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Spring 2020 Newsletter

IN THE LAW

The IRS provides flexibility for cafeteria plan elections due to the challenges created by COVID-19.

See below for details.

IN THE SPOTLIGHT

Many of our clients have asked for a definition of the Good Faith Necessity found in the Paycheck Protection Program and the CARES Act.

We've got an answer.

IN THE LAW

The Tennessee Court of Appeals delivered an opinion that affects future litigation for those who own or lease commercial real estate.

We explain the case.

The IRS Provides More Flexibility for Cafeteria Plans

by: Kathy D. Aslinger, Esq.
and Law Clerk Becca Hanniford

On May 12, 2020, the Internal Revenue Service released IRS Notices 2020-29 and 2020-33 creating more flexibility in cafeteria plans. Notice 2020-29 addresses concerns raised by employers and employees stemming from COVID-19 and applies only to 2020, while Notice 2020-33 is not specific to COVID-19 or limited to this year. These changes are discussed below.

Notice 2020-29:
(1) Mid-Year Election Changes

Typically, when employees elect benefits under a cafeteria plan, those elections are irrevocable for the remainder of the plan year except in certain circumstances, such as a change in employee status. Due to COVID-19 and the current climate of unpredictability, some employers have expressed a willingness to allow employees who initially declined employer-sponsored health coverage an opportunity to elect health coverage, or allow employees to elect to enroll in different health coverage offered by the employer or to drop their existing health coverage. Additionally, employers are recognizing that because of new-found health risks and school and day-care closures, employees may need to increase or decrease amounts of their health flexible spending accounts ("FSAs") and/or amounts for dependent care assistance.

In response to these concerns, Notice 2020-29 permits an employer to amend it cafeteria plan to allow employees to make mid-year election changes during calendar year 2020 to:

- elect employer-sponsored health coverage, if the employee initially declined;
- revoke their existing health coverage and elect to enroll in different health coverage sponsored by the same employer;
- revoke an existing election for employer-sponsored health coverage, so long as employee attests in writing that employee is enrolled or will enroll in health coverage not sponsored by employer;
- revoke an election, make a new election, or decrease or increase an existing election regarding a health FSA; and
- revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care assistance program.

Prior to accepting an employee's revocation of existing employer-sponsored health-coverage, the employer must receive from the employee a written declaration of the employee's enrollment or intent to enroll in other health coverage.

An employer who chooses to allow for this flexibility is not required to provide unlimited election changes but may, in its discretion, determine the extent to which to permit and apply the changes. In making these decisions, employers may want to consider the potential for adverse selection. For health FSAs and dependent care assistance programs, employers are permitted to limit mid-year elections to amounts not less than already reimbursed.

This relief may be applied retroactively to periods prior to the issuance of Notice 2020-29 and on or after January 1, 2020, to address a cafeteria plan that permitted mid-year election changes otherwise consistent with the requirements for relief provided in Notice 2020-29.

(2) Unused Amounts Remaining in a Heath FSA or Dependent Care Assistance Program

Notice 2020-29 also allows an employer to amend its non-calendar year cafeteria plan to permit employees an extended period of time to apply unused amounts remaining in a health FSA or a dependent care assistance program at the end of a plan year ending in 2020 to pay or reimburse expenses incurred for the same benefit through December 31, 2020. This extension of time for incurring claims is available both to cafeteria plans that have a grace period and plans that provide for a carryover. Further, an employee who is allowed an extension period pursuant to an amended cafeteria plan, and has unused amounts remaining at the end of a plan year or grace period ending in 2020, shall not be permitted to contribute to an HSA during the extension period, except in the case of an HSA-compatible health FSA.

(3) Amending Cafeteria Plans

Employers that wish to amend their cafeteria plans consistent with Notice 2020-29 must adopt a plan amendment. An amendment for the 2020 plan year must be adopted on or before December 31, 2021, and may be effective retroactively to January 1, 2020, so long as the plan operates according to Notice 2020-29. Additionally, employers are responsible for informing all employees eligible to participate of the changes.

(4) High Deductible Health Plans ("HDHPs")

Notice 2020-29 clarifies several aspects of Notice 2020-15, which permits HDHPs to cover expenses related to testing for and treatment of COVID-19 prior to meeting the minimum deductible. First, Notice 2020-29 clarifies that the relief provided in Notice 2020-15 applies to reimbursements of expenses incurred on or after January 1, 2020. Further, testing and treatment of COVID-19, for purposes of Notice 2020-15, includes the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus, and any items or services required to be covered with zero cost sharing under the Families First Act, as amended by the CARES Act.

Section 3701 of the CARES Act allows employees to retain eligibility to contribute to an HSA if they also receive coverage for telehealth and remote care services outside an HDHP and allows for HDHPs to retain HDHP status even if coverage of telehealth and remote care services is provided before the minimum deductible is met. The treatment of telehealth and other remote care services under the CARES Act applies with respect to services provided on or after January 1, 2020, with respect to plan years beginning on or before December 31, 2021.

Notice 2020-33
(1) Carryovers for Health FSAs

Historically, cafeteria plans operated on a "use-or-lose" rule, meaning unused benefits or contributions that remained at the end of the plan year were forfeited. A few years ago, the IRS began allowing plans to provide for a $500 carryover of any unused amounts in an employee's health FSA. Notice 2020-33 increases the maximum permitted carryover amount to 20% of the maximum annual contribution, which is indexed for inflation. Thus, the available carryover from 2020 to a plan year beginning in 2021 increases from $500 to $550.

Employers who wish to permit this expansion of the carryover limit must amend their cafeteria plans on or before the last day of the plan year from which amounts may be carried over, and the amendment may be effective retroactively to the first day of the plan year. Additionally, employers are responsible for informing all employees eligible to participate of the changes.

(2) Individual Coverage HRAs

Notice 2020-33 provides guidance on the payment of individual health insurance coverage premiums from Health Reimbursement Arrangements ("HRAs"). HRAs may only pay or reimburse medical care expenses incurred by an employee during a plan year, and medical care expenses are typically treated as incurred when a covered individual is provided medical care that gives rise to the expense, not when the amount is billed or paid.

Notice 2020-33 permits an HRA to treat an expense for a premium for individual health insurance coverage as incurred on (1) the first day of each month of coverage on a pro rata basis, (2) the first day of the period of coverage, or (3) the date the premium is paid. Thus, an individual coverage HRA with a calendar plan year may immediately reimburse a substantiated premium for health insurance coverage that begins on January 1 of that plan year, even if the covered individual paid the premium for the coverage prior to the first day of the plan year.

The Paycheck Protection Program Flexibility Act of 2020

by: Elijah C. Lovingfoss, Esq.

On Wednesday, June 3, 2020, Congress passed the Paycheck Protection Program Flexibility Act of 2020 (the "Act"). The Act was meant to make the provisions of the Paycheck Protection Program (the "PPP") more lenient to allow recipients to take full advantage of the forgiveness provisions and to defer taxes. There are several key takeaways from the Act that businesses who are eligible for the PPP program should be aware of.

First, the Act has extended the minimum maturity date of PPP loans from two years to five years.

Second, and of particular relevance to businesses who have already accepted PPP loans, the period for which PPP funds may be used (for allowed payroll and other expenses) and the use of those funds applied towards forgiveness has been extended. Put more simply, if a business uses PPP funds during the extended period, those funds will be used to calculate the amount of forgiveness that the business is eligible for. Instead of eight weeks from the date the loan was originated, the period now ends the earlier of either twenty-four weeks from the origination of the loan or December 31, 2020. However, if a business received a PPP loan prior to the enactment of the ACT, it may choose to utilize the original eight-week period as the forgiveness period.

Third, the Act also now includes a provision that provides an exemption for loan forgiveness if a business is not able to rehire its staff or similarly qualified individuals. Specifically, the amount of loan forgiveness will now be calculated without regard to a proportional reduction in full-time employees so long as the business was unable to rehire individuals who were employees prior to February 15, 2020, and the business was unable to hire similarly qualified individuals to fill the position between February 15, 2020 and December 31, 2020. Alternatively, if the business can show that, due to restrictions placed on its operations by HHS, the CDC, or OSHA, it cannot return to its pre-February 15, 2020 levels of business activity between March 1, 2020 and December 31, 2020, then it will also be eligible for the exemption.

Fourth, the Act has placed new limitations on forgiveness while also reducing the percentage of payroll requirement for forgiveness. The Act now requires that a business use only 60% of PPP funds for payroll rather than 75%. However, the Act also now provides that if a business uses less than 60% of its PPP funds for payroll it will not be eligible for forgiveness at all. This is harsher than the old provision, which only proportionally reduced the amount of forgiveness if less than 75% of PPP funds were used for payroll.

Fifth, the Act also updates the loan deferment provisions of the PPP program. The Act replaces the previous six month minimum deferment period with a deferment period that lasts until the PPP lender receives the approved amount of forgiveness for that loan. If a business does not apply for forgiveness within ten months from the end of the covered period (the covered period is the 24 week period from the date of the origination of the loan or the period from the date of the origination of the loan to December 31, 2020), then the business must begin making payments on the day after the ten-month period expired. Accordingly, a business could potentially extend its deferment period by waiting to apply for forgiveness until near the expiration of the ten-month period.

Finally, the ACT now permits businesses that accepted PPP loans and had those loans forgiven to defer their payroll taxes, which had been prohibited in the original program.

DISCLAIMER: The information in this article is meant only for the general knowledge of our readers and not as legal advice. The situation surrounding the PPP program and COVID-19 is rapidly evolving and no guarantee of the accuracy of the information contained in this article is made beyond the date of publication. It is expected that published guidance from the SBA and future legislation will impact this information going forward. If you require legal advice, please contact an attorney with Kennerly, Montgomery & Finley who can provide up to date information regarding the Paycheck Protection Program.

Wealth Transfer Planning During the COVID-19 Crisis

by: Michael R. Crowder, Esq. and Marshall H. Peterson, Esq.

The COVID-19 pandemic has caused massive disruption in our relationships and lifestyles. Millions are out of work and a

number of businesses will not weather the storm. Going to the office, hanging out with friends, celebrating with family—all curtailed as public health professionals and public officials battle the scourge.

The equity markets are also roiled by the dislocations and uncertainties resulting from the COVID-19 crisis. Values in stock portfolios are subject to wild fluctuation, interest rates are at historical lows, and all this as a backdrop to what will certainly become political discord on tax policy. Although many feel helpless, or wonder what can be done, these unfortunate events do create opportunities for wealth transfer planning.

Keep in mind that the federal transfer tax exemption is currently $11.58 million, $23.16 million for married couples. This level of exemption, though, is temporary. If Congress does not step in, it is scheduled to “sunset” on January 1, 2026, at which time the exemption will revert to $5 million for an individual (indexed). A future Congress could also accelerate the reversion to $5 million, or further decrease the exemption amount.

For those who are concerned that greater wealth transfer taxes will reduce the amounts for future generations, some longstanding planning techniques seem compelling. Here are just a few strategies we are currently recommending to our clients:

1) Establishing Irrevocable Trusts

An irrevocable trust may be used to remove assets from what would be a taxable estate. By funding an irrevocable trust now—say, for your spouse’s or children’s benefit—you may be able to “lock in” current estate tax exemption levels. The IRS’s stated position is that exemption gifts, including generation-skipping transfers (“GST”), will not be recomputed if the exemption levels decrease, so long as the transfer was made before exemptions decrease.

2) Grantor Retained Annuity Trust (GRAT)

GRATs provide the opportunity for a substantial tax-free, low-risk transfer of wealth. A GRAT is a certain type of irrevocable trust under which the individual transferring the assets (“Grantor”) retains a payout from the trust (the “annuity”) that is equal to the value of the transfer with a mandated appreciation rate specified by the IRS. At the termination of the GRAT, the value in the trust over and above the required annuity transfers tax free to the remainder beneficiaries named by the Grantor when the trust is established. Most GRATS are short term—two years is typical.

GRATs have been in wide use as effective wealth transfer tools since 1989 when they were made part of the Internal Revenue Code. Two factors seem to make them especially attractive now:

1. the interest rate specified by the IRS is at a historical low (0.6% in June 2020), and
2. the market volatility of stocks means that there is a good chance that assets will be transferred to the GRAT at a low valuation compared to recent times.

The success of a GRAT is measured by the increase in its total value over its term, meaning the appreciation of the underlying asset in addition to dividends. With such a low hurdle rate, we recommend considering, along with your financial advisor, the stock holdings most appropriate to use in funding a GRAT. Almost all appreciation will be passed on free of transfer tax.

3) Low interest Loans

The historically low interest rates can also be used on loans to benefit family members and transfer wealth. Under IRS rules, loans must bear interest, but the current required interest rate is lower than even the extremely low interest rate for a GRAT. An asset can be sold to the next generation at the current value; (though, assets such as family business interests which asset may be devalued by the current economic uncertainty); free of transfer tax—a bona fide sale is not subject to transfer tax, and at almost interest-free rates.
As with any planning concept, whether it is appropriate for you depends on an analysis of all facets of your planning. We are ready to discuss these, and other aspects of your planning.

COVID-19 Special Edition Newsletters

We've Been Keeping Up For You

April 27, 2020 - Special Edition #4
includes:
How to Get Your Paycheck Protection Program Loan Forgiven: An FAQ Guide for Small Businesses and Self-Employed Individuals
and
Are COVID-19 Business Losses Covered by Insurance?

April 13th, 2020 - Special Edition #3
includes:
CARES Act: Small Business Loans
and
Six Reasons for Paid Leave Under the FFCRA

March 27th, 2020 - Special Edition #2
includes:
CARES Act Provides Early Access to Retirement Funds and Other Retirement Plan Relief

March 20th, 2020 - Special Edition
includes:
A Summary of the Family First Coronavirus Response Act for Employers and Employees

TN Court of Appeals: Premises Liability Who is exercising control?

by: Toby R. Carpenter, Esq.

The Court of Appeals issued an opinion in Jones v. Earth Fare, Inc., a Knox County premises liability case, on Wednesday, April 15, 2020, which shows how good deeds don't go unpunished. If you own or lease commercial real estate, this opinion might affect any future liability in insurance/injury litigation you may have.

Earth Fare was a natural foods grocery store leasing space in a shopping center. The lease provided that the landlord would maintain the common areas, including the parking lot, in a "first class condition," and would clean and remove "any impediments to easy and safe movement."

A few minutes before the plaintiff's injury, another customer slipped in a puddle of antifreeze in the parking lot. There was no proof of who made the puddle or how long it was there. That customer reported the puddle to the Earth Fare manager, who went outside, saw it, then returned to the store to get a bag of cat litter to absorb and clean up the puddle. While she was inside, the plaintiff exited the store and slipped and fell in the puddle, causing injuries.

In her deposition, the manager testified that although the landlord was responsible for cleaning and maintaining the parking lot, Earth Fare employees regularly cleaned up any broken glass, spills, and other hazards in the parking lot if they became aware of them. The manager also said they did not contact the landlord about those conditions.

Earth Fare moved for summary judgment, arguing that it had no legal duty to the plaintiff because of the lease terms. The trial judge, Hon. William T. Ailor, agreed with the defendant and granted the motion. The plaintiff appealed, arguing that the manager's testimony created an issue of fact regarding whether Earth Fare had a duty of care.

The Court of Appeals reversed the summary judgment, holding that a lessee has no duty of care to a customer injured in a common area where the lease says the landlord is responsible for maintenance of that common area, but only if the lessee has not exercised control over the common area. Because the manager testified that Earth Fare had essentially exercised control over the parking lot, there was an issue of fact regarding its duty to the plaintiff that precluded summary judgment. The Court remanded the case back to the trial court.

From a risk management perspective, this case illustrates how a party can expose itself to liability through actions that it intends to be benevolent and/or efficient. I'm sure that Earth Fare's employees believed that they were doing the landlord a favor, and that it was just easier and faster to deal with parking lot spills and debris themselves. By doing that, however, they created a legal duty that otherwise would not have existed.

While it might have been bothersome to call the landlord every time someone dropped a jar or bottle in the parking lot, that's exactly what they should have done. To avoid this type of liability, lessees of commercial property need to make sure their management employees understand the lease terms regarding maintenance of common areas, and that they act consistent with those terms.

The Good Faith Necessity Certification Requirement under the CARES Act and Paycheck Protection Program: A Borrower's Guide

by: Zack. R Gardner, Esq.
and Law Clerk Zach Kiffmeyer

For the past few weeks, many small businesses that received loans under the Paycheck Protection Program ("PPP") have wrestled with the decision of whether to keep the money or give it back after confusing guidance from the Treasury Department and the Small Business Association ("SBA") raised questions about the good faith necessity certification. Much to their relief, new guidance released May 13, 2020 provides a certification safe harbor for businesses receiving

loans under $2 million.**

The Coronavirus Aid, Relief, and Economic Security (“CARES”) Act, which governs the PPP, requires borrowers to certify that “the *uncertainty* of economic conditions makes *necessary* the loan request to support the ongoing operations of the [borrower].” CARES Act § 1102 (emphasis added). In response to public companies requesting and receiving larger loans from the PPP, causing many smaller, local businesses to be left out, the SBA and the Treasury Department provided guidance on the “necessity” of a PPP loan as part of their FAQs. The guidance, however, raised more questions than answers for smaller companies.

In FAQ #31, published April 23, 2020, the SBA presented the following question: “Do businesses owned by large companies with adequate sources of liquidity to support the business’s ongoing operations qualify for a PPP loan?” In response, the SBA stated:

“In addition to reviewing applicable affiliation rules to determine eligibility, all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application. Although the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere (as defined in section 3(h) of the Small Business Act), borrowers still must certify in good faith that their PPP loan request is necessary. Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Borrowers must make this certification in good faith**, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business**. **For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.**

Lenders may rely on a borrower’s certification regarding the necessity of the loan request. Any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 [extended to May 14, 2020] will be deemed by SBA to have made the required certification in good faith. (Emphasis added).”

In FAQ #37, the SBA asked, “Do businesses owned by private companies with adequate sources of liquidity to support the business’s ongoing operations qualify for a PPP loan?”, but the answer merely referenced the question and answer to FAQ #31.

On April 28, 2020, Treasury Secretary Steve Mnuchin declared that any business that receives more than $2 million in PPP loan proceeds will be audited. On April 29, in response to Mnuchin’s declaration, the SBA added FAQ #39, stating:

“To further ensure PPP loans are limited to eligible borrowers in need, the SBA has decided, in consultation with the Department of the Treasury, that it will review all loans in excess of $2 million, in addition to other loans as appropriate, following the lender’s submission of the borrower’s loan forgiveness application. Additional guidance implementing this procedure will be forthcoming.”

This guidance left borrowers receiving loans of less than $2 million and some access to other forms of liquidity worried about whether the SBA would conclude retroactively that their loans were not “necessary” to support ongoing operations and subject them to penalties.

The day before the deadline to repay the PPP loans without consequences, the SBA released FAQ #46, which asked, “How will SBA review borrowers’ required good faith certification concerning the necessity of their loan request?” In its response, the SBA created a certification safe harbor, stating, “Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than $2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith.”

In justifying the safe harbor, the SBA noted that businesses receiving loans for less than $2 million likely did not have other sources of liquidity; the safe harbor comports with the overarching goal of the PPP, which is to keep people employed in small businesses; and finally, the SBA, by only auditing businesses who took out loans in excess of $2 million, will be able to conserve its finite audit resources and focus on those businesses which might yield the highest number of compliance issues.

The SBA also gave further guidance to borrowers receiving loans in excess of $2 million, as follows:

"Importantly, borrowers with loans greater than $2 million that do not satisfy this safe harbor may still have an adequate basis for making the required good-faith certification, based on their individual circumstances in light of the language of the certification and SBA guidance. SBA has previously stated that all PPP loans in excess of $2 million, and other PPP loans as appropriate, will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form. If SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request. SBA's determination concerning the certification regarding the necessity of the loan request will not affect SBA's loan guarantee."

In light of this guidance, businesses receiving loans of less than $2 million can breathe easier and concentrate on using their loan proceeds for the purposes outlined in the CARES Act. Businesses receiving loans in excess of $2 million should be preparing to document support for the necessity certification. Until additional guidance is released on the audit review process, we would suggest gathering documentation of the following items to help smooth the audit experience with the SBA:

1) Uncertainties in your business operations due to COVID-19 such as:

- uncertainties in supply chain of products;
- uncertainties about when your business may reopen due to constantly evolving state government executive orders regarding COVID-19;
- uncertainties about whether your usual customers or others in the market will purchase goods/services from you if your business were to reopen;
- uncertainties about what will happen to your business if a new wave of the virus should occur based off medical expert opinions and data; and/or
- uncertainties about whether your customer or target markets will be able to afford your products/services given the overall economic impact of COVID-19.

2) Inability to access liquidity elsewhere. Public companies may have a harder time showing this given their access to larger capital markets and sources of liquidity outside the PPP.

3) Risks involved with maintaining your current workforce, such as:

- employees that may choose to leave your business should they find a more cash-healthy business to work for;
- employees that would prefer to collect unemployment payments instead of receiving pay from your business; and
- employees that are fearful of working during the pandemic.

4) Impacts to competitors that you feel would soon affect your business as well.

5) Overhead cuts and other reduction in working capital made by similar businesses within your industry.

6) Cash flow, revenue, and balance statements since the national emergency and quarantine orders were declared demonstrating how the COVID-19 pandemic is currently impacting your business.
