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HOW TO PREPARE FOR A PAYCHECK PROTECTION PROGRAM LOAN AUDIT



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In anticipation of Paycheck Protection Program loan audits, especially for PPP loans in excess of \$2 million, businesses should be prepared to defend their good-faith certifications, to provide documentation substantiating eligible expenses, and for the possibility of further review by the IRS if they take corresponding business expense deductions.

Businesses must be ready to defend the certifications made on their PPP loan applications and promissory notes by accounting for business activity at the time the certification was made and whether they had access to other sources of liquidity which would not be significantly detrimental to their business. The negative

effects of the Covid-19 pandemic on business activity can be demonstrated through a combination of financial records and analysis, such as comparisons of revenue, sales or other industry-specific metrics to show actual and anticipated financial performance relative to 2019 and the time leading up to the certification date. Consider also referencing ordinances that impacted business activity and industry or regional trends/projections.

A business should also be prepared to explain why existing lines of credit that were not fully exhausted at the time of the application could not be used for payroll without being "significantly detrimental" to the business. For example, a hypothetical business might explain that it relies on its line of credit to purchase inventory before the summer season and to divert such funds to payroll would prevent the business from being able to meet potential demand.

Businesses must be prepared to provide comprehensive documentation to substantiate eligible expenses. This documentation will be reviewed by the lender servicing the PPP loan and possibly the SBA/IRS during the loan forgiveness application process and/or subsequent audit. Loan forgiveness is based in part on the total amount of eligible expenses made during the 8-week or 24-week covered



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period following the first disbursement of PPP loan funds, subject to the requirement that 60% or more of such expenses be for eligible payroll costs.

For payroll expenses, businesses should be prepared to provide bank account statements, tax forms (Forms 941), payroll records and receipts, cancelled checks, and account statements documenting any employer contributions to employee health

and retirement plans.

For non-payroll expenses, businesses should be prepared to provide documentation verifying the existence of the obligations and/or services prior to February 15, 2020 and eligible payments made during the covered period. This includes a copy of the lender amortization schedule, lease agreement, and/or invoices.

Under IRS Notice 2020-32, the current IRS position is that business expenses are not deductible to the extent they were paid with forgiven PPP loan funds. A bipartisan group of Senators disagreed and stated that their intent was that these business expenses should be deductible. If additional legislation does not provide clarification, Notice 2020-32 appears subject to challenge as being inconsistent with Congressional intent, in addition to other legal challenges. Finally, it should be noted that IRS notices are not afforded the same level of legal precedent as a statute passed by Congress and courts are not bound by them.

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