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PPP Update – November 2020: Loan Necessity Questionnaires and Tax Treatment of Expenses Paid with PPP Funds

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Corporate Client ALERT re PPP Update - November 2020

The Small Business Administration ("SBA") has released draft Loan Necessity Questionnaires for high-dollar for-profit and non-profit Paycheck Protection Program ("PPP") borrowers that must be submitted in connection with their applications for loan forgiveness. In addition, the Internal Revenue Service ("IRS") has released guidance on whether and when PPP borrowers may deduct expenses paid using funds from PPP loans. Both of these releases raise many questions and concerns for PPP borrowers.

The Loan Necessity Questionnaires

The SBA has proposed a questionnaire be submitted by all borrowers who, together with their affiliates, received PPP funds in excess of $2 million. The questionnaires – one form for for-profit borrowers, and another for nonprofits – will be issued by the lender servicing the loan, and the completed form is due within ten business days of receipt from the lender. The questionnaires purport to collect information to facilitate the SBA's review of a borrower's good-faith certification of necessity. Specifically, the questionnaires request financial information from March 2020 through the present, such as certifications and disclosure of quarterly revenues, distributions to owners and compensation levels for employees.

The questionnaires' focus on economic performance since March 2020 may come as a surprise to many. While some may question the wisdom of certain aspect of PPP as a policy matter in retrospect, the program's purpose when enacted was to save jobs. As such, the CARES Act required borrowers to certify that then-current uncertainty – not certainty as to subsequent negative economic performance – required PPP money in order to avoid cutting jobs. Moreover, the CARES Act did not condition forgiveness of PPP loans on subsequent negative economic performance. It is unclear whether the SBA believes that after-the-fact performance is evidence of what borrowers knew (or did not know) when they applied for PPP loans, or whether the SBA is seeking to impose additional requirements for forgiveness.

As of the date of this alert, the questionnaires remain in draft form and the SBA has not released final versions. Stay tuned for more details if/when the final versions are released.

Deductions for Expenses Paid with PPP Proceeds

On November 18, 2020, the IRS released Revenue Ruling 2020-27 and Revenue Procedure 2020-51, addressing the tax treatment of expenses paid for with proceeds from a PPP loan.

According to the Revenue Ruling, a PPP borrower may not claim deductions for 2020 for expenses paid with PPP funds, so long as there is a reasonable expectation of forgiveness, regardless of whether it applies for forgiveness by the end of the year. Thus, most borrowers who followed PPP's rules have little to no chance of deducting the relevant expenses now and adding back those expense later if their loans are not ultimately forgiven in full, as many PPP borrowers had hoped would be permitted.

The corresponding Revenue Procedure provides that, to the extent a borrower is denied forgiveness or does not apply for forgiveness, either voluntarily or because it determines that it is not eligible for complete forgiveness, it can subsequently claim the deductions. Here the IRS struck a taxpayer-friendly tone, granting PPP borrowers a choice as to which year for which the deductions may be claimed. Specifically, the deductions may be taken in 2020 – via its original tax return if not yet filed, or an amended return otherwise – or for the year in which the borrower is denied or forgoes seeking forgiveness.

This latest IRS guidance does not address all questions remaining with respect to the tax treatment of PPP dollars. For example, the releases do not provide any guidance for PPP borrowers whose eligible expenses exceed their PPP loan amounts as to which expenses should be considered as having been made with PPP money. This can have a significant impact, particularly for borrowers taxed as partnerships who may have used PPP to fund distributions to partners. To the extent PPP money is considered to have been spent on such distributions, which are already not deductible, the borrower avoids forfeiting other deductions.

If you have any questions about PPP, please contact Jason Navarino, Rich Lomuscio, Hannah Greendyk or any member of Riker Danzig's Tax and Corporate Departments.

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