

Small Business Loan Warning Doesn't Get to Heart of the Issue

Posted on Apr. 24, 2020

By Eric Yauch

The government's recent guidance that said some large companies that received small business loans should consider giving that money back has businesses wondering if they'll run afoul of the law's vague certification standards.

The Small Business Administration and Treasury [updated an FAQ](#) April 23 to clarify that applicants seeking Paycheck Protection Program (PPP) loans that are public companies with substantial market value and access to capital markets likely can't certify in good faith that they need the loans. The warning wasn't just for large public companies — the FAQ says all borrowers should carefully review the certification language before applying for a loan.

The guidance comes after it was revealed that major companies, including Shake Shack and Ruth's Chris Steak House, received millions in PPP loans while small businesses were left in the dust. In response, lawmakers and Treasury Secretary Steven Mnuchin [called for strengthening](#) the certification rules to avoid abuse.

But the FAQ doesn't provide clarity on the meaning of the required certification language, Jeffrey B. Tate of Arent Fox LLP told *Tax Notes*.

According to language in the Coronavirus Aid, Relief, and Economic Security (CARES) Act ([P.L. 116-136](#)), a taxpayer applying for a PPP loan must certify that current economic uncertainty makes the loan necessary to support ongoing operations of the applicant.

The certification language raises questions, and the latest guidance didn't provide any help, Tate said.

"For example, if potential borrowers have maintained sales to date, but are concerned about the impact that COVID-19 could have on their continued manufacturing ability or their distribution network, are they still eligible to apply for a loan?" Tate asked. "Alternatively, would private companies with potential access to additional equity capital be eligible?"

Amal U. Dave, also of Arent Fox, said the determination is still a judgment call based on the good-faith belief of the applicant at the time application is made.

"But we now know that there will likely be heightened scrutiny on these decisions," Dave said.

Unknown Consequences

The CARES Act gave employers options for paying workers during the economic shutdown as the nation tries to halt the spread of COVID-19. The options include an employee retention credit that is fully refundable and applied against the employer's portion of payroll taxes, but only \$10,000 in wages per employee can be counted for all calendar quarters, and the credit is capped at \$5,000 per employee.

Employers can forgo that credit and instead apply for a new loan under the CARES Act to help with payroll costs. The CARES Act modified section 7(a) of the Small Business Act to create the PPP, for which Congress authorized nearly \$350 billion to provide guaranteed loans for small businesses.

The PPP [ran out of money](#) the week of April 13, and lawmakers are negotiating on additional funding for the program.

According to Severiano E. Ortiz of Kozusko Harris Vetter Wareh Duncan LLP, the FAQ seems to raise the question of whether companies with venture capital or private equity backing can certify in good faith that they don't have alternative access to liquidity.

"It seems unlikely that a venture capital or private equity fund would let their investments go under without supporting them through additional funding," Ortiz said. "Does this mean then that they don't qualify for the SBA loan?"

Ortiz said the FAQ makes eligibility increasingly unclear, especially because it still relies on self-certifications. And with a lack of clarity, some eligible businesses might not want to risk it, to the detriment of their business, while others that shouldn't qualify might be comfortable with the risk, he added.

While lenders may rely on the self-certification, it's unclear what happens to the borrower if the loan is later challenged, Ortiz said.

"Does the loan just become unforgivable, or will penalties be assessed?" Ortiz asked.

'Significant Ambiguity'

Several Husch Blackwell LLP lawyers told *Tax Notes* that if four lawyers were asked for their interpretation of the FAQ, there'd likely be four different answers. One point of confusion is language that says borrowers must certify in good faith, taking into account "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."

"That language is open to significant ambiguity," Craig Kovarik said. Anytime a taxpayer borrows money, there's a potential it will be detrimental to their business, he said. There are consequences if the loan isn't repaid, but even if the loan is repaid, there are consequences such as interest payments and covenants.

John D. Moore said he thinks that if a business has a good-faith argument that it is eligible for the loan, but the SBA comes back and determines that the company didn't qualify, repayment should be the only penalty. It's unclear whether that repayment should be over two years or immediate, he added.

According to the FAQ, a borrower that applied for a PPP loan prior to the release of the FAQ can repay it by May 7 and will be deemed by the SBA to have made the certification in good faith.

The certification is that the taxpayer needed the loan at the time they applied for it, so why should they now have to look back and re-examine that certification? David Eckhardt asked.