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Banking & Finance

Professional

KIRSTIN P. SALZMAN

KANSAS CITY:

816.983.8316

KIRSTIN.SALZMAN@

HUSCHBLACKWELL.COM

New PPP Guidance on Owner-Employees and Rent/Mortgage Interest Forgiveness

On August 24, 2020, the Small Business Administration (SBA) released a new interim final rule (IFR) regarding permitted forgiveness of loans made under the Paycheck Protection Program (PPP). This new guidance provides relief for corporations with owner-employees who own less than 5 percent of the corporation but restricts forgiveness for certain rent and mortgage interest.

Owner-employees

The most recent IFR states that individual borrowers with less than a five percent ownership stake in a C- or S-Corporation are exempt from the limitations placed on the amount of owner-employee compensation eligible for forgiveness. The First Loan Forgiveness Rule, as revised by the Revisions to Loan Forgiveness and Loan Review Procedures IFRs, caps the amount of loan forgiveness for payroll compensation attributable to an owner-employee for:

1. borrowers that received a PPP loan before June 5, 2020, and elect to use an eight-week covered period, at eight weeks' worth of 2019 compensation, or \$15,385 per individual, whichever is less; and
2. all other borrowers, at 2.5 months' worth of 2019 compensation, or \$20,833 per individual, whichever is less.

The IFR clarifies that the purpose of this exemption is to provide relief for those C- or S-Corporation owner-employees with no meaningful ability to influence decisions over how PPP loan proceeds are allocated.

This is good news for corporations that provide their employees with equity incentives, which often amount to less than a 5 percent ownership share in the

corporation. The IFR does not address whether owner-employees of partnerships and LLCs are similarly exempted from the owner-employee rule.

Nonpayroll costs

The IFR restricts the ability to obtain forgiveness for certain rent and mortgage interest expenses attributable to a tenant or subtenant and for home-based business expenses. The SBA clarifies through examples that:

If a borrower subleases space to another business, the amount of rent attributable to a sublease does not count as an eligible nonpayroll rent expense;

Similarly, the amount of mortgage interest that is eligible for forgiveness is limited to the percentage of the fair market value of the space not leased out to another business;

A borrower in a shared rented space with another business must prorate rent and utility payments in the same manner as the borrower's 2019 tax filings (or expected 2020 tax filings, if a new business) to determine the amount of rent and utility payments eligible for forgiveness; and

For home-based businesses, expenses eligible for forgiveness are limited to those deductible on the borrower's 2019 tax filing (or expected 2020 tax filings, if a new business).

Finally, the SBA clarifies that rent payments to related parties can be included as a nonpayroll expense, but significantly limits the amount eligible for forgiveness. Only mortgage interest owed by the related party landlord on the space being rented during the covered period is eligible for forgiveness if both the lease and mortgage were entered into before February 15, 2020. The borrower must provide its lender with the mortgage interest documentation from its landlord to verify these payments. If the landlord and the business have any ownership in common, they are deemed to be related parties. The SBA also clarifies that while rent or lease payments to a related party are eligible for forgiveness, if a borrower purchased property from a related party, mortgage interest payments made to the related party are not.

This new guidance outlines an important consideration for businesses that hold property in a separate entity with common ownership and for acquisitive companies that often acquire a business and allow a seller to retain the real estate and an interest in the ongoing business.

Contact us

If you have questions on how these new SBA guidelines impact your PPP loans, contact Kirstin Salzman, Jessica Zeratsky, Colleen Pagnotta or your Husch Blackwell attorney.

Comprehensive CARES Act and COVID-19 guidance

Husch Blackwell's CARES Act resource team helps clients identify available assistance using industry-specific updates on changing agency rulemakings. Our COVID-19 response team provides clients with an online legal Toolkit to address challenges presented by the coronavirus outbreak, including rapidly changing orders on a state-by-state basis. Contact these legal teams or your Husch Blackwell attorney to plan a way through and beyond the pandemic.