New Law Makes Major Changes to the Paycheck Protection Program

Alert
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The Paycheck Protection Program Flexibility Act of 2020, H.R. 7010 (PPPFA) recently passed by Congress and signed by the president on June 5, 2020 makes significant changes to the Paycheck Protection Program (PPP) in an effort to provide greater flexibility and benefits to borrowers. The implementation of these changes will depend in part upon further rule-making from the Small Business Administration (SBA), as a number of the rules enacted by the SBA now contain inconsistencies with the statutory framework of the PPP as set forth in the CARES Act (as amended).

Minimum Maturity for New Loans Extended to Five Years. Previously, the CARES Act provided that PPP loans would have a maximum maturity of 10 years, and did not provide for a minimum maturity. In its Interim Final Rule 1 published in the Federal Register on April 15, 2020 (85 Fed. Reg. 20811), the SBA determined that the maturity of PPP loans would be two years. The PPPFA now provides that PPP loans will have a minimum maturity of five years. However, this change only automatically applies to loans made on and after the enactment of the PPPFA, and does not change the maturity of PPP loans originated prior to enactment of the PPPFA. The PPPFA provides that lenders and borrowers may mutually agree to modify PPP loans originated prior to enactment of the PPPFA to be consistent with the minimum five year maturity. However, it is unclear whether lenders will have an appetite for engaging in these amendments, since it will extend the period during which they would have to carry these low interest loans, without receiving any additional fees.

Extension of "Covered Period" for Provision of Loans. The definition of "covered period" in Section 1102 of the CARES Act previously referred to the period from February 15, 2020 to June 30, 2020. The PPPFA extends the covered period in Section 1102 to December 31, 2020. The term "covered period" is used in different contexts in the CARES Act. In Section 1102 the term is used in the definition of certain terms, and is used to establish the period during which the SBA may guaranty PPP loans and to define certain parameters of the PPP. This change in the definition of covered period in Section 1102 appears to permit the SBA to continue making PPP loans until December 31, 2020, or until the current funding runs out, but a bipartisan letter of congressional intent, "to make sure the terms of the program and its legislative intent are properly understood," was incorporated into the Congressional Record at the time the Senate voted on the PPPFA. That letter stated that Congress did not intend that the PPPFA extend the time period for accepting PPP loan applications beyond June 30, 2020. As with many provisions relating to PPP loans, this change when read in conjunction with the use of the term "covered period" throughout Section 1102 of the CARES Act raises several questions. The term was used in connection with the $100,000 compensation cap, expansion of loan eligibility to borrowers other than "small business concerns," waiver of affiliation rules for some borrowers, waiver of certain SBA fees, waivers of the "credit elsewhere" and guarantee requirements, and the provisions relating to permitted uses of PPP loan proceeds. Perhaps the only meaningful result of the change to the covered period definition in Section 1102 is that borrowers may now have through December 31, 2020 to spend PPP loan funds. Borrowers should keep in mind that even though they can use PPP loan funds through December 31, 2020, only amounts spent within the "covered period" under Section 1106 of the CARES Act (discussed below) are eligible for loan forgiveness.

Change to the 75% Payroll Cost Requirement. The CARES Act previously did not provide guidance on the proportion of PPP loan proceeds that must be spent on the various categories of eligible expenses, but in Interim Final Rule 1 the SBA imposed a requirement that at least 75% of the PPP loan proceeds must be spent on payroll costs and at least 75% of the amount of forgiveness must relate to payroll costs. Notably, the PPPFA increases the proportion of PPP loan funds that can be used to pay for non-payroll expenses during the covered period from 25% to 40%. In addition, the PPPFA provides that at least 60% of the PPP proceeds must be used to pay payroll costs "to receive loan forgiveness." Although not entirely clear, this language appears to establish an all-or-nothing rule for forgiveness, which is in contrast to the previously existing forgiveness application that allowed proportional forgiveness even if the 75% payroll cost threshold was not met. The SBA may assert authority to impose the more restrictive 75% payroll cost threshold and we will await SBA guidance as to whether the SBA will permit application of this expansion to current PPP loan recipients seeking forgiveness.

Rehire and Salary Restoration Safe Harbor. Section 1106 of the CARES Act provided that a borrower's forgiveness amount could be reduced if its average FTE level for the covered period had decreased from the selected reference period, and if any of its employees were subject to greater than 25% reductions in salary during the covered period as compared to the specified reference period. However, the CARES Act provided a safe harbor that allowed a borrower to escape this reduction in forgiveness if the borrower could eliminate salary reductions or restore its employee count to reference period levels by June 30, 2020. The PPPFA now extends the June 30, 2020 deadline to December 31, 2020. Given that certain borrowers will seek forgiveness before this date, it is not clear precisely how this will this work in practice as the forgiveness application has to be filed within 90 days after the end of the covered period.

The PPPFA also adds exceptions which prevent a borrower from having its forgiveness amount reduced (i) if the borrower can document that the borrower was unable to rehire individuals who were employees of the borrower as of February 15, 2020 and that the borrower was also unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020, or (ii) the borrower can document an inability to return to the same level of business activity as it was operating at before February 15, 2020 as a result of compliance with federal guidelines (from the Secretary of Health and Human Services, the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration) "related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19." Note, however, that many businesses will be primarily impacted by state and local guidelines regarding such matters, which are not covered by this exception.

Questions remain about the manner in which a borrower will be required to "document" these circumstances. The exception relating to an inability to re-hire workers was already set forth in the SBA's Interim Final Rule on Loan Forgiveness published in the Federal Register on June 1, 2020 (85 Fed. Reg. 33004). That rule includes specific steps borrowers must take in order to document the inability to rehire employees and may serve as a guide; however, since the June 1 Interim Final Rule will need to be substantially updated as a result of the PPPFA, it is possible the existing guidance on that point will change. We will also need to await SBA guidance on how a borrower can document an inability to hire similarly qualified individuals or its inability to return to its prior level of business activity.

Extension of Deferral Period. The CARES Act allowed for full payment deferment on PPP loans for up to one year, and the SBA's Interim Final Rule 1 established a six-month deferral. The PPPFA extends the deferment period to the date on which the lender is reimbursed by the SBA for the forgivable portion of the loan, provided that the deferment period must be at least six months and not more than one year. However, if a borrower has not applied for forgiveness within 10 months after the end of its covered period, then the borrower will be required to begin making payments at that time.

Delay of Payment of Employer Payroll Taxes. The CARES Act provided that employers could delay payment of payroll taxes otherwise due in 2020 as long as 50% of such delayed payments were made by December 31, 2021 and the remaining 50% of the delayed payments were made by December 31, 2022. However, Section 2302(a)(3) of the CARES Act had provided that any borrower who received PPP loan forgiveness would be ineligible for the payroll tax delay. The PPPFA removes Section 2302(a)(3) from the CARES Act, thus making PPP borrowers who receive forgiveness eligible for the payroll tax delay. This change is retroactive, effective as if included in the CARES Act, and therefore should be applicable to loans made either pursuant to Section 1102 or Section 1109 of the CARES Act. Note that this change does not amend Section 2301 of the CARES Act, which provides that borrowers who receive a PPP loan are not entitled to the Employee Retention Tax Credit.

Overall, the PPPFA seems to provide additional benefits for some borrowers to take full advantage of their PPP loans, although the PPPFA may have come too late for many borrowers. However, despite these changes, additional uncertainties remain. Such uncertainties may be addressed in subsequent rulemakings or guidance by the SBA, as we have seen in the past. We will continue to monitor and report on developments in this area.

For more information on the Paycheck Protection Program Flexibility Act of 2020, please contact Judith Araujo, Susan Warshaw Ebner, David Jenson, Johnny Wang, Gerald Weidner or the Stinson LLP contact with whom you regularly work.

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