December 28, 2020

PPP Update: Latest COVID-19 Relief Legislation Includes Extension of Paycheck Protection Program and Establishes Second Draw Loans

On Sunday, December 27, 2020, the President signed into law the Consolidated Appropriations Act, 2021 (the "Act"). The Act is intended to provide additional assistance to individuals and businesses impacted by the COVID-19 pandemic.

Among other forms of relief, the Act makes available approximately $284.5 billion for loans under the Paycheck Protection Program ("PPP") as well as a new second draw loan program ("PPPSD"), which the Act creates to enable PPP borrowers who have exhausted their initial PPP loans to apply for a second loan.[1] The Act will be of particular interest to certain potential borrowers who were previously excluded from PPP eligibility, to borrowers who may be able to take advantage of the broader scope of permitted uses of PPP funds and permitted forgivable expenses, and to borrowers who have exhausted their initial loans and may be eligible for PPPSD loans. The Act directs the SBA to issue implementing regulations within 10 days of enactment of the Act.

Reopening of PPP

The initial term of the PPP expired on August 8, 2020 and the Act reinstates the PPP through March 31, 2021. The PPP will reopen generally on the same terms and conditions as it previously operated, subject to certain modifications set forth in the Act. This memorandum summarizes a number of key modifications set out in the Act.

1 Of the total appropriated amount, the Act also includes set-asides of at least: (i) $15 billion for loans made by community financial institutions; (ii) $15 billion for loans made by insured depository institutions, credit unions or institutions of the Farm Credit System with consolidated assets of less than $10 billion; (iii) $15 billion for PPP loans and $25 billion for PPPSD loans for eligible recipients with 10 or fewer employees, or in an amount not more than $250,000 and made to a recipient in a low-income or moderate-income neighborhood (as determined by the Community Reinvestment Act of 1977 (12 U.S.C. 2901 et seq.)); and (iv) $35 billion for first-time recipients of PPP loans.

- *Eligibility*[2]
  - *Newly Eligible Businesses* – In addition to businesses previously eligible to participate in the PPP, the following entities are now also eligible for PPP loans:
    - Debtors in possession or trustees, if approved by court order. PPP loans must be given superiority in the bankruptcy process in order for the debtor in possession or trustee to be an eligible borrower.
    - News organizations that either employ no more than 500 (300 for PPPSD loans) employees, or the applicable SBA size standard, per physical location or that are public college or university broadcasting stations under section 511 of the Internal Revenue Code, so long as these organizations certify that the loan will support locally focused or emergency content. Furthermore, affiliation rules are waived for (i) non-profit broadcasters and (ii) any business that is majority owned or controlled by a newspaper or broadcaster, as long as the business has no more than 500 (300 for PPPSD loans) employees, or the applicable SBA size standard, per physical location.
    - Housing cooperatives with no more than 300 employees.
    - 501(c)(6) organizations (other than professional sports leagues and organizations with the purpose of promoting or participating in political campaigns) and Destination Marketing Organizations registered as a 501(c) organization, quasi-governmental entities or political subdivisions of state or local government, in each case if:
      - the organization derives no more than 15% of its receipts from lobbying activity;
      - lobbying activities comprise no more than 15% of the organization's total activities;
      - the cost of lobbying activities did not exceed $1,000,000 during the most recent tax year that ended prior to February 15, 2020; and
      - the organization has 300 or fewer employees.
  - *Newly Ineligible Businesses* – In addition to previously ineligible businesses, ineligible entities now also include:
    - Publicly traded entities.

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2 The Act reiterates that an entity that was not in operation as of February 15, 2020 is not eligible for a PPP loan.

    - Entities receiving a grant under the Act's Shuttered Venue Operator Grants.[3]

- *Loan Amount Calculations*

  - Consistent with prior SBA guidance, the Act provides that payments required for the provision of group vision or dental insurance may be included in payroll costs, which in turn is used to determine the borrower's PPP loan amount. The Act further provides that payments required for the provision of group life or disability insurance may now also be included in payroll costs.

  - In addition, new loan amount calculations for specific types of borrowers have been developed with the goal of more accurately addressing such borrowers' particular needs:

    - Farmers and ranchers who operate as sole proprietors, independent contractors or self-employed individuals and who report income and expenses on a Schedule F may use their gross income in 2019 as reported on Schedule F. Lenders may (i) recalculate the maximum loan amounts applicable to loans that were previously made to these entities, if such calculation would result in a larger loan, and (ii) lend to the entity with any additional loan amount derived from the recalculation.

    - Seasonal employers (i.e., entities that operate no more than seven months in any calendar year or earned no more than one-third of their gross receipts in any six months of the prior calendar year) may use their average total payments for payroll costs incurred or paid in any 12-week period between February 15, 2019 and February 15, 2020.

  - *Permitted Uses of Loan Proceeds* – In addition to currently permitted uses of PPP funds (e.g., payroll costs, mortgage interest payments, lease payments and utility payments), the Act provides for the following additional uses. These expanded uses are effective with respect to PPP loans made before or after the enactment of the Act, except for loans as to which the borrower received forgiveness before such enactment.

    - Covered operations expenditures – payments for business software or cloud computing services that facilitate business operations, product or service delivery, the processing, payment or tracking of payroll expenses, human resources, sales and billing functions or accounting or tracking of supplies, inventory, records and expenses.

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3 This program has been funded with $15 billion to provide grants to theaters and other venues and cultural institutions as part of the Save Our Stages Act portion of the Act.

- Covered property damage costs – costs related to property damage, vandalism or looting due to public disturbances during 2020 that were not covered by insurance or otherwise compensated.

- Covered supplier costs – expenditures for goods (i) essential to operations at the time the expenditure is made and (ii) made pursuant to a contract, order or purchase order (x) in effect before the date of the PPP loan's disbursement or (y) with respect to perishable goods, in effect during the borrower's forgiveness covered period.[4]

- Covered worker protection expenditures – certain operating or capital expenditures required to meet worker or customer safety requirements or guidance related to COVID-19 issued by the Department of Health and Human Services, the Centers for Disease Control, the Occupational Safety and Health Administration, or any equivalent state or local requirements implemented between March 1, 2020 and the date the COVID-19 national emergency is lifted, for example, the purchase or renovation of drive-through windows, ventilation or filtration systems, or the expansion of physical space.

- *Prohibited Uses of Loan Proceeds* – PPP loans may not be used for lobbying activities, lobbying expenditures related to state or local campaigns or expenditures to influence the enactment of legislation, appropriations, regulation or administrative action.

- *Loan Forgiveness* – In general, the same terms and conditions for loan forgiveness apply, with the following notable changes:

  - *Additional Forgivable Expenses* – Consistent with the new categories of permitted uses of loan proceeds, covered operations expenditures, covered property damage costs, covered supplier costs and covered worker protection expenditures are also eligible for forgiveness. This change is effective with respect to PPP loans made before or after the enactment of the Act, except for loans as to which the borrower received forgiveness before such enactment.

  - *Simplified Forgiveness Application* – For loans of less than $150,000, a borrower need only submit a one-page certification that includes a description of the number of employees the borrower retained because of the loan, the estimated total amount of the loan spent on payroll and the total loan amount. Further, the borrower must attest that the borrower accurately provided the required certification, complied with PPP requirements and retains records that prove such compliance. Such borrowers are no longer required to submit any supporting documentation evidencing their use of loan proceeds in the first instance. Furthermore, the Act

[4] The forgiveness covered period is the period beginning on the date of the origination of the PPP loan and ending on a date selected by the recipient of the PPP loan that occurs between eight and 24 weeks after the date of origination.

provides that this simplified forgiveness application process also applies to PPP loans that were made before the enactment of the Act.

- *Repeal of EIDL Advance Deductions* – Repeals section 1110(e)(6) of the CARES Act, which reduced the borrower's PPP loan forgiveness amount by the amount of any EIDL advance the borrower received. The Act provides that the repeal shall be effective as if included in the CARES Act.

- *Clarification of Tax Treatment* – Clarifies that a borrower does not include any cancellation of indebtedness income as a result of PPP or PPPSD loan forgiveness and that such exclusion does not result in the denial of any tax deduction or tax basis increase nor in the reduction of any other tax attribute. For partnerships and S corporations, any amount excluded from income will be treated as tax exempt income for the purposes of sections 705 and 1366 of the Internal Revenue Code and, except as provided by the Treasury Secretary, any increase in the adjusted basis of a partner's interest under section 705 shall equal the partner's distributive share of deductions resulting from costs giving rise to loan forgiveness. With respect to PPP loans, the clarification applies to taxable years ending after the enactment of the CARES Act.

- *Other Changes*

  - *Returned Loans* – If a borrower has returned amounts of a disbursed PPP loan or has not accepted the full approved loan amount, such borrower may reapply for a PPP loan or apply for a loan amount increase up to the maximum loan amount, as applicable, so long as the borrower has not yet received forgiveness as of December 27, 2020. The Act requires the SBA to issue guidance on this topic within 17 days of enactment of the Act.

  - *Loan Amount Increases* – The Act provides that, notwithstanding the SBA's interim final rule dated May 19, 2020,[5] borrowers who are eligible for an increase in PPP loan amount as a result of an interim final rule may submit a request for such an increase even if the initial amount has been fully disbursed.

Paycheck Protection Program Second Draw Loans

In order to provide relief to the hardest hit businesses, the Act creates a new program for second draw loans, which will be available to PPP borrowers that have exhausted their original PPP loans. PPPSD loans

5 Interim Final Rule on Business Loan Program Temporary Changes; Paycheck Protection Program – Loan Increases, 85 FR 29842, Doc. No. 2020-10658.

generally operate on the same terms and conditions as PPP loans, subject to some exceptions. PPPSD loans will be available until March 31, 2021. The key aspects of the program are summarized here.

- *Eligibility Requirements* – PPPSD loans may only be made to PPP borrowers who (i) have used (prior to origination of the PPPSD loan) all proceeds of their PPP loan and (ii) satisfy the following additional criteria:

  - Employ no more than 300 employees. However, similar to the PPP, entities in industries assigned to NAICS code 72 (including hotels and restaurants) and with more than one physical location are subject to a limit of no more than 300 employees *at each physical location*.

  - Demonstrate at least a 25% reduction in gross receipts in the first, second or third quarter of 2020 relative to the same quarter in 2019. These timelines may vary if a business was not in operation during some of 2019 or if the business submits its PPPSD application after January 1, 2021.

- *Ineligible Entities* – The following entities are ineligible to receive PPPSD loans:

  - Entities that fall under the various ineligible business types described in 13 CFR 120.110 (or any successor regulation or guidance), except for non-profits and entities principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs.

  - Entities primarily involved in political and lobbying activities, "which shall include any entity that is 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."

  - Any business (i) of which at least 20% of its economic interest is owned either directly or indirectly by an entity created or organized in China or Hong Kong or that has "significant operations" in China or Hong Kong or (ii) that retains a resident of China as a member of its board of directors.

  - Registrants under the Foreign Agents Registration Act.

  - Entities that receive a Shuttered Venue Operator Grant.

- *Loan Amount Calculations* – Like in the PPP, PPPSD borrowers may receive a loan of up to 2.5 times their average monthly payment for payroll costs, up to a maximum of $2,000,000**.** However, entities in industries assigned to NAICS code 72 (including hotels and restaurants) may receive up to 3.5 times their average monthly payment for payroll costs, also up to a maximum of $2,000,000.

- *Loan Forgiveness* – In general, entities are eligible for forgiveness of PPPSD loans on substantially the same terms as PPP loans (as modified by the Act). However, the PPPSD forgiveness amount is capped at the quotient of (i) the amount of the PPPSD loan used for payroll costs during the forgiveness covered period divided by (ii) 0.60.

Lender Considerations

Under the Act, any lender permitted to make PPP loans is also permitted to make PPPSD loans. The Act also enhances the hold harmless protections that apply to lenders, and this enhancement applies to PPP loans made prior to and after the Act's enactment.

Under this new hold harmless provision, a lender may rely on any certification or documentation submitted by an applicant or eligible recipient that (i) is submitted pursuant to all applicable statutory requirements, regulations and guidance related to PPP or PPPSD loans and (ii) attests that the applicant or eligible recipient has accurately provided the certification or documentation in accordance with such requirements, regulations and guidance.

The Act further provides that, to the extent that a lender relies on such certification or documentation, no enforcement action may be taken against the lender and the lender shall not be subject to "any penalties" relating to loan origination or forgiveness, as long as the lender acts in "good faith" and complies with all federal, state, local and other statutory and regulatory requirements applicable to the lender with respect to the loan.

Audit Plans

Within 45 days of the enactment of the Act, the SBA is required to present to the House of Representatives an audit plan that details policies and procedures for conducting forgiveness reviews and audits of covered loans and the metrics to be used in its audits. The Act requires the SBA to provide the House with monthly status reports about its audits and reviews commencing after submitting the audit plan.

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We will continue to monitor developments in this space.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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