

MEMORANDUM

TO: PPP Recipients
FROM: B. Lanigan & T. Harrison
RE: Update Number 2 regarding PPP Loans and Emerging Guidance
DATE: May 1, 2020

First from the Treasury FAQ #31:

31. 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 "Current 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.

L&A Comments: This guidance has caused many of our clients to be concerned about the certifications they made on the PPP application. The language of the actual statute should be kept in mind. It only requires that at the time of the application, *the borrower certify in good faith that due to the uncertainty of current economic conditions, the loan request is necessary to support ongoing business operations.* For those applying for loans in the initial wave after April 3, given what was know at the time, and considering the level of uncertainty, it would be fair to say that almost every small business owner in the country could honestly answer that question “yes.” We do expect additional clarification on this issue, and currently we believe the worst-case scenario is that the loan would not be forgiven and would have to be paid back in two years. Still, we have had some clients decide to pay back the loan after considering their needs. For clients who are concerned about their need for the loan or the subsequent forgiveness of the loan, we suggest you adhere to the strict documentation and accounting we suggested in our April 20, 2020 memorandum. **In addition, we think you should document your uncertainty at the time of the application by a memorandum to your documentation file.**

Second, IRS Notice 2020-32.

This notice provides guidance regarding the deductibility for Federal income tax purposes of certain otherwise deductible expenses incurred in a taxpayer’s trade or business when the taxpayer receives a loan (covered loan) pursuant to the Paycheck Protection Program. Specifically, this notice clarifies that **no deduction** is allowed under the Internal Revenue Code (Code) for an expense that is otherwise deductible if the payment of the expense results in

forgiveness of a covered loan and the income associated with the forgiveness is excluded from gross income.

L&A Comments: The IRS ruling clarifies the ambiguity from the law and follows court cases and historical precedent consistent with settled tax law that expenses related to tax exempt income are not deductible. Some members of Congress have already stated that this was not their intent so perhaps a new law could change the deductibility of these expenses. **This does potentially change the accounting for the covered costs as suggested in our April 20, 2020 memorandum.** Because of the meticulous documentation we have suggested it should be easy to identify and reclassify in your books and records the non-deductible expenses associated with the loan forgiveness. **At this time, and until the loan is actually forgiven, we suggest you continue to account for your covered expenses in a manner consistent with how you have always accounted for these expenses. If, and when, the loan is forgiven and the forgiven amount is reclassified to non-taxable income, then we believe it would be appropriate to reclassify an offsetting amount to nondeductible expense.**

We expect additional rulings, notices and Frequently asked questions to be issued. When they are, we will review them and advise you of our interpretation and update any previous advice we have issued.