New PPP Rules Benefit Self-Employed Individuals

Related People:

Howard M. Berkower
William D. Brown, Jr.

New York Law Journal / Corporate Alert

03.23.2021

Last year, self-employed individuals who conducted their business without any employees could qualify for a Paycheck Protection Program (PPP) loan in an amount equal to approximately 20.8% (2.5 months divided by 12 months) of their 2019 annual net earnings from self-employment not to exceed $100,000, or no greater than $20,833 (20.8% of $100,000 capped). Since the calculation of net earnings for self-employment is conducted after deductions for fixed and other business expenses that a small business must cover to stay afloat, annual net earnings from self-employment can often be a very small number resulting in an extremely small PPP loan amount. For example, annual net earnings from self-employment of $5,000 would qualify for a PPP loan of just $1,042 (20.8% of $5,000). As a result, many sole proprietors who report their net earnings from self-employment on Schedule C of their Individual Tax Return on IRS Form 1040 (Schedule C) haven't bothered to apply for PPP loans. Furthermore, sole proprietors without employees are 70% owned by women and minorities—the underserved groups sought to be helped by the PPP.

Significantly, earlier this month, the Small Business Administration ("SBA") issued new PPP rules in a new Interim Final Rule (the "New IFR") titled "Business Loan Program Temporary Changes; Paycheck Protection Program — Revisions to Loan Amount Calculation and Eligibility" and in a new Frequently Asked Questions (the "New FAQ"). The New IFR and New FAQ (collectively the "Revised Rules") account for changes made to the PPP by the Consolidated Appropriations Act, 2021 (CAA), and incorporate directives by the Biden Administration to create greater available PPP funds for self-employed Schedule C filers by permitting the calculation of PPP loan amounts to be based on gross income rather than net earnings.

Loan Calculation for Schedule C Filers (Sole Proprietors and Independent Contractors)

The SBA and the US Treasury Department seized on the definition of "payroll costs" contained in the CARES Act, which provides, in relevant part, that "any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment or similar compensation" constitutes "payroll costs" to *allow sole proprietors to receive the larger PPP loans by using their gross income (maximum $100,000)* instead of net profit. The New IFR allows a Schedule C filer who has yet to be approved for a First Draw or Second Draw PPP loan to elect to calculate the owner compensation share of its payroll costs based on either:

1. **Net Profit** (as reported on line 31 of Schedule C); or
2. **Gross Income** (as reported on line 7 of Schedule C).

- In determining a borrower's eligible expenses and forgiveness amount, the New IFR regards the owner compensation share of a Schedule C filer's loan amount as "proprietor expenses," which exclude employee payroll costs.
- To avoid double counting, Schedule C filers must subtract gross income from the following expenses, which represent "employee payroll costs":

3. Employee benefit programs as reported on line 14 of Schedule C
4. Pension and profit-sharing plans as reported on line 19 of Schedule C
5. Wages less employment credits as reported on line 26 of Schedule C

- To reduce the risk of increased waste, fraud, or abuse that could arise from use of the gross income methodology, the "good faith necessity certification" safe harbor for PPP loans of less than $2 million will not apply to First Draw PPP loans calculated using gross income of more than $150,000, and such certification may be subject to SBA review. However, this safe harbor exclusion will not apply for Second Draw PPP loans; an applicant must certify that they have realized more than a 25% reduction in quarterly gross receipts relative to the comparison quarterly period. See FAQ 46.
- Schedule C filers using the "gross income test" must apply for a First Draw PPP loan on the new SBA Form 2483-C and new SBA Form 2483-SD-C for a Second Draw PPP loan.
- The New IFR also removes eligibility restrictions that prevented PPP loans from going to small-business owners with prior non-fraud felony convictions (fraud, bribery, embezzlement, or making a false statement in a loan application or application for federal assistance) and who are delinquent on their student loans.

PPP Eligibility Enhancements

The New IFR removes certain eligibility restrictions and enables more small businesses to qualify for PPP loans, including (a) small-business owners who are delinquent or have defaulted on federal student loans and (b) small-business owners who, within the past year, were convicted of, pleaded guilty to, or commenced any form of parole or probation for a felony not involving financial fraud. A five-year look-back still applies to financial felonies involving fraud, bribery, embezzlement, or a false statement on a loan application or application for financial assistance.

Additional PPP Clarifications

- Second Draw applicants who receive partial forgiveness (for failing to use at least 60% of First Draw PPP proceeds for payroll costs) of their First Draw PPP loans are still eligible for a Second Draw PPP loan, as long as the borrower used the total amount of its First Draw PPP loan only for eligible expenses. See FAQs 61 and 62.
- Applicants for a Second Draw PPP loan, together with their affiliates, can employ no more than 300 employees. SBA size and alternate size standards are not available for determining eligibility for second-draw loans.

  The only exceptions are if an applicant:

  - Is assigned a NAICS code beginning with 72 and employs no more than 300 employees per physical location.
  - Is a news organization that is majority owned or controlled by a business concern that is assigned NAICS code 51110 or a NAICS code beginning with 5151, or is a nonprofit public broadcasting entity with a trade or business under NAICS code 511110 or 5151, and employs no more than 300 employees per physical location. See FAQ 63.
- A sole proprietor, a self-employed individual, or an independent contractor that has an individual taxpayer identification number (ITIN) can use the ITIN on the borrower application forms (SBA Forms 2483, 2483-C, 2483-SD, and 2433-SD-C, or lender's equivalent) for a PPP loan and forms to apply for loan forgiveness (SBA Forms 3508, 3508EZ, and 3508S, or lender's equivalent) instead of a Social Security Number (SSN). See FAQ 64.

Borrowers that received a First Draw PPP loan or Second Draw PPP loan can claim the Employee Retention Credit. However, payroll costs that are qualified wages for the Employee Retention Credit must not be paid with the proceeds of a PPP loan or claimed as "payroll costs" qualifying for PPP loan forgiveness.

- Qualified Wages used for the Retention Credit are not eligible to be claimed as "payroll costs" in applying for PPP loan forgiveness. Borrowers must segregate and specifically identify those payroll costs which are claimed as "qualified wages" for the Retention Credit and those payroll costs that are funded by PPP loan proceeds and qualify for loan forgiveness. FAQ 65.
- Lenders have the following options to assist Schedule C filers who wish to use the gross income methodology to calculate PPP loan amounts but have already submitted PPP loan applications. FAQ 66.
  - If the lender has received but has not submitted a loan guaranty application for the Schedule C applicant, the applicant must submit to the lender SBA Form 2483-C for a First Draw PPP loan or SBA Form 2483-SD-C for a Second Draw PPP loan, and the lender must then submit a loan guaranty application to SBA using SBA Form 2484 (Revised 3/21) for a First Draw PPP loan or SBA Form 2484-SD (Revised 3/21) for a Second Draw PPP loan.
  - If the lender has submitted a loan guaranty application and the loan guaranty application has not yet been approved, the lender may withdraw the loan guaranty application and resubmit a loan guaranty application after receipt from the applicant of SBA Form 2483-C for a First Draw PPP loan or SBA Form 2483-SD-C for a Second Draw PPP loan. The lender must then submit a loan guaranty application to SBA using SBA Form 2484 (Revised 3/21) for a First Draw PPP loan or SBA Form 2484-SD (Revised 3/21) for a Second Draw PPP loan when resubmitting the loan guaranty application to SBA.
  - If SBA has issued a loan number but the loan has not yet been disbursed, the lender may cancel the loan in E-Trans Servicing, and the applicant may apply for a new loan using SBA Form 2483-C for a First Draw PPP loan or SBA Form 2483-SD-C for a Second Draw PPP loan.
  - If the lender has disbursed the loan but has not filed the related Form 1502 Report reporting disbursement of the loan, the applicant must repay the PPP loan in full, the lender must cancel the loan in E-Trans Servicing, and the applicant may apply for a new loan using SBA Form 2483-C for a First Draw PPP loan or SBA Form 2483-SD-C for a Second Draw PPP loan.
  - If the lender has disbursed the loan and filed the related Form 1502 Report reporting disbursement of the loan, no changes can be made to the loan amount calculation.

McCarter can assist you with determining whether you are eligible for a PPP loan, completing the loan application, gathering the documentation necessary to provide to the lender after the application has been submitted, and maximizing loan forgiveness.

Related media coverage includes the article below:

New York Law Journal