

**The Total PPP Workshop:
A Deep Dive into PPP Loans, Related Tax Issues,
and Recent Developments**

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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

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.



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Today's Program

- 2:30 hours (1-3:45 (ET), including breaks)
- 5 minute coffee/bathroom break after 1st hour 10 minutes after 2nd hour
- Try and stay on schedule with us for ce/cpe reasons
- Enter questions into



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CE/CPE

- 12 Attendance Check Words
- Write them down
- Get link at the end for claiming your certificate



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Agenda

- PPP loans generally
- PPP loan forgiveness
- PPP enforcement issues
- Tax issues for PPP loans
- Main Street Business Program
- Payroll deferral executive order
- What's next
- Questions

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PPP Loans Generally



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PPP Loans Generally

- Applications closed **August 8th**
- Amount of loan: 2.5x your average payroll costs
 - Wages, self-employed income, healthcare costs (for employees), retirement contributions (for employees and employee/owners of C-corps)
- PPP money may be spent over 24 weeks
- 60% must be spent on payroll but no cliff (pro rata reduction of forgiveness)
- Can use to refinance EIDL loans
- 6/26/2020 – Updated guidance released (if program reopens changes are likely)

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PPP Loan Forgiveness

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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
 - Covered Period vs. Alternative Payroll Covered Period for 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

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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")

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Process for Obtaining Loan Forgiveness

- Borrower to submit SBA Form 3508 or 3508-EZ – the loan forgiveness forms
- Banks are likely to create 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.

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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 (be it 8 or 24 weeks) 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 or 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**

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Loan Forgiveness Process

- If forgiveness is denied, the loan must be repaid over the 2-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)

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What the Application Clarifies

Length of the "Covered Period"

- The covered period was the 24 (or 8) weeks from the day the bank deposited PPP loan proceeds in borrower's account
- For pre-June 5th Borrowers, the Borrower can elect either.
- The Application's definition of "Covered Period" provides flexibility:
- **Option 1:** Covered Period means: the 24 weeks (or 168 days) from deposit.
- **Option 2 (Alternative Payroll Covered Period)** means: 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.

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Compliance with Covered Period

- Per the Forgiveness FAQs, the Covered Period may **not** extend past December 31, 2020
- Thus, funds that are advanced after July 16, 2020 must be spent in less than 24 weeks.
- For example, if a PPP is funded on August 14th, the borrower has 19 weeks and 6 days to spend the money.

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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.*

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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)**

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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 (or \$15,385 for 8 week 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.)

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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

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What the Application Clarifies

Payments to Owners/Self-Employed

- Amount capped at \$20,833 (\$100,000/12 months x 2.5 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?

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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)

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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

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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.

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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)

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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.

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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 employees hours are cut to ½ time, but their hour rate remained the same, there is no wage reduction. *But*, if the employees 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)

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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

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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*

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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

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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

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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

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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)

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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

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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

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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

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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
- The Alternative Payroll Covered Period (discuss below) does not apply to non-payroll costs

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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

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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

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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.)

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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

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Completing Form 3508 and 3508EZ



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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

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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.

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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**

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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.

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Hourly Employee

Assumptions

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

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: **\$16.75/hour**

b. Enter average annual salary or hourly wage between January 1, 2020 and March 31, 2020: **\$25.00/hour**

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.

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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.

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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**

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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 x 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




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Appeals of PPP Loan Forgiveness Denial




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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.




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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.

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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

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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

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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 ALJ 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 ALJ may rule that the administrative record can be supplemented
- Upon "good cause shown" the ALJ may permit submissions, including discovery, beyond the administrative record

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Appeal of Forgiveness Denial: The Hearing

- ALJ will generally decide case on the papers, no trial or hearing
- ALJ 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

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Additional Items

- Only lawyers can represent clients before the SBA.
-

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PPP Tax Issues

- PPFA allows employers to both obtain a PPP loan and defer the employer portion of withholding taxes through the remainder of 2020
- Borrower's loan and forgiveness applications must be consistent with tax documents
- No fix (yet) for non-deductibility of expenses paid with PPP funds
 - S.3612, Small Business Expense Protection Act, introduced on May 5th has not received any action
 - Several arguments have been raised as to why the expenses are not taxable despite IRS Notice 2020-32
 - If Congress does not act, the issue is sure to be litigated
- On June 19th the IRS issued Notice 2020-50 related to taxpayers who took retirement distributions due to COVID-19

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PPP Tax Issues

- IRS released updated FAQs on tax issues related to employment tax deferrals
- Employers can now both obtain a PPP loan and defer the employer portion of withholding taxes, with payments due:
 - 50% by 12/31/2020
 - 50% by 12/31/2021
- The IRS is taking the position that once a PPP loan is forgiven, the employer may no longer defer (FAQ 1, 4)
- The IRS has clarified that the deferral period is March 27 – December 31, 2020 (unless the loan is forgiven earlier)
- The IRS will be revising Form 941 and providing guidance on how to properly prepare Q2 2020 941s
- If an employer believes they are entities to refundable tax credits for paid COVID-19 leave, they can still defer

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Deferral of Employer Paid SS Taxes

- Independent contractors/sole proprietors may defer
- If you defer, there will be no estimate tax penalty on the deferred amount

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IRS Notice 2020-32

- Despite nothing in the CARES Act, the IRS has issued guidance that expenses paid with PPP loan proceeds (which are to be forgiven) are not deductible as ordinary business expenses.
- IRS Position: Because the taxpayer does not recognize income from receipt of the PPP loan, it should not get a deduction for spending the government's money.
- The IRS opines that under IRC 265 and TR 1.265-1 (c), that the PPP funds are "wholly exempt income" and, thus, a Section 165 (or 212) deduction is disallowed.

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IRS Notice 2020-32

"No deduction shall be allowed for... Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle."

IRC 265(a)(1).

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IRS Notice 2020-32

Counter arguments:

- Inconsistent with legislative intent. As Sen. Grassley said: "[t]he intent [of the PPP] was to maximize small businesses' ability to maintain liquidity, retain their employees and recover from this health crisis as quickly as possible. This notice [Notice 2020-32] is contrary to that intent."
- No case applies Section 265 in this way. The cases cited by the IRS in the Notice deal with deductibility of expense where expenses were funded with gifts and other oddities.
- The IRS has not applied Section 265 with respect to Section 108 "tax-exempt income".
- Section 265 applies only to "wholly exempt" from Subtitle A. The CARES Act just exempts the forgiveness of PPP loans from the COD income rules.
- The Notice is sub-regulatory guidance. It is not subject to deference. CCM-2016-006 (Sept. 17, 2019) ("Chief Counsel attorneys representing the IRS before the U.S. Tax Court will not argue for deference under Auer or Chevron to positions taken only in subregulatory guidance.")

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Executive Order Deferring Payroll Taxes

- Issued August 8, 2020
- Directs Treasury Secretary to defer collecting social security taxes on bi-weekly "wages or compensation" of less than \$4000
- Deferred without penalties or interest
- Treasury Secretary shall explore forgiveness
- IRS/Treasury has not released any implementing guidance
- Not clear if this is mandatory

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Executive Order Deferring Payroll Taxes

August 13, 2020 AICPA Request for Guidance

AICPA has recommended that the Government clarify the Executive Order as follows:

- Employee must request deferral in writing
- Defining an "eligible employee" as an employee with gross wages of less than \$4,000 (or equivalent amount depending on the employer's pay period) per biweekly period;
- Provide a model notice concerning the deferral and election;
- Explaining whether the eligibility amount is a cliff or applicable to all wages under the threshold.
- The \$4,000 limit should apply separately to each employer of an employee;
- Provide notice that it is the responsibility of the employee and not the employer to pay the deferred payroll taxes;
- Stating a payment due date(s) for the deferred taxes and a mechanism for employees to pay the deferred taxes.

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Early Withdrawal from Qualified Plans (Notice 2020-50 (Jun. 22, 2020))

- Allows "qualified individuals" to avoid 10% penalty on early withdrawals (or certain loans) from qualified plans taken during 2020
- Permits employers to implement rules to facilitate early distributions/loans
 - Not required
- Definition of "qualified individual":
 - Diagnosed with COVID-19
 - Spouse or dependent is diagnosed with COVID-19
 - Experienced adverse financial consequences due to (a) being quarantined, (b) unable to work due to lack of childcare, (c) lost job or hours, (d) job rescinded, (e) adverse financial consequences of spouse or family member who share's individual's personal residence

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Don't Commit Fraud

- 36 prosecutions as of August 5th
- Don't by a Lamborghini (at least 4 prosecutions involve Lamborghini), or Range Rovers, Mercedes, etc.
- Can't pay for your kid's college
- No creating false companies
- Can't make up the existence of employees
- No buying racing boats and gambling
- No buying crypto
- Can't pay off your home mortgage
- No paying off student loans
- Can't use for luxury (or even run of the mill) vacations

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One of my favorites

'Love & Hip Hop: Atlanta' star Maurice Fayne charged with misusing coronavirus relief funds
-USA Today, May 14, 2020

- Claimed he had 107 employees
- Submitted forged bank statements.
- Spent money on:
 - Rolex Presidential watch
 - 5.73 carat diamond ring
 - Paid \$50,000 for restitution in a previous fraud case, \$40,000 in back child support, \$139,000 to lease a Rolls Royce
 - \$230,000 to co-conspirators who had helped him run a previous Ponzi scheme.

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Main Street Lending Program: Background

- As part of the CARES Act, Congress authorized the Treasury Department and Federal Reserve to establish special credit facilities to assist small and medium sized businesses, in addition to the Paycheck Protection Program loans ("PPP Loans").
- Fed will deploy up to \$2.3 trillion together with \$454 billion from Treasury to support the programs through the Main Street Lending Program ("MSLP").
- A SPV, administered by the Boston Fed, will purchase loans originated by banks.
- There will be 3 primary facilities.
- The Fed issued detailed FAQs concerning the program.
- Open to for-profit and non-profit businesses.

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Main Street Lending Program: Background

- Treasury has released basic terms.
- Continued further guidance is needed to understand how these credit facilities will work in practice.
- Detailed FAQ released on April 30th updated July 31st
[file:///C:/Users/jsklarz/Downloads/frequently-asked-questions-faqs%20\(1\).pdf](file:///C:/Users/jsklarz/Downloads/frequently-asked-questions-faqs%20(1).pdf)
- 3 core programs:
 - New Loan Facility ("MSNLF")
 - Extended Loan Facility ("MSELF")
 - Priority Loan Facility ("MSPLF")
- Key differences are how facilities address borrower's present debt load.
- SPV may purchase up to \$600 billion in loans.
- Program will stop purchasing September 30, 2020.

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General Borrower Eligibility Criteria

- Eligible Borrowers:
 - Established prior to March 13, 2020
 - Up to 15,000 employees; or
 - Up to \$5 billion in 2019 revenue
 - For profit enterprise
 - NFPs may be allowed to participate but not yet
- Eligible Lenders: Any federally insured lending institution
- Loan Terms:
 - 4 year maturity
 - 1 year deferred P&I, with deferred interest capitalized
 - Rate: LIBOR + 3%
 - No prepayment penalty

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General Borrower Eligibility Criteria

- Underwriting:
 - Lender must assess each borrower with their "own underwriting standards." FAQ F.1.
 - If borrower has other loans, must meet "pass" standard under Financial Institutions Examination Council's supervisory rating system.
- Collateral Requirement: Unclear. FAQ G.6 says can be either secured or unsecured.
- Origination Fee: 1% origination fee on the principal of the loan
- Servicing Fee:
 - Up to 1% paid by borrower
 - 0.25% paid by SPV
- Other than a PPP loan, no other CARES Act support.

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General Borrower Certifications

- Will not pay balance of other loans until Main Street facility is repaid.
- Will not cancel existing loans.
- Can meet financial obligations for next 90 days.
- Does not expect to file for bankruptcy during next 90 days.
- Will follow other CARES Act requirements, including compensation, and conflict of interest requirements.
- Will make "commercially reasonable" efforts to retain employees.

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General Lender Requirements

- Proceeds will not be used to refinance old loans.
- No cancelation of outstanding loan facilities.
- Certification of methodology for calculating EBITDA (i.e. the Fed is not mandating a methodology, but lender must select an appropriate procedure).
- CARES Act conflict of interest rules have been met.

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Main Street New Loan Facility

- Borrower must not have existing term loan facilities.
- Loan Size:
 - Minimum: \$500,000
 - Maximum: Lesser of (a) \$25 million or (b) 4x EBITDA, less committed and available credit.
- No specific collateral requirement.
- MSNLF loans are not supposed to be for distressed businesses, grants or forgivable.
They are for companies that were financially doing well before COVID-19 and were impacted. The intent of the program is to give otherwise healthy companies inexpensive liquidity.
- Borrowers cannot also participate in MSELF or MSPLF.
- Loan originated after April 24, 2020.
- Repayment: No payment year 1; 1/3rd P&I years 2-4.

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Main Street Expanded Loan Facility

- Allows borrowers to increase borrowing, with less risk to the lender.
- Borrower must be seeking to upsize a loan made prior to 4/24/2020.
- Loan Size:
 - Minimum : \$10 million
 - Maximum: Lesser of (a) \$200 million, (b) 35% borrowers outstanding and available credit, or (c) 6x 2019 EBITA, less committed and available credit.
- Collateral Requirements: Any collateral securing the original loan must secure the upsized loan. FAQ D.1.
- Repayment: No payment year 1
 - Interest repayment: 15% in year 2, 15% in year 3, and 70% in year 4.
 - Principal repayment: 1/3rd years 2-4.

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Non-Profit Facilities

- Non-profits have 2 options for MSLP loans
- Nonprofit Organization New Loan Facility (NONLF)
 - Similar to MSNLF (new loan)
- Nonprofit Organization Expanded Loan Facility (NOELF)
 - Similar to MSELF (upsized loan)

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General Criteria for Non-Profits

- At least 10 employees
- In operation since at least 1/1/2015
- Either (i) less than 15,000 employees or (ii) less than \$5 billion in 2019 gross revenue
- Less than \$3 billion in endowment
- Total non-donation revenue of at least 60% of expenses from 2017-2019
- 2019 adjusted EBITDA to unrestricted 2019 operating revenue of at least 2%
- Has a ratio (expressed as a number of days) of (i) liquid assets at the time of loan origination to (ii) average daily expenses over the previous year, equal to or greater than 60 days.
 - In English: Has at least 60 days cash on hand
- At the time of loan origination, has a ratio of (i) unrestricted cash and investments to (ii) existing outstanding and undrawn available debt, plus the amount of any loan under the Facility, plus the amount of any CMS Accelerated and Advance Payments, that is greater than 55%

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NONLF

- 5 year maturity
- 2 year deferred P&I (interest amortized)
- Repayment: 15% end of year 3; 15% end of year 4; 70% at maturity
- Adjustable rate of LIBOR (1 or 3 month) + 300 basis points
- Minimum loan size of \$250,000
- Maximum loan size that is the lesser of (i) \$35 million or (ii) the Eligible Borrower's average 2019 quarterly revenue
- Must be in first position
- Prepayment permitted without penalty.

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NOELF

- 5 year maturity
- 2 year deferred P&I (interest amortized)
- Repayment: 15% end of year 3; 15% end of year 4; 70% at maturity
- Adjustable rate of LIBOR (1 or 3 month) + 300 basis points
- Minimum loan size of \$10 million
- Maximum loan size that is the lesser of (i) \$300 million or (ii) the Eligible Borrower's average 2019 quarterly revenue
- Must be *pari passu* with original debt
- Prepayment permitted without penalty.

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Take Aways

- With underwriting delegated to bank, it is unclear what criteria will be used to lend.
- Not clear why the MSPLF – the only facility that allows a refinance – would require a new lender.
- Usefulness of MSNLF is unclear, given it requires payment of 1/3rd of loan in years 2-4.
- Essentially, these are all bridge facilities, that will need to be refinanced.
- Prohibition on use by chapter 11 debtors is unfortunate.

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PPP Loans in Bankruptcy and Related Topics

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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

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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

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CARES Act Facilities in Chapter 11

PPP Loans

- Unsecured, no personal guarantee
- DIP cannot get a PPP loan
- 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

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SBA's Position: No PPP Loans For DIPs

- The SBA has taken a strong stance against companies in chapter 11 seeking PPP loans
- The SBA has also argued against companies that get PPP loans from keeping them if they file
- Courts have split.
 - Some bankruptcy courts have enjoined the SBA from holding up PPP loans to DIPs
 - Some have denied DIPs PPP loans
 - Some have suggested the case be dismissed, the company get the PPP loan, then immediately refile
- Proposed legislation would allow for PPP loans in bankruptcy, but give them "super priority" repayment status.

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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

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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

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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?

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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 for 8 weeks.
- 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*, there is no guidance yet as to whether such a strategy would be rendered illegal by the SBA.

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CARES Act Facilities in Chapter 11: MSLP Loans

MSNLF/MSELF

- Cannot be accessed by DIPs
- Underwriting will be required
- Originating bank retains a 5% interest
- NLF – Unsecured term loan
- ELF – Secured term loan (with no new collateral, or so it appears)

- Might work as entrance facilities or to be entered into after final decree, but will require a lot of discussion with lender.

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CARES Act Facilities in Chapter 11: MSLP Loans

PMCCF

- Syndicated loans or bonds
- Not for DIPs
- More flexible
- Security interest not clear
- May allow for a revolving facility
- Can be used to refi debt (in a narrow way)

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Prospective Legislation

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Prospective Legislation

- HEROS Act
- HEALS Act
- Continuing Small Business Recovery and Paycheck Protection Program Act
 - Allow a "second draw" for PPP money
 - Less than 300 employees
 - 50% or greater revenue reduction
 - Could be used for operational costs, COGS, and certain capital expenditures
 - Automatic forgiveness for loans under \$150,000
 - Expansion of the Employee Retention Tax Credit
 - Group healthcare "covered payroll expense"

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Questions?



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Eight Money-Making Tips to Build and Grow Your Tax Representation Practice

- Several Thousand have already sat in
- 25 Million in trouble before COVID-19
- 1 in 3 can't pay their 2019 taxes
- Check it out – It's FREE on-demand



<https://taxreplc.com/8-money-making-tips/>

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