New Paycheck Protection Program Rules for Self-Employed Individuals; SBA Announces No More New PPP or EIDL Applications Due to Exhaustion of Funding

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UPDATE – On April 16, 2020, the Small Business Administration ("SBA") announced it is unable to accept new applications for the Paycheck Protection Program ("PPP") and Economic Injury Disaster Loan ("EIDL") COVID-19 program (including emergency advances) based on available appropriations funding. However, Congress is negotiating for an additional $250 billion in funding for these programs, so future funding is anticipated. It is possible that future funding may come with additional or different requirements.

On April 14, 2020, the Small Business Administration ("SBA") issued another interim final rule (the "Guidance") related to the implementation of the Paycheck Protection Program (the "PPP") under the CARES Act. The Guidance supplements the **First Interim Final Rule** issued on April 2, 2020 and can be found at this **link**.

A substantial portion of the Guidance provides clarity on and instructions for calculating the maximum PPP loan amount, and the forgiveness amount, for self-employed individuals, such as sole proprietors, independent contractors, and partners in a partnership. Below is a summary of key aspects of the Guidance.

While the information provided by the Guidance is helpful in addressing many open questions around the mechanics of the PPP with respect to self-employed individuals, it does raise a number of additional questions for applicants, particularly those who have already submitted applications without the benefit of this Guidance. As such, decisions with respect to how to proceed may vary across applicants and banks, and may be dependent upon individual facts and circumstances, as well as any further rules the SBA may issue.

Also note that, according to information published by the SBA **here**, the gross dollar amount of loans approved by the SBA under the PPP through April 13, 2020 was over $247.5 billion, or nearly 71% of the $349 billion appropriated to the PPP under the CARES Act. Approximately $101.5 billion remains available for funding these loans, including applications that may already be in process, but are not yet approved.

How Does a Sole Proprietor, Independent Contractor, or Partner in a Partnership Establish Eligibility for a PPP Loan?

With respect to self-employed individuals, the Guidance clarifies that you are eligible for a PPP loan if:

- You were in operation on February 15, 2020;
- You have self-employment income;
- Your principal place of residence is in the United States; and
- You filed or will file a Form 1040, Schedule C for 2019.

Importantly, the provisions around eligibility contained in the Guidance clarify that the income of general active partners (up to $100,000 annualized) may be included in the calculation of “payroll costs” for purposes of a PPP loan application filed by a partnership (including a limited liability company filing taxes as a partnership), as individual partners are not eligible for PPP loans themselves.

In order to establish that you were in operation on February 15, 2020, you will be required to submit a 2020 invoice, bank statement, or book of record with your PPP application.

The Guidance cautions that participation in the PPP may affect eligibility for state-administered unemployment compensation or unemployment assistance programs, including the programs authorized by Title II, Subtitle A of the CARES Act or CARES Act Employee Retention Credits.

How Does a Self-Employed Individual Without Employees Calculate the Maximum PPP Loan Amount?

If you are a self-employed individual *without* employees, you should calculate the maximum PPP loan amount as follows:

1. Find the 2019 IRS Form 1040, Schedule C, line 31 net profit amount. (If you have not yet filed a 2019 return, complete and compute the value.) If this amount is over $100,000, reduce it to $100,000. If this amount is zero or less, you are not eligible for a PPP loan.
2. Divide the amount from Step 1 by 12 to calculate the average monthly net profit amount.
3. Multiply the average monthly net profit amount from Step 2 by 2.5.
4. Add the outstanding amount of any Economic Injury Disaster Loan (“EIDL”) made between January 31, 2020 and April 3, 2020 that you seek to refinance, less the amount of any advance under an EIDL COVID-19 loan (because it does not have to be repaid).

The 2019 Form 1040, Schedule C must be provided with the PPP loan application to substantiate the applied-for PPP loan amount regardless of whether you have filed a 2019 tax return with the IRS. This clarifies and expands upon the guidance set forth in the First Interim Final Rule, which seemed to suggest that a self-employed individual should submit Form 1099-MISC in order to demonstrate the qualifying payroll amount for purposes of calculating the maximum loan amount.

The Guidance does require that you provide a 2019 IRS Form 1099-MISC detailing nonemployee compensation received (box 7), invoice, bank statement, or book of record in order to establish you are self-employed.

How Does a Self-Employed Individual With Employees Calculate the Maximum PPP Loan Amount?

If you are a self-employed individual *with* employees, you should calculate the maximum PPP loan amount as follows:

1. Total the following:

   a. 2019 Form 1040, Schedule C, line 31 net profit amount (if you have not yet filed a 2019 return, complete and compute the value), up to $100,000 annualized (if this amount is over $100,000, reduce it to $100,000, if this amount is less than zero, set this amount at zero);
   b. 2019 gross wages and tips paid to your employees whose principal place of residence is in the United States. Compute using 2019 IRS Form 941 Taxable Medicare wages & tips (line 5c, column 1), from each quarter, plus any pre-tax employee contributions for health insurance or other fringe benefits excluded from Taxable Medicare wages & tips. Subtract any amounts paid to any individual employee in excess of $100,000 annualized and any amounts paid to any employee whose principal place of residence is outside the United States; and
   c. 2019 employer health insurance contributions (health insurance component of Form 1040, Schedule C, line 14), retirement contributions (Form 1040, Schedule C, line 19), and state and local taxes assessed on employee compensation (primarily under state laws commonly referred to as the State Unemployment Tax Act, or SUTA, from

state quarterly wage reporting forms)

2. Divide the amount from Step 1 by 12 to calculate the average monthly amount.
3. Multiply the average monthly amount from Step 2 by 2.5.
4. Add the outstanding amount of any EIDL made between January 31, 2020 and April 3, 2020 that you seek to refinance, less the amount of any advance under an EIDL COVID-19 loan (because it does not have to be repaid).

For the PPP application, you must also supply: 2019 Form 1040, Schedule C, Form 941 (or other tax forms or equivalent payroll processor records containing similar information) and state quarterly wage unemployment insurance tax reporting forms from each quarter in 2019 or equivalent payroll processor records, along with evidence of any retirement and health insurance contributions, if applicable.

You must also provide a payroll statement, or similar documentation, from the pay period that covered February 15, 2020 to establish you were in operation on February 15, 2020.

How Can Eligible Self-Employed Individuals Use PPP Loan Proceeds?

The PPP loan proceeds can be used for:

- Owner compensation replacement, calculated based on 2019 net profit (as described above and subject to the restrictions on loan forgiveness for owner compensation replacement as set forth below);
- Employee payroll costs (as defined in our **March 27, 2020 Client Alert** and the **First Interim Final Rule**) for employees who have a principal place of residence in the U.S.;
- Mortgage interest payments (but not mortgage prepayments or principal payments) on any business mortgage obligation on real or personal property, business rent payments, and business utility payments;
    - You must have claimed or be entitled to claim a deduction for such expenses on your 2019 Form 1040, Schedule C for them to be a permissible use.
- Interest payments on any other debt obligations that were incurred before February 15, 2020 (but such amounts are not eligible for PPP loan forgiveness); and
- Refinancing an SBA EIDL loan made between January 31, 2020 and April 3, 2020 (maturity will be reset to PPP's maturity of two years).

The Guidance reiterates the requirement that at least 75% of the PPP loan's proceeds be used for payroll costs.

Are PPP Loan Proceeds Used to Compensate a Self-Employed Individual Eligible for Forgiveness?

Yes, but the forgiveness amount is limited to eight weeks' worth (8/52) of an individual's 2019 net profit, excluding any qualified sick leave equivalent amount for which a credit is claimed under section 7002 of the Families First Coronavirus Response Act (FFCRA) (Public Law 116-127) or any qualified family leave equivalent amount for which a credit is claimed under section 7004 of FFCRA.

What Other Amounts Paid by a Self-Employed Individual Are Eligible for Forgiveness?

In addition to owner compensation, self-employed individuals may add up the following costs incurred in the eight-week period after the PPP loan proceeds are received to calculate the forgiveness amount:

- For self-employed individuals with employees, payroll costs including salary, wages, and tips, up to $100,000 of annualized pay per employee (for eight weeks, a maximum of $15,385 per individual), as well as covered benefits for employees (but not owners), including health care expenses, retirement contributions, and state taxes imposed on

employee payroll paid by the employer (such as unemployment insurance premiums);
- Payments of interest on mortgage obligations on real or personal property incurred before February 15, 2020, but only if deductible on Form 1040, Schedule C (business mortgage payments);
- Rent payments on lease agreements in force before February 15, 2020, but only if deductible on Form 1040, Schedule C (business rent payments); and
- Utility payments under service agreements dated before February 15, 2020, but only if deductible on Form 1040, Schedule C (business utility payments).

What Documentation Must a Self-Employed Individual Submit When Requesting Forgiveness?

Regardless of whether you have employees, you must submit evidence of business rent, business mortgage interest payments on real or personal property, or business utility payments during the eight-week period after you received the PPP loan, if you used loan proceeds for those purposes.

If you have employees, you should also provide Form 941 and state quarterly wage unemployment insurance tax reporting forms, or equivalent payroll processor records that best correspond to the eight-week period after you received the PPP loan, with evidence of any retirement and health insurance contributions.

The 2019 Form 1040, Schedule C provided with the PPP loan application will be used to determine the amount of net profit allocated to owner compensation for the eight-week period.

We are here to help answer specific questions and offer advice on your options. Feel free to contact any member of our Corporate & Business Group.

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