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# Congress Updates and Expands the Paycheck Protection Program

December 29, 2020

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Title III of Division N of the Consolidated Appropriations Act of 2021 (the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act or the “Act”) adds a new subsection (a)(37) to the Small Business Act 7(a) loan program, describing new parameters for borrowers seeking to receive a second PPP loan (a “second draw” loan). The Act appropriates \$284.45 billion for both new Paycheck Protection Program (PPP) loans under existing subsection (a)(36) and “second draw” PPP loans under new subsection (a)(37), with \$35 billion explicitly set aside for first-time PPP borrowers. In addition, the Act appropriates \$20 billion for “targeted EIDL advance[s],” \$15 billion for “shuttered venue operators” (read our alert on the Shuttered Venue program [here](#)), \$3.5 billion for loans made under Section 325 (extension of debt relief program), and \$2.05 billion for certain other programs.

The new Act makes a few important modifications to the existing Section 7(a)(36) Paycheck Protection Program. It extends the application period for first-time PPP loans to March 31, 2021. It also expands the scope of forgivable expenses to include certain operations expenditures, property damage costs, supplier costs, and worker protection expenses. Forgiveness for this expanded list of expenses is available to borrowers whose loans have not received forgiveness before the enactment of the Act.

The Act also creates a new program for PPP borrowers who previously received, and spent, PPP funding to take a “second draw” from the Paycheck Protection Program. Applications for second draw PPP loans must also be submitted by March 31, 2021. The second draw loan requirements are described more fully below.

The Act also addresses issues of tax deductibility, eligibility of borrowers in bankruptcy, and eligibility of 501(c)(6) organizations.

## Enhancements to PPP Loan Forgiveness

### Expanded Scope of PPP Uses

The Act expands the list of expenses that can be paid with PPP funds, and which may be forgiven. The expanded covered expenses apply to most PPP loans made before, on, or after the date of the Act’s enactment (December 27, 2020); the expanded covered costs do not apply to loans for which a borrower received forgiveness before the date the Act was enacted.

The new covered expenses include:

**Covered operations expenditures:** Payments for business software or cloud computing services that facilitated business operations, including, among other expenses:

- delivery, processing, and payment for products and services
- sales and billing,
- human resources, and
- accounting services.

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**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 are essential to the recipient's operations at the time at which the expenditure was made. Contracts for perishable goods can be made before or during the life of the loan.

**Covered worker protection expenditures:** 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 on COVID-19 restrictions. This may include costs to create or expand drive-through window facilities, ventilation or filtration systems, physical barriers (e.g., sneeze guards), or expansion of indoor, outdoor, or combined business space, among other things.

In addition to these expansions, Section 308 of the Act clarifies that other employer-provided group insurance benefits, including group life, disability, vision, and dental insurance, are included in the PPP's definition of payroll costs.

Although the SBA has excluded only borrowers who have received forgiveness from taking advantage of this expanded list of expenses, it remains to be seen how borrowers who are in the midst of the forgiveness process (and their lenders) will navigate the revision of their applications. The SBA's interim final rules do not set out a process whereby a borrower may retract and refile an application and loan decision packet that has been submitted by a lender to the SBA, but not yet approved by the SBA.

## Flexible Covered Period

The Act allows borrowers to choose a forgiveness covered period within a window of 8 weeks before and 24 weeks after origination. The Act amends the CARES Act to remove the qualification that only borrowers that received PPP loans before June 5, 2020 could elect to use an 8-week covered period.

## Simplified Loan Forgiveness Certification

The Act creates a simplified loan forgiveness process for PPP loans under \$150,000 and calls on the SBA to establish a new application form to accommodate the more streamlined procedure within 24 days after the Act is signed into law.

Under the simplified process, eligible borrowers may submit a one-page certification that:

- Describes the number of employees the borrower was able to retain because of the covered loan,
- Estimates the total amount of the loan spent on payroll costs, and the total loan amount; and
- States the total loan value.

The borrower must also attest that the borrower:

- Accurately provided the required certification,
- Complied with PPP loan requirements, and
- Retains records relevant to the form that prove compliance with such requirements. The simplified application, however, provides for a more relaxed record retention period. Rather than the 6-year retention period prescribed by the standard application and EZ application, borrowers eligible for the new, simplified process will be required to retain relevant records related to employment for four years and other records for three years.

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In creating the form to accompany this process, the Act prohibits the SBA from requiring additional materials unless they are necessary to substantiate revenue loss requirements or satisfy relevant statutory or regulatory requirements. Furthermore, while limited in what it can require on the simplified application, the SBA may still review and audit loans for potential fraud. This fraud review includes an audit of the records related to compliance with the PPP requirements.

As with the expanded scope provisions, the new, simplified application process requirements apply “as if included in the CARES Act”; thus the new process will be available to PPP borrowers that have not yet applied for forgiveness and are under the \$150,000 cap.

### Clarification to the Applicable Period for Proration

The Act clarifies the applicable period for proration for employee salaries. Section 344 amends the proration of payments to a sole proprietor or independent contractor, or employee’s salaries of \$100,000 to be “on an annualized basis as prorated during the period in which compensation is paid or incurred.”

### Deductibility of Expenses Associated with Forgiven PPP Loans

The Act overturns an IRS position that had disallowed the deduction of business expenses associated with forgiven PPP loans. As described in a previous client alert, the Internal Revenue Service (in Notice 2020-32) classified any PPP loan forgiveness as “exempt income” for tax law purposes. Accordingly, to prevent a “double tax benefit,” the IRS disallowed any deduction to the extent the expense is funded by such exempt income. The IRS reiterated its position in administrative guidance issued in November.

Section 276 of the Act clarifies the tax treatment of business expenses paid with PPP forgiven loans. Specifically, the legislation states that “no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied” for business expenses paid in connection with forgiven PPP loans. This provision applies to existing PPP loans made pursuant to the CARES Act as well as new loans.

### PPP Loan Second Draw

#### Eligibility

Second draw loans may be made only to eligible entities that

- Previously received a PPP loan under subsection (a)(36) loan and
- Have exhausted the full amount of the loan (or will exhaust it on or before the second draw loan’s expected disbursement date)

To be eligible, a borrower must:

- Employ 300 or fewer employees
- Demonstrate a 25% or more reduction in gross receipts<sup>1</sup> in the first, second, or third quarter of 2020 as compared to the same quarter of 2019 (applications submitted on or after January 1, 2021 may reference Q4 2020 and Q4 2019)<sup>2</sup>

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<sup>1</sup> For nonprofits, “gross receipts” is set forth in Section 6033 of the Internal Revenue Code.

<sup>2</sup> The Act contains additional formulas for entities that were not in business for all of 2019.

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Eligible entities include business concerns or organizations made eligible for loans under subsection (a)(36), but exclude businesses described in 120.110 of title 13 of the C.F.R. (but nonprofit businesses and certain religion-based businesses remain eligible), political or lobbying businesses, and businesses for which 20% is held by a business with significant connections to China or Hong Kong.

Notably, the Act now renders publicly traded entities ineligible for PPP loans. This new prohibition applies after the date of enactment of the Act, so existing PPP recipients will not be affected. Additionally, the CARES Act's waiver of affiliation rules once again applies for franchises on the SBA's franchise list and businesses assigned an NAICS code 72, subject to a 300-employee limitation rather than the 500-employee limitation under the CARES Act.

## Second Draw Terms

Loans will be guaranteed under the same terms, conditions, and processes as under subsection (a)(36) of the CARES Act. The maximum loan amount is the lesser of 2.5 times the average monthly payroll costs during the 1-year period prior to the date the loan is made (3.5 times for NAICS code 72 businesses) or during the 2019 calendar year, or \$2 million (this is a downward adjustment from the \$10 million maximum available under the original PPP program). Slight modifications to this calculation exist again for businesses employing seasonal employees and new entities. The covered period of second draw loans is to be selected by the recipient, but must be between 8 and 24 weeks after the date of origination.

## Certification Requirements

Eligible entities may receive only one second draw loan. To receive a loan, the borrower must again certify that (a) the uncertainty of current economic conditions makes the loan necessary, and (b) the funds will be used to retain workers and maintain payroll or mortgage, lease, and utility payments.

Entities receiving a loan of \$150,000 or less may submit a simplified certification regarding the applicable revenue loss requirement; upon filing for forgiveness, the entity must then produce adequate documentation showing it met the revenue loss requirement.

## Forgiveness Requirements

Forgiveness generally tracks the existing procedures under the CARES Act, including that borrowers who want to obtain 100% loan forgiveness must use 60% of the loan for payroll costs.

However, as discussed above, the remainder on second draw loans may be used for operations expenditures, property damage costs, supplier costs, or worker protection, in addition to expenses for payment of interest on covered mortgage obligations, rent obligations, and utility payments. The process for reducing loan forgiveness amounts because of headcount and salary reductions, as well as the exemptions applying thereto, also mirror those under the CARES Act.

## Expansion of PPP Loan Program to 501(c)(6) Organizations; Nonprofit Destination Marketing Organizations; and Other Nonprofits

The Act expands the PPP loan program to those 501(c)(6) organizations and nonprofit "destination marketing organizations" with 300 or fewer employees. The Act imposes several lobbying-related eligibility restrictions on these organizations. Namely, 501(c)(6) organizations and nonprofit destination marketing organizations are barred from receiving PPP loans if they receive 15% or more of their receipts from lobbying activities; the lobbying activities comprise more than 15% of the total activities of

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the organization; or the cost of the organization's lobbying activities for the most recent tax year that ended prior to February 15, 2020 exceeded \$1,000,000. Furthermore, none of the proceeds of the PPP loan may be used for lobbying activities.

The bill also expands PPP eligibility to housing cooperatives. Certain news and broadcast organizations are also eligible to receive PPP loans to produce or distribute locally focused or emergency information. In addition, the bill reaffirms SBA regulations issued in April that clarified the eligibility of churches and other religious organizations for PPP loans.

## Revised Lender Rules

### Enhanced Lender Protections through a Hold Harmless Provision

For lenders, the hold harmless provision in section 304 modifies and expands the original CARES Act provision, now giving lenders greater protection from enforcement for both originations and forgiveness decisions. The Act clarifies that lenders may rely on applicant or borrower certifications and information submitted as part of either a first or second draw PPP loan.

Furthermore, where the CARES Act non-enforcement and no penalties clauses related only to actions under section 47(e) of the SBA or by the administrator, the Act uses more expansive language for a lender that acts in reliance on such certifications and information, stating, "an enforcement action may not be taken against the lender, and the lender shall not be subject to any penalties relating to loan origination or forgiveness of the initial or second draw PPP loan." The Act cautions, however, that a lender must still satisfy "all other relevant Federal, State, local, and other statutory and regulatory requirements."

### Lender Eligibility for Making Second Draw PPP Loans

The lender eligibility terms for second draw PPP loans are the same as for first draw loans. With two modifications, lenders will be reimbursed for processing and servicing PPP loans at the same rates as for first draw PPP loans: 5% for loans from \$50,000 to \$350,000 and 3% for loans above \$350,000. To encourage lending to smaller borrowers, the Act provides enhanced compensation for loans of less than \$50,000, providing the lesser of 50% of the disbursement balance or \$2,500. Also, for the second draw PPP, there is no reimbursement category for loans above \$2,000,000, since that is now the maximum. In addition, the Act expressly provides that lenders should be permitted to follow SBA guidance and standard operating procedures, which have been significantly updated during the SBA's implementation of the original PPP.

There are many provisions of the Act that incorporate the paragraph (36) terms into paragraph (37), meaning those provisions are the same for first and second draw PPP loans. For example, the financial terms of the second draw PPP loans (e.g., interest rate and maturity) are "the same terms, conditions, and processes as a loan made under paragraph (36)." The current interest rate for CARES Act PPP loans is 1%, per the SBA's prior rulemaking.<sup>3</sup>

## EIDLs

The Act extends the covered period for EIDL grants through December 31, 2021. The EIDL advance amount no longer needs to be deducted from the PPP forgiveness amount, and borrowers that have already had EIDL advance amounts deducted from their PPP forgiveness will be made whole through additional rulemaking.

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<sup>3</sup> The new Act does allow for a statutory maximum interest rate of 4%.

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The Act also provides additional EIDL funding for eligible entities located in low-income communities. Entities in low-income communities that have previously received EIDL funding are now eligible to receive an amount equal to the difference between the initial funding and \$10,000.

## **Conflicts of Interest**

Section 322 of the new Act adds conflict of interest provisions that apply to both first and second draw PPP loans. Businesses in which the U.S. president, vice president, the head of an executive department, or a member of Congress (or their spouse) owns or controls 20% or more of any class of equity interest are banned from taking any new first or second draw PPP loans. For any existing PPP loans to such businesses, the principal executive officer must disclose to the administrator such conflict when the business applies for forgiveness or, if it has already applied for forgiveness, within 30 days after enactment of the Act.

## **PPP Loan Access for Borrowers in Bankruptcy**

The Act addresses whether PPP loans may be extended to borrowers in bankruptcy. The SBA's Fourth Interim Final Rule (posted April 24, 2020) disqualified applicants currently in bankruptcy proceedings, or which became a debtor in bankruptcy proceeding before the PPP loan was disbursed, from receiving a PPP loan. This prohibition was litigated, and on June 12, 2020, the United States Bankruptcy Court for the District of Arizona entered an order finding the SBA's prohibition against debtors in bankruptcy from participating in the PPP unenforceable.

Section 320 of the Act amends the Bankruptcy Code, 11 U.S.C. § 364, by establishing special procedures for debtors in the midst of bankruptcy proceedings that qualify for second draw PPP loans to obtain those loans. Either a debtor in possession or a trustee authorized to operate the business of the debtor may obtain the loan. Importantly, any unforgiven amounts will have priority over administrative expenses.

To obtain the loan, the debtor or trustee must file and serve notice and the court must hold a hearing within 7 days of service. The court has discretion to approve or deny the debtor obtaining the loan. Section 320, however, is not effective until the SBA administrator submits to the director of the Executive Office for United States Trustees that, as long as they may satisfy the eligibility requirements, a debtor in possession or a trustee authorized to operate the business of the debtor will be eligible for second draw PPP loans.

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We will continue to monitor and provide updates on developments relating to the new Act. We expect that there will be new IFRs and loan and forgiveness applications, as well as additional clarifications and reporting from the SBA.