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M&A ACADEMY

RETAIL COMPANIES AND COVID-19 IMPACT

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WHAT WE PLAN TO COVER

- ❑ CARES Act Paycheck Protection Program and Treasury loans (eligibility and process)
- ❑ Tax benefits for retail companies
- ❑ M&A due diligence risk for retail targets
 - Employment issues
 - Contract defaults

STATE OF RETAIL

- Closure of non-essential businesses
- Evaluation of liquidity and preserving cash position
- Monitoring safety of employees
- Looking forward
 - *Changes to operations and states start to open for business
 - *Evaluating supply chain as businesses open
 - *Maintaining customer loyalty

Paycheck Protection Program (“PPP”) and Treasury Loans

□ **PPP Highlights**

- Up to a \$10,000,000 (up to \$349 billion) loan with an interest rate of 1% on ***first come first serve basis***
- Loan proceeds may be used to cover certain specific expenses such as payroll costs, rent utilities, mortgage interest payments, and interest on other debt
- Borrowers include small businesses with noted affiliation waivers for certain hospitality businesses, franchises and businesses with SBIC lenders
- Forgivable, subject to maintaining employment levels and use of funds

□ **Treasury Loan Highlights**

- *“US business not otherwise received adequate economic relief in the form of loans or loan guarantees provided under the CARES Act” (mid to large businesses)*
- Loan proceeds come with certain restrictions
- US-based businesses with 500-10,000 employees

Main Street Lending Program and Mid-Sized Business Lending Program

☐ **Main Street Lending Program**

- *Eligible Businesses:* 10,000 or fewer workers or less than \$2.5 billion of revenue in 2019
- *Main Street New Loan Facility*
- *Main Street Expanded Loan Facility*
- Four Year Maturity
- Interest rate equal to the Secure Overnight Financing Rate (SOFR) plus 250-400 basis points
- Principal and interest payments deferred for one year

☐ **Mid-Sized Business Lending Program**

- *Eligible Businesses:* 500-10,000 employees
- Interest rate of less than 2% with no payment due in first six months

COVID-19 Relief Provisions Benefiting Retail Companies

- **March 13, 2020:** President declares national emergency.
- **March 18, 2020:** President Signs the “**Families First Coronavirus Response Act**”.
- **March 20, 2020:** IRS issues Notice 2020-18 superseding and expanding on Notice 2020-17 to extend income tax **payment & filing** deadlines.
- **March 24, 2020:** IRS issues Frequently Asked Questions regarding Notice 2020-18.
- **March 25, 2020:** IRS issues IR 2020-59, the “People First Initiative”.
- **March 27, 2020:** President signs the “**Coronavirus Aid, Relief, and Economic Security Act**”.
- **March 31, 2020:** IRS issues Notice 2020-22, “Relief from Penalty for Failure to Deposit Employment Taxes.”
- **April 8, 2020:** IRS issues Rev. Proc. 2020-23, granting partnerships the ability to file amended returns to take advantage of CARES Act provisions.
- **April 9, 2020:** IRS issues Notice 2020-23, extending over 300 deadlines and Notice 2020-26 allowing providing relief for certain taxpayers to take advantage of NOL provisions in CARES Act.
- **April 13, 2020:** IRS issues press release about fax filing procedures to enable processing during COVID-19 shut downs

Families First Coronavirus Response Act (FFCRA)

- Signed into law by the President on March 18, 2020.
- Included legislation for:
 - Leave mandate and associated employer credit - established a federal emergency paid-leave benefits program for employers with fewer than 500 employees to provide two weeks of sick leave if employees are unable to work because they are subject to quarantine or isolation or experiencing symptoms of COVID-19, are caring for someone who is in quarantine or have children who are in schools that are closed.
 - Complements Family Medical Leave Act for additional 10 weeks of pay at a reduced rate for paid family leave for child care – Emergency FMLA
 - Provides employers with refundable tax credits (arising generally from payroll taxes) to offset the cost of paying leave.
 - IRS Notice 2020-21 provides that this Act will apply to wages paid for the period beginning April 1, 2020 and ending on December 31, 2020.
 - Wages used to qualify under FFCRA cannot also be used to qualify for the Employee Retention Credit, although both credits are available.

Families First Coronavirus Response Act Tax Credits

Payroll Credit for Required Paid Sick Leave

- For an employee who cannot work because of COVID-19, eligible employers may receive a refundable credit at the employee's regular pay, up to \$511 per day and \$5,110 in the aggregate, for a total of 10 days.
- For an employee who is caring for someone else with COVID-19, eligible employers may claim a credit up to \$200 per day and \$2,000 in the aggregate, for a total of 10 days.
- Eligible employers may also receive an additional tax credit for certain qualified health plan expenses.

Payroll Credit for Required Paid Family Leave

- Eligible employers may receive a refundable credit up to \$200 per day while the employee is receiving paid leave, or an aggregate of \$10,000.

IRS Guidance available at <https://www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs>.

- Guidance allows for deferral of employment taxes to extent of refundable tax credits.

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

- Passed the Senate on March 25; passed the House on March 27 and signed by the President that day.
- Included legislation for:
 - Relief for small and large businesses through loans, guarantees and other investments
 - A temporary suspension of net operating loss limits and a 5-year carryback period;
 - An increase of the limitation on deductible business interest;
 - A reduction of the applicable recovery period for qualified improvement property;
 - A refund for corporate AMT credits in years 2018 and 2019
 - A refundable credit, paid in cash for 2020 of \$1,200 to individuals and \$2,400 to married couples with an additional \$500 for each “qualifying child,” the credit is subject to AGI limits and phase outs.
- Regulations, forms, and guidance implementing CARES have already begun to be issued by the IRS and Treasury.

Modifications For Net Operating Losses

- The CARES Act provides taxpayers with additional cash flow and liquidity through the temporary repeal of the 80% of taxable income limitation on the utilization of net operating loss (NOL) carryovers imposed by the Tax Cuts and Jobs Act (PL 115-97).
- For a taxable year beginning before January 1, 2021, a taxpayer can fully offset its taxable income in that year with NOLs generated in prior taxable years.
- Taxpayers may also carry back NOLs arising in 2018, 2019, and 2020 to their five preceding taxable years.
- The IRS announced a special rule allowing applications for tentative carryback refunds for periods that would otherwise be ineligible and a fax submission process that will begin April 17, 2020. Which provides taxpayers with the opportunity to get cash refunds more quickly.
- Given the interaction with other provisions, and the “reopening” of otherwise closed statutes, its important to model out options to understand the best course of action.

Reduction of the Applicable Recovery Period For “QIP”

- Corrected the “retail glitch” by shortening the recovery period for qualified improvement property to 15 years and making it eligible for bonus depreciation.
- Observations:
 - Unlike other CARES provisions, this is a correction to the TCJA and applies retroactively to 2018 and 2019 and prospectively;
 - Taxpayers who incurred costs related to QIP during 2020 and before January 1, 2023 can deduct the full cost immediately; and
 - Taxpayers who incurred costs related to QIP in 2018 and 2019 should consider amending returns to fully expense the cost and obtain refunds or to generate NOLs which can be carried back.

Increase in the Limitation of Deductible Business Interest (Section 163(J))

- The limitation is increased to 50% of a taxpayer's adjusted taxable income ("ATI").
- Taxpayers can use 2019 ATI to calculate 2020 deductions.
- Special rules for partnerships:
 - 50% for 30% only applies for 2020;
 - Allows partner to take 50% of the excess business interest allocated to the partner (computed using the 30% limitation in 2019) and deem it to accrue in 2020.
- Observations:
 - Taxpayers may elect out to defer the deduction and avoid increasing an already existing NOL;
 - Taxpayers subject to BEAT should be mindful of the interplay with the section 163(j) deduction – decreasing your taxable income may increase your liability under BEAT; and
 - The CARES act did not address the problem for manufacturers who cannot increase their ATI by adding back depreciation, amortization and depletion expense deductions.

Employee Retention Credit

- The CARES Act provides a qualifying employer with a refundable payroll tax credit of up to \$5,000 for each employee's wages paid from March 13, 2020 through December 31, 2020.
- An employer is generally an eligible employer if its operations were fully or partially suspended during the COVID-19 crisis by a governmental shut-down order, or if its gross receipts declined by more than 50 percent when compared to the same quarter in 2019.
- The credit is claimed on a quarterly basis against the employer portion of social security tax (6.2%) on Form 941.
- IRS FAQs and Form 7200, *Advance Payment of Employer Credits due to COVID-19*
 - Applies to employee retention credits and FFCRA credits
 - Federal income tax withheld from employees
 - Employee and employer share of Social Security and Medicare taxes
- Employers cannot receive both a SBA loan under the Payroll Protection Program and an Employee Retention Credit.
 - Employers who have received the PPP loan, but whose loan has not yet been forgiven, may defer deposit through the date the lender issues the decision to forgive the loan without penalties.

Filing And Payment Extensions

- Employers may defer the employer portion of social security tax (6.2%) due from the effective date of the CARES Act through December 31, 2020
 - 50% due by December 31, 2021
 - Remainder due by December 31, 2022
- 2019 Federal Income Tax Returns and payments due between April 1 and July 15, are now due July 15, 2020
 - Relief provided for both calendar and fiscal year filers
- 2020 Estimated Payments originally due between April 1 and July 15, 2020 are now due July 15, 2020
- Other Administrative Relief – IRS Notice 2020-23
- State Specific Relief

Impact of Tax Benefits in Purchase Agreements

- Purchase Agreement impact for future M&A
 - Negotiated terms

- Existing M&A Agreements
 - Obligations
 - Who gets benefits of NOLs and refunds (buyer/seller)

CLE Code

We will now announce the CLE code. Please save this number; you will be asked to provide this code in a survey immediately following the presentation today, which will generate once you exit the WebEx application. Please be sure to take the survey and apply the code where necessary in order to receive credit.

Please email Erik Scott at **erik.scott@morganlewis.com** if you have any questions.

COVID-19 Related M&A Due Diligence Risk For Retail Targets

- ❑ *Employment Issues*
- ❑ *Contract Diligence*
- ❑ *Customer & Vendor Relationships*

Employment Issues

- Employee safety for continued on-site work
- Use of PTO and vacation
- Local, state, and federal sick leave obligations
- Federal and state notice requirements prior to layoffs (WARN)
- Workforce change alternatives
 - Hours and pay reductions
 - Temporary Furloughs
 - Lay Offs

Employee Safety

- Implement policies to minimize chance of employees reporting to work sick
 - Wellness questions
 - Temperature checks
 - Sick leave pay
- Implement physical distancing
- Implement regular and frequent cleaning
- Keep-up with CDC guidance
- Consider facial covering and protection

Use of PTO/Vacation/Sick

- Allow use of paid time off in accordance with policies
- Be aware of expanded sick leave reasons associated with COVID-19
- During a temporary furlough
 - Allow vacation/PTO in accordance with policies
 - Payout vacation/PTO in accordance with applicable state law and local ordinances
 - Allow use of sick leave for its purposes, including expanded COVID-19 purposes
 - Remain aware of WARN and Cal-WARN issues
- During an indefinite furlough or layoff
 - Payout vacation/PTO timely where required
 - Payout final wages where required
 - Remain aware of layoff selection criteria
 - Remain aware of WARN and Cal-WARN notice obligations

Contract Issues

Contract Defaults

- Leases
- Supply chain
- Force Majeure

Revisions put in place since impact with COVID

Review contracts for termination ability

Customer messaging

Key Takeaways

- ❑ PPP Program/Treasury Loans – Additional guidance to be provided on loan programs – need careful evaluation of eligibility criteria and review of certifications
- ❑ Employment – Companies should be very careful in handling employment matters during this time
- ❑ Tax – Discuss with a Tax lawyer to truly understand tax impact
- ❑ Diligence – Successfully managing relationships now will benefit companies in the future

Biography



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Christina's corporate and securities practice focuses on representing public and private corporations and private equity sponsors and their portfolio companies in mergers and acquisitions, asset purchases, joint ventures, private and public equity and debt financings, securities offerings, and other general corporate matters. Christina also assists companies to raise capital in the public markets, including initial public offerings and secondary offerings. Christina counsels clients on SEC reporting and securities law disclosure, annual meeting and proxy related issues, corporate governance matters, and stock exchange listing requirements. Additionally, she currently serves as Morgan Lewis's firmwide hiring partner and co-leader of the firm's retail and eCommerce industry initiative.



Biography



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Jennifer concentrates her practice on tax controversy and planning matters, with an emphasis on audits and controversies and Internal Revenue Service (IRS) administrative proceedings. Jennifer routinely handles matters involving US federal income tax, foreign tax, state and local corporate and business tax, and sales and use tax. She has experience representing major corporations, partnerships, S corporations, and individuals in resolving domestic and international compliance and controversy issues before the IRS.



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Barbara J. Miller handles complex employment litigation for a range of clients, particularly in the retail, technology, financial services, and energy industries. She defends wage and hour class actions as well as a broad range of other employment disputes, from those involving employee proprietary information to harassment, discrimination, retaliation, and whistleblowing. Barbara also provides counsel and internal training on a range of workplace issues including wage and hour compliance, leaves of absence, workforce change, and tailoring incentive plans to meet both business needs and California's technical wage laws.



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Allison focuses her practice on advising Fortune 500 companies, private equity sponsors, investment banks, and emerging market companies on a broad range of corporate matters, including mergers, acquisitions, dispositions and private equity investments, in both domestic and cross-border transactions. She also advises clients on general corporate and compliance matters. Allison has experience in a broad range of industries, including media, technology, retail and financial services.

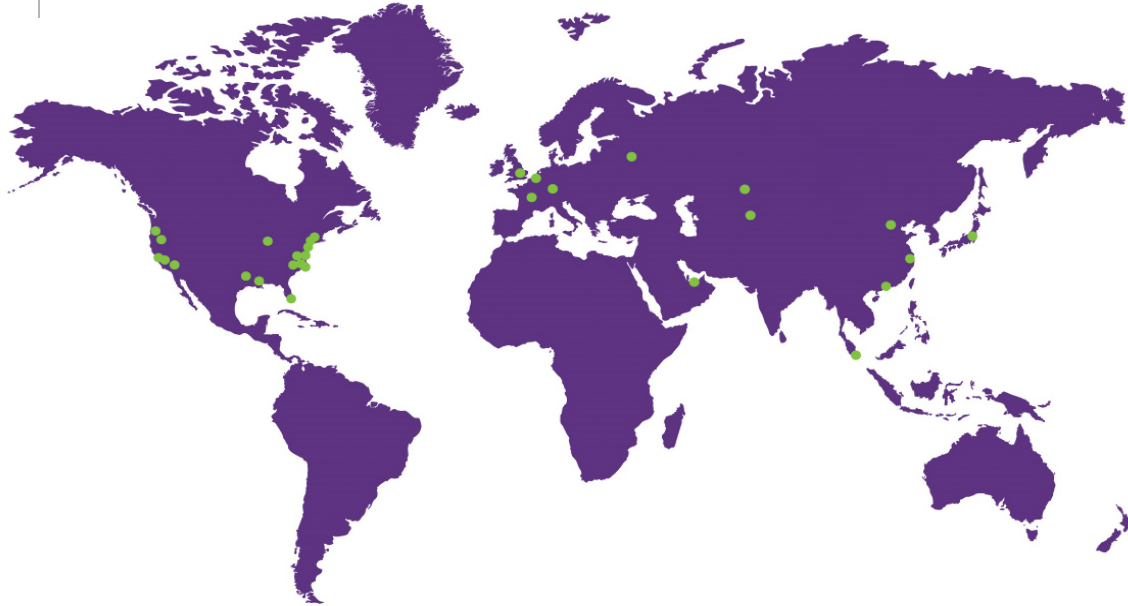


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