

Paycheck Protection Program Eligibility Requirements Clarified

Coronavirus Legal Advisory

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Here we clarify PPP eligibility requirements for independent contractors, sole proprietors and individuals with self-employment income, as well as additional guidance regarding partnerships and other issues.

On Tuesday, April 14, 2020, the U.S. Small Business Administration (SBA) posted an [Interim Final Rule](#) (Final Rule) clarifying how the [Paycheck Protection Program](#) (PPP) applies to self-employed individuals such as independent contractors, sole proprietors, partners in a partnership, members in an LLC and other individuals who use Form 1040, Schedule C when they file taxes. The Final Rule also addressed eligibility requirements for certain business concerns and pledges of PPP loans. The Final Rule applies to all applications under PPP through June 30, 2020, or until funds made available are exhausted. Below are key takeaways regarding the Final Rule.

Independent Contractors, Sole Proprietors and Individuals with Self-Employment Income

Independent contractors, sole proprietors and other individuals with self-employment income who file a Form 1040, Schedule C are eligible for a PPP loan if (i) they were in operation on February 15, 2020; (ii) their principal place of residence is in the United States; and (iii) they filed or will file a Form 1040, Schedule C for 2019. The SBA is expected to issue additional guidance for individuals with self-employment income who (i) were not in operation in 2019 but who were in operation on February 15, 2020; and (ii) will file a Form 1040, Schedule C for 2020.

Partners' Income Should Be Reported on Partnership PPP Loan Application

Partners in a partnership are not eligible for a separate PPP loan as self-employed individuals. Instead, the income of general active partners should be reported as a payroll cost, up to \$100,000 annualized, on a PPP loan application filed by or on behalf of the partnership. The secretary of the Treasury has determined that limiting a partnership and its partners (and an LLC filing taxes as a partnership) to one PPP loan is necessary to ensure as many eligible borrowers as possible can meet the statutory deadline of June 30, 2020.

Calculating Maximum Loan Amounts

The Final Rule sets forth a specific process to calculate the maximum loan amount under the PPP for a variety of situations involving self-employed individuals.

(1) Self-Employment With No Employees

Step 1. Find 2019 IRS 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.) If this amount is over \$100,000, reduce it to \$100,000. If this amount is zero or less, you are not eligible.

Step 2. Calculate the average monthly net profit amount by dividing the amount from Step 1 by 12.

Step 3. Multiply the average monthly net profit amount from Step 2 by 2.5.

Step 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 a COVID-19 EIDL (because it doesn't have to be repaid).

A 2019 Form 1040, Schedule C must be submitted with a PPP loan application to substantiate the applied-for PPP loan amount, as well as with a 2019 IRS Form 1099-MISC detailing nonemployee compensation received (box 7), an invoice bank statement or a book of record that establishes self-employment. A 2020 invoice bank statement or book of record must also be submitted to establish ongoing operations on February 15, 2020.

(2) Self-Employment With Employees

Step 1. Compute 2019 payroll by adding the following:

1. **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.) If this amount is over \$100,000, reduce it to \$100,000. If this amount is zero or less, set the amount to zero.
2. **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 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 employee in excess of \$100,000 annualized and any amounts paid to any employee whose principal place of residence is outside the United States.
3. **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 on state quarterly wage reporting forms).

Step 2. Calculate the average monthly net profit amount (divide the amount from Step 1 by 12).

Step 3. Multiply the average monthly net profit amount from Step 2 by 2.5.

Step 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 a COVID-19 EIDL (because it doesn't have to be repaid).

A 2019 Form 1040, Schedule C or a 2019 Form 941 (or other tax forms or equivalent payroll processor records containing similar information) must be submitted with PPP loan applications and state quarterly wage unemployment insurance tax reporting forms from each quarter in 2019, or the equivalent payroll processor records, along with evidence of any retirement and health insurance contributions, if applicable. A payroll statement or similar documentation from the pay period that covered February 15, 2020, must be provided to establish ongoing operations on February 15, 2020.

Participation in PPP May Affect State-Administered Unemployment Compensation

Participation in PPP may affect eligibility for state-administered unemployment compensation or unemployment assistance programs, including programs by Title II, Subtitle A of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) or CARES Act Employee Retention Credits.

Use of PPP Loan Proceeds for Individuals With Income From Self-Employment Who File 2019 Form 1040, Schedule C

The proceeds of a PPP loan are to be used for the following:

1. Owner compensation replacement, calculated based on 2019 net profit.
2. Employee payroll costs. Payroll costs include salary, wages and tips, 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), up to \$100,000 of annualized pay per employee. No more than 25 percent of the forgiven amount may be for non-payroll costs.
3. Mortgage interest payments (but not mortgage prepayments or principal payments) on any business mortgage obligation on real or personal property.
4. Business rent payments.
5. Business utility payments (must have claimed or be entitled to claim a deduction for utility expenses on 2019 Form 1040, Schedule C for expenses to be permissible during the eight-week period following the first disbursement of the loan (the “covered period”).
6. Interest payments on any other debt obligation incurred before February 15, 2020. However, interest payments on other debt obligations are not eligible for PPP loan forgiveness.
7. Refinancing an SBA EIDL made between January 31, 2020, and April 3, 2020 (maturity will be reset to PPP’s maturity of two years). If you received an SBA EIDL between January 31, 2020, and April 3, 2020, you can apply for a PPP loan. If an EIDL was used for payroll costs, the PPP loan must be used to refinance the EIDL . Proceeds from any advance up to \$10,000 on an EIDL will be deducted from the loan forgiveness amount on the PPP loan.

Although the CARES Act makes businesses in operation on February 15, 2020, eligible for PPP loans, self-employed individuals will need to rely on their 2019 Form 1040, Schedule C, which provides verifiable documentation on expenses between January 2, 2019, and December 31, 2019.

Terms of Loan Forgiveness for Individuals With Income From Self-Employment Who File 2019 Form 1040, Schedule C

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

1. Payroll costs (the amount of any refinanced EIDL will be included). For forgiveness purposes, 75 percent of PPP loan proceeds must be used for payroll costs.
2. Owner compensation replacement, calculated based on 2019 net profit, with forgiveness amounts limited to eight weeks’ worth of 2019 net profit, but excluding any qualified sick leave equivalent amount for which a credit is claimed under Section 7003 of the Families First Coronavirus Response Act (FFCRA) (Public Law 116-127) or a qualified family leave equivalent amount for which a credit is claimed under Section 7004 of FFCRA.
3. Payments of interest on mortgage obligations on real property incurred before February 15, 2020, to the extent they are deductible on Form 1040, Schedule C (business rent payments).
4. Utility payments under service agreements dated before February 15, 2020, to the extent they are deductible on Form 1040, Schedule C (business utility payments).

Independent contractors, sole proprietors and individuals with income from self-employment will need to provide their lender with the following documents with a request for loan forgiveness:

1. Borrower certification that the documentation presented in connection with forgiveness is true and correct, and the amount for which forgiveness is requested that was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation or make covered utility payments, as required under Section 1106(e)(3) of the CARES Act.
2. Documents reflecting the number of employees (Form 941).
3. State quarterly wage unemployment insurance tax reporting forms or the equivalent payroll processor records that best correspond to the covered period (with evidence of any retirement and health insurance contributions).
4. Evidence of business rent, business mortgage interest payments on real or personal property, and utility payments during the covered period if you used loan proceeds for those purposes.

PPP Requirements for Directors, Shareholders, Officers and Key Employees of PPP Lenders

Traditionally, the SBA restricts businesses that are owned by directors or shareholders of SBA lending institutions from obtaining SBA loans from those institutions. The Final Rule relaxes those requirements significantly in the case of PPP loans. Eligible businesses that are owned by directors or shareholders of less than 30 percent equity interest in a PPP lender are permitted to apply for a PPP loan from a lender on whose board the director serves or in which the equity owner holds an interest, as long as the lender complies with all applicable state and federal regulations concerning loans to associates of the lender. Officers and key employees of a lender may apply for a PPP loan from a different lender but may not apply with the lender with which they are associated.

Businesses That Receive Revenue From Legal Gaming Are Eligible for a PPP Loan

A legal gaming business that is otherwise eligible for a PPP loan can apply as long as it meets the existing standard in 13 CFR 120.110(g) 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) accounted for less than 50 percent of the business's total revenue in 2019.

Pledge Requirements for Loan Pledges Under 13 CFR 120.434 Do Not Apply to PPP

Finally, the Final Rule makes it easier for a participating bank to monetize PPP loans to the Federal Reserve Bank by clarifying that regulations requiring the SBA's prior written consent or notice to the SBA, or SBA approval of the underlying documentation effectuating such monetization, do not apply to PPP loans.

McCarter & English, LLP, can assist you with determining whether you are eligible for a PPP loan, completing the loan application and gathering the documentation necessary.