

Paycheck Protection Program (PPP) Update

Calculation of Loan Forgiveness Amount for Independent Contractors and Other Owner-Employees



The Paycheck Protection Program Flexibility Act of 2020 (the “Flexibility Act”), extended the covered period for determining the amount of PPP loan forgiveness to 24 weeks after the date of loan disbursement, but no later than Dec. 31, 2020. Borrowers that received a loan before June 5, 2020, may elect to use a covered period of 8 weeks from the date of loan disbursement rather than 24 weeks. The Small Business Administration (SBA) has issued updated guidance on the compensation limit for PPP loan forgiveness purposes, including how the limit applies depending on whether the borrower is using an 8-week covered period or a 24-week covered period. This article provides a high-level overview of the compensation limit as applied to owner-employees, focusing on two of the most common small business types, independent contractors and S corporations. Information on other changes made by the Flexibility Act is in our [prior PPP Advisory](#).



Calculation of Loan Forgiveness Amount for Independent Contractors and Other Business Owners

In general, the maximum amount of compensation that can be taken into account per employee for PPP loan forgiveness is limited to \$100,000, which is pro-rated based on the covered period. In calculating the maximum compensation limit, business owners (“owner-employees”) are subject to restrictions that do not apply to other employees. The precise rules for owner-employees depend on how the business is organized.

For independent contractors, sole proprietors and other self-employed individuals that report their business income for federal tax purposes using a Schedule C:

- Compensation for the business owner is capped at:
 - 2.5 months (2.5/12) of 2019 net profit up to a maximum of \$20,833 for a 24-week covered period, or
 - 8 weeks (8/52) of 2019 net profit up to a maximum of \$15,385 for borrowers that received a PPP loan before June 5, 2020 and elect to use an 8-week covered period.
- Net profit for 2019 is the amount shown on IRS Form 1040 Schedule C line 31 for 2019.
- As under previous SBA guidance, no additional amount of loan forgiveness is allowed for payments for health insurance, retirement, or state or local taxes.



For S-corporation owner-employees:

- Cash compensation for an owner-employee is capped at:
 - 2.5 months (2.5/12) of 2019 employee cash compensation up to a maximum of \$20,833 for a 24-week covered period, or
 - 8 weeks (8/52) of 2019 employee cash compensation up to a maximum of \$15,385 for borrowers that received a PPP loan before June 5, 2020 and elect to use an 8-week covered period.
 - Under newly released SBA guidance, the special owner-employee cap does not apply to owner-employees with less than a 5 percent ownership stake in the S corporation.
- Cash compensation is defined as it is for other employees.
- Borrowers are also eligible for loan forgiveness for payments for employer state and local taxes paid by the borrowers and assessed on their compensation, and for employer retirement contributions to their employee retirement plans capped at the amount of 2.5/12 of their 2019 employer retirement contribution for a 24-week covered period or 8/52 of their 2019 employer retirement contribution for an 8-week covered period.
- As under prior guidance, employer contributions for health insurance are not eligible for additional forgiveness for S-corporation employees with at least a 2% stake in the business, including for employees who are family members such employees because those contributions are included in cash compensation.

The different rules that apply for other business types, such as C corporations and partnerships, are provided in SBA guidance.

Conclusion

The details of the PPP continue to evolve as new guidance is issued and legislative changes are enacted. New rules may impact borrowers differently, depending on the type of business and the particular circumstances. As of Aug. 8, 2020, the PPP is closed to new loans. Congress is considering further changes to the program, including possibly extending the program as well as easing certain current requirements. Be sure to check with your lender and the SBA website for the most recent information.

The information above is provided for general informational purposes and is not provided as tax or legal advice for any person or for any specific situation. Employers and employees and other individuals should consult their own tax or legal advisers about their situation.

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