GMS Surgent
CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS

PPP Update: (1) Risk Factors and (2) Tax Impact

Risk Factors to Consider for PPP Loan Eligibility/ Certification

Numerous recent headlines have highlighted the distribution of PPP funds to large restaurant chains including Shake Shack, as well as other prominent public and private companies. Many have questioned the propriety of the eligibility requirements and the integrity and ethics of many organizations that have applied for funding. Unfortunately, this scrutiny is not limited solely to publicly traded companies and applies to all companies applying for PPP loans.

As discussed in our PPP Forgiveness webinar last Friday, guidance was issued the day before on 4/23 related to the PPP borrower certification that "current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." Click here for a link to the SBA FAQs.
https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf)

FAQ #31:

- The 4/23 guidance indicates that "Borrowers must make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business."
- Any borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith.

Additional related FAQs have since been posted:

FAQ # 37:

- Businesses owned by private companies with adequate sources of liquidity to support the businesses's ongoing operations should also refer to FAQ 31.

FAQ #39:

- To further ensure PPP loans are limited to eligible borrowers in need, the SBA will review all loans in excess of $2 million, in addition to other loans as appropriate, following the lender's submission of the borrower's loan forgiveness application.

There are potential risks of receiving these funds as these loans will be subject to regulatory and public scrutiny. Loan recipients will not remain anonymous as EINs will be made public. We anticipate heightened government scrutiny will be forthcoming to investigate potential fraud and abuse. Businesses who have received PPP loans and are later found to have not qualified under the eligibility rules and/or businesses who do not use the funding in accordance with the terms of the program, could be subject to significant legal or regulatory consequences. Further, businesses may experience reputational damage for having pursued these loans.

Given the revised guidance issued by the SBA and the pending May 7, 2020 deadline for returning loan proceeds, we strongly encourage you, your organization's management, and board of directors to carefully and immediately review your company's financial situation and reconsider the relief you may have already received with a PPP loan. Specifically, consider whether your circumstances fall within the spirit and intent of this economic relief program. If you do receive and keep PPP funding, it is critical that you maintain complete and accurate documentation to support your eligibility for such funding, the specific use of these funds, as well as your qualifications for forgiveness under the terms of the program. This documentation will be crucial were your business to be audited and/or investigated. This defensive documentation will greatly minimize your potential exposure to fraud and abuse allegations related to your participation in this loan program.

GMS comment:

- This provides a safe harbor - if you now believe your company does NOT demonstrate the necessity for the loan, you can repay the loan in full by May 7, 2020, no questions asked.
- If you DO believe your company is eligible for the loan and decide to keep the funds, you should take affirmative steps now to document the need.

The new guidance introduces the need to consider additional factual issues management needs to assess. Unfortunately, these factual determinations also may require legal interpretations of terminology used in the new guidance. If you are concerned that your company could be at risk under this new guidance or you have questions as to the impact of the new guidance upon your outstanding or pending PPP loan or application, we strongly encourage you to contact your legal advisors as soon as possible. We're happy to help you and your legal advisors in your assessment of the factual issues and in your determination of the actions to be taken as a result of such guidance.

Tax Impact: Forgiven Costs Nondeductible

Last night, the IRS issued Notice 2020-32, https://www.irs.gov/pub/irs-drop/n-20-32.pdf} which clarifies that no tax deduction is allowed for an expense paid with non-taxable PPP forgiveness funds.

The CARES Act specifically indicated that the forgiveness income would not be taxable, but it was silent as to the tax treatment of the related deductions. The IRS invoked Section 265 of the tax code, which says that deductions can't be taken if they are tied to tax-exempt income.

Congress could override the IRS ruling by passing a law that specifically allows the deduction, which it has done in other cases. But unless that happens, the income will not be taxable and the expenses paid will not be deductible. State tax treatment may vary.