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BANKING & FINANCE LAW ALERT

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Better late than never? COVID-19 appropriations package addresses key issues in Paycheck Protection Program redux

On Dec. 20, 2020, U.S. Congress authorized a second wave of COVID-19 relief by way of a second significant stimulus package. The bill was in limbo until it was finally signed into law a week later. The 5,593-page bill features enhanced unemployment payments and direct cash payments to Americans nationwide, and it also makes several adjustments to the Paycheck Protection Program (PPP).

The most encouraging news for small business owners is that the PPP is reopening to those hardest-hit, giving some small businesses the ability to apply for a second PPP loan. The Small Business Administration (SBA), the agency charged with running the PPP program, originally stopped accepting PPP loan applications on Aug. 8, 2020. Under the "second draw" of PPP, eligible small businesses that have already received a PPP loan in the first round of funding may apply for a second loan if they have used, or plan to expend, all of the loan proceeds from their first loan. Additionally, businesses that never obtained a PPP loan during the term of the original program can apply for their first loan under the same terms and conditions as the original program.

Borrowers must apply for PPP draws by March 31, 2021. It is not clear whether some PPP lenders in round one will participate in this new program. SBA fees are waived for both borrowers and lenders, and payments of principal and interest can be deferred.

The changes authorized by Congress bring many borrowers a bit of relief. Simplification of forgiveness applications for small loans and expanded eligibility for forgivable expenses are two of the most notable changes in the bill. Generally, second draw PPP loans will work the same as the first round of PPP; however, there are some notable differences as discussed below. Other primary changes made by the bill are as follows:

Deductibility of expenses paid

Since the Internal Revenue Service (IRS) reaffirmed in Notice 2020-32 that borrowers would not be able to deduct expenses paid using forgiven PPP funds, borrowers and tax professionals alike have been looking for ways to shelter struggling businesses from what would otherwise be an unexpected tax bill. Thankfully, Congress specifically overruled the IRS on this issue. Deductions of expenses paid with PPP-forgiven funds will be permitted, which can be applied to all borrowers, even those who have already applied for or received PPP forgiveness.

Eligibility for the second draw of PPP

In general, businesses were eligible for the first round of PPP if they had under 500 employees. Businesses also had to make certain certifications. The issue that received the most attention was the borrower's good-faith certification of its need for a loan given the economic uncertainty that existed at the time of application. In previous guidance from the government, borrowers with PPP loans of less than $2 million were told that they would not be challenged to prove economic necessity.

Under the second round of the PPP, borrowers must have 300 or fewer employees per location. Instead of having to make the good-faith economic necessity certification described above, borrowers will have to certify that they lost significant revenue during 2020. Specifically, in order to be eligible for a second draw, a borrower will have to show that it had a loss of revenue (exclusive of PPP funding) of at least 25 percent in one of their first three quarters in 2020 as compared to that same quarter in 2019. For newer businesses that were formed after the first three quarters of 2019, there are alternative calculations to determine eligibility.

As with the first round of funding, certain businesses are ineligible, regardless of size, if they are otherwise ineligible for SBA funding under 13 C.F.R. §120.110 (certain nonprofits, religious organizations, certain financial institutions, foreign businesses, businesses engaged in gambling or illegal activities, private clubs, etc.). However, the bill complicates the eligibility rules by expanding eligibility for housing cooperatives, news organizations, Section 501(c)(6) organizations and Economic Injury Disaster Loan (EIDL) recipients. In addition to these rules, businesses are ineligible for second draws if they are:

- An entity engaged in public policy or advocacy or that otherwise describes itself as a "think tank," subject to certain exceptions;
- Any entity primarily engaged in political or lobbying activities;
- Certain entities affiliated with the People's Republic of China, the Special Administrative Region of Hong Kong, or that retain as a

member of their board of directors a person who is a resident of the People's Republic of China.

Calculations of loan amount

While the maximum loan available under the first PPP program was $10 million, the maximum loan amount available under the second round will be limited to $2 million. As before, the loan amount is determined based on a borrower's payroll. The calculation of monthly payroll costs is still the same as the first round: a borrower's PPP loan is equal to its average monthly payroll costs in 2019 multiplied by 2.5. However, the second round of PPP loans provides businesses in the restaurant industry with a larger loan amount. If a business can be categorized in the restaurant industry (meaning it has a North American Industry Classification System code that begins with "72"), then it can calculate its loan amount by taking its average monthly payroll costs multiplied by 3.5.

Expanded eligibility for expenses

Pursuant to the SBA's Interim Final Rules for the first round of PPP lending, expenses eligible for forgiveness include payroll, rent, utilities and mortgage interest payments. Borrower complaints regarding the narrowly-defined categories have been numerous, as borrowers have struggled to maintain pre-COVID-19 employment levels. Congress heard those cries and has expanded the forgiveness-eligible expenses to include:

- Operational expenses (software, cloud computing, human resources, accounting);
- Property damage not covered by insurance;
- Contractual supplier costs which were in effect prior to taking the PPP loan and which were essential to the recipient's operations at the time the expenditures were made;
- Personal protective equipment expenditures and other adaptive investments to help the business comply with federal, state or local health and safety guidelines between March 1, 2020 and the end of the national emergency declaration (for example, physical barriers, air ventilation or filtration systems, etc.).

The expanded list of eligible expenses applies to all PPP borrowers, regardless of when they received their loan proceeds, except for those borrowers which have already applied for forgiveness.

The legislation also clarifies that other employer-provided group insurance benefits are included as "payroll costs." This includes group life, disability, vision and dental insurance premiums.

Covered period changes

Prior to the bill, the only options for a borrower's "covered period" for calculating "eligible expenses" were eight or 24 weeks, beginning on the date of loan origination. Following passage of the bill, however, borrowers have the right to elect any period of time, between eight and 24 weeks in length, which begins on the date of origination and ends on the last day of the 24th week. For example, one borrower may elect a nine-week period, while another borrower may elect a 17-week period. This allows borrowers added flexibility in ensuring that the covered period ends when PPP funds are completely spent.

Increases in loan amounts

Due to differing and sometimes confusing regulations, guidance, interim final rules and FAQ responses from the SBA over the past year, a number of PPP borrowers rejected or returned all or a portion of their requested PPP loan out of fear of repercussions for keeping or using the loan proceeds. Congress has directed the SBA administrator to release guidance on how these borrowers can reapply or request the maximum amount applicable, based on current regulations, as long as the borrower has not received forgiveness.

Forgiveness

Like the first round of PPP funding, second draw PPP loans retain the benefit of potential forgiveness. The second draw loans are forgivable subject to the same limitations under the original PPP program, including the requirement that borrowers spend at least 60 percent of the loan on payroll costs to obtain full forgiveness. Still up in the air is when banks will allow borrowers to apply for forgiveness of the new loans.

Simplified forgiveness application for loans under $150,000

After much debate about creating a simplified way of applying for forgiveness, Congress has finally streamlined the forgiveness process for PPP loans of less than $150,000 (both existing loans and round two loans). Qualifying borrowers may submit a one-page form, either online or in paper, which will only be subject to an audit if the SBA is notified of an allegation of fraud or use of proceeds for an improper purpose.

It is yet to be seen, but qualifying borrowers may not be required to substantiate their forgiveness applications with additional records, except those to support revenue loss requirements or other relevant statutory and regulatory requirements. Borrowers should continue to document the certifications originally made on their loan applications, and they are still required to maintain relevant records for four years following PPP loan forgiveness. The bill requires the SBA to report to Congress by mid-February on audit policies and procedures, so hopefully the SBA will have produced additional guidance on how audits will be conducted prior to that report.

Seasonal employers

Given the extended nature of the pandemic, Congress has re-defined the term “seasonal employer” to include an employer which: (1) operates for no more than seven months in a year, or (2) earned no more than 1/3 of its receipts in any six months in the prior calendar year.

The bill also provides seasonal employers with flexibility in choosing any 12-week seasonal period which begins and ends between Feb. 15, 2019 and Feb. 15, 2020.

Farmers and ranchers

Farmers and ranch operators will be pleased to know that new loan calculations were announced for those who operate as a sole proprietor, independent contractor or self-employed individual, and who report income on Schedule F and were in business as of Feb. 15, 2020. Lenders are advised to recalculate loans that have been previously approved for these applicants, to see if it would entitle the applicants to a larger sum.

Farm Credit System Institutions are now specifically eligible to apply for loans under the PPP. Such eligibility is retroactive to loans made in Spring 2020.

Emergency Injury Disaster Loan (EIDL) grants

Congress decisively repealed the requirement that PPP borrowers deduct the amount of any EIDL advance from their PPP forgiveness amounts. It further has directed the SBA administrator to make borrowers whole if they previously received forgiveness with their EIDL grant being deducted from the forgiveness amount.

The bill extends the emergency EIDL coverage period through Dec. 31, 2021, while giving the SBA more flexibility in verifying grant applicant information and disbursement timelines. It also provides additional targeted funding for entities located in low-income communities through the EIDL Advance program from Section 1110 of the CARES Act. Eligible entities will be provided a $10,000 grant if they did not secure a grant during the first round of funding. Other qualified entities that did receive a partial grant during the first round of funding may be given an additional amount equal to the difference of what the entity received under the CARES Act and $10,000.

For more information please contact Jack Beeler, Cassandra Rice or any member of Porter Wright's Banking & Finance Group.