

Surety Bond Quarterly

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PPP and the Rollercoaster Ride of Changes

By James Miller and James Wiedemann

Changes related to the COVID-19 crisis and the construction and surety industries are still occurring; some data in this article may have changed from the time of article submission and the publication date.

The day was Wednesday, March 11, 2020, as we sat with our audit team at a restaurant in Boston, Massachusetts. Across the news we heard that the National Basketball Association was cancelling a game due to COVID-19. Over the prior two weeks, we had all heard rumblings about this new virus; but this one event caused the world at large to realize this was something to be taken much more seriously. A few days later, our firm closed its offices nationwide, much like many other companies, and began the era of working remotely, for what many of us thought would be a week. A week turned into months, and a year later many companies are still battling with restrictions and figuring out this “new norm.”

As various industries began to shut down operations, the construction industry tried to identify which trades and jobs would be deemed “essential” and allowed to continue work. We began working with a lot of our construction clients, talking about how they were going to navigate through all of the pandemic restrictions, health concerns, project delays, and shut-downs. Prior to the pandemic, finding skilled labor was one of the biggest challenges that contractors nationwide faced, so keeping their skilled workers, in whom companies had made a significant investment to recruit, was top of the list.

While construction companies are still discussing change orders with owners over these additional costs, in the short-term the construction industry, along with almost every other industry, turned to the federal government for relief. On March 27, 2020, the \$2.2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law, which included the \$349 billion Paycheck Protection Program (PPP). The PPP provided small businesses the opportunity to obtain loans backed by the Small Business Administration (SBA) which, if spent on eligible payroll and non-payroll costs, would be forgivable. The PPP was advertised as a “win” by Congress and the federal government, and all small businesses eligible under the CARES Act were encouraged to apply.

Businesses flocked to their banks for applications, feeling confident that the advertised PPP was their golden ticket to help them through the pandemic. But there were items within the PPP program and CARES Act that were subsequently clarified by the SBA and IRS and that now present a significant challenge for borrowers.

A Forgiven PPP Loan Will NOT be Taxable ... Or Will It?

The CARES Act includes provisions stating that a forgiven PPP loan will not be included as taxable income on a company's tax return. For businesses shut down by the pandemic, the cash infusion helped keep people employed while the company was generating little to no operating income. On April 30, 2020, after many businesses had begun spending their PPP funds, the Internal Revenue Service (IRS) issued Notice 2020-32, announcing that while the forgiveness of a loan in it of itself does not create taxable “income,” borrowers cannot deduct expenses funded by the loan, thus rendering otherwise deductible expenses non-deductible; this, in essence, makes the loan taxable. So, for example, if a contractor ended the year with a net loss of \$100,000 due to the COVID-19 slow-down, but received a PPP loan for

\$150,000, the business would have non-deductible expenses of \$150,000 that would actually result in taxable income of \$50,000 and the contractor having to repay a portion of the PPP loan in the form of taxes. This has created a lot of anxiety and frustration for companies that received a PPP loan, feeling that they were misled. Under pressure, Congress began considering a response to the IRS ruling that the PPP was not intended to be a “taxable” event, whether through income or the non-deductibility of the related expenses.

More updates from the SBA were subsequently released regarding the timing and forgiveness of PPP loans, but there was no response from Congress on the tax issue. Despite the IRS ruling, there was still much uncertainty as to when the expenses funded by PPP loans were considered non-deductible: in the year incurred or in the year of legal forgiveness. Existing IRS guidance provided many companies with the idea that the forgiveness of a loan and non-deductibility of expenses are tied to legal release from the SBA. Many contractors decided to take a “wait and see” approach to PPP forgiveness, not rushing to apply for forgiveness with the bank or the SBA and instead applying for forgiveness in 2021 while incurring the expenses in 2020.

In November 2020, the IRS and the Treasury Department closed the door on this thought process, stating, “If a business reasonably believes that a PPP loan will be forgiven in the future, expenses related to the loan are not deductible, whether the business has filed for forgiveness or not.” Many contractors were in the middle of year-end tax planning and had more certainty that the taxability of the PPP is a 2020 issue, potentially requiring significant cash flow for companies in the near term, whether paying quarterly estimates or year-end April 15, 2021, liabilities, to avoid underpayment penalties and interest. All of which answers the question: the loan is taxable.

Then in late December 2020, Congress passed new legislation that further clarified the original intent of the PPP and declared that the forgiveness itself will not be taxable and the expenses that were funded by PPP proceeds submitted for forgiveness are also tax deductible, therefore rendering the IRS ruling invalid. Entities that received these loans were now able to take a deep breath and not worry about the tax consequences that arose from what was initially thought to be a tax-free program. As part of this new legislation, Congress also provided additional funding for the PPP whereby entities could submit for a second PPP loan. Part of the provisions aimed to provide funding to those entities most deeply impacted by the pandemic, which was determined to be entities whose revenues decreased by more than 30 percent. In addition the maximum loan balance was now set to \$2 million and the maximum number of employees at the company was capped at 300.

Getting the PPP was a “Must” for My Business ... Or Was It?

Congress, the Treasury Department, and the government urged all small business to take advantage of the PPP program as the lifeline to help them through these uncertain times. The number of PPP loans issued by the SBA during Round One of the PPP far exceeded the agency's expectations, resulting in a Round Two of funding. After many companies applied, received, and began using PPP funds to pay for expenses, the SBA issued guidance challenging the “need” claimed by all companies on their loan applications and requiring additional certifications by borrowers based on the current environment and economic necessity. While many companies had cash in the bank, the necessity for loans was based on government shut-downs, uncertainty of cash flow, and collection of receivables, presenting companies with decisions about whether to lay-off or furlough employees. The PPP loan provided companies with the certainty to pay employees.

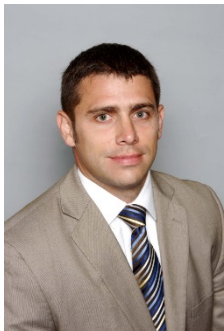
In November 2020, the SBA released a loan necessity questionnaire, requiring all borrowers with PPP loans in excess of \$2 million to complete, as well as certain borrowers under \$2 million selected randomly for an audit by the SBA. What is included in this questionnaire? From the SBA's standpoint, it is providing a “pre-audit” roadmap to the borrower's certification of the need for the PPP loan at the time of original application. The issue that many organizations have with the necessity questionnaire is that any

circumstances occurring after the certification was made and throughout the pandemic should have no bearing on evaluating a company's good faith statement at the time it made the certification. For contractors, keeping money in the business (building equity), making investments in its people, and maintaining cash by billing ahead of the schedule of values has always been a best-practice approach to building a strong company. The necessity questionnaire focuses on cash balances, which can be restricted based on a contractor's overbilling, revenue reduction tests, and other liquidity tests to assess a company's financial standing. Borrowers and associations feel the questionnaire signals bias against PPP borrowers who have managed to weather the uncertainties of the pandemic and to survive or remain profitable, ultimately penalizing these businesses by prioritizing forgiveness.

This has caused many organizations to rethink what should be done with regard to forgiveness of their loans. Companies are determining whether it will be better simply not to submit for forgiveness and just repay the loan at 1% interest. It is worth noting that the PPP debt was adjusted from a 2-year term to a 5-year term to assist entities with repayment.

Other organizations within the construction industry also have to think about what submitting for reimbursement means overall. For entities that operate in the architectural and engineering space, a lot of work is performed using a Federal Acquisition Regulation (FAR) rate. This rate is calculated utilizing certain expenses incurred by the entity. One point of discussion is that, to the extent that expenses are utilized for forgiveness under the federal PPP program, those same expenses must not be included under the FAR calculation. Therefore, entities have to consider if having these balances forgiven (which as of now will result in taxable income) will also lower their FAR rate to a level that makes submitting for forgiveness actually cost more than simply repaying the loan.

While more about the PPP program has been learned since April 2020, the core of the program was always the need to supply businesses with cash in the short-term to help ensure that doors could remain open. There are many people who, looking back at the numerous changes to the program, may not have taken the money initially; but in large part the program has helped many businesses. Entities should consult with their trusted advisors to explore the pros and cons of submitting for forgiveness with the taxable feature and make sure to properly support the certifications made to avoid surprises in the future.



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