

The PPP Business Activity Safe Harbor – Proceed with Caution

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In our conversations with PPP borrowers, we discover that many are planning to rely on the *business activity safe harbor* provision when applying for loan forgiveness. We urge that they proceed with caution however, because for many of these borrowers the safe harbor may not apply.

The business activity safe harbor provision was added by the PPP Flexibility Act in June 2020. It states that a borrower is exempt from full-time equivalent employee (FTE) reductions if the borrower is unable to return to the same level of business activity during their covered period that the borrower was operating at before February 15, 2020 due to compliance with requirements established or guidance issued by the Secretary of Health and Human Services (HHS), the Director of the Centers for Disease Control (CDC), or the Occupational Safety and Health Administration (OSHA) (“COVID-19 Guidance”) between March 1, 2020 and December 31, 2020. The SBA has stated that this COVID-19 Guidance can be direct or indirect. According to the SBA, *indirect guidance* means “state and local shutdown orders that are based in part on guidance from the three federal agencies.”

To rely on the business activity safe harbor, a borrower must demonstrate two things:

1. First, there must be a shutdown order or operating restriction issued by a federal, state or local government based on COVID-19 Guidance that the borrower was required to comply with.
2. Second, the borrower must be able to demonstrate a reduction in business activity through their covered period.

These two requirements are not as straightforward as they seem. Many borrowers have suffered a reduction in business activity and some, quite a significant reduction. But these reductions may have resulted from a drop in demand due to compliance with COVID-19 Guidance by customers and others, not the borrower directly, or due to supply chain disruptions or labor issues. Furthermore, the terms *reduction* and *business activity* are not defined and raise a number of questions for which the answers are unclear, including:

- **How much of a reduction is necessary to meet this standard?**
 - Is a one percent reduction sufficient?
 - Or does it need to be five percent?
 - Or twenty-five percent?
- **What exactly is a *business activity* and how is it measured?**
 - While there are many definitions of the term business activity, they can generally be boiled down to *an activity regularly carried on for profit*. It's probably safe to assume that a business activity can be measured by the revenue it generates; but can it also be measured by profit?
- **What about the activities of nonprofit organizations (including fundraising activities)?**
 - Are these business activities?

If the borrower runs a restaurant, non-essential retail business, gym, hair salon or a day care facility, there is little question that the business activity safe harbor should apply in most cases. But what about the many other industries that were severely impacted by the pandemic? Let's explore some examples.

Hotels – Few industries have been hurt by the pandemic as severely as the lodging industry. Some hotels have seen revenue declines of 80 percent or more. Yet, in most states, hotels were deemed *essential businesses*. The reductions in revenue were the result of federal and state travel restrictions, shelter in

place orders and consumer fear, but generally not the result of the hotels' compliance with COVID-19 Guidance. Hotels that had significant restaurant, catering, conference and event businesses probably have a strong argument that the business activity safe harbor applies. But absent these activities, it may be a stretch.

Independent Schools – Many independent schools believe they qualify for the business activity safe harbor because they were ordered to shutdown classrooms and implement remote learning. These schools may have seen a small reduction in ancillary revenues related to after school and other extracurricular activities, but very few reduced or refunded tuition or fees. Galas may have been canceled or postponed and contributions may have been impacted, but were these reductions *significant*, and more important, are these even *business activities*?

Distributors – Many distributors – especially those that service restaurants, schools or the travel industry – have seen sharp declines in revenue. While their customers may have been subject to COVID-19 Guidance, that guidance generally did not extend to the distributors themselves, despite the significant impact to their businesses.

Transportation Companies – With schools closed and travel nearly coming to a halt, many private transportation companies have also seen sharp declines in revenue. Like distributors, however, these declines were not the result of the businesses' compliance with COVID-19 Guidance. Rather, it was the customers of these businesses that were subject to compliance. While bus companies servicing school districts *may* have an argument that the school closings extended to the school bus companies that are retained by the schools, other private transportation providers will probably have a more difficult time making the connection to compliance with specific COVID-19 Guidance.

Law Firms – We have seen law firms with large litigation or immigration practices that have experienced significant declines in revenue because the courts were shut down and government offices were closed. But like so many other businesses that were severely impacted by the pandemic, law firms were deemed essential businesses and were not ordered to close.

Our advice for those thinking about relying on the business activity safe harbor:

Unless you are a business that clearly qualifies for the safe harbor – most restaurants, non-essential retailers, etc. – consider other avenues to full forgiveness. With 24 weeks to accumulate eligible costs, many borrowers will be able to achieve full forgiveness despite some reductions in FTEs. It may require a bit more work than simply checking the safe harbor box, but it's a sure thing. For most borrowers, there's a lot of money at stake.

If you are a business that does not clearly qualify for the business activity safe harbor and will not qualify for full PPP forgiveness due to FTE reductions, do your homework. Search the executive orders for those that might apply. Reach out to your industry association to see what advice it has to offer. Then, work with your accountant and your attorney to build and document your case.

At this moment, we don't know how lenient the SBA will be in accepting the business activity safe harbor without explicit compliance guidance; nor do we know how it will respond to a denied safe harbor. Will they allow the borrower to resubmit a forgiveness application based on FTEs? Or will they simply deny forgiveness and force the borrower to file for an appeal hearing? Accordingly, we recommend borrowers include as much information as they can with their forgiveness application. If the lender's portal allows, use the regular forgiveness form (as opposed to the EZ form) and check the safe harbor box. Include with the form all of the FTE information for both the covered period and the base period. If necessary, attach a statement with this information so that the SBA can see how much forgiveness you will qualify for without applying the safe harbor. We believe the more information you can provide, the better.

Unfortunately, there are many businesses that have been severely impacted by the pandemic but were not directly subject to compliance with COVID-19 Guidance, and therefore, may not qualify for the business activity safe harbor. The sad irony is that many of the businesses that need the PPP loans the most, those that are truly fighting for survival, are the same businesses that were unable to maintain sufficient FTE levels to qualify for full loan forgiveness. Yet, another major flaw in the design of the PPP. Maybe some additional relief will be forthcoming. In the meantime, be sure to make the best of a difficult situation by avoiding shortcuts and building your case.

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Contact Us

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