

Paycheck Protection Program Flexibility Act and Updates on Foreign Affiliates and Loan Forgiveness

The [Paycheck Protection Program Flexibility Act of 2020](#) (the "PPP Flexibility Act"), which was signed into law by President Trump on June 5, 2020, provides Paycheck Protection Program (the "PPP") loan borrowers additional time to incur costs that count towards PPP loan forgiveness, reduces the portion of such costs that must be payroll costs, provides an additional exemption from the CARES Act's loan forgiveness reduction provisions and extends the deadline to rehire workers in order to remain qualified for full forgiveness. The PPP Flexibility Act also allows businesses that receive loan forgiveness to defer payroll taxes and extends the PPP loan maturity date and loan payment deferral period.

In addition, the Small Business Administration (the "SBA") continues to release guidance for borrowers and lenders of PPP loans. Before passage of the PPP Flexibility Act, the SBA released guidance on the treatment of employees of borrowers' foreign affiliates in determining eligibility for PPP loans. Also before passage of the PPP Flexibility Act, the SBA released guidance on the process for borrowers and lenders to apply for forgiveness of PPP loans, and the process by which the SBA will review borrowers' PPP loans. While this guidance clarifies several points about PPP loan forgiveness, it also raises new questions and leaves some old questions unanswered. Furthermore, the guidance introduces new rules not previously reflected in the PPP statute and guidance.

Background

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was signed into law on March 27, 2020. The CARES Act authorizes up to \$349 billion in forgivable loans to small businesses through the PPP administered by the SBA. On April 24, 2020, \$484 billion of additional coronavirus relief was approved, which includes an additional \$310 billion in funding for the PPP.

Paycheck Protection Program Flexibility Act

On June 3, 2020, the Senate unanimously passed the PPP Flexibility Act which had previously passed the House nearly unanimously on May 28, 2020. The PPP Flexibility Act was signed into law by the President on June 5, 2020. The PPP Flexibility Act retroactively modifies the PPP under the CARES Act and provides additional flexibility to PPP loan borrowers in a number of respects.

Extension of Covered Period

The CARES Act determines the amount of a borrower's PPP loan that may be forgiven based on the amount of certain costs incurred and payments made by such borrower during a "covered period" (the "Covered Period"), which was originally defined as 8 weeks from the date of loan origination. The PPP Flexibility Act provides PPP borrowers with a longer period of time to incur expenses and make payments that count towards PPP loan forgiveness by extending the Covered Period to the earlier of (i) 24 weeks after loan origination or (ii) December 31, 2020. An existing PPP loan borrower may still elect to keep the shorter 8-week Covered Period. SBA guidance since passage of the CARES Act, but predating the PPP Flexibility Act, clarified that the Covered Period begins when the PPP loan is disbursed or, with respect to payroll costs, at the election of the borrower, from the start of the first regular payroll period after the PPP loan is first disbursed. The SBA has not yet released guidance as to whether these clarifications continue to apply with respect to the new, longer Covered Period.

Reduced Payroll Cost Requirement

The CARES Act provides that all costs incurred and payments made in select categories during the Covered Period count towards forgiveness, but subsequent SBA rules imposed a requirement that PPP loan borrowers must have incurred or paid payroll costs during the Covered Period equal to at least 75% of the amount forgiven, that is, the forgiveness amount would be capped at the quotient obtained by dividing the payroll costs incurred or paid during the Covered Period by 0.75.

The PPP Flexibility Act adds a new provision to the CARES Act that requires a borrower to use at least 60% of its PPP loan amount for payroll costs in order to be eligible for forgiveness. A PPP loan Borrower may now use up to 40% of its PPP loan proceeds on non-payroll costs (such as mortgage interest, rent and utilities) without limiting its forgiveness. However, as drafted, the new 60% threshold is a "cliff" threshold, meaning that at least 60% of the loan amount must be spent on payroll costs in order for any of the PPP loan proceeds to be eligible for forgiveness, i.e., if a PPP borrower does not spend at least 60% of its loan proceeds on payroll costs, such borrower will not qualify for any loan forgiveness.

Since the intent of the PPP Flexibility Act is to ease PPP loan forgiveness requirements, the SBA may provide guidance removing the cliff, i.e., limiting forgiveness such that no less than 60% of the forgiveness amount is spent on payroll costs. This provision of the PPP Flexibility Act does not mention the Covered Period, but the SBA may clarify that only those payroll costs incurred during the Covered Period are counted towards the 60% requirement.

Extended Rehire and Compensation Restoration Safe Harbor and Additional FTE Employee Reduction Exemption

Under the PPP, a borrower's loan forgiveness amount may be subject to reduction for certain reductions by the borrower of full-time equivalent ("FTE") employees (the "FTE Employee Reduction") or for certain reductions by a borrower of employee compensation (the "Compensation Reduction"). Originally, borrowers were exempt from the FTE Employee Reduction and the Compensation Reduction if the reduction in FTE employee headcount or compensation, as applicable, was reversed by June 30, 2020. The PPP Flexibility Act extends this deadline to restore FTE employee headcount or compensation from June 30, 2020 to December 31, 2020.

In addition, the PPP Flexibility Act adds a new exemption from the FTE Employee Reduction. A borrower's PPP loan forgiveness will not be reduced by the FTE Employee Reduction if such borrower is able to document that either (i) it was unable to rehire individuals who were employed as of February 15, 2020 and unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020, or (ii) it was unable to return to the same level of business activity as commensurate with the business's activity level as of February 15, 2020 due to compliance with requirements and guidelines related to COVID-19 issued by Health and Human Services, Occupational Safety and Health Administration or the Centers for Disease Control and Prevention.

Payroll Tax Deferral

The CARES Act allows employers to defer payment of employer-side Social Security taxes otherwise due for the period from March 27, 2020 to December 31, 2020. The CARES Act originally provided that PPP loan borrowers were not eligible for this deferral of their payroll tax obligations if they received any PPP loan forgiveness. The PPP Flexibility Act lifts this exception and allows PPP loan borrowers to take advantage of the CARES Act's payroll tax deferral provisions regardless of any PPP loan forgiveness.

Extended Loan Maturity Date and Loan Deferral Period

The CARES Act initially provided that, with respect to any amount of a PPP loan outstanding after a partial forgiveness, such loan amount would have a maximum maturity of 10 years from the date on which loan forgiveness is applied for.

The SBA, in an Interim Final Rule issued in early April 2020, set the loan maturity at 2 years. The PPP Flexibility Act provides that the minimum maturity for the unforgiven portion of a PPP loan following a partial forgiveness is 5 years from the date forgiveness is applied for. This extended minimum maturity applies only to PPP loans disbursed after enactment of the PPP Flexibility Act, provided that lenders and borrowers may mutually agree to modify the maturity terms of existing PPP loans.

The PPP Flexibility Act also extends the original 6-month payment deferral period for principal, interest and fees on PPP loans until (i) the date that the loan forgiveness amount is remitted to the lender or (ii) 10 months after the applicable Covered Period if a borrower does not apply for loan forgiveness within 10 months after the last day of the Covered Period.

Updates on Foreign Affiliates and Loan Forgiveness

Employees of Foreign Affiliates

Initial Interpretations of the 500 Employee Limit

Section 7(a)(36)(D)(i) of the Small Business Act, as added by the CARES Act, provides for PPP loan eligibility for “any business concern, nonprofit organization, veterans organization or Tribal business concern...if [it] employs not more than...500 employees.” The CARES Act itself was not entirely clear on whether affiliate employees would be counted towards such limit, but subsequent guidance suggested that certain pre-existing SBA affiliation rules would apply, including 13 CFR 121.301(f)(8), which provides that “[i]n determining the concern’s size, SBA counts the... employees...of the concern whose size is at issue and all of its domestic and foreign affiliates.”

Guidance Suggesting Foreign Employees are Not Counted towards the 500 Employee Limit

Subsequent guidance in the form of [Frequently Asked Questions](#) (the “FAQs”) posted by the U.S. Department of the Treasury and Interim Final Rules posted by the SBA called the foregoing interpretation into question, suggesting that non-U.S. resident employees might not be included in determining whether a PPP loan applicant complies with the 500 employee limit. The SBA’s [Interim Final Rule on Applicable Affiliation Rules](#) (the “Affiliation Rule”), posted April 3, 2020, provides that “[a]n entity generally is eligible for the PPP if it, combined with its affiliates...has 500 or fewer employees whose principal place of residence is in the United States...” FAQ 3, posted 3 days later, provides that “a business is eligible for a PPP loan if the business has 500 or fewer employees whose principal place of residence is in the United States...[s]imilarly, PPP loans are also available for qualifying tax-exempt nonprofit organizations..., tax-exempt veterans organization[s]...and Tribal business concerns...that have 500 or fewer employees whose principal place of residence is in the United States...” Such guidance seemed incongruous with the CARES Act and prior SBA affiliation rules, which do not consider employee residence in determining an applicant’s size, but the plain meaning of the language provided compelling support for excluding foreign employees in determining compliance with the 500-employee limit.

The First Apparent Correction

Many commentators saw FAQ 44 as correcting erroneous references to employee residence in FAQ 3 and the Affiliation Rule. FAQ 44, posted May 5, 2020, provides that “[f]or purposes of the PPP’s 500 or fewer employee size standard, an applicant must count all of its employees and the employees of its U.S. and foreign affiliates.” However, FAQ 44 does not specifically say that FAQ 3 is incorrect, and does not mention employee residence at all, leading other commentators to suggest an interpretation of FAQ 44 that is consistent with FAQ 3 and the Affiliation Rule, i.e., that, per FAQ 44, an applicant determining its compliance with the 500 employee limit must start by looking to all employees of its U.S. and foreign affiliates, but that, per FAQ 3 and the Affiliation Rule, it may then exclude all such employees who do not have a principal place of residence in the U.S.

The Latest Clarification

The [Interim Final Rule on Treatment of Entities with Foreign Affiliates](#) clarified that all employees of foreign affiliates are included for purposes of determining whether a PPP borrower has more than 500 employees. It also acknowledges the confusion caused by earlier guidance and provides a safe harbor for those relying on the misleading guidance, saying “as an exercise of enforcement discretion due to reasonable borrower confusion based on SBA guidance (which was later resolved through a clarifying FAQ on May 5, 2020), SBA will not find any borrower that applied for a PPP loan prior to May 5, 2020 to be ineligible based on the borrower’s exclusion of non-U.S. employees from the borrower’s calculation of its employee headcount if the borrower (together with its affiliates) had no more than 500 employees whose principal place of residence is in the United States.”

Loan Forgiveness Guidance

The SBA released two new interim final rules on May 22, 2020 regarding PPP loan forgiveness: [the Interim Final Rule on Loan Forgiveness](#) (the “[Loan Forgiveness Rule](#)”), which focuses on eligibility for forgiveness and calculation of the forgiveness amount, and the [Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities](#) (the “[Forgiveness Review Rule](#)”), which provides some guidance on the process for applying for forgiveness, and on the SBA’s review procedure both for forgiveness and for PPP loans generally. While these new rules provide some information about forgiveness eligibility and the review process, they leave open many questions, including when a borrower can expect final approval of forgiveness.

The Loan Forgiveness Rule and the Forgiveness Review Rule were released before passage of the PPP Flexibility Act. It is possible that subsequent rules may modify these rules based on the PPP Flexibility Act.

Timing of Forgiveness Approval

Section 1106(g) of the CARES Act provides that a lender must issue a decision on loan forgiveness within 60 days after receiving a loan forgiveness application. The Loan Forgiveness Rule provides that this 60-day deadline refers to the lender issuing a decision to the SBA. The SBA then has 90 days to make a payment to the lender in the amount of forgiveness determined, subject to the SBA’s review of the loan. It is not clear whether there is any time limit on the SBA’s review of a loan.

The Lender must notify a borrower that has applied for forgiveness if the lender issues a decision to the SBA denying the forgiveness application, in whole or in part, at the time the lender issues such decision. A borrower so notified may, within 30 days of such notice, request that the SBA to review the lender’s denial of forgiveness. It is not clear to what extent the SBA will be required to review the lender’s decision. The Loan Forgiveness Rule provides that the lender is responsible for notifying the borrower of the forgiveness amount, but it is unclear if this applies at the time the lender submits its decision to the SBA, the time the SBA concludes a review, the time the SBA remits the forgiveness amount to the lender, or some other time.

SBA Review

The Forgiveness Review Rule provides that the SBA has discretion to review any PPP loan of any size at any time with respect to a borrower’s initial eligibility for the loan, the borrower’s calculation of the loan amount borrowed, the borrower’s proper use of PPP loan proceeds, the borrower’s proper calculation of the amount of loan forgiveness applied for and the information, certifications and representations of the borrower on its PPP loan application and PPP loan forgiveness application. The SBA will notify the PPP loan lender of any such review, and the lender must notify the borrower of such review within 5 business days of such notice from the SBA. The Forgiveness Review Rule does not mention the \$2 million review and safe harbor thresholds from FAQ 39 and FAQ 46, [which we have written about previously](#).

If an SBA review is pending when the lender is supposed to issue a decision on forgiveness, the SBA will instruct the lender to deny the forgiveness application without prejudice due to such pending SBA review. In such case, the borrower may subsequently request the lender to reconsider its forgiveness application, unless the SBA has determined that the borrower is ineligible for the PPP loan.

The Forgiveness Review Rule provides that the SBA intends to create an appeal process for borrowers who are determined by the SBA to be ineligible for a PPP loan or forgiveness thereof, and will issue a separate interim final rule on such appeal process.

PPP Loan Eligibility vs. PPP Loan Forgiveness Eligibility

Ineligibility for a PPP loan makes a borrower ineligible for forgiveness of a loan, but it is not clear whether a determination of ineligibility for a PPP loan will lead to different consequences compared to a determination of ineligibility for forgiveness. The Forgiveness Review Rule provides that if the SBA determines a borrower was ineligible for a PPP loan, in whole or in part, it will direct the lender to deny any request for forgiveness, in whole or in part. The Loan Forgiveness Rule provides that, if a forgiveness application is denied, in whole or in part, the borrower must repay the loan before the 2-year maturity (and presumably before the 5-year maturity of such loan if made after the date the PPP Flexibility Act was enacted). This comes immediately following a reference to loan forgiveness being denied when it is determined that a borrower was ineligible for the PPP loan in the first place, suggesting that borrowers who are denied forgiveness because they are ineligible for PPP loans may nonetheless be allowed to keep loan proceeds for the duration of the term of the loan. The Forgiveness Review Rule says that, in such cases, the SBA may seek repayment of the outstanding PPP loan balance or pursue other available remedies, again suggesting that the SBA *may*, in its discretion, allow borrowers who were ineligible for PPP loans in the first place to keep those loans outstanding until they mature. In general, the Loan Forgiveness Rule and Forgiveness Review Rule do not always differentiate between a determination that a PPP loan is not forgivable and a determination that a borrower was not initially eligible, often referring to one such determination without clarifying whether the other determination would be treated similarly.

Payments on PPP Loans Forgiven

To the extent a borrower has made payments on the PPP loan, the SBA will still remit the full forgiveness amount to the lender and the lender must remit the excess of such amount over the remaining principal to the borrower (i.e., the amount already repaid by the borrower).

Inclusion of Health Insurance and Retirement Contributions for Certain Owners

The PPP loan forgiveness application suggests that certain owner-employees, self-employed individuals and general partners may not include health insurance and retirement contributions on behalf of themselves in calculating their forgiveness amounts. The Loan Forgiveness Rule provides that no additional forgiveness is provided for retirement or health insurance contributions for self-employed individuals, including Schedule C filers and general partners, as such expenses are paid out of their net self-employment income. However, in the same paragraph, it says that the cap on owner-employee compensation counted towards forgiveness is based on the owner-employee's 2019 cash compensation and employer retirement and health care contributions made on his or her behalf. Presumably, if such contributions are included in determining the cap, they should be included in determining forgiveness. One interpretation is that owner-employees may include their health care and retirement contributions in determining the forgiveness amount because, unlike self-employed individuals, Schedule C filers and general partners, such contributions are not paid out of self-employment income, and thus, their inclusion does not lead to double counting.

Forgiveness Reduction Calculations

SBA rules and the PPP loan forgiveness application previously provided that PPP loan forgiveness will not be reduced for a laid-off employee who is offered to be rehired, but declines such offer. The Loan Forgiveness Rule extends this exception to any employee whose hours were reduced, and who then declines an offer to restore those hours.

The Loan Forgiveness Rule adds a new requirement for application of the rehire offer exception that the borrower inform the applicable state unemployment insurance office of the employee's rejected offer within 30 days of rejection.

The Loan Forgiveness Rule provides that, in determining a reduction in loan forgiveness based on a reduction in compensation, borrowers can disregard compensation reductions resulting from hours reductions. That is, if an employee's per hour compensation is unchanged but the employee receives reduced compensation on account of reduced hours, the borrower would only have its forgiveness amount reduced on account of its reduction in full-time equivalent employees, and would not be doubly penalized for the concomitant reduction in the employee's compensation.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

<u>Peter J. Schaeffer</u>	212.336.2313	<u>pjschaeffer@pbwt.com</u>
<u>Tara S. Knapp</u>	212.336.2068	<u>tknapp@pbwt.com</u>
<u>Jonah Rizzo-Bleichman</u>	212.336.2863	<u>jrizzo@pbwt.com</u>
<u>Zuo (Zoey) Yi</u>	212.336.2974	<u>zyi@pbwt.com</u>

To subscribe to any of our publications, call us at 212.336.2813, email info@pbwt.com or sign up on our website, <https://www.pbwt.com/subscribe/>.

This publication may constitute attorney advertising in some jurisdictions.

© 2020 Patterson Belknap Webb & Tyler LLP