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MEMORANDUM

TO: SBA PPP Loan Recipients

FROM: B. Lanigan & T. Harrison, L&A Task Force

RE: Update Number 3 regarding PPP Loans and FAQ 46 & 47

DATE: May 19, 2020

On April 20, L&A's PPP task force sent our first memo regarding suggested accounting and documentation of the PPP loans. Since then, SBA has updated Frequently Asked Questions (FAQ) and the IRS issued a Notice regarding the deductibility of the covered costs if indeed the Payroll Protection Program (PPP) loans are forgiven. On May 1, the L&A task force sent our second memorandum regarding SBA FAQ #31 and IRS Notice 2020-32.

Recently the SBA has issued several more updates including FAQ 46 & 47, (see attached) that this L&A memorandum addresses. We suggest you read these important FAQ's carefully. Of course, we are available to discuss any questions you have regarding your specific situation and the FAQ's etc.

FAQ's 46 & 47 are directly related to FAQ #31 (Attached), which provides a safe harbor to "*businesses owned by large Companies with adequate sources of liquidity*" if they repay the loan by May 7, which was extended to May 14, then again to May 18. The extension to May 18, was made in FAQ #47.

FAQ #46 is both good news and bad news. As we discuss below, it is good news for PPP Loans less than 2 million (\$2MM), and generally bad news for PPP Loans of more than \$2MM. We refer you back to our May 1, L&A update #2 memorandum for a complete discussion of FAQ Question #31. In addition, we want to reiterate you should document your business specific economic uncertainty¹ at the time of the application by a contemporaneous memorandum and related supporting documentation file. **A member of our L&A task force would be happy to review and discuss your internal memorandum with you.**

FAQ #46 is good news for PPP Loans of less than \$2MM. SBA says that recipients of PPP loans of less than \$2MM dollars, together with its affiliates,² **are deemed to have made good-faith certification of necessity for PPP loans (safe harbor).** “*The SBA has determined this safe harbor is appropriate because borrowers with loans below this threshold are generally less likely to have had access to adequate sources of liquidity in the current economic environment than borrowers that have obtained larger loans.*” **This FAQ #46 safe harbor appears to effectively remove the need for consideration of certification of necessity, or whether to pay back the PPP Loan at this time, due to a question of necessity as certified, under the new safe harbor for loans under \$2MM.**

The bad news for Loans over \$2MM. FAQ 46 says: “*SBA has previously stated that all PPP loans in excess of \$2MM and other PPP loans as appropriate³, will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form. If SBA determines in the course of its review that*

¹ See SBA FAQ #31 regarding economic uncertainty and necessity of the loan in good-faith.

² For purposes of this safe harbor, a borrower must include its affiliates to the extent required under the interim final rule on affiliates, 85 FR 20817 (April 15, 2020).

³ We are not sure what this means, other than those borrowers with substantial resources.

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.”

Therefore, for loans of \$2MM or more, we believe the standard of review (audit?) will be much higher by the SBA for the loan to be forgiven. We believe the review/audit of the **initial certification** of the necessity of the loan will be a substantial part of the review/audit. You will have to prove that you needed the loan and had an adequate basis to make the necessity certification! Therefore, we believe you must be prepared to prove the necessity of the loan and have contemporaneous documentation such as financial proformas, internal memorandums, and other “what if scenarios” or sensitivity analysis to support your certification so that you can qualify for forgiveness of the PPP loan.

Even if the “disbursement requirements” are met not all loans will be forgiven! FAQ 46 goes on to say: *“If the borrower repays the loan after receiving notification from SBA that the loan is not eligible for forgiveness (L&A i.e., it does not meet the necessity test for certification), 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.”* **This is good news even for borrowers over \$2MM** because it clarifies that the worst case scenario is that if they are denied forgiveness after SBA review, they would have to repay the loan, and if they do repay the loan, there would be no further action or other legal liability related to the loan. **It also implies that some loans will not be forgiven based on necessity for the loan at the time of application.**

FAQ 46 also says: *“Importantly, borrowers with loans greater than \$2Million that do not satisfy this safe harbor may still have 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.”* This leave’s many questions regarding certification of the necessity, in the application and subsequent forgiveness which we think will likely be reviewed/audited by the SBA for loans over \$2MM and some under \$2MM (may be considered “as appropriate”³).

Recommended Immediate Action Steps

1. Prepare internal memorandum (contemporaneous with the date of application is key) to document your business’ economic uncertainty and necessity of the loan to support operations and retain employees, etc. We feel this should include any supporting documents including financial proformas to document your loan need, and any considerations you had for laying off employees or furloughs.
2. If your PPP Loan is less than \$2MM, we reiterate drafting an internal memorandum of your business’ economic uncertainty and loan need as of April 3, 2020 or the date of your application if later, and continue to follow the guidance we have previously suggested in our first 2 memos including: a) segregation of PPP loan proceeds to facilitate discrete accounting for the funds, b) rigorous documentation of covered costs.
3. If your PPP Loan is more than \$2MM, in addition to the steps above, you will need to prepare for a review/audit of your loan by the SBA to determine your original eligibility for the loan and subsequent forgiveness. You should include detail financial proformas referenced in the internal memo and other supporting documents, to support your certifications of the necessity due to economic uncertainty, etc. on the PPP application and the Loan Forgiveness Application.

In closing, our L&A task force is happy to review your internal memorandum, other documentation and make recommendations thereto as appropriate, for inclusion in your documentation file. Each internal memorandum and supporting documents should be specific to your facts and circumstances of your situation and business.

Also, we reiterate our recommendation to reread FAQ #31 as well as FAQ #46.

We expect additional rulings, notices and FAQ's to be issued. When they are issued, we will review and advise you of our interpretation and update any previous advice we have issued.

****As we write this memorandum, The SBA has just issued the “Loan Forgiveness Application,” and our next communication will be based on our review of this document.**

Enclosures
SBA FAQ #31
SBA FAQ #46
SBA FAQ #47

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Attachment

FAQ #31 (Question 31, published April 23, 2020)

Question: Do businesses owned by large companies with adequate sources of liquidity to support the business's ongoing operations qualify for a PPP loan?

Answer: In addition to reviewing applicable affiliation rules to determine eligibility, all borrowers must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application. Although the CARES Act suspends the ordinary requirement that borrowers must be unable to obtain credit elsewhere (as defined in section 3(h) of the Small Business Act), borrowers still must certify in good faith that their PPP loan request is necessary. Specifically, before submitting a PPP application, all borrowers should review carefully the required certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”

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. For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.

Lenders may rely on a borrower's certification regarding the necessity of the loan request. 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.

FAQ #46 (Question 46 published May 13, 2020.)

Question: How will SBA review borrowers required good-faith certification concerning the necessity of their loan request?

Answer: When submitting a PPP application, all borrowers must certify in good-faith that “[c]urrent (sic) economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” SBA, in consultation with the Department of the Treasury, has determined that the following safe harbor will apply to SBA’s review of PPP loans with respect to this issue: Any borrower that, together with its affiliates,²⁰ 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.

SBA has determined that this safe harbor is appropriate because borrowers with loans below this threshold are generally less likely to have had access to adequate sources of liquidity in the current economic environment than borrowers that obtained larger loans. This safe harbor will also promote economic certainty as PPP borrowers with more limited resources endeavor to retain and rehire employees. In addition, given the large volume of PPP loans, this approach will enable SBA to conserve its finite audit resources and focus its reviews on larger loans, where the compliance effort may yield higher returns.

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. SBA has previously stated that all PPP loans in excess of \$2 million, and other PPP loans as appropriate,

will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form. 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. 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. SBA's determination concerning the certification regarding the necessity of the loan request will not affect SBA's loan guarantee.²¹

Footnotes:

²⁰ For purposes of this safe harbor, a borrower must include its affiliates to the extent required under the interim final rule on affiliates, 85 FR 20817 (April 15, 2020).

²¹ Question 46 published May 13, 2020.

FAQ #47(Question 47 published May 13, 2020.)

Question: An SBA interim final rule posted on May 8, 2020 provided that any borrower who applied for a PPP loan and repays the loan in full by May 14, 2020 will be deemed by SBA to have made the required certification concerning the necessity of the loan request in good faith. Is it possible for a borrower to obtain an extension of the May 14, 2020 repayment date?

Answer: Yes, SBA is extending the repayment date for this safe harbor to May 18, 2020, to give borrowers an opportunity to review and consider FAQ #46. Borrowers do not need to apply for this extension. This extension will be promptly implemented through a revision to the SBA's interim final rule providing the safe harbor.