

Client Alert

April 2020

SBA Issues Interim Final Rule with Additional Guidance on the Paycheck Protection Program

On April 14, the US Small Business Administration (“SBA”) released an immediately effective interim final rule (the “Interim Final Rule”) providing additional guidance for the “Paycheck Protection Program” established under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act” or “Act”). This Interim Final Rule supplements the interim final rule issued by the SBA on April 2, 2020 (the “PPP Interim Final Rule”) and provides long awaited guidance on loans to self-employed individuals and independent contractors.

Qualified Borrowers

The Paycheck Protection Program (the “PPP”) applies to individuals with self-employment income who had business operations on February 15, 2020, had self-employment income, whose principal place of residence is in the United States and filed or will file a Form 1040 Schedule C for 2019.

Individuals who are partners in a partnership may not separately file as a self-employed individual. These individuals must apply at the partnership level. Self-employment income of general active partners must be reported on the PPP loan application for the partnership and will be capped at \$100,000 annualized. This requirement for partnerships to apply as an entity reduces the complexity of sorting out payroll and overhead costs that are paid at the partnership level. The SBA intends to publish additional guidance for individuals with self-employment income who began operations between January 1, 2020 and February 15, 2020 and will file a Form 1040 Schedule C for 2020.

Participation in the PPP as a self-employed individual may affect the eligibility for state-administered unemployment compensation and the unemployment benefits under Title II of the CARES Act.

Calculating Maximum Loan Amount

If the self-employed individual does not have other employees, the maximum loan amount is determined by (1) finding the 2019 IRS Form Schedule C line 31 net profit amount, capped at \$100,000, (2) dividing this number by twelve to determine the average monthly net profit amount, (3) multiplying by 2.5 and (4) adding the outstanding amount of any Economic Injury Disaster Loan (EIDL) made between January 31, 2020 and April 3, 2020 that is to be refinanced, less the amount of any advance under an EIDL COVID-19 loan.

If the self-employed individual has employees, the maximum loan amount is determined by (1) finding the 2019 IRS Form Schedule C line 31 net profit amount, capped at \$100,000, (2) adding 2019 gross wages and tips for employees whose principal place of residence is in the United States, capped at \$100,000 plus any pre-tax employee contributions for health insurance and benefits, (3) adding 2019 employer health insurance contributions, retirement contributions, state and local taxes assessed on employee compensation, (4) dividing this number by twelve, (5) multiplying by 2.5 and (6) adding the outstanding amount of any Economic Injury Disaster Loan (EIDL) made between January 31, 2020 and April 3, 2020 that is sought to be refinanced, less the amount of any advance under an EIDL COVID-19 loan.

Required Documentation for Calculating Maximum Loan Amount

The applicant must provide the 2019 Form 1040 Schedule C with their loan application, regardless of whether or not it has been filed with the IRS. The applicant must also provide a 2020 invoice, bank statement, or book of record to establish business operations on or around February 15, 2020.

If the applicant has employees, it must provide their 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. A payroll statement or similar documentation from the pay period that covered February 15, 2020 must be provided to establish existing operations on February 15, 2020.

Applicable Uses for Paycheck Program Funds

Individuals with income from self-employment who file a 2019 Form 1040, Schedule C can use PPP loan funds for the following:

- Owner compensation replacement, calculated as outlined above;
- Employee payroll costs for employees whose principal place of residence is the United States;
- Mortgage interest payments or any business mortgage obligation on real property, business rent payments, and business utility payments—all such expenses must have been claimed or permitted to have been claimed on the individuals 2019 Form 1040 Schedule C in order to be a permissible use during the eight-week period following disbursement of the loan;
- Interest payments on other debt obligations incurred prior to February 15, 2020 (these expenses will not be eligible for loan forgiveness); or
- Refinancing an SBA Economic Injury Disaster Loan made between January 31, 2020 and April 3, 2020.

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

As was the case with the PPP Interim Final Rule, released on April 2, 2020, at least seventy five percent (75%) of the PPP loan proceeds must be used for payroll costs.

Payroll costs eligible for forgiveness include:

- Salary, wages, commissions, or tips (capped at \$100,000 on an annualized basis for each employee);
- Covered benefits for employees (but not owners), including health care expenses, retirement contribution, and state taxes imposed on employee payroll paid by the employer (such as unemployment insurance premiums);
- Owner compensation replacement, calculated based on 2019 net profits, with forgiveness of such amounts limited to eight weeks' worth of 2019 net profit, but excluding certain qualified leave;
- Payments of interest on mortgage obligations on real or personal property incurred before February 15, 2020, to the extent deductible on Form 1040 Schedule C;
- Rent payments on lease agreements in force before February 1, 2020, to the extent deductible on Form 1040 Schedule C; and
- Utility payments under service agreements dated before February 15, 2020 to the extent deductible on Form 1040 Schedule C.

Paycheck Program Loan Forgiveness

The maximum loan amount is based on 2.5 months of the borrower's payroll during the one-year period preceding the loan. The maximum amount of loan forgiveness is based on the borrower's eligible payments over the eight-week period following the date of loan disbursement. The SBA limits loan forgiveness for individuals with self-employment income who file a Schedule C to a proportionate eight-week share of 2019 net profit because the SBA determined that such individuals have few overhead expenses that qualify for forgiveness under the CARES Act. At least 75 percent of the amount forgiven must be attributable to payroll costs for the same reasons cited in the first PPP Interim Final Rule.

Required Documentation for Calculating Forgiveness

Borrowers are required to submit both a borrower certification and a Form 941 and state quarterly wage unemployment insurance tax reporting forms or equivalent payroll processor records that best correspond with the covered period (along with evidence of any retirement and health insurance contributions). Regardless of whether a borrower has employees, the borrower is required to submit evidence of business rent, business mortgage interest payments on real or personal property, or business utility payments during the covered period if loan proceeds are used for such purposes. The 2019 Form 1040 Schedule C provided at the time of the PPP loan application must be used to determine the amount of net profit allocated to a borrower for the eight-week covered period.

Other Developments in this Interim Final Rule

Legal Gambling

An entity that is otherwise eligible for the PPP will not be considered ineligible due to legal gambling revenue as long as (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.

Pledging of SBA Loans

Pursuant to SBA regulations at 13 CFR Section 120.435(d) and (e), a pledge of 7(a) loans to a Federal Reserve Bank or Federal Home Loan Bank does not require SBA's prior written consent or notice to the SBA. The SBA also stated the requirements set forth in Section 120.434 on pledging SBA guaranteed loans do not apply to PPP loans so that the SBA would not have to approve loan documents or require a multi-party agreement among the SBA, the lender, and others.

- Notwithstanding the provisions of Section 120.434(e), 7(a) loans may be pledged for the following purposes without notice to or consent by SBA:
 - Treasury tax and loan accounts;
 - The deposit of public funds;
 - Uninvested trust funds;
 - Borrowings from a Federal Reserve Bank; or
 - Advances by a Federal Home Loan Bank.

For purposes of the PPP, the other provisions of Section 120.434, such as the SBA having to approve loan documents or requiring a multi-party agreement, also do not apply to PPP loans pledged for borrowings from a Federal Reserve Bank or advances by a Federal Home Loan Bank.

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