

# SBA Paycheck Protection Program Update—Sole Proprietorships and Independent Contractors

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*Certain provisions of the coronavirus/COVID-19 economic stimulus legislation are subject to the issuance of government regulations and other government action; thus, certain details regarding the legislation may be clarified or added.*

On April 14, 2020, the Small Business Administration (SBA) issued its third **Interim Final Rule** (the Third Interim Final Rule) on the Paycheck Protection Program (PPP) created by the CARES Act. Specifically, the Third Interim Final Rule provides significant guidance with respect to sole proprietorships and independent contractors. In the Third Interim Final Rule, the SBA has waived the comment period and the normal 30-day delayed effective date, making the rule effective immediately. In this alert we will summarize the guidance issued by the SBA with respect to the PPP as it applies to sole proprietorships and independent contractors.

### (1) Eligibility

An individual who files a Form 1040 Schedule C is eligible for a PPP loan if the individual:

- (i) was in operation on February 15, 2020;
- (ii) has self-employment income (as, for example, an independent contractor or sole proprietor);
- (iii) has his or her principal place of residence in the United States; and
- (iv) filed or will file a Form 1040 Schedule C with his or her 2019 federal tax return.

If you are a partner in a partnership, you may not submit a separate PPP loan application for yourself as a self-employed individual. Instead, the self-employment income of general active partners may be reported as a payroll cost, up to

\$100,000 annualized, on a PPP loan application filed by or on behalf of the partnership. In addition, please be aware that participation in the PPP may affect your 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.

### (2) Calculating Maximum Loan Amount and Supporting Documentation

#### A. If you have no employees:

##### 1. Calculating Loan Amount

- (i) **Step 1:** Find your 2019 IRS Form 1040 Schedule C line 31 net profit amount. If your net profit amount is over \$100,000, reduce it to \$100,000. If your net profit amount is zero or less, you are not eligible for a PPP loan.
- (ii) **Step 2:** Calculate the average monthly net profit amount by dividing the net profit amount calculated in Step 1 above by 12.
- (iii) **Step 3:** Multiply the average monthly net profit amount calculated in Step 2 above by 2.5.
- (iv) **Step 4:** If applicable, 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 any such advance does not have to be repaid).

##### 2. Supporting Documentation for Requested Loan Amount

With your application, you should be prepared to submit all of the following:

(i) 2019 Form 1040 Schedule C to substantiate the applied-for PPP loan amount;

(ii) a 2019 IRS Form 1099-MISC detailing nonemployee compensation received (box 7), an invoice, a bank statement, or a book of record that establishes you are self-employed;<sup>1</sup> and

(iii) a 2020 invoice, bank statement, or book of record to establish you were in operation on or around February 15, 2020.

## B. If you have employees:

### 1. Calculating Loan Amount

(i) **Step 1:** Compute 2019 payroll amount.<sup>2</sup>

(ii) **Step 2:** Calculate the average monthly amount by dividing your 2019 payroll amount calculated in Step 1 by 12.

(iii) **Step 3:** Multiply the average monthly amount calculated in Step 2 by 2.5.

(iv) **Step 4:** If applicable, 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 any such advance does not have to be repaid).

### 2. Supporting Documentation for Requested Loan Amount

With your application, you should be prepared to submit all of the following:

(i) 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;

(ii) evidence of any retirement and health insurance contributions, if applicable; and

(iii) a payroll statement or similar documentation from the pay period that

covered February 15, 2020, in order to establish you were in operation on February 15, 2020.

### (3) Eligible Uses of PPP Proceeds

(i) owner compensation replacement, calculated based on 2019 net profit as described in 2.A.1 above

(ii) employee payroll costs for employees whose principal place of residence is in the United States, if you have employees<sup>3</sup>

(iii) 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<sup>4</sup>

(iv) interest payments on any other debt obligations that were incurred before February 15, 2020 (but note that such amounts are not eligible for PPP loan forgiveness)

(v) refinancing an SBA EIDL made between January 31, 2020, and April 3, 2020 (maturity will be reset to PPP's maturity of two years)

Self-employed individuals will need to rely on their 2019 Form 1040 Schedule C, which provides verifiable documentation of expenses between January 1, 2019, and December 31, 2019. For individuals with income from self-employment from 2019 for which they have filed or will file a 2019 Form 1040 Schedule C, expenses incurred between January 1, 2020, and February 14, 2020, may not be considered because of the lack of verifiable documentation of expenses in this period.

### (4) Determining Loan Forgiveness

The actual amount of loan forgiveness will depend, in part, on the total amount spent over the covered period on:

(i) 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),

<sup>1</sup> You must provide these documents regardless of whether you have filed a 2019 tax return with the IRS.

<sup>2</sup> "Payroll" is calculated by adding the following:

a. Your 2019 Form 1040 Schedule C line 31 net profit amount (if you have not yet filed a 2019 return, fill it out and compute the value), up to \$100,000 annualized; if this amount is over \$100,000, reduce it to \$100,000, or 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, computed using 2019 IRS Form 941 taxable Medicare wages and tips (line 5c column 1) from each quarter plus any pretax employee contributions for health insurance or other fringe benefits excluded from taxable Medicare wages and 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).

<sup>3</sup> For clarity, at least 75% of the PPP loan proceeds shall be used for payroll costs as articulated in the [First PPP Interim Final Rule](#). For purposes of determining the percentage of use of proceeds for payroll costs (but not for forgiveness purposes), the amount of any refinanced EIDL will be included.

<sup>4</sup> For clarity, 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 during the eight-week period following the first disbursement of the loan (i.e., the "covered period").

including health care expenses, retirement contributions, and state taxes imposed on employee payroll paid by the employer (such as unemployment insurance premiums);

(ii) owner compensation replacement, with forgiveness of such amounts limited to eight weeks' worth of 2019 net profit (net profit multiplied by eight divided by 52), but 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 qualified family leave equivalent amount for which a credit is claimed under Section 7004 of FFCRA;

(iii) payments of interest on mortgage obligations on real or personal property incurred before February 15, 2020, to the extent they are deductible on Form 1040 Schedule C (business mortgage payments);

(iv) rent payments on lease agreements in force before February 15, 2020, to the extent they are deductible on Form 1040 Schedule C (business rent payments); and

(v) utility payments under service agreements dated before February 15, 2020, to the extent they are deductible on Form 1040 Schedule C (business utility payments).

It is worth noting again that the SBA Administrator has determined that it is appropriate to limit the forgiveness of owner compensation replacement for individuals with self-employment income who file a Schedule C to eight weeks of 2019 net profit (net profit multiplied by eight divided by 52).<sup>5</sup>

## **(5) Documentation Required for Loan Forgiveness**

In addition to the borrower certification required by Section 1106(e)(3) of the CARES Act, to substantiate requests for loan forgiveness, if you have employees, you should submit Form 941 and state quarterly wage unemployment insurance tax reporting forms or equivalent payroll processor records that best correspond to the covered period (with evidence of any retirement and health insurance contributions). Whether or not you have employees, you must submit evidence of business rent, business mortgage interest payments on a real or personal property, or business utility payments during the covered period if you used loan proceeds for those purposes. The 2019 Form 1040 Schedule C that was provided at the time of the PPP loan application must be used to determine the amount of net profit allocated to the owner for the eight-week covered period.

## **(6) Clarification on Eligible Businesses**

### **A. Are eligible businesses owned by directors or shareholders of a PPP lender permitted to apply for a PPP loan through the lender with which they are associated?**

The SBA Administrator has determined that SBA regulations (including 13 CFR 120.110 and 120.140) shall not apply to prohibit an otherwise eligible business owned (in whole or part) by an outside director or holder of a less than 30 percent equity interest in a PPP lender from obtaining a PPP loan from the PPP lender on whose board the director serves or in which the equity owner holds an interest, provided that the eligible business owned by the director or equity holder follows the same process as any similarly situated customer or account holder of the lender. Favoritism by the lender in processing time or prioritization of the director's or equity holder's PPP application is prohibited. According to the Third Interim Final Rule, lenders should comply with all other applicable state and federal regulations concerning loans to associates of the lender. Lenders should also consult their own internal policies concerning lending to individuals or entities associated with the lender.<sup>6</sup>

### **B. Are businesses that receive revenue from legal gaming eligible for a PPP loan?**

A business that is otherwise eligible for a PPP loan is not rendered ineligible due to its receipt of legal gaming revenues if the existing standard in 13 CFR 120.110(g) is met or the following two conditions are satisfied: (a) the business's legal gaming revenue (net of payouts but not other expenses) did not exceed \$1 million in 2019; and (b) legal gaming revenue (net of payouts but not other expenses) comprised less than 50 percent of the business's total revenue in 2019. Businesses that received illegal gaming revenue are categorically ineligible.

***To see our prior alerts and other material related to the pandemic, please visit the [Coronavirus/COVID-19: Facts, Insights & Resources](#) page of our website by clicking [here](#).***

<sup>5</sup> According to the Third Interim Final Rule, this is because many self-employed individuals have few of the overhead expenses that qualify for forgiveness under the CARES Act. For example, many such individuals operate out of either their homes, vehicles, or sheds and thus do not incur qualifying mortgage interest, rent, or utility payments. As a result, most of their receipts will constitute income. Allowing such a self-employed individual to treat the full amount of a PPP loan as net income would result in a windfall.

<sup>6</sup> For clarity, officers and key employees of a PPP lender may obtain a PPP loan from a different lender, but not from the PPP lender with which they are associated. Further, the "Authorized Lender Official" for each PPP loan is subject to the limitations described in the [Lender Application Form](#).

# Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

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