

# SBA RELEASES TRIO OF NEW INTERIM FINAL RULES ADDRESSING ELIGIBILITY, FORGIVENESS, AND SBA REVIEW OF FIRST DRAW AND SECOND DRAW PPP LOANS

*COVID-19 Litigation and Employment Action Team Alert*  
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The Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (“Economic Aid Act”) was adopted on December 27, 2020, extending the availability of the original First Draw Paycheck Protection Program (“PPP”) Loans through March 31, 2021. It also created a new Second Draw PPP Loan program (“PPP2”) allowing prior PPP borrowers to seek a second loan. The Economic Aid Act required the SBA to issue initial regulations within ten days of enactment to carry out the provisions of the Act and amendments to the PPP and, on January 6, 2021, the SBA posted two new Interim Final Rules (“IFRs”) to its website.

## **IFR 1—Consolidation and Updating of Prior PPP IFRs**

The first new IFR (“IFR 1”) consolidates, amends, and restates most (but not all) of the content of nineteen prior IFRs rolled out by the SBA between April 2, 2020 and June 25, 2020. This consolidated rule is much more user friendly than trolling through prior IFRs individually, and should still be interpreted consistently with the SBA’s previously published Frequently Asked Questions (FAQs) posted to the SBA’s and Treasury’s websites last year. But IFR 1 cautions that the Economic Aid Act overrides anything inconsistent in the IFRs and that the SBA will be revising the FAQs to fully conform to the Economic Aid Act as quickly as feasible. Because there may be some inconsistencies that have yet to be ironed out, new PPP borrowers should ensure that, if they are relying on a prior FAQ response to apply for a loan, the FAQ response remains consistent with the Economic Aid Act and IFR 1.

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While IFR 1 mostly carries forward the original PPP rules for new borrowers, one of the major changes instituted by the Economic Aid Act was the expansion of four new categories of non-payroll costs that are forgivable: covered operations expenditures, covered property damage costs, covered supplier costs, and covered worker protection expenditures. The IFR includes definitions of these items, which are also set forth in our prior [alert](#), along with a summary of other substantive changes implemented by the Economic Aid Act. The Economic Aid Act also updates the “covered period” for forgiveness purposes to a period between 8 weeks and 24 weeks at the election of the borrower. As a result of this change, IFR 1 eliminates the “alternative covered period” described in its prior IFR published in June 2020.

Another major addition to IFR 1 is the implementation of the Economic Aid Act’s provisions allowing certain borrowers to reapply or request an increase in a prior PPP loan if proceeds were returned or the borrower did not accept the full amount of the loan for which it was eligible. IFR 1 explains that any request for an increase must be received by March 31, 2021 and is subject to the availability of funds. Unfortunately, the SBA has not yet outlined the details and process for these situations.

New PPP borrowers should be mindful of the overarching purpose of the program: to support America’s small businesses and nonprofits. And IFR 1 includes an express statement that “[u]nder no circumstances may PPP funds be used to support non-U.S. workers or operations.” The limitations on eligibility imposed by affiliation rules generally carry forward, and the Economic Aid Act also includes new categories of ineligible businesses, which IFR 1 repeats and incorporates.

### **IFR 2—Second Draw PPP2 Loans**

The second IFR (“IFR 2”) specifically addresses PPP2 loans. A significant portion of the Economic Aid Act is devoted to creating PPP2, but many of the provisions applicable to First Draw Loans still apply to Second Draw Loans. IFR 2 expressly states that the SBA’s rules for First Draw PPP Loans under IFR 1, prior FAQs, and other guidance remains applicable to PPP2 loans, except to the extent set forth in IFR 2, as may be inconsistent with the Economic Aid Act, or as amended in the future.

Many businesses that obtained First Draw Loans may find themselves ineligible for a PPP2 loan. IFR 2 emphasizes that “the eligibility requirements for Second Draw PPP Loans [is] narrower than the eligibility requirements for First Draw PPP Loans.” Unlike first draw PPP loans, PPP2 eligibility requires the borrower to make a revenue comparison of “gross receipts,” which for most borrowers will be a comparison of one quarter of 2020 to the same quarter in 2019, to demonstrate a 25% reduction. The Economic Aid Act, however, provided no definition of “gross receipts” for purposes of making that comparison. IFR 2 adopts one. Applicants making their revenue comparisons should consult the definition to ensure the data used in the revenue comparison comports with the IFR 2 definition, which is nearly identical to the SBA’s definition of “receipts” in 13 C.F.R. 121.104. IFR 2 expressly excludes any forgiven First Draw PPP Loan amounts from gross receipts. There are other limited exceptions that borrowers should carefully review with their accountants when calculating and making revenue comparisons. Notably, applicants seeking loans of \$150,000 or less do not need to substantiate the revenue reduction with documentation at the time of application, and may simply certify to it for now. They will, however, need to be prepared to prove it up later. Applicants seeking loans in excess of \$150,000 must submit proof of the revenue reduction with the application and the lender is required to perform a good faith review to confirm the calculations. If there is a

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discrepancy found, the lender should contact the applicant and work together to resolve the issue.

IFR 2 confirms the headcount reduction to 300 employees for most applicants and the \$4 million aggregate cap for PPP2 loans for a single corporate group. There are some special rules, exceptions, and waivers applicable to NAICS 72 businesses (e.g., Accommodation and Food Services industry) and certain news organizations. IFR 2 also adds a clarifying provision prohibiting an entity that has permanently closed from receiving a PPP2 loan, as only businesses still in operation retain employees, and preserving employment is a primary purpose of the PPP. IFR 2 also provides guidance with respect to the calculation of payroll costs for self-employed individuals and partnerships and adjustments to eliminate the provision for refinancing of EIDL loans, consistent with amendments made by the Economic Aid Act.

Another important element of IFR 2 are the procedures SBA will follow for borrowers who want to apply for a PPP2 loan, but the applicant's First Draw Loan is under review by the SBA or its forgiveness application is still pending. If the original loan is under SBA review, the lender will be notified when the PPP2 application is submitted and an SBA loan number will not issue. IFR 2 states that the SBA will resolve the issue expeditiously and notify the lender of the process to obtain an SBA number, if appropriate. IFR 2 explains that an SBA review or pending forgiveness application is not necessarily a disqualifier for a PPP2 loan, as many of these matters will be resolved in borrowers' favor. Therefore, the SBA will set aside PPP2 loan funds for these unresolved borrowers in the event their PPP2 applications are later approved.

With regard to forgiveness, IFR 2 notes that forgiveness of PPP2 loans will generally be assessed on the same terms and conditions as First Draw PPP Loans. For PPP2 applicants who obtain loans of \$150,000 or less and do not submit documentation at the time of application to support their 25% revenue reduction, that documentation must be submitted with the forgiveness application. And if the borrower does not submit a forgiveness application, the SBA may still request this information to assess the borrower's program compliance in taking the loan. Borrowers of questionable eligibility that might be enticed by a low interest rate to apply for a loan with no intention of seeking forgiveness should carefully reconsider that plan. A borrower's failure to submit a forgiveness application will be an obvious red flag that could prompt an SBA audit of the loan.

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### IFR 3—Forgiveness and SBA Audits

IFR 1 and IFR 2 were not a wholesale or complete carryover of all prior IFRs issued in 2020, particularly as it relates to forgiveness. The SBA therefore issued a third new IFR (“IFR 3”) on January 19, 2021. IFR 3 serves to consolidate prior loan forgiveness and SBA loan review rules from eight previous IFRs, updates them to conform to the Economic Aid Act, and extends them to PPP2 loans. The vast majority of IFR 3 offers nothing new of substance, but there are a few changes and some important elements worthy of comment.

Under the Economic Aid Act, a PPP2 applicant must have taken a First Draw Loan in order to be eligible for a PPP2 loan. IFR 3 requires the applicant to submit a forgiveness application for the First Draw Loan, even if the calculated amount of forgiveness is zero, before or with the PPP2 forgiveness application. As cautioned above, a PPP2 applicant who took a First Draw Loan but did not seek forgiveness, or sought a significantly lower amount of forgiveness than the loan, is likely to draw attention and could prompt an SBA audit.

IFR 3 restates the expanded list of forgivable expenses adopted in the Economic Aid Act and explains that the broader list can also be applied to prior First Draw PPP Loans, but only if the SBA had not yet remitted a forgiveness payment to the lender as of December 27, 2020. Forgiveness applications will continue to be vetted by lenders in the first instance and they will issue their decisions to the SBA within 60 days of receiving a complete application.

IFR 3 updates the full time equivalent (“FTE”) reduction penalty, the salary and wage reduction penalty, and the reference periods to conform them to the Economic Aid Act and PPP2 loans. Among other things, IFR 3 conforms the FTE penalty exemption to the Economic Aid Act for borrowers who can document a good faith inability to return to the same level of business activity compared to pre-February 15, 2020, due to compliance with safety requirements or guidance issued after March 1, 2020 by the Secretary of Health and Human Services, the CDC, or OSHA related to COVID-19. The SBA has also exercised its own rulemaking authority in IFR 3 with respect to adjusting four other *de minimis* exemptions to the FTE reduction penalty as relates to: (1) offers to rehire; (2) firings for cause; (3) borrower elimination of FTE reduction by December 31, 2020; and (4) certain sub-\$50,000 loans. It also added an additional reference period option for seasonal employers calculating the FTE reduction and offers a *de minimis* exemption to the salary and wage reduction penalty for certain sub-\$50,000 loans.

Consistent with prior IFRs, IFR 3 states that the SBA may review a PPP loan of any size at any time, in its discretion and as it deems appropriate. Such reviews will focus on three primary areas: (1) borrower eligibility, including the 25% “gross receipts” comparative reduction for PPP2 loans, borrower certifications, representations, and information submitted; (2) the loan amount and use of loan proceeds; and (3) entitlement to loan forgiveness and amount. Meeting the gross receipts test will be a focal point for would-be PPP2 borrowers.

While PPP2 borrowers may be focused on calculating “gross receipts” to make quarterly reduction comparisons, they must still certify on the PPP2 loan application (SBA Form 2483-SD) and be prepared to demonstrate that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” While the SBA has yet to articulate a clear litmus test for measurement, and it has not clarified the relationship (if any) to the gross receipts comparisons, PPP2 borrowers should carefully and critically evaluate the extent to which they are currently facing

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economic uncertainty, whether the loan is actually necessary, and how they would substantiate these elements with currently available information. That information should be collected and preserved. The perception of both uncertainty and need today may be very different, both objectively and subjectively, than it was in the April-August 2020 time frame when the First Draw Loan was sought. If the SBA raises issues of eligibility in a review or audit, including as regards the necessity certification, IFR 3 reflects that the borrower will have an opportunity to respond and submit information. Borrowers should be prepared to justify and prove their cases before that happens.

IFR 3 also explains that “SBA may, in its discretion, review a borrower’s First Draw PPP Loan and Second Draw PPP Loan at the same time or at different times.” So borrowers should be wary that inconsistencies or red flags in connection with a prior PPP or new PPP2 loan could trigger a much broader review of both loans. IFR 3 reminds that borrowers with loans in excess of \$150,000 must retain their loan documentation and supporting materials for six years after the loan is forgiven or paid in full, implying that the SBA could undertake a review years later if circumstances warrant. The Economic Aid Act also expressly provides that the SBA may review and audit loans of less than \$150,000, but those borrowers are subject to lesser document retention requirements of three years or four years for certain types of records. It remains to be seen whether the SBA will set a threshold lower than \$2 million for automatic review of PPP2 loans or perhaps identify other new audit triggers.

IFR 1, IFR 2, and IFR 3 are lengthy documents containing an extensive compilation of PPP rules and procedures. If you have questions about applying for a loan or seeking forgiveness under PPP or PPP2, or how the Economic Aid Act or the IFRs may affect your situation, please contact [Jason Markel](#) (716.848.1395), [Reetuparna Dutta](#) (716.848.1626), or [Valerie Stevens](#) (646.218.7614).

Please check our [Coronavirus Resource Center](#) and our [CARES Act](#) page to access information related to both of these rapidly evolving topics.

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