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Latest Developments:
Paycheck Protection Program and Employee Retention Credit

S.R. Snodgrass recently issued a Tax Update that summarizes the Consolidated Appropriations Act, 2021 (the "Act")'s most significant provisions. As it provided a very high-level overview, we want to share additional details on two specific areas—the Paycheck Protection Program (PPP) and employee retention credit (ERC)—that are available to nonprofits and small businesses alike.

The U.S. Small Business Administration (SBA) and Treasury Department issued guidance on January 6, 2021, for the reconstituted PPP that included two interim final rules (herein IFR or IFRs) that consolidate the rules for PPP forgivable loans for first-time borrowers; outline changes made by the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Economic Aid Act), contained within the Act; and lay out the guidelines for new PPP loans to businesses that previously received a PPP loan. The below guidance has been updated in accordance with these IFRs.

The SBA has also released the application forms for first-time borrowers and for second draw PPP borrowers. Lenders began accepting applications to make First Draw PPP Loans on Monday, January 11, 2021 and Second Draw PPP Loans on Wednesday, January 13, 2021. Initially, the SBA will accept applications only from participating community financial institutions, to allow underserved small businesses to obtain access to funds. However, the program is expected to open to other participating lenders shortly thereafter.

First Draw PPP Loans

The Act extended the application period until March 31, 2021, and expanded eligibility of First Draw PPP Loans (PPP1 loans) to organizations that were in operation on February 15, 2020, to include the following entities:

- Businesses with 500 or fewer employees that are eligible for other SBA 7(a) loans.
- Sole proprietors, independent contractors, and eligible self-employed individuals.
- Nonprofits described in Sec. 501(c)(3) and 501(c)(19).
- Accommodation and food services operations (those with NAICS codes starting with 72) with fewer than 500 employees per physical location.
- Sec. 501(c)(6) business leagues, such as chambers of commerce, visitors' bureaus, etc., and destination marketing organizations that have 300 or fewer employees and do not receive more than 15 percent of receipts from lobbying. The lobbying activities must comprise no more than 15 percent of the organization's total activities and have cost no more than $1 million during the most recent tax year that ended prior to February 15, 2020. Sports leagues are not eligible.

- News organizations that are majority-owned or controlled by an NAICS code 511110 or 5151 business or not-for-profit public broadcasting entities with a trade or business under NAICS code 511110 or 5151. The size limit for this category is no more than 500 employees per location.

In addition, if an organization was eligible to claim the ERC but did not because it participated in the PPP (or visa-versa), there could be potential opportunities for the organization, as organizations can now take advantage of both the PPP and the ERC instead of having to pick one. In order to do so, organizations must not claim the same payroll costs for both the PPP and the ERC, which would underscore the importance of underlying books and records.

Second Draw PPP Loans

Fortunately, Second Draw PPP Loans (PPP2 loans) are generally subject to the same terms as PPP1 loans, including:

- a 100 percent SBA guarantee;
- no collateral requirement;
- no personal guarantee requirement;
- a non-compounding and non-adjustable interest rate of 1 percent,
- a five-year maturity;
- similar borrower eligibility and certification requirements; and
- similar processing requirements for lenders administering the PPP2 loan program. As a result, the PPP2 loan IFR generally addresses only those terms where a PPP2 loan is different from a PPP1 loan. Thus, except where noted in the PPP2 loan IFR, the IFR applies to both PPP1 and PPP2 loans.

Congress also made changes with funding availability under PPP2 loans to businesses that had previously received a PPP loan. Borrowers are eligible for a PPP2 loan of up to $2 million, provided they have:

- 300 or fewer employees.
- Used or will use the full amount of a first PPP loan on or before the expected date for the PPP2 loan to be disbursed to the borrower. The IFR also clarifies that the borrower must have spent the full amount of the first PPP loan on eligible expenses.
- Experienced a revenue reduction of 25 percent or more in all or part of 2020 compared with all or part of 2019. This is calculated by comparing gross receipts in any 2020 quarter with an applicable quarter in 2019, or, in a provision added in the IFR, a borrower that was in operation for all four quarters of 2019 can submit copies of its annual tax forms that show a reduction in annual receipts of 25 percent or greater in 2020 compared with 2019.
    - The SBA's reasoning for implementing this variable method for borrowers to substantiate their revenue reduction is to allow a borrower to provide annual tax return forms to substantiate its revenue reduction. This method will be particularly important for small borrowers that may not have quarterly revenue information readily available.
    - PPP2 loans under $150,000 need not demonstrate such decline at the time of application, but ultimately must demonstrate it later to obtain forgiveness.

The Economic Aid Act did not provide a general definition of gross receipts for determining a borrower's revenue reduction, so the new guidance makes the definition consistent with the definition of receipts in 13 C.F.R. Section 121.104 of the SBA's size regulations. Specifically, the IFR defines gross receipts to include all revenue in whatever form received or accrued (in accordance with the entity'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. Forgiveness of PPP1 loans is not included in the 2020 gross receipts.

There are exceptions, but for the most part, if a borrower qualifies, it should have access to the same amount of PPP2 loan funding, as it did for PPP1 loan funding, capped at $2 million.

Further, an eligible borrower must have already received a PPP1 loan and must have used the full amount of its PPP1 loan for permitted purposes prior to the disbursement of the PPP2 loan. The Act requires that the loan had been or will be used without specifying the time period for such use. The IFR interprets that to mean that borrowers can apply for a PPP2 loan before they have fully used the PPP1 loan but cannot receive the disbursement of the PPP2 loan until they have fully used the PPP1 loan proceeds.

PPP – Maximum Amounts, Eligible Costs, and Simplified Forgiveness

PPP Loan Maximum Amounts

In general, PPP1 loan and PPP2 loan borrowers may receive a loan amount of up to 2.5 times their average monthly payroll costs (with a cap per employee of $100,000 annualized) in 2019, 2020, or the year prior to the loan. PPP borrowers with NAICS codes starting with 72 (such as hotels and restaurants) can receive up to 3.5 times their average monthly payroll costs on PPP2 loans.

The maximum amount for a PPP1 loan is $10 million, the same as in the original PPP. Applicants must provide a Form 941, Employer's Quarterly Federal Tax Return, (or other forms with similar information) and state quarterly wage unemployment insurance tax reporting forms from each quarter in 2019 or 2020 (whichever is used to calculate the loan amount), or equivalent payroll processor records, along with evidence of any retirement and health insurance contributions.

Eligible Costs

The Act expands the allowed use (for forgiveness) of PPP loan proceeds to include not only payroll and covered utilities/rent payments but also:

- Covered worker protection and facility modification expenditures, including personal protective equipment, to comply with COVID-19 federal health and safety guidelines.
- Covered property damage costs related to property damage and vandalism or looting due to public disturbances in 2020 that were not covered by insurance or other compensation.
- Expenditures to suppliers that are essential at the time of purchase to the recipient's current operations.
- Covered operating expenditures, which refer to payments for any business software or cloud computing service that facilitates business operations; product or service delivery; the processing, payment, or tracking of payroll expenses; human resources; sales and billing functions; or accounting or tracking of supplies, inventory, records, and expenses.

Simplified Forgiveness

Borrowers that receive a PPP loan of $150,000 or less shall receive forgiveness if the borrower signs and submits to the lender a certification that is not more than one page in length, that includes a description of the number of employees the borrower was able to retain because of the loan, the estimated total amount of the loan spent on payroll costs, and the total loan amount. The SBA must create the simplified application form by January 20, 2021. The form may not require additional materials unless necessary to substantiate revenue loss requirements or satisfy relevant statutory or regulatory requirements. Borrowers are required to retain relevant records related to employment for four years and other records for three years, as the SBA may review and audit these loans to check for fraud.

Borrowers that receive loans between $150,000 and $2 million will still be required to complete and submit an application for loan forgiveness but will not be required to submit the required supporting documentation (which, for those who have already submitted their application know, is voluminous). Borrowers must retain the supporting documentation for at least four years.

To be eligible for full loan forgiveness, PPP borrowers will have to spend no less than 60 percent of the funds on payroll over a covered period between 8 weeks or 24 weeks. Borrowers can now select any covered period between 8 weeks and 24 weeks after loan origination. This is a change from the previous covered period, which had to be either 24 weeks or 8 weeks from loan disbursement.

The Act clarifies that employer-provided group insurance benefits other than healthcare benefits, such as group life, dental, vision, or disability, are considered forgivable payroll costs.

The Economic Injury Disaster Loan (EIDL) Advances provided by the SBA will no longer reduce the amount of PPP loan forgiveness. As explained in the SBA's Procedural Notice released on January 8, 2021, for those loans where SBA remitted a forgiveness payment to a PPP lender that was reduced by an EIDL Advance, SBA will automatically remit a reconciliation payment to the PPP lender for the previously deducted EIDL Advance amount, plus interest, through the remittance date. PPP lenders are not required to request remittance of the reconciliation payment but are responsible for notifying the borrower of the reconciliation payment and re-amortizing the loan and notifying the borrower of the amount of the next payment due or advising the borrower that the note is paid in full. If the amount remitted by the SBA to the PPP lender exceeds the remaining principal balance of the PPP loan, the PPP lender must remit the excess amount, including accrued interest paid by the borrower, to the borrower.

ERC Tax Credit

The ERC is extended by the Act to apply to compensation paid to covered employees through June 30, 2021 (two additional quarters). The Act makes other changes, generally beneficial to taxpayers, in the calculation of the ERC as follows:

Amount of Credit

The Act increases the credit percentage from 50 percent in 2020 to 70 percent of eligible wages for the first two quarters in 2021.

Maximum Credit Amount

The Act increases the maximum amount of creditable, qualified wages to $10,000 for **ANY** quarter. Thus, in 2020, if an employee was paid $10,000 in the third quarter and $10,000 in the fourth quarter, the resulting credit would be $5,000 (capped at 50 percent of $10,000 in wages TOTAL) under the Coronavirus Aid, Relief, and Economic Security Act. In 2021, however, if an employee was paid $10,000 in the first quarter and $10,000 in the second quarter, the resulting credit would be $14,000, 70 percent of $10,000 wages for EACH quarter.

Eligibility Requirement

The qualifying criteria to receive the credit under the Act include either:

- Being subject to a full or partial shutdown during the applicable period to receive the ERC (businesses should internally document their specific government shutdown orders); **or**
- Qualifying under gross receipts test, which increased from 50 percent of 2019 gross receipts in 2020 to 80 percent of 2019 gross receipts in either the first or second quarter of 2021.

Credit Eligibility whether an Employee Is or Is Not Working

Effective January 1, 2021, the threshold for ineligibility has been raised to 500 employees from 100 employees, so that for the first two quarters of 2021, a company with 500 or fewer employees will be eligible for the credit, even if employees are working.

PPP Loan Eligibility

A company that receives a PPP loan is no longer prohibited from claiming the ERC, however:

- A credit may not be claimed for wages paid with the proceeds of a PPP loan that has been forgiven (no double-dipping). This change is retroactive to the effective date under the original law (for wages paid after March 12, 2020). As a result, a company that received a PPP loan in 2020 and paid qualified wages in excess of the amount of the forgiven PPP loan used to pay wages and is otherwise eligible to claim the credit. The Internal Revenue Service is expected to issue guidance on how to claim the credit retroactively.
- Furthermore, companies related to a PPP borrower that did not claim the credit because an affiliated company that shares common ownership received a PPP loan should also be able to file amended employment tax returns to claim the credit, if they were otherwise eligible to do so.
- Companies that did not claim the credit due to a PPP loan should review the credit requirements to determine if they might be eligible to claim the credit for qualified wages paid after March 12, 2020.

Disallowance of Credit for Governmental Entities

Effective January 1, 2021, an exception allows the credit for state or locally run colleges, universities, and organizations providing medical or hospital care, and certain organizations chartered by Congress (which includes organizations such as Fannie Mae, the Federal Deposit Insurance Corporation, federal home loan banks, and federal credit unions).

Limitation on Increase in Pay Rate

This disallowance of the credit for pay rate increases is repealed, now allowing the credit for hazardous duty pay increases, among others.

If you wish to discuss any of the matters in this update in more detail, please contact Brian Bender at bbender@srsnodgrass.com or 724-934-0344.