
CARES Act: To Accept, or Not to Accept (and Refund) Paycheck Protection Program Loan

Updated: May 14, 2020

Since the CARES Act rolled into effect on March 27, 2020, some borrowers have experienced substantial scrutiny, whether from internal or outside sources, as to their good faith qualification for the Paycheck Protection Program (PPP) loans.

Under the CARES Act, eligible recipients must “make a good faith certification” that, among other things, the **uncertainty of current economic conditions** makes **necessary** the loan request to support the ongoing operations of the eligible recipient. The certifying borrower also must acknowledge that the PPP loan funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments. These certification requirements open the door for a government audit of matters such as “necessity” for a PPP loan, amount of PPP loan, and use of PPP loan funds.

On April 23, 2020, and then on at least seven occasions thereafter, the Small Business Administration (SBA) issued guidance in the form of Frequently Asked Questions. The SBA stresses the “necessity” requirement for eligibility of a PPP loan, primarily in Questions 31, 37, 39, 43, 46 and 47 of the [SBA FAQs issued on May 13, 2020](#):

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: . . . [A]ll 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. . . . **[B]orrowers 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. . . .

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. . . .

43. Question: FAQ #31 reminded borrowers to review carefully the required certification on the Borrower Application Form that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” SBA guidance and regulations provide that any borrower who applied for a PPP loan prior to April 24, 2020 and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith. Is it possible for a borrower to obtain an extension of the May 7, 2020 repayment date?

Answer: SBA is extending the repayment date for this safe harbor to May 14, 2020. Borrowers do not need to apply for this extension. . . . SBA intends to provide additional guidance on how it will review the certification prior to May 14, 2020.

In the SBA FAQs issued on May 13, 2020, the SBA stated in FAQ No. 47 that the SBA extended the safe harbor date to May 18, 2020, and in FAQ No. 46, the SBA further addresses the “good faith” standard. For all loans less than \$2 million, the SBA will assume the borrower determined in good faith that it met the requirement for the PPP loan. For loans of \$2 million or more, the SBA indicates it will examine whether the borrower met the standards for the loan. If the SBA determines that the borrower does not qualify, it will demand repayment of the loan. If the borrower repays the loan, then the SBA will not pursue any other remedies.

Granted, the SBA’s FAQs do not carry the force and effect of law independent of the CARES Act and regulations on which the FAQs are based. Still, some in Congress and now the SBA according to its FAQs, are promising audits for those receiving funds through the PPP loan program to ensure the “necessary” requirements were applicable for the borrower.

Moreover, several criminal statutes could be triggered upon submission of a fraudulent or false PPP loan application, and there are avenues for a whistleblower to bring a purportedly false or fraudulent PPP loan application before a court of law or regulatory agency such as the Department of Justice or the Security and Exchange Commission. These judicial and agency-related procedures place the borrower and those who approve or certify the PPP loan application at risk of criminal prosecution and civil liability.

According to Secretary Mnuchin, liquidity is a critical factor in the certification. Some eligible recipients are more “liquid” than others. But the depth of liquidity is, in most situations, certainly “uncertain” when it comes to meeting the goals intended by the PPP loans; that is, maintaining payrolls through the applicable eight-week covered period to be funded by the PPP loan as the COVID-19 period continues.

PPP loan certifications revolve or focus on these core factors: borrower qualification as an “eligible recipient”, necessity for the loan, loan amount, and qualified uses once PPP loan dollars are disbursed to a borrower.

For the loans of more than \$2 million (and even for all others, just in case of audit), documentation is the primary key to substantiating the good faith certification for a PPP loan, and showing as much is not a perfect science. To substantiate a good faith certification under the CARES Act, borrowers will inevitably turn to an innumerable list of factors applicable to the borrower’s business or commercial activity, including, but not limited to, its financial state, access to credit lines, customer base, supply chain challenges, COVID-19-related government orders affecting a specific locality, uncertainties about future business, remote-working capabilities and other employment-focused and revenue-producing conditions.

Borrowers should have documented their state of affairs before applying for a PPP loan. Still, it is likely not too late to take a look back and account for the state of business

affairs that existed when the PPP loan application was submitted to the applicable lender. The borrower should document the risks and uncertainties that led the borrower to apply for the PPP loan, such as cash on hand, anticipated and actual revenue declines, and other factors. Borrowers should also document its efforts to keep their employees compensated during the foreseeable future, even when work was not available. The borrower should document how various government policies adversely affected the borrower's ability to continue in business. Measure and document (such as through an internal memorandum) the adverse impact after March 15 (or the shutdown date for the borrower's location(s)) when the government policies came into effect.

To be forgiven, PPP loan proceeds must be used for qualified uses within the borrower's applicable "covered period". The eight-week period begins on the date the lender makes the first disbursement of the PPP loan to the borrower. Borrowers should consider placing PPP loan proceeds in an account separate from general use funds. Borrowers should consider using the PPP loan proceeds on qualified PPP payroll costs before using the borrower's general use fund account. Not more than 25 percent of the loan forgiveness amount may be attributable to non-payroll costs. Borrowers should consider requesting that their lender provide information or guidance as to what the lender will require at the end of the 8-week covered period for forgiveness purposes. Request any application for forgiveness form, if there is any.

If the borrower's accounting software permits, consider creating a COVID cost center for qualified costs. Essentially, borrowers should make sure the PPP loan uses are adequately traced and documented in a systematic manner. Contact payroll administration (internal or external, as applicable) to ensure the borrower can easily extract payroll information within the covered period that are funded by PPP loan proceeds. Borrowers should establish a systematic process for transfers of funds to cover the costs permitted for a PPP loan to be forgiven.

In closing, borrowers should carefully and systematically document the "necessity" qualifications for a PPP loan as well as the uses of the loan proceeds to establish how those government funds were used to their intended purposes – to keep Americans employed in a most uncertain period of economic conditions. A borrower or its control persons may not be willing to accept the risk that comes with certification for a PPP loan, including for forgiveness and possible audit purposes. In that case, the borrower, per SBA FAQs issued on May 13, 2020, has until May 18, 2020, to repay the loan in full, and the SBA will, according to its FAQs, deem that the borrower made the required certification in good faith.

DISCLAIMER. This article does not constitute, nor should it be construed as legal or tax advice. Any external websites or links provided in this information article are not intended to support private or commercial organizations or businesses. They are provided for information purposes only. WKPZ does not guarantee, approve, or endorse the applicable source, entity, information or products available on the external sites. Each reviewer is encouraged to seek independent legal and tax counsel with regard to the subjects of this informational article.