REID & RIEGE ATTORNEYS

COVID-19 Alert

CARES ACT PAYCHECK PROTECTION PROGRAM LOANS JUNE 12, 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).

WHAT HAS CHANGED?

On June 3, 2020, the Senate passed the "Paycheck Protection Program Flexibility Act of 2020" (the Flexibility Act), which had previously been passed by the House of Representatives. As discussed in our June 4 update, the Flexibility Act provides for substantial changes in the PPP.

On June 5, 2020, the President signed the Flexibility Act into law.

On June 11, 2020, SBA promulgated a new Interim Final Rule titled "Business Loan Program Temporary Changes; Paycheck Protection Program – Revisions to First Interim Final Rule" (the New IFR). The New IFR is a largely technical undertaking to revise SBA's Interim Final Rule issued April 2, 2020 and published in the Federal Register April 15, 2020 (the First IFR), to conform the First IFR to changes to the PPP made by the Flexibility Act. The First IFR was SBA's initial rule-making to implement the PPP, and was discussed in our April 3 update.

WHAT DOES THE NEW IFR SAY?

The First IFR established a broad regulatory structure for the PPP. The New IFR serves mainly to modify the regulations adopted in the First IFR to implement the new 24 week Covered Period, as well as the new PPP loan duration, loan deferral, and loan forgiveness provisions discussed in our June 4 update.

The most significant aspect of the New IFR is to answer a question on PPP loan forgiveness created by the Flexibility Act. As we have discussed, prior to the Flexibility Act, SBA (in the First IFR) imposed a requirement that Payroll Costs must constitute at least 75% of the eligible expenses taken into account in determining the base loan forgiveness amount, with Non-Payroll Costs limited to not more than 25%. The Flexibility Act substantially loosened this restriction to require only 60% Payroll Costs and permit up to 40% Non-Payroll Costs. However, the language of the Flexibility Act arguably established the 60% Payroll Costs as a pre-requisite for ANY loan forgiveness, not just a limitation on the amount that could be forgiven.

OUR COVID-19 TEAM

Business & Contracts

Kathleen M. Coss
(860) 240-1035 • kcoss@rrlawpc.com
Thomas R. Kasper
(860) 240-1084 • tkasper@rrlawpc.com
Cathryn A. Reynolds
(860) 240-1019 • creynolds@rrlawpc.com

Commercial Real Estate

Louis J. Donofrio
(860) 240-1042 • ldonofrio@rrlawpc.com
Thomas R. Kasper
(860) 240-1084 • tkasper@rrlawpc.com

Employee Benefits & Compensation

Douglas K. Knight
(860) 240-1028 • dknight@rrlawpc.com

Estate Planning & Trust Matters

John R. Ivimey
(860) 240-1062 • jivimey@rrlawpc.com
Barbara A. Taylor
(860) 240-1033 • btaylor@rrlawpc.com

Finance & Business Insolvency

Jon P. Newton
(860) 240-1090 • jnewton@rrlawpc.com

Government & Regulatory Investigations

Thomas V. Daily
(860) 240-1067 • tdaily@rrlawpc.com

Health Care Providers & Privacy

Adam Carter Rose
(860) 240-1065 • arose@rrlawpc.com

HR & Employee Issues

Adam T. Boston
(860) 240-1023 • aboston@rrlawpc.com
Brian O'Donnell
(860) 240-1012 • bodonnell@rrlawpc.com

Trust & Wealth Management

*David L. Sullivan, CTFA**
(860) 240-1022 • dsullivan@rrlawpc.com

**Mr. Sullivan is a Certified Trust Financial Advisor; he is not an attorney.*

SBA, in consultation with the Secretary of the Treasury, has chosen to answer the question in favor of PPP borrowers, stating that it “interprets this requirement as a proportional limit on [Non-Payroll Costs] as a share of the borrower’s loan forgiveness amount, rather than a threshold for receiving any loan forgiveness.” It introduces an example into the rules to illustrate how the proportional limit works. In the example, the borrower has obtained a $100,000 PPP loan, and during the Covered Period has Payroll Costs of $54,000 (54% of loan amount). Since this is less than 60% of loan amount, the full amount of the loan cannot be forgiven. Rather, the maximum loan forgiveness amount will be $90,000, consisting of the $54,000 of Payroll Costs and up to $36,000 of Non-Payroll Costs (which cannot constitute more than 40% of the amount actually forgiven). If the Non-Payroll Costs in the Covered Period are in fact less than $36,000, then the amount forgiven will be $54,000 plus the amount of those Non-Payroll Costs – subject to reduction by reason of any FTE or compensation reductions not subsequently made up by December 31, 2020.

The New IFR also states that SBA will be issuing revisions to prior IFRs on loan forgiveness and loan review procedures to further address the effects of the Flexibility Act. We note that it must also issue a new form Loan Forgiveness Application to account for those effects, something it has promised to do promptly in recent public statements outside the New IFR.

The New IFR also amends the First IFR to impose a requirement that at least 60% (75% in the First IFR) of PPP loan proceeds be used to fund Payroll Costs. So, applying SBA’s example discussed above, the borrower would need to have at least $6,000 of additional Payroll Costs following the Covered Period, or be at risk for claims that it improperly obtained and used the loan. This means the up to $90,000 forgiven in the example might actually not be forgiven (or clawed back if previously forgiven), and the borrower might additionally be subject to other consequences. The take away is that EVERY PPP borrower will need to have Payroll Costs of at least 60% of the PPP during the Covered Period or subsequently during the remaining loan term, whether or not the borrower applies for forgiveness or any of the loan is forgiven.

The substantive provisions of the New IFR and each of SBA’s prior IFRs related to the PPP have been contained in part III of the IFR. We note that buried in the boilerplate of part II of the New IFR, pertaining to how the public may comment and effective dates, is a statement that “the last day on which a lender can obtain an SBA loan number for a PPP loan is June 30, 2020,” meaning there will be no further PPP loans approved after June 30. SBA thus appears to be following the lead of Senate Republicans who chose to publicly state that to be their interpretation, although not to try to amend the Flexibility Act to have it say as much. We also note that a look at SBA’s PPP webpage indicates that well in excess of $100 billion of lending availability remained under the PPP at the close of June 10.

WHAT REMAINS UNADDRESSED?

A lot, with some examples below.

Reid and Riege, P.C.
One Financial Plaza
Hartford, CT 06103

or

Reid and Riege, P.C.
234 Church Street
New Haven, CT 06510

As noted above, SBA needs to issue additional interpretations on loan forgiveness and a new form Loan Forgiveness Application. This is particularly pressing as phase one borrowers have now exited, or about to exit, their original eight-week Covered Periods. Those who do not need to, or have chosen not to, extend to the new 24-week Covered Period are now ready to apply for forgiveness, but unable to do so. How long it will take lenders to get up to speed with whatever SBA issues is unclear, but it seems likely no forgiveness applications will be accepted prior to July.

As noted in our June 4 update, the Flexibility Act raises questions about whether the Alternate Payroll Covered Period and "incurred" expense concepts previously created by SBA continue to apply. It is possible they do not, or at least do not for borrowers choosing a 24-week Covered Period.

Another open question is how soon a borrower adopting the 24-week Covered Period may apply for forgiveness. May it do so as soon as it has paid expenses giving rise to the maximum amount of forgiveness that may be available to it, even if that is week 11 or 12 of the Covered Period? Or must it wait for the full 24 weeks to run? If it must wait out the entire 24 weeks, it will not be able to apply until October or later, depending on when its loan was funded. Given that lenders have up to 60 days to act initially on forgiveness applications, and that SBA has up to 90 days to review and approve or disapprove each lender decision, it may be well into 2021 before many borrowers know the outcome of their forgiveness applications. This creates serious implications for those with other loans who will need to make financial covenant calculations at December 31, 2020. It also has tax preparation implications. The Payroll Costs and Non-Payroll Costs giving rise to forgiveness are typically deductible expenses, but IRS has ruled they may not be deducted if they give rise to loan forgiveness (see our May 1 update). A calendar year taxpayer waiting until 2021 for a forgiveness decision will have these expenses in one taxable year, and the forgiveness income that makes them non-deductible in a different taxable year. How is this mismatch to be resolved?

PRIOR UPDATES

For our previous PPP articles, please see April 1, 2020, April 3, 2020, April 9, 2020, April 16, 2020, April 24, 2020, May 1, 2020, May 6, 2020, May 13, 2020, May 18, 2020, June 1, 2020, and June 4, 2020.

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.

BUSINESS SERVICES

Karen L. Brand
(860) 240-1089 • kbrand@rrlawpc.com

Kathleen M. Coss
(860) 240-1035 • kcoss@rrlawpc.com

Louis J. Donofrio
(860) 240-1042 • ldonofrio@rrlawpc.com

Coleen Hurlie-Dunn
(860) 240-1085 • churlie-dunn@rrlawpc.com

Thomas R. Kasper
(860) 240-1084 • tkasper@rrlawpc.com

Earl F. McMahon
(860) 240-1016 • emcmahon@rrlawpc.com

Robert M. Mulé
(860) 240-1010 • rmule@rrlawpc.com

Cathryn A. Reynolds
(860) 240-1019 • creynolds@rrlawpc.com

Adam Carter Rose
(860) 240-1065 • arose@rrlawpc.com

Mark X. Ryan
(860) 240-1056 • mryan@rrlawpc.com