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Paycheck Protection Program: SBA Issues Guidance on First Draw and Second Draw PPP Loans and Releases PPP Applications Pursuant to the Economic Aid Act

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On January 6, 2020, the SBA published its 26th Interim Final Rule (the *First Draw PPP IFR*) and 27th Interim Final Rule (the *Second Draw PPP IFR*)[1] with respect to the Paycheck Protection Program (*PPP*), as reauthorized and modified under Title III (cited as the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (the *Economic Aid Act*)) of Division N of the Consolidated Appropriations Act, 2021. The PPP was originally enacted under the Coronavirus Aid, Relief, and Economic Security Act (as amended, supplemented or otherwise modified from time to time prior to the enactment of the Economic Aid Act, including by the Paycheck Protection Program and Health Care Enhancement Act, the Paycheck Protection Program Flexibility Act, applicable federal regulations and interpretive guidance issued by the SBA and Treasury, the *CARES Act*).

As detailed in our client alert summarizing the reauthorization and modification of the PPP under the Economic Aid Act, the Economic Aid Act reopens the application process for businesses seeking PPP funds for the first time (a *First Draw PPP Loan*), while expanding the authorized uses for PPP loan proceeds and increasing flexibility to obtain loan forgiveness. The Economic Aid Act also permits an eligible business that received a First Draw PPP Loan to apply for a second draw of PPP loan proceeds (a *Second Draw PPP Loan*), albeit by adopting generally more restrictive eligibility criteria and reducing the maximum amount of proceeds available for a Second Draw PPP Loan.

The First Draw PPP IFR and Second Draw PPP IFR have been issued pursuant to the mandates of the Economic Aid Act. The First Draw PPP IFR restates certain of the interim final rules issued by the SBA and/or Treasury prior to the enactment of the Economic Aid Act, and updates such rules to incorporate the applicable amendments effectuated by the Economic Aid Act in relation to the First Draw PPP Loans. The Second Draw PPP IFR supplements the Economic Aid Act by providing further regulations pertaining to the Second Draw PPP Loans.

Further, on January 8, 2020, the SBA issued a revised First Draw PPP Application Form and new Second Draw PPP Application Form for PPP applicants to account for changes to the program under the Economic Aid Act.

Highlights of material new guidance or clarification of existing guidance regarding the PPP contained in the First Draw PPP IFR and Second PPP IFR are as follows:

I. First Draw PPP IFR

A. Calculating the Maximum PPP Loan Amount

The First Draw PPP IFR clarifies that applicants seeking First Draw PPP Loans under the Economic Aid Act may use calendar year 2019 or calendar year 2020 for purposes of calculating their average payroll costs for purposes of determining their maximum PPP loan amount, even though the Economic Aid Act did not revise Section 1102 of the CARES Act instructing PPP applicants to calculate their maximum loan amount by using "payroll costs incurred during the 1-year period before the date on which the loan is made."

B.$20 Million First Draw PPP Loan Amount Limitation for a Single Corporate Group

The First Draw PPP IFR confirms that businesses that are part of a single "corporate" group are not permitted to receive more than $20 million of First Draw PPP Loans in the aggregate. The SBA elaborates that for purposes of this $20 million aggregate limit, businesses are part of a single corporate group if "they are majority owned, directly or indirectly, by a common parent." The First Draw PPP IFR states that it is the responsibility of a PPP applicant to notify the lender if such applicant and its affiliated businesses have applied for or received First Draw PPP loans in excess of the $20 million aggregate limit. Failure to do so will be regarded as "a use of PPP funds for unauthorized purposes, and the loan will not be eligible for forgiveness." A PPP lender may rely on an applicant's representation concerning the applicant's compliance with this $20 million limitation.

C. General Eligibility and Restrictions for "Permanently Closed" Businesses

The First Draw PPP IFR confirms that, except for expanding the list of prohibited applicants to include publicly-traded companies and businesses that are "permanently closed,"[2] the eligibility criteria for businesses applying for First Draw PPP Loans remains unchanged. For analysis on eligibility for First Draw PPP Loans, please visit our article on the subject matter here.

D. Conflicting Guidance on Eligibility for PPP Applicants in Bankruptcy

As discussed in our extensive summary of the legislation, the Economic Aid Act reverses SBA rules set forth in the fourth interim final rules published April 28, 2020 in connection with the initial PPP loan program as well as the growing majority of decisions out of the federal bankruptcy and appellate courts that held debtors-in-possession and bankruptcy trustees in bankruptcy cases to be ineligible to obtain PPP loans. By contrast, Section 320 of the Economic Aid Act expressly amends the U.S. Bankruptcy Code to authorize a debtor-in-possession or a trustee authorized to operate the business of a debtor to apply for and borrow a PPP loan (which is to be accorded the priority of an administrative claim), notwithstanding any contrary contractual restriction, prior prohibition under Section 363 of the Bankruptcy Code regarding use of cash collateral, or other law prohibiting the debtor from incurring additional debt.

Surprisingly, the SBA appears to have directly contradicted Section 320 of the Economic Aid Act in the First Draw PPP IFR by preserving the PPP regulations in place prior to the enactment of the

Economic Aid Act. The SBA, in the First Draw PPP IFR, indicates that it will be revising its previously issued PPP Frequently Asked Questions (*FAQs*) to fully conform to the Economic Aid Act "as quickly as possible." We query whether the SBA will, in a subsequent interim final rule, revise its position in the First Draw PPP IFR to be consistent with Section 320 of the Economic Aid Act. In the meantime, courts will need to enforce Section 320 of the Economic Aid Act against the conflicting backdrop of the First Draw PPP IFR.

E. Eligibility for Form 1040, Schedule C Filers and Partners; Increase in PPP Loan Amount for Partners

The First Draw PPP IFR confirms that, generally, an applicant that files a U.S. Internal Revenue Code (*IRC*) Form 1040, Schedule C is eligible for a PPP loan if such applicant: (i) was in operation on February 15, 2020; (ii) is an individual with self-employment income (such as an independent contractor or a sole proprietor); (iii) has a principal place of residence in the United States; and (iv) filed or will file a Form 1040, Schedule C for 2019.[3] However, the First Draw PPP IFR adds that if the applicant is a partner in a partnership, then such applicant may not submit a separate PPP loan application as a self-employed individual. Instead, the self-employment income of general active partners may be reported as a payroll cost, up to $100,000 on an annualized basis, as prorated for the period during which the payments are made or the obligation to make the payments is incurred on a PPP loan application filed by the partnership. The SBA has determined that limiting a partnership and its partners (and an LLC filing taxes as a partnership) to one collective PPP loan is necessary "to help ensure that as many eligible borrowers as possible obtain PPP loans before the statutory deadline of March 31, 2021." The SBA additionally reasons that authorized uses of PPP Loans (*e.g.*, for rent, mortgage interest, utilities, operations expenditures, property damage costs, worker protection expenditures, etc.) are generally incurred at the partnership level, so it is "most natural to provide the funds for these expenses to the partnership, not individual partners."

To accommodate the foregoing, the First Draw PPP IFR permits a partnership that received a PPP loan to increase its PPP loan amount if it did not originally include the compensation of its partners (subject to the pro-rated annual $100k cap on an individual's compensation) in determining its maximum loan amount eligibility. The PPP borrower may do so by asking the lender to submit a request through the SBA's E-Tran Servicing site on or before March 31, 2021, and such request is permissible even if the loan has been fully disbursed and/or the lender's first SBA Form 1502 report to the SBA on the subject PPP loan has already been submitted.

F. Eligibility for 501(c)(6) Organizations

The First Draw PPP IFR confirms that any organization that is described in IRC Section 501(c)(6) and that is exempt from taxation under IRC Section 501(a) (excluding professional sports leagues and organizations with the purpose of promoting or participating in a political campaign or other activity) will be eligible to receive a First Draw PPP Loan as long as other eligibility requirements established under the CARES Act and Economic Aid Act are met, and if: (i) the organization does not receive more than 15% of its receipts from lobbying activities; (ii) the lobbying activities of the organization do not comprise more than 15% of the total activities of the organization; (iii) the cost of the lobbying activities of the organization did not exceed $1 million during the most recent tax year of the organization that ended prior to February 15, 2020; and (iv) the organization employs not more than 300 employees.

G. Ability to Reapply or Request an Increase in the PPP Loan Amount

The First Draw PPP IFR restates the provisions in the Economic Aid Act that permit PPP borrowers to reapply for, or request an increase in, a PPP loan in the following qualified circumstances:

- If a borrower returned all of a PPP loan, the borrower may reapply for a PPP loan in an amount the borrower is eligible for under current PPP rules;
- If a borrower returned part of a PPP loan, the borrower may reapply for an amount equal to the difference between the amount retained and the amount previously approved; and
- If a borrower did not accept the full amount of a PPP loan for which it was approved, the borrower may request an increase in the amount of the PPP loan up to the amount previously approved.

The First Draw PPP IFR adds that seasonal employers who received a PPP loan prior to December 27, 2020 to increase the amount of its existing PPP loan by using the revised calculation of the maximum loan amount available for seasonal borrowers under the Economic Aid Act.

Any request for an increase must be submitted electronically in the SBA's E-Tran Servicing site on or before March 31, 2021, and is subject to the availability of PPP funds.

The SBA will issue additional guidance on the process to reapply or request a loan increase.

H. Affiliation

The First Draw PPP IFR confirms that, generally, the affiliation rules that applied to applicants of PPP Loans prior to the enactment of the Economic Aid Act continue to apply, except that, for purposes of a Second Draw PPP Loan, the employee size standard is reduced to a maximum of 300 employees (from 500 employees) for purposes of determining affiliation.[4] For further analysis on the PPP affiliation rules, please visit our firm's articles here and here.

I. Loan Repayment Commencement Date

The First Draw PPP IFR provides that so long as a PPP borrower submits its forgiveness application date within 10 months after the end of its loan forgiveness covered period, it will not have to make any payments of principal or interest on its PPP loan until the SBA (i) makes a determination on such PPP borrower's forgiveness application, and (ii) remits the determined forgiveness amount (if any) to the PPP lender. This stance is a modification of the loan repayment rules in place prior to the enactment of the Economic Aid Act, which directed that unless the PPP loan was previously repaid or forgiven in full, the PPP borrower would be required to begin making payments on the unforgiven balance of its PPP loan beginning on the 10 month anniversary of the last day of the 24-week (or, if applicable, 8-week) loan forgiveness covered period. Under such prior guidance, if all or a portion of the PPP loan was subsequently forgiven, the SBA would remit to the borrower that portion of the payments made by the borrower that were subsequently forgiven.

II. Second Draw PPP IFR

A. March 31, 2021 Application Deadline

The Second Draw PPP IFR confirms that the last day to "apply for and receive" a Second Draw PPP loan is March 31, 2021. The guidance, however, does not clarify what is intended by "receive a PPP loan," and whether the receipt date is considered to be: (i) the date of the SBA loan approval; (ii) the date the PPP note is executed; or (iii) the date the PPP loan is disbursed. As there will be a gap in time between submission of a PPP loan application and the disbursement date of the PPP loan, applicants for Second Draw PPP Loans are encouraged to submit their applications well in advance of the March 31, 2021 deadline.

B. Eligibility

The Second Draw PPP IFR confirms that for Second Draw PPP Loans the maximum cap of 300 employees established under the Economic Aid Act is the only size test permitted to determine general eligibility. The CARES Act and the ensuing implementing SBA regulations and guidance expanded the 500 employee size cap for First Draw PPP Loans to include, as independent alternative bases of size eligibility: (i) NAICS Code size standards applicable to the primary industry sector in which the PPP loan applicant operates; and (ii) the SBA's Alternative Size Standards, both of which are used to determine eligibility for other SBA loan programs. These alternative size tests to determine eligibility remain limited to First Draw PPP Loans and do not apply to Second Draw PPP Loans.

C. Calculating Gross Receipts

In addition to the 300 employee maximum size test, the Economic Aid Act also conditions eligibility for Second Draw PPP loans on whether the applicant can demonstrate a 25% reduction in gross receipts in any quarter in 2020 compared to the corresponding quarter in 2019. While the Economic Aid Act does not define "gross receipts," the Second Draw PPP IFR generally defines the term to include "all revenue in whatever form received or accrued (in accordance with the [PPP borrower's] accounting method) from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances." The Second Draw PPP IFR adds that, generally, receipts are considered "total income" (or in the case of a sole proprietorship, independent contractor, or self-employed individual "gross income") plus "cost of goods sold," and excludes net capital gains or losses as these terms are defined and reported on IRS tax return forms.[5] All other items, such as subcontractor costs, reimbursements for purchases a contractor makes at a customer's request, investment income, and employee-based costs such as payroll taxes, may not be excluded from gross receipts.

The Second Draw PPP IFR notes that its definition of gross receipts is consistent with 13 CFR.121.104 used by the SBA, among other things, to calculate conformance with the NAISC Code-based alternative size test for eligibility for a First Draw PPP Loan, and further excludes First Draw PPP Loans from the calculation of gross receipts.

D. Calculating Average Payroll Costs to Determine Maximum Second Draw PPP Loan Amount

The Economic Aid Act adjusted the methodology for calculating a borrower's payroll costs for PPP loans, and the Second Draw PPP IFR clarifies that applicants for Second Draw PPP loans will be able to use any of (i) calendar year 2019, (ii) calendar year 2020 or (iii) the 12 months preceding the date of application for a Second Draw PPP Loan for purposes of calculating average payroll costs in determining a maximum loan amount.

E. $4 Million Second Draw PPP Loan Amount Limitation for a Single Corporate Group

The Second Draw PPP IFR provides that businesses that are part of a single corporate group shall not receive more than $4 million of Second Draw PPP Loans in the aggregate. The SBA concluded that a limitation of $4 million is appropriate because it is proportional to the $20 million maximum amount available for corporate groups with respect to First Draw PPP Loans.

F. The Unresolved Borrower Dilemma

An otherwise eligible borrower applying for a Second Draw PPP Loan may find its application process adversely impacted if its First Draw PPP Loan is under review by the SBA and/or a determination has been made that the borrower in ineligible pursuant to PPP regulations or "information in [the] SBA's possession." The SBA defines such a borrower to be an "unresolved borrower," and if the SBA notifies the PPP lender that the applicant for a Second Draw PPP Loan is an unresolved borrower, the SBA will not issue an SBA loan number, and additional loans are prohibited from being made to such borrower until the outstanding issues are resolved. The SBA states that it will "resolve issues related to unresolved borrowers expeditiously," and that ongoing review by the SBA of an unresolved borrower does not disqualify an eligible unresolved borrower from receiving a Second Draw PPP Loan. Nonetheless, being classified as an unresolved borrower could result in a substantial delay in the approval and funding of Second Draw PPP loans for interested businesses or, even worse, cause an unresolved borrower to miss out on the briefly available second draw PPP funds altogether. Moreover, it is unclear as to whether a borrower of First Draw PPP Loans who submitted its forgiveness application and is awaiting SBA review constitutes an "unresolved borrower". This is particularly so for borrowers with First Draw PPP Loans of $2 million or more as the SBA has stated that it will separately review each such loan as to its "necessity certification".[6]

****Things are changing quickly and the measures and interpretations described herein may change. Our analysis is necessarily limited by the time sensitivities of the current crisis, as well as the absence of precedent for some of what is contained here. This analysis represents our best interpretation and recommendations based on where things currently stand.****

FOOTNTOES

[1] The 26th IFR and 27th IFR are effective without advance notice and public comment because Section 1114 of the CARES Act authorizes SBA to issue regulations to implement the PPP without regard to notice requirements.

[2] The SBA notes that this exclusion applies to any business that has "gone out of business and has no intention of reopening" but, for the avoidance of doubt, a business that has "temporarily closed or temporarily suspended its business but intends to reopen" remains eligible for a PPP loan.

[3] On June 26, 2020, the SBA issued additional guidance for those individuals with self-employment income who: (i) were not in operation in 2019 but who were in operation on February 15, 2020, and (ii) filed a Form 1040 Schedule C for 2020. *See* Question 10 in the SBA's How To Calculate Maximum Loan Amounts – By Business Type fact sheet.

[4] Section 317 of the Economic Aid Act adds an exception to the PPP affiliation rules for news organizations.

[5] The SBA excludes the following from constituting "gross receipts": (i) taxes collected for and remitted to a taxing authority if included in gross or total income (such as sales or other taxes collected from customers and excluding taxes levied on the concern or its employees); (ii) proceeds from

transactions between a concern and its domestic or foreign affiliates; and (iii) amounts collected for another by a travel agent, real estate agent,

advertising agent, conference management service provider, freight forwarder or customs broker.

[6] Please visit our previous client alerts discussing the “necessity certification” here and here.

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