As Congress moves towards fixing the CARES Act, some borrowers seek relief from arguably invalid SBA rulemaking through the Administrative Procedures Act

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On March 27, 2020, Congress passed, and President Trump signed into law, 880 pages of stimulus in response to COVID-19, commonly referred to as the CARES Act. Due to the emergency pace at which Congress was required to act in response to the growing public health and economic crisis, the legislative history for the CARES Act is less clear as to Congress' intent than typical legislation. Businesses and advisors have been left to decipher the CARES Act on its face while the Treasury scrambles to issue guidance via FAQs, interim final rules, and other less formal public announcements. As businesses navigate the CARES Act, they, therefore, need to be careful to understand when and to what extent such guidance can be changed, and what those changes mean for them. Businesses that understand this process will be better positioned to make planning decisions. Recent developments relating to the Paycheck Protection Program (PPP) illustrate this point.

On April 30, the Internal Revenue Service (IRS) issued Notice 2020-32 (the Notice), which declared that PPP loan recipients cannot deduct the business expenses paid for by the loan proceeds which were slated to be forgiven. We wrote in depth about this Notice last week, doing the math on the cost of losing the deductibility, and again reminding small business owners that they should compare the benefits available through the Employee Retention Credit against the loan amounts available under the PPP before making a decision to use the PPP. The Notice makes clear the view of the IRS that under Internal Revenue Code Section 265, and applicable case law, the deduction cannot be allowed. In other words, the Treasury is saying, unless Congress acts, its hands are tied.

In the week since the Notice, pressure has mounted for Congress to act. This pressure culminated in a bill introduced on May 5 in the Senate (S. 3612) (the Bill) to reverse the effects of the Notice. The Bill, with only 14 lines, is considered a "technical correction." This means that Congress is saying that it never intended for the tax deduction to be disallowed, and any contrary language is (essentially) a drafting error. If enacted into law, the Bill would nullify the Notice and would permit all otherwise qualifying expenses paid for with PPP money to be tax-deductible.

In contrast to this legislative approach to fixing the problem highlighted by the Notice, a number of Senators recently signed a letter addressed to the Treasury and the Small Business Administration (SBA) urging greater flexibility with respect to PPP loan forgiveness, so that 50% of the PPP loan proceeds could be used for non-payroll costs (increased from 25% as set by the SBA's April 15, 2020, Interim Final Rule). Because this change would not require a departure from the language in the CARES Act, these Senators rightly believe that the Treasury and the SBA have the power to depart from or adjust their own regulatory guidance.

In some instances, a letter like this can work. On May 4, 2020, some Senators wrote to the Treasury asking it to reverse a position it had taken in an FAQ with respect to health plan expenses being included in wages, despite the employee not receiving other wages. This issue arises in the CARES Act with respect to the Employee Retention Credit (Section 2301). The Treasury quickly responded on May 7 and revised the FAQ. In this case, unlike with the Notice, the Treasury clearly felt that neither the CARES Act, the Internal Revenue Code, nor other case law prevented it from adopting this interpretation.

Sometimes, however, no corrective action is taken by legislators to fix what seems to be an incorrect reading of a statute by a regulator or administrator. For example, some businesses believe (and not without reason) that the efforts by the SBA and the Treasury in FAQs 31, 37, and 43 to interpret the CARES Act to preclude otherwise qualifying borrowers from accessing PPP loans if they have "liquidity" through other sources of funds (for example, by accessing the capital markets) are simply wrong. The argument is that the CARES Act *expressly* makes the usual SBA "no credit elsewhere" requirement for borrowers inapplicable to PPP lending.[1]

Such businesses have a potential remedy in the Administrative Procedure Act, 5 U.S.C. § 706(2)(A) & (C) (2020). Under those provisions, an aggrieved party can challenge agency action (here, likely the offending FAQs) as having been issued in excess of the authority granted to the agency, or simply as contrary to law.[2] While agency guidance and interpretations receive deference from courts under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[3] that deference is limited (and under attack in the Supreme Court).

Indeed, one court has already granted a preliminary injunction with respect to PPP loan applications that were denied based on the SBA's adoption of a rule "excluding from PPP loan guarantee eligibility a wide range of businesses—including banks, political lobbying firms, certain private clubs with restrictive admissions practices, and sexually oriented businesses that present entertainment or sell products of a 'prurient' (but not unlawful) nature (the 'PPP Ineligibility Rule')."[4] According to the court, the CARES Act rejected such limitations "by establishing only two criteria for PPP loan guarantee eligibility and providing that 'any business concern . . . *shall* be eligible' for a PPP loan guarantee if it met those criteria. 15 U.S.C. § 636(a)(36)(D)(i) (emphasis added)."[5] The court, therefore, held that "the SBA's PPP Ineligibility Rule is invalid because it

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[1] *See* 15 U.S.C. § 636(a)(36)(I) (2020).

[2] *See. e.g.,* Complaint, *Zumasys, Inc. v. United States Small Business Admin.,* No. 20-cv-00851-JLS-DFM (C.D. Cal. May 4, 2020) [PACER Dkt. #1]) (challenging the validity of FAQs 31 and 37).

[3] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

[4] Opinion and Order, *DV Diamond Club of Flint, LLC v. United States Small Business Admin.*, No. 20-cv-10899, slip op. at 2 (E.D. Mich. May 11, 2020) [PACER Dkt. # 42].

[5] *Id.*

contravenes the PPP."[6] While the injunction issued is specific to this case, the decision provides a detailed road map for borrowers to seek relief for administrative overreach by the Treasury and the SBA.

Nixon Peabody has successfully litigated cases with respect to invalid agency guidance in the past and received an attorneys fee award pursuant to the Equal Access to Justice Act. The firm is continuing to track COVID-19 developments related to the CARES Act, legislative and administrative developments, and beyond. We are well-positioned to represent parties injured by administrative overreach or invalid agency rulemaking.

If you have any questions about COVID-19 relief programs, contact your regular Nixon Peabody attorney or:

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[6] *Id*. at 3.