Summary of Interim Final Rule on Self-Employed Individuals

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On April 14, 2020, the U.S. Small Business Administration ("**SBA**") released an Interim Final Rule regarding, among other things, the eligibility of individuals with self-employment income to receive SBA-backed forgivable loans under the Paycheck Protection Program, which was enacted as part of the Coronavirus Aid, Relief, and Economic Security Act of 2020 (the "**CARES Act**"). This Interim Final Rule provides clarity that certain individuals with self-employment income may apply for Paycheck Protection Program loans, but also clarifies that partners in partnerships who include self-employment income from the partnership on their returns may only apply for Paycheck Protection Program loans in connection with the partnership, and not in their individual capacity.

Background

On March 27, 2020, President Trump signed the CARES Act into law. The CARES Act authorized the Paycheck Protection Program, which provides for 100% forgivable loans to small businesses through participating SBA lenders, guaranteed by the SBA. To be eligible to receive loans under the Paycheck Protection Program prospective borrowers must meet certain eligibility requirements set forth in the CARES Act and in applicable SBA regulations issued since the CARES Act's enactment.

April 14 Interim Final Rule Regarding Eligibility

Two principal issues clarified by the April 14, 2020 Interim Final Rule (the "**Interim Final Rule**") are: (i) individuals with self-employment income who file Form 1040 Schedule C for 2019 will be eligible for Paycheck Protection Program loans, and (ii) partners in partnerships (including members of limited liability companies that elect to be treated as partnerships) should include their individual share of partnership profits reported as self-employment income in the applicable partnership's loan application and should not apply for loans separately as individuals.

The rationale expressed in the Interim Final Rule for excluding partners from individual Paycheck Protection Program loan eligibility is to help ensure that as many other borrowers as possible are able to take advantage of the program before the statutory deadline of June 30, 2020, and to allow lenders to more quickly process applications. Moreover, because partnerships themselves are eligible to apply for Paycheck Protection Program loans and include the amount of partners' self-employment income (up to $100,000 per year, consistent with the CARES Act) as eligible payroll costs that may be covered by a Paycheck Protection Program loan, allowing partners to apply as self-employed individuals would result in confusion over which entity, the partner or the partnership, should report partner and LLC member income on its application, and could cause issues regarding the coordination and allocation of loan proceeds.

Loan Amounts and Uses for Non-Partner Self-Employed Individuals

The Interim Final Rule also specified that non-partner self-employed individuals will be eligible to apply for Paycheck Protection Program loans and how such individuals can calculate their maximum loan amounts.

Specifically, the Interim Final Rule guides non-partner self-employed individuals that have filed or will file a Form 1040 Schedule C for the 2019 tax year. Additional guidance for those self-employed individuals whose businesses were not in operation in 2019 but were operating in 2020 will be forthcoming from SBA.

Maximum loan amounts for non-partner self-employed individuals *without employees* are calculated under the Interim Final Rule as follows:

1. Locate the net profit amount from Form 1040 Schedule C line 31 (and reduce to $100,000 if over that amount; if less than $0, the individual will not be eligible for a Paycheck Protection Program loan);

2. Divide the net profit amount by 12;

3. Multiply the result by 2.5; and

4. If applicable, add the outstanding amount of any Economic Injury Disaster Loan made to the individual between January 31, 2020 and April 3, 2020 that the individual seeks to refinance, less the amount of any advance under such loan (which does not need to be repaid)

Maximum loan amounts for non-partner self-employed individuals *with employees* are calculated under the Interim Final Rule as follows:

1. Compute 2019 payroll by adding:

    - The net profit amount from Form 1040 Schedule C line 31 (and reduce to $100,000 if over that amount; if less than $0, set at $0); plus

    - 2019 gross wages and tips paid to employees (from Form 941, line 5c column 1), plus any pre-tax employee contributions for health insurance or benefits excluded from taxable Medicare wages and tips (less any amounts paid to any individual employee over $100,000 annualized and any employees whose principal residence is not in the United States); plus

    - 2019 employer health insurance contributions (from Form 1040 Schedule C line 14), retirement contributions (from Form 1040 Schedule C line 19) and state and local taxes on employee compensation.

2. Divide the sum of items 1.a. through 1.c. by 12;
3. Multiply the result by 2.5; and
4. If applicable, add the outstanding amount of any Economic Injury Disaster Loan made to the individual between January 31, 2020 and April 3, 2020 that the individual seeks to refinance, less the amount of any advance under such loan (which does not need to be repaid).

Under the Paycheck Protection Program, the loan amounts obtained as a result of the applicable calculations may be used to refinance Economic Injury Disaster Loans obtained between January 31, 2020 and April 3, 2020, and for interest payments on other debt obligations incurred before February 15, 2020. In addition, the loan proceeds may be used as (i) owner compensation replacement, (ii) employee payroll costs (as defined in the CARES Act and applicable regulations), (iii) mortgage interest payments on business mortgage obligations, (iv) business rent payments and (v) business utility payments. Importantly, for the loan funds to be permissibly expended on these business expenses, the non-partner self-employed individual must have claimed or been entitled to claim deductions for such expenses on his or her 2019 Form 1040 Schedule C. Consistent with the CARES Act, 75% of the loan funds must be used for payroll costs.

Required Documentation for Non-Partner, Self-Employed Individuals

With their applications, eligible non-partner, self-employed individuals are required to submit supporting documentation.

For individuals without employees, this documentation will include a copy of such individual's 2019 Form 1040 Schedule C and either a 2019 Form 1099-MISC detailing any non-employee compensation, bank statement, invoice or book record that establishes their status as self-employed. In addition, such individual will need to provide a 2020 invoice, bank statement or records to establish business operations on or around February 15, 2020.

In addition to the foregoing, eligible individuals with employees will be required to submit an IRS Form 941 or equivalent payroll records to establish payroll amounts, along with state payroll tax or payroll processor records, and records of any retirement and health benefit contributions. A payroll statement from on or around February 15, 2020 must also be submitted to verify operations.

Resources

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