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Congress passes legislation modifying the Paycheck Protection Program

PPP Audits and Investigations Practice Client Alert

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Congress late last night passed legislation modifying the Paycheck Protection Program (the PPP). The *Consolidated Appropriations Act, 2021* (the Act) provides \$900 billion for COVID-19 related relief, which also includes \$285 billion for the restart and expansion of the PPP, is expected to be signed by the President this week. First-time borrowers looking for an initial PPP loan and certain eligible borrowers with existing PPP loans have through March 31, 2021 to apply for the next round of PPP loans (once the SBA starts accepting applications).

Borrowers with existing PPP loans may be eligible for a second loan, referred to as a Second Draw loan, if they satisfy stricter eligibility requirements. The Act also expands the types of expenses eligible for forgiveness and clarifies that all forgiven PPP loans are excluded from gross income and the expenses paid with those loans are deductible.

I. Tax Treatment of All PPP Loans

The Act provides that ordinary business expenses forgiven as part of any PPP loan, including a Second Draw loan, are deductible. Under the CARES Act, forgiven loans are excluded from gross income. The IRS previously noted in Notice 2020-32, Revenue Ruling 2020-27, and Revenue Procedure 2020-51 that it would not allow such deductions, but its position is no longer supportable. Chamberlain Hrdlicka attorneys and others have noted in national publications that the IRS position may be subject to challenge because it appeared contrary to Congressional intent, among other reasons. Congress has now resolved this issue definitively in favor of all taxpayers.

II. Eligibility for a Second Draw Loan

In general, to be eligible for a Second Draw loan, a business must have used, or will use, the full amount of its initial PPP loan on or before the date the Second Draw loan is disbursed, and must:

- 1 Employ 300 or fewer employees; and
- 2 Experience at least a 25% decline in gross receipts in 1Q, 2Q, 3Q, or 4Q of 2020 when compared to the same quarter in 2019.

While this is a more straightforward test than was laid out in the CARES Act for initial PPP loans, it imposes more stringent requirements on the applicant, reducing the

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maximum number of employees a business can employ to 300 from 500 and requiring a year-over-year decline in gross receipts.

A business with more than one physical location is eligible for a Second Draw loan if, in addition to fully using its initial PPP loan, it:

- 1 Is assigned an NAICS code of 72 (associated with hotels and restaurants);
- 2 Employs 300 or fewer employees *per physical location*; and
- 3 Has experienced at least a 25% decline in gross receipts in 1Q, 2Q, 3Q, or 4Q of 2020 when compared to the same quarter in 2019.

III. Maximum Second Draw Loan Amount

For most borrowers, a Second Draw loan can be up to the LESSER of \$2 million OR:

- 5 times the average monthly payroll costs during either (i) the one-year period before the date the loan is made or (ii) 2019, whichever the borrower elects to use.

For borrowers with an NAICS code of 72 (associated with hotels and restaurants), the 2.5x multiplier is increased to 3.5x, potentially resulting in such businesses receiving greater loan amounts than other businesses with similar monthly payroll costs.

For seasonal employers, the one-year period is reduced to any twelve-week period between February 15, 2019 and February 15, 2020, but the multiplier stays at 2.5x.

IV. Only One Second Draw Loan is Allowed

The Act limits each borrower, including borrowers with more than one physical location, to one Second Draw loan.

V. Expansion of Expenses Eligible for Forgiveness

Forgiveness for any PPP loan, including a Second Draw loan, is still limited to 60% payroll costs and 40% non-payroll costs, as Congress first provided in the *Flexibility Act*. In addition to payroll costs, mortgage interest, rent/lease payments, and certain utility payments, the following expenses are also eligible for forgiveness (counting as non-payroll costs):

- Operations Expenditures: 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.
- Property Damage Cost: Costs 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.
- Supplier Cost: Expenditures made to a supplier for goods that are essential to the operations of the entity at the time at which the expenditure is made. These expenditures must be made pursuant to a contract, order, or purchase order in effect before the Second Draw loan Covered Period or if for perishable goods, before *or during* the Second Draw loan Covered Period.

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- Worker Protection Expenditures: Operating or capital expenditures to facilitate the adaptation of business activities to comply with COVID-19 requirements/guidance issued by HHS, CDC, OSHA, or equivalent State/local guidance from March 1, 2020 to the end of COVID-19 national emergency. The expenditures must be related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19.

Overall, the *Consolidated Appropriations Act, 2021* is a positive next step for the PPP. It clarifies the tax treatment of forgiven expenses in favor of the taxpayer, allocates \$285 billion to the PPP and reopens the application period through March 31, 2021, and allows certain borrowers with existing PPP loans to apply for Second Draw loans up to \$2 million if they satisfy strict eligibility requirements. At this time, the forgiveness application process and SBA review process for existing PPP loans has not changed, so borrowers with such loans should make sure they have an understanding of what to expect.

Please contact Chamberlain Hrdlicka should you have any questions about any aspects of the PPP, including the loan certification and forgiveness process, audit, investigation, and appeal process, Second Draw loan process, or anything else relating to PPP.