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The Paycheck Protection Program Flexibility Act of 2020 Is Now Law

By Larry Brant on 6.5.20 | Posted in Federal Law, Legislation, Tax Planning

As I previously reported, the Paycheck Protection Program Flexibility Act of 2020 (“PPPFA”) was jointly introduced in the U.S. House of Representatives (“House”) by Representative Chip Roy, a Republican from Texas and Representative Dean Phillips, a Democrat from Minnesota. By a nearly unanimous vote, the PPPFA was passed in the House on May 28, 2020. As anticipated, the legislation was promptly introduced in the U.S. Senate (“Senate”), where (without amendment) it was unanimously passed on June 3, 2020 by a voice vote. President Trump signed the PPPFA into law today.

This is especially good news for businesses that have been shut down and/or otherwise severely financially impaired by the COVID-19 pandemic. The PPPFA changes the landscape relative to loans received by businesses under the Paycheck Protection Program (“PPP”) that was enacted as part of the CARES Act. The PPPFA, at least for some PPP loan borrowers, may not bring glee and joy! The law contains some provisions that could be detrimental to some businesses.

PPPFA Provisions

Dissecting the PPPFA into its essential parts, we find that the legislation makes at least six significant changes to the PPP loan landscape, namely:

- The PPPFA extends the period in which borrowers must spend their PPP loan funds in order to be considered in the loan forgiveness computation from eight weeks following the date of the loan (i.e., disbursement of loan proceeds) to the earlier of: (i) 24 weeks following the date of the loan (i.e., disbursement of loan proceeds); or (ii) December 31, 2020. For businesses that could not spend the funds during the original eight-week period because they were shut down in whole or in part by an executive order of the governor of their state, this is terrific news. Businesses who obtained PPP loans before the effective date of the PPPFA, however, may elect to use the original eight-week period, thereby allowing them to apply for forgiveness sooner.
- The PPPFA changes the loan proceeds use formula of 75 percent payroll/25 percent rent, interest on debt and utilities rule to 60 percent payroll/40 percent rent, interest on debt and utilities. As discussed below, this change may not be well received by all PPP loan

borrowers.

- The PPPFA allows borrowers that receive loan forgiveness to potentially defer payroll taxes. Prior to the enactment of the PPPFA, borrowers who received any PPP loan forgiveness were not eligible for payroll tax deferral otherwise allowed under the CARES Act. Again, this provision of the PPPFA will likely be well received by PPP borrowers who will undoubtedly be navigating financially troubled waters for at least the near future.
- The PPPFA loosens up the requirement that borrowers must rehire employees by June 30, 2020. Under this provision of the PPPFA, the amount that may potentially be forgiven will not be lessened due to a reduced full-time equivalent ("FTE") workforce count if the borrower can document that it: (i) attempted, but was unable, to rehire persons who had been employees on February 15, 2020; and (ii) was unable to hire "similarly qualified employees" before December 31, 2020. Additionally, the amount potentially forgiven will not be lessened due to a reduced FTE workforce count if the borrower, in good faith, can document an inability to return to the "same level of business activity" as prior to February 15, 2020 due to sanitation, social distancing, and worker or customer safety requirements. Again, for businesses that have been shut down or have had operations curtailed by the COVID-19 pandemic, this provision should be helpful. Lawmakers recognize that these businesses may not be allowed to reopen by June 30, and even if they are allowed to reopen by that date, they may have to reopen in stages, thereby requiring that they hire back employees over a longer period of time. Additionally, the PPPFA recognizes that businesses may not be able to locate and hire qualified employees, as in many industries where the workforce has relocated due to the pandemic and may no longer be available to employers. This provision of the PPPFA is likely good news for a large percentage of PPP borrowers.
- The PPPFA extends the two-year repayment requirement for loans not totally forgiven to a minimum of five years. Lawmakers recognized, even with the statutorily imposed interest rate of one percent, many businesses could not repay non-forgiven PPP loans in such a short time period. As discussed below, extending the repayment term to five years will only be a welcome change to some PPP loan borrowers.
- The PPPFA extends the PPP loan deferral period. Under the CARES Act, borrowers generally were not required to commence repaying unforgiven PPP loans for six months after loan funding (or up to 12 months upon agreement with the lender in certain circumstances). The PPPFA extends the minimum deferral period to 12 months or, in the case where the borrower does not apply for forgiveness, 10 months after the applicable period in which the borrower would have been required to spend the loan proceeds for loan forgiveness. This provision should bring joy to all PPP loan borrowers who do not qualify for total loan forgiveness.

PPPFA Shortcomings

The PPPFA is not without shortcomings, namely:

- The PPPFA appeared to extend the life of the PPP to December 31, 2020 in that it extended the "covered period" to that date. The program was initially set to expire on June 30, 2020. Therefore, if the program's life was so extended, businesses that have not yet applied for PPP loans, assuming funds remained available, would have until the end of the year to obtain a PPP loan. Unfortunately, the U.S. Small Business Administration ("SBA") has quashed that dream. It announced that the extension of the covered period "should not be construed as to permit the SBA to continue accepting applications for [PPP] loans after June 30, 2020." So, the PPP application deadline remains June 30, 2020; borrowers in need of a PPP loan only have until the end of this month to submit their applications. Given the likely last minute traffic lenders will be facing and to avoid any snafus in loan submissions, applications should be made well in advance of the June 30 deadline. Don't wait until the last minute!
- The PPPFA extension of the loan repayment term from two years to five years only applies to loans made on or after the effective date of the PPPFA. While the law expressly provides that lenders and borrowers may amend loans entered into before the PPPFA was enacted to incorporate a five-year repayment term, it does not require that lenders do so. Consequently, it will be incumbent upon borrowers with unforgiven PPP loans that predate the PPPFA to request that their lender extend the repayment term to five years. Whether lenders will accommodate such extension requests is yet to be determined. If lenders do not extend the repayment term for borrowers that obtained their PPP loans pre-PPPFA enactment, these borrowers will clearly be at a disadvantage merely due to the timing of their loans.
- The PPPFA does not remedy one of the PPP ills that I discussed in a previous blog post, namely the terrible ill created by IRS Notice 2020-32. This ill, likely unintended by lawmakers, was brought to the forefront by the IRS when it issued Notice 2020-32. In that notice, the IRS emphatically announced (relying primarily on Code Section 265) that taxpayers who have their PPP loans forgiven and, in accordance with the CARES Act, have no cancellation of debt income, cannot deduct the business expenses for which they used the forgiven loan proceeds. The government's conclusion, from a purely academic perspective, makes sense. In normal times, taxpayers should not get a double tax benefit from a forgiven debt (i.e., a deduction with respect to expenses paid from the loan proceeds and an exemption from tax on the forgiven loan). However, we are not living in normal times. This was just one more blow to the bellies of businesses close to being down for the count! In the Senate, a bill was introduced (Senate Bill 3612) to nullify IRS Notice 2020-32. In essence, the bill provides that the receipt of coronavirus assistance (i.e., loan forgiveness) does not affect the tax treatment of ordinary business expenses. The bill has lingered in the Senate, waiting for bipartisan action that never appeared. With Senate Bill 3612 having died a slow death, we had hoped that the PPPFA

would adopt the provisions contained in Senate Bill 3612. Sadly, that did not happen. Consequently, IRS Notice 2020-32 is still in effect.

- The PPPFA may have an unintended adverse impact on some borrowers relative to loan forgiveness. As discussed above, the PPPFA changes the forgiveness percentages from 75 percent/25 percent to 60 percent/40 percent.

Section 3(b)(8) of the PPPFA provides:

"To receive loan forgiveness ...., an eligible recipient shall use at least 60 percent of the ..... loan amount for payroll costs, and may use up to 40 percent of such amount for any payment of interest on any ..... mortgage obligation (which shall not include any prepayment of or payment of principal on a ..... mortgage obligation), any payment on any ..... rent obligation, or any ..... utility payment (emphasis added)."

The new provision seems to indicate that, unless 60 percent or more of the loan proceeds are used for payroll, no forgiveness will be allowed. This is definitely a departure from the CARES Act and the initial guidance provided by the SBA.

Section 1106 of the CARES Act allows forgiveness of PPP loans because lawmakers recognize the ever important need to provide economic relief to businesses adversely impacted by COVID-19. This seems to be a provision that lawmakers would want to be generously applied by administrators.

In accordance with the SBA Interim Final Rules ("Rules"), the actual amount of loan forgiveness depends, in part, on the total amount of payroll costs, payments of interest on mortgage obligations incurred before February 15, 2020, rent payments on leases dated before February 15, 2020, and utility payments under service agreements dated before February 15, 2020, over the eight-week period (now extended by the PPPFA) following the disbursement date of the loan. However, under the Rules, not more than 25 percent of the loan forgiveness amount may be attributable to qualifying non-payroll costs. Consequently, up to 75 percent of loan forgiveness may be attributable to qualifying payroll costs.

The clear language in the Rules seems straightforward that this is not an all or nothing equation. In other words, if, for example, a borrower were to spend 40 percent of the loan proceeds on qualifying payroll costs and 60 percent on qualifying non-payroll costs during the applicable period, 65 percent of the loan (subject to certain other qualifications) would be forgiven (40 percent payroll costs plus 25 percent non-payroll costs). The PPPFA language appears to change that conclusion. Under the PPPFA, since at least 60 percent of the loan was not spent on qualifying payroll costs, it appears none of the loan in this example would be eligible for forgiveness.

The PPPFA makes it a requirement that 60 percent of PPP loans be spent on qualifying payroll costs, otherwise no loan forgiveness will be allowed. It will be interesting to see if the SBA reads Section 3(b)(8) of the PPPFA differently. Unless and until that happens, borrowers need to be aware of the 60 percent payroll costs threshold.

We will continue to report on COVID-19 related tax matters.

Tags: CARES Act, Coronavirus, COVID-19, employers, forgivable loans, FTE employees, interim final rule, Paycheck Protection Program, Paycheck Protection Program Flexibility Act of 2020, payroll costs, President Trump, small business, Taxpayer