

CARES Act Temporarily Extends Favorable Bankruptcy Provisions to Small and Medium-Sized Businesses Seeking to Reorganize



- The COVID-19 pandemic has many businesses considering a wide range of options for continuing operations, including restructuring and/or bankruptcy.
- Two recent changes to bankruptcy law include favorable provisions for small and medium-sized businesses seeking a reorganization under Chapter 11 of the U.S. Bankruptcy Code.
- As part of navigating the restructuring and/or bankruptcy process businesses must consider a host of valuation and tax issues.

Expanded Definition of *Small Business Debtors*

Two important changes to the U.S. Bankruptcy Code were enacted before and during the COVID-19 pandemic. Subchapter 5 of the U.S. Bankruptcy Code was added by the [Small Business Reorganization Act](#) (SBRA), which took effect February 19, 2020, and aims to reduce the costs and expenses for small businesses to reorganize under Chapter 11.

The [CARES Act](#) makes bankruptcy reorganizations a viable option for small and medium-sized businesses by temporarily raising the maximum debt threshold to \$7,500,000 from \$2,725,625 for filing under Subchapter 5 of the U.S. Bankruptcy Code. The increased debt limit under SBRA applies to cases filed after the enactment of the CARES Act and is in effect for one year after the CARES Act took effect on March 27, 2020.

Before SBRA was enacted, small businesses were limited to choosing between a Chapter 7 or Chapter 11 reorganization. Under SBRA, *small business debtors* who do not exceed the maximum debt threshold have a third bankruptcy option that combines aspects of Chapter 7 and Chapter 11 to lower costs and streamline the plan confirmation process. SBRA includes several advantageous features for *small business debtors* seeking relief under Chapter 11, including:

- Continued ownership and management.
- No disclosure statement requirement unless ordered by the court for cause.
- Permitting administrative expenses to be paid over time and not on plan effectiveness.
- No creditors' committee unless ordered by the bankruptcy court for cause.
- No U.S. trustee quarterly fees.

How Can Andersen Help?

Andersen has extensive experience advising enterprises through all tax aspects of their financial restructuring and/or bankruptcy process – planning, implementation, compliance and controversy. We help businesses and business owners ensure that their tax positions are practically and properly aligned with the goals of the enterprise. Examples of tax issues and opportunities that must be considered include:

- Cancellation of debt (COD) income may result from changes in debt instruments.
 - Change in payment terms (forbearance) or security.
 - Change in interest rate or addition of contingent interest.
 - Related party debt acquisitions.
- Directors and officers will want to avoid personal liability for trust fund taxes.
- Restructuring to address the attribute reduction rules in connection with debt modification.
- Adjusting restructuring plans to improve federal, state and international tax profile.
- Modeling alternative attribute reduction methodologies.

- Using taxable transaction to generate post-transaction attributes (e.g., basis).
- Accelerating losses to reduce net unrealized built-in loss (NUBIL) and recognized built-in loss (RBIL) consequences.
- Managing ownership changes through restrictions on stock or by bankruptcy court order.

The Takeaway

Businesses are looking at a wide range of options to help recover from the harmful economic environment wrought by the COVID-19 pandemic, including restructuring and/or bankruptcy. Two important recent changes to bankruptcy law that took effect in 2020 include favorable provisions for small to medium-sized business debtors. Regardless of the restructuring and/or bankruptcy option a business chooses, Andersen can help them navigate the myriad of tax and valuation issues they will likely face.

For further information please contact your Andersen advisor.

