Cohen & Co

April 6, 2020

Dianna Seaborn
Director, Office of Financial Assistance
U.S. Small Business Administration
409 3rd St, SW
Washington DC 20416

Re: SBA-2020-0015

Director Seaborn,

Thank you for the opportunity to provide comments on the Interim Final Rule for the implementation of Sections 1102 and 1106 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

As a brief introduction, Cohen & Company, Ltd. is a CPA firm that has had a strong emphasis on tax expertise since the firm's inception in 1977. We provide tax, assurance and consulting services to a significant number of small businesses.

Regarding the Interim Final Rule, we commend the SBA with the speed at which this guidance was introduced. Small businesses desperately need this aid to facilitate maintaining employees' pay while weathering the effects of COVID-19. As the SBA finalizes the rules, we request the following to be considered:

1.) **Eligible Businesses:** The interim guidance lists the following as eligible small businesses: 500 or fewer employees whose principal place of residence is in the United States, or are a business that operates in a certain industry and meets the applicable SBA employee-based size standards for that industry, **and are:**
   - i. A small business concern as defined in Section 3 of the Small Business Act (15 USC 632), and subject to SBA's affiliation rules under 13 CFR 121.301(f), unless specifically waived in the Act;
   - ii. In operation on February 15, 2020, and either had employees for whom you paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC;
   - iii. An individual who operates under a sole proprietorship or as an independent contractor or eligible self-employed individual and was in operation on February 15, 2020.

Comments: The guidance should be updated to include the following businesses that were included in the CARES Act:

- i. **Section 1102(a)(36)(D)(i)** states that in addition to small business concerns, **any business concern is eligible** if it **employs not more than the greater of** 500 employees or, if applicable, the size standard in the number of employees established by the Administration for the industry in which the business concern operates, based on NAICS code.

This provides eligibility for any business with less than 500 employees and any business who employs more than 500 employees if the NAICS code listed in the SBA Standards table lists an employee count greater than 500.

ii. **Section 1102(a)(36)(D)(iii)** business concerns with more than one physical location: During the covered period, any business concern that employs not more than 500 employees per physical location and is assigned an NAICS code beginning with 72 at the time of disbursal shall be eligible to receive a covered loan.

iii. **Section 1102(a)(36)(D)(iv)** Waiver of affiliation rules: The affiliation rules were waived for the following business concerns:
   - Any business concern with not more than 500 employees that, as of the date on which the covered loan is disbursed, is assigned an NAICS code beginning with 72
   - Any business concern operating as a franchise that is assigned a franchise identifier code by the Administration
   - Any business concern that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958 (15 U.S.C. 681).

Additionally, we recommend the SBA further relax the affiliation rules. Many small businesses are owned or partially owned by outside investor groups, such as private equity funds, which would have "control", as set forth in the affiliation rules, through their ability to control the Board of Directors of a "portfolio company" or because of common management between the private equity fund and its portfolio company. We recommend waiving the affiliation rules if a small business is not controlled by a single outside shareholder.

In the environment of private equity funds, the funds themselves are often prohibited by contractual arrangements with their investors (such as the operating agreement) from borrowing or raising additional investment capital to further support their investments in the portfolio companies. The private equity fund is generally operated in a manner where the portfolio company is required to stand on its own and raise capital through borrowings or additional equity investments at the portfolio company level. The control rules would prohibit these businesses from applying for a 7(a) loan directly even though they otherwise would be eligible borrowers. The funds are prohibited from borrowing to support these portfolio companies due to the affiliation rules, which would require funds to aggregate employee counts from multiple investments, and they are otherwise limited by contractual arrangements from raising capital through borrowings or otherwise to support the portfolio company investments.

The affiliation rules would unnecessarily subject the portfolio companies to the economic risk of the current crisis, and significantly reduce their ability to survive the crisis and continue to employ persons during and after the crisis. It is contrary to congressional intent, which is to use the 7(a) program to support as many small business employers through the crisis and insure that a strong business base is in place post crisis to provide a strong "bounce back" in economic growth and employment.

2.) **Employee Test:** Clarify what date is the testing date for determining the number of employees. Section 1102(a)(36)(D)(i) states **during the covered period** any business that employs not more than 500 employees is eligible for a covered loan, which would lead a reader to believe that at any point during the covered period a business could qualify. Section 1102(a)(36)(D)(iii) states during the covered period any business concern that employs no more than 500 employees per physical location (assigned a NAICS code starting with 72) **at the time of disbursal shall be eligible to receive a covered loan.**

Our recommendation would be to test the number of employees as of the date of the loan application or as of February 15, 2020.

3.) **Payroll Costs:** The interim guidance lists 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.

Comments: We recommend this provision be clarified, such that the exclusion of the employee's employment taxes and withholding taxes during the covered period is intended to prevent a double counting of these expenses as being part of the employee's compensation amount and a separate cash expenditure of the loan proceeds of the borrower. The SBA should also clarify that the exclusion is intended to cover the eight-week period considered for purposes of the forgivable amount of the loan and that to the extent this period extends beyond June 30, 2020, such expenses would continue to be excluded from the borrower's forgivable amount.

In addition, it should be clarified in determining the "borrowing" base that the employee share of taxes under chapters 21, 22 and 24 are not to be included as a separate expenditure within the calculation of employee cost, as these amount would already be included in employee compensation.

Including this in the guidance gives business concerns the impression that either those costs should not be included in the maximum loan amount or that they need to pay their employees 120.3% (assuming Federal tax withholding at 30%, and Employee/Employer FICA of 15.3% less the 25% that the salary can be reduced) of their salary in order to meet the salary reduction test in the forgivable loan limitation.

4.) **Payroll Costs:** In Section 2(e)(i), the Interim Final Rule, states the "borrowing base" is calculated based on "Aggregate payroll costs from the **last twelve months** …" Section 3(b)(iii) states that each lender shall: "confirm the dollar amount of average monthly payroll costs for the preceding **calendar year** … The loan application indicates the borrower should submit payroll costs for calendar year 2019.

Comments: We recommend the Interim Final Rule use consistent language when describing payroll costs to be used in determining borrowing base. Under section 2(e)(i), the borrower may interpret "last twelve months" as indicating the 12-month period ending as of the end of the month preceding the month of application. This period would be inconsistent with the payroll costs requested in the application and the payroll cost the lender is required to confirm. The guidance should clearly state in all sections referring to "average monthly payroll for the 12-month period" is the period beginning January 1, 2019, and ending December 31, 2019. In addition, the interim guidance should be clear that the payroll costs to be included for compensation of employees should be equal to the amounts reported on form W-2, box 5 for the calendar year 2019. This clarification will insure consistent calculations by all loan applicants of employee compensation.

5.) **Sole Proprietorships, Independent Contractors, Self-Employed:** Under Section 2(b) flush language at the end of the paragraph, it indicates that for this class of borrower the "borrowing base" is calculated on payroll records, 1099-MISC, or income and expenses of a sole proprietorship. These items can be overlapping concepts, as a 1099-MISC would report gross income and payroll cost would be entered into the calculation of self-employment net income.

In addition, partners in a partnership are allocated self-employment income in many circumstances, including guaranteed payments for services and their share of the partnership's net taxable income, if they are general partners, or actively participate in a partnership organized as a limited liability company.

Comments: We recommend the Interim Final Rule provide clarification regarding the calculation of the "borrowing base" for this category. The Interim Final Rule should clearly state that the borrowing base is equal to the average monthly payroll costs as defined in the CARES Act, plus gross income minus expenses as reported on schedule C of the borrower's 2019 form 1040, or with respect to borrowers who did not file a schedule C, net self-employment reported on form 1040, schedule SE. This would provide for consistent reporting among borrowers and would provide a basis for verification by lender or the government.

In addition, with respect to loan applicants organized as an entity taxed as a partnership, it should be clarified that the entity, not its individual partners, should file the application for the loan. For purposes of calculating the borrowing base amounts allocated to a partner as net self-employment income should be included in the calculating "average monthly payroll costs" for the entity.

In addition, for purposes of determining the number of employees employed by the partnership, the partnership should include in its count the number of partners who were allocated self-employment income/loss. This clarification would provide consistency between applicants that are organized as a partnership and applicants organized as corporations, where the owners of the corporations are active employees of the entity and receive a wage. Finally, the $100,000 capped would be applied to self-employment income allocated to each partner of the partnership.

6.) **Calculation for the amount of loan forgiven.** The interim guidance states not more than 25% of the loan forgiveness amount may be attributable to non-payroll costs.

Comments: This language is not in the law and therefore should be removed from the Interim Final Rule. The law that Congress passed and President Trump signed provided flexibility in what the loan proceeds could be used for (payroll costs, rent, utilities, interest).

Congress further provided a calculation to limit the amount of debt forgiveness if:

- The average number of full time equivalent employees were not maintained when compared to February 15, 2019, through June 30, 2019, and
- The salary or wages of the employees decreased by more than 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed (before the covered period).

Additionally, the language regarding this provision is harmful to certain industries whose operations have been fully or partially suspended by government orders, and would impair their ability to survive the crisis period and provide employment after the government order is lifted and they can resume operations. This provision is counter-productive to the overarching goal to re-employ persons as soon as possible and does not align with the intent of Congress as outlined in the CARES Act. The language of the passed law must be the presiding language used to execute these actions.

We thank you for your consideration of our comments and, again, we appreciate all you have done to provide guidance on the Interim Final Rule for the implementation of Sections 1102 and 1106 of the CARES Act.

We welcome the opportunity to discuss our recommendations further. Please feel free to contact Dave Sobochan at 216.774.1163 or dsobochan@cohencpa.com, Adam Hill at 216.774.1130 or ahill@cohencpa.com, or Anthony Bakale at 216.774.1147 or tbakale@cohencpa.com.

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