Updated PPP Rules for Sole Proprietors, Contractors, & New Forms Released

In February, the Biden administration announced several reforms to the U.S. Small Business Administration's (SBA) Paycheck Protection Program (PPP). On March 3, 2021, the SBA released an interim final rule incorporating those updates, issued several new/updated loan application forms, and updated its frequently asked questions (FAQ) document.

By statute, the SBA cannot approve any PPP loans after March 31, 2021. Borrowers should allow ample lead time when submitting PPP applications to allow time for processing and error resolution. The Biden administration has not announced any plans for a deadline extension.

Schedule C Maximum Loan Amount Updates

A borrower that files a Schedule C (sole proprietors, self-employed individuals, and contractors) may now elect to use either gross income or net income to determine their PPP loan amount. Previously, PPP rules defined payroll costs for individuals who file Form 1040, Schedule C as payroll costs (if employees exist) plus net profits, which is net earnings from self-employment. This formula excluded many sole proprietors with very little or negative net profit from obtaining a PPP loan. **The election to use gross income is available for both first draw loans and second draw loans.**

For first draw loans made in 2020, the 2019 Schedule C is used. For first draw loans made in 2021 and all second draw PPP loans, the borrower can elect to use either their 2020 or 2019 Schedule C.

- A Schedule C filer that has **no employees** calculates the loan amount by starting with either gross income from line 7 of Schedule C or net profit from line 31. Regardless of the line used, the amount is limited to $100,000. The amount is then divided by 12 to get an average monthly amount that is multiplied by 2.5 (3.5 for a second draw loan for a NAICS 72 borrower) to arrive at the loan amount.
- A Schedule C filer **with employees** starts with the above calculation with one modification. If gross income is elected, it must be reduced by Schedule C amounts for wages (line 14), health insurance (line 19), and retirement plan contributions (line 26). Added to the gross income, as adjusted or the net profit, if elected, are payroll costs (line 14), health insurance (line 19), and retirement plan contributions (line 19). The total is then divided by 12 to get an average monthly amount that is multiplied by 2.5 (3.5 for a second draw loan for a NAICS 72 borrower) to arrive at the loan amount.

This calculation change only applies to loans approved after the interim final rule (IFR) effective date, March 3, 2021. Borrowers that have already had their loans approved cannot increase their PPP loan amount based on the new maximum loan formula.

As an anti-abuse measure, borrowers with reported gross income greater than $150,000 may be subject to additional SBA review. If a Schedule C filer elects to use gross income in the limitation calculation, and such amount is greater than $150,000, the borrower will not automatically be deemed to have made the required certification concerning the necessity of the loan request in good faith and may be subject to review of the certification by the SBA. The SBA felt these borrowers may be more likely to have other available sources of liquidity to support their business's operations.

This anti-abuse provision only applies to first draw loans; it does not apply to second draw loans.

Modifications to Loan Forgiveness Provisions for Schedule C Borrowers

The election to use gross income in the loan amount calculation also required a modification to the forgiveness calculations for Schedule C borrowers. If a borrower uses the Schedule C net profit, there are no changes to the previously published limitations and calculations of "owner compensation replacement."

If gross income is elected, a new term, "proprietor expenses," and calculation is used to determine the owner compensation replacement.

- If there are no employees, proprietor expenses equal the gross income.
- If there are employees, proprietor expenses equal gross income less payroll expenses (lines 14, 19, and 26 of Schedule C).

Once the owner replacement amount is calculated using either the net profit or the proprietor expenses, the limitation calculation is modified as well. If gross income was used, the limitation is based on the gross income (limited to the $100,000) prorated to the selected covered period, but in all events, limited to 2.5 months of the 2019 or 2020 gross income (up to $20,833).

New/Updated Forms

- Form 2483-C – New loan application form for Schedule C filers that elect to use gross income to calculate the PPP loan amount for a **first draw loan**. (There is no mention in the form or instructions that the borrower is not deemed to automatically meet the economic necessity certification safe harbor if gross income is more than $150,000.)
- Form 2483-SD-C – New loan application form for Schedule C filers that elect to use gross income to calculate the PPP loan amount for a **second draw loan**.
- Form 2483 – General loan application form for **first draw loans**. The instructions for the number of employees to report on page one has been updated to clarify that applicants may use their average employment over the time period used to calculate aggregate payroll costs, or may elect to use the average number of employees per pay period in the 12 completed calendar months prior to the date of the loan application.
- Form 2483-SD – General loan application form for **second draw loans**. The changes are the same as were made to the first draw application (Form 2483).

Removal of Certain PPP Eligibility Restrictions

The SBA removed certain restrictions for PPP eligibility:

- Eliminated a restriction that prevents small business owners with prior nonfraud felony convictions from obtaining PPP relief. Previously, a business was ineligible for PPP if it is at least 20 percent owned by an individual who has either: (1) an arrest or conviction for a felony involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance within the previous five years; or (2) any other felony within the previous year. This update eliminates the second restriction (the one-year look-back).
- Eliminated a restriction that prevents small business owners who are delinquent on their federal student loans from obtaining PPP relief. Previously, a PPP loan was not available to any business with at least 20 percent ownership by an individual who is currently delinquent or has defaulted within the last seven years on a federal debt, including a student loan. The elimination of the student debt restriction applies to new PPP applicants and those borrowers who have already received a PPP loan. The change applies to any first draw or second draw loans, regardless of when the PPP loan was made. This removes any possibility that a borrower would be forced to repay the loan because they did not qualify at the time of the application.

FAQ Updates

The FAQ issued on March 3, 2021, primarily address issues arising from the *2021 Consolidated Appropriations Act* (CAA) enacted on December 27, 2020. Another set of FAQ is being prepared to address the March 3, 2021, IFR. Several questions were amended to conform with the CAA requirements. Below are new items:

- **Lobbying activities.** The CAA expanded PPP eligibility to 501(c)(6) organizations; however, it excluded lobbying organizations, *i.e.*, those receiving more than 15 percent of receipts from lobbying activities. The latest FAQ defines "lobbying activity" (as defined in Section 3 of the *Lobbying Disclosure Act of 1995*) and prohibits the use of PPP proceeds (both first and second draw) for lobbying activities.
- **Bankruptcy.** A borrower of a first draw loan that subsequently filed for bankruptcy is still eligible for loan forgiveness (provided it meets all other requirements for loan forgiveness) but would not be eligible to apply for a second draw loan.
- **Eligible expenses versus payroll costs.** An applicant for a second draw loan must certify, before disbursement, it will have used all its first draw proceeds only for "eligible expenses." Failure to meet the 60 percent payroll cost requirement for the first draw loan will affect forgiveness.
- **Partial loan forgiveness.** A borrower that only received partial forgiveness of its first draw loan may still be eligible for a second draw loan as long as the borrower used the full amount of the first draw loan for eligible expenses.
- **SBA size standards for second draw loans.** An applicant cannot use the SBA revenue-based or employee-based size standards, or the alternative size standards to qualify for a second draw loan. Instead, the borrower (together with its affiliates) must employ no more than 300 employees (with the exception of the 300 employees per physical location rule for NAICS code 72 entities and news organizations/public broadcasting entities).
- **Noncitizen eligibility.** Noncitizens may apply using Individual Taxpayer Identification Numbers (ITIN). All lawful U.S. residents are eligible for the PPP, including ITIN holders, *e.g.*, green card holders or those here on a visa. To be eligible for a PPP loan or to receive loan forgiveness, the applicant must meet all eligibility criteria and PPP requirements, which includes the requirement that the principal place of residence for a sole proprietor, self-employed individual, or independent contractor must be in the United States.
- **Eligibility for employee retention credit (ERC).** Payroll costs that are qualified wages for ERC purposes cannot be used for loan forgiveness if the employer uses those wages to claim the ERC. See this **BKD Thoughtware®** article for additional details on the interaction of the PPP with the ERC.

2021 Program Update

The CAA included $284 billion to reopen the PPP through March 31, 2021. Through February 28, 2021, approximately 2.2 million loans have been approved totaling $156 billion (up from approximately 1.9 million loans totaling $140 billion on February 21). This includes $16 billion in first draw loans and $140 billion in second draw loans.

2020 Program Update

The SBA continues its review and forgiveness of PPP loans. As of February 25, 2021, 1.8 million of the 5.3 million loans issued have been forgiven and 242,000 loans representing $83 billion are under review (up from 187,000 loans representing $77 billion on February 18). The loans forgiven represent $160 billion (up from $152 billion on February 18) of the $521 billion in total PPP loans issued in 2020. Only $480 million of the loans that have completed the forgiveness process has not been forgiven. A forgiveness application has not been submitted by borrowers for approximately 60 percent of the PPP loans issued in 2020 (approximately 3.2 million loans totaling $278 billion).

Accounting guidance generally requires borrowers to record PPP funds as a liability on the balance sheet until the SBA forgives the debt.

Conclusion

BKD will continue to follow this developing situation. As with most topics related to COVID-19, changes are being made rapidly. Please note that this information is current as of the date of publication. Visit BKD's COVID-19 Resource Center to learn more. If you have questions about these changes, contact your **BKD Trusted Advisor™** today.

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