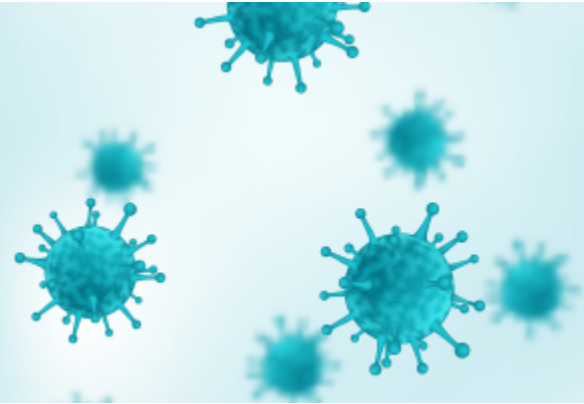


COVID-19 Alert: Interim Final Rule

PPP Fund Exhausts; Important PPP Update for Partnerships and LLCs

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Treasury Department Clarifies That Distributions to LLC Members and Partnership Partners Constitutes "Payroll Costs" for Purposes of PPP Loan Applications

As has been widely reported, the \$350 Billion fund allocated by Congress for the Paycheck Protection Program ("PPP") has exhausted. The U.S. Treasury Department has indicated that unless Congress authorizes additional funds for the PPP, it would instruct the Small Business Administration to cease authorizing pending or new PPP loan applications, as of today. Although it is likely that Congress will extend PPP funding, the timing of such legislative action is in doubt. As such, clients are advised to expect, and model, for continued disruptions in PPP loan application processes.

Amid these reports, the U.S. Treasury Department issued a second, supplemental *Interim Final Rule* (the "*Second Rule*") that provides further guidance on the PPP loan program.

The *Second Rule* concerns, in main part, special PPP loan application procedures for independent contractors and sole proprietors. However, buried in the *Second Rule* is a tangential discussion that provides important guidelines relevant to **Limited Liability Companies and Partnerships**. Specifically, the *Second Rule* instructs that K-1 distributions to LLC members and partnership partners, relating to employment activities of those members and partners, constitute Payroll Costs for purposes of PPP loan amount calculation procedures:

... if you are a partner in a partnership, you may not submit a separate PPP loan application for yourself as a self-employed individual. **Instead, the self-employment income of general active partners may be reported as a payroll cost, up to \$100,000 annualized, on a PPP loan application filed by or on behalf of the partnership.** Partnerships are eligible for PPP loans under the Act, and the Administrator has determined, in consultation with the Secretary of the Treasury (Secretary), that limiting a partnership and its partners (**and an LLC filing taxes as a partnership**) to one PPP loan is necessary to help ensure that as many eligible borrowers as possible obtain PPP loans before the statutory deadline of June 30, 2020.

Second Rule, III (1) (a).

This clarification has important implications for LLCs (filing taxes as a partnership) and partnerships that have applied, or are considering applying, for PPP loans.

Under general PPP rules, the total loan amount available to an applicant is determined by

reference to the applicant's total monthly Payroll Costs. For most LLCs and partnerships, income earned by partners as compensation for services is allocated through a K-1 and is treated as self-employment income, rather than reported on a W2. We understand that some lenders have adopted underwriting standards that *prohibit* LLCs and partnerships from claiming any amounts paid or allocated to members and partners as "Payroll Costs" for loan amount calculation purposes – *effectively precluding many LLCs and Partnerships from applying for material loan sums.*

The *Second Rule* appears to instruct lenders that such an underwriting standard is inconsistent with the purpose of the PPP loan program. As such, it appears that LLCs and partnerships may now apply for loan amounts using calculations that include the self-employment income of members and partners who are active in the business of the LLC or partnership. Generally speaking, income that is classified as self-employment income for a member or partner includes guaranteed payments, as well as that member's or partner's distributable share of income arising from the trade or business of the LLC or partnership.

To be certain, the *Second Rule* leaves a number of questions unanswered. For example, before the *Second Rule*, most commentators suggested that equity partners in a partnership should not be counted for purposes for calculating the PPP's 500 employee threshold. Based on this understanding, a large accounting firm with 200 equity partners and 499 employees would be eligible for a PPP loan. Because member and partner distributions are now counted towards employee Payroll Costs, does the *Second Rule* now imply that partnership applicants must count equity partners as "employees" for purposes of determining loan eligibility thresholds? If so, many large professional services businesses may be excluded from the PPP.

These unanswered, technical questions notwithstanding, the key takeaway is: ***many of our start-up clients, that are structured as LLCs, may be eligible for greater loan amounts than originally anticipated.*** However, this late issued, technical clarification, is expected to cause lender and applicant confusion, and additional, resulting loan processing delays – particularly for those LLCs and partnerships that have already applied for PPP loans under prior understandings.

Morse is focused on assisting our clients through these unprecedented and challenging times. Please contact the Firm should you have questions concerning the PPP loan program, or any other COVID-19 response matters.

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