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Congress Revises PPP Rules for Existing Borrowers; Allows Certain Borrowers to Access Second Round of Funding

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On December 21, 2020, the U.S. Congress passed the "Consolidated Appropriations Act, 2021" (the "***Omnibus Bill***") which is expected to be signed into law shortly by President Trump. Title III of Division M of the Omnibus Bill, titled the "Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act" ("***Title III***") contains several important enhancements for existing and potential borrowers in the Paycheck Protection Program ("***PPP***"). Among other changes, Title III allows certain borrowers to obtain a second round of PPP loans from the Paycheck Protection Program and makes additional changes to the PPP rules and tax treatment that will affect existing and new PPP borrowers alike.

Title III extends PPP through March 31, 2021 and provides $284.45 billion in additional direct appropriations for the program. Such funding includes several set-asides, including: (i) $15 billion for PPP loans made by certain community financial institutions, (ii) $15 billion for PPP loans issued by certain small depository institutions, (iii) $35 billion for first-time borrowers ($15 billion of which is for borrowers with 10 or fewer employees or small loans in low income areas), and (iv) $25 billion for borrowers with 10 or fewer employees taking out a second PPP loan (including certain small loans in low income areas).

While we expect new regulations or guidance to be published in the coming weeks, the bill includes the following significant highlights for small businesses who have obtained, or are considering applying for, PPP loans:

CHANGES AFFECTING NEW AND EXISTING PPP LOANS

1. **Covered period extended to March 31, 2021**
    a. The covered period for eligibility and use of PPP loan funds has been extended from December 31, 2020 to March 31, 2021.

2. **Borrowers would be permitted to spend PPP Funds on the following additional types of expenditures (and qualify for forgiveness for such expenditures):**
    a. **Covered operations expenditures**, meaning payments for any business software or cloud computing service that facilitates 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;

    b. **Covered property damage costs,** meaning any cost related to property damage and vandalism or looting due to public disturbances that occurred during 2020 that was not covered by insurance or other compensation);

    c. **Covered supplier costs**, meaning expenditures by the borrower to a supplier of goods, for the supply of goods that (i) are "essential to the operations of the business" at the time of such expenditure, and (ii) were purchased pursuant to contracts that were in effect *prior* to the covered loan period (or during the covered loan period, in the case of perishable goods); and

d. **Covered worker protection expenditures**, meaning any operating or capital expenditure that facilitates the adaptation of the borrower's business activities to comply with HHS, CDC, or OSHA requirements (or equivalent state or local guidance) related to COVID-19 during the period between March 1, 2020 and the end of the national emergency declaration. The foregoing explicitly excludes the cost of any residential real property or intangible property.

e. **Additional types of qualifying Payroll Costs.** The types of group insurance premiums eligible for forgiveness would now include premiums for group life, disability, vision or dental insurance policies (in addition to group health insurance premiums).

3. Changes to Borrower Eligibility Requirements.

a. Title III enlarges the types of borrowers that would be eligible for a first draw and second draw of PPP loans, including certain (i) non-profit organizations organized under Section 501(c)(6) of the Internal Revenue Code (e.g., trade associations and chambers of commerce)[1]; (ii) tourism and hospitality marketing non-profit or governmental entities (defined as "destination marketing organizations" in the bill)[2]; (iii) newspaper and broadcasting companies (including non-profit organizations with NACIS codes beginning with 5151) that were previously ineligible to apply because of the traditional application of SBA affiliation rules; and (iv) housing cooperatives with less than 300 employees.

b. The following entities would be ineligible for PPP loans after the date of enactment of the Omnibus Bill: (i) entities listed in 13 C.F.R. 120.110 and subsequent regulations (except as otherwise provided by statute or guidance, and except for nonprofits and religious organizations); (ii) entities involved in political and lobbying activities (including political strategy firms or think tanks); (iii) entities wholly or partially owned by equityholders based in or otherwise affiliated with the People's Republic of China or Hong Kong, or entities that have a Chinese resident on their board of directors;[3] (iv) registrants under the Foreign Agents Registration Act; and (v) entities that receive a grant under the Shuttered Venue Operator Grant program created under Section 324 of Title III.

[1] These 501(c)(6) organizations are only eligible for the PPP loan if: (i) the organization does not receive more than 15% of its receipts from lobbying; (ii) lobbying activities do not make up more than 15% of activities; (iii) the cost of lobbying activities for the organization does not exceed $1,000,000 during the most recent tax year (prior to February 15, 2020); and (iv) the organization has 300 or less employees. Note that professional sports leagues and organizations with the purpose of promoting or participating in political campaigns (and other similar activates) are excluded

[2] These organizations are only eligible for PPP loans if: (i) the organization does not receive more than 15% of its receipts from lobbying; (ii) lobbying activities do not make up more than 15% of activities; (iii) the cost of lobbying activities for the organization does not exceed $1,000,000 during the most recent tax year (prior to February 15, 2020); (iv) the organization has 300 or less employees; and (v) the organization is registered as a 501(c) organization, a quasi-government entity, or a political subdivision of a State or local government.

[3] Any borrower's shareholder or member that (i) is created or organized in China or Hong Kong or has "significant operations" in China or Hong Kong, and (ii) holds owns or holds, directly or indirectly, not less than 20 percent of the economic interest of the borrower, including as equity shares, or a capital or profit interest will fall under this exclusion for Chinese-owned or affiliated businesses.

4. Changes to Tax Implications of PPP Funds.

a. **PPP Expenses are deductible.** Section 276 of Title III provides that "no deduction shall be denied [and] no tax attribute shall be reduced . . . by reason" of the exclusion of PPP funds from a borrower's gross income. This change overrides prior IRS Guidance to the contrary and makes clear that business expenses paid for using PPP funds are deductible.

b. **Tax Free Forgiveness of PPP Loan will not Reduce Tax Basis or Attributes**. Title III further provides that "no tax attribute shall be reduced and no basis increase shall be denied, by reason of the exclusion" of PPP funds from a borrower's gross income. In the case of a partnership, the partners may use the basis created by their PPP loan to deduct the costs that give rise to the forgiveness of the PPP loan because even if the PPP loan is forgiven the partner will be allocated an amount of tax-exempt income equal to such costs.

c. **Confirmation that forgiveness is non-taxable**. The bill further codifies the original intent of Congress that forgiveness of any PPP loan is not taxable.

5. Ability for PPP Borrowers to Request an Increase in Loan Amount.

a. Borrowers who have obtained PPP loans (including those that have returned all or part of them) are eligible to modify their loan amounts based on changes in regulations if it results in a larger loan amount for the borrower.

b. The SBA must release guidance within 17 days of enactment of Title III regarding procedures on seeking additional loan amounts.

c. Borrowers who have received forgiveness for existing PPP loans are not eligible to request a larger loan amount.

6. Publicly Traded Companies Excluded.

a. Publicly traded companies are now excluded from eligibility for PPP loans.

b. This change is prospective, meaning that it likely will only affect those publicly traded companies that have not received a PPP loan or that would have otherwise been eligible for a second PPP loan.

7. Clarification of Certain Terms and Interest Provisions.

a. Fee waivers, personal guarantee waivers, and deferral eligibility would attach for the life of the PPP loan (not just the "covered" period).

b. The interest rate for the portion of PPP loans that are not forgiven will be non-compounding and non-adjustable for all new PPP loans, including second PPP loans.

c. Section 319 of Title III prohibits PPP borrowers from using proceeds of the covered loan for lobbying activities, lobbying expenditures related to state or local campaigns, and expenditures to influence the enactment of legislation, appropriations, or regulations.

SOME BUSINESSES ELIGIBLE FOR SECOND ROUND OF PPP LOANS

The new legislation provides certain businesses with a “second draw” of PPP funds. While the rules applicable to second draw loans are generally similar to the rules applying to the PPP rules generally, borrowers must meet certain more restrictive criteria highlighted below.

1. **Narrower Eligibility Requirements.**
    a. To be eligible, borrowers must have been eligible for the initial round of PPP loans (except as outlined below), and must have used (or will have used by the time of disbursement of the second draw loan) the full amount of the initial PPP loans;

    b. **Have less than 300 employees** (together with affiliates);[4] and

    c. Be able to demonstrate a **year-over-year decline of 25% or more gross receipts**[5] **for any quarter in 2020** (as compared to the same quarter in 2019).[6]

2. **Calculating Loan Amounts for Second Loan Draws.**
    a. Loan amounts would be capped at **$2 million**.

    b. Loan amounts are generally calculated by multiplying the average total monthly payroll costs for the one-year period prior to date the loan is made or calendar year 2019, at the election of the borrower, by 2.5.

    c. Borrowers within the accommodation and food service industry (NAICS 72) are eligible to use a 3.5 multiplier instead of the 2.5 multiplier for calculation of loan amounts.

    d. Seasonal employers may use any 12-week period between February 15, 2019 and February 15, 2020 for average monthly payroll costs to calculate loan amount.

3. **Eligibility for Forgiveness.**
    a. Borrowers are eligible for forgiveness in an amount equal their payroll costs, covered mortgage, rent, utility payments, covered operations expenditures, covered property damage costs, covered supplier costs, and covered worker protection expenditures.

    b. To be eligible for full forgiveness, 60% of the loan must be spent on payroll costs (as is currently the case with first draw PPP loans).

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[4] For those borrowers within the accommodation and food service industry (NAICS 72) that qualified for waiver of affiliation rules for their first PPP loan based on being a business concern with no more than 500 employees per physical location, the size limit is also reduced to 300 employees per physical location.

[5] For loans of not more than $150,000, the entity may submit a certification attesting that the entity meets the revenue loss requirements on or before the date the entity submits their loan forgiveness application. Non-profit and veterans organizations may utilize gross receipts to calculate their revenue loss standard.

[6] Borrowers that were not in operation in Q1, Q2, or Q3 of 2019 are entitled to compare 2020 quarterly gross receipts to any quarter during 2019 in which they were in operation. Borrowers that were not in business during 2019 (but were in business on or before February 15, 2020) are entitled to compare Q2, Q3, or Q4 2020 gross receipts against gross receipts in Q1 of 2020.

AUDIT AND FORGIVENESS PROCEDURE CHANGES

1. **Simplification of the SBA Audit and Forgiveness Process.**
    a. Loans up to $150,000 will require completion of a one-page online or paper form with limited borrower certifications (with such form to be released within 24 days of enactment of the Omnibus Bill).

    b. Loans $150,000 to $2 million will have simplified documentation requirements.

    c. The SBA must enact specific policies and procedures for conducting audits and reviews of PPP within 45 days of enactment.

2. **Extension of Employee Restoration Date for Safe Harbors.**
    a. For PPP loans made after the enactment of Title III, the date to restore FTE employee and salary/wage levels is extended to the last date of the covered period for that loan.

ADDITIONAL LENDER PROTECTIONS AND PROVISIONS

1. **Hold Harmless**. Section 305 of Title III provides that a PPP lender may rely on any certification or documentation submitted by a borrower for an initial or second draw PPP loan, and that 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, if (1) the lender acts in good faith relating to loan origination or forgiveness; and (2) all relevant federal, state, local and other statutory and regulatory requirements are satisfied.
2. **New Compensation Structure for Second Draw Loans.** The SBA is authorized to reimburse a lender by the following tiered structure:
    a. Loans up to $50,000: Lender processing fee will be the lesser of 50 percent of the principal amount or $2,500.

    b. Loans between $50,000 and $350,000: Lender fee will be five percent.

    c. Loans $350,000 and above: Lender fee will be three percent.

3. **Lender Eligibility for Second Draw Loans**. A lender approved to make loans under initial PPP loans may make second draw loans under the same terms and conditions as the initial loans.

Unless otherwise specified under the statute, the provisions of Title III are effective the date of enactment of the Omnibus Bill (and are thus not retroactive to first draw loans that have already been obtained).

Given the fast pace of developments, businesses are encouraged to seek advice from qualified legal counsel concerning these matters.

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For more information, please see the following resources:

1. **Prior Haynes and Boone Guidance on the Paycheck Protection Program:**
    a. SBA Issues Clarifying Guidance for PPP Borrowers in M&A Transactions (October 7, 2020)
    b. Bridging the Gap - An Overview of SBA Loans under the Paycheck Protection Program (updated June 8, 2020)
    c. Full List of Haynes and Boone Alerts on PPP
2. **Prior SBA Guidance on the Paycheck Protection Program:**
    a. PPP Frequently Asked Questions (updated December 9, 2020)
    b. PPP – Frequently Asked Questions on Loan Forgiveness (updated October 13, 2020)
    c. Full List of SBA Guidance and Regulations
3. **Resources on the SBA Economic Injury Disaster Loan (EIDL) Program**.
    a. Looking for an Alternative to PPP? Taking a Second Look at the Economic Injury Disaster Loan Program (Haynes and Boone Alert, May 1, 2020).
    b. SBA's COVID-19 Disaster Loan Program (Haynes and Boone Alert, March 24, 2020)
    c. SBA EIDL Resource Page

Additional Questions? Contact a member of the Haynes and Boone Finance or Corporate Practice Groups at Haynes and Boone, including the following individuals:

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