

OBSERVATIONS

Second Round of Paycheck Protection Loans

January 8, 2021

At the end of 2020, Congress passed, and President Trump signed, a new law that provides for additional relief related to the coronavirus (COVID-19) pandemic. This law, the Consolidated Appropriations Act, 2021 (CAA 2021), includes a second draw of Paycheck Protection Program (PPP) loans. It also allows businesses to deduct ordinary and necessary expenses paid from the proceeds of PPP loans.

The U.S. Department of the Treasury and Small Business Administration unveiled new guidance in the form of Interim Final Rules (IFR) for \$284.5 billion worth of federally backed relief loans to small businesses harmed by the coronavirus pandemic. The rules refer to first round PPP Loans as “First Draw PPP Loans” and this second round as “Second Draw PPP Loans.”

The CAA 2021 permits certain smaller businesses who received a PPP loan and experienced a 25% reduction in gross receipts to take a Second Draw PPP Loan of up to \$2 million.

Eligible entities. In order to qualify for a Second Draw PPP Loan, a taxpayer must have taken out an Original PPP Loan. Eligible entities include, for-profit businesses, certain non-profit organizations, housing cooperatives, veterans' organizations, tribal businesses, self-employed individuals, sole proprietors, independent contractors, and small agricultural co-operatives.

Prior PPP borrowers must meet the following conditions to be eligible for the PPP Second Draw Loans:

- Employ no more than 300 employees per physical location;
- Have used or will use the full amount of their first PPP loan; and
- Demonstrate at least a 25% reduction in gross receipts in the first, second, or third quarter of 2020 relative to the same 2019 quarter. Applications submitted on or after Jan. 1, 2021 are eligible to utilize the gross receipts from the fourth quarter of 2020.

The 25% revenue reduction is a different standard than the First Draw Loans. Based on the IFR, the calculation could be done by either:

1. Compare the quarterly gross receipts for one quarter in 2020 with gross receipts for the corresponding quarter of 2019. An example in the IFR:

“A borrower with gross receipts of \$50,000 in the second quarter of 2019 and gross receipts of \$30,000 in the second quarter of 2020 has experienced a revenue reduction of 40 percent between the quarters and is therefore eligible for a Second Draw PPP loan.”

2. Alternatively, if a business were in operation in all four quarters of 2019, it can qualify if the annual receipts show a 25% or greater reduction in 2020 compared to 2019. But even if the business did not experience a 25 percent annual decline in revenues, or was not in operation in all four quarters of 2019, it may still meet the revenue reduction requirement under one of the quarterly measurements above.

The SBA defines gross receipts as “all revenue in whatever form received or accrued (in accordance with the entity’s accounting method) from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees or commissions, reduced by returns or allowances.” For sole proprietorships, independent contractor or self-employed individuals, “gross income” will be the amount reported on Schedule C. Forgiveness amounts of the First Draw PPP Loan received in calendar year 2020 will not be included in gross receipts.

The maximum amount of the loan is the lesser of two and half months of your average monthly payroll costs or the \$2 million cap. The two and a half months salary calculation are the same as for First Draw loans. However, borrowers in the hospitality or food services industries (NAICS code 72) may receive PPP Second Draw Loans of up to 3.5 times average monthly payroll costs. Only a single PPP Second Draw Loan is permitted to an eligible entity.

Documentation: The documentation required to substantiate payroll cost calculation is generally the same as documents required for First Draw PPP Loans. As such, the business’s bank may already have the documentation it needs and not require anything additional. More guidance is expected on the type of documentation needed to support the 25% revenue reduction.

Taxpayers who borrow PPP Second Draw Loans of no more than \$150,000 may submit a certification, on or before the date the loan application is submitted, attesting that the eligible entity meets the applicable revenue (gross receipts) loss requirement.

Loan forgiveness. Like Original PPP loans, PPP Second Draw Loans may be forgiven for payroll costs of up to 60% (with some exceptions) and nonpayroll costs such as such as rent, mortgage interest and utilities of 40%. Forgiveness of the loans is not included in income as cancellation of indebtedness income.

Deductibility of expenses paid by PPP loans. The CAA 2021 provides that expenses paid both from the proceeds of loans under Original PPP loans and PPP Second Draw Loans are deductible.

Lenders will determine when to accept applications. Some may be very close to accepting applications, and the last day to apply for and receive a PPP Loan is March 31, 2021. Funds are limited, and businesses, banks and the SBA are more familiar with processing these loan applications, the expectation is the money is likely to go fast.

Please contact our office with any further questions you might have on PPP loan forgiveness.