Updates

The U.S. Senate and House of Representatives, on December 21, 2020, approved H.R. 133, referred to as the "Consolidated Appropriations Act, 2021." This advances to the president legislation to provide appropriations for 2021 and changes to the Paycheck Protection Program (PPP) administered by the U.S. Small Business Administration (SBA). The portions of the legislation providing for the continuation of PPP loans (entitled the "Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act") has been framed as a major element of Congressional efforts to provide economic relief in the wake of the COVID-19 pandemic. The legislation gives new life to the PPP by extending the program, which had previously expired on August 8, 2020, and creating an option for a "second draw" for PPP borrowers. In addition, the legislation introduces changes to PPP loans that will impact both new and existing PPP borrowers. Any business with an existing PPP loan or that is considering applying for this new wave of PPP loans should pay attention to this legislation and the new guidance that should be coming from the SBA over the next few weeks, as it changes the rules yet again.

Key takeaways regarding how this new legislation impacts PPP loans are summarized below.

Key Takeaways for New PPP Loans

New PPP and EIDL Funds Available

The initial wave of PPP loans in April 2020 was provided on a first-come, first-served basis and quickly ran out of funding. The second wave of PPP loans was available until August 8, 2020 and expired with funds still available. For both rounds of PPP funding, each borrower could obtain only one loan, with the loan amount calculated based on 2.5x the borrower's monthly average payroll costs in 2019 (with certain exceptions).

The new legislation included appropriations for new loans and advances to be administered by the SBA, including approximately $284 billion for PPP loans and $20 billion for Economic Injury Disaster Loans (EIDLs). Such funding is to be made available between the enactment of this legislation and March 31, 2021.

The specific details on how this third tranche of PPP loans will be made available remain to be determined, but the legislation does mandate that a portion of the authorized funds be set aside for loans by community lenders and small depository lenders, loans to borrowers with 10 or fewer employees, and loans of no more than $250,000 to borrowers located in designated low-income or moderate-income neighborhoods. Additional SBA rulemaking is due to be provided within 10 days after the enactment of the new legislation.

Expanded Eligibility for PPP Loans

The CARES Act, which authorized the PPP, included limits on the types of entities that were eligible for PPP loans. Under the new legislation, certain categories of borrowers previously not eligible are now more clearly eligible, including local chambers of commerce, housing cooperatives, and certain news stations. Congress also included language confirming that churches and religious organizations are eligible borrowers.

Separately, the new legislation provides for a new relief program for certain music venues. However, the legislation also states that entities receiving such grants are not eligible for PPP loans.

"Covered Period" for Loan Forgiveness

In calculating the amount of eligible expenses paid or incurred that would qualify for loan forgiveness, borrowers who received loans before June 5, 2020 were previously given the option of choosing between an 8-week period contemplated by the CARES Act or a 24-week period contemplated by an interim amendment to the PPP legislation. The duration of this "covered period" impacts the amount of expenses that could be included in the borrower's forgiveness calculation, but also impacts the measurement period for potential reductions to loan forgiveness that are based on changes in full time employee equivalents (FTEs) or salary or hourly wage reductions. Borrowers who received their loan on or after June 5, 2020 were required to use the longer 24-week "covered period," but in theory were allowed to apply for forgiveness before the end of their "covered period."

The new legislation provides that PPP borrowers will be provided the option to choose between an 8-week covered period and a 24-week covered period. It is not clear whether this flexibility to choose a customized covered period will apply retroactively to loans made prior to the enactment of the new legislation.

Key Takeaways for "Second Draw" PPP Loans

Eligibility for "Second Draw" PPP Loans

The new legislation permits borrowers that previously received and fully spent a PPP loan to apply for a "second draw" PPP loan. These "second draw" PPP loans are subject to new eligibility requirements, including the following:

- Eligible borrowers are capped at no more than 300 employees (rather than 500); however, borrowers that have more than 300 employees but whose primary industry is in NAICS category 72 (accommodations and food service) and that have no more than 300 employees per physical location will also be eligible. The SBA's "affiliation" rules continue to apply, except with respect to certain excluded businesses as discussed here.
- Eligible borrowers must have had gross receipts during the first, second, or third quarter of 2020 (or for loans after January 1, 2021, the fourth quarter of 2020) that demonstrate not less than a 25% reduction compared to the same quarter in 2019 (or, if the borrower was not in business in 2019, a 25% reduction in the second, third, or fourth quarter of 2020, compared to the first quarter of 2020). The SBA may require documentation substantiating the revenue loss as part of the loan forgiveness process.
- Certain business types are specifically excluded from eligibility, regardless of their number of employees or revenue losses. This includes businesses created in or organized under the laws of China or Hong Kong, or having significant operations in China or Hong Kong, or those that are more than 20% owned by businesses in China or Hong Kong, or businesses with a Board member who is a resident of China. We anticipate that the SBA will need to provide further guidance on what constitutes "significant operations in China or Hong Kong."

In addition to the new eligibility requirements described above, applicants for "second draw" PPP loans will still be required to certify that current economic uncertainty makes this loan request necessary to support the ongoing operations of the applicant.

Calculation of "Second Draw" PPP Loan Amount

The CARES Act provided that the calculation of the loan amount for PPP loans was based on 2.5x the borrower's average monthly payroll costs in 2019, up to a total of $10 million.

For "second draw" PPP loans, the loan amount is capped at the lower of (1) 2.5x the borrower's average monthly payroll costs for the 1-year period before the loan is made (this need not be calendar year 2019), or calendar year 2019, or (2) $2 million. However, for certain borrowers, a different formula applies. Specifically, for accommodation and food service businesses categorized under NAICS Sector 72, the payroll multiplier is increased from 2.5x to 3.5x. Additional adjustments to the formula apply for seasonal employers and businesses that did not exist for a full year prior to February 1, 2020.

In addition, borrowers who previously applied for and returned a PPP loan can apply again for the difference between (1) the loan amount they retained and (2) the amount they could now qualify to obtain.

Key Takeaways for All PPP Loans

Expanded Eligible Uses of PPP Loan Proceeds

The CARES Act and subsequent guidance issued by the SBA limited the use of PPP loan proceeds to cover the following: payroll costs; payments of interest on any mortgage obligation (excluding prepayments); rent (including rent under a lease agreement); utilities; and interest on any other debt obligations that were incurred before the applicable "covered period" of the loan (i.e., the period during which permitted uses of PPP loan proceeds would be eligible for forgiveness). For background on how these categories of permitted uses are defined, including limitations on which eligible uses would qualify for loan forgiveness, see here.

The new legislation expands the scope of expenses that PPP loans may be used for and for which forgiveness may be granted to include the following types of expenses:

- "Covered operations expenditures"—defined as business software or cloud computing expenses for business operations, product or service delivery, payroll processing, payment, or tracking, human resources, sales and billing functions, or accounting or tracking of supplies, inventory, records, and expenses.
- "Covered property damage costs"—defined as costs relating to damage and vandalism or looting due to public disturbances in 2020 that were not covered by insurance or other compensation.
- "Covered supplier costs"—defined as supplier payments that are essential to the borrower's operations and were made either (1) pursuant to a contract, order, or purchase order in effect *prior to* the covered period, or (2) with respect to perishable goods, pursuant to a contract, order, or purchase order *before or during* the covered period.
- "Covered worker protection expenditures"—defined as operating costs or capital expenditures incurred by a borrower, during the period beginning on March 1, 2020 and ending upon the expiration of the presidential national emergency declaration with respect to COVID-19, to facilitate adoption of business activities to comply with applicable laws and guidance relating to COVID-19. For example, this could include expenditures on drive-through improvements, ventilation or filtration systems, physical barriers, expansion of business space, establishment of health screening capabilities, or other assets as determined by the SBA in consultation with HHS and the Secretary of Labor, as well as personal protective equipment (PPE).
- To the extent there was doubt about whether group life, disability, vision, or dental insurance could be included as "payroll costs," the new legislation clarifies that these expenses are included and thus are eligible uses and qualify for loan forgiveness.

These changes to the list of expenses that qualify as permitted uses apply to both new and existing PPP loans, but do not apply to PPP loans that have already been forgiven.

Deductibility of Expenses Covered by a Forgiven PPP Loan or EIDL Advance

The CARES Act provided that the forgiveness of a PPP loan would not be included as taxable income to the borrower, thereby changing the normal rule that cancellation of indebtedness gives rise to taxable income. In May 2020, the Internal Revenue Service (IRS) took the position in Notice 2020-32 that business expenses paid for with a PPP loan that is forgiven would not qualify for tax deductions. The logic was that borrowers would get a duplicative benefit if they could both get a tax deduction for their expenses and pay for those expenses with a federal loan that was forgiven on a tax-free basis. Many borrowers criticized this position as changing the tax treatment contemplated by Congress under the CARES Act. More recently, in November, the IRS issued a revenue ruling reiterating its position that taxpayers cannot claim a deduction for any otherwise deductible expense if the payment of the expense results in forgiveness of a PPP loan. Among other things, this settled a question of what happens if the borrower does not receive a determination on loan forgiveness before filing their 2020 federal income tax return—providing that a taxpayer with a reasonable expectation of loan forgiveness at the end of 2020 should not be allowed to claim a deduction for the related expenses.

The new legislation affirms that no gross income must be included by a recipient of PPP loan forgiveness by reason of such forgiveness and overturns the IRS's position announced in the above-described Notice and Revenue Ruling, providing that "no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income [for forgiven PPP loans]." Similarly, for partnerships and S corporations, forgiven PPP loans are to be treated as tax-exempt income. The legislation clarifies that any increase in a partner's outside basis in a tax partnership by reason of a forgiven PPP loan being treated as tax-exempt income shall be equal to that partner's distributive share of the deductions resulting from costs giving rise to PPP loan forgiveness. These provisions in the new legislation apply to taxable years ending after the date of the enactment of the CARES Act (March 27, 2020), and thus are expected to apply to all PPP loans, regardless of whether the loan was received prior to, or after, passage of the new legislation.

In addition, the new legislation clarifies that EIDL advances that are not required to be repaid similarly do not give rise to gross income or the denial of deductions for the recipients of such EIDL advances.

Simplified Loan Forgiveness for PPP Loans of $150,000 or Less

The legislation also provides for a streamlined loan forgiveness process for loans of $150,000 or less. Based on SBA data, loans of $150,000 or less represented 87.4% of the number of PPP loans, or 28.2% of the aggregate value of PPP loans, made through August 8, 2020.

Specifically, the legislation provides for automatic forgiveness if the borrower (i) signs and submits to the SBA lender a certification, to be established by the SBA not later than 24 days after the enactment of the new legislation, which (1) shall not be more than 1 page in length; (2) shall only require the borrower to provide (a) a description of the number of employees the eligible recipient was able to retain because of the covered loan, (b) the estimated amount of the covered loan amount spent by the eligible recipient on payroll costs, and (c) the total loan value; (ii) provides certifications as to complying with PPP loan requirements; and (iii) retains records that prove compliance for four years, as to employment records, or three years, as to all other records. This forgiveness process is much simpler than what existed prior to the new legislation, in that it eliminates the need for borrowers of $150,000 or less to submit supporting documentation to validate their claim for forgiveness, other than documentation to substantiate the borrower's revenue loss required to make them eligible for the PPP loan.

Reduced Document Retention Requirements for Loans Under $150,000

Unlike larger loans that require borrowers to retain relevant supporting documentation for six years, for loans of up to $150,000, borrowers will only be required to retain applicable documents for four years, as to employment records, or three years as to other records. These changes are retroactive to the passage of the CARES Act.

Oversight of SBA Audits

A source of frustration for many PPP borrowers has been the opaque nature of the SBA's rulemaking and review process, including as to whether borrowers properly made the so-called "necessity" certification in their PPP loan application. The new legislation directs the SBA to provide to Congress audit plans detailing (1) the policies and procedures of the SBA for conducting forgiveness reviews and audits of PPP loans and (2) the metrics that the SBA will use to determine which PPP loans will be audited. The SBA will then have to submit monthly reports on its forgiveness review activities, including the number of active reviews and audits, the number of reviews and audits that have been ongoing for more than 60 days, and any substantial changes made to the audit plan the SBA previously submitted to Congress. The SBA has 45 days to submit these audit plans, meaning the audit plans may be submitted by the Biden administration.

Next Steps

The latest legislation represents a critical first step for PPP lending to begin anew, but this legislation remains subject to enactment by the president and implementation by the SBA and other applicable regulators. The implementation process will undoubtedly provide further clarifications and could potentially create new hurdles for PPP borrowers. It is important to continue to monitor these developments as they unfold if you are looking to obtain a new or "second draw" PPP loan. SBA lenders will be responding to these developments in real time as well, and their internal requirements and process for reopening for PPP loans may vary. Accordingly, staying in contact with your SBA lender may help ensure you receive updates as this process unfolds. Perkins Coie is also available to assist as needed.

Authors

Joe Bailey

Partner
JoeBailey@perkinscoie.com 503.727.2173

Teri A. Lindquist

Partner
TLindquist@perkinscoie.com 312.324.8547

Eric Ashcroft

Counsel
EAshcroft@perkinscoie.com 206.359.3214

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