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**What Small Businesses Need to Know Now:
Just Released – SBA and IRS Guidance on PPP
Loan Compliance and Safe Harbor Tipping Point -
Is Your PPP Loan \$2 Million or More?**

- Recipe for Anxiety. A wise friend once counselled: “The perfect recipe for anxiety is to give someone responsibility for making a crucial decision while also withholding the facts necessary to make that decision.”
- Has Help Arrived? On May 13, 2020, the Small Business Administration (“SBA”) and Internal Revenue Service (“IRS”) released long-awaited guidance for small businesses regarding how SBA will audit a borrower’s required good-faith certification concerning the necessity of its Paycheck Protection Program (“PPP”) loan request.
- Maybe. Buckle up and read on.

Brief History of PPP

- On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) established the PPP, which is a forgivable loan program.
- The purpose of the PPP is to address eligible borrowers’ critical financial needs and keep their employees on the payroll during these unprecedented times.
- Under the PPP, borrowers may only use the PPP loan proceeds for the following permissible purposes: payroll costs, rent, utilities, and payment on mortgage interest during the 8 weeks from the date of disbursement of the loan.

- Initially, the guidelines were relaxed for the PPP compared to historical SBA borrowing requirements.
- Required Borrower Certifications. The PPP loan application requires applicants to make the following certifications in good faith when applying for the PPP loan:
 - “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”
 - Recently, SBA redefined “economic uncertainty” to require applicants to assess:
 - 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.
 - “The funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under the Paycheck Protection Program Rule; I understand that if the funds are knowingly used for unauthorized purposes, the federal government may hold me legally liable, such as for charges for fraud.”
- Adverse Impact. Because there is a presumption that an applicant has been adversely impacted by COVID-19, an applicant must demonstrate that COVID-19 affected the applicant in an increased or distinctive manner.
- Frequent Updates. SBA and IRS have been providing some guidance on the PPP loans through published [Frequently Asked Questions \(“FAQs”\)](#) (as of this writing, the latest update was May 13, 2020), which may be relied upon by borrowers as SBA’s interpretation of the PPP.
- Loan Repayment Safe Harbor. SBA promulgated a limited safe harbor: any borrower that applied for a PPP loan prior to April 23, 2020 and repays the loan in full by May 14, 2020 (extended from May 7, 2020) “will be deemed by SBA to have made the required certification in good faith.” See FAQs #31 and #43.

- Increased Borrower Uncertainty. Notwithstanding the benefits of the PPP, potential applicants and borrowers should be aware that applying for the PPP loan and retaining the PPP loan proceeds may involve federal criminal and civil risk. Recent reports state that the Department of Justice’s (“DOJ”) Fraud Section’s Market Integrity and Major Fraud Unit is currently conducting a criminal review of the PPP loan applications for evidence of material misrepresentation or fraud in borrowers’ PPP loan applications. In addition, Treasury Secretary Steve Mnuchin warned that SBA would audit all loans over \$2 million, in addition to other loans as appropriate.
- Borrower Reassessment. Because of this limited safe harbor and the statements made by public officials, borrowers and potential applicants should carefully assess whether any potential long-term risks outweigh the short-term benefits of receiving PPP funds.
- Risk/Benefit Analysis. In addition to criminal liability, borrowers and potential applicants should also be aware of the potential civil liability and reputational harm of applying for, retaining, or returning the PPP funds.

Latest Guidance from SBA and IRS
(One Day Before the Repayment Safe Harbor Deadline)

- Safe Harbor Tipping Point. “Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith.” See FAQ #46.
- Loans Greater than \$2 Million. “Importantly, borrowers with loans greater than \$2 million that do not satisfy this safe harbor may still have an adequate basis for making the required good-faith certification, based on their individual circumstances in light of the language of the certification and SBA guidance.” See FAQ #46.
- SBA Review of Loans. “If SBA determines in the course of its review that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness.” See FAQ #46.
 - “If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or

referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request.” See FAQ #46.

Possible Action Steps for PPP Loan Applicants and Borrowers

Unfortunately, this most recent SBA/IRS update sheds no light on how to best defend your loan certifications. And given the shifting PPP regulatory landscape, it is nearly impossible to provide an exhaustive list of factors that may help evidence a borrower’s need for a PPP loan. Nonetheless, regardless of the amount of your PPP loan, some important possible analyses and actions steps to consider are:

- Pre-Funding Considerations. If you have not yet submitted a PPP loan application:
 - Evaluate and create a contemporaneous, detailed memorandum, with supporting documentation, addressing the points below in support of your “necessity” certification. The format of the memorandum should be an internal report of key issues for review by management, should emphasize facts specific to your business, and reflect a tone accurately evidencing the genuine concerns within your management team at the time of the loan application. Pro Tip: Better to create a contemporaneous document now than later face the scrutiny of an auditor armed with hindsight in an unexpectedly improved economy.
 - Business Financial Condition.
 - What is your present business financial condition? What are your business’s long and short term risks and needs?
 - What are the specific facts and circumstances evidencing that your business has endured financial hardship and faced economic uncertainty due to COVID-19?
 - What is the impact of COVID-19 and the work-from-home orders on your business operations? Were there contract cancellations, decline in demand, reduction in business, outbreak at any

location, increased costs, facility closings, or changes in the workforce?

- Is or will there be a reasonably foreseeable need to reduce wages, or lay off or furlough employees, if you do not obtain the PPP loan? Are you unable to retain, recruit, or train employees?
- Can you prepare financial forecasts and reforecasts through the end of 2020 that project the business's liquidity position and effect on the business operations if you do not obtain PPP funds and that demonstrates that a PPP loan was necessary to support the ongoing business operations?
- Are there any industry publications that provide economic or financial forecasts that you rely upon in making financial decisions for your business?

- Liquidity Position and Borrowing Capacities.

- Do you have available resources, such as cash on hand or a line of credit? Are those resources earmarked for other uses or do you have other priorities? Why is additional financial support needed?
 - Do you have the ability to obtain capital from other sources, such as your current lender(s) and equity holders? Are existing and available credit facilities sufficient to meet projected liquidity needs at a reasonable cost and other terms? Do your internal governing agreements provide the ability to require capital contributions or loans from the equity holders on reasonable terms?
 - Can you reasonably use the capital obtained from other resources to pay employee's wages and benefits?
- Determine and document how you plan to use the PPP funds.

- Submit the foregoing financial summaries and the PPP loan application to your board of directors or other governing body for review and approval and memorialize those discussions.
- Post-Funding Considerations. If you have already received the PPP loan proceeds:
 - Complete the steps under Pre-Funding Considerations above, if you have not already done so.
 - Keep the PPP funds in a separate bank account.
 - At the beginning of each week for the 8-week period, consider defining PPP expenses that are planned for the week ahead and then at the end of the week, finalize and approve the expense report, amount listed, and at that point, reimburse that corresponding amount back to your business operating account. Keep copies of the relevant invoices.
 - Consider holding meetings of the board of directors or other governing body to reassess the business's eligibility and evaluate the potential risks and benefits of retaining and utilizing the PPP funds.
 - Disclose to all of the owners the business's financial health and response action plans, ensuring that you are making certifications to the government in good faith.
 - Consider any impacts on the business's reputation of accessing PPP loan proceeds, especially if your eligibility is likely to be challenged.
 - Practice "email hygiene." Do not send emails or other written communications that could later be inaccurately construed to contradict your need for the PPP loan?
 - Limit your discretionary spending during the loan period, such as retreats and sponsorships, and carefully consider the necessity of capital expenditures to grow the business or acquire other businesses. Analyze whether you would make the expenditure if the PPP loan proceeds were unavailable. If yes, then make a contemporaneous record explaining your justification.

Summary Observations

Borrowers and potential applicants should carefully consider the new guidance from SBA and IRS, appropriately memorialize, with supporting documentation, their good faith determination of need, and be ready to demonstrate the qualifying basis for applying for the PPP loans and use of the loan proceeds. Ultimately, the written substantiated record, approved by the borrower's board of directors or other governing body, could help evidence that a bona fide, good faith effort was undertaken to support the borrower's certifications in the PPP loan application.

If you have concerns about PPP loan application certifications or your eligibility for a PPP loan and repayment forgiveness, we recommend that you consult your attorney and your CPA, accountant, or other tax advisor. Please feel free to contact us if you have any questions or if we can otherwise be of assistance.

We wish you good health and continued success with your business.

We are here to help,

Jim, May, and Shama

Index of Our Prior COVID-19 Updates:

- May 5, 2020 – [What Small Businesses Need to Know Now: IRS and DOJ Raise Concerns Regarding PPP Loan Eligibility](#)
- March 30, 2020 – [What Small Businesses Need to Know Now: Just Released – Small Business Owner's Guide to CARES Act Programs/New Effective Date for Family Leave Requirements.](#)
- March 27, 2020 – [What You Need to Know Now: Just Announced SBA Low-Interest Working Capital Loans for Small Businesses.](#)
- March 20, 2020 – [What Small Businesses Need to Know Now – New Paid and Unpaid Leave Requirements for Coronavirus Absences.](#)

James P. O'Sullivan



Biography

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Biography

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Biography

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