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PAYCHECK PROTECTION PROGRAM FLEXIBILITY ACT OF 2020: WHAT YOU NEED TO KNOW

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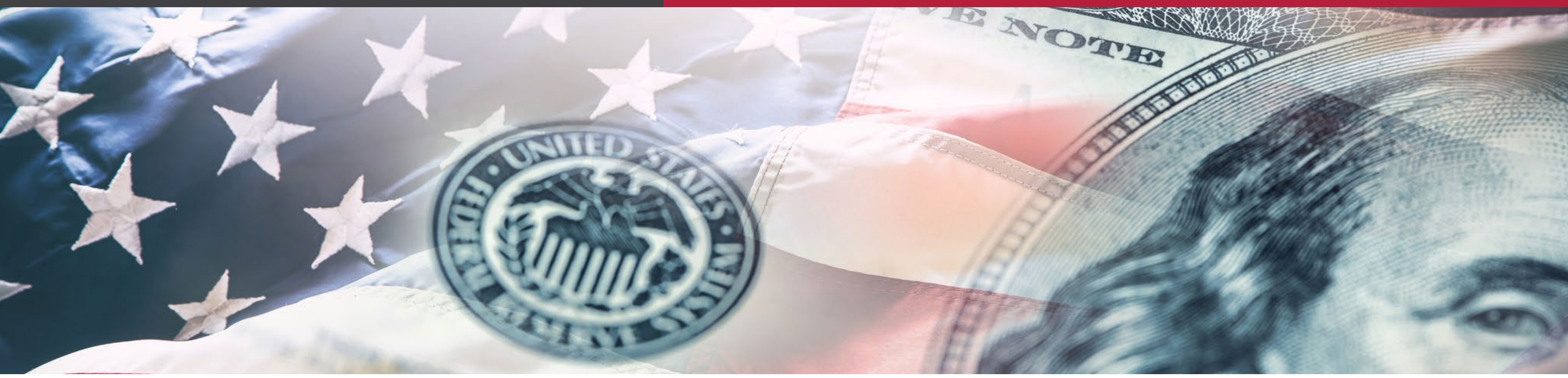
June 12, 2020



The Paycheck Protection Program (PPP) was implemented after President Trump signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act into law on March 27, 2020. Since then, the PPP has gone through significant changes in the form of interim rules and Frequently Asked Questions (FAQs) issued by the Small Business Administration (SBA) and Department of Treasury (DOT). Ultimately, these changes resulted in confusion, prompting Congress to pass the PPP Flexibility Act of 2020 (Flexibility Act). The Flexibility Act was signed into law by President Trump on June 5, 2020 and provides borrower-favorable changes to the PPP, including extensions of key dates and more beneficial loan forgiveness terms, as detailed below.

MATURITY DATE EXTENSION

The CARES Act provided for PPP loans to have a maximum maturity of 10 years from the date the borrower applies for loan forgiveness. In the First Interim Final Rule, the SBA adopted a 2 year term for all PPP loans.

The Flexibility Act now provides for a minimum maturity of 5 years for PPP loans made on or after June 5, 2020. For loans made before June 5, 2020, the lender and borrower can mutually agree to extend the maturity of a PPP loan to 5 years. Accordingly, existing borrowers that expect their PPP loan will not be fully forgiven should contact their lender and request a loan amendment if they wish to extend the term of their loan to 5 years.

COVERED PERIOD EXTENSION

Under the CARES Act, a borrower was eligible for loan forgiveness in an amount equal to the sum of certain expenses incurred and paid during the 8-week period beginning on the date when the PPP funds were disbursed. However, this 8-week period proved challenging for many borrowers as they were forced to spend their PPP funds while their businesses were shut down due to the COVID-19 pandemic.

The Flexibility Act helps alleviate this problem by extending the covered period for determining loan forgiveness to the period beginning on the date when the PPP funds are disbursed and ending on (i) the date that is 24 weeks after the date of such disbursement, or (ii) December 31, 2020, whichever date is earlier. This change not only gives borrowers more time to spend their PPP funds, but it also allows borrowers to use the funds for expenses incurred during a significantly longer period. It is currently unclear whether PPP borrowers may proportionally increase cash compensation payments to employees and owners to account for the prolonged covered period; however, the SBA is expected to release clarifying guidance on this issue in the coming days.

Note, however, that the 8-week period originally provided for in the CARES Act is still an option for existing PPP borrowers. The Flexibility Act states that borrowers that received PPP loans before June 5, 2020 may elect for the covered period to end 8 weeks after the date the PPP funds were disbursed. This option is ultimately beneficial for borrowers that spend their PPP funds within the original 8-week window and do not wish to wait any longer to apply for loan forgiveness.

Although the covered period has been extended to December 31, 2020, the Revised First Interim Final Rule issued by the SBA on June 11, 2020 confirms that June 30, 2020 remains the last date on which a borrower will be permitted to apply for a PPP loan.

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EXEMPTION BASED ON EMPLOYEE AVAILABILITY

The CARES Act reduced the amount of a PPP loan eligible for forgiveness if the borrower decreased its number of full-time equivalent employees (FTEs) or employee compensation (i.e., annual salary or hourly wages) during the covered period when compared to their pre-pandemic levels. Although the CARES Act allows for "de minimis exemptions" to this rule, it was not until the SBA's Application for Loan Forgiveness was released in May that borrowers were made aware of any concrete exceptions. The Application for Loan Forgiveness provides exemptions for FTEs that (i) voluntarily resigned, (ii) voluntarily requested and received a reduction in hours, (iii) were fired for cause, or (iv) rejected a good-faith, written offer to be re-hired by the borrower.

The Flexibility Act goes further and provides that during the period beginning on February 15, 2020 and ending on December 31, 2020, the amount of loan forgiveness will be determined without regard to a proportional reduction in the number of FTEs if a borrower, in good faith is able to document an inability to:

(i) rehire individuals who were employees of the eligible recipient on February 15, 2020, <u>and</u> an inability to hire similarly qualified employees for unfilled positions on or before December 31, 2020, <u>or</u>
(ii) return to the same level of business activity as such business was operating at before February 15, 2020, due to compliance with requirements established or guidance issued by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration during the period beginning on March 1, 2020, and ending December 31, 2020, related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19.

Unlike what was provided for in the CARES Act and subsequent guidance, these new exceptions make it easier for a borrower to avoid a reduction in loan forgiveness if their FTEs or employee compensation decrease due to unavoidable issues arising from the novel COVID-19 pandemic.

SAFE HARBOR EXTENSION

Although the CARES Act included a PPP loan forgiveness reduction "safe harbor" that allowed borrowers to avoid a reduction in loan forgiveness if they fully restored their FTEs and employee compensation to pre-pandemic levels by June 30, 2020, given the longer-than-expected impact of the COVID-19 pandemic, this did not provide many borrowers with enough time to restore their FTEs and compensation to pre-pandemic levels.

Fortunately, the Flexibility Act extends the safe harbor deadline to December 31, 2020. Therefore, as long as PPP borrowers fully restore their FTEs and employee compensation to pre-pandemic levels before the end of the year, they will not receive a reduction in loan forgiveness.

Despite this safe harbor extension, some questions still remain. For example, what happens if FTEs and compensation are fully restored to pre-pandemic levels, but then subsequently decline before December 31, 2020? Are borrowers required to wait until the end of the covered period to apply for loan forgiveness, even if they have spent their PPP proceeds and restored their FTEs and compensation to pre-pandemic levels prior to that time? Although questions remain, the SBA and DOT have stated that they intend to release further guidance to clarify the implementation of these new rules which may provide answers to these questions.

REDUCED MINIMUM FOR PAYROLL COSTS

The CARES Act did not provide a minimum amount that a borrower is required to spend on payroll costs (as defined in the CARES Act as modified by the SBA's First Interim Final Rule and the FAQs) in order for PPP borrowers to receive full loan forgiveness. Borrowers were eligible for complete forgiveness if they used PPP proceeds exclusively for payroll costs, interest on covered mortgage obligations, covered rent obligations, and covered utility payments that were incurred and paid during the covered period. However, in the First Interim Final Rule, the SBA added a requirement that to be eligible for complete forgiveness, at least 75 percent of the PPP funds must be spent on payroll costs, and no more than 25 percent of the PPP funds may be spent on non-payroll costs (i.e., interest on covered mortgage obligations, any covered rent obligation, and covered utility payments).

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Notably, this 75/25 rule operated on a sliding scale, so if a borrower used less than 75 percent on payroll costs, it would merely reduce the amount of the loan that could be forgiven. However, despite this allowance for partial forgiveness, the 75/25 rule was problematic as small businesses, particularly those in the restaurant and hospitality industries, expressed the need for greater flexibility to spend their PPP funds.

Fortunately, the Flexibility Act changed the 75/25 requirement. Now, in order to receive full loan forgiveness, a borrower must use at least 60 percent of the PPP funds on payroll costs, and no more than 40 percent of the PPP funds on non-payroll costs. Although the language of the Flexibility Act can be read to eliminate the sliding scale, the Revised First Interim Final Rule issued by the SBA clarified that if a borrower uses less than 60 percent of its PPP loan on payroll costs during the forgiveness covered period, the borrower will still be eligible to apply for partial loan forgiveness. For example, if a borrower receives a $100,000 PPP loan and spends $54,000 (or 54 percent) of it on payroll costs and 40 percent on non-payroll costs during the covered period, the maximum amount of loan forgiveness the borrower could receive is $90,000 (with $54,000 in payroll costs constituting 60 percent of the forgiveness amount and $36,000 in non-payroll costs constituting 40 percent of the forgiveness amount).

DEFERRAL PERIOD EXTENSION

The CARES Act required lenders to defer the payment of principal and interest for 6 months following the date of the disbursement of PPP funds.

The Flexibility Act extends the payment deferral date to the date on which the amount of forgiveness determined under Section 1106 of the CARES Act is remitted to the lender. In other words, borrowers are no longer required to start repaying their PPP loans until the SBA has determined what portion, if any, of the borrower's loan will be forgiven. Furthermore, if a borrower does not apply for PPP loan forgiveness within 10 months of the expiration of the covered period, the Flexibility Act states that payments of principal and interest will be deferred for 10 months following the last day of the covered period.

The SBA's Revised First Interim Rule provides clearer detail on the PPP loan deferral period, including a statement that interest will accrue during this time period. Borrowers have 10 months after their loan forgiveness covered period ends to submit a loan forgiveness application. If a borrower timely submits its application, no payments of principal or interest will be due until the borrower's lender provides notice of the loan forgiveness amount determined by the SBA (or alternatively, that the loan will not be forgiven) and the date that the first payment is due. If a borrower does not submit a loan forgiveness application within the 10-month window, the obligation to begin making payments of principal and interest will commence after the 10-month window expires. For example, if a borrower's PPP loan is disbursed on June 25, 2020, the 24-week period will end on December 10, 2020. If the borrower does not submit a loan forgiveness application to its lender by October 10, 2021 (i.e., 10 months after the loan forgiveness covered period ends), the borrower must begin making payments on or after October 10, 2021.

These changes ultimately provide PPP borrowers with a longer period in which they not are not required to repay the unforgiven amount of their PPP loans.

DEFERRAL OF TAX OBLIGATIONS

The CARES Act allows employers and self-employed individuals to defer the remittance of the employer portion of the Social Security portion of FICA (i.e., 6.2 percent of compensation up to $137,700), due between March 27, 2020 and December 31, 2020. These deferred tax amounts must be paid in two equal payments due on December 31, 2021 and December 31, 2022. Employers who also received PPP funds were initially prohibited from deferring these taxes after forgiveness of any portion of the PPP loan.

The Flexibility Act amends the CARES Act to ease some of these restrictions, including the restriction against payroll tax deferral for PPP borrowers after they receive loan forgiveness. Employers who receive PPP loan forgiveness may now continue to defer payment on these taxes that would otherwise be due through December 31, 2020.

CONCLUSION

The Flexibility Act provides existing and potential PPP borrowers numerous advantages under the PPP. Although some borrowers would argue that these changes came too late, the PPP is now better designed to help small business navigate

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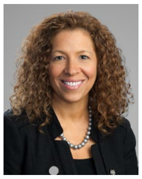
these difficult and unprecedented times. The members of Gray Reed's CARES Act Task Force will continue to monitor the rules and guidance issued by the SBA and DOT. Please contact us if you would like to discuss the contents of this alert or how to utilize your PPP funds strategically to maximize loan forgiveness and keep your business operating smoothly throughout the COVID-19 pandemic.

ABOUT THE AUTHORS



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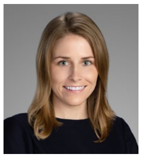

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