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Mission Agencies and Paycheck Protection Program Loans

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A number of mission agencies have chosen to apply for loans under the new federal Paycheck Protection Program (PPP) created by the CARES Act. Nonprofits, including mission agencies, are eligible to participate in this loan program. However, there is one significant drawback: the payroll costs used to determine the maximum amount of a PPP loan cannot include payroll costs related to an employee whose "principal place of residence" is not in the U.S.

Definition of Principal Place of Residence

The CARES Act does not define the term "principal place of residence." As an initial matter, we believe it is clear a missionary who is a U.S. citizen or permanent resident who claims the *foreign earned income exclusion* under either the bona fide residence test or the physical presence test would not be able to claim a principal place of residence in the U.S.

But what about individuals who are either ineligible for the foreign earned income exclusion or elect not to claim the foreign earned income exclusion? We believe it is possible to gain some insight from other portions of the code.

First, the Small Business Administration (SBA) has used a 180-day residency test for participants in its "HUBZone" program.[1] This residency test requires that an individual must "live at a location full-time and for at least 180 days immediately prior to the [relevant] date."[2]

"[I]ndividuals temporarily residing overseas in connection with the performance of a contract" are deemed "to reside at their U.S. residence."[3] It appears this test requires consecutive days of residency at a physical location in the U.S., with the exception of temporary overseas assignments in connection with the performance of a contract.

To establish residency, the SBA first looks to the address on an individual's driver's license.[4] Presumably, an individual with a current driver's license issued by a foreign jurisdiction would be deemed to live in that foreign jurisdiction. However, the SBA will consider other documentation establishing "proof of residency, such as deeds, leases, or utility bills."[5]

Next we consider the *substantial presence test*, which is applied to determine whether a non-resident alien is required to file a U.S. resident income tax return, IRS Form 1040.[6] This test states that presence in the U.S. for 183 days is sufficient to establish U.S. residency.[7] These 183 days are not required to be consecutive.

[1] The HUBZone program is described at 13 CFR Part 126. This program is designed to provide federal contracting assistance to small business concerns.
[2] 13 CFR 126.103 (definition of *reside*).
[3] Ibid.
[4] Ibid.
[5] Ibid.
[6] This test is defined at IRC § 7701(b)(3). The test is described on page 4 of IRS Publication 519 and on the IRS's website at https://www.irs.gov/individuals/international-taxpayers/substantial-presence-test.
[7] In implementation, the substantial presence test looks at the number of days an individual has been in the U.S. for the current and two preceding tax years. The test only applies if the individual was in the U.S. for at least 31 days in the current year. Once this threshold is met, days in the U.S. during the current year are counted in full. Only one-third of the days in the immediately preceding tax year are counted. Finally, one-sixth of the days in the second preceding tax year are counted. If the aggregate of the countable days over the three-year period equals or exceeds 183 days, then the individual is a U.S. resident for U.S. income tax purposes.

A third potential source of guidance as to the location of an individual's principal place of residence is Internal Revenue Code (IRC) section 121, the code section that excludes from gross income a portion of the gain realized from the sale of a *principal residence*. Among the factors considered in determining whether a property is a taxpayer's principal residence are:

1. The number of days in a year the taxpayer spends at the residence.
2. The taxpayer's place of employment. [This is the location where the employee performs services; not the location of the employer's principal offices.]
3. The principal place of abode of the taxpayers' family members. [This is the location where daily living activities take place.]
4. The address listed on the taxpayer's federal and state tax returns, driver's license, automobile registration, and voter registration card.
5. The taxpayer's mailing address for bills and correspondence.
6. The location of the taxpayer's banks.
7. The location of religious organizations and recreational clubs with which the taxpayer is affiliated.[8]

Readers familiar with the factors that make up the bona fide residence test used to determine eligibility for the foreign earned income exclusion will recognize that many of these factors are used in that test as well.

These factors must be viewed under the totality of the circumstances. For example, the mere fact that someone has maintained their U.S. voter registration, a U.S. driver's license, and a convenience address in the U.S. will not overcome the fact that the taxpayer spends the majority of their time outside the U.S. and that their family's principal place of abode is outside the U.S. The bottom line is that in most cases these factors will tend to establish that a foreign-serving missionary's principal place of residence is outside the U.S.

In sum, the principal place of residence of a person who claims or is eligible to claim the foreign earned income exclusion is outside the U.S. In contrast, a strong argument can be made that a person's principal place of residence is the U.S. if the person spends 183 or more days in the U.S. during a given year. Alternatively, in certain cases the facts-and-circumstances test from IRC section 121 may provide a more nuanced answer for persons in the U.S. less than 183 days.

Use of PPP Loan Proceeds

Both the CARES Act and the PPP loan application require that a PPP loan recipient desiring loan forgiveness demonstrate that the proceeds were spent on qualifying expenses during the eight-week period following disbursement of the loan. Qualifying expenses are clearly stipulated in the statute as payroll costs related to U.S. resident employees (at least 75% of the total), rent, interest on mortgages, and utilities. Once the entity has demonstrated that it has paid such qualifying expenses, this portion of the PPP loan will be forgiven in the form of a grant to the entity.

From a financial accounting perspective, the provisions of Accounting Standards Update (ASU) 2018-08 provide guidance as to how this loan forgiveness transaction should be recorded. Because there does not appear to be any direct commensurate value received by the resource provider (i.e., the party authorized to forgive the loan), the amount of the loan forgiven is considered to be a contribution. As there is a right of return (i.e., this is a loan, not a gift) and at least one barrier in place, if not multiple barriers (either through limited discretion or measurable performance criteria,

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[8] Treas. Reg. § 1.121-1(b)(2).

i.e., the requirement to use the loan proceeds on qualifying expenses), the amount of the loan forgiven is properly treated as a conditional contribution. Because the conditions will have been met at the same time as the loan is forgiven, the loan forgiveness would be recorded as a contribution and, given the related restrictions as to its use, it should be recorded as a restricted contribution. For financial reporting purposes, this donor restriction would be released at the same time.

Separate from the accounting treatment described above, from a cash management perspective and recognizing the concept that cash is fungible, if the entity has had the ability to pay its qualifying expenses from its general cash reserves, it would be appropriate for the entity to replenish these reserves from the PPP cash proceeds. This is assuming that the entity placed these PPP funds in a separate bank account.

How might this specifically be applied to support raising mission agencies?

Many mission agencies employ the deputized fundraising model. A typical attribute of this model is that missionary-raised support is credited to a ministry account or support account (we will use "support account" throughout this article) that tracks support raised by an individual missionary unit.[9]

While a strong correlation (perhaps even a 1-to-1 correlation) almost always exists between funds raised by an individual missionary unit and the amounts credited to that missionary unit's support account by the mission agency, it must be remembered that for federal income tax purposes, the mission agency, not the missionary, must have discretion and control over the support account funds. If this step is missing, then the donors to that missionary's support account have made a gift **to the missionary** and **not to the mission agency**. A gift to the mission agency is a tax-deductible gift for U.S. income tax purposes. A gift to the missionary is not.[10]

An additional point to be made here is that the discretion and control the mission agency has over the missionary support-raised funds means that these funds are owned and controlled by the agency, even if there may be related donor restrictions. The mission agency demonstrates its ownership and control by directing all activities and approving all expenditures. To facilitate internal accounting and management reporting and honor donor intent, the missionary support account structure is maintained as an overlay over these funds, but it does not create in the missionary unit any legal rights over the funds.

When completing its PPP loan application, the mission agency is required to compute the average monthly payroll costs of employees (i.e., missionaries) during either calendar 2019 or the 12 months preceding the date of the loan application, excluding any employees whose principal place of residence is not the U.S. This may have included some employees who are paid from their support accounts and some who are paid from the mission agency's general fund.

The fact that only U.S. resident personnel may be counted for loan forgiveness may lead some to the conclusion that the PPP loan funds must be used for payroll costs without drawing funds from the U.S. resident employee's support accounts or reimbursing salary funds withdrawn from their support accounts. However, this is not the case. There is no requirement that a U.S. resident missionary's support account either be left undisturbed because that missionary's salary is paid from PPP loan funds or that the missionary's support account be reimbursed.

Both the PPP loan and the subsequent portion forgiven are made to the mission agency, not to the missionary (or the missionary's support account). Accordingly, subsequent to satisfying the implied PPP donor restriction, the mission agency may direct or apportion the PPP funds in any manner its board and management deem appropriate. This presupposes there are sufficient cash reserves represented by support account balances and general fund balances to meet payroll without using the PPP loan funds.

Financial accounting standards provide that if both funds with donor restriction and funds without donor restriction are available for the same purpose and use, the restricted funds must be used first. This means that for financial accounting

[9] We've used the term "missionary unit" to encompass both single individuals and married couples working as a single fundraising unit.

[10] For an excellent discussion of this issue, please see *Charitable Giving Guide for Missionaries and Other Workers*, by Dan Busby, Michael Martin, and John Van Drunen, ECFA Press (2013); available for purchase at https://www.amazon.com/Charitable-Giving-Guide-Missionaries-Workers/dp/1936233134/ref=sr_1_8?dchild=1&keywords=dan+busby&qid=1586956467&sr=8-8.

purposes, restricted support account funds must be allocated or charged with related payroll costs and the PPP loan funds may be used for other purposes. Accordingly, among the possibilities (and again assuming the expenditures incurred qualify to be counted towards the restrictions related to the loan forgiveness and sufficient cash reserves to permit choice), mission agency leadership may choose to:

- Apportion the PPP loan funds to all missionary support accounts, irrespective of the missionaries' country of residence;
- Apportion the funds to support accounts with deficit or near-deficit balances;
- Hold the PPP loan funds in reserve against a drop in contributions to missionary support accounts over the next year;
- Use the PPP loan funds to supplementing under-funded activities; or
- Use the PPP loan funds to kick start new initiatives.

Please contact us online or at info@capincrouse.com with any questions or to discuss how we can assist your mission agency. We are here to help.

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Note: Although licensed to practice law in Indiana, Ted's services through CapinCrouse do not involve the practice of law and consequently do not result in the creation of an attorney-client relationship.

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