

# Client Alert

March 2020

## Coronavirus Aid, Relief, and Economic Security Act (CARES Act) – Key Provisions Impacting the Hospitality Industry

The hospitality industry has taken the brunt of the impact of the ongoing coronavirus pandemic as occupancy rates have plummeted across the globe. The American Hotel and Lodging Association estimates that since mid-February, hotels in the United States alone have lost over \$2.4 billion in room revenue and expects this trend to continue.<sup>1</sup> The Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) was signed on March 27, 2020, to provide economic relief to American individuals, companies and government bodies affected by COVID-19. Below is a summary of the provisions of the CARES Act that apply to hotel owners, operators and mortgagees of hospitality properties. These provisions include (1) the Paycheck Protection Program, which provides funding for small businesses with 500 employees or less, with chain hotels benefiting from the waiver of normal affiliation rules; (2) the Economic Stabilization Fund, which provides low-cost financing opportunities for eligible hotel businesses; and (3) temporary bankruptcy and tax relief.

### Paycheck Protection Program

These provisions of the CARES Act authorize the Small Business Administration (“SBA”) to provide full guarantees of repayment of loans made to affected covered businesses, including hotel owners and operators.

**Which Businesses Are Covered?** Any business which employs 500 employees or less (including both full-time and part-time employees).

- For North American Industry Classification System (“NAICS”) Sector 72 companies or businesses (i.e., Accommodation and Food Services), this restriction applies to 500 employees per physical location. This category should include most hotels.

**Waiver of Normal Affiliation Rules.** Normally, the number of employees of affiliated businesses are aggregated for the determination of small business status for SBA loan guarantees. These affiliation rules are waived by the CARES Act with respect to loan eligibility for (1) any NAICS Sector 72 company or business with 500 employees or less; (2) any SBA-designated franchise; and (3) any business that receives financial assistance from an SBA-licensed company under Section 301 of the Small Business Investment Act.

**Maximum Loan Amount.** The lesser of: (1) \$10,000,000; or (2) 250 percent of the applicant’s monthly payroll costs for the preceding one-year period.

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<sup>1</sup> <https://www.ahla.com/covid-19s-impact-hotel-industry>.

- Seasonal employers (as determined by the SBA) can elect to use the average monthly payroll for the period beginning February 15, 2019, or March 1, 2019, and ending June 30, 2019.
- The maximum loan amount will be reduced by the amount of any Emergency Economic Injury Disaster Loan (“EIDL”) provided to any eligible employer during the period beginning on January 31, 2020, and ending on the date on which any such loan is refinanced under the Paycheck Protection Program.

**Allowable Uses of Loan Proceeds.** (1) payroll costs; (2) costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums; (3) employee salaries, commissions or similar compensation; (4) payments of interest on any mortgage obligation (which shall not include any prepayment of or payment of principal on a mortgage obligation); (5) rent (including rent under a lease agreement); (6) utilities; and (7) interest on any other debt obligations that were incurred before the covered period (February 20, 2020, to June 30, 2020).

**Certification Regarding Use of Funds.** Unlike a typical SBA loan, the CARES Act does not require the applicant to demonstrate its inability to find credit elsewhere. However, applicants must make a good faith certification that (1) the current economic uncertainty necessitates the need for additional support for the applicant’s ongoing operations; (2) the funds will be used to retain workers and maintain payroll or make other covered payments; and (3) the applicant has not received funds, between February 15, 2020, and December 31, 2020, under the SBA 7(a) loan program and does not have another application pending for the same purpose and duplicative of amounts applied for or received under the Paycheck Protection Program.

**Loan Deferment.** For any applicant in operation on February 15, 2020, payment deferment relief will be provided for a period of not less than six months.

**Loan Forgiveness.** Loan forgiveness is available during the eight-week period commencing on the date of loan origination for (1) payroll costs (which may include employer-funded tips for certain employees); (2) mortgage interest payments (excluding payments of principal); (3) rent; and (4) utilities, reduced, however, by (a) payroll reductions due to employee losses for the covered period (i.e., February 15, 2020–June 30, 2020) compared to the monthly average number of employees for the period of February 15, 2019–June 30, 2019 (or January 1, 2020–February 29, 2020), or (b) payroll reductions of greater than 25 percent per employee during the most recent full quarter for which the employee was employed before the covered period. Any amount that would be includable in gross income by reason of forgiveness shall be excluded from gross income.

- Exemption for Re-hires: If there has been a reduction in the number of full-time equivalent employees or in the salary or wages of employees of an eligible recipient between February 15, 2020, and ending 30 days after the date of the enactment of the CARES Act, the reduction will be disregarded for the purposes of calculating the amount of reduction in loan forgiveness if the employer eliminates such reduction by June 30, 2020.

**Additional Consideration for Hotel Owners.** Participation in the Paycheck Protection Program may violate single-purpose entity (“SPE”) provisions of existing financing documentation and consequently activate recourse guaranties, and therefore all debt obligations should be reviewed carefully.

## Emergency EIDL Grants

In addition to the Paycheck Protection Program, advances of \$10,000 in the form of emergency EIDL grants are available to eligible businesses with not more than 500 employees during the period of

January 31, 2020, and ending on December 31, 2020, that apply for a loan under the SBA (7)(b)(2) program, which provides loans to eligible businesses in the amount up to \$2 million. The grant does not need to be repaid, even if the EIDL loan application is subsequently denied, and can be applied to similar costs and payments as the Paycheck Protection Program.

## **Economic Stabilization Fund**

These provisions of the CARES Act establish a \$500 billion fund for use of the Secretary of Treasury to provide liquidity and support to covered businesses, states and municipalities that have incurred losses from COVID-19.

**Which Businesses Are Covered?** Passenger or cargo air carriers, businesses important for maintaining national security or US businesses (i.e., businesses that are organized in the US and that have significant operations in the US and a majority of their employees based in the US) that have not otherwise received adequate economic relief from a loan or loan guaranty under the CARES Act.

**How Can the Treasury Secretary Use the Fund?** The Treasury Secretary has broad authority to determine the terms, conditions and rates of the loans or loan guarantees, but there are restrictions on the duration and rates of loans or guarantees and additional conditions depending on companies' industries and whether companies are publicly traded or privately owned.

**Portions of the Fund Are Earmarked for Certain Covered Businesses.** The CARES Act reserves (1) an aggregate of \$29 billion of the fund to support passenger and cargo air carriers and certain related businesses; and (2) \$17 billion for critical national security businesses. The remaining \$454 billion of the fund are not reserved by the CARES Act for any particular industry or use ("Category 4 Loan Programs"). Presumably loans, loan guaranties and other investments may be made to hotel owners or operators as part of the Category 4 Loan Programs but that cannot be assured.

**Prohibition on Loan Forgiveness.** Unlike the Paycheck Protection Program, there is no loan forgiveness relief under the Economic Stabilization Fund.

**Tax Treatment.** Loans or guarantees granted pursuant to the Economic Stabilization Fund must be treated as indebtedness for the purpose of the Internal Revenue Code.

**Additional Consideration for Hotel Owners.** Participation in the Economic Stabilization Fund may violate SPE provisions of existing financing documentation and consequently activate recourse guaranties, and therefore all debt obligations should be reviewed carefully.

**New Programs.** Any eligible business may apply to the following programs:

- **Direct Loan From the Federal Reserve.** The federal government is authorized to provide financing to companies requesting relief under the Economic Stabilization Fund provided that they agree to certain restrictions on their operations during the term of the loans and for one year after their repayment. The CARES Act does not set forth the economic terms of these loans.
  - **Restrictions.** Companies that receive loans, loan guaranties or other investments as part of any Category 4 Program from the Federal Reserve will be subject to restrictions on their operations. During the duration of the loan, loan guaranty or other investment and for one year after repayment: (1) the eligible business may not buy back any of the equity securities listed on a national securities exchange of the eligible business or any parent company except pursuant to contractual commitments existing on March 27, 2020, or pay dividends or make other capital distributions with respect to the common stock of

the eligible business; (2) the total compensation (which includes salary, bonuses, stock awards and other financial benefits) of any officer or employee of the eligible business whose total compensation in 2019 exceeded \$3,000,000 is capped during any 12 consecutive months during the period at the sum of \$3,000,000 plus 50 percent of the excess over \$3,000,000 of the total compensation in 2019; and (3) the total compensation of any employee or officer of the eligible business whose total compensation in 2019 exceeded \$425,000 is capped at the 2019 amount for any 12 consecutive months during the period and any severance pay or other benefits upon termination of employment payable to the employee or officer may not exceed twice the total compensation in 2019. These restrictions are subject to waiver by the Treasury Secretary.

- **Assistance for Mid-size Businesses.** In addition to direct loans, programs/facilities will be implemented to provide financing to banks and other lenders that make direct loans to eligible businesses having between 500 and 10,000 employees subject to a maximum interest rate of 2 percent per annum. No principal or interest will be due for the first six months of the loan term or such longer period as the Treasury Secretary may determine in his discretion.
  - **Certification.** Applicants must certify that: (1) the uncertainty of economic conditions makes the loan request necessary to support the business's ongoing operations; (2) the funds will be used to retain at least 90 percent of its work force, at full compensation and benefits, until September 30, 2020; (3) it intends to restore not less than 90 percent of its workforce that existed as of February 1, 2020, and to restore all compensation and benefits to its workers no later than four months after the termination date of the public health emergency declared by the Secretary of Health and Human Services on January 31, 2020; (4) it is created or organized in the United States or under the laws of the United States with significant operations and the majority of employees located in the United States; (5) it is not a debtor in a bankruptcy proceeding; (6) it will not pay dividends on its common stock or buy back any of the equity securities listed on a national securities exchange of the eligible business or any parent company except pursuant to contractual commitment existing on March 27, 2020; (7) it will not outsource or offshore jobs for the term of the loan and two years after completing repayment of the loan; and (8) it will not abrogate existing collective bargaining agreements for the term of the loan and two years after completing repayment and that it will remain neutral in any union organizing effort for the term of the loan.
- **Main Street Lending Program.** The Federal Reserve may establish a Main Street Lending Program that supports lending to small and mid-size businesses on terms and conditions consistent with Section 13(3) of the Federal Reserve Act.

### Temporary Bankruptcy and Tax Relief

**Bankruptcy.** The CARES Act temporarily amends the recently enacted Small Business Reorganization Act<sup>2</sup> (the "SBRA") to increase the debt threshold for small businesses eligible to file under the SBRA from \$2,725,625 to \$7,500,000. This temporary eligibility increase sunsets after one year, after which the debt threshold returns to \$2,725,625 (subject to any other dollar adjustments imposed by Congress). A bankruptcy filing under the SBRA simplifies the Chapter 11 plan process, allows small business debtors to retain equity under certain circumstances, shortens certain deadlines in the case and eliminates committees of unsecured creditors in an

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<sup>2</sup> President Trump signed the Small Business Reorganization Act, which is contained in Subchapter V of the Bankruptcy Code, into law in August 2019.

effort to reduce costs. The SBRA itself is only a few months old, and given the lack of precedent interpreting the SBRA, courts may employ broad discretion to fashion equitable relief to small business debtors impacted by COVID-19.

**Employee Retention Tax Credit.** The CARES Act provides eligible employers with a tax credit equal to 50 percent of the qualified wages paid to its employees.

- Qualified wages are capped at \$10,000/employee (including qualified health plan expenses). Wages associated with the employer credit for extended paid family and medical leave, and wages associated with the payroll tax credits for the required paid sick leave or required paid family leave, under the Families First Coronavirus Response Act, are not qualified wages.
- Eligible employers are those employers whose: (1) operations were fully or partially suspended as a result of a governmental order limiting commerce, travel or group meetings due to COVID-19; or (2) gross receipts (commencing Q1 2020) declined by more than 50 percent compared to the same quarter in the prior year.
- Employer eligibility commencing pursuant to (2) of the preceding bullet point terminates when gross receipts exceed 80 percent compared to the same quarter in the prior year.
- >100 full-time employees: Qualified wages paid by eligible employers with greater than 100 full-time employees are wages paid to employees when they are not providing services for the period that the employer qualifies as an eligible employer.
- ≤100 full-time employees: Qualified wages paid by eligible employers with 100 or fewer full-time employees are wages paid to all employees, whether the employee is providing services or not, for the period that the employer qualifies as an eligible employer.
- Full-time employee generally means an employee who is employed an average of at least 30 hours of service per week or 130 hours of service per month with the employer.
- This credit is available through December 31, 2020. This credit is not available to employers with Small Business Interruption Loans.

**Delay of Payment of Employer Payroll Taxes.** This provision allows employers to defer payment of the employer's share of the federal Social Security tax (6.2 percent) on employee's wages paid, as of the date of enactment through December 31, 2020. This provision requires that the deferred tax be paid over the following two years, with half of the amount required to be paid by December 31, 2021, and the other half by December 31, 2022.

**Modifications to Net Operating Loss ("NOL") Limitations.** This provision relaxes the limitations on a taxpayer's use of losses from prior years. Currently, as a result of the 2017 Tax Cuts and Jobs Act (TCJA, P.L. 115-97) ("TCJA"), NOLs are subject to an 80 percent taxable income limitation and cannot be carried back to reduce income in a prior tax year. This provision provides that an NOL generated in 2018, 2019 or 2020 may be carried back to the preceding five tax years. It also temporarily removes the taxable income limitation to allow an NOL to fully offset income.

Consistent with the limitations that existed the last time NOLs were permitted to be carried back, REITs are not eligible to carry back NOLs, and NOLs cannot be carried back to any prior REIT year. REITs, however, do benefit from the ability to offset 100 percent of taxable income with NOLs that are carried forward. REITs utilize NOLs only after they have applied their dividends paid deduction, so the ability of a REIT to use an NOL may be limited if the REIT is paying dividends.

**“Excess Business Loss” Limitation Temporarily Suspended.** This provision temporarily suspends the “excess business loss” limitation that limits current losses attributable to trades or businesses for non-corporate taxpayers to \$250,000 (\$500,000 in the case of joint filers), so they can benefit from the NOL carryback rules described above.

**Modification to Credit for Prior Year Minimum Tax Liability of Corporations.** The corporate AMT was repealed as part of the TCJA, but corporate AMT credits were made available as refundable credits over several years. This provision accelerates the ability of companies to recover those AMT credits.

**Modification to Limitation on Business Interest Deduction.** After the TCJA, business interest expense deductions were limited to the sum of business interest income and an amount equal to 30 percent of “adjusted taxable income.” This provision temporarily increases the amount of interest expense businesses are allowed to deduct on their tax returns, by increasing the 30 percent of taxable income (computed without any reduction for amortization, depreciation or depletion) limitation to 50 percent of taxable income for 2019 and 2020. Additionally, this provision allows businesses to apply their 2019 taxable income (and limitation) to their 2020 tax year.

**Modification to Charitable Contribution Deduction.** This provision increases the limitation on charitable contribution deductions. For corporations, the “10-percent of taxable income” limitation is increased to “25-percent of taxable income” for the 2020 tax year. Additionally, the limitation on deductions for contributions of food inventory is increased, from a 15 percent limitation to a 25 percent limitation.

**Technical Amendment Regarding Qualified Improvement Property.** This provision retroactively (to the effective date under the TCJA) classifies “qualified improvement property” as 15-year MACRS property, enabling certain taxpayers to immediately expense, through bonus depreciation, costs associated with improving nonresidential real property. Qualified improvement property is defined as “any improvement made by the taxpayer to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.” This provision is intended to fix an unintended technical glitch in the TCJA that has been the subject of intense lobbying by the restaurant and hotel industries for two years. As a result of this amendment, hotel owners can write off costs associated with improving a hotel property over a much shorter period than before. It also allows prior year tax returns to be amended for this purpose to provide a source of cash flow.

## A Word on Hotel REITs

Several provisions in the CARES Act may directly or indirectly benefit hotel REITs. For hotel REITs that lease their hotels to taxable REIT subsidiaries (“TRSs”), an eligible independent contractor (“EIK”) generally will be the employer of the hotel employees. The EIK may be eligible to apply for a loan under the Paycheck Protection Program if it employs 500 employees or less, which generally would be measured per physical location for hotels. A loan to the EIK will allow the EIK to get the hotel operating again and generating revenue. TRSs generally make payments to EIKs out of hotel revenues, so reimbursements of expenses to the EIK, even on a deferred basis, may be covered under existing management agreements once revenues recover. As the borrower, the EIK may be exposed to additional liability despite the potential loan forgiveness under the Paycheck Protection Program, which should be discussed on a case-by-case basis.

TRSs may also be eligible borrowers under the Paycheck Protection Program, but we note again that the maximum loan amount is limited to the lesser of (1) \$10,000,000 and (2) 250 percent of the applicant’s monthly payroll costs for the preceding one-year period, which limitation will not mitigate hotel losses for an extended period of time and pragmatically may require that the funds be used to solely satisfy payroll



costs. However, as noted above, loans under the Paycheck Protection Program can be used for rent in addition to payroll costs and certain other costs.

An eligible EIK, TRS or REIT may also apply for loans or programs under the Economic Stabilization Fund but such loan provisions prohibit the distribution of any dividends during the term of the loan and for one year after its repayment, making it difficult for REITs to apply for relief under the fund and continue to satisfy their distribution requirements.

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