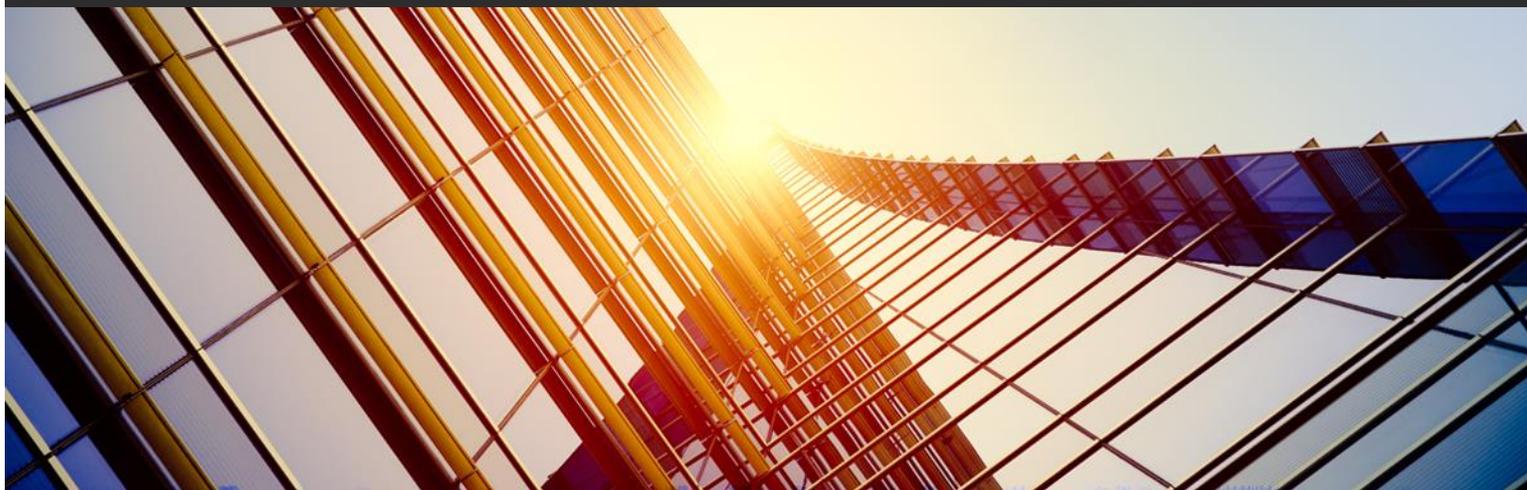


**Alert | Health Emergency Preparedness Task Force:
COVID-19 Economic Stimulus**



January 2021

Paycheck Protection Program – Expected Impact of ‘Second Draw’ Loans

On Dec. 21, 2020, Congress approved H.R. 133, referred to as the “Consolidated Appropriations Act, 2021” (the Act). The legislation, signed into law by President Trump on Dec. 27, 2020, enhances and expands certain provisions of the Coronavirus Aid, Relief, and Economic Security Act of 2020 (the CARES Act) (H.R. 748) and changes the Paycheck Protection Program (PPP) administered by the U.S. Department of the Treasury’s Small Business Administration (SBA) by (i) authorizing additional liquidity for a second round of PPP loans and (ii) expanding PPP borrower eligibility in some instances, while implementing changes to PPP loans that will impact both new and existing PPP borrowers. The SBA is expected to issue new guidance in the coming days to address the particulars of the revitalized PPP and to answer questions that have arisen since the date of enactment of the Act.

Second Draw Loan Amounts

The Act creates a second loan from the PPP, called a “PPP second draw” loan for smaller and harder-hit businesses, with a maximum amount of \$2 million.

Eligibility

In order to receive a PPP second draw loan under the Act, eligible entities must:

- Employ not more than 300 employees (as opposed to 500 employees in the first round of PPP). Unless subject to an exemption, e.g., hospitality (NAICS code 72), the SBA affiliation rules apply in determining the number of employees;
- Have used or will use the full amount of their first PPP loan; and
- Demonstrate at least a 25% reduction in gross receipts in the first, second, or third quarter of 2020 relative to the same quarter in 2019.

Eligible entities must be businesses, certain nonprofit organizations, housing cooperatives, veterans' organizations, tribal businesses, self-employed individuals, sole proprietors, independent contractors, and small agricultural co-operatives.

Similar to the first round, ineligible entities include:

- a) those entities listed in 13 C.F.R. § 120.110 and subsequent SBA guidance, excluding (i) such listed entities which have otherwise been made eligible by statute or guidance and (ii) nonprofits and religious organizations;
- b) entities primarily involved in political and lobbying activities including engaging in advocacy in areas such as public policy or political strategy, or that otherwise describe themselves as a think tank in any public document;
- c) entities affiliated with entities in the People's Republic of China;
- d) registrants under the Foreign Agents Registration Act; and
- e) entities that receive a grant under the Shuttered Venue Operator Grant program.

Eligibility of News Organizations for Loans under the Paycheck Protection Program

The Act makes eligible (a) FCC license holders and newspapers with more than one physical location, as long as the business has no more than 500 employees per physical location or the applicable SBA size standard, and (b) section 511 public colleges and universities that have a public broadcasting station, if the organization certifies that the loan will support locally focused or emergency information. The Act waives affiliation rules for newspapers, television and radio broadcasters, and public broadcasters, as long as the organization has no more than 500 employees per physical location or the applicable SBA size standard and further waives the prohibition against publicly traded news organizations from being eligible if the business certifies that the loan will support locally focused or emergency content.

Eligibility of Certain 501(c)(6) and Destination Marketing Organizations Under the Paycheck Protection Program

Excluded from PPP participation in the first round, the following organizations are now eligible to receive a PPP loan under the Act's expanded criteria:

- 501(c)(6) organizations if:
 - the organization does not receive more than 15% of receipts from lobbying;
 - the lobbying activities do not comprise more than 15% of activities;

- the cost of lobbying activities of the organization did not exceed \$1,000,000 during the most recent tax year that ended prior to Feb. 15, 2020; and
- the organization has 300 or fewer employees.

Professional sports leagues or organizations with the purpose of promoting or participating in a political campaign or other political activities are not eligible under this section.

- Destination Marketing Organizations if:
 - the organization does not receive more than 15% of receipts from lobbying;
 - the lobbying activities do not comprise more than 15% of activities;
 - the organization has 300 or fewer employees; and
 - that destination marketing organization is registered as a 501(c) organization, a quasi-government entity, or a political subdivision of a state or local government.

Guidance to Prioritize Underserved Communities

The Act directs the SBA administrator to issue guidance addressing barriers to access to capital for underserved communities no later than 10 days after the date of the Act's enactment.

Churches and Religion Organizations

The Act codifies that the prohibition on eligibility in 13 CFR § 120.110(k) – businesses principally engaged in teaching, instructing, counseling, or indoctrinating religion or religious beliefs, whether in a religious or secular setting – does not apply for initial and second draw PPP loans.

Loan Terms

In general, PPP borrowers may receive a loan amount of up to 2.5 times their average monthly payroll costs in the one year prior to the loan or the calendar year. No loan can be greater than \$2 million.

Entities in industries assigned to NAICS code 72 (Accommodation and Food Services) may receive loans of up to 3.5 times their average monthly payroll costs. Such businesses with multiple locations that are eligible entities under the initial PPP requirements may employ not more than 300 employees per physical location. The waiver of affiliation rules that applied during initial PPP loans applies to these NAICS code 72 second loans; however, an eligible entity may only receive one PPP second draw loan.¹

For loans of not more than \$150,000, the borrower entity may submit a certification attesting that it meets the revenue loss requirements on or before the date the entity submits its loan forgiveness application. Nonprofit and veterans organizations may use gross receipts to calculate their revenue loss standard.

Loan Forgiveness

Borrowers of a PPP second draw loan are eligible for loan forgiveness equal to the sum of their payroll costs, as well as covered mortgage, rent, and utility payments, covered operations expenditures, covered property damage costs, covered supplier costs, and covered worker protection expenditures incurred

¹ The waiver of affiliation rules that applied during initial PPP loans applied to NAICS code 72 entities, meaning that each individual applicant was assessed independently with regard to the employee cap, and any affiliates of such PPP borrowers were not aggregated in determining the number of employees with regard to the borrower's business size.

during the covered period. Borrowers are still required to use at least 60% of PPP loan proceeds on eligible payroll costs in order to receive full forgiveness.

The Act extends existing safe harbors on restoring FTE and salaries and wages.

‘Covered Period’ for Loan Forgiveness

In calculating the amount of eligible expenses paid or incurred that would qualify for loan forgiveness, borrowers who received loans before June 5, 2020, previously could choose between an eight-week period contemplated by the CARES Act or a 24-week period contemplated by the new PPP legislation. The duration of the “covered period” impacts the amount of expenses that could be included in the borrower’s forgiveness calculation and also impacts the measurement period for potential reductions to loan forgiveness that are based on changes in full-time employee equivalents (FTEs) or salary or hourly wage reductions. Borrowers who received their first loan on or after June 5, 2020, were required to use the longer 24-week “covered period.” The new legislation provides that PPP borrowers will be provided the option to choose between an eight-week covered period and a 24-week covered period. However, it is not clear whether this flexibility to choose a customized covered period will apply retroactively to loans made prior to the enactment of the new legislation.

Additional Eligible Expenses

The Act makes the following additional expenses of a borrower allowable and forgivable uses for PPP funds:

- Covered operations expenditures. Includes the payment for any software, cloud computing, and other human resources and accounting needs.
- Covered property damage costs. Costs related to property damage due to public disturbances that occurred during 2020 that are not covered by insurance.
- Covered supplier costs. Expenditures to a supplier pursuant to a contract, purchase order, or order for goods in effect prior to taking out the loan that were essential to the recipient’s operations at the time at which the expenditure was made. Supplier costs of perishable goods can be made before or during the life of the loan.
- Covered worker protection expenditure. Personal protective equipment and adaptive investments to help a loan recipient comply with federal health and safety guidelines or any equivalent state and local guidance related to COVID-19 during the period between March 1, 2020, and the end of the national emergency declaration.

Loans made under the first round of PPP are eligible to use the expanded forgivable expenses, except for borrowers who have already had their loans forgiven.

Lender Safe Harbor

Under the Act, a lender may rely on any certification or documentation submitted by a borrower for an initial or second draw PPP loan and that no enforcement action may be taken against the lender, and the lender will not be subject to any penalties relating to loan origination or forgiveness, if: (1) the lender acts in good faith relating to loan origination or forgiveness; and (2) all relevant federal, state, local and other statutory and regulatory requirements are satisfied.

Tax Treatment

The Act contains several tax provisions that will benefit companies that have or will receive PPP loans. Below is a top-line summary; however, the IRS will likely publish guidance further clarifying the new law, so this discussion should be considered preliminary and subject to change:

- **Deductibility of Expenses and Other Tax Benefits:** The new law clarifies that the expenses paid with the proceeds of a forgiven PPP loan are deductible, legislatively overruling IRS Notice 2020-32, which disallowed deductions for such expenses. The new law goes further, stating that no tax benefit shall be denied, and no loss carryovers or basis adjustment will be required as a result of the tax-free forgiveness of a PPP loan. This will prevent the IRS from taking the position that a company must reduce loss carryovers or the basis of its assets by the amount of the forgiven loan (which, but for this clarification, would be the general treatment when a forgiven loan is excluded from income under the special cancellation of debt provision of the tax code).

In addition, the new law clarifies that for pass-through entities, the amount of the forgiven PPP loan will be treated as tax-exempt income received by the entity. This will result in an increase in the basis of the entity owner's ownership interest. This technical refinement will ensure that the economic benefit to the pass-through entity resulting from the exclusion from income of the PPP loan forgiveness will carry through to the pass-through entity owner's interest when they sell their interest in the company, or the company distributes its assets in liquidation (without this basis increase, the owners of the pass-through entity would ultimately pay tax on their share of the forgiven amount).

- **Eligibility for Employee Retention Tax Credit:** The CARES Act enacted a 50% tax credit for wages paid to employees when business operations have been fully or partially suspended, or the company has experienced a significant decline in gross receipts. However, the CARES Act did not allow the credit to a company which received a PPP loan – even if the loan was not forgiven. The new law changes this, now allowing the credit – except that the credit is not available for the wages paid with the proceeds of a PPP loan which are forgiven. This change is especially welcome because the employee retention credit has been increased effective Jan. 1, 2021, (from 50% to 70%) and the maximum credit per employee has been increased from \$5,000 for wages paid in 2020 up to a total of \$ 14,000 for wages paid during the first two quarters of 2021 (\$7,000 maximum credit per quarter). There are several requirements and limitations for this credit. See [this GT Alert](#) for more details.

Since the employee retention credit is only available for wages paid with non-PPP loan funds, a company wishing to maximize its tax credit may benefit from the use of PPP loan proceeds to pay the minimum amount of wages required for loan forgiveness, and use of non-PPP loan funds to pay as much of other eligible expenditures allowed with PPP loan funds.

Because the credit is only available for wages paid with non-PPP loan funds, a company should be able to trace funds used to pay wages to be able to demonstrate that the wages are not paid with PPP money. Until guidance is issued by the IRS on tracing funds, a PPP borrower who is otherwise eligible for the employee retention tax credit should consider keeping PPP loan proceeds in a separate account so that it can prove which wages are not eligible for the credit (those paid from the PPP account) and which wages are eligible for the credit (those not paid from the PPP account).

- **Retention Credit for Related Companies:** Under the CARES Act, not only was a company receiving a PPP loan ineligible to claim the employee retention tax credit, but any other related company sharing more than 50% common ownership was likewise barred from claiming the credit. This limitation affected private equity firms, since if one of its portfolio companies received a PPP loan, its other portfolio companies would not be eligible to claim the credit. Since the new law eliminates the

prohibition against a PPP borrower from claiming the credit, companies related to a PPP borrower would be eligible to claim the credit.

- **Refund Claims:** The change in the law allowing a PPP borrower (and its related companies) to claim the employee retention credit is retroactive to the effective date of the CARES Act. Consequently, a PPP borrower should be eligible to file amended payroll tax returns to claim the credit for wages that were not paid with PPP loan proceeds that were forgiven, assuming the credit requirements were otherwise satisfied. The same is true for companies related to a PPP borrower which did not file a refund claim because of the prior rule.
- **Size of Company for Employee Retention Tax Credit Purposes:** An additional change to the employee retention tax credit rules is especially relevant to PPP borrowers. Under the CARES Act, a company with 100 or fewer employees was eligible to claim the credit, even if its employees were working. By contrast, a company with more than 100 employees was eligible for the credit only for wages paid to employees who were not working. The new law increases this threshold to a company with 500 employees or less. This 500-employee threshold would cover any company eligible under the second round of PPP company size threshold of no more than 300 employees (*but see* the discussion below on the special PPP rule for hotel and restaurant businesses). Consequently, a company eligible for a second round PPP loan would also be eligible for the favorable employee retention credit rule for wages paid, even if its employees are working (but remember that the credit is not available for wages paid with a PPP loan that is forgiven).

However, this tax credit benefit for companies of 500 or fewer employees may not be available to all companies in the hotel or restaurant industry taking a PPP loan. A special rule for PPP loan eligibility for hotel or restaurant businesses tests the number of employees on a separate location basis, rather than the number of employees system-wide. On the other hand, the 500-employee threshold for the favorable tax credit rule is still tested on a company-wide basis, even for a hotel or restaurant business. For example, a company that owns 10 hotels, where each location has 75 employees, would be eligible for a second round PPP loan, since the PPP rules test the employee-count threshold on the number of employees at each separate location; however, the company would not be eligible for the favorable retention credit rule allowing the credit for wages paid to employees who are working, since it would have a total of 750 employees, which exceeds the new 500-employee threshold for this beneficial tax credit treatment.

Simplified Application

The Act creates a simplified application process for loans under \$150,000, such that:

- A borrower shall receive forgiveness if a borrower signs and submits to the lender a certification that is not more than one page in length and includes a description of the number of employees the borrower was able to retain because of the covered loan, the estimated total amount of the loan spent on payroll costs, and the total loan amount. The borrower must also attest that borrower accurately provided the required certification and complied with PPP loan requirements. SBA must establish this form within 24 days of enactment and may not require additional materials unless necessary to substantiate revenue loss requirements or satisfy relevant statutory or regulatory requirements. Additionally, borrowers are required to retain relevant records related to employment for four years and other records for three years. The SBA administrator may review and audit these loans to ensure against fraud.
- At the discretion of the borrower, the borrower may complete and submit demographic information for all PPP loans.

- This applies to loans made before, on, or after the date of enactment, including the forgiveness of the loan.

Reduced Document Retention Requirements for Loans Under \$150,000

Unlike larger loans that require borrowers to retain relevant supporting documentation for six years, for loans of up to \$150,000, borrowers will only be required to retain applicable documents for four years, as to employment records, or three years as to other records. These changes are retroactive to the passage of the CARES Act.

Increased Ability for PPP Borrowers to Request an Increase in Loan Amount Due to Updated Regulations

The Act requires the SBA administrator to release guidance to lenders within 17 days of enactment that allows borrowers who returned all or part of their PPP loan to reapply for the maximum amount applicable, so long that they have not received forgiveness. Additionally, this section allows borrowers whose loan calculations have increased due to changes in interim final rules to work with lenders to modify their loan value regardless of whether the loan has been fully disbursed, or if Form 1502 has already been submitted.

Oversight of SBA Audits

The Act directs the SBA to provide to Congress audit plans detailing the policies and procedures of the SBA for conducting forgiveness reviews and audits of PPP loans, including the criteria that the SBA will use to determine which PPP loans will be audited. The SBA has 45 days to submit these PPP audit plans.

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This GT Alert speaks as of the date of issuance. Guidance is expected soon from SBA that may materially alter or supplement the information set out in this GT Alert. Interested parties should review any updated guidance posted on SBA's website and consult with counsel prior to submitting their application for forgiveness.

For more information and updates on the developing situation, visit [GT's Health Emergency Preparedness Task Force: Coronavirus Disease 2019](#) or [GT's COVID-19 Economic Stimulus Team](#).

Authors

This GT Alert was prepared by:

- [Barbara A. Jones](#) | +1 310.586.7773 | jonesb@gtlaw.com
- [Marvin A. Kirsner](#) | +1 954.768.8224 | kirsnerm@gtlaw.com
- [Robert Mangas](#) | +1 202.530.8507 | mangasr@gtlaw.com
- [Carl A. Fornaris](#) | +1 305.579.0626 | fornarisc@gtlaw.com
- [Bryan X. Grimaldi](#) | +1 212.801.9337 | grimaldib@gtlaw.com
- [Marc J. Musyl](#) | +1 303.572.6585 | musylm@gtlaw.com

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