PILLA TALKS TAXES

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The Paycheck Protection Program Flexibility Act Of 2020

New Changes Provide More Options

On Friday June 5, President Trump signed H.R. 7010, titled the Paycheck Protection Program Flexibility Act (the Flexibility Act). See: Public Law 116-132, June 5, 2020. The act adds considerable flexibility to small businesses with PPP loans. There are seven major aspects to the Act which I discuss in turn.

1. Increased maturity date. Under the CARES Act, if a Paycheck Protection Program (PPP) loan was not forgiven, it converted to a 1% loan with a two-year maturity. Under §2(a) of the Flexibility Act, businesses have up to five years to repay any portion of a PPP loan that's not forgiven.

The five-year rule applies automatically to any PPP loan made on or after June 5, 2020. For loans made prior to June 5, the law provides that lenders and borrowers may "mutually agree to modify the maturity terms" of their loan in order to "conform with the requirements of this section." See: Flexibility Act, §2(b). That is to say, your two-year maturity provision can be stretched to five years by agreement with the lender.

2. Extended time period for use of loan proceeds. Under the CARES Act, a PPP loan had to be used for authorized expenses (discussed in detail in past articles) within "the covered period." The covered period was defined as the period beginning February 15 and ending June 30, 2020. See CARES Act, §1102.

This limitation caused serious concerns for many

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businesses, especially those in service industries. For example, under CARES, at least 75% of the proceeds (changes to this element are discussed further below) of a PPP loan had to be used to pay employees' salaries. The money had to be spent by June 30. However, with most service businesses shut down through at least the end of May, and with openings thereafter being greatly restricted, it was questionable whether a restaurant, for example, would be able to pay wages anywhere close to the amount required in order to obtain forgiveness of the loan.

In light of this concern, §3 of the Flexibility Act makes a couple of critical changes to the "covered period." First, the Flexibility Act extends the "covered period." The time available to spend PPP proceeds is extended to either, a) 24 weeks from the date the loan is received, or b) December 31, 2020, whichever comes first. See: Flexibility Act, §3(b).

As an example, if you received your loan on May 1, 2020, you have 24 weeks in which to spend the money as authorized by law. If you receive your loan on November 1, 2020, you have until December 31, 2020, in which to spend the money. It is also important to note that this provision applies to all PPP loans, including those obtained prior to the passage of the Flexibility Act. However, for loans issued prior to June 5, the borrower may elect to have the "covered period" end eight weeks after the date the loan was issued. See: Flexibility Act, §3(b)(3).

Second, for loans received after June 5, 2020, the covered period is now calculated from the date a PPP loan is received. See: Flexibility Act, §3(b). Under the CARES Act (the old law), if a business obtained a PPP loan on June 10, for example, it had to spend the money by June 30, as that date was the end of the "covered period." For loans issued on or after June 5, 2020, the fact that we start the covered period from the date the loan is received means that businesses don't have to scramble to spend the money before June 30, when in fact, many businesses might not even be fully operational by then.

This amendment addresses the most significant concern businesses had, which was the June 30 deadline by which to spend PPP proceeds. As stated, most businesses, even as of this writing, are still at least partially shutdown. There's no way they could have spent PPP proceeds, 75% of which had to be used on payroll, during a time they were not even allowed to operate.

Third, everywhere the limitation of June 30 is used in §1106(d) of the CARES Act, regarding the forgiveness of the loan, that date is moved to December 31, 2020. This means that businesses now have until December 31, 2020 to restore full-time equivalent employee levels to pre-COVID levels to qualify for full forgiveness.

3. Reduction in percentage dedicated to payroll. Under the CARES Act, 75% of the proceeds of a PPP loan had to be directed to payroll. Perhaps the most important change made by the Flexibility Act reduces this threshold. Under the new law, just 60% of the total proceeds of PPP loans must be used on payroll; 40% can be used for any of the other authorized expenditures.

Moreover, of the 40% that can be directed to non-payroll items, the entirety of the 40% can be used to pay "any payment of interest on any covered mortgage obligation (which shall not include any prepayment of or payment of principal on a covered mortgage obligation)…" See: Flexibility Act, §3(b)(2)(B).

4. Safe-harbor when employers can't maintain prior employment levels. Under CARES Act §1106(d)(2), the amount of loan forgiveness available under the law is reduced if the average number of full-time equivalent employees is reduced compared to either the corresponding period in 2019, or the period from January 1, 2020, to February 29, 2020 (at the employer's election).

However, as we all know, workers who have been laid off from the service industry may well have found work elsewhere. We know from recent reports that as of June 5, approximately 2.5 million workers have found their way back onto company payrolls. We also know that most of those workers cannot be working in service industries, such as hotels and restaurants, since most restaurants are still shutdown and very few people are traveling. As such, many companies simply will not be able to hire back the number of workers needed to meet the CARES Act requirement to maintain the same number of full-time equivalent workers needed to achieve full loan forgiveness.

Section 3(b) of the Flexibility Act adds a safe-harbor regarding the required number of employees. It provides that "the amount of loan forgiveness under this section shall be determined without regard to a proportional reduction in the number of full-time equivalent employees if" any of the following conditions apply:

a. The company is unable "to rehire individuals who were employees" of the company on or before February 15, 2020;

b. The company is unable "to hire similarly qualified employees on or before December 31, 2020;" or

c. The company is unable to "return to the same level of business activity as such business was operating at prior to February 15, 2020."

This provision will prevent the lack of availability of workers from negatively affecting one's ability to get loan forgiveness.

It is clear that the burden of proof with regard to any of the three exceptions is squarely on the employer. The statute states that the applicant for loan forgiveness must "in good faith be able to document" that one or more of the three factors shown above applies. Just exactly how such a thing will be documented is unclear.

For starters, it is important for employers to keep minutes of conversations with past employees in order to reflect their unwillingness to return to work. And, employers should keep minutes of interviews with prospective employees to document their lack of sufficient education, background, training or experience necessary to do the work required. A good way to do this would be to make contemporaneous notes of your interview and keep those notes right with the prospective employee's resume or job application. For those prospective workers who are unsuited to the job, a good practice would be send them a follow up letter explaining that they are unqualified for the job and why.

5. Extension of payment deferral period. Under the

CARES Act, payments on PPP loans were deferred for at least six months, and up to one year. The deferral includes principal, interest and fees. Under the Flexibility Act, the deferral is in effect until the amount of forgiveness is determined and transmitted to the lender. If the loan is fully forgiven, it follows that no payments are necessary. If the loan is partially or not at all forgiven, payments began at that time based upon the amount determined to be owed.

A new rule is added to the PPP constellation of rules providing that if a borrower fails to apply for loan forgiveness within ten months after the last day of the "covered period" (see point 2 above), then the borrower must start making payments on the loan beginning the first day following the end of the ten-month period. See: Flexibility Act, §3(c).

6. Payroll tax deferral. Under the CARES Act, employers are allowed to defer the payment of non-trust fund employment taxes for up to two years. See my discussion of this provision in the April/May issue of PTT. However, the CARES Act provided that any business that had a PPP debt forgiven could not defer payroll taxes under that provision. See CARES Act, §2302(a)(3).

Section 4 of the Flexibility Act strikes this rule. Now, employers that did or will obtain a PPP loan can also elect to defer employment taxes under the scheme I outlined in the April/May issue of PTT. What's more, the repeal §2302(a)(3) is effective "as if [it were] included in the CARES Act," and is therefore applicable to "any loan made pursuant to" the PPP rules. See: Flexibility Act, §4(b).

7. Application deadline. Please note that the Flexibility Act does not change the application deadline for PPP loans. Loans must be sought by June 30, as expressed in the CARES Act.

CONCLUSION

In more than 40 years of experience in watching Congress and its machinations, I have never seen the kind of piecemeal approach with respect to public policy and legislation as with the PPP loan. As such, it appears that it continues to be a work-in-progress.

Time will tell whether Congress will continue to tinker with this program.

Paying For The Paycheck Protection Program

"Pay-As-You-Go" Does Not Apply

The Paycheck Protection Program Flexibility Act (the Flexibility Act), Public Law 116-132, brought significant changes to the Paycheck Protection Program. Among them is the designation of the program as an "emergency" for federal budgeting purposes.

Section 5 of the Flexibility Act reads as follows:

This Act is designated as an emergency requirement pursuant to section 4(g) of the Statutory Pay-As-You-Go Act of 2010 (2 U.S.C. 933(g)).

WHAT DOES THIS MEAN?

The Pay-As-You-Go Act was an attempt (however futile) in 2010 to control the growth of budget deficits by requiring Congress to "pay for" fiscal provisions added to the law by adding other provisions that would offset the costs of the initial provisions.

For example, we hear Democrats saying all the time, "How are we going to pay for tax cuts?" The idea of "paying for" a tax cut suggests that spending must be cut someplace else in order that no additional deficits would be added. However, Democrats will never cut spending—not by a single dime. Thus, they cannot possibly fathom the idea of a tax cut.

On the other hand, when additional spending is added to the budget, that spending must be "paid for" only with tax increases. The reason is that Democrats will simply not consider spending cuts in other areas to "pay for" the additional spending called for by the latest project.

THE "EMERGENCY" EXCEPTION

The Pay-As-You-Go Act contains an emergency exception, which is referenced above. Section 933(g)(1) of Title 2 of the United States Code reads in part, as follows:

> If a provision of direct spending or revenue legislation in a PAYGO Act is enacted as an emergency requirement that the Congress so designates in statute pursuant to this section, the amounts of new budget authority, outlays, and revenue in all fiscal years resulting from that provision shall be treated as an emergency requirement for the purposes of this Act.

Then in subsection (g)(4), the law reads:

> If a provision is designated as an emergency requirement under this Act, CBO or OMB, as applicable, shall not include the budgetary effects of such a provision in its estimate of the budgetary effects of that PAYGO legislation.

In other words, as long as Congress says there's an "emergency," and then enacts budgetary authority of any kind in response thereto, it simply doesn't matter what the provision costs. We don't even bother to ask what it costs, where the money will come from, who will pay, or how. That is what is meant in subsection (g)(4), where it says that the Congressional Budget Office (CBO) or the Office of Management and Budget (OMB) "shall not include" the effects of such legislation in any scoring reports on the proposed law that it issues.

The only way to counter the "emergency" designation is by a vote of a supermajority in the Senate, consisting of three-fifths of the members. See: 2 U.S.C. §933(g)(3)(B)(i). Such a majority is practically impossible.

What Has Covid Cost The Federal Government?

The Numbers are Staggering

In light of the Pay-As-You-Go "emergency" provision discussed in the preceding article, Senator Rick Scott (Rep., FL) tapped the CBO in an attempt to get a read on what the federal government's response to COVID through its various programs has cost. The report is stunning.

CBO director Phillip Swagel, in a letter dated June 5 to Senator Rick Scott, summarizes the various effects on revenue collection and spending at the federal level. Here are the highlights of the CBO's findings.

1. CBO has no idea how much federal tax revenue was lost due to COVID, whether and to what extent it will be collected in the future, or how much will be permanently lost.

2. It is estimated that collection of up to $200 billion in 2020 payroll taxes will be delayed for least two years, and as much as $12 billion will never be collected.

3. It is unknown the extent to which deferred business income taxes will or will not be collected in the future.

4. CBO expects that business and personal income taxes deferred until July 15, 2020, will be paid. However, it cannot anticipate how many businesses will be insolvent by then, and therefore will be unable to pay in full.

5. CBO estimates that the budget deficits as a result of all COVID-related legislation and business shut-downs will be $3.7 trillion in fiscal year 2020 and $2.1 trillion in 2021.

These deficits are two to three times higher than CBO's baseline projections from March 2020, which were issued just before the manure hit the ventilator.

6. The CARES Act will add $1.721 trillion in deficits.

7. The PPP alone will add $670 billion in deficits.

8. The individual $1,200 pre-paid tax credit will increase deficits by $292 billion over fiscal years 2020–2021.

9. CBO estimates that the additional $600 per week unemployment compensation benefit will increase deficits by a total of $267 billion in 2020 and 2021.

These numbers are, quite simply, staggering. I can only imagine the shrill cries we will hear for across-the-board tax increases to "pay for" this massive spending.

I am including the full text of Director Swagel's letter here. If you're like me, reading it will give you chills.

Looking Forward To The Next *PTT*

In the next issue of *PTT*, I will discuss at length the procedure for getting forgiveness of PPP loans. Don't miss it.

How You Can Ask Dan Pilla a Question

If you have questions or problems you'd like Dan Pilla to address, please write to Dan at:

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Write the word "newsletter" in the subject line.

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CONGRESSIONAL BUDGET OFFICE
U.S. Congress
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Phillip L. Swagel, Director

June 5, 2020

Honorable Rick Scott
United States Senate
Washington, DC 20510

Re: Budgetary Effects of the 2020 Coronavirus Pandemic

Dear Senator:

As you requested, this letter provides information about certain budgetary effects of the 2020 coronavirus pandemic and the federal government's response to it.

Effects of Tax Deferrals on Revenues

First, you asked about federal revenues that will be lost because of tax deferrals. As you noted, revenues collected since late March have been much weaker than those collected during the same period last year and also much weaker than the Congressional Budget Office projected earlier this year. The lower revenues result in part from the economic disruption caused by the pandemic, which has reduced wages and other taxable income, and in part from the government's actions to address that disruption.

The federal government's response included a variety of changes to tax rules. Some of them reduce the amount of taxes that businesses and individuals owe; others just allow taxpayers to defer paying taxes. CBO anticipates that most of the revenues affected by those deferrals will be collected in July, some will be collected in later years, and some will be permanently lost. CBO does not have an estimate of the amounts that fall in each of those categories.

Payroll Taxes. The Coronavirus Aid, Relief, and Economic Security (CARES) Act allows employers to delay their payments of payroll taxes—until 2021 and 2022—on wages paid from March 27, 2020, through December 31, 2020. That delay provides additional liquidity to businesses that may be facing reduced revenues or increased costs as a result of the pandemic. In effect, those firms have been provided an interest-free loan that equals a fraction of their payroll. The firms are obligated to pay half of the deferred payroll taxes on December 31, 2021, and the remainder on December 31, 2022.

The staff of the Joint Committee on Taxation (JCT) has estimated that the delay will reduce tax revenues in 2020 by over $200 billion. But by JCT's estimate, most of the payroll taxes deferred under the CARES Act will be paid in future fiscal years, so the net loss from the delay will be $12 billion.[1] The reason for that loss is that some of the affected firms will cease operations before they can make their payments, so some of the deferred taxes will not be paid.

Effect of Business Losses on Tax Liability. The CARES Act also temporarily modified the rules governing the use of business losses in determining tax liability. One change allows losses to result in the refund of income taxes paid for earlier years, not just for the following year, and another allows losses to reduce tax liability more than would have otherwise been the case. By allowing losses to be applied now rather than against future taxes, the changes give businesses liquidity now and increase the income taxes that they will pay in the future. As with other types of deferral of tax liability, if a business ceases to exist, its deferred taxes may not be paid.

Other Taxes. Deadlines for filing returns and paying taxes have been delayed for many other taxes. The Administration delayed the tax filing and payment deadlines for individual and corporate income taxes from April 15 to July 15, and it also delayed the due dates for estimated payments during that period. For excise taxes on wine, beer, distilled spirits, tobacco products, firearms, and ammunition that were originally due during the period from March 1, 2020, through July 1, 2020, the Administration delayed due dates by 90 days. And the Administration is allowing customs duties on some imports to be deferred for 90 days for businesses facing significant financial hardship.

CBO expects that most of the revenues that would have otherwise been paid when taxes were originally due will be paid by the new deadlines. In

[1] See Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. 748, the "Coronavirus Aid, Relief, and Economic Security ('CARES') Act," as Passed by the Senate on March 25, 2020, and Scheduled for Consideration by the House of Representatives on March 27, 2020*, JCX-11R-20 (April 23, 2020), https://go.usa.gov/xvQuv.

particular, CBO expects that most of the income tax revenues that would otherwise have been collected in the period from April through June, when taxpayers would ordinarily have filed their 2019 returns and made estimated payments of taxes for 2020, will be paid in July of this year. However, because some individuals or businesses may become insolvent and fail to make those payments, the government may not collect all of the deferred taxes.

Projected Federal Deficits for 2020 and 2021

You also asked how large CBO anticipates the federal deficit will be in fiscal year 2020. In late April, CBO provided preliminary projections of federal deficits in fiscal years 2020 and 2021, which took into account recent events and the enactment of pandemic-related legislation.[2] According to those projections, if laws currently in place governing spending and revenues generally remained unchanged and no significant additional emergency funding was provided, the federal deficit would be roughly $3.7 trillion in fiscal year 2020 and $2.1 trillion next year. (In CBO's March baseline projections, deficits were just over $1 trillion in each of those years.)

Those projected deficits are significantly larger than the budget shortfall in 2019 because of sharply lower revenues and substantially higher noninterest spending. Even though federal borrowing grows in those projections, declines in interest rates mean that net interest outlays are lower in both years than in 2019.

CBO will scrutinize its projections of federal revenues and spending over the next several months, and the budget outlook in the updated baseline projections that the agency plans to release in early September of this year may be significantly different from the estimates described here.

Budgetary Effects of Pandemic-Related Legislation

Finally, you asked what provisions enacted into law to respond to the pandemic were having the largest effects on the federal deficit. CBO has provided cost estimates for each of the four pandemic-related bills that were

[2] See Congressional Budget Office, "CBO's Current Projections of Output, Employment, and Interest Rates and a Preliminary Look at Federal Deficits for 2020 and 2021," *CBO Blog* (April 24, 2020), www.cbo.gov/publication/56335.

enacted through the end of May. The budgetary effects of those bills over the 2020–2030 period are as follows.

- The Coronavirus Preparedness and Response Supplemental Appropriations Act (Public Law 116-123, enacted March 6, 2020) is estimated to increase deficits by $8 billion.[3]

- The Families First Coronavirus Response Act (P.L. 116-127, enacted March 18, 2020) is estimated to increase deficits by $192 billion.[4]

- The CARES Act (P.L. 116-136, enacted March 27, 2020) is estimated to increase deficits by $1.721 trillion.[5]

- The Paycheck Protection Program and Health Care Enhancement Act (P.L. 116-139, enacted April 24, 2020) is estimated to increase deficits by $483 billion.[6]

Those laws would have the biggest impact on the budget in fiscal year 2020. The policies in those laws with the largest projected effects on deficits over the 2020–2030 period are as follows.

- **The Paycheck Protection Program (PPP)** provides funding to guarantee loans, which may be forgiven, to small businesses and other eligible entities to cover payroll and other eligible costs over eight weeks. The CARES Act provided a direct appropriation of $349 billion for the subsidy cost of guaranteeing and delivering PPP loans in 2020, and the Paycheck Protection Program and Health Care Enhancement Act increased the subsidy appropriation

[3] See Congressional Budget Office, cost estimate for H.R. 6074, the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 (March 4, 2020), www.cbo.gov/publication/56227.

[4] See Congressional Budget Office, cost estimate for H.R. 6201, the Families First Coronavirus Response Act (April 2, 2020), www.cbo.gov/publication/56316.

[5] See Congressional Budget Office, cost estimate for H.R. 748, the CARES Act, Public Law 116-136 (April 16, 2020), www.cbo.gov/publication/56334.

[6] See Congressional Budget Office, cost estimate for H.R. 266, the Paycheck Protection Program and Health Care Enhancement Act (April 22, 2020), www.cbo.gov/publication/56338.

for PPP by $321 billion in 2020, increasing deficits in that year by a total of $670 billion.

- **Recovery Rebates for Individuals,** which were provided by the CARES Act, consist of a refundable tax credit of $1,200 per person (or $2,400 for joint filers) plus $500 per dependent child under the age of 17. The credit phases out for taxpayers whose adjusted gross income is over $75,000 (or $150,000 for joint filers, or $112,000 for taxpayers filing as heads of households). JCT estimates that the credits will increase deficits by $292 billion over the 2020–2021 period.[7]

- **Changes to unemployment insurance,** which were included in the CARES Act, expand eligibility for unemployment compensation benefits and increase the weekly benefit amount and the number of weeks when beneficiaries can claim benefits. Major changes include creating the Pandemic Unemployment Assistance program to provide weekly benefits to unemployed people affected by the pandemic who would otherwise be ineligible for unemployment compensation benefits; temporarily adding $600 to the weekly benefit amount in unemployment programs; providing an additional 13 weeks of unemployment compensation benefits through the Pandemic Emergency Unemployment Compensation program to people who have exhausted regular benefits; and federally funding various other unemployment compensation benefits, as well as states' administrative expenses. Overall, CBO estimates that the changes to unemployment insurance will increase deficits by a total of $267 billion in 2020 and 2021.

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[7] See Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. 748, the "Coronavirus Aid, Relief, and Economic Security ('CARES') Act," as Passed by the Senate on March 25, 2020, and Scheduled for Consideration by the House of Representatives on March 27, 2020*, JCX-11R-20 (April 23, 2020), https://go.usa.gov/xvQuv.

Honorable Rick Scott
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I hope this information is useful. Please contact me if you would like further assistance.

Sincerely,

Phillip L. Swagel
Director

cc: Honorable Mike Enzi
Chairman
Senate Committee on the Budget

Honorable Bernie Sanders
Ranking Member
Senate Committee on the Budget