

MSF CLIENT ALERT

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Too Little Too Late?

SBA Issues Supplemental Interim Rules With Guidance For Independent Contractors & Sole Proprietors Under The Paycheck Protection Program

With the Initial Paycheck Protection Program appropriated funds completely utilized, the Small Business Administration issues new guidance regarding eligibility for Independent Contractors and Sole Proprietors.

April 20, 2020

Need for Additional PPP Funds

The U.S. Treasury Secretary Steven T. Mnuchin and U.S. Small Business Administration Administrator Jovita Carranza issued a press statement on April 15, 2020 urging Congress to appropriate additional funds for the Paycheck Protection Program. According to the statement, the SBA will not be able to issue new loan approvals once the \$349 billion in funds appropriated lapse. On April 16, 2020, the SBA issued a notice that it is currently unable to accept new applications for the Paycheck Protection Program based on available appropriations funding.

In a Paycheck Protection Program (PPP) Report ("Report") issued by the SBA for loan approvals through 12 p.m. on April 16, 2020, the SBA reported that in just thirteen days from the Paycheck Protection Program launch, over 1.6 million loans had been approved in the amount of \$342 billion. As of April 16, 2020, the funding had been completely utilized.

According to the Report:

- The overall average loan size is \$206,000;

- Over 74 percent of the loans approved have been for \$150,000 and under, accounting for 17% of the total amount of loans disbursed;
- In nod to the criticism brewing about PPP, just over 4% of loans approved have been for greater than \$1,000,000, accounting for just under 50% of the total amount of loans disbursed;
- The states with the most funds disbursed, include:
 - California - \$33.4 billion
 - Texas – 28.4 billion
 - New York - \$20.1 billion
 - Florida - \$17.8 billion
 - Illinois - \$15.9 billion
 - Pennsylvania - \$15.6 billion
 - Ohio - \$14.1 billion
- The states with the most approved loans; include:
 - Texas - 134,737
 - California – 112,967
 - Florida – 88,997
 - New York – 81,075
 - Illinois - 69,893
 - Pennsylvania – 69,567
 - Ohio – 59,800
- Connecticut and New Jersey lag far behind with loan dollars disbursed equaling \$4.1 billion and \$9.5 billion, respectively; and
- The top sectors to receive loans in approved dollar amounts include Construction; Professional, Scientific and Technical Services; Manufacturing;

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Health Care and Social Assistance; Accommodation and Food Services; and Retail Trade.

Congress is considering additional funding for the Paycheck Protection Program, but as of this Client Alert, no measures have been approved.

Supplemental Interim Rules for Independent Contractors and Sole Proprietors

In another effort to provide guidance for the PPP loan process, the SBA issued a supplemental Interim Rule relating to eligibility for independent contractors and sole proprietors.

Eligibility To Apply

The guidance clarifies that individuals who have income from self-employment and file a Form 1040, Schedule C are eligible for a loan if they meet four requirements:

- The business was in operation on February 15, 2020;
- The borrower is an individual with self-employment income (such as an independent contractor or sole proprietor);
- The borrower's principal place of residence is the United States; and
- The borrower filed or will file a Form 1040 Schedule C for 2019.

The SBA intends to issue additional guidance for those individuals with self-employment income who were not in operation in 2019 but were in operation on February 15, 2020 and will file a Form 1040 Schedule C for 2020.

2019 Schedule C Required

Notably, with the delay in tax filings, many self-employed individuals may now be required to race to complete their 2019 Schedule C in order to complete their application.

The guidance provides that regardless of whether a 2019 tax return has been filed, borrowers must provide:

- The 2019 Form 1040 Schedule C with the PPP loan application to substantiate the loan amount;
- A 2019 IRS Form 1099-MISC detailing non-employee compensation, invoice, bank statement or book or record that establishes that the borrower is self-employed; and
- A 2020 invoice, bank statement or book of record to establish the borrower was in operation on or around February 15, 2020.

The guidance provides no options not to provide 2019 data simply stating "if you have not yet filed a 2019 tax return, fill [a Schedule C] out and compute" the net profit amount.

Calculation of Maximum Amount of Loan

The guidance provides different methods to calculate the maximum loan amount depending on whether the self-employed individual employs other employees.

The employee calculations are similar to previous guidance received. For those self-employed, the payroll costs should be determined based on a review of Schedule C net profits up to \$100,000 annualized. If net profits are zero or less, the borrower is not eligible for a PPP loan for the self-employed portion.

Use of PPP Loans by Self-Employed Individuals

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

- Owner compensation replacement based on 2019 net profit
- Employee payroll costs

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- Mortgage interest payments on any business mortgage obligation on real or personal property (including warehouses, interest on an auto loan)
- Business rent payments
- Business utility payments
- Interest payment on other debt obligations incurred before February 15, 2020 (however such amounts are not eligible for loan forgiveness)
- Refinancing an SBA EIDL loan made between January 31, 2020 and April 3, 2020

The guidance provides a qualification that the borrower must have claimed or be entitled to claim a deduction for such expenses on the 2019 Form 1040 Schedule C for the expense to be a permissible use.

Similar to prior guidance from the SBA, at least 75% of loan proceeds to self-employed individuals must be used on payroll costs.

Loan Forgiveness

The guidance provides some additional detail on loan forgiveness indicating that the amount of loan forgiveness may include:

- Payroll costs up to \$100,000 of annualized pay per employee (a maximum of \$15,385 per individual)
- Covered benefits for employees (but not owners) including health care expenses, retirement contributions and state taxes imposed on payroll
- Owner compensation replacement based on 8 weeks (8/52 weeks) of 2019 net profit capped at \$100,000
- Payments of interest on mortgage obligations on real or personal property

- Business rent payments on lease agreements
- Utility payments under service agreements

The interest obligations, business rent payments and utility payments must be incurred or in effect on February 15, 2020 and be deductible expenses on Schedule C. The SBA justifies the limitation on owner compensation in an effort to prevent self-employed individuals from using loan proceeds as a windfall and because many self-employed individuals have few of the overhead expenses that qualify for forgiveness under the Act because they work out of “homes, vehicles, or sheds.”

Partners in a Partnership

The guidance also clarifies that partners in a partnership must file through the partnership and not file separately. In those cases, the partnership may report the self-employment income of general active partners as a payroll cost, up to \$100,000 annualized per partner.

Eligibility for Unemployment and PPP Proceeds

The guidance provides, as an aside and without more detail, that participation in PPP may affect eligibility for state-administered unemployment compensation or unemployment assistance programs, including those under the CARES Act.

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For more information or if you have any questions about how these new developments may affect your business, please contact a member of our Employment team.



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