

Summary of Paycheck Protection Program Loan Regulations

By Ted R. Batson, Jr., Partner and Tax Counsel

The Small Business Administration (SBA) has released temporary regulations on which lenders, employers, independent contractors, and sole proprietors may rely when applying for Paycheck Protection Program Loans (PPPLs).

A few highlights:

1. The terms of the loan have been finalized at 1% interest, a two-year maturity, and a six-month deferral of interest, principal, and fees (although no fees are anticipated).
2. Interest will begin accruing from the date of disbursement, but is eligible for forgiveness.
3. The regulations require that 75% of the funds be used for payroll costs. The portion of funds that fail to reach the 75% threshold will need to be repaid. Knowingly using the funds for unauthorized purposes could subject the organization to a fraud action.
4. The regulations make it clear that organizations receiving a PPPL will remain eligible for all relevant constitutional, statutory, and regulatory protections of religious liberty.

Below is a summary of key provisions in the regulations.

What do the regulations say about employer eligibility?

An eligible employer:

- Has 500 or fewer employees whose principal place of residence is in the U.S.;
- Is either a small business concern as that term is defined in the Small Business Act and SBA regulations, a tax-exempt organization described in Internal Revenue Code (IRC) § 501(c)(3) or 501(c)(19), or a Tribal business concern as described in the Small Business Act; and
- Was in operation on February 15, 2020 and had employees for which it paid salaries and payroll taxes or paid independent contractors as reported on Form 1099-MISC.¹

In addition to employers, sole proprietors and independent contractors in operation on February 20, 2020 are eligible applicants. Prop. Reg. 13 C.F.R. 120-2(a).

The regulations do not answer the question of whether organizations with more than 500 employees total but only 500 or fewer who reside in the U.S. are eligible organizations. (For example, an organization with 750 employees, only 300 of whom have their principal place of residence in the U.S.) If this situation describes your organization, we recommend that you discuss this with your lender to determine whether the lender will accept your application before you proceed.

¹ However, note that the regulations explicitly exclude payments to independent contractors when defining payroll costs.

What is the maximum amount of a PPPL?

The maximum of amount of a PPPL is the lesser of:

- (1) \$10 million; or
- (2) Average monthly payroll costs plus the amount of an Economic Injury Disaster Loan (EIDL) obtained on or after January 31, 2020 and on or prior to April 3, 2020 that is refinanced into the PPPL.

The regulations suggest the amount of any EIDL advance, up to \$10,000, be subtracted from the maximum loan amount on the basis that such an advance must reduce the amount of any loan forgiveness.

Prop. Reg. 13 C.F.R. 120-2(e).

What costs are includable in payroll costs used to determine the maximum PPPL amount?

Payroll costs consist of:

- Compensation to employees (whose principal place of residence is the U.S.) in the form of salary, wages, commissions, or similar compensation;
- Cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips);
- Payment for vacation, parental, family, medical, or sick leave;
- Allowance for separation or dismissal;
- Payment for the provision of employee benefits consisting of group health care coverage, including insurance premiums, and retirement; and
- Payment of state and local taxes assessed on compensation of employees.

Prop. Reg. 13 C.F.R. 120-2(f).

This list is consistent with the language of the CARES Act.

For an independent contractor or sole proprietor, payroll costs consist of wages, commissions, income, or net earnings from self-employment or similar compensation. Prop. Reg. 13 C.F.R. 120-2(f).

Neither the CARES Act nor the regulations specifically address whether a minister's housing allowance is includable in payroll costs. Some lenders have apparently been disallowing inclusion of the minister's housing allowance, while others have allowed inclusion of the minister's housing allowance. It seems reasonable that the minister's housing allowance can be interpreted as a component part of the minister's salary. Accordingly, the minister's housing allowance should be includable in payroll costs. However, the ultimate answer to this, at least for the moment, is in the hands of the individual lenders.

Similarly, cellphone allowances, automobile allowances, and non-accountable expense reimbursement plan allowances should be includable in employee compensation consistent with the manner in which they are reported on Form W-2. Finally, employer-provided dental and vision benefits provided on a group basis would seem to fall within the definition of "group health care coverage" as described above and therefore be includable in payroll costs.

The regulation resolves an ambiguity in the statute created by the phrase "the sum of *payments of any compensation to or income of a sole proprietor or independent contractor*" found at 15 U.S.C. 636(a)(36)(A)(viii)(I)((bb) in favor of applying this language solely to an application for a PPPL submitted by an independent contractor or sole proprietor.

Neither the CARES Act nor the regulations specifically address whether a minister's housing allowance is includable in payroll costs.

What costs are NOT includable in payroll costs used to determine the maximum PPPL amount?

The regulations follow the statute closely with respect to identifying the following items as not includable in payroll costs:

- Any compensation of an employee whose principal place of residence is outside the U.S.;
- The compensation of an individual employee in excess of an annual salary of \$100,000, prorated as necessary;
- Federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including the employee's and employer's share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees; and
- Qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act.

Prop. Reg. 13 C.F.R. 120-2(g). **Two items are of particular note: First, both the employer and employee share of FICA and Medicare payments are not includable in payroll costs.** We previously understood that only the *employer* share would be excluded. However, a closer reading of the statute reveals the regulations correctly interpret the statute. **Second, federal income taxes withheld from an employee's compensation are *not* includable in payroll costs.**

The regulations do not define an employee's principal place of residence.

What maturity date will apply to PPPLs?

PPPLs will have a two-year term. The SBA acknowledged that the statute states that the unforgiven balance of PPPLs would have a maximum term of 10 years, but explains that "the considerable economic disruption caused by the coronavirus is expected to abate well before the two year maturity date such that borrowers will be able to recommence business operations and pay off any outstanding balances on their PPP loans." Prop. Reg. 13 C.F.R. 120-2(j).

What interest rate will apply to PPPLs?

An interest rate of 1% will apply to PPPLs. This differs from the 0.5% rate previously published. The regulations also make clear that the SBA considered the maximum 4% rate allowed for in the CARES Act and selected the lower 1% rate as being consistent with interest rates for loans of similar maturity in current interest rate environment. Prop. Reg. 13 C.F.R. 120-2(i).

Do independent contractors count as employees for purposes of PPPL calculations?

No. The regulations point to the fact that independent contractors may apply for their own PPPL.² Prop. Reg. 13 C.F.R. 120-2(h).

Can an organization apply for more than one PPPL?

No. The regulations acknowledge that this limit is not in the statute. However, the SBA believes that a "one loan per borrower limitation is necessary to help ensure that as many eligible borrowers as possible may obtain a PPP loan." Prop. Reg. 13 C.F.R. 120-2(k).

What is the deferral period for a PPPL?

The regulations provide for a six-month deferral period from the date of disbursement of the loan. Interest will accrue during the deferral period. The regulations acknowledge that the statute permits a deferral period of up to 12 months, but the SBA exercised its discretion to set the deferral period at six months "in light of the modest interest rate (one percent) on PPP loans and the loan forgiveness provisions contained in the [CARES] Act." Prop. Reg. 13 C.F.R. 120-2(n).

² However, it is interesting to note that in describing the certifications a borrower must make when applying for a PPPL, the regulations state that the borrower must certify that it "had employees for whom it paid salaries and payroll taxes *or paid independent contractors, as reported on a Form 1099-MISC.*" (Prop. Reg. 13 C.F.R. 120-2(t))

For what purposes may a borrower use the funds?

The proceeds of a PPP loan are to be used to cover:

- Payroll costs, as that term is defined above
- Costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums
- Mortgage interest payments (but not mortgage prepayments or principal payments)
- Rent payments
- Utility payments
- Interest payments on any other debt obligations that were incurred before February 15, 2020, and/or refinancing an SBA Economic Injury Disaster Loan (EIDL) made between January 31, 2020 and April 3, 2020

It is unclear how self-insured organizations will be able to factor in their costs of continuing their group health care benefits.

Importantly, the regulations state that you *must* use at least 75% of the funds for payroll costs. For purposes of determining whether this 75% threshold was reached, any amount of an EIDL loan refinanced into the PPP must be included in the computation.

Prop. Reg. 13 C.F.R. 120-2(r).

What happens if a borrower does not use 75% of the loan proceeds on payroll costs?

If you fail to reach the 75% threshold (i.e., some portion of the funds are used for “unauthorized purposes” because you failed to reach the 75% threshold, even though those purposes are authorized under the CARES Act), then you will be required to repay that portion. It is unclear whether this repayment is immediate, or simply means that portion will not be eligible for forgiveness.

Knowingly using the funds for an unauthorized purpose could subject the borrower to additional liability, such as charges for fraud.

We recommend that you forecast and track your use of the funds to ensure you do not “knowingly” use the funds for an unauthorized purpose.

Prop. Reg. 13 C.F.R. 120-2(s).

How does a PPPL interact with an EIDL?

You may apply for a PPPL even if you received an EIDL loan from January 31, 2020 through April 3, 2020. This implies that if you apply for an EIDL loan after April 3, you are not eligible to apply for a PPPL. It similarly implies that if you apply for a PPPL, you are precluded from applying for an EIDL loan.

If your EIDL loan was used for payroll costs, your PPP loan must be used to refinance your EIDL loan. In addition, the proceeds from any advance on the EIDL loan will be deducted from the loan forgiveness amount on the PPPL. The CARES Act authorized an EIDL loan advance of up to \$10,000.

Prop. Reg. 13 C.F.R. 120-2(r).

What is the maximum amount of a PPPL that can be forgiven?

Assuming the borrower uses all of the loan proceeds for forgivable purposes, loan forgiveness is available up to the full amount of the loan principal *plus any accrued interest*. However, the actual amount of loan forgiveness is subject to the use of at least 75% of the borrowed funds for payroll costs.

Prop. Reg. 13 C.F.R. 120-2(o).

What costs are considered when determining the PPPL forgiveness amount?

Subject to the requirement that at least 75% of the borrowed funds be used for payroll costs, the sum of the following costs actually paid during the eight-week period following the date of the loan will be used to determine the PPPL forgiveness amount:

- Payroll costs;
- Payments of interest on mortgage obligations incurred before February 15, 2020;
- Rent payments on leases dated before February 15, 2020; and
- Utility payments under service agreements dated before February 15, 2020.

It is unclear how payroll costs paid for with an EIDL obtained prior to February 3, 2020 will be factored into the forgiveness computation since these costs, by definition, will not have occurred in the 89-week period following the date of the loan. Additional guidance on forgiveness is expected and will hopefully address this point.

Prop. Reg. 13 C.F.R. 120-2(o)

What documentation must a borrower provide a lender in support of its PPPL application?

A borrower must provide the lender with:

- A signed application that includes the certifications on the application form;
- Information demonstrating that the borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020;
- Payroll records documenting the average monthly payroll costs for the preceding *calendar year*; and
- Information required by the lender to satisfy its obligations under the Bank Secrecy Act and related Know Your Customer and anti-money laundering regulations.

The regulations describe acceptable payroll records as including “payroll processor records, payroll tax filings, or Form 1099-MISC, or income and expenses from a sole proprietorship.”

The use of “calendar year” above is inconsistent with the language of the CARES Act and the language found at Prop. Reg. 13 C.F.R. 120-2(e)(i), which states you use the payroll costs “from the last twelve months.”

Prop. Reg. 13 C.F.R. 120-3(c).

Lenders are permitted to rely on a borrower’s documentation for loan forgiveness without conducting any verification if a borrower supplies supporting documentation and attests that it (the borrower) has accurately verified that the payments shown are for eligible costs.

Prop. Reg. 13 C.F.R. 120-3(c).

What terms and conditions apply to a PPPL?

A number of terms and conditions apply to a PPPL, including:

- A PPPL is 100% guaranteed by the SBA;
- There is no requirement for collateral;
- No personal guarantees are required;
- The interest rate is 1%; and
- Lenders are permitted to rely on certifications by the borrower to determine eligibility and use of loan proceeds.

Prop. Reg. 13 C.F.R. 120-4(a).

Do the regulations provide clear religious liberty protections for churches and faith-based organizations?

The regulations explicitly state that:

[a]ll loans guaranteed by the SBA pursuant to the CARES Act will be made consistent with constitutional, statutory, and regulatory protections for religious liberty, including the First Amendment to the Constitution, the Religious Freedom Restoration Act, 42 U.S.C. 2000bb-1 and bb-3, and SBA regulation at 13 C.F.R. 113.3-1h, which provides:

Nothing in [SBA nondiscrimination regulations] shall apply to a religious corporation, association, educational institution or society with respect to the membership or the employment of individuals of a particular religion to perform work connected with the carrying on by such corporation, association, educational institution or society of its religious activities.

SBA intends to promptly issue additional guidance with regard to religious liberty protections under this program.

Prop. Reg. 13 C.F.R. 120-5.

Please [contact us online](#) or at info@capincrouse.com with questions or to discuss how we can assist you. Developments are occurring rapidly, and we will continue to provide updates as new information becomes available.

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