

June 15, 2020

## Paycheck Protection Program Flexibility Act

On June 3, 2020, the Senate unanimously passed the House of Representative bill 7010, the “Paycheck Protection Program Flexibility Act.” The Flexibility Act passed both houses of Congress with just a single dissenting vote. President Trump signed the legislation into law on June 5th.

The legislation makes a number of changes to the CARES Act’s PPP provisions, almost all of which provide greater flexibility for PPP loans and the forgiveness of indebtedness process. These changes affect not only those borrowers who have already received PPP loans, but may also encourage other potential applicants (who were reluctant to apply because they were uncertain that the program met their needs) to apply.

The key changes in the Paycheck Protection Program Flexibility Act are as follows:

- **The time period to spend funds in order to achieve forgiveness has been expanded from 8 weeks to 24 weeks.** Existing borrowers have the option of using the 8 week period if they prefer.
- The SBA’s regulatory **requirement that at least 75% of the amount requested to be forgiven must have been used for payroll costs has been dropped down to a 60% level.** According to follow-up rules from the SBA, Borrowers must also ultimately use at least 60% of the entire loan for payroll costs.
- Loans issued after enactment must have a 5 year payback period, rather than the current 2 year payback period. For those borrowers who have already received loans, their 2 year term can be extended to 5 years with consent of the bank that issued the loan, but the Flexibility Act does not require banks to do so. Recipients of existing loans should work with their banks to seek the longer term payback. Even if banks may not have a direct financial incentive in making such modifications, their client relationships and public reputations could suffer if they fail to do so.
- The 6-month deferral period before payments are due has been replaced. The deferral period now begins on the loan date and ends on the date the SBA remits the amount of

forgiveness to the lender. Borrowers must apply for forgiveness within 10 months after the last day of the covered period. Combine this 10-month period with the fact that lenders have 60 days to make a decision on the application and then SBA has an additional 90 days to act, and it might be a long time before the first payment on a PPP loan comes due.

- The CARES Act established limitations on forgiveness if the borrower's headcount or payroll was less than its historical numbers. Those reductions in forgiveness are disregarded if headcount and payroll were restored by June 30, 2020. **The Flexibility Act extends that amnesty date to December 31, 2020.**
- The Flexibility Act provides additional flexibility in determining whether the headcount limitation must be applied, by **allowing borrowers to disregard instances where it is not possible to find qualified people to rehire.**
- **The Flexibility Act allows PPP borrowers to take advantage of the 2 year deferral of payroll taxes that the CARES Act implemented for other taxpayers but prohibited PPP borrowers from using.**

The following are preliminary observations regarding the effects of the Flexibility Act that may not be apparent at first blush:

#### Flexibility on Rehires

In order to avoid reduction of the maximum loan forgiveness because of a smaller headcount than the borrower's historical numbers, the Flexibility Act provides some welcome options, but some of these require warnings.

One of the items of flexibility is if the borrower could not rehire the required number of employees because of limitations of federal laws (e.g., under guidelines of HHS, CDC or OSHA). So, if federal laws prohibit or limit the borrower from rehiring because of social distancing or other requirements, the borrower will not suffer from that. However, what if state or local laws prohibit rehiring while federal laws do not? If there is an inconsistency between federal and state requirements, the borrower gets a benefit only if the federal laws imposed the limitation.

Borrowers should also be aware that the SBA provides its own additional elements of grace regarding rehiring. One of those allows the borrower to disregard an employee from the headcount test if the borrower can document that a job was offered but the employee declined to come back without a good reason. To take advantage of this exception, the borrower must notify the agency that would otherwise be providing unemployment payments to the employee who declines to come back.

The moving of the “amnesty” date from June 30th to December 31st at first blush seems entirely welcome, giving borrowers more time to rehire. However, some borrowers may find that June 30th is better for them in their particular circumstances. Borrowers should be aware of the implications and plan accordingly.

#### Maximum Payroll For Persons Earning Over \$100,000 Per Annum

Before the Flexibility Act, borrowers could include only the ratable portion of \$100,000 (i.e., 8/52nds of \$100,000) in the forgiveness request in respect of payroll costs for employees earning over \$100,000. We believe that this ratable treatment will continue under the 24-week forgiveness period established by the Flexibility Act. Thus, the maximum that can be taken into account for the forgiveness request should presumably increase from \$15,385 (8/52 x \$100,000) to \$46,154 (24/52 x \$100,000), but whether this presumption survives SBA clarification awaits further word from the SBA.

#### Documentation Requirements

Borrowers are required to maintain documentation regarding their loan application and use of funds for 6 years following the date that all principal and interest has been forgiven or repaid. With the Flexibility Act extending the term of loans from 2 years to 5 years, borrowers must be aware that the need to retain documentation is similarly extended.

#### What About Deductibility of Expenses?

The IRS has issued a revenue procedure holding that expenses paid with PPP funds for which the indebtedness was forgiven cannot be deducted.

Although the IRS’s analysis is in most respects impeccable, many members of Congress immediately complained that it was not Congress’s intention to deny deductions for these expenses. The Flexibility Act is completely silent in regard to this issue, so any changes to the IRS position must come either from future legislation or from the IRS changing its position.

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