible businesses pay rent, mortgage payments, payroll (including paid sick or medical leave), health benefits, insurance premiums and certain other operational costs. Loan amounts may be forgiven under the expanded program subject to certain conditions (as further described below).

SBA Loan Terms and Size - The bill will allow the SBA, either directly or in cooperation with the private sector, to provide federally-backed “7(a) loans” to eligible businesses of up to 2.5 times their average monthly payroll cost, with a maximum loan size of \$10,000,000. The interest rate for the new 7(a) loans cannot exceed 4% and no collateral or personal guarantees will be required. The government will guarantee 100% of all 7(a) loans through the end of 2020, following which the guarantee percentages will return to 75% for loans above \$150,000 and 85% for loans of \$150,000 or less. All loan fees will be waived with no penalties for prepayment through the end of the year and loan recipients will receive complete deferment of all principal and interest payments for six months to one year.

SBA Loan Eligibility - Under the existing SBA regulations, business eligibility for 7(a) loans is limited by size standards based on either number of employees or average annual gross receipts. The expanded SBA program covers businesses with fewer than 500 employees (including those employed full-time, part-time or on other basis), unless the SBA size standard for the covered industry allows more than 500 employees. While the existing SBA regime provides that employees of affiliates are counted in determining number of employees, as applied to hotels and other hospitality businesses, the CARES Act provides that (i) a business will be eligible if it employs fewer than 500 employees *per physical location* so long as it is assigned to the “accommodation and food services” sector (with a North American Industry Classification System code beginning with 72); and (ii) the affiliation rules are waived with respect to any business with a North American Industry Classification System code beginning with 72 and any franchise business assigned a franchise identifier code by the administration. Thus, as long as they are owned by separate entities, separate properties with less than 500 employees are eligible for SBA loans. Note that under the existing (pre CARES Act) real estate investment firms holding property for investment purposes and gaming companies with one-third or more of their annual gross income derived from gambling operations are ineligible for SBA loans, it is not clear if that applies under the expanded rules.

Loan Forgiveness - 7(a) loan recipients under the bill will be entitled to loan forgiveness in an amount equal to the sum of all payroll costs, interest payments on any covered mortgage, payments on any covered rent obligations and any covered utility payment, in each case, for the covered eight-week period after origination of the loan. Upon forgiveness, the SBA will remit to the applicable lender within 90 days the amount forgiven plus accrued interest through the date of payment. In addition, businesses with tipped employees can get debt forgiveness on any additional wages paid to those employees between March 1, 2020 and June 30, 2020. Loan forgiveness amounts will be reduced by a percentage corresponding to any full-time employee reductions during the covered period and the amount of any salary or wage reductions of greater than 25% for certain employees (with an exception for employees re-hired or whose salary or wages are restored by June 30, 2020). **Any loan amounts forgiven under the program would not result in cancellation of indebtedness income for tax purposes.**

Additional Market Loan Program (Coronavirus Economic Stabilization Act of 2020)

While the Paycheck Protection Program summarized above is the primary loan program for small businesses with less than 500 employees, the Coronavirus Economic Stabilization Act of 2020 under the CARES Act would provide the largest potential impact with up to \$454 billion available to provide liquidity to covered businesses, including in the hospitality sector (an additional \$46 billion are earmarked for specific industries). The program would provide \$454 billion in financing to banks and other lenders that make direct loans or guaranties to certain eligible businesses on market terms.

Eligible borrowers must agree to cap all employee compensation (including salary, stock, and bonuses) for a period ending one year after the loan is repaid. During such period, officers or employees whose annual 2019 compensation exceeded:

- \$425,000, cannot receive (i) compensation in excess of their 2019 compensation in any consecutive 12 month-period or (ii) severance pay or other benefits upon termination of more than twice their 2019 compensation; and
- \$3 million, cannot receive total compensation in excess of (i) \$3 million plus (ii) 50% of the excess over \$3 million.

Borrowers under this program may not pay dividends or other capital distributions and may not repurchase listed stock of the borrower or any parent company while a loan is outstanding and for 12 months thereafter, except (with respect to repurchases) as required by contracts in effect on the date of the enactment of the CARES Act;

As part of this program, the US government will endeavor to implement a loan program for mid-sized businesses with between 500 and 10,000 employees. Applicable terms for the mid-sized business loan program include complete deferral of all principal and interest payments for at least six months and an annual interest rate capped at 2%.

Loan Eligibility – Eligible mid-sized business loan recipients will be required to certify that:

- Loan support is necessary to support ongoing operations because of current conditions;
- Funds will be used to retain at least 90% of workforce, at full compensation and benefits, until 9/30/20;
- Recipient intends to restore not less than 90% of workforce that existed before 2/1/20, and to restore all compensation and benefits to workers no later than four months after the declared COVID-19 public health emergency is over;
- Recipient is a US entity with significant US operations;
- Recipient is not in bankruptcy;
- Recipient will not pay dividends or other capital distributions and will not repurchase listed stock of recipient or any parent company while a loan is outstanding, except as required by contract as in effect on the date of the enactment of the CARES Act;
- Recipient will not outsource or offshore jobs for two years after loan repayment;
- Recipient will remain neutral in any union organizing effort during term of loan; and
- Recipient will not abrogate their collective bargaining agreements for the term of the loan and 2 years following loan repayment.

Tax Provisions

50% Employee Retention Credit for Employers Closed Due to COVID-19 - The CARES Act would provide eligible employers with 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 the employer is engaged in an active trade or business in 2020 and the wages are paid:

- While operation of that trade or business is fully or partially suspended due to a governmental order related to COVID-19; or
- 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.

The credit is capped at \$5,000 (50% of the first \$10,000 of qualified wages) per employee for all calendar quarters. The employee retention credit is available for employers with more than 500 employees, but for employers with more than 100 employees, the credit is available only with respect to wages paid to an employee that is not providing services due to COVID-19-related circumstances and will not be available to employers who have had indebtedness forgiven under SBA 7(a) loans (described above).

Payroll Tax Payment Extensions - The CARES Act would postpone the deadline for payment of the employer portion of the 6.2% employer share of the Social Security tax (but not the 1.45% employer share of the Medicare tax) from the date of the bill’s enactment through the end of 2020. The deferred amounts would be payable over the following two years, with 50% payable by December 31, 2021 and the remaining 50% by December 31, 2022.

Immediate Expensing of Costs Associated With Improving Qualified

Improvement Property – The CARES Act would permit businesses to expense certain costs for improvements to “qualified improvement property,” correcting existing provisions of the Tax Cuts and Jobs Act (TCJA) that prevented businesses from expensing these costs and required them 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. This change would be retroactive to the 2017 enactment of the TCJA, which means that companies could amend prior years’ returns and expense capex expenditures that are qualified improvement property.

Note: The above summary was prepared prior to the House vote on the CARES Act and does not reflect any changes to H.R. 748 if any were made in connection therewith.

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