

Navigating the Paycheck Protection Program (PPP) Loan Forgiveness Application, Lender Review and Government Audit Process, and Corresponding Tax Consequences

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The Paycheck Protection Program (“PPP”) is part of the most prominent governmental response to the novel coronavirus and subsequent COVID-19 pandemic in 2020. The PPP was formed by a panoply of federal legislation, including the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”),⁴ the Paycheck Protection Program and Health Care Enhancement Act (“Enhancement Act”),⁵ and the Paycheck Protection Program Flexibility Act of 2020 (“Flexibility Act”) (collectively, the “PPP legislation”).⁶ Its impact and reach has been profound, having provided \$525 billion in potentially forgivable PPP loans to 5.2 million sole proprietors, independent contractors, and businesses.⁷ Every state, as well as six territories and the District of Columbia, has benefited from this program.⁸ Despite this success, the PPP stopped accepting applications on August 8, 2020.⁹ When the program closed, it had nearly \$134 billion in remaining funds.¹⁰

Most businesses that have received PPP loans are preparing to begin or have already started the loan forgiveness application process. As of October 26, 2020, none of the PPP loans

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⁴ 116 PL 136, Coronavirus Aid, Relief, and Economic Security Act (Mar. 27, 2020) (hereinafter “CARES Act”); 85 FR 20811 (Apr. 15, 2020). The CARES Act created the PPP and authorized the SBA to lend up to \$349 billion in forgivable section 7(a) small business loans.

⁵ 116 PL 139, Paycheck Protection Program and Health Care Enhancement Act (Apr. 24, 2020) (hereinafter “Enhancement Act”). The Enhancement Act appropriated another \$310 billion to the PPP.

⁶ 116 PL 142, Paycheck Protection Program Flexibility Act of 2020 (June 5, 2020) (hereinafter “Flexibility Act”). The Flexibility Act modified various aspects of the PPP in response to growing opposition to the program, including expanding the covered period from 8-weeks to 24-weeks for most borrowers and requiring that 60 percent of forgiven expenses be for payroll costs.

⁷ Small Business Administration, *Paycheck Protection Program (PPP) Report*, 2 (Aug. 8, 2020).

⁸ *Id.* at 5.

⁹ *Id.* at 2.

¹⁰ *Id.* at 9.

have been formally and fully forgiven by both the applicable lending bank and the Government. Applying for and receiving the appropriate amount of loan forgiveness is critical to the PPP's ultimate success as most businesses applied for PPP loans with the assumption that the loans would be forgiven. Any failure to attain appropriate loan forgiveness could result in businesses faltering, which could affect employees, their families, and communities as a whole.

Preparing for the tax consequences associated with forgiveness is essential. Certain important tax issues have been crystal clear since the beginning of the PPP regarding the potentially forgivable loans—namely that any portion of a PPP loan that is forgiven will not be included in the income of the applicable borrower. However, in other areas there is contradictory information about whether borrowers should work with their lender regarding the potential receipt of a Form 1099-C, *Cancellation of Debt*, and whether forgiven expenses are also deductible as ordinary business expenses. Therefore, it is crucial to understand how the loan forgiveness application process works, including submitting the application, the lender and SBA review process, and the tax consequences therefrom.

I. Tax Consequences of Loan Forgiveness

a. Form 1099-C, Cancellation of Debt

The PPP did not initially address whether lenders should issue Form 1099-C for amounts forgiven under a PPP loan. The CARES Act provides that borrowers are, “eligible for forgiveness of indebtedness” on a PPP loan with those amounts being excluded from gross income.¹¹ In general, section 6050P of the Code requires lenders to report discharged debt of \$600 or more on a Form 1099-C whether or not the discharged debt is included in the borrower's gross income.¹² For purposes of this reporting requirement, the regulations provide that “indebtedness” means any amount owed to an applicable entity, including stated principal, fees, interest, penalties, administrative costs, and fines.¹³ On its surface, section 6050P of the Code appears to apply to PPP loan forgiveness.

On September 22, 2020, the IRS announced that lenders should not file Form 1099-C for amounts forgiven under a PPP loan.¹⁴ “When all or a portion of the stated principal amount of a [PPP loan] is forgiven because the eligible recipient satisfies the forgiveness requirements...an applicable entity is not required to, for federal income tax purposes only, and should not, file a Form 1099-C with the IRS or provide a payee statement to the eligible recipient...as a result of the qualifying forgiveness.”¹⁵ Filing the form could result in under reporting notices being issued to borrowers and cause confusion.¹⁶ Therefore, borrowers should not expect their lender to file a Form 1099-C in connection with amounts forgiven under a PPP loan.

¹¹ CARES Act § 1106(b), (i); 15 USC § 9005(b), (i).

¹² IRC § 6050P

¹³ Treas. Reg. § 1.6050P-1(c).

¹⁴ IRS Announcement 2020-12 (Sep. 22, 2020).

¹⁵ *Id.*

¹⁶ *Id.*

b. Ordinary Business Expense Deduction

As we previously discussed in the Spring edition of the Texas Tax Lawyer, while borrowers may exclude from gross income expenses that are forgiven under a PPP loan, the IRS intends to prohibit the deduction of ordinary business expenses to the extent they were paid with forgiven PPP loan funds.¹⁷ The effect of the current IRS position as set forth in Notice 2020-32 is that borrowers cannot deduct business expenses they normally would have deducted but for the PPP loan, thereby diminishing the benefit associated with loan forgiveness. Shortly after the IRS disclosed its position in Notice 2020-32, Senate Finance Committee Chairman Chuck Grassley responded:

“When we developed and passed the Paycheck Protection Program, our intent was clearly to make sure small businesses had the liquidity and the help they needed to get through [the Covid-19 pandemic]. Unfortunately, Treasury and the IRS interpreted the law in a way that’s preventing businesses from deducting expenses associated with PPP loans. That’s just the opposite of what we intended and should be fixed.”¹⁸

The bipartisan Small Business Expense Protection Act of 2020 (“Senate Bill 3612”) was introduced in the Senate shortly thereafter,¹⁹ confirming the intent of Congress that business expenses forgiven as part of a PPP loan would be deductible under section 162 of the Code as ordinary business expenses.²⁰ There was measured expectation that Congress would remedy this issue in the intervening months.²¹ However, the Flexibility Act, passed in June, did not address the deductibility of forgiven expenses and Senate Bill 3612 has stalled in the Senate Finance Committee and the House Committee on Ways and Means. Other potential legislative attempts to provide further PPP funding and associated clarifications have also stalled out recently in Congress.²²

IRS Notice 2020-32 is still in effect as of the end of October, but may be subject to Court challenge and be entitled to little or no deference.²³ Nevertheless, borrowers will need to decide whether to comply with the notice or take the ordinary business deductions under the assumption that Congress will not address this issue. Further complicating tax planning is whether a fiscal

¹⁷ Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *Who CARES About Tax Issues for Small Business: A Review of the Tax Forgiveness, Tax Deduction, and Other Tax Issues Associated with the CARES Act’s Paycheck Protection Program (“PPP”)*, TEX. TAX LAWYER (Spring 2020); see also IRS Notice 2020-32 (2020).

¹⁸ Chuck Grassley, *Bipartisan Senators Introduce Bill to Clarify Small Business Expense Deductions Under PPP* (May 6, 2020); *Here are 3 Things to Know About the Extended Paycheck Protection Program*, ABC 13 EYEWITNESS NEWS HOUSTON (July 18, 2020) (Interview with Juan F. Vasquez, Jr.).

¹⁹ S. 3612, *Small Business Protection Act of 2020*, 116th Cong. (May 5, 2020).

²⁰ *Id.*

²¹ Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *IRS Undermines Congressional Intent for Payroll Protection Program*, BLOOMBERG TAX DAILY TAX REPORT (July 23, 2020).

²² S.3814, *RESTART Act*, 116th Cong. (May 21, 2020); HR.7197, *RESTAURANTS Act of 2020*, 116th Cong. (June 6, 2020); S.4321, *Continuing Small Business Recovery and Paycheck Protection Program Act*, 116th Cong. (July 27, 2020);

²³ Juan F. Vasquez, Jr., *Judicial Deference for Revenue Rulings in a Post-Mead World*, J. Tax Practice & Proc. (Aug/Sep 2004).

year borrower may take ordinary business deductions in 2020 for expenses that may ultimately be forgiven in 2021. Under the CARES Act, banks have 60 days from the receipt of the forgiveness application to make a forgiveness determination.²⁴ Banks are then required to forward their determination to the SBA, which in turn has 90 days to issue its determination regarding loan forgiveness.²⁵ The forgiveness determination, while for many taxpayers may be made in 2021, will effect 2020 returns. Is income formally excluded in 2020 or 2021? Deciding to disallow deductions when the amount of loan forgiveness has not been determined could result in the foregoing of available deductions if the borrower receives less than the full amount of forgiveness. Whether or not the borrower elects to take ordinary business deductions in 2020 inconsistent with Notice 2020-32, it should be ready to amend its 2020 return if necessary based on the final loan forgiveness determination and new legislative developments in 2021 that may relate back to 2020.

II. Submitting a Loan Forgiveness Application: SBA Forms 3508, 3508EZ, and 3508S

The SBA currently offers borrowers the ability to submit to their lender one of three loan forgiveness application forms: Form 3508, Form 3508EZ, or Form 3508S. The primary difference between the forms is how much detail they require borrowers to provide. While all borrowers may submit Form 3508, it is the most complex, requiring the borrower to calculate the Full-Time Equivalent (FTE) Reduction Test and Wage Reduction Test.²⁶ Because of the complexity of Form 3508, borrowers should first determine their eligibility for the simplified Forms 3508EZ or 3508S.

a. Form 3508EZ

Borrowers eligible for Form 3508EZ do not need to calculate the FTE Reduction Test and Wage Reduction Test on the form, but do need to certify that the tests were met or that they satisfy a safe harbor.²⁷ To be eligible to use Form 3508EZ, a borrower must have not reduced the salary or wages of any employee who worked during the covered period by more than 25 percent when compared to the first quarter of 2020.²⁸ Employees who were paid more than \$100,000 annualized during any 2019 pay period are excluded from this requirement.²⁹

In addition, the borrower either must have maintained its employment levels through the end of the covered period or can show that its business activity declined due to compliance with federal guidance related to the COVID-19 pandemic.³⁰ With regard to employment levels, the business cannot have reduced the number of employees or the average paid hours of employees

²⁴ CARES Act § 1106(g).

²⁵ 85 FR 38304, 38306 (June 26, 2020).

²⁶ See Small Business Administration, *PPP Loan Forgiveness Application Form 3508* (June 2020) (hereinafter “Form 3508”).

²⁷ Small Business Administration, *PPP Loan Forgiveness Application Form 3508EZ* (June 2020).

²⁸ Small Business Administration, *PPP Loan Forgiveness Application Form 3508EZ Instructions for Borrowers*, 1 (June 2020).

²⁹ *Id.*

³⁰ *Id.*

between January 1, 2020 and the end of the covered period.³¹ The loss of an employee is not counted if the business was unable to rehire an individual employed before February 15, 2020 because such individual declined the offer and the business was unable to hire a similarly qualified employee.³² With regard to a decline in business activity, the business must be able to demonstrate that it was unable to operate during the covered period at the same level of business activity as before February 15, 2020 due to compliance with federal guidance issued between March 1, 2020 and December 31, 2020, including from the Department of Health and Human Services, the Centers for Disease Control and Prevention, and the Occupational Safety and Health Administration.³³

b. Form 3508S

Borrowers eligible for Form 3508S are exempt from the FTE Reduction Test and Wage Reduction Test, unlike Form 3508EZ, which requires the borrower to certify that it satisfied the Wage Reduction Test and either did not reduce employment levels or suffered a decline in business activity due to compliance with federal guidance related to the COVID-19 pandemic.³⁴ To be eligible to use Form 3508S, a borrower must have a PPP loan of \$50,000 or less.³⁵ If multiple affiliated entities received PPP loans, then the aggregate amount of the affiliated entities' PPP loans cannot be \$2 million or more.³⁶

III. Expectations During the Lender's Review of the Loan Forgiveness Application

The PPP legislation did not adequately address how the loan forgiveness application process would look, but instead delegated that responsibility to the SBA.³⁷ The SBA has been slow to issue guidance on many aspects of the PPP, including the responsibilities of lenders during the review process. Because of this, businesses applied for and received PPP loans without knowing what was required to achieve forgiveness or its consequences.³⁸ In fact, the Flexibility Act was in part enacted as a response to growing concerns voiced by the business community over the program's lack of clarity.³⁹

Starting in June, the SBA issued guidance describing how the loan forgiveness process would look. When a loan forgiveness application is submitted to the lender, it must confirm that the certifications contained in the application were made, that substantiating documentation has

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ Small Business Administration, *PPP Loan Forgiveness Application Form 3508S* (Oct. 2020).

³⁵ Small Business Administration, *PPP Loan Forgiveness Application Form 3508S Instructions for Borrowers*, 1 (Oct. 2020).

³⁶ *Id.*

³⁷ CARES Act § 1106(k) (giving the SBA 30 days after the enactment of the CARES Act to issue guidance and regulations).

³⁸ Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *IRS Undermines Congressional Intent for Payroll Protection Program*, BLOOMBERG TAX DAILY TAX REPORT (July 23, 2020).

³⁹ Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *INSIGHT: Congress Adds 'Flexibility' to Loan Forgiveness and Corresponding Tax Consequences*, BLOOMBERG TAX DAILY TAX REPORT (June 5, 2020).

been submitted, and that the calculations are correct.⁴⁰ If the lender identifies errors in the borrower's calculation or material lack of substantiation in the borrower's supporting documents, SBA guidance directs the lender to work with the borrower to remedy the issue rather than simply denying the application.⁴¹ This likely would entail requesting additional documentation from the borrower.

Borrowers can expect the lender to make a decision within 60 days after the lender receives a complete loan forgiveness application.⁴² That decision may take the form of an:

1. approval, in whole or in part;
2. denial; or
3. if directed by SBA, a denial without prejudice due to a pending SBA review of the loan for which forgiveness is sought.⁴³

In the case of a denial without prejudice, the borrower may subsequently request that the lender reconsider its application for loan forgiveness, unless the SBA has determined that the borrower is ineligible for a PPP loan.⁴⁴

a. Approval by the Lender

If the lender determines that the borrower is entitled to complete or partial forgiveness, the lender must request payment from the SBA when it issues its decision.⁴⁵ The SBA will then remit within 90 days the loan forgiveness amount to the lender, plus any interest accrued through the date of payment, subject to SBA review of the PPP loan application and forgiveness application.⁴⁶ Note, the borrower should not expect the lender to file a Form 1099-C, *Cancellation of Debt*, for the forgiven amounts as the IRS has announced that Forms 1099-C should not be filed.⁴⁷

b. Denial by the Lender

In the event that the lender denies loan forgiveness, it must provide the reason for its denial.⁴⁸ The lender must also notify the borrower in writing that its decision has been issued to the SBA, which the SBA may or may not review.⁴⁹ Fortunately, the borrower does have the ability to challenge a denial, if within 30 days it notifies the lender that it requests the SBA to

⁴⁰ 85 FR 33010, 33013 (June 1, 2020).

⁴¹ *Id.*

⁴² CARES Act § 1106(g); 15 USC § 9005(c)(3).

⁴³ 85 FR 38304, 38310 (June 26, 2020).

⁴⁴ *Id.*

⁴⁵ *Id.* at 38306.

⁴⁶ *Id.*

⁴⁷ IRS Announcement 2020-12 (Sep. 22, 2020).

⁴⁸ 85 FR 38304, 38310.

⁴⁹ *Id.*

review the decision.⁵⁰ To reiterate, to challenge a denial by the lender, a borrower must tell the lender that it wants the SBA to review within 30 days of the decision. Within 5 days of receipt, the lender must then notify the SBA of the borrower's request for review.⁵¹

If the borrower does not request SBA review or the SBA declines the request, then the lender is responsible for notifying the borrower of the date on which the borrower's first payment is due.⁵² If the SBA accepts a borrower's request for review, the SBA will notify both the borrower and the lender of the results of the review.⁵³ SBA guidance does not provide a time limit associated with this type of review.

IV. Preparing for a Government Audit

The SBA will review all PPP loans in excess of \$2 million following the lender's submission of the forgiveness application.⁵⁴ However, loans that are \$2 million or less may also be reviewed subject to the SBA's discretion.⁵⁵ This review is not only limited to the loan forgiveness application, but also covers initial eligibility for a PPP loan.⁵⁶ If a review is made, then the SBA will notify the lender in writing, and the lender must notify the borrower in writing within five business days.⁵⁷ To minimize the risk and potential consequences associated with an SBA audit, all borrowers should ensure that they have (i) satisfied the certification of need made on the initial PPP loan application and (ii) gathered comprehensive documentation substantiating eligible expenses.⁵⁸

a. The Certification of Need

Borrowers must be ready to defend the certification of need they made when they applied for their PPP loans and potentially when they signed their promissory notes.⁵⁹ For borrowers that fail to satisfy the certification of need, the SBA may not pursue further administrative enforcement or refer the borrower to other governmental agencies if the loan is repaid in full.⁶⁰ Although, even if repaid in full, the borrower is still not shielded from all potential liability and is subject to enforcement for other violations. Therefore, it is best to ensure that the certification has been satisfied.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ Small Business Administration, *Paycheck Protection Program Frequently Asked Questions*, #39 (Oct. 7, 2020) (hereinafter "SBA FAQ").

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ 85 FR 33010.

⁵⁸ Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *How to Prepare for a Paycheck Protection Program Loan Audit*, Hous. Bus. J. (Sep. 3, 2020).

⁵⁹ Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *Preparing for a Potential Audit of Your Client's Paycheck Protection Program Loan*, TODAY'S CPA (July 2020).

⁶⁰ SBA FAQ #47.

The certification states, “That the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient.”⁶¹ To make the certification in good faith, borrowers must take into account two factors: (i) their business activity at the time the certification was made and (ii) whether they had access to other sources of liquidity, the use of which would not be significantly detrimental to their business.⁶²

i. Business Activity

Importantly, for purposes of the good-faith certification, business activity is determined at the time the application was made.⁶³ A borrower will therefore want to show that its business activity was expected to be or actually was negatively affected by the COVID-19 pandemic when its application was signed. This should be done through a combination of financial records and analysis and secondary sources. With regard to financial records, year-over-year comparisons of revenue, sales, or other industry-specific metrics can be used to show the decline relative to 2019 and the days leading up to the application date to further emphasize any actual declines in business activity. With regard to secondary sources, borrowers should consider referencing trade publications or other industry examples of similarly situated taxpayers experiencing challenges due to the COVID-19 pandemic, and/or ordinances that prohibited business activity and/or specifically targeted the business. Note that multiple ordinances were likely in effect before the application date. Industry-wide or regional trends/projections published by trade associations around the application date may also be relevant. Finally, if applicable, a borrower should note whether it was experiencing, or expected to experience, reductions in the number of jobs, furloughs, or supply chain disruptions.

ii. Access to Liquidity

The second factor, access to liquidity, is also important. SBA guidance and Congressional action have directly addressed public companies, but not private companies. The SBA notes, “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 company should be prepared to demonstrate to SBA, upon request, the basis for its certification.”⁶⁴ The U.S. House of Representatives’ Select Subcommittee on the Coronavirus Crisis (the “Coronavirus Subcommittee”) sent a letter to Gulf Island Fabrication, Inc. (“Gulf Island Fabrication”) in addition to four other public companies requesting that it return its \$10 million PPP loan.⁶⁵ Gulf Island Fabrication has over 900 employees, reported revenue of more than \$300 million in 2019, and is publicly traded on the NASDAQ stock exchange.⁶⁶ The Coronavirus Subcommittee reasoned that:

“Since [Gulf Island Fabrication] is a public entity with a substantial investor base and access to capital markets, [the funds

⁶¹ *Id.* at #31.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ Select Subcommittee on the Coronavirus Crisis, House of Representatives, *Letter to Mr. Heo, Chief Executive Officer of Gulf Island Fabrication, Inc.* (May 8, 2020).

⁶⁶ *Id.*

should be returned] immediately. Returning these funds will allow truly small businesses—which do *not* have access to alternative sources of capital—to obtain the emergency loans they need to avoid layoffs, stay in business, and weather the economic disruption caused by the coronavirus crisis.”⁶⁷

It is clear from the SBA and Congress assumes that public companies with access to capital markets, i.e., a publicly traded stock exchange, are generally deemed to have sufficient access to liquidity such that they should not make the certification of need in good faith. Of course, there may be exceptions to the rule if a public company is having financial difficulty or trouble accessing financial markets.

There has been no SBA guidance or Congressional action directly addressing when a private company would have sufficient access to liquidity such that it could not make the certification of need in good faith. This factor therefore remains relevant in determining whether the certification of need was accurate.⁶⁸

Although there is no requirement to utilize a line of credit to secure a PPP loan, a private business with access to a line of credit may determine the amount of available credit at the application date. If the line of credit is not fully exhausted, the borrower could argue that its historical use is for a certain purpose and shifting the funds away from such purpose would be significantly detrimental to the business. For example, a hypothetical borrower might argue that it relies on the line of credit to purchase inventory before the busy summer season and to divert such funds to payroll would prevent the business from being able to meet demand. Additionally, the borrower may review the terms for the line of credit in case there are any restrictions that would be applicable. Thus, private companies have more opportunity than public companies to demonstrate why accessing certain sources of liquidity would be significantly detrimental to their businesses.

b. Documenting Eligible Expenses

Borrowers must be able to provide comprehensive documentation to substantiate all eligible expenses.⁶⁹ This documentation will be reviewed by the lender servicing the PPP loan and possibly the SBA during an audit. Potential loan forgiveness is primarily based on the total amount of eligible expenses made during the 8-week or 24-week covered period following the first disbursement of PPP loan funds,⁷⁰ subject to the requirement that 60% or more of such

⁶⁷ *Id.*

⁶⁸ Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *Preparing for and Defending Against a Potential Audit of Your Client's CARES Act PPP Loan*, NORTH DAKOTA CPA NEWSLETTER (Sep. 2020).

⁶⁹ CARES Act § 1106(e); *See also*, Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *INSIGHT: Tax Issues Associated with the Paycheck Protection Program Loan Forgiveness Process*, BLOOMBERG TAX DAILY TAX REPORT (May 21, 2020).

⁷⁰ If a borrower received a PPP loan before June 5, 2020 it may choose either the 8-week or 24-week covered period. A borrower that receives a PPP loan on or after June 5, 2020 must use the 24-week covered period. Pub. L. 116-142, *Paycheck Protection Program Flexibility Act of 2020* § 3(b)(1) (June 5, 2020) (hereinafter “Flexibility Act”). *See also* Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *INSIGHT: Congress Adds ‘Flexibility’ to Loan Forgiveness and Corresponding Tax Consequences*, BLOOMBERG TAX DAILY TAX REPORT (June 5, 2020).

expenses be for eligible payroll costs (paid or incurred during the covered period) and up to 40% of eligible expenses for non-payroll costs.⁷¹

With regard to payroll costs, the borrower must provide: bank account statements; tax forms, including federal payroll tax filings and state wage reporting and unemployment insurance tax filings; and payment receipts, cancelled checks, or account statements documenting employer contributions to employee health and retirement plans.⁷²

With regard to non-payroll expenses, the borrower must provide documentation verifying the existence of the obligations and/or services prior to February 15, 2020 and eligible payments made during the covered period. For business mortgage interest payments, this includes a copy of the lender amortization schedule and receipts or cancelled checks or lender account statements from February 2020 and the months of the covered period through one month after the covered period.⁷³ For business rent or lease payments, this includes a copy of the current lease agreement and receipts or cancelled checks; or lessor account statements from February 2020 and from the covered period through one month after the end of the covered period.⁷⁴ For business utility payments, this includes a copy of invoices from February 2020 and those paid during the covered period; and receipts, cancelled checks, or account statements verifying eligible payments.⁷⁵

c. PPP Enforcement

Government enforcement efforts have generally focused on egregious fraudulent activity. Criminal investigation and enforcement actions have only involved PPP loan applications and unauthorized or lavish expenditures thus far, but will likely include loan forgiveness applications as well going forward. Actions which may result in government enforcement action being taken include:

1. providing false information on the PPP loan application, loan forgiveness application, or supporting documentation; or
2. using PPP loan funds for non-authorized purposes such as luxury items, large bonuses, compensation above the maximum allowed (potentially up to \$46,154 for each employee and up to \$20,833 for each owner-employee), and significant investments.

In a representative example, the Department of Justice charged two businessmen with conspiracy to make false statements to influence the SBA and conspiracy to commit bank fraud.⁷⁶ The businessmen allegedly applied for PPP loans to pay employees of businesses that were not operating prior to the start of the COVID-19 pandemic and to pay employees of a business one applicant did not own.⁷⁷ They discussed via email the creation of fraudulent loan

⁷¹ 85 FR 20811, 20814; SBA IFR 2020-37; Flexibility Act § 3(b)(1).

⁷² CARES Act § 1106(e).

⁷³ Form 3508.

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ Justice Department, *Two Charged in Rhode Island with Stimulus Fraud* (May 5, 2020) <https://www.justice.gov/opa/pr/two-charged-rhode-island-stimulus-fraud>.

⁷⁷ *Id.*

applications and supporting documentation in order to receive more than a half-million dollars in PPP loans.⁷⁸

The Department of Justice also charged a reality TV personality with federal bank fraud after he diverted PPP loan proceeds for his own personal gain.⁷⁹ Within days of receiving the proceeds, the individual allegedly used more than \$1.5 million in PPP funds on unauthorized purchases including a 2019 Rolls-Royce Wraith, jewelry, and child support.⁸⁰

V. Conclusion

5.2 million sole proprietors, independent contractors, and businesses have taken advantage of the PPP and have received \$525 billion in partially forgivable loans. The loan forgiveness process that these millions of borrowers must navigate, while not fully formed during the initial months of the PPP, has started to take shape through further legislative action and SBA guidance. Borrowers will have to determine what application to use based on the size of their loan and whether they have satisfied the FTE Reduction Test and Wage Reduction Test, or alternatively a safe harbor. They must also understand the steps they need to take in submitting their application and, if necessary, contesting the lender's decision. To protect against an SBA audit, borrowers must ensure that they have satisfied the certification of need and that they provide comprehensive documentation substantiating their eligible expenses. Finally, borrowers will need to plan for the uncertain tax consequences associated with loan forgiveness, including whether to deduct ordinary business expenses forgiven as part of their PPP loan. Identifying and understanding these issues is critical to successfully navigating the loan forgiveness process.

⁷⁸ *Id.*

⁷⁹ Justice Department, *Reality TV Personality Charged with Bank Fraud* (May 13, 2020) <https://www.justice.gov/opa/pr/reality-tv-personality-charged-bank-fraud>.

⁸⁰ *Id.* The Justice Department continues to indict individuals who provide false documentation/information during the application process or who misappropriate PPP funds for personal gain. See the indictments of William Sadleir (<https://www.justice.gov/usao-sdny/pr/former-chairman-and-ceo-movie-production-company-arrested-fraud-charges>), Baoke Zhang (<https://www.justice.gov/opa/pr/software-engineer-charged-washington-covid-relief-fraud>), and Hummer Mars (<https://www.justice.gov/usao-sdny/pr/chinese-national-arrested-20-million-scheme-fraudulently-obtain-loans-intended-help>).