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Are You a Government Contractor Seeking PPP Loan Forgiveness? Be Careful What You Wish For!

By Kevin J. Cosgrove and Sean B. O'Connell*

If a government contractor received a Paycheck Protection Program ("PPP") loan and thereafter obtains forgiveness of that loan, it may be required to credit the amount of the forgiveness back to the government. For that and other reasons discussed here, the authors of this article suggest that government contractors carefully consider whether seeking forgiveness of a PPP loan makes good business sense.

Anyone engaged in government contracting work knows that it is very different from working in the private sector. The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act")[1] passed in March of last year illustrates this point. For most private sector companies, loans received under the Paycheck Protection Program ("PPP") were eligible to be fully forgiven and treated—essentially—like grants. There was no obligation on private sector businesses to refund these loans to the government. The whole purpose of the PPP program was to help businesses keep their doors open and their employees working during a global pandemic. Requiring private businesses to repay those loans would have defeated that purpose.

PPP LOANS AND GOVERNMENT CONTRACTORS

For government contractors, however, the rules are very different. If a government contractor received a PPP loan and thereafter obtains forgiveness of that loan, it may be required to credit the amount of the forgiveness back to the government. For the reasons set forth below, a government contractor should carefully consider whether seeking forgiveness of a PPP loan makes good business sense. In some cases, government contractors might be worse off financially if they obtain forgiveness of that PPP loan than if they simply pay it back.

On April 17, 2020, the Department of Defense ("DOD") posted the following to its Frequently Asked Questions ("FAQs") dealing with the implementation of Section 3610 of the CARES Act:

Q23: Please confirm that neither the FAR Credits provision, FAR

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[1] https://www.congress.gov/116/bills/hr748/BILLS-116hr748enr.pdf.

> 31.201-5, the credit provision in the Allowable Cost and Payment Clause, FAR 52.216-7(h)(2), nor any other FAR or DFARS provision imposes an obligation on a contractor to credit any amount of [PPP] loan that is forgiven to any flexibly priced government contract or subcontract. We consider a contractor that has received a PPP loan will use the loan proceeds as it would any other funds in its corporate treasury to pay costs of doing business.
>
> A23: *We disagree*. Any PPP loan that has been forgiven necessarily can be treated as though it belongs to the company to use as it pleases. FAR 31.201-1, Composition of Total Cost, states that total cost is the sum of the direct and indirect costs allocable to the contract less any allocable credits. *Accordingly, to the extent that PPP credits are allocable to costs allowed under a contract, the Government should receive a credit or a reduction in billing for any PPP loans or loan payments that are forgiven. Furthermore, any reimbursements, tax credits, etc. from whatever source that contractors receive for any COVID-19 Paid Leave costs should be treated in a similar manner and disclosed to the government.* (Emphasis added).

This post was updated on August 17, 2020, but the message remained the same. On that date the DOD reiterated that, "to the extent that PPP credits are allocable to costs allowed under a contract, the Government should receive a credit or a reduction in billing for any PPP loans or loan payments that are forgiven."

DOD's position finds solid support in the Federal Acquisition Regulations ("FAR"). The FAR provisions referenced in the above FAQ make clear that, to the extent a government contractor receives forgiveness of some or all of a PPP loan, the amount of the forgiven loan may have to be credited back to the government. If you have received payment for contract costs such as labor, rent or other covered costs in a cost plus contract, you cannot also receive PPP loan forgiveness for those identical costs.

FAR Section 31.201-5 states the following:

> The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor *shall be credited to the Government either as a cost reduction or by cash refund*. See 31.205-6(j)(3) for rules governing refund or credit to the Government associated with pension adjustments and asset reversions. (Emphasis added.)

Additionally, FAR Section 52.216-7(h) (2) states that:

> The Contractor shall pay to the Government any refunds, rebates,

> credits, or other amounts (including interest, if any) accruing to or received by the Contractor or any assignee under this contract, to the extent that those amounts are properly allocable to costs for which the Contractor has been reimbursed by the Government. Reasonable expenses incurred by the Contractor for securing refunds, rebates, credits, or other amounts shall be allowable costs if approved by the Contracting Officer.

The Defense Contract Audit Agency ("DCAA") issued guidance earlier this year explaining how forgiven PPP loan proceeds would be audited.[2] If the loan proceeds were used to pay costs related to firm-fixed price contracts, those loan proceeds need not be credited back to the government. On the other hand, if the proceeds were used to pay indirect costs in cost plus type contracts, the indirect cost pool must be adjusted accordingly. You should be certain to maintain documentation that demonstrates how the loan proceeds were spent.

FRAUDULENTLY OBTAINED PPP LOANS

This is not simply an academic exercise. The Department of Justice ("DOJ") is relentlessly pursuing companies and individuals that are suspected of having fraudulently obtained PPP loans.[3] In both criminal prosecutions and civil actions alleging violations of the False Claims Act ("FCA"), DOJ has concentrated its enforcement efforts on those who falsified information on PPP loan applications.

But there is no reason to think criminal and civil enforcement efforts will stop there. The FCA prohibits people and businesses from making a false or fraudulent claim to wrongfully retain money or property that is owed to the government. At the very least, federal contractors that "double dip" contract payments and PPP loan proceeds that have been forgiven will probably find themselves in the cross hairs of a DCAA audit.

TAX IMPLICATIONS

There is yet another issue to consider. For purposes of federal income tax, forgiven PPP loans are not taxable. However, some states—including Virginia—do not follow the federal guidelines. Virginia does not tax forgiven PPP loans as income. That, however, does not end the analysis. On January 3, 2021,

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[2] *See* DCAA Revised Audit Alert on Coronavirus Legislation and Regulations, *available at* https://www.dcaa.mil/Portals/88/Documents/Guidance/MRDs/REVISED%2020-PIC-006(R)%20Revised%20Audit%20Alert%20on%20Coronavirus%20Legislation%20and%20Regulations_1.pdf?ver=JVxkE84cTWGnZQLDAbAUdQ%3D%3D.

[3] https://www.natlawreview.com/article/doj-continuing-to-target-ppp-recipients-fraud.

Congress passed the Consolidated Appropriations Act 2021 ("CAA").[4] The CAA permits taxpayers to claim a federal deduction for business expenses funded by forgiven PPP loan proceeds. But the Virginia General Assembly recently passed a bill capping that deduction at $100,000.[5]

Thus, depending on your state tax laws, obtaining forgiveness of your PPP loan could have adverse state tax consequences.

SHOULD CONTRACTORS' PAY BACK THEIR PPP LOANS?

PPP loans have very favorable terms for the borrower. They bear an interest rate of one percent. Loans issued before June 5, 2020, mature in two years. Loans issued after that date have a maturity date of five years. No collateral or personal guarantees are required. Neither the government nor the lender charges any fees to small businesses. Given the requirements to credit the government for any loan forgiveness—as well as the collateral issues discussed above—it might make sense for your business simply to pay the loans back in due course.

Obviously, each business has different financial considerations. There is no "one size fits all" approach to this issue. Before you make the decision to seek PPP loan forgiveness, discuss these issues with your financial advisors and accountants. Seeking and obtaining PPP loan forgiveness might be right for your business—but it might not. As with most things, the devil is in the details.

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[4] https://www.congress.gov/116/bills/hr133/BILLS-116hr133enr.pdf.

[5] *See* Virginia Tax Bulletin 21-4, March 15, 2021, *available at* https://www.tax.virginia.gov/sites/default/files/inline-files/tb-21-4-irc-conformity-advanced.pdf.