



Deja Vu All Over Again: *PPP-2, the New Rules and Tax Consequences*

January 12, 2021 (revised and updated January 15, 2021)

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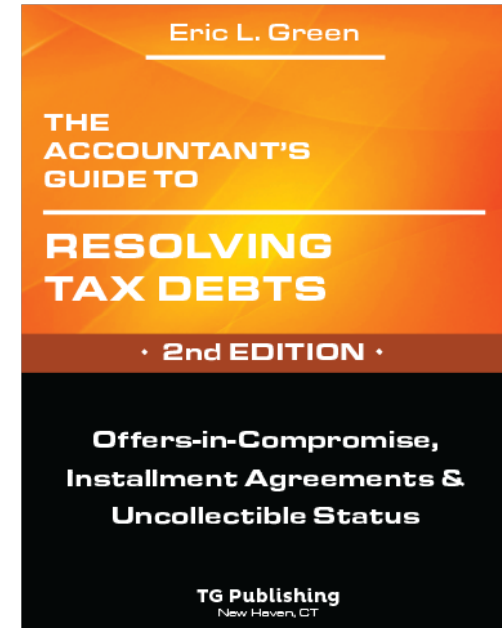
- 12 Attendance Check Words
- Please write them down
- Look for an email link within an hour of this program
- Submit your information and the words
- Your CE/CPE certificate will be email to you automatically
- If you do not receive it check your spam folder
- If it is not there by tomorrow am email us

Housekeeping

- We will take a 10 minute break about 90 minutes through the program.
- Please try and stay with us so you don't miss the attendance check words.
- I'll try and answer questions during attendance checks, but we have reserved 20 additional minutes at the end for questions.
- Program runs 1-4 PM (Eastern Time), including a 10 minute break and 20 minutes of Q&A at the end.

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Disclaimer

This program was put together to provide information and our personal opinion on what might happen surrounding the current federal loan programs. The situation surrounding the PPP and other loan programs is very fluid and may change daily. Given this situation, we want to be clear that the information provided in this presentation is not legal advice you or your clients can rely on, and each client's situation must be considered based upon the facts and circumstances. Hence, we advise you to seek a legal opinion if you have a situation where you need advice that you can rely upon.

Introductory Material

About Jeff Sklarz

Tax Rep Network (TRN) provides consulting and coaching services to tax professionals to aid them in their practices, providing substantive training and advice on how to grow their business. Please visit taxrepllc.com for more information.

Jeff Sklarz is a principal at Green & Sklarz LLC and represents business and individuals around the country in matters involving bankruptcy, civil and criminal tax litigation, and business litigation.

Jeff is a Fellow of the American College of Tax Counsel (ACTC), and has been included in the 2021 Edition of *The Best Lawyers in America*® for Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law.

He received his J.D. from the University of Connecticut School of Law, and received his LL.M (taxation) from the Boston University School of Law.



Agenda

- Review of Chronology
- PPP Loans generally
- Second Draw PPP Loans
- PPP Forgiveness Update
- Clarification of Tax Treatment of PPP Loans
- Employee Retention Tax Credit (ERTC)
- EIDL Update
- Ethical issues (what you can and cannot advise clients)
- Enforcement issues

A Brief History of Coronavirus Relief Time

- 3/18/2020 Families First Coronavirus Response Act, P.L. 116-127
- 3/27/2020 Coronavirus Aid, Relief, and Economic Security (“CARES”) Act, P.L. 116-136
- 6/5/2020 Paycheck Protection Program Flexibility (“PPPFA”) Act, P.L. 116-142
- *HEROS Act, passed House 5/15/2020, H.R. 6800*
- *HEALS Act, introduced to Senate 7/27/2020*
- 8/8/2020 Executive Order Deferring Payroll Taxes
- 12/21/2020 Congress passed the *Consolidated Appropriations Act of 2021*
- *1/6/2021 and 1/8/2021 SBA releases updated guidance and forms*

Since April 3rd, the SBA has issued guidance on PPP in a variety of forms, including most importantly, FAQs (the “PPP FAQ”) that have been revised frequently. More guidance was just released last week.

Key Contents for Businesses

The Economic Aid to Hard-Hit Small Business, Nonprofits, and Venues Act

- We'll just call it "CARES II" because that name is terrible
- EAH-HSBNVA does not exactly roll off the tongue
- Additional PPP funding: \$284 billion to support small businesses and non-profits.
- Additional money for EIDL program
- Grants to venue operators
- Enhanced Unemployment Insurance.
- Continued 50% cost share for unemployment insurance for non-profits
- Direct stimulus checks.
- Extension and expansion of various tax provisions.

Overview: PPP Loans Generally

- 2 types of PPP loans: “1st draw” and “2nd draw”
- Each have slightly different rules
- Both require good faith certification, including that:

Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.

- Previous 1st draw applications can be amended to increase amount of draw.
- 1st draw must have been spent at least 90 days prior to accessing 2nd draw.

Overview: New Round of PPP Loans

- \$284 billion allocation
 - \$15 billion allocation to community lenders serving non-traditional borrowers
 - \$15 billion set aside for very small borrowers (borrowing \$250,000 or less with 10 or fewer employees)
- Open through March 31, 2021
- Allows for a 2nd draw for prior recipients
- If you did not apply for a PPP loan previously, you can this time around
- 60% of PPP funds must still be spent on “payroll expenses” to receive full forgiveness, unless an exception applies.
- Expanded definition of “covered expense”

Overview: Eligibility Requirements

- Max. Amount: \$2 million
 - Entity must have been in business by Feb. 15, 2020
 - 2.5x payroll costs
 - *Note*, Food service businesses (NACIS Code 72) can get 3.5x average monthly payroll costs
- “Payroll Costs” now include group insurance payments
- 300 employees or fewer for 2nd draw
- 500 employees or fewer if PPP-2 would be 1st draw
- Still must make “necessity” certification
 - *Can a business that survived and is limping along make this certification?*
 - SBA will not question certifications for loans under \$2 million, but other government actors (IRS, US Attorney) may.
- PRC affiliated businesses ineligible

Eligibility Requirements (cont.)

- 1st Draw – Old rules apply, but have been updated.
- 2nd Draw – Must show 25% reduction in *gross receipts* in any quarter of 2020 when compared with the same quarter in 2019, or year-to-year overall.
 - You have to compare the same quarter for 2019 with 2020, e.g. Q2 2019 with Q2 2020.
 - If only in business Q3 or Q4 2019 – compare Q4 2020 with Q3 or Q4 2019.
 - If only in business Q4 2019 – compare Q4 2020 with Q4 2019.
 - If not in business until Q1 2020 – compare Q1 2020 with any other quarter in 2020.
 - **NFPs**: Gross receipts defined as *revenue* on Form 990.
- Must wait 90 days between spending 1st draw funds and receiving 2nd draw
- Borrower cannot receive more than \$10 million total between 1st and 2nd draws.

Eligibility Requirements (cont.)

- Borrowers can amend 1st draw application to request more money or reapply if they returned money under the safe-harbor regs.
- Funds must be spent within 24 weeks (but borrower can choose a covered period of 8-24 weeks).
- If more than 1 location is eligible for a 2nd draw, each location must meet 2nd draw rules for eligibility. An affiliated group is capped at \$4 million.
- **PPP Loans in Bankruptcy:** After notice and hearing, bankruptcy judge can approve a DIP getting a PPP-2 loan if the debtor is otherwise eligible. *Only available for SBRA cases under Chapter 11 (subchapter V small business cases), and Chapter 12 or 13 debtors.*
- If you receive a *Shuttered Venue* grant, you cannot also get a PPP loan.

PPP-2 Misc.

- Special Rules for farmers, seasonal businesses, housing cooperatives, etc.
 - Make sure to check for special rules for unusual businesses.
- Receipt of EIDL loan or grant will *not* reduce PPP eligibility.
- **Forgiveness:** Loans of \$150,000 subject to easy forgiveness (1 page application).



Calculating the Amount of PPP Loans and Completing the Application

Summary

- Applications close for 1st and 2nd draw loans **March 31, 2021**
 - New application forms for each
- Amount of loan: 2.5x your **average payroll costs** for *either* 2020 or 2019
- PPP money may be spent over 8-24 weeks
- 60% must be spent on payroll but no cliff (pro rata reduction of forgiveness)
- Can use to refinance EIDL loans
- Updated guidance released 1/6/2021 and 1/8/2021 – with more to come.

1st Draw IFR Approved Method of Calculating Amount

1st Draw IFR at 31-34

- Step 1: Calculate average monthly payroll from 2019 or 2020, making sure not to include compensation in excess of \$100,000/year
- Step 2: Divide the number in Step 1 by 12
- Step 3: Multiply the number in step 2 by 2.5 (or 3.5 for 2nd draw loans for certain hospitality businesses)
- Step 4: Add the amount of outstanding amount of EIDL loans received between 1/31/2020 and 4/3/2020. Do *not* include the grant portion of an EIDL advance, which does not have to be repaid.

1st Draw IFR Approved Method of Calculating Amount: In Action

- Step 1: Calculate average monthly payroll from 2019 or 2020, making sure not to include compensation in excess of \$100,000/year

\$1,200,000 total annual payroll, capped at \$100,000 per person

- Step 2: Divide the number in Step 1 by 12

\$100,000

- Step 3: Multiply the number in step 2 by 2.5 (or 3.5 for 2nd draw loans for certain hospitality businesses)

\$250,000

- Step 4: Add the amount of outstanding amount of EIDL loans received between 1/31/2020 and 4/3/2020. Do *not* include the grant portion of an EIDL advance, which does not have to be repaid.

EIDL loan of \$500,000

Total PPP-1 Loan = \$750,000

1st Draw PPP Loans: Rules are Generally the Same as Before

- Generally, 500 or fewer employees (subject to certain exceptions)
 - For the hospitality industry (NAICS Code 72, Accommodation and Food Services) the 500-employee cap applied *per location*, so large companies that own hotels or restaurants with multiple locations may still qualify as small businesses if each location has less than 500 employees.
 - Otherwise apply SBA affiliation/size rules
 - Franchises qualify as well.
 - The terms “employee” is defined broadly and includes full and part-time. But not independent contractors.
- **Loan Amount:** 2.5x the average total monthly payments for payroll; capped at \$10 million.
- Loan guarantees by government but funded through private lenders.
- Independent contractors and sole proprietors may apply.
- Public companies are generally ineligible per IFR, but not CARES I or II.

Ineligible Businesses – Spotlight

Paycheck Protection Program as Amended by Economic Aid Act Interim Final Rule (“1st Draw IFR”) at p. 25:

You, or any business owned or controlled by you or any of your owners, has ever obtained a direct or guaranteed loan from SBA or any other Federal agency that is currently delinquent or has defaulted within the last seven years and caused a loss to the government....

Presumably this does not mean an unpaid EIDL loan. If it does, a lot of businesses will be ineligible for 1st draw and maybe 2nd draw loans since the Paycheck Protection Program Second Draw Loans Interim Final Rule (“2nd Draw IFR”) at 25, refers to entities ineligible under the 1st Draw IFR referenced above (although definitions don’t quite align).

Ineligible Businesses – Other Concerns

- Business in bankruptcy cannot get 1st draw loans.
 - But some can get 2nd draw.
 - Not sure how this makes sense
- Hedge funds, private equity firms, or other investment companies are generally ineligible
 - This generally includes portfolio companies. 1st Draw IFR at 30.

Calculating the Amount that Can be Borrowed

- Use either 2019 or 2020 average monthly “payroll costs”
 - Obviously use whichever costs were higher to maximize draw
- Payroll amount is capped at \$100,000 per employee pro rated for the covered period.
- *Ex patriot* workers are excluded.
- K-1s: Self-employed owners who receive a K-1 have their compensation included in the calculation (up to \$100,000).
 - Multiply net self-employment compensation (from K-1) by 0.09235 (to account for employee paid self-employment taxes), cannot exceed \$100,000
- Schedule C: 2019 Net Profit (Line 31 of Sch. C).

Calculating the Amount that Can be Borrowed

- CARES II expanded the definition of *payroll costs*, which include:
 - Cash compensation for labor (capped at \$100,00), including self-employment income, tips, commissions, etc.
 - Paid leave
 - Contributions to health insurance
 - Contributions to group life, disability, vision, or dental insurance
 - Payment of state and local employment taxes

Distributions to investors are not cash compensation.

Calculating the Amount that Can be Borrowed

Evidence to Support “Payroll Expenses”

- Payroll journal/report
- K-1 or tax return (for non-wage compensation), along with payment journal
- Bills for payment of benefits, such as health insurance
- Statements from administrator for retirement plan contributions

For 2nd draw loans, if you are applying to the same bank and not seeking to change the amount of average monthly payroll costs, no additional materials need be submitted

General Matters

- No requirement to seek credit elsewhere *this is different than typical SBA loans, which require borrower to show lack of access to other credit*
 - \$2 million safe harbor for good faith certification
 - Companies with access to capital markets – such as public companies or portfolio companies – are not generally eligible
- Maximum maturity of 10 years
 - SBA decided it would be a 5 year loan
- Interest rate not to exceed 4%
 - SBA fixed rate at 1%
- At least 10 months deferral of P&I (up to 1 year)
 - SBA decided it would be only 6 months of forbearance
- No prepayment penalties

PPP Loans Permitted Uses: Covered Payroll Expenses

- Owner compensation replacement based on 2019 or 2020 net profits, capped at \$100,000 per owner.
- Employee payroll costs.
- Costs related to the continuation of group benefits, such as health, life, disability, sick leave, family leave, dental, vision
- State payroll taxes

PPP Loans Permitted Uses: Covered Non-Payroll Expenses

- Business rent and utilities.
- Mortgage interest (not principal).
 - Note: if you work out of your home, you cannot deduct home mortgage payments (although home mortgage interest is generally otherwise deductible).
- Interest payments on other debt incurred prior to 2/15/20
- Refinancing an SBA EIDL loan made between 1/31/20 and 4/3/20.
- Costs of PPE to protect against COVID-19
- Supplier costs essential to the business
 - Made pursuant to a contract or purchase order that (a) was in effect *prior to* the covered period with respect to the applicable loan **or** (b) relates to perishable good purchased before or during the covered period.
- Property damage related to public disturbances in the summer of 2020 not covered by insurance
- Certain operational expenses related to cloud computing for inventory control and delivery

Use of PPP Funds for Unauthorized Expenses

- SBA can require you to repay the amounts
- If knowingly used for unauthorized purposes, you can be prosecuted for fraud

What are the limits of this? Are all expenses not authorized by CARES, CARES II, and the 1st Draw IFR, at pp. 48-52, prohibited?

PPP Loans: Good Faith Certification

“Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”

- FAQ 31, 37: “Borrowers must make this certification... taking into account... their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.”
- FAQ 46: Companies that receive less than \$2 million are deemed to meet the good faith requirement.
 - 1st Draw IFR at p. 57-58 reiterates the safe harbor
- Companies borrowing more than \$2 million are required to fill out additional paperwork to verify the “necessity” certification

PPP Loans: Good Faith Certification

- What are “other sources of liquidity”?
- What does it mean to use “other sources of liquidity” to “support ongoing operations that is not detrimental to the business”?
- What does “necessary” mean?
- What are “ongoing business activities”
- What is “access to capital market”
- FAQ 31 refers to “large companies” and “public company[ies]”
- FAQ 37 says the same rules apply to “private companies with adequate sources of liquidity”
- FAQ 43 indicated the SBA would provide additional guidance regarding “review of [good faith] certifications”

PPP Loans: Good Faith Certification

- Nothing in the FAQs released so far address any of these questions
- Likely a breeding ground for litigation
- SBA will review the certification as part of the forgiveness process (to be discussed later)

If SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request.

PPP Loans: Good Faith Certification

“[O]ther sources of liquidity” / “access to capital market”

- Capital markets
- Deep pocketed owner
- Other credit facilities

“Necessary”

- In whose eyes
- When determined

“[S]upport ongoing operations that is not detrimental to the business”

- Maintain pre-COVID operations
- Not fire people
- Not close
- Not bankrupt owner

“[O]ngoing business activities”

PPP Loans: Good Faith Certification

- What about small public companies?
- Nothing in CARES, CARES II or the IFRs specifically prohibit public companies from accessing funds

“It’s sort of been poisoned by certain companies that have taken advantage where they shouldn’t have taken advantage, but we have a need... We’re out of business without that money.”

- *Small-Business Loan Deadline Poses Test for Mnuchin*,
NYT 5/13/2020

PPP Loans: Good Faith Certification

Zumasys, Inc.v. SBA, Case No. 8:20-cv-851-KES (C.D. Cal.)

- Zumasys is a small private company with less than 50 employees
- Zumasys (and affiliates) received less than \$1 million of PPP loans
- Zumasys has access to other credit
- Seeks declaratory judgment that Zumasys' PPP loans were received in good faith and FAQ 31 and 37 do not create a "no credit elsewhere" requirement
- *Is this lawsuit moot after the enactment of FAQ 46? It is still pending and been sent to mediation*

PPP Loans: How to use the money

- Goal is forgiveness
- Must be used for covered expenses to be forgivable
- Can the funds be used for other purposes and repaid?
 - Is it illegal to use the funds other than as directed by statute

PPP Loans: How to use the money

- Maintain a separate account – keep it simple
- Make payment of covered expenses from the PPP account
- Transfer funds from the PPP account to payroll accounts, if needed
 - Only transfer funds for covered expenses
- Burden is on the borrower to provide documentation to support forgiveness
- Documentation standards have not been released

PPP Loans: How to use the money

- Funds must be spent in the 8-24 weeks from the day the bank deposits money in your account.
- No guidance on what happens if you can't spend the money – but likely becomes a loan at 1% due in 5 years with a 10 month deferral
- Best practice would be to return the funds, but may have to pay some interest.


PPP Loans: How to use the money

- What happens if I spend the money on something other than covered expenses?
- What if I just take the money? I always wanted a vacation home.
- What if my bank sweeps the money and pays other debt I owe?
- What if I get the money and file for bankruptcy?

Affiliation/Size Rules

- CARES I has three categories of qualifying companies: (1) “small business concerns” as defined by the SBA, (2) companies with 500 (or 300 under CARES II) or fewer employees, and (3) companies that may not be “small business concerns” but meet the size requirements in the regulations.
- FAQ Q5 states: “Are borrowers required to apply SBA’s affiliation rules under 13 C.F.R. 121.301(f)?
 - Answer: Yes. Borrowers must apply the affiliation rules set forth in SBA’s Interim Final Rule on Affiliation. **A borrower must certify** on the Borrower Application Form that the borrower is eligible to receive a PPP loan, and that certification means **that the borrower is a small business concern as defined in section 3 of the Small Business Act (15 U.S.C. 632), meets the applicable SBA employee-based or revenue-based size standard, or meets the tests in SBA’s alternative size standard**, after applying the affiliation rules, if applicable. SBA’s existing affiliation exclusions apply to the PPP, including, for example the exclusions under 13 CFR 121.103(b)(2).
 - The 1st Draw IFR at p. 28, does not appear to change this
- The takeaway is that you may be able to qualify your business for a PPP loan even though you have more than 500(or 300) employees.

New Application Form

 **Paycheck Protection Program**
Borrower Application Form Revised January 8, 2021

OMB Control No.: 3245-0407
Expiration Date: 7/31/2021

Check One: <input type="checkbox"/> Sole Proprietor <input type="checkbox"/> Partnership <input type="checkbox"/> C-Corp <input type="checkbox"/> S-Corp <input type="checkbox"/> LLC <input type="checkbox"/> Independent Contractor <input type="checkbox"/> Self-Employed Individual <input type="checkbox"/> 501(c)(3) nonprofit <input type="checkbox"/> 501(c)(6) organization <input type="checkbox"/> 501(c)(19) veterans organization <input type="checkbox"/> Housing cooperative <input type="checkbox"/> Tribal Business <input type="checkbox"/> Other	DBA or Tradename (if applicable)	Year of Establishment (if applicable)
Business Legal Name	NAICS Code	Applicant (including affiliates, if applicable) Meets Size Standard (check one): <input type="checkbox"/> No more than 500 employees (or 300 employees, if applicable) <input type="checkbox"/> SBA industry size standards <input type="checkbox"/> SBA alternative size standard
Business Address (Street, City, State, Zip Code - No P.O. Box addresses allowed)	Business TIN (EIN, SSN)	Business Phone
	Primary Contact	Email Address

Average Monthly Payroll:	\$	x 2.5 = EIDL (Do Not Include Any EIDL Advance) equals Loan Request Amount:	\$	Number of Employees:	
Purpose of the loan (select all that apply):	<input type="checkbox"/> Payroll Costs	<input type="checkbox"/> Rent / Mortgage Interest	<input type="checkbox"/> Utilities	<input type="checkbox"/> Covered Operations Expenditures	
	<input type="checkbox"/> Covered Property Damage	<input type="checkbox"/> Covered Supplier Costs	<input type="checkbox"/> Covered Worker Protection Expenditures	<input type="checkbox"/> Other (explain):	

Applicant Ownership
List all owners of 20% or more of the equity of the Applicant. Attach a separate sheet if necessary.

Owner Name	Title	Ownership %	TIN (EIN, SSN)	Address

If questions (1), (2), (3), or (6) are answered "Yes," the loan will not be approved.

Question	Yes	No
1. Is the Applicant or any owner of the Applicant presently suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any Federal department or agency, or presently involved in any bankruptcy?		
2. Has the Applicant, any owner of the Applicant, or any business owned or controlled by any of them, ever obtained a direct or guaranteed loan from SBA or any other Federal agency that is (a) currently delinquent, or (b) has defaulted in the last 7 years and caused a loss to the government?		
3. Is the Applicant or any owner of the Applicant an owner of any other business, or have common management (including a management agreement) with any other business? If yes, list all such businesses (including their TINs if available) and describe the relationship on a separate sheet identified as addendum A.		
4. Did the Applicant receive an SBA Economic Injury Disaster Loan between January 31, 2020 and April 3, 2020? If yes, provide details on a separate sheet identified as addendum B.		
5. Is the Applicant (if an individual) or any individual owning 20% or more of the equity of the Applicant presently incarcerated or, for any felony, presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction? <i>Initial here to confirm your response to question 5 →</i>		
6. Within the last 5 years, for any felony involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance, or within the last year, for any other felony, has the Applicant (if an individual) or any owner of the Applicant 1) been convicted; 2) pleaded guilty; 3) pleaded nolo contendere; or 4) commenced any form of parole or probation (including probation before judgment)? <i>Initial here to confirm your response to question 6 →</i>		
7. Is the United States the principal place of residence for all employees included in the Applicant's payroll calculation above?		
8. Is the Applicant a franchise?		
9. Is the franchise listed in the SBA's Franchise Directory? If yes, enter the SBA Franchise Identifier Code here: _____		

2nd Draw Loan Rules

Overview

- Covered Period: 8-24 weeks
- Proceeds spent on “covered expenses,” same as 1st draw loans
- 60% spent on payroll costs
- Borrower must demonstrate at least 25% reduction in gross revenue
- No more than 300 employees
- \$2 million maximum loan
- 2nd draw loans must be disbursed within 10 days of approval
- No public companies

25% Revenue Reduction

- “Gross Receipts” means “all revenue in whatever form received or accrued... Gross receipts do not include... taxes collected for and remitted to a taxing authority,” most intercompany transfers and transactions, and conduit type payments. 2nd Draw IFR at p. 8 n. 9.
- At least 25% decline in gross receipts during 2020 quarter compared to the same quarter in 2019 **or** 25% reduction in overall 2020 revenue versus 2019
- If Borrower was not in business in 2019, or opened before 2/15/2020:
 - Opened 3Q 2019: Any 2020 quarterly receipts are 25% less than 3rd or 4th quarter 2019
 - Opened 4Q 2019: Any 2020 quarterly receipts are 25% less than 4th quarter 2019
 - Opened in 2020 before 2/15: 2nd, 3rd, or 4th qtr2020 receipts are at least 25% lower than 1st quarter 2020 receipts
- **Substantiation:** Provide 2019 tax return and 2020 financial reports. *You will need to provided 2020 tax return when you apply for forgiveness.*

Calculating Loan Amount

- Use either 2020 or 2019 average monthly payroll costs
- Alternatively, use the 1-year prior starting the day before the loan was made
 - Self-Employed individuals cannot use this alternative period. 2nd Draw IFR at p. 13.
- Seasonal businesses have special rules as with PPP-1
- NAICS Code 72 companies get 3.5x their monthly payroll costs as the loan amount
- Groups of affiliated companies can receive a maximum of \$4 million (max. \$2 million per company)

Documentation Requirements (other than to show 25% Reduction in Gross Receipts)

- None, if you use the same bank, same 2019 average, and your application would not change from prior submission of an approved PPP-1 loan.
- None, if the loan request is \$150,000 or less, but documents will be required at the time of the forgiveness application
- Otherwise, the documentation is the same as for PPP-1, but you must also submit the documentation to show a 25% reduction in gross receipts.
 - Payroll records (941s or payroll journals)
 - 1065s, K-1s, Schedule C


Loans to Borrowers with Unresolved 1st Draw Issues

- If a borrower's 1st draw loan is under review, the 2nd draw application will be subjected to increased scrutiny
- SBA is supposed to resolve any issues “expeditiously”
- Unresolved 1st draw issues do not automatically disqualify a borrower from a 2nd draw loan

Affiliation Rules

- Affiliation rules do not apply to NACIS Code 72 entities.
- Otherwise same rules apply as for 1st draw loans.
- Gross receipts for affiliate groups are calculated by adding gross receipts of the affiliated entities. 2nd Draw IFR at p. 23.
 - If a borrower acquires an affiliate during 2020, gross receipts of the group include those of acquired business
 - Gross receipts of a former affiliate (sold or closed during 2020) do not count toward total

2nd Draw Application Form

 **Paycheck Protection Program
Second Draw Borrower Application Form** OMB Control No.: 3245-0417
Expiration Date: 7/31/2021

Check One: <input type="checkbox"/> Sole Proprietor <input type="checkbox"/> Partnership <input type="checkbox"/> C-Corp <input type="checkbox"/> S-Corp <input type="checkbox"/> LLC <input type="checkbox"/> Independent Contractor <input type="checkbox"/> Self-Employed Individual <input type="checkbox"/> 501(c)(3) nonprofit <input type="checkbox"/> 501(c)(6) organization <input type="checkbox"/> 501(c)(19) veterans organization <input type="checkbox"/> Housing cooperative <input type="checkbox"/> Tribal Business <input type="checkbox"/> Other		DBA or Tradename (if applicable)	Year of Establishment (if applicable)
		Business Legal Name	
		NAICS Code	
Business Address (Street, City, State, Zip Code - No P.O. Box addresses allowed)		Business TIN (EIN, SSN)	Business Phone
		Primary Contact	Email Address
Average Monthly Payroll:	\$	x 2.5 (or x 3.5 for NAICS 72 applicants) equals Loan Request Amount (may not exceed \$2,000,000):	\$
Purpose of the loan (select all that apply):	<input type="checkbox"/> Payroll Costs	<input type="checkbox"/> Rent / Mortgage Interest	<input type="checkbox"/> Utilities
	<input type="checkbox"/> Covered Property Damage	<input type="checkbox"/> Covered Supplier Costs	<input type="checkbox"/> Covered Worker Protection Expenditures
PPP First Draw SBA Loan Number:			
Reduction in Gross Receipts of at Least 25% (Applicants for loans of \$150,000 or less may leave blank but must provide upon or before seeking loan forgiveness or upon SBA request):	2020 Quarter (e.g., 2Q 2020):	Reference Quarter (e.g., 2Q 2019):	
	Gross Receipts: \$	Gross Receipts: \$	

Applicant Ownership
List all owners of 20% or more of the equity of the Applicant. Attach a separate sheet if necessary.

Owner Name	Title	Ownership %	TIN (EIN, SSN)	Address

If questions (1), (2), (4), or (5) are answered "Yes," the loan will not be approved.

Question	Yes	No
1. Is the Applicant or any owner of the Applicant presently suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any Federal department or agency, or presently involved in any bankruptcy?		
2. Has the Applicant, any owner of the Applicant, or any business owned or controlled by any of them, ever obtained a direct or guaranteed loan from SBA or any other Federal agency that is (a) currently delinquent, or (b) has defaulted in the last 7 years and caused a loss to the government?		
3. Is the Applicant or any owner of the Applicant an owner of any other business, or have common management (including a management agreement) with any other business? If yes, list all such businesses (including their TINs if available) and describe the relationship on a separate sheet identified as addendum A.		
4. Is the Applicant (if an individual) or any individual owning 20% or more of the equity of the Applicant presently incarcerated or, for any felony, presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction? <i>Initial here to confirm your response to question 4 --</i>		
5. Within the last 5 years, for any felony involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance, or within the last year, for any other felony, has the Applicant (if an individual) or any owner of the Applicant 1) been convicted; 2) pleaded guilty; 3) pleaded nolo contendere; or 4) commenced any form of parole or probation (including probation before judgment)? <i>Initial here to confirm your response to question 5 --</i>		
6. Is the United States the principal place of residence for all employees included in the Applicant's payroll calculation above?		
7. Is the Applicant a franchise?		
8. Is the franchise listed in SBA's Franchise Directory? If yes, enter SBA Franchise Identifier Code here: _____		



Forgiveness Rules Update

Summary

- Form of Application
 - Long form – SBA Form 3508
 - Short form – SBA Form 3508EZ
- Loan forgiveness process (Forgiveness IFR, Forgiveness FAQ, Appeals IFR)
- Clarification of issues
 - Computing payroll costs and forgiveness
 - “Payroll costs paid” and “payroll costs incurred”
 - Loan forgiveness if 60% payroll cost test is not met
 - PPP Schedule A computation of FTE and payroll rate reductions
 - Definition of Full-Time Equivalent Employee
 - Definition of Cash and Non-Cash Compensation
 - Exceptions to FTE reduction and safe harbor
- Good faith certifications and potential legal implications for lender and borrowers
- Key unresolved issues
 - No new forgiveness regulations or FAQs yet.

CARES II/IFR Changes

- EIDL loans refinanced with PPP-2 loans are now subject to forgiveness
- ERTC has been expanded and can now be use *in addition to* PPP
 - Note, payroll costs that are “qualified wages” cannot be forgiven
- Elimination of “alternative covered period” given flexible covered period of 8-24 weeks.
- The amount of 1st draw loan forgiveness is not included in the borrower's gross receipts for calculating 2nd draw
 - Does not exactly say the 1st draw proceeds are excluded, but must be the case.

PPP Loan Forgiveness Application

- On May 15th, the SBA issued its Loan Forgiveness Application (the “Application”).
- On June 16th the application was revised and a “short form” application was provided.
- Borrowers complete the form and attach documentation to the bank that lent them PPP funds
- Lenders will review and certify accuracy of form and documentation. Lenders initials and signature required.
- The SBA will “review” loans in excess of \$2 million (PPP FAQ 46)
- On May 22nd, the SBA released 2 additional interim final rules concerning:
 - PPP loan forgiveness (“Forgiveness IFR”)
 - SBA loan forgiveness review procedures (“Procedure IFR”)
- On August 11, 2020, the SBA issued additional guidance:
 - FAQs regarding loan forgiveness (“Forgiveness FAQ”)
 - Interim Final Rule on Appeals of SBA Loan Review Decisions Under the PPP (“Appeal IFR”)
- CARES II, 1st Draw IFR, and 2nd Draw IFR make no major changes to forgiveness rules, other than for loan under \$150,000, by establishing a even shorter form for forgiveness.

Process for Obtaining Loan Forgiveness

- Borrower to submit SBA Form 3508 or 3508-EZ – the loan forgiveness forms
- Banks have created on-line portals for borrowers to submit forgiveness information
- Borrowers have 10 months to submit forgiveness application
- Lender has 60 days to review and submit to SBA with a reimbursement application
- SBA then has 90 days to review the lender's submission and issue reimbursement
- The SBA may retroactively determine that a borrower was not eligible for a PPP loan ("for example, because the borrower lacked an adequate basis for the certifications it made in its PPP application.") 6/22/2020 Interim Final Rule at 8.
- *Payroll costs that are "qualified wages" taken into account for the ERTC cannot be forgiven.*
 - *Can't triple dip*

Deferral Period and Forgiveness

- Borrowers can apply for forgiveness anytime after they have used all of the loan proceeds (including before the end of the covered period)
- If you apply for forgiveness *before* the end of the covered period you must still account for additional FTE/wage reduction *for the entire covered period*
 - Thus, if you apply before the end of the covered period and later reduce FTEs/wages you will *not* be able to take advantage of FTE/wage restoration safe harbor
 - The open question is if you can *further* reduce FTEs/wages after the forgiveness application is filed and if that would effect forgiveness (for example, reducing salary that was reduced below the 25% threshold even further)
- Borrowers decide whether to use the 8-24 week period when they submit the forgiveness application
- **Borrower must apply for forgiveness within 10 months after the last day of the covered period, or the loan cannot be forgiven**

Loan Forgiveness Process

- If forgiveness is denied, the loan must be repaid over the 5-year period from the time the loan was approved.
- The Appeal IFR establishes an administrative review process and access to federal courts for appeals of PPP forgiveness decisions (discussed in detail later)

What the Application Clarifies

Length of the “Covered Period”

- The covered period was the 8-24 weeks from the day the bank deposited PPP loan proceeds in borrower's account
- The Application's definition of “Covered Period” provides flexibility:
- Alternative Covered Period has been eliminated: *The Alternative Payroll Covered Period* was, for borrowers with bi-weekly payrolls, the 24 weeks (or 168 days) commences on the first day of the pay period that begins *after* the PPP loan is deposited in their account.
 - For example, if the loan proceeds are deposited on Monday, April 20th, and the first pay period after that date commences Monday April 27th, the 24 week period runs from April 27th to June 28th.
 - Borrower must make this election on the forgiveness form
 - The election *only applies* to payroll items. Non-payroll items must abide by the 24 weeks from date of deposit rule.

This is now obsolete. 1st Draw IFR at p. 59.

Compliance with Covered Period

- The Covered Period may **not** extend past 24 weeks after funds are deposited in borrower's bank account.
- Unlike PPP-1, which had a required end date of December 31, 2020, PPP-2 does not.
- However, 24 weeks after March 31, 2021 is September 15, 2021, which is effectively the program end date.

What the Application Clarifies

Payroll Costs: Meaning of “Paid and Incurred”

- Payroll costs *incurred* but not *paid* during the last pay period of the Covered Pay Period or Alternative Payroll Covered Period are eligible for forgiveness ***if paid on or before the next regular payroll date.***
- Eliminates need to schedule a special payroll to be paid on day 168 of the applicable covered period.
- Count payroll costs that were both paid and incurred once.
- *Keep good records, this will be an audit/review point for banks.*

What the Application Clarifies

Three Types of “Payroll Costs” (line 1)

- Cash compensation
 - Gross salary, wages, tips, commission, hazard pay, etc.
 - Paid leave (other than FFCRA leave)
 - Separation pay
- Employee Benefits
 - Healthcare benefits paid by employer only
 - Retirement benefits
 - State and local tax payments assessed on compensation
- Owner Compensation
 - Owner-employees
 - Self-employed
 - General partners

**** Forgiveness does *not include* payments that are accelerated other than as allowed under the various rules (e.g. certain payments made in the ordinary billing cycle)**

What the Application Clarifies

Payment of Bonuses in Excess of Regular Payroll

- Nothing in the Application specifically addresses increasing compensation during the Covered Period
- Compensation paid to any employee (or owner) during the Covered Period cannot exceed \$20,833 (\$15,385 for 8 week period, or the pro rated amount for the elected covered period).
- Increases in owner compensation are likely to be scrutinized
- The Forgiveness FAQ specifically allows “bonuses” as a covered payroll cost. (Subject to the \$100,000 cap.)

What the Application Clarifies

Forgiveness FAQ - Owner compensation caps :

- **For C Corps:** 2.5/12ths of 2019 cash compensation, employer health care contributions, 2.5/12ths of employer retirement contributions
- **For S-Corps:** 2.5/12ths of 2019 cash compensation, employer retirement contributions (capped at 2.5/12 of the employer retirement contribution)
 - For +2% owners, no forgiveness for healthcare contributions
- **For Sched. C or GPs:** 2.5/12ths of 2019 cash compensation. Also applies to LLC members where LLC is taxed as a partnership

What the Application Clarifies

Payments to Owners/Self-Employed

- Amount capped at \$20,833 ($\$100,000 / 12 \text{ months} \times 2.5 \text{ months}$)
- Amounts paid to owner-employees are excluded from calculation of FTE or salary reduction calculations.
- “Owner” is still not a defined term.
- Under the Forgiveness IFR, 92.35% of Section 179 depreciation is excluded for purposes of calculating net business income (this reflects the inclusion of self-employment tax on Form 1040 Schedule SE, Section A line 4).
- Rules for defining who is an “owner” may depend on state laws
 - For example, in community property states, are both spouses treated as owners if the business is treated as community property?

What the Application Clarifies

Non-Payroll Costs: Meaning of “Paid and Incurred”

- Costs must have commenced prior to 2/15/2020
- Payments *incurred* during the 24 weeks must be paid prior to the next regularly scheduled due date for the bill (even if paid outside the 24-week period)
- Costs can only be paid/incurred once
 - A prepayment of a bill is not eligible
 - A bill incurred before the covered period and paid during the covered period would be eligible
- Transportation costs *seemed* to be allowable as expenses (per Application)
- Forgiveness FAQ appears to clarify that the application is referring to “transportation utility” costs are considered a *utility* payment and thus forgivable. This still doesn’t make sense.
- Forgiveness IFR Q.4(b): Prepayments of mortgage interest is not permitted
- Not forgivable: interest on unsecured debts (e.g. credit card interest)
- Given the more flexible covered period rules, this should not be much of an issue anymore

What the Application Clarifies

The 60% Rule is Not a Bar to Loan Forgiveness

- The 60/40 rule is not a total bar to forgiveness if it is not met.
- If <60% of loan proceeds are used for eligible payroll costs, i.e. if 50% of loan proceeds were used for eligible payroll costs, seek forgiveness of that 50%. However, eligible nonpayroll costs cannot exceed 40% of the total forgiveness

What the Application Clarifies

Defining FTEs

- 2 options in calculating FTE:
 - Option 1: Average full-time equivalency (FTE) is the average number of hours paid per week divided by 40 (rounded to nearest tenth), with the maximum for each employee capped at 1
 - Option 2: Borrower may elect to assign a 1.0 for employees who work 40 hours/week or more and 0.5 for employees who work less than 40 hours/week
- Forgiveness IFR Q.5(d) provides further explanation.

What the Application Clarifies

Borrow Not Penalized for FTE Refusing to Return to Work

Borrower does not have to reduce FTE if borrower shows:

- Good faith written offer to rehire that was rejected by employee (PPP FAQ 40);
- Employee was fired for cause (PPP FAQ 40);
- Employee voluntarily resigned (PPP FAQ 40);
- Employee voluntarily requested (in writing) and received a reduction in their hours (PPP FAQ 40);
- Inability to rehire similarly qualified individuals (Forgiveness FAQ); or
- Inability to operate at the same capacity during Covered Period (Application p. 5)

What the Application Clarifies

FTE Re-Hire Safe Harbor

- No loan forgiveness reduction as long as FTEs are rehired by December 31st.
 - *Note*, funds must still be expended during Covered Period
 - 40% cap on non-payroll expenses still applies
- Borrower must restore FTEs to February 15th level.
- No relief if employer reduced employees before February 15th.

What the Application Clarifies

Forgiveness IFR Q.5(f) explains what happens when FTEs are not restored and salary is reduced by more than 25%

- Nothing in the CARES Act specifically addresses this
- Wage reduction applies *only* to the part of reduced wage that is *not* also attributable to FTE reduction
- Example: If an employee's hours are cut to ½ time, but their hour rate remained the same, there is no wage reduction. *But*, if the employee's wages were also reduced by ½ the wage reduction forgiveness limitations would be applicable.
- Forgiveness FAQ provides more examples.
- If restoration occurs before December 31, 2020, no forgiveness reduction
- Increases in compensation need not be referenced on Schedule A to the forgiveness application (Forgiveness FAQ)

Documentation to be Provided for Forgiveness

To Verify Payroll

- Bank account statements or payroll service provider reports to verify cash compensation
- Tax forms (i.e. Forms 941, state wage reporting and unemployment insurance tax filings) for the Covered Period
- Receipts, cancelled checks, account statements verifying employer benefit contributions for health insurance and retirement plans

Documentation to be Provided for Forgiveness

To Verify FTEs (Application line 11, Sched. A)

- Information showing the average number of FTEs between 2/15/2019 and 6/30/2019
- Information showing the average number of FTEs between 1/1/2020 and 2/29/2020
- *Or, seasonal employers may also use:* average number of FTEs for any 12 week period between 5/1/2019 and 9/15/2019

Documentation to be Provided for Forgiveness

To Verify Non-Payroll Costs

- Verify existence of all nonpayroll eligible payments and that they were paid.
 - Cancelled checks, ACH/wire confirmation, credit card statements, etc.
 - Invoices, bills, etc.
 - What you would need to justify the expense for an IRS audit!
- For Mortgages: Loan agreement and amortization schedules.
- For Leases: Lease agreement.
- For Utilities: February 2020 bill

PPP Loans: Good Faith Certification

Borrower Must Certify That:

- Request for forgiveness is as to funds were knowingly used for authorized purposes
- Confirms that borrower acknowledges civil and criminal liability for seeking forgiveness of unauthorized amounts
- The Application is accurate
- Submission to lender of required verification docs.
- The Application is correct in all “material” respects (The Application cites USC codes and defines fines and imprisonment time frames if there is a false statement held to be knowingly made (i.e. fraud)).
- Tax documents given to lender are the same as those provided to the IRS
 - Lender can share tax documents with the IRS
- That SBA may request additional information and Borrower’s failure to provide it may result in denial of loan forgiveness.
- SBA has authority to direct lender to disapprove loan forgiveness

Form of Application

PPP loan forgiveness calculation form and instructions

- Includes Lines 1-11 to calculate forgiveness
- Requires that numbers be entered from PPP Schedule A
- Schedule A is where forgiveness amount is computed
- Check the box if loan *greater than* \$2 million (together with affiliates).
 - Per PPP FAQ 46, this means the loan is subject to SBA review
 - Practically speaking, it is unclear how the SBA will have the resources to review the number of applications at issue
- Certain documents *must* be included with the application
- Other documents need not be submitted by the borrower, must be retained
- Borrower is required to maintain records for 6 years

Form of Application

PPP Schedule A

- Summarizes data that is calculated on supporting worksheets
- Worksheets calculate
 - Table 1: Under \$100,000 employee compensation
 - Table 2: Over \$100,000 employee compensation
- Worksheet for FTE reduction and safe harbor
- *For tipped employees:* Per Forgiveness IFR, the borrower (employer) needs to keep some record of tips, including for cash and “cash equivalents” (unclear what this means)

Which Form to Use if no Employees?

Forgiveness FAQ

- “Sole proprietors, independent contractors, and self-employed individuals who had no employees at the time of the PPP loan application and did not include any employee salaries in the computation of average monthly payroll in the Borrower Application Form automatically qualify to use the Loan Forgiveness Application Form 3508EZ or lender equivalent and should complete that application.”
- Use the short form

Payroll Costs and The Covered Period: Owner Compensation

- Generally
 - If 8 weeks: 8/52nds of 2019 cash compensation
 - If 24 weeks: 2.5/12ths of 2019 cash compensation
- C-Corporations
 - Payroll costs include: salary, employer retirement and healthcare contributions
- S-Corporations
 - Payroll costs include employer retirement contributions
 - Payroll costs *do not* include healthcare insurance contributions
- Partnerships, LLCs
 - Payroll costs include: net earnings from self-employment x 0.9235 divided by either: 8/52 or 2.5/12
 - Payroll costs do not include retirement or health insurance contributions
 - Max. forgivable compensation to owners is \$20,833
- *Pro rate for in between periods*

Payroll Costs and The Covered Period

- Payroll costs “paid or incurred” during the covered period are eligible for forgiveness, as well as up to 40% of non-payroll costs
- The covered period starts the day the loan proceeds are deposited
- Payroll costs are considered paid on the day paychecks are distributed or an electronic payment is initiated
- Borrowers don’t have to change their payroll cycle to obtain forgiveness
 - Even if payroll costs are incurred after the end of the covered period, as long as paid during the regular payroll cycle they are forgivable

Non-Payroll Costs

- Non-payroll costs that are incurred during the covered period are forgivable (not to exceed 40% of the loan amount)
- If payments are made pursuant to a regular billing cycle, if the payment is made after the end of the covered period, it is still forgivable
- Example: Borrower receives its electric bill monthly on the 20th. The loan was advanced on May 1st and the borrower elects the 24 week period. The “covered period” ends October 16th. Even though the electric bill is received after the end of the covered period, it is for costs incurred during the covered period and will be a forgivable expense
- Under PPP-1, the Alternative Payroll Covered Period (discuss below) does not apply to non-payroll costs. Note, this is likely obsolete, but no additional forgiveness regs have been issued yet.

Reduction of Loan Forgiveness

- FTEs/wages now must be replaced by December 31, 2020
 - It appears restoration can be on December 30th with no ramifications
- Borrowers will not have forgiveness reduced if they cannot rehire FTEs because:
 - FTEs quit or refuse to return to work – you must document their refusal to return to work in writing to comply with record keeping requirements
 - Borrowers are required to inform state authorities of a refusal to return to work
 - A documented inability to rehire “similarly qualified” FTEs
 - A documented inability to return to the same business level as before 2/15/2020 *due to compliance with health and safety guidelines*
 - For example: a restaurant that can only have 50% capacity

Loan Forgiveness Process for Lenders

- Must ensure forgiveness application is complete and all data is supported as required
- Must perform at least a “minimal review of calculations” and supporting documents, including third-party payroll processing information
- If the payroll is not well documented or not processed by a recognized third-party processor, more diligence will need to be undertaken (i.e. obtain cancelled checks, etc.)
- If the lender finds errors or missing information, it should inform the borrower of its errors and attempt to get a correct and complete application
- It is the borrower's responsibility to provide accurate information and the lender may reasonably rely on borrower
- The SBA began accepting forgiveness applications August 10th
- Not covering the lender-side process for working with the SBA

Loan Forgiveness Denial

- When a lender recommends **denial** of a forgiveness application (in whole or part), it must provide the SBA with: (a) the forgiveness application form, (b) confirm the accuracy of information in the forgiveness application, (c) proof that borrower has been notified, and (d) basis for the denial.
- The borrower has 30 days to protest the denial.
- The SBA is not required to review the denial and has 5 days to determine whether to deny review.
- If the SBA accepts review, it has 90 days to render a decision
- “SBA may review any PPP loan or any size at any time at its discretion.” (SBA Procedural Notice, 7/23/2020.)

Rules for Refinancing EIDL Loan

- An EIDL loan **cannot** be refinanced with a PPP loan if funds were received (a) before 1/31/2020 or (b) after 4/3/2020
- A borrower is **not** required to use PPP loan funds to refinance EIDL loans if: (a) the EIDL loan was received between 1/31/2020 and 4/3/2020 and (b) the EIDL loan proceeds were used for purposes **other than** to fund payroll costs
- A borrower **must** use PPP loan funds to refinance an EIDL loan when: (a) the EIDL loan was received between 1/31/2020 and 4/3/2020 and (b) the EIDL loan proceeds were used to fund payroll costs

Which form to use?

When to Use 3508EZ

- If you are sole proprietor or an independent contractor; or
- If your business did not reduce FTEs or wages more than 25% during the covered period; or
- If your business did not reduce wages more than 25% but could not maintain FTEs due to compliance with governmental COVID-19 orders effecting normal operations
- Advantage: 2 pages – much simpler
- Otherwise use the long form



**Paycheck Protection Program
PPP Loan Forgiveness Application Form 3508EZ**

OMB Control No. 3245-0407
Expiration Date: 10/31/2020

PPP LOAN FORGIVENESS APPLICATION FORM 3508EZ INSTRUCTIONS FOR BORROWERS

Checklist for Using SBA Form 3508EZ

You (the Borrower) can apply for forgiveness of your Paycheck Protection Program (PPP) loan using this SBA Form 3508EZ if you can check at least one of the three boxes below. Do not submit this Checklist with your SBA Form 3508EZ.

- ☐ The Borrower is a self-employed individual, independent contractor, or sole proprietor who had no employees at the time of the PPP loan application and did not include any employee salaries in the computation of average monthly payroll in the Borrower Application Form (SBA Form 2483).

- ☐ The Borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period (as defined below) compared to the period between January 1, 2020 and March 31, 2020 (for purposes of this statement, “employees” means only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000);
AND
The Borrower did not reduce the number of employees or the average paid hours of employees between January 1, 2020 and the end of the Covered Period. Ignore reductions that arose from an inability to rehire individuals who were employees on February 15, 2020 if the Borrower was unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020. Also ignore reductions in an employee’s hours that the Borrower offered to restore and the employee refused. See [85 FR 33004](#), 33007 (June 1, 2020) for more details.

- ☐ The Borrower did not reduce annual salary or hourly wages of any employee by more than 25 percent during the Covered Period or the Alternative Payroll Covered Period (as defined below) compared to the period between January 1, 2020 and March 31, 2020 (for purposes of this statement, “employees” means only those employees that did not receive, during any single period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000);
AND
The Borrower was unable to operate during the Covered Period at the same level of business activity as before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020 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, related to the maintenance of standards of sanitation, social distancing, or any other work or customer safety requirement related to COVID-19.

If you can check at least one of the three boxes above, complete this SBA Form 3508EZ in accordance with the instructions below, and **submit it to your Lender** (or the Lender that is servicing your loan). Borrowers may also complete this application electronically through their Lender. If you are unable to check one of the boxes above, you cannot use SBA Form 3508EZ and instead you must apply for forgiveness of your PPP loan using SBA Form 3508.

Line 1: Enter total eligible payroll costs incurred or paid during the Covered Period or the Alternative Payroll Covered Period. To calculate these costs, sum the following:

Cash Compensation: The sum of gross salary, gross wages, gross tips, gross commissions, paid leave (vacation, family, medical or sick leave, not including leave covered by the Families First Coronavirus Response Act), and allowances for dismissal or separation paid or incurred during the Covered Period or the Alternative Payroll Covered Period. For each individual employee, the total amount of cash compensation eligible for forgiveness may not exceed an annual salary of \$100,000, as prorated for the Covered Period. For an 8-week Covered Period, that total is \$15,385. For a 24-week Covered Period, that total is \$46,154 for purposes of this 3508EZ. You can only include compensation of employees who were employed by the Borrower at any point during the Covered Period or Alternative Payroll Covered Period and whose principal place of residence is in the United States.

Employee Benefits: The total amount paid by the Borrower for:

1. Employer contributions for employee health insurance, including employer contributions to a self-insured, employer-sponsored group health plan, but excluding any pre-tax or after-tax contributions by employees. Do not add employer health insurance contributions made on behalf of a self-employed individual, general partners, or owner-employees of an S-corporation, because such payments are already included in their compensation.
2. Employer contributions to employee retirement plans, excluding any pre-tax or after-tax contributions by employees. Do not add employer retirement contributions made on behalf of a self-employed individual or general partners, because such payments are already included in their compensation, and contributions on behalf of owner-employees are capped at 2.5 months' worth of the 2019 contribution amount.
3. Employer state and local taxes paid by the borrower and assessed on employee compensation (e.g., state unemployment insurance tax), excluding any taxes withheld from employee earnings.

Owner Compensation: Enter any amounts paid to owners (owner-employees, a self-employed individual, or general partners). For a 24-week Covered Period, this amount is capped at \$20,833 (the 2.5-month equivalent of \$100,000 per year) for each individual or the 2.5-month equivalent of their applicable compensation in 2019, whichever is lower. For an 8-week Covered Period, this amount is capped at 8/52 of 2019 compensation (up to \$15,385).

Completing the Form 3508 (Long Form)

When to Use

- Business has reduced FTEs or wages more than 25%
- Business used more than 40% of loan for non-payroll costs

Form and Instructions

- Contains a worksheet for calculating wage reduction
 - Safe harbors still apply: (1) employee refuses to return to work and refusal is documented, (2) COVID-19 prevented “regular” operations due to governmental action, or (3) restoration of FTEs/wages by 12/31/2020
- FTE reduction calculation:
 - FTEs are those working 40+ hours/week – assigned a value of 1.0
 - If an FTE is reduced (and not restored), they get a value of 0.0
 - If FTEs are >0.75, *pro rata* forgiveness reduction

Step 1. Determine if pay was reduced more than 25%.

- a. Enter average annual salary or hourly wage during Covered Period or Alternative Payroll Covered Period: _____.
- b. Enter average annual salary or hourly wage between January 1, 2020 and March 31, 2020: _____.
- c. Divide the value entered in 1.a. by 1.b.: _____.
If 1.c. is 0.75 or more, enter zero in the column above box 3 for that employee; otherwise proceed to Step 2.

Step 2. Determine if the Salary/Hourly Wage Reduction Safe Harbor is met.

- a. Enter the annual salary or hourly wage as of February 15, 2020: _____.
- b. Enter the average annual salary or hourly wage between February 15, 2020 and April 26, 2020: _____.
If 2.b. is equal to or greater than 2.a., skip to Step 3. Otherwise, proceed to 2.c.
- c. Enter the average annual salary or hourly wage as of the earlier of December 31, 2020 and the date this application is submitted: _____.
If 2.c. is equal to or greater than 2.a., the Salary/Hourly Wage Reduction Safe Harbor has been met – enter zero in the column above box 3 for that employee. Otherwise proceed to Step 3.

Step 3. Determine the Salary/Hourly Wage Reduction.

- a. Multiply the amount entered in 1.b. by 0.75: _____.
- b. Subtract the amount entered in 1.a. from 3.a.: _____.

If the employee is an hourly worker, compute the total dollar amount of the reduction that exceeds 25% as follows:

- c. Enter the average number of hours worked per week between January 1, 2020 and March 31, 2020: _____.
- d. Multiply the amount entered in 3.b. by the amount entered in 3.c. _____ . Multiply this amount by 24 (if Borrower is using a 24-week Covered Period) or 8 (if Borrower is using an 8-week Covered Period): _____ . Enter this value in the column above box 3 for that employee.

If the employee is a salaried worker, compute the total dollar amount of the reduction that exceeds 25% as follows:

- e. Multiply the amount entered in 3.b. by 24 (if Borrower is using a 24-week Covered Period) or 8 (if Borrower is using an 8-week Covered Period): _____ . Divide this amount by 52: _____ . Enter this value in the column above box 3 for that employee.

Calculating Forgiveness Reduction Due to Wage Reduction of More than 25%

Example

- Prior to the February 15th Eric's Café had average monthly wages of \$250,000 (\$3,000,000 annually)
- Due to COVID Eric's Café reduced its monthly payroll to \$100,000/month as it was only able to do take-out and delivery (\$1,200,000 annually)
- On May 5th, Eric's Café applied for and received a \$625,000 PPP loan
- To date, Eric's Café has not restored wages

Salaried Employee

Step 1. Determine if pay was reduced more than 25%.

- a. Enter average annual salary or hourly wage during Covered Period or Alternative Payroll Covered Period: **\$50,000**
- b. Enter average annual salary or hourly wage between January 1, 2020 and March 31, 2020: **\$75,000**
- c. Divide the value entered in 1.a. by 1.b.: **0.67**

If 1.c. is 0.75 or more, enter zero in the column above box 3 for that employee; otherwise proceed to Step 2.

Salaried Employee

Step 2. Determine if the Salary/Hourly Wage Reduction Safe Harbor is met.

- a. Enter the annual salary or hourly wage as of February 15, 2020: **\$75,000**
- b. Enter the average annual salary or hourly wage between February 15, 2020 and April 26, 2020: **\$60,000**

If 2.b. is equal to or greater than 2.a., skip to Step 3. Otherwise, proceed to 2.c.

- c. Enter the average annual salary or hourly wage as of the earlier of December 31, 2020 and the date this application is submitted: **\$75,000.**

If 2.c. is equal to or greater than 2.a., the Salary/Hourly Wage Reduction Safe Harbor has been met – enter zero in the column above box 3 for that employee. Otherwise proceed to Step 3.

Salaried Employee

Step 3. Determine the Salary Reduction (salaried employee)

a. Multiply the amount entered in 1.b **(\$75,000)** by 0.75:
\$56,250

b. Subtract the amount entered in 1.a. from 3.a.: **\$56,250**
- \$50,000 = \$6,250

Salaried Employee

If the employee is an hourly worker, compute the total dollar amount of the reduction that exceeds 25% as follows:

c. Enter the average number of hours worked per week between January 1, 2020 and March 31, 2020:

d. Multiply the amount entered in 3.b. by the amount entered in 3.c. Multiply this amount by 24 (if Borrower is using a 24-week Covered Period) or 8 (if Borrower is using an 8-week Covered Period):_____. Enter this value in the column above box 3 for that employee.

If the employee is a salaried worker, compute the total dollar amount of the reduction that exceeds 25% as follows:

e. Multiply the amount entered in 3.b. by 24 (if Borrower is using a 24-week Covered Period) or 8 (if Borrower is using an 8-week Covered Period): **\$6,250 x 24 = \$150,000**, divide this amount by 52 = **\$2,884.62**

Enter this value in the column above box 3 for that employee.

\$2,884.62 is the non-forgivable amount associated with this employee (if their salary was not restored prior to 12/31/2020)

Hourly Employee

Assumptions

- \$25/hourly wage
- 40 hours per week work

Step 1. Determine if pay was reduced more than 25%.

- Enter average annual salary or hourly wage during Covered Period or Alternative Payroll Covered Period: **\$16.75/hour**
 - Enter average annual salary or hourly wage between January 1, 2020 and March 31, 2020: **\$25.00/hour**
 - Divide the value entered in 1.a. by 1.b: **0.67**
- If 1.c. is 0.75 or more, enter zero in the column above box 3 for that employee; otherwise proceed to Step 2.

Hourly Employee

Step 2. Determine if the Salary/Hourly Wage Reduction Safe Harbor is met.

- a. Enter the annual salary or hourly wage as of February 15, 2020: **\$25.00/hour**
- b. Enter the average annual salary or hourly wage between February 15, 2020 and April 26, 2020: **\$16.75/hour**

If 2.b. is equal to or greater than 2.a., skip to Step 3. Otherwise, proceed to 2.c.

c. Enter the average annual salary or hourly wage as of the earlier of December 31, 2020 and the date this application is submitted: **\$16.75.**

If 2.c. is equal to or greater than 2.a., the Salary/Hourly Wage Reduction Safe Harbor has been met – enter zero in the column above box 3 for that employee. Otherwise proceed to Step 3.

Hourly Employee

Step 3. Determine the Salary/Hourly Wage Reduction.

a. Multiply the amount entered in 1.b **\$25/hour** by 0.75:
\$18.75

b. Subtract the amount entered in 1.a. from 3.a.: **\$18.75 - \$16.75 = \$2.00**

Hourly Wage Example

If the employee is an hourly worker, compute the total dollar amount of the reduction that exceeds 25% as follows:

c. Enter the average number of hours worked per week between January 1, 2020 and March 31, 2020: **40**

d. Multiply the amount entered in 3.b. by the amount entered in 3.c. (**$2 \times 40 = 80$**)
Multiply this amount by 24 (if Borrower is using a 24-week Covered Period): **\$1,920** or 8 (if Borrower is using an 8-week Covered Period): **\$16.00**. Enter this value in the column above box 3 for that employee.

If the employee is a salaried worker, compute the total dollar amount of the reduction that exceeds 25% as follows:

e. Multiply the amount entered in 3.b. by 24 (if Borrower is using a 24-week Covered Period) or 8 (if Borrower is using an 8-week Covered Period): _____, divide this amount by 52.

Enter this value in the column above box 3 for that employee.

\$1,920 is the non-forgiveable amount attributable to the wage reduction

Appeals of Forgiveness Denials

Appeal of Forgiveness Denial

- 8/11/2020 Interim Final Rule published (“Appeals IFR”)
- Establishes quasi-judicial administrative review procedure
- Appeals go to SBA Office of Hearings and Appeals (“OHA”)
- Not all SBA decisions are reviewable under the Appeals IFR. OHA has jurisdiction to hear appeals involving an SBA determination that finds a borrower:
 - Ineligible for a PPP loan
 - Ineligible for the amount received
 - Used proceeds for ineligible purposes
 - Is ineligible for forgiveness (in whole or part)
- Only the actual borrower has standing to pursue an appeal
- Deadline to file: 30 days after the **earlier of** (a) borrower's receipt of the final SBA loan review decision or (b) notification by the lender of the SBA decision.

Appeal of Forgiveness Denial (cont.)

- A borrower **cannot** appeal a decision by a lender, only a final decision of the SBA
 - Thus if borrower's lender denies (in full or part) forgiveness, borrow **must** request SBA review or borrow will be precluded from further appeals or relief.
- An appeal does **not** extend the repayment date.
- If the SBA remits partial payment to the lender, the borrower cannot appeal to OHA
 - Does this mean borrower has no appeal rights for a partially denied forgiveness application?
- Standard of review: Clear error.
- Burden of Proof: Borrower must prove its case by a preponderance of evidence.
- The “judge” need not be an administrative law judge, and it is unclear who will be assigned to hold appeal hearings.

Appeal of Forgiveness Denial: The Petition

The petition initialing the appeal must include:

1. The basis for OHA jurisdiction, including, that the appeal is timely.
2. A copy of the SBA loan review decision that is being appealed.
3. An explanation of why the SBA loan review decision was decided wrongly, together with all factual support, legal arguments, and supporting documents
4. The relief being sought
5. Required documents to be attached to petition: (a) copies of payroll tax and unemployment tax filing or, if not available, the PPP Loan Forgiveness Application, or an explanation as to why they are not relevant or not available and (b) copies of federal tax returns actually filed with the IRS, if not provided with the PPP Borrower Application Form, or an explanation as to why they are not relevant or not available
6. Signed under penalty of perjury
7. Address and phone number of borrower and its counsel

Appeal of Forgiveness Denial: Dismissal of Appeal

The Judge may dismiss an appeal if:

- It exceeds OHA jurisdiction
- Appellant lacks standing
- No final decision has been rendered by the SBA
- The petition fails to set forth fact, which if true, would constitute a valid appeal

Appeal of Forgiveness Denial: The Administrative Record

- The appeal is not a “de novo” hearing
- Based on administrative record
- The administrative record is a set of documents that the judge will review to determine if the SBA decision was valid
 - The SBA prepares the administrative record
 - The appellant may seek to add documents to the administrative record by *objecting* to the SBA’s failure to include such documents
 - The appellant may also object to the SBA’s inclusion of documents in the administrative record
 - The judge may rule that the administrative record can be supplemented
- Upon “good cause shown” the judge may permit submissions, including discovery, beyond the administrative record

Appeal of Forgiveness Denial: The Hearing

- Judge will generally decide case on the papers, no trial or hearing
- Judge has discretion to hold argument, or hear witnesses
- After the record is closed, the ALJ will issue a decision, which is considered an *initial decision*
 - The losing party may appeal to the SBA Administrator within 30 days
 - If no appeal is filed, the decision becomes final
 - To exhaust administrative remedies and preserve the right to seek judicial review, the losing party must seek SBA Administrator review. Failure to seek this second administrative review precludes federal court relief.
- Further appeals to U.S. District Court will be subject to procedures governing appeals from administrative agencies

Additional Items

- Only lawyers can represent clients before the SBA.



Other Economic Stimulus

Other Economic Stimulus

- \$20 billion added to EIDL program
 - Must show loss of 30% of gross revenue, less than 300 employees
 - \$10,000 “emergency” loan is now a grant
- \$15 billion for grants to venue operators (i.e. sports arenas, theaters, performing arts, museums, and others).
 - Must show loss of 25% of gross revenue, less than 50 FTEs
- Unemployment Insurance Support for NFPs
 - Federal government will cover 50% of NFPs self-insured liability through March 2021
- \$10 billion for states to disburse through the *Childcare Development Block Grant*
- States may use CARES Act state and local relief funds through December 31, 2021

Individual Stimulus

- Direct payment of stimulus funds
 - For those making \$75,000 or less (\$150,000 for a married filing jointly taxpayer). Benefit phases out between \$75,001 and \$99,000.
 - \$600 for each adult (\$1200 for joint filers) and dependents
- \$300 per week of enhanced unemployment benefits through March 14, 2021
- \$100 per week of *Pandemic Emergency Unemployment* for self-employed workers eligible for CARES Act unemployment payments

Tax Provisions

Tax Provisions

- Expenses paid with PPP funds are deductible.
- Extension of \$300 charitable universal (“above the line”) deduction for 2021 (\$600 for joint filers)
 - Extension of charitable itemized deductions to allow up to 100% of AGI to be donated
- Employ~~EE~~ deferral of FICA extended to 12/31/2021 (though this is very dangerous since employer is on hook to collect)

Tax Provisions (cont.)

- **Treatment of S-Corps:** owners of S-corps: S-Corp owners will get a step-up in their basis upon loan forgiveness for the forgiven amount
 - If forgiveness does not occur until 2021, owners may not have flow-through loss on 1040.
 - Thus, for end of year tax planning, S-corp. owners may wish to make contributions now to increase their basis to be able to use the flow through loss for 2020.
 - Loss not used maybe used in 2021 if suspended due to lack of basis.

Tax Provisions (cont.)

- **Paid Leave:** Extension of refundable tax credit through March 31, 2021 for COVID-19 related leaves.
- Unspent FSA funds may be rolled over to 2021 without reducing 2021 benefits.
- Itemized Deduction for Medical Expenses: 7.5% of AGI floor made permanent
- Tax extenders for Opportunity Zones, New Market Credit, employer credits for paid FMLA
- 100% of meals and entertainment deductible in 2021-22
 - 12/22/2022: Wall Street Journal Editorial “Trump and the GOP revive the loophole for business meals. It’s bad policy and bad politics.”
- ~~Makes permanent excise tax relief for beer, wine, and liquor producers~~

Tax Provisions: Employee Retention Tax Credit

- Extended until June 2021
- Increases tax credit from 50% to 70% of wages (up to \$10,000) for each quarter
- Max. benefit is \$14,000 per employee in 2021 Q1 and Q2 (up from \$10,000 maximum benefit from CARES I for 2020 Q3 and Q4)
- Businesses with 500 or fewer employees qualify for *small business treatment*
- Employers who received PPP loans may use tax credit (but can't get forgiveness of associated payroll costs)
- Report on Form 941 *but* file Form 7200 to claim advance credit
- FAQ: <https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act>

Tax Provisions: Employee Retention Tax Credit

How it Works

- Requires the business to be partially or completely suspended due to COVID or governmental actions
- Under CARES II, gross receipts must be reduced by 20% (vs. 50% under CARES I) versus same quarter in 2019.
- Under CARES I once 50% threshold is met, every quarter is eligible for the credit until gross receipts return to 80% of 2019 quarterly earnings – no such provision exists in CARES II
- An employer that anticipates receiving ERTCs can request an advance against potential 941 liability

Tax Provisions: Employee Retention Tax Credit

How it Works

- “Qualified Wages” means
 - For 2020, for businesses with *less* than 100 average FTEs in 2019, ***all wages paid in*** 2020 Q2, Q3 and 2021 Q1 and Q2 are qualified wages, whether the employees were working or not
 - For 2020 for businesses with *greater* than 100 average FTEs in 2019, wages paid in 2020 Q2 and Q3 are qualified wages ***only if*** the employees ***did not work***
 - For 2021, for businesses with *less* than 500 average FTEs in 2019, ***all wages paid in*** 2021 Q1 and Q2 are qualified wages, whether the employees were working or not
 - For 2021 for businesses with *greater* than 500 average FTEs in 2019, wages paid in 2021 Q1 and Q2 are qualified wages ***only if*** the employees ***did not work***

ERTC: An Example

<u>Q2 Wages</u>	<u>Wages</u>	<u>Fed. WH (10%)</u>	<u>ER SS (6.2%)</u>	<u>EE SS (6.2%)</u>	<u>ER Med. (1.45%)</u>	<u>EE Med. (1.45%)</u>
Eric	5,000	500	310	310	73	73
Jeff	10,000	1,000	620	620	145	145
Amanda	15,000	1,500	930	930	218	218
<u>Total</u>	<u>30,000</u>	<u>3,000</u>	<u>1,860</u>	<u>1,860</u>	<u>435</u>	<u>435</u>

What is the amount of the credit?

Seems like it should be 70% of \$30,000 or \$21,000....

EmployER withholdings = \$2,298

ERTC: An Example (cont.)

- Nope, remember “qualified wages” are capped at \$10,000 per employee per quarter

<u>Q2 Wages</u>	<u>Wages</u>	<u>Credit</u>
Eric	5,000	3,500
Jeff	10,000	7,000
Amanda	15,000	7,000
<u>Total</u>	<u>30,000</u>	<u>17,500</u>

- The \$17,500 can be applied to the Q2 941 liability prospectively.
- The total withholding liability is \$ \$2,298
- Thus, Employer will receive cash of \$9,910, or a rolling credit going forward

ERTC: There's More

Because ERTC can now be used in conjunction with PPP there are coordinating provisions in CARES II. CARES II § 206(c) provides:

- You can't take the ERTC and get a payroll cost deduction for the qualified wages
- But, you can opt certain wages (and allocable healthcare costs) out of ERTC treatment
- This allows you to preserve PPP forgiveness
- The SBA and IRS will need to issue additional guidance on this
- Lots of other tricky rules, so we'll have to revisit it when the guidance is issued



Ethical issues

Overview

- Best Practices for Advising Clients
- PPP Loan Agents

PPP Agent/Brokers

- CARES I established a role for third-parties to assist PPP borrowers to access funds
- Such “agents” are accountants, attorneys, consultants, and other brokers who prepare the loan application
- They are entitled to receive a portion of the lender's fee from originating a PPP loan
- Agents may not be compensated by *both* the borrower and the bank
- Fee Schedule:
 - 1% on loans under \$350,000
 - 0.5% on loans from \$350,000 - \$2 million
 - 0.25% on loans greater than \$2 million
- The issues are when and how can agents secure fees from banks

Advising Clients

- Use common sense. Any time there is essentially a give away of money, people can get a little crazy.
- We have had clients ask if they can use PPP funds for all sorts of purposes.
- You cannot advise clients to use funds for improper purposes. This is not only unethical, but likely a crime.
 - Remember also, there is no attorney client privilege for the advise you give.
 - If you believe your client has *already* done something wrong, have them consult a lawyer

Advising Clients

- There is no reason an accountant should be signing a PPP loan application for a client (although they can as agent)
 - AICPA considers preparation of loan applications a “non-attest service”
 - Thus, they should not be performed by independent auditors as it may impact independence
- Determining whether the client meets the “necessity” requirement is an exercise of professional judgment
- This is particularly true for 2nd draw loans.
 - What if the business had 1 terrible quarter but then came roaring back?
 - It meets the 25% threshold, but is the 2nd draw “necessary”
 - If the SBA later determines that necessity was not met, is there malpractice risk? OPR risk?

Advising Clients

- Know your client. As always, get source documents from client before assisting with a PPP loans or forgiveness request.
- Most PPP fraud has been based on submission of false employee data for relatively newly formed company
- Get tax returns, *certified* entity formation documents
 - Because of affiliation rules, you need to get an understanding of the business' corporate and capital structure
- Use third-party information to verify source material

PPP Agent/Brokers

- PPP Agent fees have become controversial, primarily because banks have to share their fees
- The main issue is whether agents must have agreements in place with the banks *before* they submit applications on behalf of borrowers
- Hence a number of lawsuits have occurred, which have not gone well for agents.
 - At bottom, unless the agent has a pre-existing agreement with the bank, they are unlikely to get paid
 - *Johnson, et al v. JPMorgan Chase*, 20-cv-4100 (S.D.N.Y.): “absent an agreement between agent and lender, defendant banks are not required to pay agent fees under the text of the CARES Act or its implementing regulations.”
- CARES II puts this to rest as it requires a direct relationship between the bank and the agent, and makes the rule retroactive to March 27th

Accountant's Role as an Agent

- If you are the outside auditor, you should not be arranging or assisting with arranging PPP loans. This can eliminate your independence.
- If the fees are paid by the client, further to their ordinary engagement, there should be no issue. It is no different than assisting with any loan application

The background of the slide is a blue textured surface, possibly a book cover or a piece of fabric, with a pattern of dark blue, wavy, and irregular lines. A dark blue, semi-transparent rectangular box is positioned in the upper right quadrant of the slide, serving as a background for the text.

Enforcement

Enforcement

- Last DOJ update was October 7, 2020 (by Jeffrey Rosen, then Deputy AG)
- 65 prosecutions – 2 major crime categories:
 - Applications for businesses that did not really exist
 - Improper use of funds
- Fortunately, there have not been any instances (yet) of professionals conspiring with criminals to obtain false PPP loans
- Most of the schemes have been ham-handed
 - Spending money on cars, personal expenses (college for kids), bling, paying off co-conspirators
- Some have been very sophisticated
 - Creating shell companies and then paying fake employees created using identity fraud to launder money



PPP Loans in Bankruptcy

Overview

- CARES I did not speak to whether bankrupt could receive PPP loans
- Regulations and certification prohibited bankruptcy companies from applying
- With some exceptions, courts have upheld the prohibition based on defense to SBA rule making powers
 - On December 30, 2020 the 11th Circuit held that the SBA could prohibit bankruptcy entities from getting PPP loans. *In re Gateway Radiology Consultants, P.A.*, No. 20-13462 (11th Cir. Dec. 22, 2020).
- CARES II amended this to allow for Chapter 12, 13, and Chapter 11, Subchapter V (small businesses) debtors to obtain PPP loans while in bankruptcy
- After notice and hearing, bankruptcy judge can approve a DIP getting a PPP-2 loan if the debtor is otherwise eligible.

CARES Act Facilities in Chapter 11

EIDL Loans

- A debtor in bankruptcy cannot apply for EIDL loans based on underwriting standards
- Secured, personally guaranteed
- Generally “all assets”
- SBA will appear through AUSA
- No special treatment in bankruptcy because they are government loans
- SBA Guidance: *SOP 50-52-2 Disaster Loan Servicing & Liquidation*, Office of Capital Access, SBA (Sept. 1, 2015) - https://www.sba.gov/sites/default/files/sops/SOP_50_52_2.pdf
- Write off of EIDL loan constitutes COD income, SBA will issue 1099-C

CARES Act Facilities in Chapter 11: EIDL Loans

- The SBA will generally work with borrowers
- *Remember*, the loan will generally be secured by all assets of the debtor, so you need to speak with the SBA prior to filing to reach agreements on cash collateral

CARES Act Facilities in Chapter 11

PPP Loans

- Unsecured, no personal guarantee
- 60% to be used for payroll
- DIP cannot get a PPP loan under CARES I, some debtors can get PPP-2 under CARES II
- Chapter 11 debtors *not* under SBRA *cannot get PPP-2*
 - Unclear why this distinction was made
 - SBRA is based on a \$7.5 million debt limit
 - Would seem that any debtor that can complete certifications and subject to court approval should be able to access
- Nothing says a company cannot take out a PPP loan and then file bankruptcy – question is: what happens *next*?
- Advanced by a bank, not the SBA directly

CARES Act Facilities in Chapter 11: PPP Loans

Cash Collateral Issues

- Are co-mingled funds “cash collateral” of the secured lender?
- UCC §§ 9-312(b)(1), 9-314 – security interests in deposit accounts perfected only by control
- UCC § 9-104 – control means:
 - The money is in the account at the secured creditor/bank
 - Entry into a deposit account control agreement (DACA) between secured party/bank and third-party depository
- Thus, if PPP loan proceeds are maintained in an account of the business at the secured creditor/bank, the secured lender likely has control, and the funds would be cash collateral (given the PPP loan was likely advanced by that bank, it’s a good chance control exists)
- However, if the proceeds are kept in a separate account at a different bank, without a DACA, the funds are not cash collateral, even under an all assets UCC

CARES Act Facilities in Chapter 11: PPP Loans

Confirmation Issues

- PPP loans are unsecured
- Thus, in a POR they would likely be classified without GUCs unless an argument could be made for different treatment
- If used according to their statutory purpose, PPP loans are forgivable, thus, they may not be a debt come confirmation under the correct circumstances
- If the PPP loans are not forgiven, treated as an administrative claim

CARES Act Facilities in Chapter 11: PPP Loans

Concerns

- Loan proceeds become cash collateral?
 - In this case, it is hard to believe that the secured creditor would not want the proceeds used for forgivable purposes.
- Debtor uses proceeds for non-forgivable purposes but seeks to discharge liability?
 - If PPP loan was taken out without the intent to repay, DIP officers and directors could have personal liability for fraud; possible crimes under CARES Act
 - May present a confirmation issue under 1129(b)(3) (“The plan has been proposed in good faith and not by any means forbidden by law....”) – is discharging a PPP loan “forbidden by law” if the funds were used for an unauthorized purpose?

CARES Act Facilities in Chapter 11: PPP Loans

PPP Loans as Entrance Financing

- A PPP loan may be a good source of entrance financing – covers payroll, rent, mortgage interest payments, and utilities.
- Other collections can be used for operations, adequate protection.
- Since PPP loans are forgiven, if spent correctly, it can provide a company with additional short term liquidity.
- **Caution**, as to PPP-1, the SBA has indicated that proceeds should be returned. No guidance under PPP-2

The CARES Act and the SBRA

- SBRA enacted into law on August 23, 2019 and became effective on February 19, 2020 as Subchapter V of Chapter 11, Title 11
- Must affirmatively elect treatment on the petition
- The Act increases the debt limit to access the procedures to \$7.5 million (from \$2,725,625)
- This may provide a solution for companies hard hit by a short but extreme loss of revenue.
- **SARE debtors may not elect subchapter V.**

The CARES Act and the SBRA

SBRA Basics

- Courts have held that debtors whose chapter 11 cases were filed before February 19, 2020 can elect treatment as a “small business debtor” under SBRA, if they meet eligibility requirements, by amending their chapter 11 petitions to so elect or seeking that treatment by motion, effectively making SBRA retroactive:
 - *In re Ventura*, 2020 WL 1867898 (Bankr. E.D.N.Y. Apr. 10, 2020)
 - *In re Bello*, 2020 WL 1503460 (Bankr. E.D. Mich. Mar. 27, 2020)
 - *In re Body Transit, Inc.*, 2020 WL 1486784 (Bankr. E.D. Pa. Mar. 24, 2020)
 - *In re Moore Properties of Person County, LLC*, 2020 WL 995544 (Bankr. M.D.N.C. Feb. 28, 2020)
 - *In re Progressive Solutions, Inc.* (Bankr. C.D. Cal. Feb. 21, 2020)

The CARES Act and the SBRA

Debt Limits

- Originally, to qualify as a “small business debtor,” debtor's aggregate noncontingent liquidated secured and unsecured debts could not exceed \$2,725,625, but CARES Act increased debt limitations to \$7.5 million with a one-year sunset provision
- Excludes debts owed to one of more affiliates or insiders of the debtor
- For any guaranteed debt by the debtor where the guarantee is absolute and unconditional, it will likely be considered noncontingent and liquidated to the extent there is a default on the principal obligation guaranteed
- At least 50% of debts must arise from commercial or business activities of debtor

The CARES Act and the SBRA

Principal features of SBRA

- No creditors' committee unless court orders one for cause (§§1181(b), 1102(a)(3))
- No disclosure statement required unless the court orders one for cause, in which case either the plan itself can be considered adequate disclosure, the court could approve a disclosure statement submitted on standard forms, and court can conditionally approve pending confirmation hearing (§§1181(b), 1187(c), 1125(f))
- No US trustee fees (28 USC §1930(a)(6))
- While debtor does remain in possession, automatically appoints Subchapter V trustee whose principal function is to supervise and monitor the case and to facilitate development and confirmation of a consensual plan (§1183)

CARES Act and the SBRA

- Section 1183 enumerates trustee's duties, which notably do not include, *inter alia*, investigating acts, conduct and financial affairs of debtor unless, for cause and on request of a party in interest, the court orders an investigation.
- Only debtor may file a plan, which must be filed within 90 days of petition date, subject to extension if need therefor is attributable to circumstances for which debtor should not justly be held accountable (§1189)
- Allows for modification of residential mortgage if loan proceeds were not used primarily to acquire residence but instead were used in debtor's business (§1190(3))
- Allows debtor to pay administrative claims over 5 years (include lease assumption claims)

The CARES Act and the SBRA

Cramdown Plans:

- All requirements of section 1129(a) still must be met, except subsections (8) (all classes must accept or be unimpaired), (10) (at least one impaired accepting class) and (15) (best efforts test for individual plan)
- no requirement that there be at least one impaired, accepting class of creditors, i.e., even if all classes reject, cram down is still available
- new “fair and equitable” standard that eliminates the absolute priority rule and in place, imposes a requirement that debtor’s “projected disposable income” must be applied to plan payments for three years or, if the court orders, up to five years; or the value of proposed plan distributions in the applicable payout period is not less than projected disposable income for that period (§1191(c)(2))
- “disposable income” means income not reasonably necessary to pay for expenses necessary to continue and preserve business operations (§1191(d)(2))

The CARES Act and the SBRA

Cramdown Plan (cont.)

- In addition, for an individual debtor, “disposable income” means income that is not reasonably necessary for support of debtor or his or her dependents or to pay a domestic support obligation coming due after the filing of the petition ((§ 1191(d)(1))
- For individual plans, the new “projected disposable income” standard supplants § 1129(a)(15), which, if invoked by an unsecured creditor, requires that an individual debtor distribute property equal to or greater than projected disposable income, as defined in § 1325(b)(2), for the longer of five years or the period for which the plan provides payments.
- Discharge will not occur until debtor completes all payments due within first three years of plan or such longer period, not to exceed five years as the court may fix.
- Subchapter V trustee remains in place to make plan payments unless the plan or confirmation order provides otherwise

The CARES Act and the SBRA

Cramdown Plans (cont.)

- Administrative expenses do not have to be paid on confirmation, but can be paid through the plan ((§ 1191(e))
 - This includes cure payments for leases
- Feasibility requirement modified to require finding that debtor will be able to make all plan payments or has a “reasonable likelihood” of doing so (§ 1191(c)(3)(A))
- Plan must provide appropriate remedies on default, “which may include liquidation of nonexempt assets” (§ 1191(c)(3)(B))
- Cramdown requirements for secured claims remain unchanged
- Section 1111(b) election can still be made. Since there likely will be no disclosure statement, Interim Bankruptcy Rule 3017 provides that in a Subchapter V case, the election may be made not later than a date the court may fix
- Postconfirmation modification of plan permitted during plan term if circumstances warrant and cramdown confirmation requirements under § 1191(b) are met (only debtor may request modification) (§ 1193(c))

The CARES Act and the SBRA

Consensual plans

- Shall be confirmed if all requirements of section 1129(a) are met, other than subsection (15)
- Subchapter V trustee discharged upon substantial consummation of plan
- Discharge occurs upon confirmation
- Postconfirmation modification not permitted after substantial consummation (§1193(b))

The influence of COVID-19 on pending cases

Mothballing and Other Special Case Administration Orders

- Seminal and prototype order entered in *In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 (VFP) (Bankr. D. N.J. March 27, 2020) (ECF No. 166)
 - Pursuant to sections 305 and 105 of the Bankruptcy Code, suspends jointly administered chapter 11 cases until April 30, when a further extension will be considered
 - Suspends all deadlines that would otherwise occur until suspension period terminates
 - Parties permitted to seek relief from court for exigent and unforeseen circumstances
 - Authorizes payment of "essential expenses," and the deferral of all others, including payment of rent

The influence of COVID-19 on pending cases

In re Craftworks Parent, LLC, Case No. 20-10475 (BLS) (Bankr. D. Del. March 30, 2020) (ECF No. 217): Order (I) Establishing Temporary Procedures and (II) Granting Related Relief

- Establishes special lease rejection procedures, initiated by Rejection Notice
- Establishes special stay relief and other motion filing procedures related to lift stay motions, motions or applications for administrative expense, motions to compel assumption or rejection or for payment of rent under sections 365(d)(3) or (d)(5), whereby settlement is encouraged and no hearings scheduled prior to April 30 or such later date as determined by the Court

The influence of COVID-19 on pending cases

In re Pier 1 Imports, Inc., Case No. 20-30805 (KRH) (Bankr. E.D. Va. April 6, 2020) (ECF No. 493): Order (I) Approving Relief Related to the Interim Budget, (II) Temporarily Adjourning Certain Motions and Applications for Payments, and (III) Granting Related Relief

- Authorizes temporary shutdown of operations until notice of intent to reopen filed after consultation with DIP lender (the “Limited Operation Period”)
- Authorizes critical expense budget for payment of wages, utilities, insurance, security, trust fund taxes and “other corporate and professional costs,” with deferral of all other payments, including payment of rent and payments to vendors and suppliers (except for debt incurred in suspension period)
- Debtors to make good faith efforts to pay deferred payments within 45 days following Limited Operation Period
- Adjourns to next omnibus hearing that is no less than 45 days after end of Limited Operation Period motions seeking payment of expenses not in interim budget, lift stay and adequate protection motions and motions to compel rejection or assumption

The influence of COVID-19 on pending cases

Orders entered in *In re Sakon*, Case No. 19-21619 (Bankr. D. Conn. 2019) (Tancredi, J.)

- Orders granting and extending temporary stay of proceedings due to *pro se* debtor's medical complications (ECF Nos. 64, 79)
- Order denying temporary stay of proceedings – which requested a 21-day extension of all existing deadlines to file responsive pleadings due to COVID-19 – in favor of promptly addressing extension motions on a matter by matter basis

Effect of COVID-19 on Bankruptcy Code Mandated Deadlines

- **SARE Cases** – 90 day deadline to file a plan or make adequate protection payments otherwise stay relief is granted under § 362(d)(3).

Considerations

- May make sense to file a plan early given valuations may be lower, particularly based on income analysis
- Beware of the 1111(b) election
 - Secured creditors gives up deficiency/unsecured claim and must be paid full amount of secured claim over life of plan
 - Can create feasibility issues
 - But, do banks really want real estate back?

Effect of COVID-19 on Bankruptcy Code Mandated Deadlines

- **Section 365(d)(4)** – Limitation on ability of DIP to extend time assume/reject non-residential real estate leases without landlord consent, beyond 210 days following the petition date.
- “No subsequent extensions may be granted by the court without the prior written consent of the lessor in each instance.” 2 Norton Bankr. L. & Prac. 3d § 46:41 (2020)

Considerations

- So long as a motion to assume is filed prior to the deadline, it can be acted on after the deadline. *In re Simbaki, Ltd.*, 520 B.R. 241, 245 (Bankr. S.D. Tex. 2014); *In re Eastman Kodak Co.*, 495 B.R. 618, 622 (Bankr. S.D.N.Y. 2013)
- Under certain circumstances, an appropriate assumption motion could be filed and later withdrawn.
- All “gap” rent must be paid on an administrative basis.

Effect of COVID-19 on Bankruptcy Code Mandated Deadlines

- **SBRA Deadlines:**

- 60 days from petition date to hold status conference and present plan outline, which must be filed 14 days prior to the status conference
- 90 days to file a plan
- *Note, court can extend these deadlines for cause based reasons beyond the debtor's control*

Considerations

- Certainly COVID-19 is beyond the debtor's control.
- Courts will likely afford reasonable extensions of these deadlines so *long* as the excuse is legitimate and the debtor is complying with operating criteria generally. *Talk to the trustee!*

Questions?

Thank you!