Paycheck Protection Program: Unintended Consequences

The Paycheck Protection Program (PPP) within the CARES Act has had a profound impact on nearly every small business in America. While this program has generally been met with hope and optimism from those that have received the loans, the Engineering community is gravely concerned about some serious unintended consequences. This revolves around two key issues:

1. The deductibility of the underlying expenses for income tax purposes, and
2. The treatment and impacts on a consultant's overhead rate.

Issue 1

Under current guidance from IRS in Notice 2020-32 (recently re-affirmed by Revenue Ruling 2020-27), the expenses that are paid by the forgiven funds are not deductible for tax purposes. This in essence makes the forgiven loan taxable income to the firm. While there is still benefit to the forgiven loan, it is much less than what was originally intended within the Act. This is not only a problem for Engineering firms, but for every small business that received a PPP loan.

Issue 2

The overhead rate implications are specific to government contractors but have the potential for a much more profound impact on these small businesses. FAR 31.201-5 states:

"the applicable portion of an income, rebate, allowance or other credit relating to allowable costs and received by the contractor shall be credited to the Government either as a cost reduction or by cash refund."

Unfortunately, there is no authoritative guidance on the practical application of this section for non-Federal agencies. Instead, many within the industry are inserting opinion to stipulate that ALL of the forgiven funds should be credited to a firm's overhead no matter what those funds were actually spent on (direct labor, indirect labor, rent, utilities, and interest).

Financial Implications

Below is a summary of the financial impact these two issues can create for government contractors using actual information from a small Disadvantaged Business Enterprise (DBE)-certified Engineering firm with approximately $2.5M in revenues that received a $333,000 loan and does approximately 60% of their work with the DOT:

Current projected OH rate without PPP credit		**157.46%**

	ALL forgiven funds credited to OH	Forgiven funds are allocated between cost categories
Adjusted Overhead Rate	119.61% (-37.85%)	139.93% (-17.53%)
PPP Loan amount	$ 333,000.00	$ 333,000.00
Additional Taxes to be paid	$ (100,000.00)	$ (100,000.00)
Revenue decrease	$ (568,000.00)	$ (263,000.00)
Net cost to the small business	**$ (335,000.00)**	**$ (30,000.00)**

As you can see, there is a very real possibility that by accepting a PPP loan, using the funds on allowable expenses as defined by the Act and applying for forgiveness, many small Engineering firms could actually be worse off than if they never applied for the loan in the first place.

ACEC Recommendation

These extraordinary times call for outside the box thinking and the ability to come to a reasonable resolution to these complex issues. ACEC recommends the DOT view these funds received by the Federal Government as outside of the intentions of FAR 31.201-5 for State contracting and overhead calculation purposes to avoid adversely impacting many small Engineering businesses within the State.