

SBA PUBLISHES PPP 3.0 REGULATIONS AND PPP SECOND DRAW LOAN REGULATIONS

Date: 11 January 2021

U.S. Corporate Alert

By: Rick Giovannelli, Randy J. Clark

On Wednesday, 6 January 2021, the U.S. Small Business Administration (SBA) released new guidance on the existing Paycheck Protection Program (PPP) under Sections 1102 and 1106 of the Coronavirus Aid, Relief, and Economic Security Act and on the SBA's new "Paycheck Protection Program Second Draw Loans" (the Second Draw PPP) created by Section 311 of the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (the EAA).

The SBA's guidance came via two interim final rules (IFRs)—one that helpfully restates and consolidates many of the prior interim rules on the PPP (the Consolidated IFR) and a second addressing the Second Draw PPP (the Second Draw PPP IFR and, together with the Consolidated IFR, the New IFRs). Both IFRs very closely track the precise language of the EAA, with far fewer departures than in the spring 2020 PPP IFRs. This alert will highlight some of the key new terms and instances where the IFRs may depart from, or perhaps clarify, ambiguities from the EAA.

In addition, SBA announced that in order to promote access to capital for smaller lenders and their customers, SBA will initially accept applications only from community financial institutions for [first draw PPP loans](#) starting on Monday, 11 January 2021 and from those same lenders for [Second Draw PPP](#) loans starting on Wednesday, 13 January 2021.

THE SECOND DRAW PPP IFR

Helpfully, Second Draw PPP loans are generally subject to the same terms as the original PPP loans. That includes: (1) the 100 percent SBA guarantee; (2) no collateral requirement; (3) no personal guarantee requirement; (4) a non-compounding and non-adjustable interest rate of one percent, a five-year maturity; (5) similar borrower eligibility and certification requirements; and (6) similar processing requirements for lenders administering the Second Draw PPP. As a result, the Second Draw PPP IFR generally addresses only those terms where a Second Draw PPP loan is different from a first draw PPP loan. Thus, except where noted in the Second Draw PPP IFR, the Consolidated IFR applies to both PPP and Second Draw PPP loans.

Eligible Borrowers

Under the EAA and as provided in the Second Draw PPP IFR, an eligible borrower must have less than 300 employees and have experienced a revenue decline, the latter of which is discussed in more detail below.

Further, an eligible borrower must have already received a first draw PPP loan and must have used the full amount of its PPP loan for permitted purposes prior to the disbursement of the Second Draw PPP loan. The EAA required that the loan had been or "will be used" without specifying the time period for such use. The Second

Draw PPP IFR interprets that to mean that borrowers can apply for a Second Draw PPP loan before they have fully used the PPP loan, but cannot receive the disbursement of the Second Draw PPP loan until they have fully used the original PPP proceeds.

In addition to the borrowers generally excluded from getting PPP loans, there are further categories of borrowers excluded from the Second Draw PPP. Pursuant to the Second Draw PPP IFR, those are borrowers:

- That have permanently closed;
- That are public companies;
- That have Chinese affiliates, a Chinese national on the board or certain other ties to China, or
- That are primarily engaged in political or lobbying activities, or required to register as a foreign agent.

However, as discussed in more detail below, there is some ambiguity as to whether a subsidiary of a public company, in addition to the public parent itself, is ineligible under the Second Draw PPP.

The Second Draw PPP may not be immediately available for some PPP borrowers that are “unresolved borrowers.” A borrower whose first PPP loan is being reviewed by the SBA will not be eligible to receive a second draw loan until the issues regarding the first PPP loan are resolved. This same limitation is applied to borrowers where “information in SBA's possession indicates that the [PPP] borrower may have been ineligible” for its PPP loan in whole or in part. In such cases, the SBA will notify the lender that the applicant is an “unresolved borrower.”

The SBA has committed to resolving unresolved borrower issues “expeditiously” and the introduction to the Second Draw PPP IFR says that the SBA will “set aside” funds for unresolved borrowers in the event they are ultimately approved. It is not clear what this means, but it may mean that unresolved borrowers would not lose their place in line if the Second Draw PPP appropriation would otherwise have been fully used prior to a positive resolution of the review of the unresolved borrower.

Revenue Decline

In addition, a Second Draw PPP borrower must demonstrate a revenue decline of 25 percent in any quarter of 2020 over the corresponding quarter OR submit tax returns showing a 25 percent decline in Fiscal Year (FY) 2020 revenue over FY 2019. For this purpose, “Revenue” is defined to mean “gross receipts” in accordance with the existing SBA regulations.¹

Second Draw PPP borrowers of loans under US\$150 thousand need not demonstrate such decline at the time of application, but ultimately must demonstrate it later in order to obtain forgiveness.

The Second Draw PPP IFR includes further rules on the calculation of gross receipts for borrowers who have engaged in an acquisition or disposition during 2019 or 2020, in an attempt to create an apples-to-apples revenue comparison. Under those rules,

- Entities acquired during 2020 are treated as if they were owned by the buyer during the “entire period of measurement” (i.e., all relevant quarters of 2019–20);² and
- Receipts from entities sold during 2019 OR 2020 are excluded for the “entire period of measurement.”

The treatment of entities acquired applies to equity acquisitions unless the entity purchased was a “segregable division,” in which case the gross receipts of the division are NOT included for periods prior to the acquisition. This, however, does not appear to exclude revenues acquired in 2020 via an asset acquisition, unless perhaps the borrower acquired the assets into a newly-formed acquisition sub or affiliate. This may unfortunately exclude some impacted borrowers who would otherwise be eligible.

Borrowers who sold a “segregable division” during 2020 must “continue to include the receipts of the division that was sold.”

Second Draw PPP Loan Amounts

Generally, the principal amount of a Second Draw PPP loan is limited to the lesser of US\$2 million or 2.5 multiplied by the average monthly payroll costs for most borrowers or 3.5 multiplied by the monthly payroll costs for borrowers who used North American Industry Classification System (NAICS) 72 on their most recent federal tax return.³

Borrowers can calculate their loan amounts based on payroll costs for calendar year 2019, calendar year 2020, or (for entities) the actual trailing 12-month (TTM) period before the application. This should benefit borrowers whose payrolls have declined during the pandemic. However, the New IFRs do not address the time period for determining employee counts for purposes of the eligibility determination and, therefore, it appears that the traditional SBA method of using the average pre-application TTM period would apply.

The US\$10 million limit on PPP loans has been revised to apply only to first draw PPP loans, but the SBA's corporate group limit of US\$20 million applies all PPP loans in the aggregate. A new, separate corporate group limit of US\$4 million applies to Second Draw PPP loans (i.e., two times the individual loan limit). This US\$4 million effectively functions as a sublimit within the US\$20 million aggregate cap on loans to a corporate group. Thus, borrowers within a corporate group that has received more than US\$16 million of first draw PPP loans will not be able to obtain a full US\$4 million of Second Draw PPP loans.

THE CONSOLIDATED IFR

The preamble to the Consolidated IFR notes that it is not intended to substantively alter or affect PPP rules that were not amended by the EAA and, throughout the footnotes, the Consolidated IFR indicates that changes were made for “readability.” We believe it is likely that the SBA will provide a similar consolidated IFR to address the forgiveness, loan review, and appeals IFRs that were published later than those spring 2020 IFRs that have been restated in the Consolidated IFR.

Eligible Borrowers

The Consolidated IFR tracks the original rules, as limited by the EAA to borrowers in operation on 15 February 2020 (subject to exception for seasonal employers) and expanded by the EAA to include:

- The following, if they have no more than 300 (note, not 500) employees:
 - Housing cooperatives,
 - Eligible 501(c)(6) organizations (excluding professional sports leagues and political campaigns and similar organization), and
 - Destination marketing organizations.

- A news organization that is majority owned or controlled by a NAICS code 511110 or 5151 business or a nonprofit or tax exempt public broadcasting or news entity with a trade or business under NAICS 511110 or 5151, that:
 - Employs no more than 500 employees (or the applicable SBA NAICS size standard) per location; and
 - Makes a good faith certification that the loan proceeds will “be used to support expenses at the component of the organization that produces or distributes locally focused or emergency information.”

The list of ineligible borrowers has been expanded to include:

- Businesses receiving a shuttered venue grant;
- Any entity in which certain federal political officials hold more than 20 percent “by vote or value” of any class of equity;
- Public companies, defined as “issuers” with securities listed on a “national securities exchange”; and
- Debtors in a bankruptcy proceeding.

Notably, SBA Form 3509, the Paycheck Protection Program Loan Necessity Questionnaire, addresses the public trading of securities of the borrower or any parent company, while the New IFRs, like the EAA, address only the borrower itself. Therefore, it appears that subsidiaries of public companies may be eligible for both PPP and Second Draw PPP loans. If those loans are under US\$2 million, no Form 3509 Questionnaire is required, which may make it easier for those loans to be forgiven.

The bankruptcy exclusion is consistent with the existing rules, though Section 320 of the EAA would have allowed PPP loans to bankrupt borrowers if the SBA administrator certified that they were eligible. The SBA appears to be exercising interpretive authority to decline the invitation to make such an eligibility certification.

Loan Amounts

As noted above, Borrowers can calculate their loan amounts based on payroll costs for calendar year 2019, calendar year 2020, or (for entities) the actual TTM period before the application. However, borrowers must now provide IRS Forms 941, or other tax documents, unemployment insurance reporting forms or equivalent payroll processor records with their loan applications to support the loan calculations.

The methodology for determining the loan amount for a sole proprietor (or independent contractor) or a partner in a partnership has not substantially changed from the SBA's 24 April 2020 guidance, “How To Calculate the Maximum Loan Amounts - By Business Type,” except to take into account the changes in the EAA and to eliminate provisions relating to the refinancing of economic injury disaster loans. Similar to the April guidance, the New IFRs require providing a copy of the tax return for the applicable year on which the payroll costs are determined (Form 1040 Schedule C for self-employed individuals and independent contractors, Form 1040 Schedule F for farmers, or the Form 1065 plus Schedules K-1 for a partnership).

The Consolidated IFR continues to prevent a self-employed partner in a partnership from submitting a separate PPP loan application as a self-employed individual. As such, a “general active partner” that was not eligible for a PPP loan should correspondingly not be eligible for a Second Draw PPP loan. Instead, the self-employment income of such partners may be included as a payroll cost of the partnership. The New IFRs continue to apply an

adjustment to the self-employment income of partners, as reported on Schedules K-1, explained in a footnote in the Second Draw PPP IFR to remove the “employer” share of self-employment tax consistent with the determination of payroll costs of W-2 employees of the partnership.

Use of Proceeds; Covered Period; Forgiveness

The Consolidated IFR includes the EAA provisions expanding the scope of payroll costs to include group insurance benefit payments, covered operations expenditures, covered property damage costs, covered supplier costs, and covered worker protection expenditures.

Under the Consolidated IFR, borrowers can elect a forgiveness covered period of any duration from eight to 24 weeks, and the 31 December 2020 expiration date for existing PPP covered periods has been removed.

At least 60 percent of the loan proceeds must be used for payroll costs, and the forgiveness amount is capped at payroll costs during the forgiveness covered period divided by 60 percent.

Updates to Frequently Asked Questions

The SBA did not update its existing Frequently Asked Questions (FAQs) to conform to the EAA, but notes that it intends to do so “as quickly as feasible.” Until then, the Consolidated IFR says that it is to be interpreted consistent with the FAQs, except that the EAA “overrides any conflicting guidance in the FAQs.”

PPP DEDUCTIBILITY

A welcome change for PPP borrowers in the EAA was the explicit congressional recognition of the deductibility of expenses paid with a PPP loan. The IRS had previously outlined its positions on pre-EAA deductibility of such expenses in Notice 2020-32 and Rev. Rul. 2020-27. On 6 January 2021, in response to the changes affirmed in the EAA, the IRS published Rev. Rul. 2021-2 formally obsoleting its prior guidance.

FOOTNOTES

¹ Gross receipts, for this purpose, includes all revenue in whatever form received or accrued (in accordance with the entity's accounting method) from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances. Generally, receipts are considered “total income” (or in the case of a sole proprietorship, independent contractor, or self-employed individual “gross income”) plus “cost of goods sold,” and excludes net capital gains or losses as these terms are defined and reported on Internal Revenue Service (IRS) tax return forms.

Gross receipts do not include the following: taxes collected for and remitted to a taxing authority if included in gross or total income (such as sales or other taxes collected from customers and excluding taxes levied on the concern or its employees); proceeds from transactions between a concern and its domestic or foreign affiliates; and amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder, or customs broker.

All other items, such as subcontractor costs, reimbursements for purchases a contractor makes at a customer's request, investment income, and employee-based costs such as payroll taxes, may not be excluded from gross receipts.

For non-profits, gross receipts has the meaning in Section 6033 of the Internal Revenue Code of 1986, as amended, which is generally “the gross amount received by the organization during its annual accounting period from all sources without reduction for any costs or expenses including, for example, cost of goods or assets sold, cost of operations, or expenses of earning, raising, or collecting such amounts.”

² This applies to both borrowers who were acquired and borrowers who acquired another entity.

³ The applicable NAICS code for C-corporation borrowers is the “business activity” code reported on Schedule K, line 2 of the Form 1120, for S-corporation borrowers is the business activity code reported at Item B of the Form 1120-S, and for partnership borrowers is the business code number reported at Item C of the Form 1065.

KEY CONTACTS



RICK GIOVANNELLI
PARTNER

CHARLOTTE
+1.704.331.7484
RICK.GIOVANNELLI@KLGATES.COM



RANDY J. CLARK
PARTNER

CHARLOTTE
+1.704.331.7466
RANDY.CLARK@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.