New Law Makes PPP Loans More Widely Available and Easier to Have Forgiven

Additional Relief Available in the Form of Second Draw Loans for Some Borrowers

Businesses and certain individuals will be able to seek new Paycheck Protection Program ("PPP") loans, including, for certain small businesses, a second PPP loan, when PPP lender portals open on Wednesday, January 13, 2021, for a limited number of applicants. At first, the new loans will be available only to certain borrowers, and only with certain smaller community financial institutions, but the loan portals should be available to all qualifying businesses and from all participating lenders shortly thereafter.

The new borrowings are made possible by changes to federal law brought about as part of the federal Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (the "New Law") passed on December 27, 2020 as part of the Consolidated Appropriations Act, 2021.

The New Law makes important changes to the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), the Paycheck Protection Program and Health Care Enhancement Act, the Paycheck Protection Program Flexibility Act and applicable federal regulations and interpretive guidance issued by the SBA and Treasury.

Highlights include the reopening of the PPP, adding Second Draw PPP Loans, clarification that expenses covered by a PPP Loan are deductible by the borrower, simplified "one page" forgiveness affecting 75% of all borrowers, additional categories of covered expenses that may be paid with PPP Loan proceeds, and $284.5 billion in new funding.

In addition, restaurants and hospitality firms which received only about 10% of existing PPP funding, may borrow up to 3.5 times their monthly payroll in Second Draw PPP Loans, as opposed to the 2.5 times payroll limit applicable to the initial round of PPP Loans, which continues to apply to all other borrowers.

First Draw Changes

The reopened PPP allows small businesses to apply for their first PPP Loans, largely under the program's original rules, including a $10 million loan limit and a size limit of 500 employees for most industries. At least 60% of the loan proceeds must be spent on covered payroll expenses, while up to 40% of loan proceeds can be used on specified business expenses such as interest on mortgages, rent and utilities.

One of the most important changes for all borrowers is the expansion of covered costs eligible for PPP Loan use and forgiveness. Payroll costs, once thought to include only the employer portion of employee medical insurance, have now been "clarified" to include other employer-provided group insurance benefits such as group life, disability, vision, or dental insurance. In addition, non-payroll costs that may be paid and forgiven with up to 40% of a PPP Loan have been expanded to include new categories, as detailed below. The expansion of covered costs apply to all PPP Loans as long as the borrower has not previously applied for and received loan forgiveness.

Specifically, the New Law now allows borrowers to spend PPP funds on these additional (and now forgivable) items:

- Covered operations expenditures. These may include payment for software, cloud computing, product or service delivery, processing, payment, or tracking of payroll expenses, human resources, sales and billing functions, or accounting or tracking of supplies, inventory, records and expenses, and other human resources and accounting expenses incurred during the covered period, including additional expenses required to support remote workers.
- Covered property damage costs. Costs related to property damage or vandalism not covered by insurance and related to public disturbances during 2020.
- Covered supplier costs. Expenditures to a supplier under an agreement in effect before the loan date and that are essential to the recipient's operations, together with costs of perishable goods supply made before or during the term of the loan.
- Covered worker protection expenditures. Personal protective equipment and adaptive investments to help a loan recipient comply with federal health and safety guidelines or any equivalent state and local guidance related to COVID-19 are also covered. This may include physical modifications to the business' premises, including the installation of protective screens, air filtration systems and physical barriers, expanded indoor or outdoor operating space, including increased outdoor dining areas for restaurants, onsite or offsite health screening and drive-through or curbside pickup facilities constructed because of the pandemic.

Borrowers with loans under the first round of PPP are eligible to use the expanded allowable expenses in their application for forgiveness of the loan, except for borrowers that have already had their loans forgiven.

Finally, the New Law requires the SBA to promulgate a simplified one-page forgiveness application process for loans of $150,000 or less. Specifically, a borrower would receive forgiveness if the borrower submits to the lender a certification that describes the number of employees the borrower retained because of the loan, the estimated total amount of the loan spent on payroll costs, and the total loan amount. The borrower must also attest that it accurately provided the required certification and complied with PPP loan requirements. The SBA must publish this form by Wednesday, January 20, 2021.

Neither the lender nor the SBA may require additional materials from the borrower unless necessary to substantiate revenue loss requirements or satisfy relevant legal requirements. Borrowers must retain records related to employment for four years and other records for three years, as the SBA may review and audit these loans to check for fraud. The simplified process will apply to loans made before, on, or after enactment of the New Law.

Because these changes may cause some existing PPP borrowers to be eligible for a larger PPP Loan or larger forgivable amount, a borrower that has not yet received forgiveness may reapply for a PPP Loan if the borrower previously returned some or all of an initial PPP Loan. Under certain circumstances, the borrower may request modification of an original PPP Loan amount if the borrower did not accept the full amount the borrower was eligible to receive.

The New Law does not clearly address, however, whether a borrower that has already filed its loan forgiveness application and is awaiting a forgiveness determination by the SBA may refile its application to take advantage of additional expenses now eligible for loan forgiveness.

Second Draw Loans

For certain small businesses , the New Law creates an opportunity for a second forgivable PPP Loan. A “PPP Second Draw Loan” is targeted at smaller and harder-hit businesses, with a maximum loan amount of $2 million (as compared to $10 million in the first round). To qualify for a Second Draw Loan, an eligible borrower must:

- Employ not over 300 employees (regardless of industrial classification, as previous exceptions do not apply);
- Have used or will use its full original PPP Loan; and
- Demonstrate at least a 25 percent reduction in gross receipts in any quarter of 2020 relative to the same quarter in 2019. According to regulations promulgated in early January 2021 by the Treasury, a borrower in operation in all four quarters of 2019 is deemed to have experienced the required revenue reduction if it experienced a reduction in annual receipts of 25 percent or greater in 2020 compared to 2019 and the borrower submits copies of its annual tax forms substantiating the revenue decline. This latter measurement is intended to make it easier for some borrowers to prove their revenue loss.

Borrowers may generally receive a Second Draw Loan for up to 2.5 times their monthly payroll costs, but borrowers with NAICS codes starting with 72 (hospitality and restaurants) can get up to 3.5 times their average monthly payroll costs, in each case subject to the $2 million maximum loan amount. Hospitality and restaurant businesses with multiple locations may employ up to 300 employees per physical location. The waiver of affiliation rules that applied during initial PPP Loans applies to these NAICS code 72 Second Draw Loans; however, an eligible entity may receive only one PPP Second Draw Loan.

Entities eligible for PPP Loans, including for-profit organizations, certain non-profit organizations, housing cooperatives, veterans’ organizations, tribal businesses, self-employed individuals, sole proprietors, independent contractors, and small agricultural co-operatives, remain generally the same as in the first round, with a few specific additions, such as news organizations, housing cooperatives, certain 501(c)(6) organizations, including chambers of commerce and trade groups, and certain destination marketing organizations, such as tourists boards.

More important, perhaps, are those businesses now ineligible for a PPP Loan under the New Law:

- Businesses or organizations not in operation on February 15, 2020;
- Businesses generally not eligible for SBA loans, other than (i) non-profit businesses and (ii) businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting;
- Publicly-traded companies;
- Any business concern or entity primarily engaged in political or lobbying activities, which includes any entity organized for research or for engaging in advocacy in areas such as public policy or political strategy or otherwise describes itself as a think tank in any public documents;
- 501(c)(6) organizations that constitute professional sports leagues and entities with the purpose of promoting or participating in a political campaign or other lobbying activities;
- Any business concern of which 20% of its economic interests is (i) owned by an entity either created in or organized under the laws of the People’s Republic of China or Hong Kong or that has “significant operations” in the PRC or Hong Kong, or (ii) any business concern with a board member who is a resident of the PRC; and
- Any recipient of a “Shuttered Venue Operators” grant as established by the New Law.

Waivers of affiliation rules that applied during initial PPP Loans also apply to a Second Draw Loan.

Finally, small businesses temporarily closed or suspended are eligible for a Second Draw PPP Loan, but businesses permanently closed are not. The difference between the two may come down to a borrower certification.

Tax Changes

Prior to enactment of the New Law, the IRS had taken the position that otherwise deductible business expenses that had been paid with proceeds of a forgiven PPP Loan were not deductible. For some borrowers, this loss of tax deductions negated some or all of the benefits of the PPP Loan.

The New Law explicitly provides that expenses paid with proceeds of a forgiven PPP Loan are deductible, legislatively overruling the IRS position. The New Law goes further, expressly providing that no tax benefit shall be denied, and no loss carryovers or basis adjustment will be required, as a result of the tax-free forgiveness of a PPP Loan. As a result, the IRS may not take the position that a company must reduce loss carryovers or the basis of its assets by the amount of the forgiven PPP Loan. For pass-through entities, the amount of the forgiven PPP Loan will be treated as tax-exempt income received by the entity.

Important changes were also made to the employee retention tax credit and its interaction with PPP Loans. The employee retention credit is available now to PPP Loan recipients, though only for wages paid with non-PPP Loan funds. A business wishing to maximize its employee retention credit may benefit from using PPP Loan proceeds to pay the minimum amount of wages required for loan forgiveness, and using non-PPP Loan funds to pay as much of other eligible expenditures allowed with PPP Loan funds. For this reason, employers should consider keeping PPP Loan proceeds in a segregated account to prove only wages not eligible for the credit were paid from the loan proceeds account.

The change in the law allowing a PPP borrower (and its related companies) to claim the employee retention credit is retroactive to the effective date of the CARES Act. Consequently, a PPP borrower should be eligible to file amended payroll tax returns to claim the credit for wages that were not paid with a forgiven PPP Loan, assuming the credit requirements were otherwise satisfied. The same is true for companies related to a PPP borrower which did not file a refund claim because of the prior rule.

Other Provisions

As part of a more than 5,500 page appropriations act, the New Law makes various other notable changes to the PPP:

- $20 billion in additional funding is provided for the Economic Injury Disaster Loan (“EIDL”) program. Emergency EIDL grants may now be made through December 31, 2021. The New Law clarifies that EIDL grants are not taxable, and, in an important change, there is no reduction to any PPP Loan forgiveness for borrowers receiving both an EIDL grant and a PPP Loan. It is not clear how this change will be applied to borrowers that have already received PPP Loan forgiveness with a deduction for EIDL grants.
- The New Law amends Sections 364, 503(b), 1191, 1225, 1325 of the Bankruptcy Code to enable a debtor-in-possession or trustee authorized to operate the business of a debtor to apply for and receive a PPP Loan. Any such PPP Loan is to be treated as debt to the extent such loan is not forgiven. The PPP Loan is entitled to priority as an administrative expense. A plan of reorganization will be confirmable if it proposes that the debtor make payments on the PPP Loan as required.

- In a nod to media reports of important political officials and their families receiving PPP Loans, the President, Vice President, the head of an Executive department, or a Member of Congress as well as their spouse must disclose that they have received a PPP Loan when the Loan is forgiven or 30 days thereafter. Such covered individuals may not receive a PPP loan in the future.
- The New Law authorizes the SBA to make $15 billion in "Shuttered Venue Operator" grants to eligible live venue operators or promoters, theatrical producers, live performing arts organization operators, museum operators, motion picture theatre operators, or talent representatives who demonstrate a 25 percent reduction in revenues.

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