Self-Employed Independent Contractors and Sole Proprietors Finally Allowed to Apply for PPP Loans – Too Late Now, But Get Ready for Additional PPP Funding Immediately

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One of the most important features of the CARES Act is the Paycheck Protection Program (PPP) under which small businesses[1] can apply for low-interest loans that are eligible for up to total forgiveness. CARES became law on March 27, 2020 and is being administered by the Small Business Administration.

Most small businesses became eligible to apply for PPP loans on April 3rd. SBA aimed to open the PPP program to independent contractors and sole proprietors (IC-SPs) on April 10th , but its rules for PPP loans to IC-SPs were first issued on Tuesday, April 14th.

As of that date, nearly all of the $350 billion allocated to the PPP program had already been exhausted. Despite obstacles, reports now indicate that Congress may be near to approving an additional $250 billion injection into the PPP program. IC-SPs should not absorb as much of the new PPP program funds as larger small businesses, which will continue to apply for the program or have applications already in the queue that were turned down for lack of remaining funding. So even if more funds are allocated, it will make sense for everyone who is an IC or SP to be ready to apply immediately.

Amount and Loan Terms for IC-SPs. The IC-SP must be operated by a US resident who remained in operation on February 15, 2020. IC-SPs can apply for loans equal to 2.5 times their prorated monthly profit and outside employee expenses in 2019, based on their 2019 Form 1010 Schedule C (even if you have not yet filed your actual return.) The loan will bear interest at 1% and be repayable in two years. The obligation to repay the loan can be partially or fully forgiven based on the amount of payroll, "owner compensation replacement" (applicable only for IC-SPs), and mortgage or rent payments paid by the IC-SP in the eight weeks following the date the loan is actually advanced. In general (but with some exceptions for other interest expenses and for SBA emergency "EIDL" loans), the PPP loan can only be used for these categories of expenses.

If you operate through a wholly-owned LLC, so that your LLC is a "disregarded entity" for tax purposes, then your taxable income should be flowing up to you directly and should be being reported on your Form 1040 Schedule C. For this reason, even though the new SBA rule does not address LLC's as such, we believe that individual IC-SPs operating through an LLC that the individual fully owns by herself or himself, should apply for PPP under the IC-SP rules. However, if the LLC has more than one owner and thus is likely treated as a partnership for tax

[1] Typically businesses are "small businesses" when they operate under the applicable SBA size standard (either a total revenue amount or number of employees) corresponding the NAICS code best describing their business. Franchisees are typically not small businesses because they are affiliated with the size of their franchisors, but the CARES Act allows franchisees to disregard that particular affiliation rule.

purposes, the new rules make clear that the LLC should apply for the PPP loan, not you individually, using the SBA rules applicable to PPP loans to small businesses generally.

Here is what IC-SPs will need to have in hand in order to apply:

A Participating Bank. Ideally your IC-SP already has a business relationship with a bank that is participating in PPP and is specifically handling PPP loans to IC-SPs. If not, your personal banker may be able to refer you to a participating bank, or you can seek referrals from your counsel, CPA, or other professional advisors. Participating banks will utilize the SBA's PPP application form—which is very short and omits normal credit checks—but some banks are adding their own additional questions or requirements.

Your 2019 Form 1040 Schedule C. You will need to generate this form even if you have not filed your 2019 federal income tax returns, in order to get the loan. Once completed, line 31 of this form will show your "net profit" for 2019. You will be dividing this net profit by 12 to determine your monthly net profit, and 2.5 times that amount can be borrowed under the PPP program.

Quarterly 941's and State Unemployment Insurance Tax Forms, if you have outside employees. If your IC-SP has employees (other than yourself), these forms will be needed to prove your total payroll expense during 2019. You will be eliminating compensation over $100,000 per employee, and adding the costs of employee health insurance and retirement benefits and state and local employment taxes that you pay, to determine total 2019 payroll expense. You will then divide the total by 12 to get your monthly payroll expense, and 2.5 times that amount can also be borrowed under the PPP program.

Proof of Self-Employment in 2019. This can be a Form 1099-MISC showing your receipt of payments in Box 7 of that form, invoices that you issued, bank statements for your business, or other record books showing your self-employment.

Proof of Continued Operation as of February 15, 2020. Invoices, bank statements or other records in 2020 can be used to show that you remained in operation through February 15, 2020, which is a PPP eligibility requirement for all small businesses.

If you are successful in obtaining the loan, the SBA rules allow a portion of the loan, up to all, to be forgiven based on certain expenses you incur solely in the eight-week period after you obtain the loan. You will need to provide proof of your payment of these costs after the eight-week period, when and if you apply for forgiveness. For IC-SPs, these eligible costs are:

Payroll costs, including benefits and state and local employment taxes, but excluding any portion of compensation to any individual to the extent it would exceed $100,000 when annualize for 2020;

Owner compensation replacement, meaning, the net profit shown on line 31 of your 2019 Schedule C, multiplied by the fraction of eight weeks over 52 weeks (8/52);

Interest charges that are deductible on Schedule C for business-related mortgage or loan obligations created before February 15, 2020; and

Rent and utility payments on leases and utilities contracted before February 15, 2020.