Paycheck Protection Program Act Updates

Since our last update describing changes made to the Paycheck Protection Program (the "PPP") by the Paycheck Protection Program Flexibility Act of 2020 (the "PPPFA"), which was signed into law by President Trump on June 5, 2020, the U.S. Small Business Administration (the "SBA") has published numerous revisions to prior interim final rules ("IFRs") it had released to govern implementation of the PPP with respect to eligibility requirements, disbursement, loan forgiveness and loan review to conform to the PPPFA and clarify certain requirements set forth therein. Generally, the PPPFA provides PPP loan borrowers additional time to incur costs that count towards PPP loan forgiveness, reduces the portion of such costs that must be payroll costs, provides additional exemptions from the CARES Act's (as defined below) loan forgiveness reduction provisions and extends the deadline to rehire workers in order to remain qualified for full forgiveness. The PPPFA Act also allows businesses that receive loan forgiveness to defer payroll taxes, extends (for new loans), and permits the extension (for existing loans) of, the PPP loan maturity date and extends the PPP loan payment deferral period. The IFR revisions and guidance implement these changes to the IFRs, and also introduce new rules addressing payroll costs that may be included on a PPP loan application or loan forgiveness application submitted by certain boat owners or operators that have hired one or more crewmembers who are regarded as independent contractors or otherwise self-employed that were not previously reflected in the PPP statutes and guidance.

Background

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was signed into law on March 27, 2020. The CARES Act authorizes up to $349 billion in forgivable loans to small businesses through the PPP administered by the SBA. On April 24, 2020, $484 billion of additional coronavirus relief was approved, which includes an additional $310 billion in funding for the PPP.

On April 2, 2020, the SBA posted on its website an interim final rule relating to the implementation of sections 1102 and 1106 of the CARES Act (published on April 15, 2020) (the "First IFR"). The SBA has since released the Interim Final Rule on Additional Eligibility Criteria and Requirements for Certain Pledges of Loans (the "Eligibility IFR"), the Interim Final Rule on Disbursements (the "Disbursement IFR"), the Loan Forgiveness Interim Final Rule (the "First Loan Forgiveness Rule") and the SBA Loan Review Procedures Interim Final Rule (the "First Loan Review Rule"), all of which have been updated with revisions as described below.

On June 19, the SBA and Treasury agreed with the bipartisan leaders of the U.S. Senate Small Business Committee to publicize additional PPP data to balance providing public transparency with protecting the payroll and personal income information of small businesses. The SBA announced it would disclose the business names, addresses, NAICS codes, zip codes, business type, demographic data, non-profit information and jobs supported for borrowers receiving loans in the follow amount ranges: $150,000-350,000; $350,000-1 million; $1-2 million; $2-5 million; $5-10 million, which categories account for almost 75% of approved loan dollars. For loans in amounts below $150,000, totals will be released in a format aggregated by zip code, industry, business type, and various demographic categories.

Interim Final Rule on Revisions to First Interim Final Rule (the "First IFR Revision")

The First IFR Revision was originally posted June 11, 2020 and revises the First IFR by updating provisions relating to loan maturity, deferral of loan payments, and forgiveness provisions. The Additional First IFR Revision (described further below) revises the First IFR by expanding eligibility for businesses with 20% or greater owners ("Owners") who have past felony convictions. The revisions also update the PPP application forms to conform to these changes.

The First IFR Revision modifies the First IFR to conform to the PPPFA's extension of the "covered period" PPP borrowers use to determine their payroll costs from ''the period beginning on February 15, 2020 and ending on June 30, 2020'' to ''the period beginning on February 15, 2020 and ending on December 31, 2020.'' Note that this expanded definition is effective retroactively to March 27, 2020 and relates to provisions governing PPP loan use and eligibility; it does not impact the loan forgiveness provisions in section 1106 of the CARES Act.

It also modifies the First IFR to conform to the PPPFA's extended PPP loan maturity date of five years for PPP loans made on or after June 5, 2020, while loans made before June 5, 2020 continue to have a maturity of two years unless borrowers and lenders mutually agree to extend the maturity of such loans to five years.

The First IFR Revision further reflects PPPFA provisions by extending the deferral period set forth in the First IFR, after which PPP borrowers must begin making principal and interest payments, to: (i) if the PPP borrower submits a forgiveness application within ten months of the end of the such PPP borrower's forgiveness covered period, the date on which the SBA remits the loan forgiveness amount to the lender (or notifies the lender of no forgiveness), and (ii) if the PPP borrower does not submit a forgiveness application within ten months of the end of the such PPP borrower's forgiveness covered period, then at the end of such ten-month period.

The loan forgiveness covered period—the period within which PPP borrowers may incur expenses and make payments that count towards PPP loan forgiveness set forth in the First IFR—is also extended to conform to the PPPFA by the First IFR Revision. PPP borrowers may incur expenses and make payments that count towards PPP loan forgiveness up to the date that is the earlier of (i) 24 weeks after the PPP loan is disbursed (up from eight weeks as set forth in the CARES Act) and (ii) December 31, 2020, although a PPP borrower whose loan was made before June 5, 2020 may elect to apply the original eight-week period.

With respect to the PPPFA's amended requirements reducing the amount of PPP loan proceeds that must be used for payroll costs in order to be forgivable and creating a new exemption for borrowers to avoid a reduction in loan forgiveness amount when they have a reduction in full-time equivalent employees ("FTEs"), the First IFR Revision offers some clarity. While the PPPFA's language allowed for the "cliff" interpretation that a PPP borrower qualifies for *any* forgiveness only if it uses at least 60% of its loan amount for payroll costs, the First IFR Revision incorporates the interpretation set forth in the Joint Statement by SBA Administrator Jovita Carranza and U.S. Treasury Secretary Steven T. Mnuchin Regarding Enactment of the PPPFA: that the 60% payroll costs requirement is not a threshold but rather proportional limit on nonpayroll costs as a share of the borrower's loan forgiveness amount. The First IFR Revision provides the following example: "if a borrower receives a $100,000 PPP loan, and during the covered period the borrower spends $54,000 (or 54 percent) of its loan on payroll costs, then because the borrower used less than 60 percent of its loan on payroll costs, the maximum amount of loan forgiveness the borrower may receive is $90,000 (with $54,000 in payroll costs constituting 60 percent of the forgiveness amount and $36,000 in nonpayroll costs constituting 40 percent of the forgiveness amount)."

On June 12, 2020, the SBA published another IFR revising the First IFR (the "Additional First IFR Revision"). The Additional First IFR Revision modifies the First IFR by changing the eligibility requirement related to PPP loan applicants with felony convictions and Owners of such applicants. The First IFR originally provided that an applicant that has an Owner who has been convicted of a felony within the last five years would not be approved as an applicant. The Additional First IFR Revision reflects the SBA and U.S. Department of Treasury ("Treasury") determination that a shorter timeframe (one year) for Owners convicted of felonies that do not involve fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance is more aligned with the intent to provide relief to small businesses and promotes improved criminal justice system outcomes. The five-year timeframe continues to apply to convictions of Owners for felonies that do involve fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance.

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Revised Forgiveness Applications

On June 17, the SBA in consultation with the Treasury posted a revised and borrower-friendly PPP loan forgiveness application with conforming changes to the PPPFA, as well as a second "EZ" loan forgiveness application for applicants who (A) are self-employed and have no employees; (B)(i) did not reduce the salaries or wages of any of their employees by more than 25%, and (ii) did not reduce their number of employees or hours of their employees; or (C)(i) experienced reductions in business activity as a result of health directives related to COVID-19 (described further below), and (ii) did not reduce the salaries or wages of any of their employees by more than 25%. The EZ application requires fewer calculations and less documentation for eligible borrowers. Both applications give borrowers the option of using the original eight-week covered period (if their loan was made before June 5, 2020) or the extended 24-week covered period set forth in the PPPFA.

Interim Final Rule on Revisions to the Third and Sixth Interim Final Rules (the "Eligibility and Disbursement IFR Revision")

The Eligibility and Disbursement IFR Revision was originally posted on June 17, 2020 and updates the Eligibility IFR to conform to the PPPFA by accounting for the extended covered period that PPP borrowers use to determine their payroll costs; the extended loan maturity date of five years for loans made on or after June 5, 2020 and the ability of PPP borrowers and lenders to mutually agree to a five-year maturity period for loans made before June 5; and the reduced 60% payroll-cost requirement (down from 75% in the regulations implementing the CARES Act). It also revises both the Eligibility IFR and the Disbursement IFR to reflect the extension set forth in the PPPFA of the covered period within which PPP borrowers may incur expenses and make payments that count towards PPP loan forgiveness to 24 weeks from loan origination (while allowing PPP borrowers that received PPP loans before June 5, 2020 to elect to use the original eight-week covered period).

Finally, the Eligibility and Disbursement IFR Revision also clarifies that the forgiveness of owner compensation replacement for individuals with self-employment income who file a Schedule C or F is limited to either eight weeks' worth (8/52) of 2019 net profit (up to $15,385) for an eight-week covered period or 2.5 months' worth (2.5/12) of 2019 net profit (up to $20,833) for a 24-week covered period per owner in total across all businesses, based on the combination of (i) the maximum PPP loan amount generally being based upon 2.5 months of the borrower's average monthly payroll costs and (ii) the safe harbor in the PPPFA from reductions in loan forgiveness for a borrower that is unable to return to the same level of business activity the business was operating at before February 15, 2020.

Interim Final Rule on Revisions to Loan Forgiveness Interim Final Rule and SBA Loan Review Procedures Interim Final Rule (the "Forgiveness and Review IFR Revision")

The Forgiveness and Review IFR Revision was originally posted on June 22, 2020 and updates the First Loan Forgiveness Rule and the First Loan Review Rule in light of the PPPFA.

Specifically, the Forgiveness and Review IFR Revision revises the First Loan Forgiveness Rule to reflect that eligible nonpayroll costs cannot exceed 40 percent of the loan forgiveness amount (up from 25 percent). In terms of process, it establishes that a PPP borrower may file a loan forgiveness application (whether SBA Form 3508, 3508EZ, or a lender equivalent) before the end of the applicable covered period if it has used all of the PPP loan proceeds for which it is requesting forgiveness.

It establishes that the lender shall notify the borrower of remittance by the SBA of the loan forgiveness amount (or of an SBA determination of no forgiveness) and the date on which such borrower's first payment is due, if applicable. Lenders also must render a decision on forgiveness no later than 60 days after receipt of a forgiveness application. PPP borrowers may seek review by the SBA if the lender denies forgiveness, and lenders must notify the SBA of a

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borrower's request for review within five days of receipt of the request. The SBA will notify the lender if the SBA declines a request for review, in which case, the lender shall notify the borrower of that fact and the date on which the borrower's first payment is due. If a PPP borrower's loan is deemed fully forgivable by the SBA, the lender must mark the PPP loan note as "paid in full," which will be reported on the next 1502 report filed by the lender. If the PPP borrower does not apply for loan forgiveness within ten months of the last day of the covered period, or if it there has been a SBA determination that the borrower is not eligible for forgiveness (in whole or in part), the borrower's deferral of interest and principal period terminates and the lender must notify the borrower of the due date of the first payment on the loan.

The Forgiveness and Review IFR Revision clarifies that if there are reductions of salaries or wages in excess of 25% during the period ending when the borrower files its loan forgiveness application, the borrower must account for the excess reduction through the end of the applicable covered period. However, it is still unclear how a forgiveness applicant would account for other amounts required to be set forth in the PPP loan forgiveness application for the covered period. For example, in determining average full-time equivalent employees during the covered period, it is unclear whether an applicant should report average full-time equivalent employees for the portion of the covered period through the date of its PPP loan forgiveness application, calculate such average over the entire covered period assuming it maintains its full-time equivalent employees as of the date of its application for the remainder of the covered period (similar to the guidance for salary and wage reductions) or use some other calculation.

The Forgiveness and Review IFR Revision also reiterates the Owner employees and self-employed borrower limitations set forth in the Eligibility and Disbursement IFR Revision and described above. The PPPFA's extension of the safe harbor for PPP borrowers to restore salaries and wages to December 31, 2020 remains in effect.

The Forgiveness and Review IFR Revision importantly revises the First Loan Forgiveness Rule to reflect the PPPFA's revised and expanded exemption from forgiveness amount reductions where a PPP borrower can document (A)(i) an inability to rehire individuals who were employees of the eligible recipient on February 15, 2020; and (ii) an inability to hire similarly qualified employees for unfilled positions on or before December 31, 2020; or (B) an inability to return to the same level of business activity as such business was operating at before February 15, 2020 due to compliance requirements established or guidance issued between March 1, 2020 and December 31, 2020 by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19 (the "COVID Requirements or Guidance"). To comply with the inability to rehire exemption, borrowers should maintain documentation to show compliance with this exemption, including but not limited to: the written offer to rehire an individual, a written record of the offer's rejection, and a written record of efforts to hire a similarly qualified individual. To comply with the COVID Requirements or Guidance exemption, documentation borrowers should maintain to show compliance must include, at a minimum, copies of applicable COVID Requirements or Guidance for each business location and relevant borrower financial records.
The Forgiveness and Review IFR Revision provides additional guidance on the exemption for reductions in business activity due to COVID Requirements or Guidance, saying that the reduction in business activity may stem directly or indirectly from COVID Requirements or Guidance, and provides, as an example, a retailer that experienced a reduction of business activity due to its compliance with a local government social distancing order based in part on guidance issued by the Centers for Disease Control and Prevention. It is not clear whether the exemption is available for an applicant that was not itself subject, directly or indirectly, to COVID Requirements or Guidance, but that experienced a reduction of business activity due to such compliance by its customers or suppliers, for example, a supplier of the retailer mentioned in the Forgiveness and Review IFR Revision that experienced a reduction in business activity due to the retailer's compliance and reduction in business activity.

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Interim Final Rule on Additional Eligibility Revisions to First Interim Final Rule (the "Eligibility IFR Revision")

The Eligibility IFR Revision was originally posted June 24, 2020 and further modifies the First IFR by limiting the eligibility restriction for Owners who are subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction, to pending criminal charges for felony offenses only.

The First IFR originally provided that PPP applicants are ineligible to receive a PPP loan if any of their Owners are on probation or parole. The Eligibility IFR Revision modifies this restriction to include only those individuals whose probation or parole commenced within the last five years for felonies involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance, and within the last year for other felonies. Note that the restriction against PPP applicants and Owners, as applicable, that are presently suspended, debarred, or proposed for debarment, remains effective, as do the restrictions against applicants with Owners who are presently incarcerated and those who have been convicted of or pleaded guilty or nolo contendere to felonies involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance in the last five years, or to other felonies in the last year.

Interim Final Rule on Certain Eligible Payroll Costs (the "Crewmember IFR")

The Crewmember IFR was originally posted on June 25, 2020, and addresses eligible payroll costs for loan applications submitted by certain boat owners or operators engaged in catching fish or other forms of aquatic animal life ("Fishing Boat Owners") and that have hired one or more crewmembers who are independent contractors (or otherwise self-employed) for certain federal tax purposes under 26 U.S.C. 3121(b)(20) of the Internal Revenue Code (the "Code").

The Crewmember IFR establishes that the relationship of a crewmember described in Section 3121(b)(20) of the Code and a Fishing Boat Owner is analogous to a joint venture or partnership for purposes of the PPP, and in the event of a conflict (for example, where one or more partners in a partnership are treated as independent contractors for tax purposes), the rules regarding partnership govern. Thus, a Fishing Boat Owner may include compensation reported on Box 5 of IRS Form 1099–MISC and paid to a crewmember described in Section 3121(b)(20) of the Code, up to $100,000 annualized, as a payroll cost in its PPP loan application.

However, if a crewmember performing services described in Section 3121(b)(20) of the Code obtains his or her own PPP loan and seeks forgiveness of that loan based in part on compensation from a Fishing Boat Owner, the Fishing Boat Owner cannot also obtain PPP loan forgiveness based on compensation paid to such crewmember. The Fishing Boat Owner is responsible for determining whether any of its crewmembers during the covered period for loan forgiveness received their own PPP loans. PPP loans to Fishing Boat Owners are more likely to be subject to an SBA loan review due to the increased risk of duplicate payroll costs.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

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