



CERTIFIED PUBLIC ACCOUNTANTS

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CARES Act Paycheck Protection Program

Executive Summary

In an effort to encourage businesses to retain employees, the CARES Act provides \$349 billion for a Small Business Administration (“SBA”) “Paycheck Protection Program” to offer loans up to a maximum of \$10 million to eligible businesses. These loans are to be used by small businesses to provide for certain operational costs and may be partially or even wholly forgiven.

Subsequent to passage of the CARES Act, the SBA has released an Interim Final Rule (“IFR2”) addressing some of the issues raised with respect to the Paycheck Protection Program; a supplemental Interim Final Rule (“IFR2”) specifically addressing the application of the affiliation rules to the accommodation and food service industries, along with certain faith-based organizations; and, in conjunction with the Treasury Department, a document answering frequently asked questions with respect to the Paycheck Protection Program (“SBA-Treasury FAQ”). This guidance does not, however, alleviate all uncertainty, especially with respect to how the SBA’s affiliation rules apply to foreign-owned businesses.

Eligibility

In addition to “small business concerns” as currently defined by the SBA, any business concern, nonprofit, veterans organization, or Tribal business concern may be eligible for a loan if it employs not more than the greater of: a) 500 employees (including full-time, part-time, and those employed on other bases); or b) the size standard for the number of employees established by the SBA for the industry in which the entity operates. In addition, sole proprietorships, independent contractors, and eligible self-employed individuals may also be eligible to receive loans under this program.

Expanded eligibility rules apply for businesses in the accommodation and food service industries, businesses operating as a franchise, or business receiving certain financial assistance under the Small Business Investment Act of 1958. Additionally, for the accommodation and food service industries, businesses with multiple locations may qualify for a loan under the Paycheck Protection Program provided that each location employs 500 or fewer individuals.

What is less certain, however, is how the affiliation rules apply to industries outside of those specified in the CARES Act, specifically foreign owned U.S. businesses not in the hotel or restaurant industries. In an effort to clarify the rules outlined in the CARES Act, IFR1 states that a prospective borrower is eligible for a Paycheck Protection Program loan if (i) the borrower has 500 or fewer employees *whose principal place of residence is in the U.S.*, or the business operates in a certain industry and meets the

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applicable SBA employee-based size standards for that industry, and the prospective borrower is either a small business concern as defined in the Small Business Act and subject to the SBA's affiliation rules, or a tax-exempt nonprofit organization, a tax-exempt veterans organization, a Tribal business concern, or *any other business*; and was in operation, with paid employees or independent contractors, on February 15, 2020.

Similarly, IFR2 states that an entity generally is eligible for the Paycheck Protection Program if it, combined with its affiliates, is a small business as defined in the Small Business Act, or (1) has 500 or fewer employees *whose principal place of residence is in the U.S.* or is a business that operates in a certain industry and meets applicable SBA employee-based size standards for that industry, and (2) is a tax-exempt nonprofit organization, a tax-exempt veterans organization, a Tribal business concern, or *any other business concern*.

The SBA-Treasury FAQ reiterates that, in addition to small business concerns, a business may be eligible for the Payroll Protection Program if it has 500 or fewer employees *whose principal place of residence is in the U.S.*, or the business meets the SBA's employee-based size standards for the industry in which the business operates.

Neither IFR1, IFR2, nor the SBA-Treasury FAQ seems to adequately address how foreign owners or subsidiaries of U.S. businesses should be treated for purposes of applying for a Paycheck Protection Program loan. There is a reasonable argument that, to be eligible for a loan, the Paycheck Protection Program looks at the total number of U.S. employees of a business concern, even a foreign business concern, while not counting the foreign employees of the business. For example, the language above from IFR2, could be reasonably read as follows:

An entity generally is eligible for the Paycheck Protection Program if it, combined with its affiliates, is a small business as defined in section 3 of the Small Business Act; or the entity, combined with its affiliates, is a tax-exempt nonprofit organization, a tax-exempt veterans organization, a Tribal business concern, or *any other business concern* and either: (i) has 500 or fewer employees whose principal place of residence is in the U.S. or (ii) is a business that operates in a certain industry and meets applicable SBA employee-based size standards for that industry.

With this reading, the prospective borrower would either already be considered a small business under the existing rules, or would have only its U.S. employees taken into account when measuring eligibility for relief under the Paycheck Protection Program. This interpretation does not undermine the purpose of the Paycheck Protection Program in providing aid to smaller U.S. operations trying to retain their U.S. based workforce.

This reading does not, however, alleviate all uncertainty. For example, a large U.S. based multinational likely would be disqualified from the Paycheck Protection Program while a similarly sized, foreign based multinational with minimal U.S. activities might qualify for the Paycheck Protection Program. Similarly, a U.S. company manufacturing products in the U.S. may be ineligible for a loan while their competitor, who manufactures products overseas, may qualify for a loan. As of the date of this

memorandum, it is still uncertain how the affiliation rules apply to qualify, or disqualify, prospective borrowers.

Application Process

While no specific loan application process has been included as part of the CARES Act, the SBA has provided SBA Form 2483 for prospective borrowers. Lenders may also have their own applications separate from SBA Form 2483. As part of the application process, borrowers must provide a good-faith certification that: (i) the loan is needed to continue operations during the COVID-19 emergency; (ii) funds will be used to maintain payroll or make mortgage, lease, and utility payments; (iii) the applicant does not have any other application pending under the program for the same purpose; and (iv) the applicant has not received duplicative amounts under the program.

Express loan procedures are provided to accelerate the processing of loan applications, though there is no timeline for when a lender must approve or deny a loan application. If a loan application is approved, the lender must begin distributing funds within ten days of approval.

Maximum Loan Amount and Permitted Use of Funds

The maximum loan amount is capped at \$10 million and is determined based on 2.5 times the average total monthly payroll costs incurred in the one-year period before the loan is made. Notably, the term “payroll costs” does not include (i) the compensation of an individual employee in excess of an annual salary of \$100,000; (ii) taxes imposed or withheld for the Federal Insurance Contributions Act, the Railroad Retirement Tax Act, or Collection Of Income Tax At Source On Wages; or (iii) compensation of an employee whose principal place of residence is outside of the U.S.

The SBA and Treasury have clarified that it is only the amount in excess of \$100,000 which is eliminated from the payroll calculation, not the entire compensation of individual employees earning in excess of \$100,000 per year. Additionally, the exclusion of annual compensation in excess of \$100,000 only applies to cash compensation, not to non-cash benefits such as retirement plans and health care coverage. The SBA and Treasury have also clarified that payroll costs are calculated on a gross basis without regard to federal taxes imposed or withheld. This does not, however, include the portion of payroll taxes actually paid by the employer. The SBA and Treasury provided the following example:

An employee who earned \$4,000 per month in gross wages, from which \$500 in federal taxes was withheld, would count as \$4,000 in payroll costs. The employee would receive \$3,500, and \$500 would be paid to the federal government. However, the employer-side federal payroll taxes imposed on the \$4,000 in wages are excluded from the payroll costs under the statute.

Paycheck Protection Program loans can be used for payroll costs, health benefits, payments on qualifying mortgage or rent obligations, utilities and interest on other debt obligations incurred before February 15, 2020. Limits include a cap of \$100,000 on the amount of an individual employee’s compensation that can be funded from a covered loan. Additionally, 75 percent of the funding received must be used for payroll while only 25 percent may be used for other costs.

Loan Forgiveness

Loan forgiveness is provided for loan amounts spent during an initial eight-week period for certain expenses including payroll costs, with the amount of loan forgiveness dependent on employee retention and wages. It is unclear whether, in addition to being forgiven, these costs could also be deducted from includible income for tax purposes.

The amount of loan principal eligible for forgiveness may be proportionally reduced if the average number of employees is reduced during the eight week period after the employer receives loan proceeds compared with 2019, or if there is a reduction in total employee salary or wages in excess of 25 percent during the same eight week period.

To apply for forgiveness, the borrower must submit to the lender an application which will include documentation verifying employee headcount, pay rates, and other expenses paid during the eight week period after the borrower received funding. Amounts forgiven will not be included in the borrower's taxable income, though it is unclear if there may be an impact to other tax attributes as a result of forgiveness.

This content is for general information purposes only, and does not constitute tax advice.

If you have any questions or would like additional information on the topics covered in this alert, please contact your engagement partner.

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New York

350 Fifth Avenue, 41st Floor
New York, NY 10118

Miami

1221 Brickell Avenue, Suite 1160
Miami, FL 33131

Roma

Via Po, 102
00198 Rome
Italy

Milano

Piazza Diaz, 5
20123 Milan
Italy

www.funaro.com