FRIED FRANK

To Our Clients and Friends

Memorandum

December 28, 2020

New Paycheck Protection Program (PPP) Is Approved by Congress

On December 27, 2020, the Economic Aid Act (EAA) was signed into law to provide financial relief to small businesses suffering from the impact of the COVID-19 pandemic. The EAA amends the PPP loan program that was established earlier this year under the CARES Act. As before, the PPP loans will be low-interest, forgivable loans for specified purposes, designed to encourage businesses to keep employees on the payroll during the pandemic.

The PPP program established under the CARES Act ended on August 8, 2020. At that time, PPP loans totaling $525 billion had been issued to roughly 5.2 million businesses, and $130 billion dollars of appropriated funding for PPP loans remained unused. Demand for the loans had declined dramatically over time, primarily due to concerns by many businesses that, because they were closed in accordance with governmental shut-down orders or experienced reduced demand during the pandemic, they would not be able to comply with the requirements for use and forgiveness of the loans. The EAA withdraws the unused funds and appropriates instead $284.5 billion for PPP loans, with somewhat more restrictive eligibility requirements and substantially expanded permitted uses than previously applied.

Most notably, under the EAA:

- ***Expansion of permitted uses of proceeds.*** The permitted uses of the proceeds of a PPP loan (whether issued previously under the CARES Act or issued now under the EAA) have been expanded. The permitted uses now include, among other things, the purchase of essential goods from suppliers, as well as expenditures for personal protective equipment and compliance with pandemic-related requirements and guidelines for employee and customer health and safety.
- ***More limited eligibility for second-time borrowers.*** A business that already received (and fully used) a PPP loan can apply for a new PPP loan, subject, however, to the more stringent eligibility requirements—namely, that the business must have fewer than 300 employees and it must have experienced a demonstrable decline in revenue of at least 25% in any quarter of 2020 as compared to the same quarter in 2019. It appears that the eligibility requirements have not changed for a *first-time* PPP borrower—namely, that the business must have fewer than 500 employees and it must provide a self-certification that obtaining the loan is “necessary” in light of “economic uncertainty.”
- ***Decreased principal amount of loans.*** For a first-time or second-time PPP borrower, the maximum amount of the loan to be issued under the EAA will be $2 million (rather than the $10 million cap that previously applied).

The key terms are as follows:

Deadline for application. Applications for a PPP loan must be submitted no later than March 31, 2021.

Second-time borrower's eligibility. A business that previously received a PPP loan is eligible to apply for a new PPP loan under the EAA if: (i) the proceeds of the previous loan have been (or soon will be) fully used; (ii) the business has 300 or fewer employees (per physical location); and (iii) the business can document that it has experienced a decline in "gross receipts" of at least 25% during any quarter in 2020 as compared to the same quarter in 2019. (Different measures apply to companies that were not in business during certain quarters.)

First-time borrower's eligibility. The EAA does not mention businesses that have not previously applied for a PPP loan, but it does not appear to amend the existing provisions enacted under the CARES Act. Thus, the eligibility requirements for *first-time* PPP borrowers apparently have not changed. Specifically, if a business has not previously obtained a PPP loan, we believe that the business is eligible to apply for a PPP loan under the EAA if (as is provided under the CARES Act) it (i) has 500 or fewer employees (per physical location), and (ii) provides a statement self-certifying that the current "economic uncertainty makes th[e] loan request necessary to support the ongoing operations of the Applicant."

Ineligibility. A business is *not* eligible to apply for a PPP loan under the EEA (whether for a first-time PPP loan or a second-time PPP loan) if it was ineligible under the CARES Act rules or falls within any of the following new categories of ineligibility:

- It is a public company;
- It is owned 20% or more by a Chinese or Hong Kong entity or has a resident of China on its board;
- It is primarily engaged in political or lobbying activities (including "think tanks");
- It is required to register under the Foreign Agents Registration Act; or
- It was not in operation on February 15, 2020.

Affiliation rules. There has been no change to the "affiliation" rules.

Permitted uses of proceeds. The permitted uses of the proceeds of PPP loans has been expanded. The expansion applies to PPP loans whether issued before or after enactment of the EAA (other than loans for which forgiveness already has been received). The permitted uses are, as previously, payroll costs (and the EAA provides that "payroll costs" includes costs for group health, life insurance, disability, dental and vision insurance benefits), rent, mortgage interest, and utility payments, as well as the following newly permitted purposes:

- ***To purchase essential goods from suppliers:*** Expenditures to suppliers under contracts or orders in effect prior to taking out the loan (or, in the case of perishable goods, also during the life of the loan) for goods that were essential to the business's operations at the time the expenditures were made;
- ***To pay for adaptations made to comply with guidance for worker or customer safety:*** Operating or capital expenditures to facilitate adaptation of the business's activities to comply with federal, state or local COVID-19-related requirements or guidance (issued after March 1, 2020) regarding worker or customer safety—such as purchases of personal protective equipment; on-site or off-site screening of employees or customers; and the purchase, maintenance or renovation of assets to create or expand drive-through windows, ventilation systems, physical barriers, the expansion of indoor or outdoor space, and the like;
- ***To pay for software:*** Expenditures on any business software or cloud computing service that facilitates (i) business operations, (ii) product or service delivery, (iii) the processing, payment or

tracking of payroll expenses, human resources, sales and billing functions, or (iv) accounting or tracking of supplies, inventory, records, or expenses; and

- ***Costs related to damage from public disturbances:*** Costs related to property damage and vandalism or looting resulting from public disturbances that occurred during 2020 and that were not covered by insurance or other compensation.

Forgiveness. The proceeds of a PPP loan will be eligible for forgiveness if at least 60% was used for payroll costs and up to a maximum of 40% of the proceeds was used for the other permitted purposes. (As previously, partial forgiveness may be available if less than 60% of the proceeds was used for payroll costs.)

"Covered Period." The borrower can elect to use the PPP loan proceeds over a period of between 8 and 24 weeks from the time of disbursement of the loan.

Amount of loan. A first-time PPP borrower can apply for a loan of up to $2 million. A second-time PPP borrower can apply for a loan up to the lesser of (a) $2 million or (b) 2.5 times its average monthly payroll for either calendar year 2019 or the 12-month period prior to the loan being disbursed. (The 2.5 multiple changes to 3.5 for restaurants, hotels, and others in the "Accommodations and Food Services (NAICS 72) industry category.) An existing PPP borrower with an outstanding balance less than the maximum amount applicable to the borrower (whether because it borrowed less than that amount or it returned all or part of the loan) is eligible to apply to receive an amount that brings the existing loan up to an amount equal to or less than such maximum amount (but subject to the $2 million cap).

Simplified applications for small loans. For PPP loans less than $150,000, the application to obtain the loan, and the application for forgiveness (whether the loan was issued before or after enactment of the EAA), will be simplified, with minimal documentation required.

Eligibility for local news organizations. The EAA adds eligibility for PPP loans for broadcast news and radio stations and newspapers that will use the proceeds of the loan to support the production or distribution of locally focused or emergency information. The EAA waives the affiliation rules for news organizations that are either non-profits or that have no more than 500 employees per physical location.

Eligibility for 501(c)(6) non-profits. The EAA adds eligibility for (i) Section 501(c)(6) non-profit "business leagues" with 300 or fewer employees (these are organizations such as trade or professional associations, real estate boards, boards of trade, and chambers of commerce); and (ii) Section 501(c)(6) non-profit "destination marketing" organizations with fewer than 300 employees (these are organizations that promote tourism or primarily are engaged in providing "live events")—but, in each case, excluding organizations that are significantly involved in lobbying activities.

Eligibility for coop apartment buildings. The EAA clarifies that housing cooperatives with 300 or fewer employees are eligible to apply for PPP loans.

Interest Rate. The interest rate for PPP loans is not more than 4%. The EAA clarifies that interest will be calculated on a non-compounding, non-adjustable basis.

Bankruptcy. The EAA provides that companies in bankruptcy may obtain a PPP loan (with bankruptcy court approval), and such a loan (to the extent not forgiven) would be given priority in the bankruptcy (*i.e.*, would be repaid before other debt).

Tax treatment of deductions. The CARES Act generally provides that forgiveness of PPP loans does not result in taxable income to the borrower. The Internal Revenue Service (IRS) took the position that, as a result, taxpayers cannot also deduct the wages and other expenses paid with forgiven PPP loan funds. The EAA reverses the IRS's position with retroactive effect from the CARES Act's enactment date of

March 27, 2020. Accordingly, businesses that obtained PPP loans under the CARES Act, or that obtain PPP loans under the EAA, can claim tax deductions for expenses paid with forgiven PPP loan funds if the expenses otherwise are deductible. No net operating losses (NOLs), passive loss carryovers, or other tax attributes are reduced by any PPP loans being forgiven. In addition, the EAA provides for special basis adjustments for interests in partnerships and S corporations that have forgiven PPP loans, which may create timing issues for some taxpayers in claiming their deductions.

Interaction with Employee Retention Tax Credit. The CARES Act created a refundable employee retention tax credit of up to $5,000 per employee, generally up to 50% of wages and certain health care costs paid from March 12, 2020 through December 31, 2020 by certain employers that experienced a full or partial suspension of operations due to COVID-19 or certain declines in gross receipts. The EAA retroactively repeals the rule prohibiting the same employer from claiming both the tax credit and receiving a PPP loan. Accordingly, borrowers who received a PPP loan under the CARES Act should look into whether they can claim the tax credit in 2020 as well (although it is presently unclear what procedures apply for the retroactive relief). The prohibition also previously applied to a PPP loan borrower's entire aggregate group, which may claim the tax credit after the EAA. Special rules prevent the same amount of wages from being paid with forgiven PPP loans and also giving rise to the tax credit. In addition, the EAA extended and significantly expanded the employee retention tax credit for wages and health care costs paid in the first half of 2021, for up to $14,000 of additional tax credits per employee, which can be claimed by all eligible taxpayers including those with old and new PPP loans.

Grants to "live venue operators." The EAA also provides $15 billion for a new program to provide grants from the SBA to live venue operators, theater-related groups, and museums, for specified expenses, subject to specified criteria. Ineligible entities include (with some exceptions) those that are publicly traded, operate venues in multiple countries or more than ten U.S. states, employ more than 500 workers, receive more than 10% of their gross revenue from federal funding, or hold performances of a "prurient sexual nature."

Lenders' safe harbor. The EAA amends the CARE Act's provision that "holds harmless" PPP lenders from a range of enforcement actions, making the provision somewhat less protective of lenders. Previously, a lender was held harmless if it received documentation from the loan recipient attesting to the accuracy of information provided by the recipient. Now, for all PPP loans, whether issued before or after enactment of the EAA, the lender will be held harmless to the extent that the lender "relies on the certifications and documentation" submitted by the loan recipient *and* the lender acted "in good faith" in originating or forgiving the loan based on that reliance.

Disaster loans (EIDLs). The EAA increases the funds available for Economic Injury Disaster Loans to $40 billion (from the current $20 billion) and extends the program (as expanded under the CARES Act) through December 31, 2021. The CARES Act expanded the program to authorize the SBA to advance up to $10,000 for recipients to pay sick leave to workers affected by COVID-19, retain employees, and make certain other payments. The EAA also repeals a CARES Act provision that requires PPP loan forgiveness amounts to be reduced based on EIDL advances.

Other items of interest:

- ***Possible reduction in the number of lenders.*** There is a general consensus that there are likely to be fewer lenders who participate in issuing PPP loans under this second round. The process under the previous round was found to be time-consuming and difficult; the lenders are currently processing forgiveness of the already-issued PPP loans, which also has proved to be a burdensome process; and many lenders were subjected to negative publicity relating to the program generally.

- ***Ongoing SBA audits of PPP loans.*** The SBA has been conducting "audits" of PPP loans issued under the CARES Act in principal amounts over $2 million. The purpose of the audits is to confirm whether the borrower's certification as to the "necessity" for the loan based on "economic uncertainty" was valid. Starting at the end of October, the SBA issued a draft Form requiring these borrowers to document their economic necessity at the time they applied for the loans. The Form requires disclosure of information including gross revenue, cash on hand, dividends made, outstanding debt, and compensation of highly paid owners and employees. A lawsuit has been filed against the SBA based on concerns about the required disclosure of this sensitive information without notice at the time of application for the loans that it later would be required. In addition, there are concerns about the need to demonstrate retrospectively that there was an economic necessity for the loan even though the SBA had expressly not required for PPP loans that the borrowers show (as SBA borrowers usually have to) that they did not have sufficient liquidity or credit otherwise available to them. Also, there are concerns about how the SBA will evaluate what constituted "economic uncertainty" at the start of the pandemic; and whether companies that so far have survived the economic impact of the pandemic will be viewed, in hindsight, as not having had a need for the loans--especially given the possibility of additional economic hardship to come.

- ***Forgiveness application deadline.*** The SBA recently clarified that PPP borrowers may submit a loan forgiveness application any time before the maturity date of the loan (which is either two or five years from the loan's origination, depending on the borrower's loan agreement)--but that loan payments are deferred only until 10 months after the last day of the borrower's loan forgiveness covered period.

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