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Paycheck Protection Program Part Two: What Small Business Owners and Non-Profit Organizations Need to Know

On December 27, 2020, the President signed into law the Consolidated Appropriations Act, 2021 (H.R. 133) (the "CAA"), which includes the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act (the "Act").[1] The Act amends and expands the Paycheck Protection Program (the "PPP") under the CARES Act and the Small Business Act, providing for an additional $284.45 billion of loans under the PPP ("PPP loans") for small businesses and non-profit organizations due to the lengthening of the anticipated road to recovery from the pandemic and its economic consequences. The Act creates a facility for second draw PPP loans, provides for additional categories of eligible expenses that may be covered by PPP loan proceeds, makes certain other changes to facilitate forgiveness of PPP loans and resolves some limitations that PPP loan borrowers were facing. The Act and other sections of the CAA also include certain favorable U.S. federal tax provisions relating to the receipt of a PPP Loan.

I. Second Draw Loans

1. Eligibility

Second draw loans are available until March 31, 2021 for any business concern, non-profit organization, housing cooperative, veterans organization, Tribal business concern, eligible self-employed individual, sole proprietor, independent contractor, or small agricultural cooperative that received a first draw PPP loan and that employs 300 people or less.[2] If a business has more than one physical location, the business may not have more than 300 employees at any one location. In calculating the number of its employees, a business must generally include the employees of any of its affiliates, as determined under the SBA's rules. The circumstances under which the affiliation rules may be waived remain the same as under prior law. Applicants that previously received loans under the PPP are eligible for a second draw PPP

[1] The text of the Act can be found here. The Act amends and is inserted into Section 7(a)(36) of the Small Business Act (15 U.S.C. 636) (the "Small Business Act"), as amended by the Coronavirus Aid, Relief, and Economic Security Act (H.R. 748) (the "CARES Act").

[2] Note that this is less than the PPP's requirement of 500 employees or less. The Small Business Administration (the "SBA") has determined that businesses in certain industries with more than 300 employees may also qualify for a loan under the PPP if they do not exceed the employee size standards listed in the table found here.

loan if they have used or will use the full amount of the first PPP loan before the second loan is disbursed. Eligible entities may receive only one second draw loan.

The applicant must also demonstrate a 25% or more reduction in gross receipts[3] between comparable quarters in 2019 and 2020. If the applicant was not in business in 2019, but was in business on February 15, 2020, then it will compare its gross receipts to those of the first quarter of 2020.

Certain entities are categorically excluded from obtaining a second draw PPP loan, regardless of the number of their employees or the amount of their gross receipts. Specifically, businesses that are not entitled to obtain an SBA loan, as listed in 13 CFR § 120.110,[4] except for (i) non-profits and (ii) businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, are ineligible for a PPP loan. The Act also excludes (a) any business primarily engaged in lobbying or political activities, (b) any business owned directly or indirectly at least 20% by an entity organized under the laws of, or that has significant operations in, the People's Republic of China or Hong Kong, (c) any business with a board member who is a resident of the People's Republic of China, (d) any person who is required to submit a registration statement under Section 2 of the Foreign Agents Registration Act of 1938, (e) any business that received a Shuttered Venue Operator grant under the CAA, and (f) any entity in which the President, the Vice President, the head of an Executive department, or a Member of Congress, or the spouse of such person, owns, controls or holds at least 20% of any class of equity.

The Act removes the requirement that the applicant has not received and does not have an application pending for a loan for the same purpose and that is duplicative of amounts received or applied for under the PPP or the Act. This means that applicants that applied for or received loans or grants, such as an Economic Injury Disaster Loan ("EIDL"), to be used for the same purpose, will still be eligible for a second draw loan under the PPP and may receive forgiveness. This requirement is also eliminated for borrowers that have not yet applied for forgiveness for loans previously received under the PPP. Loan forgiveness requirements and procedures for second draw loans are the same as for previous PPP loans.

2. Maximum Amount of Second Draw Loan

The maximum amount of a second draw PPP loan is 2.5x the average total monthly payment for payroll costs incurred or paid by the applicant during (i) the one-year period before the date on which the loan is made or (ii) the 2019 calendar year. The maximum loan amount for seasonal employers[5] is 2.5x the average total monthly payment for payroll costs incurred or paid

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[3] According to the second draw PPP loan application, "gross receipts" include all revenue in whatever form received or accrued (in accordance with the entity's accounting method) from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances. Generally, receipts are considered "total income" (or in the case of a sole proprietorship "gross income") plus "cost of goods sold" and exclude net capital gains or losses as these terms are defined and reported on Internal Revenue Service tax return forms. For a non-profit organization, veterans organization, non-profit news organization, 501(c)(6) organization, and destination marketing organization, gross receipts has the meaning found in Section 6033 of the Internal Revenue Code of 1986, as amended.

[4] The full list of ineligible businesses can be found on page 85 of the document linked here.

[5] The Act considers a "seasonal" employer to be one that does not operate for more than seven months in any calendar year or during the preceding calendar year and had gross receipts for any six months of that year that were not more than 33.33% of the gross receipts of the employer for the other six months of that year.

by the applicant during any 12-week period between February 15, 2019 and February 15, 2020. The maximum loan amount for entities that did not exist for the one-year period prior to February 15, 2020 is 2.5x the average total monthly payment for payroll costs incurred or paid by the applicant during any 12-week period between February 15, 2019 and February 15, 2020. For entities categorized under North American Industry Classification System code 27 (accommodation and food services), the maximum loan amount can be higher, using 3.5x the average total monthly payment for payroll costs incurred or paid by the applicant. Regardless of the above calculations, no second draw loans may exceed $2,000,000.

3. Applications for Second Draw PPP Loans

At least $25 billion of funds under the Act are set aside for second draw PPP loans to eligible borrowers in low- or moderate-income neighborhoods with a maximum of 10 employees or for loans up to $250,000. The SBA began accepting applications for second draw PPP loans on January 13, 2021 from community financial institutions, and will shortly begin accepting applications from all participating lenders. The SBA added to its website a free online tool to connect small businesses with lenders, which can be found here. The application form for second draw PPP loans is now available and may be found here.

II. Additional Eligibile Expenses

Prior to the enactment of the Act, borrowers were required to use loan proceeds only for payroll costs, utilities, rent payments, and interest on existing debt and mortgages. Borrowers are still required to use at least 60% of the proceeds to cover payroll costs, but the other 40% may be used to cover additional qualified expenses. The Act expands the definition of payroll costs to include certain additional insurance payments, such as for group life insurance. The Act also adds four new categories of expenses that may be covered using PPP loan proceeds: covered operation expenditures, property damage costs, supplier costs, and expenditures related to worker protection. The Act makes clear that these categories of expenses may be considered allowable expenses for all PPP loans not yet forgiven.

Covered operation expenditures include 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.

Covered property damage includes costs related to property damage and vandalism or looting due to public disturbances in 2020 that were not otherwise covered by insurance or other compensation.

Covered supplier costs are expenditures made by the borrower to a supplier for the supply of goods that are essential to the borrower's operations at the time the expenditure is made, and are made pursuant to a contract or purchase order that existed prior to the covered period for loan forgiveness or, for perishable goods, any time during that period.

Covered worker expenditures include costs incurred to comply with customer or worker safety requirements or guidance issued by the Department of Health, the Centers for Disease Control, the Occupational Safety and Health Administration or any equivalent requirements issued by a state or local government beginning March 1, 2020. These costs may include ventilation and filtration systems, drive-through facilities, physical barriers, expansion of outdoor and indoor spaces, health screening and personal protective equipment.

One change in the Act seems to narrow the expenses allowed prior to the Act. "Lease" payments were allowable expenses under the PPP. According to the original loan forgiveness application, those lease payments included payments for the use of both real and personal property. The Act replaces "covered lease obligations" with "covered rent obligations." The impact of this wording change on lease obligations in connection with personal property is unclear, but may be clarified in future guidance from the SBA.

III. Additional Changes to the PPP

1. Supplemental First Draw PPP Loans

Borrowers that previously received a loan under the PPP but have not yet received forgiveness of the loan may request an increase in the amount of the loan in certain circumstances. If the borrower returned all or part of the covered loan, the borrower may reapply for the loan amount returned. If the borrower did not accept the full amount granted, the borrower may request a modification to receive the difference between the amount initially granted and the amount accepted. Additional guidance on this topic is expected in mid-January.

The Act also expands the categories of entities that are eligible for loans under the PPP. Local newspapers, television stations, radio stations and certain 501(c)(6) entities may now be eligible for loans under the PPP under certain circumstances. Entities in which the President, the Vice President, the head of an Executive department, or a Member of Congress, or the spouse of such person, owns, controls or holds at least 20% of any class of equity are explicitly excluded. Additionally, the Act establishes a procedure in the bankruptcy process if the administrator determines that certain small business debtors in Chapter 11 are eligible for a PPP loan. Entities that are newly eligible for a PPP loan may apply for a first draw PPP loan.

At least $15 billion of funds under the Act are set aside for first draw PPP loans to eligible borrowers in low- or moderate-income neighborhoods with a maximum of 10 employees or for loans up to $250,000. The application form for a first draw PPP loan may be found here.

2. Covered Period for Loan Forgiveness

The Act modifies the covered period for which borrowers may be eligible for loan forgiveness. Borrowers that received a PPP loan may be eligible for loan forgiveness for allowable expenses made or incurred during a period that begins on the date of the loan origination and ends on a date selected by the borrower that occurs during a specified period. The specified period is the period that begins on the date that is 8 weeks after the date of the loan origination and ends on the date that is 24 weeks after the date of the loan origination. This change allows borrowers to choose the covered period that makes the most sense for them given how they expect to spend the loan proceeds.

3. Simplified Applications for Loans and Forgiveness

Applicants seeking loans of $150,000 or less may submit a certification attesting that they meet the applicable revenue loss requirement, without any supporting documentation, and can then submit the documentation when seeking forgiveness. The Act provides for the creation of a simplified, one-page forgiveness application for borrowers seeking forgiveness of $150,000 or less. The borrower will only need to provide a certification that contains the description of the number of employees that the borrower was able to retain because of the loan and the amount of the loan spent on payroll costs. The borrower must attest that the certification is accurate and that the borrower spent loan proceeds only on allowable expenses. The borrower must retain records relevant to the forgiveness application to prove compliance. Employment records must be retained for four years after submitting the forgiveness application and other records must be retained for three years after submitting the forgiveness application. The simplified loan forgiveness application is expected to be available on January 20, 2021.

4. Disclosure Requirement for Entities Controlled by Government Officials

If an entity that received a PPP Loan before December 27, 2020 is controlled directly or indirectly by the President, the Vice President, the head of an Executive department, or a Member of Congress, or the spouse of such person, the entity must disclose that information to the SBA by January 26, 2021 or not later than 30 days after submitting its application for loan forgiveness. For these purposes, an entity is deemed to be controlled by a person if that person owns, controls or holds at least 20% by vote or value of any class of equity interests in the entity.

IV. Tax Provisions Relating to PPP Loans

The CAA includes certain provisions relating to the U.S. federal tax implications of the receipt of a PPP loan.[6]

1. Deductibility of Business Expenses

The CAA clarifies that expenses that are otherwise deductible for U.S. federal income tax purposes will continue to be deductible even if the expenses are funded with the proceeds of a PPP loan that is forgiven. That clarification overrides a contrary position taken by the Internal Revenue Service in previous guidance.[7] The CAA also clarifies that the loan forgiveness will not result in a reduction of tax attributes such as net operating loss carryforwards or tax basis. Special rules apply to basis adjustments in equity interests in partnerships and S corporations. These clarifications apply to tax years ending after the date of the enactment of the CARES Act.

2. Employee Retention Tax Credit

The CAA creates an opportunity for a recipient of a PPP loan to claim the employee retention credit introduced under the CARES Act. Under the CARES Act, an eligible employer

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[6] The text of the tax provisions of the CAA described in this section can be found here and here.

[7] Notice 2020-32, 2020-21 I.R.B. 837, *amplified by* Rev. Rul. 2020-27, 2020-50 I.R.B. 1552. *See also* Rev. Proc. 2020-51, 2020-50 I.R.B. 1599. Although the CAA overturned this guidance for U.S. federal income tax purposes, expenses funded by a forgiven PPP loan might not be deductible for state income tax purposes. *See*, *e.g.*, Cal. Rev. & Tax'n Code § 17131.8(b), *as added by* 2020 Cal. A.B. 1577; N.C. Dep't of Rev., Important Notice: North Carolina's Reference to the Internal Revenue Code Updated (July 20, 2020).

was entitled to claim a refundable credit against its U.S. federal employment tax for certain wages paid to its employees. An employer that received a PPP loan, however, was not entitled to claim the credit. The CAA relaxes that restriction by allowing an employer that receives a PPP loan to claim the credit to the extent that the payroll costs with respect to which the credit is claimed are not used to support forgiveness of the PPP loan. This provision is effective as of the date of the enactment of the CARES Act.

V. Conclusion

The Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act provides expanded support to small businesses and non-profit organizations still suffering as the COVID-19 pandemic continues. Further changes and guidance are expected in order to provide small businesses, non-profit organizations and their employees a clearer way forward in these uncertain times.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail authors Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Craig M. Horowitz at 212.701.3856 or chorowitz@cahill.com; Aliza R. Levine at 212.701.3524 or alevine@cahill.com; Ann Creed at 212.701.3876 or acreed@cahill.com; or Robyn Sablove at 212.701.3753 or rsablove@cahill.com; or e-mail publications@cahill.com.

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