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BY JAMES E. HAZEL, JR.

# Impact of Paycheck Protection Program Loans on the Construction Industry

*Uncertainty* certainly defined 2020. COVID-19 became real for many when the first pandemic-related cancellation occurred in March 2020. The events that followed, like school and restaurant closings and cancellations of major sporting events, sent an unprecedented shock throughout every aspect of life.

This article will explore how the Paycheck Protection Program (PPP) has impacted the construction industry and offer some best practices for moving forward with the forgiveness application.

As we approach the forgiveness application deadline, most loan recipients are somewhere between preparing the application for forgiveness, awaiting an answer from their bank or the U.S. Small Business Administration (SBA), or celebrating that they have received the coveted letter of forgiveness. Recipients will need to determine how best to report the loans for financial statement and income tax return purposes.

## CARES Act

In March 2020, the federal government enacted the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act)<sup>1</sup> and later the *Paycheck Protection Program Flexibility Act*.<sup>2</sup> One major provision of the CARES Act was the PPP, which offered immediate, low interest rate (1%) loans that were guaranteed by the SBA.<sup>3</sup>

The program was available primarily to small businesses with fewer than 500 employees<sup>4</sup> and was designed to prevent layoffs and cover fixed costs (such as rent, utilities, and interest on loans) from potential defaults.<sup>5</sup> Initial repayment terms were two years with payments<sup>6</sup> deferred for six months,<sup>7</sup> which was expanded in June 2020 to five years with payments deferred for 10 months.<sup>8</sup> Most important, the loans could qualify for complete forgiveness if the recipient met certain compliance provisions.<sup>9</sup>

Not surprisingly, many elements of the program were not well defined. The U.S. Treasury Department responded by publishing a series of “Paycheck Protection Program Loans:

Frequently Asked Questions (FAQs),”<sup>10</sup> which provided a lot of clarification regarding the mechanics of the forgiveness application. However, some of the answers created further uncertainty and confusion and seemed to expand the requirements of the program beyond the original CARES Act.

Specifically, FAQ #31 brought into question the required certification that “[c]urrent economic uncertainty makes the loan request necessary to support the ongoing operations of the Applicant.” It further stated that it was “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 a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.” It gave borrowers an out by saying “any borrower that applied for a PPP loan prior to the issuance of this guidance and repaid the loan in full by May 18, 2020 will be deemed by SBA to have made the required certification in good faith.”

FAQ #37 expanded this response to privately owned companies. FAQ #39 stated that all loans in excess of \$2 million would be reviewed by the SBA in consultation with the U.S. Treasury Department.

Some recipients immediately refunded the money, fearing prosecution because of undetermined rules. As a result of the public outcry, FAQ #46 was issued, which offered a safe harbor to any borrower of less than \$2 million to be deemed to have met the required certification concerning the necessity of the loan request in good faith.

Borrowers with loans greater than \$2 million would have the opportunity to repay the loan without further administrative enforcement or referrals to other agencies if the SBA determined that the borrower lacked an adequate basis for the required certification concerning the necessity for the loan request.

## IRS Weighs In

CARES Act §1106(i) stated that income resulting from forgiveness of the PPP loans would be free from federal



income taxes. The IRS issued Notice 2020-32 declaring that no deduction is allowed for the payment of an expense that resulted in forgiveness of a PPP-covered loan.<sup>11</sup> This not only appeared to conflict with the original intent of the CARES Act legislation, but was also issued with little implementation guidance.

On November 18, 2020, the IRS released Revenue Ruling 2020-27, which confirmed its position that “a taxpayer that received a covered loan guaranteed under the PPP and paid or incurred certain otherwise deductible expenses listed in section 1106(b) of the CARES Act, may not deduct those expenses in the taxable year in which those expenses were paid or incurred if, at the end of such taxable year, the taxpayer reasonably expects to receive forgiveness of the covered loan on the basis of the expenses it paid or accrued during the covered period, even if the taxpayer has not submitted an application for forgiveness of the covered loan by the end of such taxable year.”<sup>12</sup>

### **Consolidated Appropriations Act, 2021**

On December 27, 2020, Congress enacted the *Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues*<sup>13</sup> within the *Consolidated Appropriations Act, 2021*,<sup>14</sup> which among many things, expanded, extended, and clarified certain aspects of the CARES Act. PPP loans were specifically amended to include a Second Draw for qualified borrowers and the program was extended through March 31, 2021.<sup>15</sup> And, perhaps more importantly, this allowed expenses paid for by loan funds and forgiven under the PPP to be deducted against taxable income, which overrides initial IRS guidance.<sup>16</sup>

Also, within the *Consolidated Appropriations Act, 2021*, the *Taxpayer Certainty and Disaster Tax Relief Act of 2020*, and later the *American Rescue Plan Act of 2021* that was enacted on March 11, 2021, expanded provisions for Employee Retention Credits (ERC) and other areas that will significantly benefit construction companies that have experienced declines in revenues.

Of note, this retroactively uncoupled the ERCs from the PPP loans, potentially providing additional benefits. Employers that received a PPP loan and that were previously prohibited from claiming the ERC may now retroactively claim the ERC for 2020.<sup>17</sup> Businesses that expect a 20% or greater decline in gross receipts in any quarter of 2021 as compared to the same quarter of 2019 may qualify for credits of up to \$7,000 per employee per quarter in 2021 and should consider exploring the ERC.<sup>18</sup>

### **Impact on the Construction Industry**

Nationwide, the construction industry is predominantly comprised of privately held businesses that met the initial qualifications for a PPP loan. The construction industry accounted for the largest percentage (13%) of approved PPP funds.<sup>19</sup>

Lenders, sureties, and other financial advisors readily encouraged participation to protect their customers from failure, knowing that increased credit would likely be scarce and bonding curtailed. Sureties even issued letters warning customers that using their lines of credit and/or equity could jeopardize future bonding capacity.

For many construction companies, work continued and remained profitable even while incurring additional costs to protect employees and make jobsites safer. This made the uncertainty less imminent, but long-term concerns remained. The industry has historically been a lagging participant in downward economic cycles and indications of potential issues persist. This has created a unique challenge of prudent business management that requires a combination of longer-term thinking while matching the use of the PPP loan funds to the program's short-term compliance structure.

### **CFMA's Response**

CFMA recognized PPP loans as a major issue for its members, and through the Emerging Issues Task Force, created a focused PPP Loan Task Force. This Task Force tackled the charge of dissecting the implications for the industry and offering useful information and guidance as it became available. The Task Force's response was to pool collective resources and offer a series of webinars to provide insight to the membership, as well as assisting with virtual continuing professional education and recertification needs.

To date, CFMA's PPP Loan Task Force has presented eight webinars covering the PPP loan requirements, the forgiveness application, the certification documentation requirements, and related financial and tax reporting developments. These sessions are available at [cafe.cfma.org/covid-19-resources/education](https://cafe.cfma.org/covid-19-resources/education) (please note that, with this being such an ever-changing topic, some of material is dated but is still a great resource when applying for PPP loan forgiveness). The process is certainly not complete, but the following summarizes much of what we have learned:

### **Forgiveness Application**

If not already, you are likely approaching the end of the period in which you have spent all your loan proceeds and have

already or are preparing to apply for forgiveness. Specifics of the loan forgiveness application are as follows:

- Due to lender bank within 10 months from the date determined to be the cutoff for spending the loan proceeds.
- Requires documentation of all costs claimed, including payroll journals, utility bills, loan interest, and rent bills, among other qualifying expenses.
- Nuances requiring adjustments such as annualized compensation over \$100,000, related companies, etc.
- Affirmation for certification of need.<sup>20</sup>
- Bank has 60 days to approve or deny. If the application is approved, it is forwarded to the SBA for forgiveness consideration.<sup>21</sup>

## COVID-19 Hurdles

Prior to COVID-19, the construction industry was enjoying a long run of prosperity. Once the pandemic hit, construction was designated an essential industry in many locations, but COVID-19 brought more business hurdles to consider:

- Could a healthy backlog sustain operations for a period of time as long as contracts were not cancelled or interrupted?
- Worksites required immediate and new safety precautions. Some improved without city congestion, airport dormancy, and lower school closures, but how much disruption would be experienced if a portion of the workforce was absent due to illness or subcontractors were forced to shut down? How much additional risk would this add to performance?
- Would cash flow suddenly stop because of a chain reaction of entire customer industries, such as commercial real estate, hospitality, sports and entertainment, and governments holding payments?
- How many projects would be delayed or cancelled entirely?
- How long would cash, working capital, and equity sustain operations? Under normal conditions, equity and working capital that might support 10-20 times its amount in revenue might suddenly cover payroll and other fixed costs for less than a month.

The FAQs on PPP loan forgiveness provided by the SBA and U.S. Treasury Department have outlined the specifics of what can and cannot be included.<sup>22</sup> The bank will have the opportunity to work with you to comply. The banks were slow to start the process but many have developed portals that are ready to capture the data in a format that meets the requirements and appear to be processing applications in a matter of days.

### General & Certification Documentation

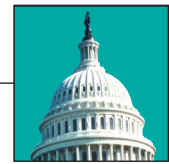
You are responsible for maintaining documentation and supporting your application for loan forgiveness to demonstrate good faith certification that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”<sup>23</sup> This documentation may be critical, can take many forms, and may generally include:

- Minutes of stockholder and management meetings.
- Financial projections, including details of layoffs planned, absent funding of the loan, etc.
- Correspondence from lenders, customers, suppliers, subcontractors, and sureties as well as other sources.
- Anticipated business disruptions such as employee absences, collection of receivables, supply chain interruptions, subcontractor failures, and delays.
- Additional compliance costs.

There has been little guidance as to what might constitute adequate documentation of the certification of need. In October 2020, the SBA issued the “Paycheck Protection Program Loan Necessity Questionnaire (For-Profit Borrowers)” (SBA Form 3509),<sup>24</sup> which instructs participant banks to solicit data from all recipients of loans over \$2 million.

The questionnaire includes some insight into areas the SBA may consider in making its determination and offers space for additional input. Response to the questionnaire is due within 10 days of receipt, emphasizing the importance of maintaining the critical documentation in advance and using this information very strategically in responding to the information requests. The U.S. Treasury Department and SBA have received substantial uproar from the public in response to this new form.

Published December 9, 2020 and revised March 3, 2021, the U.S. Treasury Department and SBA issued FAQ #53, which provided at least some general response to the uproar that ensued from these inquiries.<sup>25</sup> To date, we have little indication of how the SBA will respond to loans over \$2 million.



## SBA Review & Approval Process

Once the bank approves the application, it is submitted to the SBA for approval and forgiveness. The SBA has 90 days to approve or deny the forgiveness. If denied, an “appeal petition must be filed with [SBA’s Office of Hearing and Appeals] OHA within 30 calendar days after the borrower’s receipt of the final SBA loan review decision, or notification by the lender of the final SBA loan review decision, whichever is earlier.”<sup>26</sup>

The SBA may request additional information to make its decision over and above the explicit information questionnaire required as noted previously for loans exceeding \$2 million.<sup>27</sup>

## Accounting Guidance

In June 2020, the AICPA issued Technical Question and Answer 3200.18, “Borrower Accounting for a Forgivable Loan Received Under the Small Business Administration Paycheck Protection Program”<sup>28</sup> for guidance on the proper financial reporting of the loans and the related forgiveness.

This guidance included the following options:

- “Debt” model under ASC 470, where loan forgiveness is recognized as “other income” once the loan is officially forgiven.
- An analogy to International Accounting Standard 20, where the loan proceeds are accounted for as a deferred revenue liability and recognized as income as the related expenses are incurred. This standard includes a reasonable assurance standard (the equivalent of “probable” under generally accepted accounting principles) that the loan will be forgiven.
- Not-for-profit model, an analogy to ASC Subtopic 958-605, with the loan proceeds reflected as a conditional grant. Other income recognized as the conditions to the grant are satisfied.
- A contingency gain model under ASC 450-30, where income is recognized as the contingencies are satisfied. The latter three models all require various assessments of the probability that loan forgiveness is achieved.

## Conclusion

Recipients should exercise extreme care when preparing the forgiveness application, especially given the channels of review to which it will be subject. It is prudent to gather and organize the certification documentation in preparation for potential questions from the SBA.

Patience may also be necessary while the approval process works its way through the system, especially for larger loans. There will certainly be excitement when the confirmation letter of forgiveness arrives to soften some of the uncertainty that has characterized 2020. ■

## Endnotes

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JAMES E. HAZEL, JR., CPA, CCIFP, is Shareholder at Elliott Davis, LLC, a Southeastern regional CPA firm headquartered in Greenville, SC, with locations in Charlotte and Raleigh, NC; Columbia and Charleston, SC; Augusta, GA; and Chattanooga and Nashville, TN. Jim has 41 years of experience serving clients primarily in the construction, manufacturing, and closely held business specialties, including succession planning, budgeting, and business advisory consulting. Jim is a Past President of CFMA's Charlotte Chapter and is currently the Chair of CFMA's PPP Loan Task Force and a member of CFMA's Emerging Issues Task Force. He has given numerous presentations on accounting, audit, and tax advisory issues.

Phone: 803-255-1478  
E-Mail: [jim.hazel@elliottdavis.com](mailto:jim.hazel@elliottdavis.com)  
Website: [www.elliottdavis.com](http://www.elliottdavis.com)