Congress Adopts PPP Flexibility Act of 2020, Easing Loan Terms

By Peter E. Cooper

INTRODUCTION

Since the passage of the CARES Act on March 27, 2020, and the introduction of the Payroll Protection Program ("PPP") on April 3, 2020, almost four and a half million businesses, non-profit organizations, and self-employed individuals have received PPP loans totaling some $510 billion. The Department of the Treasury and the Small Business Administration ("SBA") worked feverishly to design and implement forms, rules and procedures that govern lending and administration of loans under the Program. Yet, the first two months of practice under the PPP revealed certain flaws in the program design and implementation. Congress has now addressed some of those deficits in the recently passed Payroll Protection Program Flexibility Act of 2020 ("Flexibility Act").

EXPANSION OF COVERED PERIOD

A key feature of the CARES Act was a borrower's ability to obtain loan forgiveness for a PPP loan pursuant to Section 1106 of the CARES Act. As written, the CARES Act provided for loan forgiveness if borrowed funds were spent on eligible expenses within eight weeks of loan funding (the "Covered Period"). The Flexibility Act amends the CARES Act by extending the covered period from eight weeks to 24 weeks, ending December 31, 2020. While the Flexibility Act does <u>not</u> increase the amount of funding available to borrowers, it does extend the period during which borrowers may spend the loan proceeds and seek full forgiveness.

REVISION OF PAYROLL/NON-PAYROLL COST RATIO

Section 1106 of the CARES Act provides that, in order to receive loan forgiveness, a borrower must use at least 75 percent of the PPP proceeds for payroll costs and only 25 percent for non-payroll costs. The Flexibility Act lowers the payroll threshold to 60 percent, allowing for 40 percent of the proceeds to be used for non-payroll purposes.

EXTENSION OF LOAN MATURITY

As written, the CARES Act provided for maturities of between two and 10 years for PPP loans. In its first Interim Final Rule, the Department of the Treasury announced that all PPP loans would have a maturity of two years.

The Flexibility Act revises the Treasury Department's actions and creates a minimum maturity period of five years. While this new five-year maturity term applies only to loans issued after passage of the act, the Flexibility Act allows existing PPP borrowers and lenders to mutually agree to modify terms of loans where proceeds have already been distributed.

EXTENSION IN LOAN DEFERRALS

The CARES Act required that all PPP loans allow a deferral on payment of interest and principal during the first six months (but not more than a year) of the promissory note. The Flexibility Act strikes the six-month limitation, and instead provides deferral "until the date on which the amount of forgiveness determined under section 1106 of the CARES Act is remitted to the lender." This apparently open-ended date is further modified by providing that deferral ends 10 months after the last day of the covered period, if the borrower fails to seek loan forgiveness within that time.

SAFE HARBOR FOR ATTEMPTING TO REHIRE EMPLOYEES

Section 1106(d) of the CARES Act provides for proportionate reduction in loan forgiveness to the extent a borrower has not maintained employment levels. Stated generally, if a borrower employed ten people during an earlier comparative period and that employment was reduced to five, the borrower's loan forgiveness would be reduced proportionately (505). The CARES Act, however, created a safe harbor for borrowers who terminated employees between February 15 and April 26, 2020, but rehire them by June 30, 2020.

First, the Flexibility Act expands the safe harbor to December 31, 2020.

Second, the Flexibility Act exempts employee positions if a borrower can document

(i) an inability to rehire individuals who are employees of the borrower on February 15, 2020, and
(ii) an inability to hire similarly qualified employees from unfilled positions on or before December 31, 2020; or
(iii) an inability to a) return to the same level of business activity as the borrower was operating at before February 15, 2020, or b) achieve compliance with requirements established or guidance issued by relevant regulatory authorities relating to social distancing or other worker or customer safe to requirements related to COVID-19.

EMPLOYER PAYROLL TAXES

Section 2302 of the CARES Act permitted employers and self-employed individuals to defer depositing the employer portion of Social Security tax. However, employers that received a Paycheck Protection Program loan were not eligible to defer the deposit and payment of the employer's share of Social Security tax if the PPP loan was forgiven. The Flexibility Act removes this carve-out for PPP recipients, thus PPP borrowers may now take advantage of delayed employer payroll taxes, even if the borrower seeks and obtains loan forgiveness.

UNANSWERED QUESTIONS

While the Flexibility Act addresses some of the problems and deficiencies in the Payroll Protection Program, it leaves certain unresolved problems and issues that have arisen in the interpretation and application of the PPP, and creates new uncertainties even as it liberalizes the loan program. These include:

- In Notice 2020-32, the IRS asserts its position that it would not allow the deductibility of expenses that were used by taxpayers to obtain loan forgiveness of PPP loans. Although various commentators and Congressional Representatives and Senators have challenged the IRS's position, the Flexibility Act does address the IRS's stated position.

- The Flexibility Act provides new terms and procedures that appear to apply to both future loans and existing loans. However, how will borrowers and lenders reflect these changed terms? Will all loan documents and promissory notes need to be amended?

- Are the limits on the eligibility for payroll costs for employees making over $100,000 adjusted by the expansion of the "covered period" from eight weeks to 24 weeks? Previously, borrowers could only use 8/52 of an employee's $100,000 salary ($15,385) for loan forgiveness purposes. Will that amount now be increased to 24/52 of the $100,000 ($46,515)?

The Flexibility Act goes a long way toward expanding the likelihood that a PPP borrower will be able to qualify for full, or least substantial, loan forgiveness. Our prior guidance concerning the importance of documenting program compliance remains in effect, and every borrower should be prepared to fully document the eligibility of expenses qualifying for loan forgiveness. Nevertheless, the Flexibility Act significantly changes some of the terms and qualifications for loan forgiveness, and borrowers would be well advised to await new rulemaking from the Department of the Treasury and the SBA before processing loan forgiveness applications.

If you have questions about SBA PPP Loan terms, please contact your Lawrence Kamin attorney.