

COVID-19 Alert

CARES ACT PAYCHECK PROTECTION PROGRAM LOANS JUNE 1, 2020 UPDATE

JUNE 2020

This continues our efforts to provide updates on the Paycheck Protection Program (PPP) loan offerings created by the CARES Act and overseen by the Small Business Administration (SBA).

OVERVIEW

On May 15, 2020, SBA issued its form [Loan Forgiveness Application](#), which was discussed in our [May 18 update](#).

On May 20, 2020, SBA, in conjunction with the Department of the Treasury, issued two new Interim Final Rules (IFRs) relating to the loan forgiveness process. These are discussed below.

IFR ON LOAN FORGIVENESS REQUIREMENTS

The [first IFR](#) was issued by SBA, and in part by Treasury, and is titled “Business Loan Program Temporary Changes; Paycheck Protection Program – Requirements – Loan Forgiveness.” The substance of the IFR is contained in part III.

The main purpose of the IFR is to provide formal rule-making to support the Loan Forgiveness Application. In addition, it provides additional details on the forgiveness process and some additional guidance on various forgiveness topics.

Process Overview

As previously determined, the lender has 60 days to process a borrower’s Loan Forgiveness Application, which may be either the SBA form or a “lender equivalent.” What is new is that the Lender’s determination will be sent initially to SBA, which has up to 90 days to review. SBA will either submit funds to the lender under its guaranty obligation (implicitly approving forgiveness, but presumably subject to further audit or investigation) or determine that the borrower was ineligible for the loan, in which case the loan will not be forgiven. If forgiveness is denied entirely, or does not cover the full loan amount, the borrower must repay the loan in accordance with its two year term. Since this process can now run beyond the date loan payments become due, there is a provision for the lender to reimburse the borrower for loan payments previously made. This process is further addressed in the other new IFR, discussed below.

Eligible Payroll Costs

This is topic 3, and begins with a discussion of the distinction between Payroll Costs “paid” and/or “incurred.” That discussion includes a formalization of

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the Covered Period and Alternative Payroll Covered Period distinction raised by the Loan Application Form. As suspected, amounts credited as paid can include amounts actually paid in the applicable eight week period despite being “incurred” earlier. Amounts credited as “incurred” are those pertaining to the payroll period overhanging the end of the eight week period, based on the day “earned” by the employee, and actually paid by the next payroll date. Amounts are “earned” by day based on days worked (or that would have been worked in the case of employees being paid but not required to work). A borrower cannot be credited twice for costs both paid and incurred.

Next, SBA is allowing credit for “bonuses” and “hazard pay” paid or incurred in the eight-week period, although only for employees compensated at \$100,000 or less on an annualized basis. This clarifies a topic raised by many borrowers, since the CARES Act itself did not include “bonuses” in its litany of Payroll Costs.

SBA also has provided limits on loan forgiveness tied to payroll compensation to owner-employees and self-employed individuals. What had appeared to be a cap of \$15,385 for each such individual is now the lesser of that amount or 8/52 of 2019 payroll compensation paid to him or her. General partners have further limitations. Also, no additional forgiveness is permitted for retirement or health insurance contributions for these individuals.

Eligible Non-Payroll Costs

This is topic 4, and also begins with a discussion of the distinction between costs “paid” and/or “incurred,” with a similar approach to that for Payroll Costs. Emphasis is put on the inability to obtain forgiveness for advance payments of mortgage interest (as well as for payment of any mortgage principal).

Reductions to Loan for Forgiveness Based on FTE and Compensation Reductions

This is topic 5. It begins by formalizing the exemption to reduction for employees who are laid-off or have their hours reduced, then are offered to be brought back to prior hour and compensation rates, but who refuse the offer. This topic was originally addressed by an FAQ and then the Loan Forgiveness Application. A new requirement has been added: employers must communicate the employee’s rejection of the offer to the applicable state unemployment office within 30 days of rejection of the offer.

SBA then moves to a discussion of the reduction to forgiveness based on reduction in FTE topic. As to reduction itself, not much new is added, but clarity is provided as to how to calculate FTEs. The general rule is to count each employee based on a norm of a 40-hour work week. An employee working 40 hours (or more) a week is one FTE; an employee working 30 hours a week is 0.75 FTE; and so on. In lieu of this, the borrower can classify each employee working fewer than 40 hours per week as 0.5 FTE. Significantly, the same approach must be used for both the Covered Period (or Alternate Payroll Covered Period) and for the applicable reference period.

Next is a discussion of the reduction to forgiveness based on reduction in salary / wage. This reduction only applies to employees compensated on a less than \$100,000 per year rate, and is a dollar for dollar reduction in

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forgiveness for reductions in compensation of greater than 25%. By use of an example, SBA clarifies this point. An employee previously compensated at \$1,000 per week and reduced to \$700 per week during the Covered Period (or Alternate Payroll Covered Period) would have suffered a 30% compensation reduction. The first \$250 of reduction (25% of the prior compensation rate of \$1,000) is exempt from forgiveness reduction, while the remaining \$50 of reduction would reduce forgiveness, resulting in \$400 of total reduction in forgiveness (the \$50 multiplied by the eight weeks of the period).

Next, SBA clarifies that borrowers will not be double penalized under these provisions for action with an employee that results in reduction both in FTEs and compensation. If a full-time employee is reduced to half-time, and thereby has his or her compensation halved, only the FTE reduction would be taken into account for calculating the reduction of loan forgiveness.

SBA then reiterates that reductions in FTEs or compensation during the Covered Period (or Alternate Payroll Covered Period) will not result in reduction of forgiveness if reversed on or prior to June 30, 2020. While confirming what is in the CARES Act itself, this portion of the IFR does not provide additional guidance for how to apply these rules. By way of example, can a borrower avoid reduction in forgiveness based on reduction in compensation simply by restoring compensation rates for the pay period including June 30, but not thereafter? A literal reading seems to say just that.

Finally, SBA formalizes certain exceptions created in the Loan Forgiveness Application. Employees who are terminated for cause, voluntarily resign, or voluntarily seek schedule reductions will not be counted as reduction to FTEs.

Documentation of Forgiveness

The IFR simply adopts the requirements of the Loan Forgiveness Application as to documentation, with respect to both documentation that must be submitted and documentation that must be maintained for six years following loan forgiveness or payment.

IFR ON SBA LOAN REVIEW PROCEDURES

The [second IFR](#) was issued by SBA, and is titled “Business Loan Program Temporary Changes; Paycheck Protection Program – SBA Loan Review Procedures and Related Borrower and Lender Responsibilities.” The substance of the IFR is contained in part III.

SBA begins by reciting the Administrator’s statutory authority “to conduct investigations to determine whether a recipient or participant in any assistance under a 7(a) program, including the PPP, is ineligible for a loan, or has violated section 7(a), or any rule, regulation or order issued thereunder.” The purpose of the IFR is “to adopt additional procedures and criteria through which SBA will review whether an action by the borrower has resulted in its receipt of a PPP loan that did not meet program requirements.”

Will SBA Review Individual PPP Loans?

Yes. This may entail review of ANY PPP loan, as the SBA Administrator deems appropriate.

NOTE: this is not limited to PPP loans in excess of \$2,000,000.

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What Borrower Representations and Statements Will SBA Review?

SBA is authorized to review three categories of items:

BORROWER ELIGIBILITY: This review generally is as to whether the borrower was eligible for a PPP loan “based on the provisions of the CARES Act, the rule and guidance available at the time of the borrower’s PPP loan application, and the terms of the borrower’s loan application.” This specifically includes the borrower’s Loan Application certifications, which in turn include certifications as to general eligibility, and as to whether the loan was “necessary” to the borrower. See our [May 1](#), [May 6](#), and [May 13](#) updates as to the “necessary” certification. Again, this applies to ANY PPP borrower, not just one with a loan in excess of \$2,000,000.

LOAN AMOUNT AND USE OF PROCEEDS: This review goes to borrower’s initial calculation of loan amount in its original application, as well as uses made of the loan proceeds.

LOAN FORGIVENESS AMOUNT: This review is broad brush as to whether a borrower is entitled to forgiveness at all and, if so, the amount of the forgiveness.

When Will SBA Review?

SBA asserts the right to review a PPP loan of any size at any time, in its discretion. So this can occur now, upon submission to SBA by the lender of a forgiveness package (discussed above and below), or, presumably, at any time after the loan has been forgiven or paid. SBA stresses the obligation of borrowers to maintain required documents for six years following forgiveness or payment, as laid out in the instructions to the Loan Forgiveness Application.

IF SBA does review and has questions, these will be forwarded to the lender, which in turn will forward them in writing to the borrower. The borrower will be expected to respond to the lender, which will then forward to SBA. Failure by the borrower to respond can result in determination of initial ineligibility for the loan, as well as negative determinations as to the original amount of the loan or the amount of forgiveness claimed.

What if SBA Determines Borrower Ineligible for the Loan?

That determination makes the loan not subject to forgiveness. Similarly, if the amount of the loan or the amount of forgiveness claimed is deemed inappropriate, SBA will direct the lender to deny forgiveness in whole or part, as applicable. In addition, “SBA may also seek repayment of the outstanding PPP loan balance or pursue other available remedies.” Other available remedies would appear to include claims under the False Claims Act or criminal referral, as discussed in our [May 1](#) update.

SBA assures that a borrower will have appeal rights for an SBA determination of ineligibility for the PPP loan in the first instance, or for the amount of the loan applied for or the amount of forgiveness sought. What that appeal process will look like is not clear. SBA promises a future IFR to explain it.

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What is the Forgiveness Process for Borrowers and Lenders?

The borrower must submit the Loan Forgiveness Application and required supporting documentation. From there, the lender has up to 60 days to review and make an initial determination. That determination can take one of three forms:

APPROVAL IN WHOLE OR PART: The lender so informs SBA and requests payment under SBA's guaranty of the amount approved by the lender for forgiveness. SBA has up to 90 days to review and make payment, subject to its right to review (i.e., SBA can deny forgiveness, or take other action as it reviews). The IFR does not make clear what, if any, information is to be provided to the borrower about the lender's initial determination. Note that if these periods are extended in full, the borrower will be past the six-month payment forbearance period and into loan repayment before a decision is finalized.

DENIAL: If the lender determines that forgiveness is fully denied, it must notify SBA with the reason, as well as appropriate documentation. It must also notify the borrower. SBA has the authority to reverse the lender's determination.

DENIAL WITHOUT PREJUDICE: This status applies only if directed by SBA, and will occur because SBA is reviewing the loan. It is not clear what is communicated to the borrower, or when, if this is the determination. Ultimately, the borrower has a right to request reconsideration from the lender "unless SBA has determined that the borrower is ineligible for a PPP loan."

This portion of the IFR is written primarily as guidance to lenders. It is almost entirely opaque to borrowers as to what will be going on with their forgiveness applications during a period of up to five months as their loan move into payment status.

IS THIS THE FINAL WORD?

Clearly not. A number of open questions remain concerning the PPP as it currently exists. As noted in our [May 18](#) update, there is legislation pending in Congress that may substantially alter the PPP generally, and the forgiveness rules in particular. What comes next is uncertain.

PRIOR UPDATES.

For our previous PPP articles, please see *CARES Act Paycheck Protection Program Loans COVID-19 Alerts* dated [April 1](#), [April 3](#), [April 9](#), [April 16](#), [April 24](#), [May 1](#), [May 6](#), [May 13](#), and [May 18](#) on our website.

We are interested to hear your experiences with the PPP.

Please contact the Reid and Riege attorney with whom you regularly work, or a member of our Business Services practice listed to the right, for more up to date information, or questions about your unique circumstances.

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