

PPP Recipients Beware – Your Loan Forgiveness May Be a Credit Due Back to Government

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One of most significant aspects of the 2020 Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was the “Paycheck Protection Program” (PPP). PPP, administered by the Small Business Administration (SBA), authorized \$349 billion for federally guaranteed loans to small businesses and self-employed individuals adversely impacted by COVID-19. These loans have very favorable terms and largely can be forgiven, and thus are essentially tax-free grants to pay for payroll and other immediate needs within certain parameters defined by the SBA and U.S. Department of the Treasury. But for some government contractors—namely those with cost reimbursable contracts subject to Federal Acquisition Regulation (FAR) 31.201-5 (Credits)—loan forgiveness may come with a surprise bill.

PPP loans were not specifically designed for small business government contractors (or larger ones that fit under the PPP’s unique definition of small). The SBA’s government contracting affiliation rules, for example, were not imposed in their entirety on PPP recipients, and only one size standard, 500 employees, was used for small business eligibility. Unfortunately, this general lack of consideration for government contractors utilizing the program left open a crucial question: how to account for these loans under the FAR cost principles? Specifically, how does FAR 31.201-5, Credits, apply to PPP loan forgiveness and what the company might owe back to the Government?

FAR 31.201-5 states in relevant part: “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

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to the Government either as a cost reduction or by cash refund.” As many contractors are now discovering through questions about their incurred cost submissions this year, the Defense Contract Audit Agency (DCAA) views PPP loan forgiveness as squarely within this cost principle, and it must be disclosed as a Credit. Essentially, DCAA is scrutinizing whether the Government might be paying twice for the same paycheck, once under PPP and again under a cost-type contract.

Indeed, on April 23, 2021, DCAA issued updated guidance to its auditors that included Frequently Asked Questions (FAQs) discussing FAR 31.201-5 and PPP loan forgiveness. See 20-PIC-005(R), Revised Audit Alert on Coronavirus Legislation and Regulations. That guidance asks: “If a contractor has cost-type contracts and its PPP loan is forgiven, will these contracts receive a credit due to the loan forgiveness?” DCAA’s unhelpful but somewhat understandable answer is “Maybe.”

The reason is that FAR 31.201-5 applies only to the “applicable portion” of the loan forgiveness. Thus, as DCAA’s answer continues, how the loan proceeds were originally accounted should be the same way that the loan forgiveness is accounted, and that will determine if a Credit is owed. The example given in the DCAA guidance is that if PPP funds were used for rent, then the credit should be applied to rent cost. If that rent was also charged directly or indirectly to a cost-type contract, then the Government must be credited the applicable portion of the loan forgiveness. But if the PPP loan was used entirely to pay for expenses under Firm Fixed Price contracts or commercial work, such as direct charge employees to that work, FAR 31.204-5 would not apply to any portion of the forgiveness.

The U.S. Department of Defense, Defense Pricing and Contracting, had previously issued its own FAQ guidance in April 2020, shortly after the CARES Act was enacted, that echoed this position on FAR 31.205-5. In response to a question that “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,” DoD stated that “We disagree . . . 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.” Although this DoD FAQ was issued with little fanfare, contractors will have a difficult time arguing that they accepted PPP loans under a false representation by the Government that PPP forgiveness would be exempt from this cost principle.

Congress has recognized this problem facing at least some contractors. In March 2021, the House Small Business Committee held a hearing on the impact to engineering firms if FAR 31.201-5 applied to their PPP loan forgiveness. Recently, in September 2021, the House passed an amendment to the FY2022 National Defense Authorization Act that would expressly waive FAR 31.205-5 and provides that no Credit shall be due for PPP loan forgiveness. However, the amendment is limited to Architectural and Engineering cost-reimbursement contracts or subcontracts awarded with federal highway or public transportation funds.

Whether Congress will expand this waiver to other contractors is unknown, but is unlikely given the potential cost to the Government, and the rationale behind the Credit cost principle—to avoid paying twice for the same cost—despite these unusual times. For now, contractors that have either faced questioning from DCAA or are preparing their incurred cost submissions should be aware of this requirement and how to account for PPP

loan forgiveness. Contractors that have not yet requested loan forgiveness should undertake the exercise to determine if a Credit would be due, and decide if the company is best served by paying back the loan over its term.

Wiley's COVID-19 Resource Center has further guidance about the PPP and other CARES Act provisions, and its Government Contracts Practice and COVID-19 Task Force are ready to help you navigate these issues.