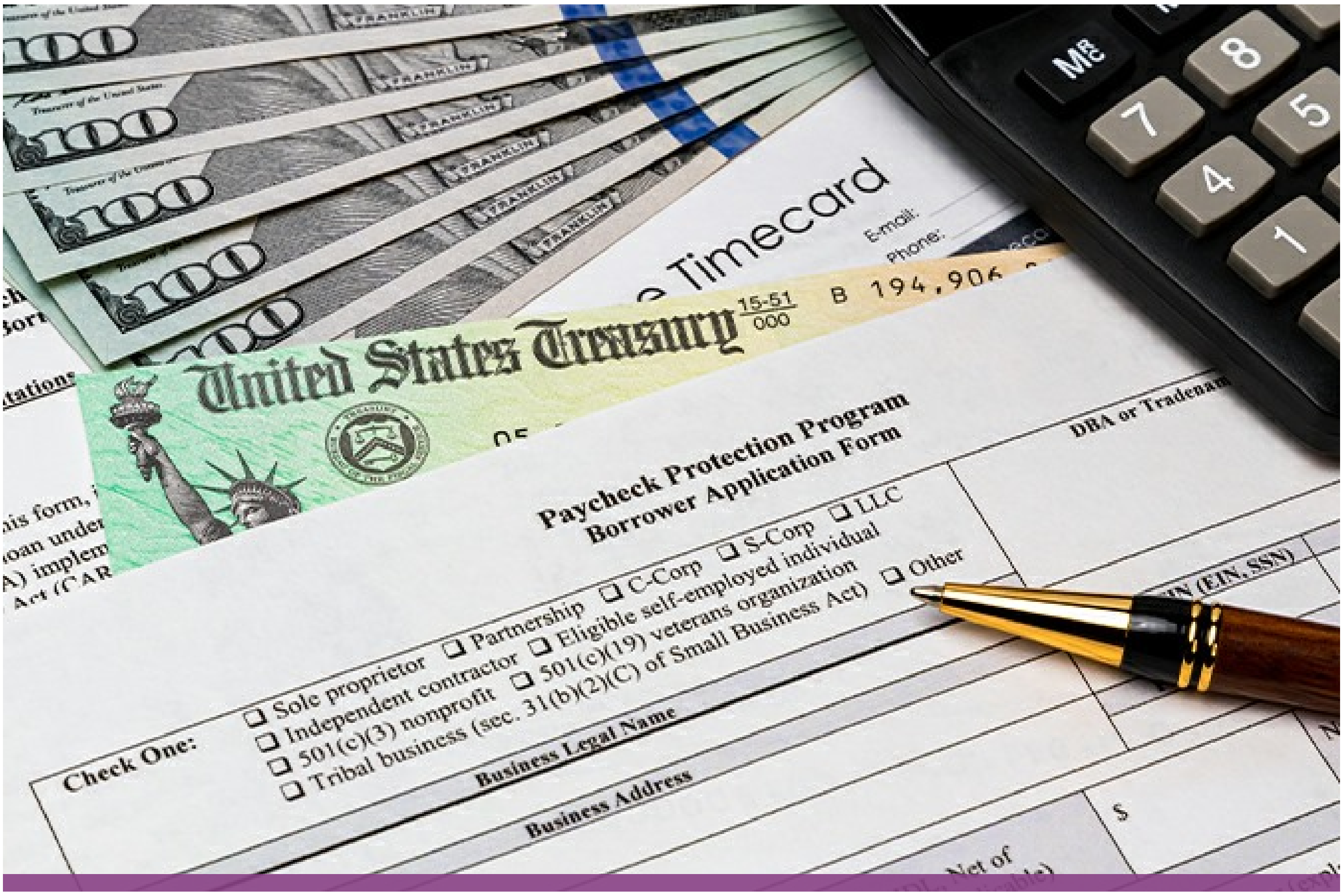
The Consolidated Appropriations Act and the impact on the Paycheck Protection Program: Here we go again…



David M. Kall, Adam Grais, Christian D. Sorensen | Tuesday, December 22, 2020

After months of negotiations, Congress finally passed the 2021 Consolidated Appropriations Act late Monday night. It is expected that the President will quickly sign the act into law.

The act provides approximately $325 billion in business relief, including roughly $275 billion for another round of Paycheck Protection Program funding. The act also provides answers to questions regarding the first round of PPP loans that have so far gone unanswered.

While the act is extremely lengthy (5,593 pdf pages long), we have attempted to summarize the most important sections regarding the Paycheck Protection Program.

Deductions Permitted for Expenses Eligible for Forgiveness

For many PPP loan borrowers, the most significant change in the rules is confirmation that borrowers will not lose the income tax deduction generally available for expenses paid with PPP loan proceeds for items that are ordinarily deductible for tax purposes.

The majority of PPP borrowers have used their PPP loan proceeds to pay wages, payroll tax expenses, utilities, rent, and interest, which are ordinarily deductible for tax purposes. Businesses that received PPP loans and had them forgiven will be allowed to deduct these costs despite prior IRS guidance to the contrary. The act also indicates that any income tax basis increase that results from a PPP loan will not be lost when the PPP loan is forgiven.

Borrowers will have to wait for additional guidance to see whether there will be any restrictions on their ability to claim ordinary and necessary business deductions. For those that have already received forgiveness prior to the effective date of the act, they will have to wait for further guidance in order to determine whether they can deduct the expenses because the new provision may arguably not apply to them.

Entities Eligible for Second Round of Loans

The act extends the PPP and allows new and old borrowers to receive a PPP loan if they meet certain eligibility requirements. As with prior PPP loans, a borrower must first satisfy the “Necessity Test,” which is based on whether the loan is “necessary to support the on-going operations of the applicant” as of the date on which the PPP loan application is submitted. This test still is not well-defined so borrowers should consult with their legal advisors to determine whether they satisfy the Necessity Test prior to applying for a new PPP loan. The SBA has announced that it will not challenge whether borrowers who have aggregate PPP borrowings less than $2 million meet the Necessity Test. However, borrowers should be aware that PPP loans are not confidential, and the SBA must disclose (and already has disclosed information regarding existing PPP loans) the names and loan amounts of all PPP borrowers. Consequently, whistleblowers or other private organizations may challenge the necessity of certain borrowers receiving a new PPP loan on their own.

Second, a more limited group of businesses may receive new PPP loans because the act added new revenue reduction tests and reduced the number of employees. Specifically:

1. The borrower must demonstrate that there was a 25% reduction from the gross receipts of the entity during any calendar quarter in 2020 when compared to the same quarter in 2019.
2. For the purposes of this 25% rule, gross receipts will include all revenues from the normal operations of the business before subtraction of expenses but will not likely include amounts received from PPP loans.
3. The borrower must employ no more than 300 employees or meet an alternative size standard.

For purposes of the 25% reduction test, borrowers who were not in business during the first, second, or third quarter of 2019, but were in business during the fourth quarter of 2019, can compare the first, second, or third quarter of 2020 to the fourth quarter of 2019.

If the entity was not in business during 2019 but was in business by Feb. 15, 2020, then the borrower can compare its gross receipts during the second or third quarter of 2020 to the first quarter of 2020 to determine whether it qualifies.

There may be additional restrictions on otherwise eligible borrowers. For instance, lobbying firms and think tanks do not qualify. In addition, borrowers owned 20% or more by companies created under the laws of, or have significant operations in, the People’s Republic of China or the Special Administrative Region of Hong Kong, or that have a board member who is a resident of the People’s Republic of China may not receive a PPP loan. In addition, a PPP loan may not be made to any organization that receives a grant under the new Shuttered Venues Operators program.

Maximum Amount of New Loan

In general, the maximum amount of the PPP loan is the lesser of (i) $2 million and (ii) 2.5 times (or 3.5 times for certain lodging, casino and food services businesses) the average total monthly payroll costs incurred or paid during, at the borrower’s election, either: (1) the 1-year period before the date on which the loan is made, or (2) calendar year 2019. If the borrower did not exist during the 1-year period preceding Feb. 15, 2020, then the payroll costs are determined by dividing (A) the sum of the total monthly payroll costs paid or incurred by the borrower as of the date on which the borrower applies for the PPP loan by (B) the number of months in which those payroll costs were paid or incurred.

For borrowers with more than one physical location, the number of employees permitted at each location is limited to 300 (as opposed to 500 employees at each location under the first round of PPP loans) and the $2 million cap will apply to the total amount of all covered PPP loans.

Simplified Applications

For borrowers requesting new PPP loans of $150,000 or less, the loan application will only require a certification that the borrower meets the revenue loss test, but the borrower will need to provide documentation of its revenue loss before applying for loan forgiveness.

For any PPP loan up to $150,000, whether an existing or a new PPP loan under the act, the PPP loan amount will be forgiven if the borrower submits a one-page form listing the amount of the PPP loan, the number of employees retained, and the amount of the PPP loan spent on payroll. The SBA is directed to release this form within 24 days after enactment. However, borrowers may want to consider filling out the long form application anyway for purposes of retaining the necessary documentation in case they are audited.

Borrowers using the simplified one-page forgiveness form are not required to submit with its application the same documentation or certifications that were required under the first round of PPP loans. Instead, the borrower is required to retain all employment records relevant to the application for PPP loan forgiveness for the four-year period following submission of the application and all other supporting documentation for the three-year period following submission of the application.

Selection of Covered Period, Changes to FTE/Salary Reduction Restoration

The act allows borrowers to select the end date of their covered period within which the PPP loan proceeds must be spent on permitted expenses to obtain loan forgiveness. The borrower may now choose a covered period of between eight and 24 weeks from the date of disbursement of the PPP loan. In addition, the act changes the deadline for restoring reductions in full-time equivalent employees (FTE) and wages for certain employees that could have limited the loan forgiveness amount. Under the prior rules, restoration had to occur by Dec. 31, 2020, but under the act, the deadline is the end of the chosen covered period. This means that borrowers potentially may be able strategically choose the length of the covered period to avoid FTE or wage-based reductions in the loan forgiveness amount.

Additional Expenses Eligible for Forgiveness

The act adds several new categories of expenses that are eligible for forgiveness for both new and existing borrowers. These include:

- Covered operations expenditures: These are payments for any business software or cloud computing service that facilitates business operations, product or service delivery, the processing of 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 costs: These are costs related to property damage and vandalism or looting due to public disturbances that occurred during 2020 that were not covered by insurance or other compensation.

- Covered supplier costs: These expenditures were made to a supplier and were (a) essential to the operations of the entity at the time the expenditures were made and (b) made pursuant to a contract or purchase order in effect any time before the covered period or, for perishable goods, any time during the covered period.
- Covered worker protection expenditures: These are operating or capital expenditure made to comply with COVID-related requirements established by the Department of Health and Human Services, the Centers for Disease control the Occupational Safety and Health Administration or by state and local governments.
- Group life, disability, vision and dental insurance are included as payroll costs.

All the original covered expenses, including payroll, interest on covered mortgage obligations, rent and utilities are still eligible for forgiveness.

Conclusion

Now that the act has passed and is expected to be signed into law, the SBA will have just 10 days to implement the new regulations and 24 days to release the simplified application. Clearly, there will be a lot of confusion and additional guidance will be issued by the SBA regarding these changes. Unfortunately, here we go again, and it appears that the process will be confusing so we will attempt to provide additional guidance as it is released.

David M. Kall

Team member bio

Adam Grais

Team member bio

Christian D. Sorensen

Team member bio