On June 5, 2020, the Paycheck Protection Program Flexibility Act (PPPFA) was signed into law. The PPPFA changes various aspects of the recently-enacted Coronavirus Aid, Relief, and Economic Security (CARES) Act to provide businesses with greater flexibility and more time to maximize forgiveness of loans received under the Paycheck Protection Program (PPP). The full text of the PPPFA can be found here.

In the wake of the PPPFA, the Small Business Administration (SBA) issued two sets of Interim Final Rules on June 11, June 12, and June 17 revising its April 2, April 14 and April 28, 2020 Interim Final Rules to conform to the changes made by the PPPFA. The full texts of the June 11 and June 12 Interim Final Rules can be found here, here and here. Similarly, on June 12 SBA also issued a revised version of its form PPP loan forgiveness application to reflect the changes made by the PPPFA. The revised form PPP loan forgiveness application can be found here.

Key Takeaways

Below is a summary of the major changes to the PPP enacted by the PPPFA and SBA's June 11 and June 12 Interim Final Rules:

- ***Covered Period Extendable to 24 Weeks or December 31, 2020***. The PPPFA allows PPP borrowers to extend their "Covered Period" (*i.e.*, the period during which a PPP borrower can incur costs eligible for forgiveness) from eight weeks after the date of loan disbursement to 24 weeks after the date of disbursement, but in no event ending later than December 31, 2020. Under the original CARES Act and the SBA implementing regulations, a PPP borrower could apply for forgiveness for up to the amount of PPP loan proceeds spent on authorized costs during the 8-week period after the date of loan disbursement. The extended covered period effectively grants PPP borrowers more time to spend their loan proceeds and have them forgiven, though borrowers that received PPP loans before enactment of the PPPFA may still elect to apply for forgiveness after the original eight-week period if they prefer to do so.

The June 11 Interim Final Rule states that, in seeking loan forgiveness, an eligible borrower whose loan was made before June 5, 2020 may elect to apply the original eight-week covered period under the CARES Act instead of the 24-week covered period referenced above.

- ***Cap on Non-Payroll Expense Forgiveness Raised to 40%***. The PPPFA increases the portion of a PPP loan that a borrower can spend on authorized non-payroll costs (*e.g.*, covered mortgage interest payments, rent and utility payments) that is eligible for forgiveness from 25% to 40%. While the CARES Act did not impose any limit on the portion of a PPP loan that may be used to pay a borrower's eligible non-payroll expenses, SBA's implementing regulations required that a PPP borrower use at least 75% of a PPP loan proceeds to pay payroll costs and that payments of eligible non-payroll costs during the covered period were only eligible for forgiveness to the extent they constituted 25% or less of the forgiven amount. The PPPFA raises this limit by providing that a borrower may use up to 40% of a PPP loan to pay eligible non-payroll costs, but adds that the borrower will not be eligible for *any* forgiveness unless the borrower uses at least 60% of the PPP loan for authorized payroll costs.

The June 11 Interim Final Rule clarifies that the new 40% cap on non-payroll costs is "a proportional limit on non-payroll costs as a share of the borrower's loan forgiveness amount, rather than a threshold for receiving any loan forgiveness." This interpretation effectively means that borrowers will not be totally excluded from receiving any forgiveness if they do not use at least 60% of the PPP loan on payroll costs. Borrowers who spend less than 60% of their PPP loan on payroll costs will simply have their maximum forgivable amount reduced based on the requirement that 60% of the forgiveness amount be attributable to payroll costs. For example, if a borrower receives a $100,000 PPP loan, and during the covered period the borrower spends $54,000 (or 54%) of its loan on payroll costs, then because the borrower used less than 60% of its loan on payroll costs, the maximum amount of loan forgiveness the borrower may receive is $90,000 ($54,000 in payroll costs equaling 60% of the forgiveness amount and $36,000 in non-payroll costs equaling 40% of the forgiveness amount).

- ***Repayment Term Extended to Five Years***. The PPPFA extends the repayment term of a PPP loan made after the enactment of the PPPFA from two years to five years. Under the original CARES Act and SBA's implementing regulations, PPP borrowers were required to repay the unforgiven portion of their loans within two years of origination. The extended repayment period does not apply to PPP loans made before enactment of the PPPFA; however the PPPFA allows lenders and borrowers to renegotiate the term of any such loan in accordance with this extension. The June 11 Interim Final Rule confirms that loans made before June 5, 2020, have maturities of two years (however, borrowers and lenders may mutually agree to extend the maturity of such loans to five years) and loans made on or after June 5 have maturities of five years.

- ***Repayment Deferral Period Extended***. The PPPFA extends the deferral period with respect to repayment of PPP loan principal, interest and fees to the date on which SBA remits to the PPP lender the amount of the PPP loan that is forgiven. Under the original CARES Act and SBA's implementing regulations, PPP lenders were required to defer the repayment of PPP loan principal, interest and fees for the first six months of the loan. The Act further provides that a PPP borrower that fails to apply for forgiveness within 10 months after the last day of the 24-week covered period must begin making principal and interest payments on the date that is 10 months after the ending date of the forgiveness period. To illustrate the above, the June 11 Interim Final Rule provides the following example: "if a borrower's PPP loan is disbursed on June 25, 2020, the 24-week [covered] period ends on December 10, 2020. If the borrower does not submit a loan forgiveness application to its lender by October 10, 2021, the borrower must begin making payments on or after October 10, 2021."
- ***FTE and Salary Reduction Safe Harbor Extended to December 31, 2020***. The PPPFA extends to December 31, 2020 the safe harbor period during which a PPP borrower can eliminate a reduction in full-time equivalent (FTE) employment, salary and wages that would otherwise reduce the forgivable amount of its PPP loan. Under the original CARES Act and SBA's implementing regulations, a PPP borrower had until June 30, 2020 to eliminate such a reduction.

In addition, the PPPFA provides that PPP borrowers will not have their PPP forgiveness amount reduced as a result of a decline in the FTE employee count if the PPP borrower, in good faith, is able to document either of the following:
A. (i) an inability to rehire individuals who were employees of the PPP borrower on February 15, 2020; and (ii) an inability to hire similarly qualified employees for unfilled positions on or before December 31, 2020; *or*
B. an inability to 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.

- ***Cap on Owner Compensation Replacement***. The April 17 Interim Final Rule provides that, even with a 24-week covered period, the amount of owner compensation replacement for a borrower with self-employment income may not exceed 2.5 months' worth (2.5/12) of the borrower's 2019 net profit across all businesses. SBA explained that this cap was intended to prevent an owner who had employees from receiving a windfall if the owner's workforce was reduced because its business was not able to return to pre-February 15, 2020 levels of business activity. In addition, SBA noted that this would not affect self-employed borrowers with no employees because such a borrower's maximum loan amount was limited to 2.5 months' worth of the borrower's 2019 net profits.
- ***PPP Borrowers May be Able to Defer 2020 Payroll Tax Payments***. The PPPFA allows an employer that obtains forgiveness of a PPP loan to defer its share of 2020 federal payroll taxes. Under the CARES Act, an employer could defer paying its share of 2020 federal payroll taxes (with 50% due at the end of 2021, and 50% due at the end of 2022), but this relief was not available to an employer that obtained full or partial forgiveness of a PPP loan. The PPPFA removes this restriction.
- ***Greater Flexibility for PPP Loan Applicants with Criminal Records***. The June 12 Interim Final Rule relaxes the eligibility restrictions for PPP loan applicants with criminal records. Under SBA's earlier implementing regulations, PPP loans were not available to an applicant if an owner of 20% or more of the equity of the applicant had been convicted of any felony within the last five years. The June 12 Interim Final Rule limits the five-year lookback to convictions for felonies involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance. For any other felony, an applicant will be ineligible if a 20% or more owner was convicted of the felony within the last year. The June 12 Interim Final Rule does not affect the ineligibility of an applicant if a 20% or more owner is incarcerated, on probation or on parole or is presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction.

Open Question Regarding Deductibility of Business Expenses Paid by Forgiven PPP Loans

Contrary to the expectations of various observers, the PPPFA did not address whether business expenses that are otherwise tax deductible are deductible when the taxpayer pays for such expenses with PPP loan proceeds that are forgiven. The original CARES Act specified that PPP loan forgiveness itself is not included in income for tax purposes, but it did not specify whether deductible expenses paid for by forgiven PPP loans would remain deductible.

On April 30, 2020, the Internal Revenue Service (IRS) issued Notice 2020-32 (the "Notice") with respect to the issue, taking the position that no deduction is allowed if the expense results in forgiveness of a covered loan under the PPP and the income associated with the forgiveness is excluded from gross income pursuant to the CARES Act. Despite disapproval expressed by some members of Congress, Secretary of the Treasury Steven Mnuchin defended the position, explaining that taxpayers should not be allowed to "double dip" by deducting expenses funded by PPP loans that are themselves forgiven without tax consequences.

Additional Resources

For additional background on small business loans available under the CARES Act, including PPP loans, please see our Client Alert on Small Business Loans under the CARES Act, available here. For additional background on SBA's guidance with respect to PPP loans, please see our Client Alerts on SBA Updates to PPP loans here, here, here, here and here. Due to the recent adoption of the CARES Act, interpretation of some of its provisions is uncertain, and it is subject to additional clarification and interpretation by Treasury, IRS, SBA and other federal regulatory agencies.