



# Congress Revises PPP Rules: Allows PPP Second Round, Reverses IRS Position on Deductibility

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Congress has come bearing gifts this holiday season to those businesses hit hard by the ongoing COVID-19 crisis. On December 21, 2020, Congress passed the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act (the “Act”), which among other things, extends the current Payroll Protection Program (the “PPP”) and provides additional funding to small businesses; makes changes to the existing PPP rules; allows certain borrowers to obtain a second round of PPP loans; and reverses the IRS position on deductibility of certain expenses paid with funds from forgiven PPP loans. After a week-long game of “chicken”, President Trump signed the Act late Sunday December 27th. This eAlert highlights the main changes in the Act.

## Extension of PPP and Additional Funding

The Act extends the PPP (both in terms of eligibility and use of PPP loan proceeds) from December 31, 2020 to March 31, 2021. The Act also provides \$284.45 billion in direct appropriations for the PPP for new borrowers and existing borrowers who meet the criteria for a second draw. The Small Business Administration (“SBA”) must promulgate regulations to carry out these changes within 10 days after the December 27th enactment date.

## Changes to Existing PPP Rules

The Act makes changes to the following existing PPP rules:

- **Eligible Borrowers.** The Act expands the types of borrowers that are eligible for PPP loans to include certain 501(c)(6) nonprofit trade organizations and business leagues; destination marketing organizations (defined as 501(c) nonprofit organizations or governmental entities that engage in tourism and hospitality marketing);

newspaper and broadcasting companies previously ineligible because of the current application of the SBA affiliation rules; and housing cooperatives with fewer than 300 employees. However, certain entities will no longer be eligible for PPP loans starting on the date of enactment of the Act, including 501(c)(4) entities involved in political and lobbying activities; entities whose owners are based in or affiliated with the People's Republic of China or Hong Kong; entities that have a Chinese resident on their board of directors; and publicly-traded companies.

- **Eligible Expenses.** In addition to using PPP loans for payroll costs, covered mortgage service and rent, and utility payments, borrowers can use their PPP loan proceeds to cover, and loan forgiveness is allowed for, new categories of expenses:
  - *Covered operations expenditures*, defined as payments for business software or cloud computing services that facilitate business operations; product or service delivery; processing, payment, or tracking of payroll expenses; human resources, sales and billing functions; or accounting or tracking of supplies, inventory, records and expenses.
  - *Covered property damage costs*, defined as costs related to property damage, vandalism, or looting from public disturbances during 2020 that were not covered by insurance or other compensation.
  - *Covered supplier costs*, defined as expenditures by the borrower to a supplier of goods that are (a) essential to the operations of the business at the time of such expenditure; and (b) made pursuant to a contract, order, or purchase order in effect before the borrower's covered period or, in the case of perishable goods, during the borrower's covered period.
  - *Covered worker protection expenditures*, defined as any operating or capital expenditures that facilitate the adaption of the borrower's business activities to comply with The U.S. Department of Health and Human Services ("HHS"), Centers for Disease Control and Prevention ("CDC") or Occupational Safety and Health Administration ("OSHA") requirements (or equivalent state or local requirements), with respect to COVID-19 during the period beginning March 1, 2020 and ending on the date the national emergency declaration ends. These expenditures include the costs of purchasing, maintaining or renovating assets that create or expand drive-through window facilities; air or air pressure ventilation or filtration systems; physical barriers like sneeze guards; expansion of additional indoor, outdoor or combined business spaces; health screening capabilities; or the purchase of certain personal protective equipment ("PPE"). However, the definition excludes residential real property or intangible property.
- **Covered Period for Loan Forgiveness.** The Act allows borrowers to choose a covered period for loan forgiveness purposes. The period selected must begin on the date of the origination of a covered loan and end on such date selected by the borrower that occurs during the period beginning on the date that is eight weeks after the origination date and ending on the date that is 24 weeks after such origination date.
- **Ability to Increase Loan Amount.** Borrowers who have obtained PPP loans (including those who have returned all or part of their loans) can now modify their original loan amounts based on changes in regulations if those changes result in a larger loan amount for the borrower. However, borrowers whose PPP loans have already been forgiven cannot apply for an increase in their PPP loan amounts. The SBA has 17 days from the enactment of the Act to issue guidance on the procedures for these increases.
- **Full-Time Equivalent ("FTE") and Salary Safe Harbor.** For PPP loans made after the enactment of the Act, the date to restore FTE headcount and salary/wage levels is extended to the last date of the covered period for that loan.
- **Simplified Loan Forgiveness Process and Audits for Certain Loans.** The forgiveness process for PPP loans of up to \$150,000 is now simplified. These borrowers will only be required to sign and submit a one-page certification. The certification will require the borrower to provide a description of the number of employees that the borrower was able to retain because of the PPP loan, the estimated amount of the PPP loan proceeds spent on payroll costs, and the total PPP loan value. The certification also will include an attestation that the borrower has complied with the requirements of the PPP loan. The SBA may review and audit loans that fall within this category. The SBA may also modify the amount of the PPP loan or the amount forgiven if it finds fraud, ineligibility, or other material noncompliance. Borrowers of these loans must retain records to prove compliance

for four years with respect to employment records, and three years with respect to all other records.

- **Forgiveness Audit Plan.** The SBA must come up with an audit plan within 45 days after the enactment of the Act that details the policies and procedures for SBA audits on forgiveness and the metrics that the SBA will use to determine which PPP loans will be audited.

## Second Round of PPP Loans

The Act provides certain borrowers with a “second draw” of PPP loan funds. While the rules applicable to the second draw largely mirror the rules applicable to the first round of PPP loans, there are some differences:

- **Narrower Eligibility Requirements.** To be eligible for a second draw, a borrower must:
  - have been eligible for the initial round of PPP loans;
  - have used, or will use by the time the second draw is disbursed, the full amount of the borrower’s initial PPP loan;
  - together with their affiliates, have fewer than 300 employees (unlike the initial PPP loan, this cap applies even if the borrower’s business is in the accommodation or food service industries and the borrower qualified for a waiver of the affiliation rules for the initial PPP loan because the borrower has no more than 500 employees per physical location); *and*
  - be able to demonstrate a year-over-year decline of 25% or more gross receipts for any quarter in 2020 as compared to the same quarter in 2019 (borrowers who commenced their business operations in Q4 of 2019 may compare their 2020 quarterly gross receipts to Q4 2019 gross receipts; and borrowers who commenced their business operations in Q1 2020 but were in business on or before February 15, 2020 may compare Q2, Q3 and Q4 2020 gross receipts against gross receipts in Q1 2020).
- **Amount of Second Draw.** The maximum amount of the second draw is the lower of (a) 2.5 times of the average total monthly payment for payroll costs incurred or paid during (at the election of the borrower) the one year period before the date the loan is made or the 2019 calendar year; or (b) \$2 million. Borrowers in the accommodation or food service industries may use a 3.5 (instead of 2.5) multiplier to calculate the amount of their second draw. Seasonal employers may use any 12-week period between February 15, 2019 and February 15, 2020 for their average monthly payroll costs.

## Deductibility of Forgiven PPP Loans

Among a slew of tax changes and extensions, the Act finally confirms that a taxpayer can deduct PPP loan-funded eligible expenses even if the lender forgives the PPP loan. The Internal Revenue Service had concluded, back in May and again only last month, that a borrower could not do so because Congress, in the original PPP legislation, had provided that a forgiven PPP loan was not taxable but did not address whether a borrower could “double dip” and deduct the expenses as well.

In reversing the IRS’ position, Congress has enhanced the economic benefits of PPP loans for borrowers. Congress also provided much-needed clarity a week before the 2020 tax reporting year closes for many borrowers. Unfortunately, California taxpayers continue to be in a bind because the state legislature provided that for state tax purposes a forgiven PPP loan was not taxable but that the related expenses were not deductible. The state legislature will need to adopt another conformity bill confirming that such expenses are deductible for state purposes, in line with the federal treatment under the Act. To date, we have seen no indication that this will occur before year-end.

This eAlert is not an exhaustive summary of the PPP; the information contained in the Act or in SBA guidance; or the tax changes in the Act. Readers are encouraged to visit the SBA's website for more complete and up-to-date information regarding the PPP and the IRS' website for information on COVID-19 tax relief and other tax changes in the Act.