

## The “New and Improved” Paycheck Protection Program

The omnibus budget act signed by President Trump on December 27 reinstates the Paycheck Protection Program, with significant changes. The act allows new borrowers to receive PPP loans and some existing borrowers to receive additional PPP funding. It also restores the tax deduction for expenses paid with PPP loan proceeds, makes a number of changes in PPP and other SBA programs, and creates a new grant program for performance venues and businesses.

The new act extends the effectiveness of the original Paycheck Protection Program (now referred to as the “first draw”), creates a new program (the “second draw”) for previous PPP borrowers who have used or will have used by the time of second draw loan disbursement their previous loans and meet new eligibility requirements, and permits some original PPP borrowers to receive an addition to their original PPP loan. In general, the amendments will be effective as of the date of signing the act. However, some changes are retroactive to the adoption of the original CARES Act in March 2020, making them applicable to existing PPP loans that are not yet forgiven.

### First Draw Loan

The first draw program is an extension of the original PPP and follows the original PPP unless otherwise changed. Thus, in many respects, it will be familiar to practitioners in this area. Here are some of the major changes in the new program:

- PPP is extended through March 31, 2021.
- Maximum loan amount is unchanged — 2.5 times average monthly payroll costs, up to \$10 million.
- SBA is to establish an expedited loan application process for loans up to \$150,000. This is supposed to be a one-page form.
- Categories of eligible borrowers expanded to include housing cooperatives with no more than 300 employees, certain television stations and newspapers, certain 501(c)(6) organizations (e.g., chambers of commerce), and “destination marketing organizations.”
- Two specific ineligible categories are also established — (i) publicly traded companies and (ii) businesses or organizations not in operation on February 15, 2020.
- If the SBA decides to allow it, small business debtors in bankruptcy proceedings (i.e., debtors with less than \$7.5 million in debt) may become eligible for PPP loans, if they otherwise qualify. The loan would receive priority as an administrative expense.
- Eligible costs (for which PPP money can be spent) in the original program — payroll, rent, utilities, and interest on secured debt — continue in the first draw program. The act clarifies that payroll costs include group insurance for life, disability, vision and dental, in addition to health.
- New categories of eligible costs have been added: “covered operations expenditures” (software or cloud computing services), “covered property damage costs” (uninsured damage caused by 2020 disturbances), “covered supplier costs” (expenditures to suppliers under contracts entered into prior to the date of the loan that are essential to operations), and “covered worker protection expenditures” (PPP and adaptive investments to comply with health and safety requirements or guidelines). The new categories fall within the 40 percent portion for non-payroll costs.
- Lobbying activities are specifically prohibited as a use of PPP proceeds.
- Borrower may elect a covered period of any length between eight and 24 weeks. Previous SBA guidance had suggested a borrower could shorten the covered period if proceeds had been spent, but not all lenders allowed this.
- Forgiveness and repayment provisions remain the same, except that previous December 31, 2020, deadlines have been appropriately extended. For example, the rehire safe harbor has



Steven J. Dickinson

**Co-Chair,  
International  
Practice**

sdickinson@cozen.com  
Phone: (612) 260-9051  
Fax: (612) 260-9080



Robert K. Magovern

**Co-Vice Chair,  
Transportation  
& Trade**

rmagovern@cozen.com  
Phone: (202) 463-2539  
Fax: (202) 912-4830



James F. Van Orden

**Member**

jvanorden@cozen.com  
Phone: (215) 665-4625  
Fax: (215) 665-2013

### Related Practice Areas

- Corporate

been extended for new loans until the end of the covered period.

- For loans up to \$150,000, a streamlined forgiveness application and documentation process is to be established, with an application no more than one page long and no requirement to submit supporting documentation. Borrowers will still be subject to document retention and audit requirements.
- SBA is to adopt rules to implement the new program within 10 days.

These changes are not retroactive to loans already forgiven even if a borrower would, for example, no longer be eligible under the new first draw PPP provisions or would be in a position to obtain a greater amount of forgiveness under those provisions.

An entity that has submitted an application for forgiveness that has not yet been granted by the SBA and for which these changes may be beneficial, may wish to speak with their lender about amending their forgiveness application prior to any grant of forgiveness by the SBA.

## Second Draw Loans

The act creates a new second draw PPP loan for borrowers that previously received a PPP loan and have spent or will have spent by the time of second draw loan disbursement all of those proceeds. Major aspects of the new program include:

- Except as specifically provided, second draw loans are to be made under the same terms, conditions, and processes as under the first draw program.
- Eligibility is limited to business concerns, nonprofit organizations, housing cooperatives, veterans organizations, Tribal business concerns, eligible self-employed individuals, sole proprietors, independent contractors and small agricultural cooperatives (all as defined for first draw purposes) that meet two additional criteria — (i) employ not more than 300 employees and (ii) had gross receipts in the first, second, or third quarter of 2020 that are at least 25 percent less than the same quarter in 2019. For applications submitted on or after January 1, 2021, the revenue reduction may also be shown for the fourth quarter of 2020 compared to the fourth quarter of 2019. There are alternative calculation methods for businesses not in operation in 2019 and for seasonal businesses and a simplified process for demonstrating revenue loss for loans up to \$150,000.
- However, none of the following may be an eligible entity: (i) certain entities not eligible for SBA loans under existing SBA rules (financial businesses, passive businesses, illegal businesses, and the like), (ii) businesses primarily engaged in lobbying or political activities, specifically including “think tanks,” (iii) entities owned 20 percent or more by businesses organized under the law of the Peoples Republic of China or that have significant operations in the PRC, (iv) entities having a PRC resident as a director, (v) any person required to be registered under the Foreign Agents Registration Act, or (vi) a person receiving a grant under the program for shuttered venue operators created under the act.
- In general, the maximum loan amount is the lesser of (i) 2.5 times average total monthly payroll costs during either the year before the loan application or calendar year 2019, at the borrower’s option, or (ii) \$2 million. There are alternate calculation methods for seasonal employers and new employers.
- For entities with a NAICS code beginning with 72 (restaurants, hotels, and other hospitality businesses), the maximum loan amount is the lesser of (i) 3.5 times average total monthly payroll costs during either the year before the loan application or calendar year 2019, at the borrower’s option, or (ii) \$2 million.
- For NAICS code 72 businesses with more than one location, there is a rule similar to first draw PPP loans. The borrower is eligible for a loan if each location meets the eligibility criteria — 300 employees and a 25 percent revenue decrease.
- The waiver of the affiliation rule used in first draw loans (NAICS code 72, SBA-registered franchises and businesses receiving SBIC assistance) also applies to second draw loans, but instead of 500 employees the limit is 300.
- An entity may only receive one second draw loan.

## Additional Loans

The general rule is that a borrower may only receive one first draw loan. However, the act instructs SBA to issue rules within 17 days of the effective date that allow a recipient of a first draw loan that

is not yet forgiven to seek an additional loan in two cases. First, a borrower that returned all or part of its first draw loan may apply for a new loan equal to the difference between the amount they actually received and the maximum amount applicable. Second, a borrower that did not accept the full amount to which they were entitled may request a modification of the loan to receive the maximum amount applicable.

## Changes Applicable to Existing Loans

Several of the changes in first draw loans are applicable not only to new loans but to existing loans that have not yet been forgiven. As a result, current borrowers may wish to alter their spending or wait to apply for forgiveness until these provisions are fully implemented.

The retroactive provisions (previously summarized) include the following:

- The new categories of permissible costs — “covered operations expenditures,” “covered property damage costs,” “covered supplier costs,” and “covered worker protection expenditures.”
- The inclusion of group life, disability, and vision and dental insurance as a payroll cost.
- The streamlined forgiveness application and documentation process for loans up to \$150,000.
- Elimination of eligibility for borrowers not in operation on February 15, 2020.

## PPP and the Employee Retention Tax Credit

The CARES Act created an employee retention credit (ERC), a refundable tax credit available to taxpayers that either had their business fully or partially suspended during at least one quarter of 2020 or had a significant drop in gross receipts for quarters in 2020 relative to the same quarter in 2019. Eligible businesses may claim a maximum credit of \$5,000 per employee who is paid “qualified wages.” The appropriations act extends ERC from January 1, 2021, to July 1, 2021.

The CARES Act prohibited a PPP borrower from receiving the ERC. Because ERC applies to a “single employer” on an aggregated basis, in general a taxpayer could not use a PPP loan for one company and still have that company or any other member of the corporate group be eligible for ERC. This provision is repealed by the appropriations act, so now even the same party may receive a PPP loan and take the ERC.

To prevent “double dipping,” a taxpayer may not receive the ERC for payroll costs that are paid for with a PPP loan, to the extent the loan is forgiven. However, a taxpayer is permitted to elect not to include certain payroll costs in the computation of the ERC, which allows them to be funded by a PPP loan. The act also requires the SBA to adopt rules so that a borrower whose PPP loan is not fully forgiven may elect for the unforgiven portion of payroll costs to be eligible for ERC.

As a result of these changes, a PPP borrower may now have payroll costs paid from PPP proceeds to the extent required to receive full forgiveness of a loan and then to take ERC with respect to the excess payroll costs. These changes are effective as of the original effective date of the CARES Act.

## Tax Treatment of Expenses Paid with PPP Proceeds

The IRS has issued guidance that expenses paid with PPP loan proceeds may not be deducted on the borrower’s federal income tax return if the borrower reasonably expects to receive forgiveness of the loan, even if forgiveness has not been received or even applied for. The premise for this position is to prevent “double dipping” because the forgiveness of the PPP loan is not taxable as cancellation of debt. This position had been widely criticized as taking away much of the economic benefit to a borrower intended by the program. The act remedies this situation by specifically mandating that no deduction shall be denied, no tax attribute shall be decreased, and no basis increase shall be denied because the forgiveness of a PPP loan is not subject to tax as cancellation of debt.

## “Necessity” and Audits of PPP Loans

In November, the SBA began using new Forms 3509 and 3510 to require certain borrowers to provide additional information concerning the necessity for their PPP loan. The forms are

discussed in a previous Alert. There has been considerable controversy surrounding the question of necessity and the use of the new forms. Some hoped that Congress would modify the necessity requirement or the SBA forms in the stimulus act, but it did not. A necessity certification continues to be required for new PPP loans of all types. In fact, for the new second draw program, Congress waived two of the certifications required in the previous PPP loan application, but not the necessity certification.

The House Select Subcommittee on the Coronavirus Crisis has identified what it believes is more than \$4 billion in questionable PPP loans. The SBA fraud hotline has received thousands of complaints, and the U.S. Department of Justice has filed criminal charges against more than 80 individuals for suspected fraud in CARES Act relief programs. As a response to concerns about fraud and waste in PPP, the act requires SBA to submit to the House and Senate small business committees within 45 days of the effective date an audit plan with regard to forgiveness of loans over \$150,000, and to provide updates on that plan every 30 days. The audit plan is to include policies and procedures for conducting forgiveness reviews and audits and the metrics the SBA will use to determine which loans will be audited. The act also appropriates \$50 million for PPP audits and fraud mitigation efforts.

It appears borrowers will need to respond to Form 3509 or 3510 when received, unless the new administration changes policy or the pending litigation challenging the forms is successful.

## Other Provisions

The act establishes a Shuttered Venue Operator Grant program to provide financial assistance to live venue operators or promoters, theatrical producers, live performing arts organizations, museum operators, motion picture theatre operators, and talent representatives that meet certain requirements. Fifteen billion dollars is appropriated for the program.

The act continues the payment of principal and interest on certain qualifying SBA loans existing prior to the CARES Act. Borrowers receive an additional three months of full payments, starting in February 2021. Thereafter, the payments will be capped at \$9,000 per month. Certain borrowers are eligible for more favorable treatment.

The SBA's regular 7(a) loan and Express Loan programs continue to operate. The act increases the 7(a) guarantee percentage to 90 percent and increases the amount and guarantee percentage for Express Loans. Changes are also made in SBA's 504 loan program for fixed assets, microloan program, and Economic Impact Disaster Loan (EIDL) program. The act repeals the CARES Act section requiring the amount of an EIDL advance (up to \$10,000) to be deducted from a PPP borrower's loan forgiveness amount. The EIDL changes are expected to increase the availability and usability of that program. PPP borrowers may also receive an EIDL loan. Companies may wish to take another look at EIDL as a funding source.

## Funding

The unused money from the original PPP is returned to the Treasury, and a new appropriation of \$284.45 billion is made for PPP and related programs. Of this, \$131.72 billion is set aside for various purposes, including PPP loans for first-time borrowers, small borrowers, or small loans in low-income areas. After 25 days, the SBA may adjust these set-asides. The total unrestricted appropriation for PPP (both first and second draw) is \$152.73 billion.

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**Cozen O'Connor has advised many borrowers on the full range of PPP issues, including eligibility, use of proceeds, forgiveness and necessity. We are here to help you with all aspects of your PPP loan.**