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Department of Agricultural and Consumer Economics, University of Illinois Urbana-Champaign

Weekly Farm Economics: The Paycheck Protection Program (PPP) of the CARES Act

Dale Lattz

Illinois FBFM Association and Department of Agricultural and Consumer Economics
University of Illinois

Bob Rhea

Illinois FBFM Association

Gary Schnitkey, Krista Swanson, Nick Paulson and Jonathan Coppess

Department of Agricultural and Consumer Economics
University of Illinois

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April 16, 2020 Editorial Note: This is an updated version of the article initially published on April 14, 2020, followed after a supplemental rule (IFR) was released. A new section "Update to the Original Release" has been added to the article.

Farm business owners, along with other self-employed individuals and sole proprietors, are eligible for the Paycheck Protection Program (PPP), a program authorized under the Coronavirus Aid, Relief, and Economic Security (CARES) Act that is administered by the Small Business Administration (SBA). Under this program, a farmer or other small businesses can receive a loan up to 2.5 times their average monthly payroll costs. A portion of or the entire loan can be forgiven based on eligible expenses during an 8-week period after the loan is disbursed. The remaining loan balance is repaid over a two-year period. All SBA 7(a) lenders are eligible lenders for the PPP. The Department of Treasury has the authority to approve additional lenders that have the necessary qualifications to process, close, disburse, and service loans made with the SBA guarantee. Illinois Farm Business Farm Management (FBFM) is aiding its members by making them aware of the program and providing documentation as requested by its members and their lenders.

Update to the Original Release

A supplemental Interim Final Rule (IFR) for the Paycheck Protection Program (PPP) was recently released that provides clarity to some of questions raised at the end of this FDD. The supplemental Interim Final Rule can be found at: https://home.treasury.gov/system/files/136/Interim-Final-Rule-Additional-Eligibility-Criteria-and-Requirements-for-Certain-Pledges-of-Loans.pdf

Some of the areas addressed in the supplemental IFR include:

- Eligibility requirements for self-employed individuals such as independent contractors or sole proprietors that file a Form 1040 Schedule C. Unless the business began between January 1, 2020 and February 15, 2020, applicants must have filed a Form 1040 Schedule C for 2019, or have a Schedule C from a pending 2019 tax return.

- One major change in the rule regarding loan forgiveness is the inclusion of "owner compensation replacement". This is a new term. The 2020 PPP loan forgiveness is based on **2019** net profits for purposes of "owner compensation replacement". The forgiveness amount is limited to eight weeks' worth (8/52) of **2019** net profits.

- In addition to the eligible uses for PPP loans discussed later in this article, individuals with income from self-employment who file a 2019 Form 1040 Schedule C can use PPP loans for owner compensation replacement based on 2019 net profit previously defined.

- For partnerships with self-employment income generated for the partners, the partnership, not the partners, should be the entity that submits the PPP loan application. Individual partners cannot submit a separate PPP loan application for partnership generated self-employment income.

- For self-employed individuals with no employees, the maximum loan amount is calculated using the 2019 Form 1040 Schedule C net profit figure, divided by 12 and multiplied by 2.5 to calculate 250% of the average monthly net earnings. This is subject to a $100,000 maximum. If the Schedule C net profit is zero or less, the individual is not eligible for a PPP loan. Another step may be needed for anyone with an outstanding Economic Injury Disaster Loan (EIDL).

- Self-employed individuals with employees may add their own net earnings with their payroll costs. Payroll costs are based upon 2019 gross wages (includes certain employee benefit costs and state and local taxes assessed on employee compensation) paid to your employees whose principal place of residence is in the United States limited to $100,000 per employee. These payroll costs are added to Schedule C net profit for 2019. If the Schedule C net profit was less than zero, set this amount to zero. First, calculate the sum of payroll costs for 2019 and Schedule C net profit for 2019. Then take this total; divide by 12 and multiply by 2.5 to determine the maximum loan amount. Another step may need to be taken if you have an outstanding Economic Injury Disaster Loan (EIDL) or for qualifying businesses that began in 2020.

- As in previous rules, at least 75% of the PPP loan proceeds shall be used for payroll.

The above bullet points highlight some of the major points in the supplemental IFR but is not meant to be all-inclusive. Please refer to the original document for more details. In addition, the supplemental IFR specifically referred to self-employment income as reported on the Form 1040 Schedule C. No mention was made of the Form 1040 Schedule F. Previous opinions have been given that farmers are eligible for the PPP loans and the presumption can be made that the reference to Form 1040 Schedule C in the supplemental IFR was a reference to all self-employed individuals, which would include Form 1040 Schedule F filers. Without clear guidance from the SBA, the ultimate interpretation of the rules lie with the lending institutions that are administering the program.

Background

On March 27, 2020, President Trump signed P.L. 16-136, the Coronavirus Aid, Relief, and Economic Security (CARES) Act into law. As part of this law, Congress appropriated $349 billion for the creation of the Paycheck Protection Program (PPP). The Small Business Administration (SBA) received the funding and authority to assist small businesses nationwide adversely affected by the COVID-19 emergency. The PPP program provides payroll assistance for small businesses and selected nonprofits in the form of 100% guaranteed loans from SBA.

The PPP is a new SBA 7(a) loan option overseen by the Treasury Department and backed by the SBA to help small businesses keep employees on the payroll and bring back workers who have been laid off. Loan amounts can be 2.5 times the borrower's average monthly payroll cost for the prior 12 months or calendar year 2019, not to exceed $10 million. Loans, which can be issued between April 3, 2020 and June 30, 2020, will carry a 1% interest rate with a two-year repayment period. Loan payments are deferred for the first six months of the loan. The six months start when the loan is disbursed. However, interest will accrue on PPP loans during the six-month deferment. Additionally, PPP loans contain a forgiveness process, allowing up to eight weeks of covered expenses to be forgiven for the borrower with no tax consequences. There are a number of requirements with typical SBA loans that have been waived for this program, including SBA fees, the requirement that the borrower sought credit elsewhere and was denied, that sufficient collateral is available, and that a personal guarantee is required.

As part of the application process for the PPP loan, the applicant must certify to a number of statements including "Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant" and "The funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under the Paycheck Protection Program Rule."

Where Do I Apply?

Applications can be processed and submitted through any existing SBA lender or through any federally insured depository institution, federally insured credit union, and Farm Credit System institution that is participating. Other regulated lenders will be available to make these loans once they are approved and enrolled in the program.

If you are interested in submitting an application, check with your current lender(s) to see if they are participating in the program as a first step. If you are not currently working with a lender who can submit an application for you, SBA has a searchable webpage to locate an approved lender by zip code. Due to high demand, some lenders are only taking applications from current clients. It is recommended that you contact lenders soon if interested in submitting an application.

Eligibility

Eligible business and entities for the PPP must have been in operation on February 15, 2020 and meet one of the following criteria:

- Small businesses with fewer than 500 employees,
- A small business that otherwise meets the SBA size standard,
- A 501(c)(3) with fewer than 500 employees,
- An individual who operates as a sole proprietor,
- An individual who operates as an independent contractor,
- An individual who is self-employed who regularly carries on any trade or business,
- A Tribal business concern that meets the SBA size standard, or
- A 501(c) (19) Veterans Organization that meets the SBA size standard.

Although agricultural-related businesses are not eligible for many of the SBA loan programs, farmers and agricultural-related businesses are specifically mentioned as generally being eligible under SBA 7(a) loan eligibility rules. In addition, the SBA's Interim Final Rule allows any other business concern to be eligible if the business meets the other program requirements. Some have interpreted this to include agricultural businesses.

Initial guidance for the program specifies how the maximum loan amount is calculated and what documentation is needed for small businesses with employees on payroll. Even though the law and the SBA Interim Final Rule indicate self-employed individuals and sole proprietors are eligible for the PPP the rules are unclear as to how a maximum loan amount will be calculated based on earnings from self-employment and what documentation is needed. Without clearly defined rules, some lenders have been reluctant to submit applications for these type of businesses as they wait for guidance from SBA on how to process loan requests for self-employed individuals. Many farmers are self-employed individuals, and may run into these challenges when trying to submit an application for these reasons.

Another eligibility condition requires PPP participants to certify that they were impacted by current economic uncertainty and they will use the funds for allowable uses as defined in the program rules. Borrowers must also provide relevant documentation as part of the application process. Borrowers must certify that the information they provide is accurate.

Loan Amount

The first-come, first-serve loans are offered until June 30, 2020, or until the program runs out of funds. Loans are capped at 250% of a borrower's average monthly payroll costs or $10 million, whichever is lower. In general, borrowers can calculate their aggregate payroll costs using data either from the previous 12 months or from calendar year 2019. For seasonal businesses, the applicant may use average monthly payroll for the period between February 15, 2019, or March 1, 2019, and June 30, 2019. An applicant that was not in business from February 15, 2019 to June 30, 2019 may use the average monthly payroll costs for the period January 1, 2020 through February 29, 2020.

An example of the loan calculation follows. A business had an annual payroll in 2019 of $120,000. No employee made over $100,000. The loan amount would be $25,000 ($120,000 / 12 x 2.5).

Payroll Costs

Costs eligible to be considered PPP payroll costs are:

- Compensation to employees (salary, wage, commissions, or similar compensation, payment of cash tips or equivalent).
- Payment for vacation, parental, family, medical, or sick leave.
- Allowance for dismissal or separation.
- Payment required for the provisions of group health care benefits, including insurance premiums.
- Payment for retirement benefits.
- Payment of state and local tax assessed on the compensation of employees.
- For an independent contractor or sole proprietor: wages, commissions, income, or net earnings from self-employment income or similar compensation.

Costs that are not eligible for payroll include:

- Any compensation of an employee whose principal place of residence is outside the United States.
- The compensation of individual employees in excess of an annual salary of $100,000, prorated as necessary.

- Federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including both the employee and employer share of FICA and Railroad Retirement Act taxes, and income taxes required to be withheld from employees. Additional guidance from SBA through a FAQ document states that gross wages are to be used in the computation of wages and are not to be reduced by the tax withholdings.

- Qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act.

- Any amounts that an eligible borrower has paid to an independent contractor or sole proprietor.

There is an important distinction to make based on what costs are eligible and non-eligible for payroll as listed above. While self-employed individuals are eligible to claim their own earned wages, commissions, income, or net earnings from self-employment income or similar compensation as part of operating their businesses, they cannot claim payments to other independent contractors or sole proprietors that have been incurred in running their business. For example, a self-employed farmer would include their own self-employed earnings (still waiting on specific guidance as previously noted) in payroll costs but would not include a payment made to an independent contractor for trucking grain. That independent contractor would be including that amount on their own PPP application.

Loan Proceeds Eligible Uses

PPP loans may be used to pay for payroll costs (same definition as above), mortgage interest obligations, rent obligations, utilities and any other interest payments on business debt obligations accrued before February 15, 2020. To qualify as eligible expenses, payments need to be for ordinary and necessary business expenses as compared to payments made for personal expenses. SBA requires 75% of the loan proceeds be used for payroll costs, while the remaining 25% can be used for the other expenses. Funds used for purposes other than those outlined above must be repaid.

Forgiveness of the PPP Loan

One aspect of the PPP loan that is unique is that the loan and interest can be forgiven if the loan proceeds are used for forgivable purposes and employee and compensation levels are maintained. The actual amount of loan forgiveness will depend, in part, on the total amount of payroll costs, payments of interest on mortgage obligations incurred before February 15, 2020, rent payment on leases dated before February 15, 2020, and utility payments under service agreements dated before February 15, 2020, and the eight-week period following the date of the loan. Again, these need to be payments for expenses related to the business. However, not more than 25% of the loan forgiveness amount may be attributable to non-payroll costs. The amount of loan forgiveness is reduced if there is a reduction in the number of employees or a reduction of greater than 25% in wages paid to employees. More guidance is to be issued on the loan forgiveness part of the program. Given what is currently known, it is important to spend at least 75% of loan proceeds on payroll expenses within the eight-week period following the loan disbursement date for the funds to be eligible for loan forgiveness.

Remaining Questions

As noted, both potential applicants and qualified lenders are waiting for additional guidance on the PPP. In addition to guidance on the pressing question of how payroll is calculated based upon self-employed earnings, other remaining questions may affect farmers and make it difficult for farmers to apply for the PPP without clarification from SBA.

1. Identifying application type on the application – applicants may choose only one of the given selections. Many farmers may be both a sole proprietor and a qualified self-employed individual. It is unclear which the appropriate classification is, or if it matters in terms of the maximum loan amount or being considered to have filled the application out correctly.

2. Individual owned multiple businesses – an individual may submit only one PPP loan application. It is unclear how individuals owning multiple businesses should proceed, if a single business must be selected or if payroll costs of all qualifying businesses can be combined. It is common for a farmer also to be a self-employed owner of another small business venture. For example, an

individual who is a self-employed owner of a farm business and separately the self-employed owner of a seed dealership business or the self-employed owner of a trucking business.

3. Businesses with employees and self-employed earnings – because guidance for self-employed individuals is forthcoming, businesses with qualified self-employed earnings and employees may be unsure how to calculated payroll costs, and if the two sets of payroll costs can be combined. On Monday April 13, 2020, Fortune reported 62% of the program funds have already been allocated just ten days after the start of the application acceptance period. Some members of Congress have sought to increase funding for PPP, but thus far no agreements have been reached and it is not clear how long a stalemate may continue. A farmer with considerably higher self-employed earnings than employee payroll costs would like to wait to apply using self-employed earnings or a combination, but may be concerned that program funds will be fully allocated before SBA provides the guidance needed to apply. This raises the questions as to if a farmer with employees on payroll should apply now using those records or wait for additional guidance from SBA.

Summary

The CARES Act authorized the Paycheck Protection Program to help small businesses keep employees and bring back employees that have been laid off due to the COVID-19 emergency. The program is designed to help small businesses by providing 100% guaranteed loans from the SBA. Loan amounts can be up to 2.5 times the business's average monthly payroll costs with a maximum of $10 million. In addition, the loan can be forgiven if payroll is maintained and loan proceeds are used for specified expenses and an appropriate percentage is used for payroll expense.

Farmers qualify under the program as self-employed individuals and sole proprietors. Farmers with a considerable amount of hired labor (payroll) should especially evaluate if they meet all the eligibility and certification requirements. Farmers with limited or no payroll may also qualify based on their net self-employment income. However, lenders and others are waiting for additional guidance on how farmers and other self-employed individuals are to submit their applications and what will be the rules governing the definition of "payroll" for determining loan amounts, loan proceed uses and determining the amount of loan forgiveness.

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