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URGENT - New "Paycheck Protection Program Flexibility Act" Significantly Changes PPP Loan Forgiveness Rules

by Anthony J. Zeoli

A FREEBORN & PETERS LLP CLIENT ALERT

On June 5, 2020, H.R. 7010, entitled the "Paycheck Protection Program Flexibility Act" (*the "**PPPFA**"*), was signed into law. As discussed below, the PPPFA significantly modifies certain of the existing rules related to the forgiveness of PPP loans in an effort to provide borrowers more flexibility with respect to the use of PPP loan proceeds. Such changes include, among other things, extending the time period allowed for borrowers to spend forgivable PPP loan proceeds and lessening the overall amount of PPP loan proceeds which are required to be spent on "payroll" costs. That being said, the PPPFA does raise some additional questions and issues of which both existing and new PPP loan borrowers should be aware.

Background

On March 27, 2020, Congress approved the Coronavirus Aid, Relief, and Economic Security Act (*the "**CARES Act**"*) to provide financial assistance to individuals and businesses. Title I of the CARES Act (*the "Keeping Workers Paid and Employed Act"*) includes several provisions intended to help small business suffering the adverse economic effects of the coronavirus (*COVID-19*). Among those is the establishment of a new loan program called the "Paycheck Protection Program" (PPP) and the allocation of billions of dollars for the making of PPP loans. One of the most attractive features of the PPP loans is the the potential ability for eligible borrowers to have a portion, and potentially all, of the amount of PPP loan funds borrowed forgiven without payment.

Since the inception of the PPP the U.S. Small Business Administration (SBA) (*in cooperation with the U.S. Department of Treasury*) has issued an ongoing series of guidance concerning the PPP loans and the application of the related rules. As many have received PPP loan funds, much of the recent SBA guidance concerning the PPP has centered around the application of the forgiveness rules. Most notably, in late May the SBA provided some clarity on outstanding questions as it released its form of PPP forgiveness application (*the "**Forgiveness Application**"*) and its Interim Final Rule on PPP loan forgiveness (*the "**Forgiveness IFR**"*).

PPFA Summary

Below is a summary of the significant changes made by the PPPFA to the PPP and the related forgiveness rules. For clarity, the PPPFA amends the applicable provisions of the CARES Act itself and, as such, if (*and to the extent*) the PPPFA conflicts with anything in the Forgiveness Application or the Forgiveness IFR (*which it does*), the provisions of the PPPFA would control.

- Extension of Covered Forgiveness Period

  The PPPFA extends the period during which PPP loan proceeds can be used and still be eligible for forgiveness from 8-weeks to 24-weeks. This 24-week period (*like the original 8-week period*) commences on the first date the PPP loan is funded.[1] **Put another way, borrowers will now have up to 24 weeks from the original date of funding to spend their PPP loan proceeds and still be eligible for forgiveness.** This extension is particularly attractive to existing borrowers that have faced, or are still facing, delays in returning to full business/staff.

  It should be noted that a borrower that received a PPP loan prior to June 5, 2020, can elect to rely on the original 8-week forgiveness period instead of the extended period. For borrower's that have already used (*or expect to use*) the majority of their PPP loan funds during the initial 8-week period of their loan, relying on the initial 8-week period may be preferable even if it results in less than the full amount of the loan being forgiven. First, by not going with the extended period, the borrower will not have to wait until 2021 to apply for forgiveness. Second, they will avoid the further risk of additional business downturns during the additional 16-weeks that could lead to further necessary staff terminations or pay decreases that could ultimately reduce the total forgivable amount (*assuming they can be corrected, of course*).

- Use of Loan Proceeds on Non-Payroll Costs

  One of the biggest critiques by PPP loan borrowers to date is the requirement that at least 75% of the total amount of forgivable PPP loan proceeds needed to be spent on eligible "payroll costs" (*with only 25% being available for eligible non-"payroll costs"; i.e. qualifying loan interest payments, lease payments, and utility payments*). **The PPPFA modifies the percentages and provides that a borrower can spend up to 60% on eligible "payroll costs" and up to 40% on eligible non-"payroll costs" and still qualify for forgiveness.** It should be specifically noted that (*absent subsequent guidance*), the plain language of the PPPFA appears to eliminate the ability for partial forgiveness if the borrower is unable to spend the entirety of their PPP loan during the forgiveness period.[2]

- Extension of Payment Deferral

  The PPPFA mandates the automatic deferral of all PPP loan payments (*including payments of principal, interest, and fees*) until the date the SBA makes its final determination as to the respective borrower's forgiveness application; provided that, if a borrower does not submit an application for forgiveness within 10-months of its respective forgiveness period (*being 8-weeks or 24-weeks, as applicable*), such borrower will be required to start making payments on the outstanding balance of their PPP loan at that time. It should be specifically noted that the foregoing deferment (*as with the initial deferment provisions of the CARES Act*) relate only to payments of amounts owed under the PPP loans and not the the accrual of interest on the PPP loans during such period. As such, (*absent subsequent guidance*) a borrower may find itself responsible for the payment of interest which accrued on their PPP loan during the deferment period even if the entire principal amount of their loan is ultimately forgiven.

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[1] *It is unclear at this time whether the current SBA guidance allowing for an alternative start date for those borrowers with a biweekly or more frequent payroll cycle will be applicable to the commencement of the new 24-week extended period. It should also be noted that there is an outside deadline of December 31, 2020 in the PPPFA but unless the current deadline for making PPP loans of June 30, 2020 is further extended that outside date is moot.*

[2] *Specifically, the PPPFA provides that a borrower "shall" use "at least" 60% of the "covered loan amount" (i.e. the total loan amount) for "payroll costs" and "up to" 40% of "such amount" (i.e. the total loan amount) for eligible non-"payroll costs." As such, if enforced literally by the SBA, partial loan forgiveness would not be permitted for those borrowers that do not spend the entirely of the PPP loan during the forgiveness period.*

- Extension of Safe Harbor Dates

Under the CARES Act, the actual total amount of PPP loan proceeds that will be forgiven with respect to a particular borrower will be subject to a 2-step potential reduction based on whether such borrower has made certain reductions to its "full time equivalent employees" (*each, an "FTE"*) and/or made certain decreases to its employees' salaries during its respective forgiveness period.[3] That being said, the CARES Act and the Forgiveness IFR created certain "safe harbors" whereby a borrower would not be subject to forgiveness reduction if (*and to the extent*) it corrected the subject FTE/salary decreases by the expiration of its respective forgiveness period.

With the extension of the forgiveness period as discussed above, a borrower (*if not otherwise eligible and electing to use the original 8-week period*) will now have a period of 24-weeks from the funding of its PPP loan in which to remedy any staff/salary decreases that might otherwise have resulted in a decrease to the total amount of their PPP loan actually forgiven. This is a bit of a two-edged sword, however, because while a borrower will have a significantly longer time to remedy existing FTE/salary decreases, that creates a greater risk that such borrower may not be able to correct the subject decrease the longer it waits (*e.g. the borrower is unable to hire back enough prior/new FTEs*) and/or that such borrower would need to make additional FTE/salary decreases which could subject them to greater potential decrease.

- Additional FTE Safe Harbors

In addition to effectively extending the period for satisfying the existing forgiveness reduction "safe harbors" as discussed above, the PPPFA creates two new FTE reduction safe harbors. Essentially the PPPFA provides that a borrower will not need be penalized for (*i.e. will not be subject to reduction of its forgiveness amount as a result of*) a reduction in its FTEs if (*and to the extent*) such borrower, in good faith, can evidence that it was unable to correct the subject FTE reduction as a result of:

  - borrower's inability to rehire previous employees (*i.e. that were employees on February 15, 2020*) that were let-go etc. and its inability to rehire similarly qualified employees on or before December 31, 2020; or

  - borrower's inability to return to the same level of business activity experienced by such borrower before February 15, 2020, due to compliance with requirements established by HHS, CDC, or OSHA related to the COVID-19 pandemic during the period March 1, 2020, through December 31, 2020.

These new safe harbors are relatively broad which is to the benefit of the borrower. However, exactly how they are to be administratively applied remains open.[4]

- Loan Maturity

Based on the original provisions of the CARES Act and prior guidance released by the SBA, current PPP loans have a maturity of 2 years. **The PPPFA, however, mandates that each PPP loan originated after June 5, 2020 must have a maturity of at least 5-years (*and no more than 10-years*).** The exact maturity period for such new loans is not yet clear.

It should be noted specifically that this new provision only applies to new PPP loans (*i.e. loans made after June 5, 2020*) so those with existing PPP loans would not automatically benefit from this extension. That being said, the PPPFA does provide that "lenders and borrowers" can mutually agree to extend the maturity of such existing PPP loans; thus leaving the door open for existing borrowers (*to the extent their respective lender agrees)* to take advantage of this maturity extension.

[3] *For a more detailed discussion on these rules see HERE.*
[4] *Including with respect to what evidence a borrower would have to (or otherwise be able to) provide to evidence compliance with the respective safe harbor qualifications.*

- Payroll Tax Deferral

  The PPPFA amends Section § 2302 of the CARES Act to eliminate the prohibition against deferment of payroll taxes by borrowers who receive loan forgiveness. **Specifically it provides that businesses that receive PPP loan forgiveness would also be able to defer payroll taxes for the period beginning March 27, 2020 and ending December 31, 2020;** provided that one-half of the deferred amount must be deposited by December 31, 2021 and the other half of the deferred amount must be deposited by December 31, 2022.

With the release of the PPPFA, we are expecting to see revised versions of the Forgiveness Application and the Forgiveness IFR, and/or additional related guidance, in the near future.

In the interim, we will continue to follow this and the other CARES Act programs and offer updates as further developments arise. If you have any questions, please contact Anthony Zeoli (azeoli@freeborn.com) or another member of the Freeborn & Peters LLP CARES Act team.

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Anthony Zeoli is a Partner in the Corporate Practice Group and the Leader of the Emerging Industries Team. He concentrates his practice in the areas of banking and commercial finance, securities, real estate, and general corporate law. Anthony's commercial finance practice includes the representation of borrowers and lenders in: secured and unsecured lending transactions; corporate reorganizations and restructuring; syndicated commercial financing transactions; and loan workouts.

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