

Taking Full Advantage of the PPP and Employee Retention Tax Credit

George E. Constantine

202.344.4790 | GEConstantine@Venable.com

Meredith Boylan

202.344.8062 | MLBoylan@Venable.com

Chris Moran

410.244.7604 | CNMoran@Venable.com

VENABLE LLP

Today's Discussion

- Introductions/Background
- New Developments—Economic Aid Act
 - First Draw Loans
 - Second Draw Loans
 - Expanded Forgiveness
- 501(c)(6) Organizations and Lobbying
- Employee Retention Tax Credit



New Developments— Economic Aid Act

Updates to the Paycheck Protection Program

- First Draw loans
- Second Draw loans
- Expanded forgiveness

SBA Top Line Overview of Reopened First Draw Loan Program

PAYCHECK PROTECTION PROGRAM FIRST DRAW LOANS

SBA is reopening the Paycheck Protection Program (PPP) for First Draw Loans the week of January 11, 2021. First Draw PPP Loans can be used to help fund payroll costs, including benefits. Funds can also be used to pay for mortgage interest, rent, utilities, worker protection costs related to COVID-19, uninsured property damage costs caused by looting or vandalism during 2020, and certain supplier costs and expenses for operations.

Full Forgiveness Terms

First Draw PPP Loans made to eligible borrowers qualify for full loan forgiveness if during the 8- to 24-week covered period following loan disbursement:

- Employee and compensation levels are maintained;
- The loan proceeds are spent on payroll costs and other eligible expenses; and
- At least 60 percent of the proceeds are spent on payroll costs.

Who Can Apply

Eligible small entities, that together with their affiliates (if applicable), have 500 or fewer employees—including nonprofits, veterans organizations, tribal concerns, self-employed individuals, sole proprietorships, and independent contractors—can apply. Entities with more than 500 employees in certain industries that meet SBA's alternative size standard or SBA's size standards for those particular industries can also apply.¹

BUT: For housing cooperatives, **section 501(c)(6) organizations**, and destination marketing organizations, **the applicable size standard is not more than 300 employees.**

First Draw Loans: A Few Notable Points

- **Limited to one First Draw per borrower:** Confirms that borrowers may not receive more than one First Draw PPP loan (subject to certain exceptions related to increases for borrowers that returned PPP funds or did not accept all of the funds for which they were initially approved) but may be eligible for a Second Draw PPP loan.
- **Timing:** Applications must be submitted by lenders through E-Tran on or before March 31, 2021, and the request is subject to the availability of funds.
- **Covered period:** Allows borrowers to choose their "covered period," which begins on the date the lender disburses the PPP loan and ends on any date selected by the borrower that is between 8 and 24 weeks after the date of disbursement.
- **Base period:** Allows new borrowers to choose calendar year 2019 or 2020 as the base period for purposes of calculating their maximum loan amount.
- **Interest rate:** Restates PPP loans will bear a 1% interest rate and adds that the interest rate is to be calculated "on a non-compounding, non-adjustable basis."

First Draw Loans: Opportunity to Reapply or Increase

- Borrowers that returned the entirety of their PPP loans may reapply for a PPP loan in an amount the borrower is eligible for under current PPP rules.
- Borrowers that returned part of a PPP loan are permitted to reapply for the difference between the amount retained and the previously approved amount.
- Borrowers that did not accept the full amount of a PPP loan for which they were approved may seek an increase up to the previously approved amount.

Second Draw Loans: Eligibility

- Eligible borrowers include:
 - Borrowers with fewer than 300 employees, that used or will use the full amount of their first PPP loan on or before the date when the second PPP loan is expected to be disbursed, and have experienced a gross revenue reduction of "25% or greater in 2020 relative to 2019."
 - Borrowers may show a 25% reduction by comparing gross receipts in any 2020 quarter compared with the same quarter in 2019 or a reduction of 25% or more in 2020 compared with 2019.
- Excludes from gross receipts the forgiveness amount of a First Draw PPP loan received in calendar year 2020.
 - Question: For all entity types (e.g., for-profit businesses and nonprofit organizations), do "gross receipts" include PPP Loan proceeds that are forgiven (or EIDL advances)?
Answer: No. The amount of any forgiven First Draw PPP Loan or any EIDL advance, which are not subject to federal income tax, is not included in the calculation of "gross receipts."
- Specifies that for borrowers with affiliates, the calculation of gross receipts should include affiliate receipts. For those borrowers, gross receipts are calculated "by adding the gross receipts of the business concern with the gross receipts of each affiliate."

First and Second Draw Loans: Economic Necessity Certification

- First and Second Draw borrowers must certify: “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”
 - FAQ 31: “Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.”
 - For Second Draw borrowers – this is in addition to demonstrating a 25% reduction.
 - Review trigger for initial PPP program was \$2 million (borrowers of \$2 million+ loans must complete Loan Necessity Questionnaire); unknown whether SBA will aggregate First and Second Draw loans.
 - SBA reserves the right to review all loans; additional reviews may be triggered by “red flags.”

Loan Reviews – FAQ 46 (May 13, 2020)

46. Question: How will SBA review borrowers' required good-faith certification concerning the necessity of their loan request?

Answer: When submitting a PPP application, all borrowers must certify in good faith that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” SBA, in consultation with the Department of the Treasury, has determined that the following safe harbor will apply to SBA’s review of PPP loans with respect to this issue: **Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith.**

SBA has determined that this safe harbor is appropriate because borrowers with loans below this threshold are generally less likely to have had access to adequate sources of liquidity in the current economic environment than borrowers that obtained larger loans. This safe harbor will also promote economic certainty as PPP borrowers with more limited resources endeavor to retain and rehire employees. In addition, given the large volume of PPP loans, this approach will enable SBA to conserve its finite audit resources and focus its reviews on larger loans, where the compliance effort may yield higher returns.

FAQ 46 – *continued*

- Importantly:
 - Borrowers with loans greater than \$2 million that do not satisfy this safe harbor may still have an adequate basis for making the required good-faith certification, based on their individual circumstances in light of the language of the certification and SBA guidance. SBA has previously stated that all PPP loans in excess of \$2 million, and other PPP loans as appropriate, will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form.
- If SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request:
 - SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness.
- If the borrower repays the loan after receiving notification from SBA:
 - SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request.

First and Second Draw Loans: Additional eligibility for uses of PPP funds

- In addition to prior eligible expenses (payroll, certain nonpayroll, utilities), eligible expenses now include:
 - Covered operations expenditures, including "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."
 - Covered property damage costs, which are "costs related to property damage and vandalism or looting due to public disturbances in 2020 that were not covered by insurance or other compensation."
 - Covered supplier costs, including expenditures made by a borrower to a supplier of goods for the goods that were essential when the expenditure was made and was made pursuant to a contract or purchase order.
 - Covered worker protection and facility expenditures to account for business modifications to comply with COVID-19-related regulatory guidance and worker personal protective equipment.
- To achieve 100% forgiveness, at least 60% of funds must be spent on payroll costs (along with meeting compensation/headcount requirements, subject to certain exemptions).

PPP Resources

- Treasury PPP Landing Page: <https://home.treasury.gov/policy-issues/cares/assistance-for-small-businesses>
- SBA PPP Landing Page: <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program>
- How to Calculate Maximum Loan Amount for First Draw Loans: <https://home.treasury.gov/system/files/136/PPP--How-to-Calculate-Maximum-Loan-Amounts-for-First-Draw-PPP-Loans-and-What-Documentation-to-Provide-By-Business-Type.pdf>
- How to Calculate Revenue Reduction and Maximum Loan Amount for Second Draw Loans: <https://home.treasury.gov/system/files/136/Second-Draw-PPP-Loans--How-Calculate-Revenue-Reduction-Maximum-Loan-Amounts-Including-Documentation-Provide1192021.pdf>
- FAQs: <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>



501(c)(6)s and Lobbying

Interim Final Rule on Paycheck Protection Program as Amended by Economic Aid Act (Jan. 14, 2021)

Are 501(c)(6) organizations eligible for PPP loans?

Yes. Any organization that is described in section 501(c)(6) of the Internal Revenue Code and that is exempt from taxation under section 501(a) of such Code (excluding professional sports leagues and organizations with the purpose of promoting or participating in a political campaign or other activity) shall be eligible to receive a PPP loan as long as other eligibility requirements are met and if:

- (1) The organization does not receive more than 15% of its receipts from lobbying activities;
- (2) The lobbying activities of the organization do not comprise more than 15% of the total activities of the organization;
- (3) The cost of the lobbying activities of the organization did not exceed \$1,000,000 during the most recent tax year of the organization that ended prior to February 15, 2020; and
- (4) The organization employs not more than 300 employees.

“Think Tanks” and Second Draw Loans

- Economic Aid Act deems ineligible: “Any business concern or entity primarily engaged in political or lobbying activities, which shall include any entity that is organized for research or for engaging in advocacy in areas such as public policy or political strategy or otherwise describes itself as a think tank in any public documents.”
- Interim Final Rule defines excluded entities as including any:
 - business concern or entity primarily engaged in political activities or lobbying activities, as defined in section 3 of the Lobbying Disclosure Act of 1995 (2 U.S.C. 1602), including any entity that is organized for research or for engaging in advocacy in areas such as public policy or political strategy or otherwise describes itself as a think tank in any public documents.
- The initial SBA program incorporated certain 7(a) program eligibility requirements:
 - c. **How do I determine if I am ineligible?** Businesses that are not eligible for PPP loans are identified in 13 CFR 120.110 and described further in SBA’s Standard Operating Procedure (SOP) 50 10, Subpart B, Chapter 2, except that nonprofit organizations authorized under the Act are eligible.
 - 13 CFR 120.110(r): “Businesses primarily engaged in political or lobbying activities” are ineligible.
 - SBA SOP 50 10 5(K): Business primarily engaged in political or lobbying activities defined as: “An Applicant that derives over 50% of its gross annual revenue from political or lobbying activities.”



Employee Retention Credit

What Is the Employee Retention Credit?

- The employee retention credit is a refundable payroll tax credit that was enacted as part of the CARES Act.
- The credit is available for employers whose operations have been fully or partially suspended due to a COVID-19-related government order, or that had certain revenue declines compared to 2019.
- The Consolidated Appropriations Act, 2021 (CAA) extended and significantly expanded the credit.

Who Is Eligible for the Credit?

- All private employers regardless of size, including tax-exempt organizations.
 - Key Change: Businesses that receive PPP loans may be eligible. But no “double-dipping” – wages funded by a PPP loan are not eligible for the credit.
- To qualify the employer has to meet one of two alternative tests. The tests are applied each calendar quarter. Either:
 - The employer’s business or programs are fully or partially suspended by a COVID-19-related government order during the calendar quarter (“governmental order test”); or
 - The employer’s gross receipts are below 20% of the correlative quarter in 2019 (“reduced gross receipts test”).

Examples

- Governmental Order Test

- Because of a governmental order limiting or restricting travel or in-person gatherings, Employer had to cancel a convention in Q1 of 2021.

- Reduced Gross Receipts Test

- Employer had \$100,000 of gross receipts in Q2 of 2019. In Q2 of 2021, Employer had \$79,000 of gross receipts. Employer is eligible in Q2 2021.

How Is the Credit Calculated?

- For the first and second calendar quarters of 2021, the amount of the credit is 70% of the “qualified wages” paid to each employee, subject to a quarterly cap of \$10,000 in wages per employee.
 - For 2021, the maximum per-employee credit is \$7,000 per quarter.
- For 2020, the credit was equal to 50% of qualified wages, with a maximum of \$10,000 in wages for all of 2020.
 - For 2020, the maximum per-employee credit was \$5,000 for all of 2020.

What Are Qualified Wages?

- For businesses that averaged 500 or fewer full-time employees in 2019, “qualified wages” are all wages and health plan expenses paid to all employees during a quarter in which the employer is eligible for the credit.
 - For 2020, this threshold was 100 or fewer full-time employees. Businesses with more than 100 full-time employees could only claim the credit for wages or health plan expenses paid for employees that were not working.
- Qualified wages are typically amounts that would be listed in W-2, Box 5, plus health plan expenses listed in Box 12.
- Examples of “qualified wages”
 - Regular salary and wages
 - Health benefits (cost paid by the employer + cost paid by employee with pre-tax salary reduction)
 - Vacation, parental, family, medical or sick leave, or other PTO

What Does Not Count as Qualified Wages?

- These are some examples of payments that do not count as “qualified wages”
 - 401(k) matching contribution
 - Payments to independent contractors (1099)
 - State or local taxes assessed on the compensation paid to employees (e.g., unemployment insurance taxes)

What Payroll Taxes Does the Credit Offset?

- The credit offsets the employer's share of social security taxes (i.e., the 6.2% social security tax).
- If the employer's credit amount exceeds the employer's social security tax liability for a quarter, the employer can get a tax refund.
- Example: Employer has \$60,000 of payroll tax liability for Q1 of 2021. Employer claims a retention credit of \$400,000 for Q1 of 2021. The credit offsets the \$60,000 of payroll taxes and generates a refund of \$340,000.

How Is the Credit Claimed?

- Eligible employers will report their total qualified wages and credit amount on their quarterly federal employment tax returns (Form 941).
- Coordinate with your payroll provider!



Thank you!

George E. Constantine

202.344.4790 | GEConstantine@Venable.com

Meredith Boylan

202.344.8062 | MLBoylan@Venable.com

Chris Moran

410.244.7604 | CNMoran@Venable.com

VENABLE LLP