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SBA issues interim final rule addressing both owner-employee compensation and rent issues

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The Small Business Administration (“SBA”) has issued additional regulations addressing loan forgiveness under the Paycheck Protection Program (“PPP”) in the form of an [Interim Final Rule published on August 24, 2020](#) (the “IFR”).¹ The latest IFR relaxes the cap on forgiveness-eligible compensation paid to certain owner-employees of PPP borrowers and attempts to clarify certain non-payroll costs that are eligible for forgiveness.

Changes to the owner-employee compensation cap for PPP loan forgiveness

The first change made by the IFR is a relaxation of the rule capping the amount of PPP loan forgiveness available for the compensation of some owner-employees of PPP borrowers. Owner-employees of S- and C-corps are allowed to include their employee cash compensation in the calculation of payroll costs incurred during the covered period. However, an Interim Final Rule published by SBA in June 2020, 85 F.R. 38304, 38307 (June 26, 2020), caps the amount an owner-employee can claim at eight-weeks’ worth (8/52) of their 2019 compensation if the borrower uses an eight-week covered loan period or 2.5-months’ worth of their 2019 compensation if the borrower uses a 24-week covered loan period. Until recently, it was assumed that this cap applied to *all* S- and C-corp owner-employees. However, the latest IFR eliminates this cap for owner-employees in S- and C-corps who have *less than a five percent (5%) ownership stake*. Per the IFR, this exemption “is intended to cover owner-employees who have no meaningful ability to influence decisions over how loan proceeds are allocated.”

Clarification of certain non-payroll costs that are not eligible for loan forgiveness

The new IFR also addresses certain non-payroll costs, relating to real estate, that are not eligible for loan forgiveness:

¹ The SBA has issued many Interim Final Rules for PPP and this one is distinguished by Docket Number SBA-2020-0044. As of August 28, 2020, the official *Federal Register* notice has not yet been posted.

Subtenants

The IFR states that amounts attributable to the business operation of a tenant or sub-tenant of a PPP borrower or, in the context of home-based business, house expenses, are not eligible for forgiveness. This means, for example, that if a PPP borrower leases an office space for \$10,000 per month and sub-leases a portion of the space to another business for \$2,500 per month, the borrower cannot claim the full \$10,000 monthly rent payment in its forgiveness application. Instead, only \$7,500 per month is eligible for loan forgiveness.

Owner rentals

If a borrower has a mortgage on an office building it operates out of, and it leases a portion of the space to other businesses, the portion of the mortgage interest that is eligible for loan forgiveness is limited to the percent share of the fair market value of the space that is not leased out to other businesses. In other words, if the leased space represents 25% of the fair market value of the office building, the borrower may only claim forgiveness on 75% of the mortgage interest.

Co-tenancy

As another example, where a borrower shares rented space with another business, the IFR explains that when determining the amount that is eligible for loan forgiveness, the borrower must prorate rent and utility payments in the same manner as on the borrower's 2019 tax filings (or the borrower's expected 2020 tax filings if the borrower is a new business).

Home office

The IFR also explains that if a borrower works out of his or her home, the borrower may include only the share of covered expenses that were deductible on the borrower's 2019 tax filings when calculating loan forgiveness. For new businesses, the borrower can use expected deductions on 2020 tax filings.

Rent payments to related parties are eligible for loan forgiveness, but limited to the amount of mortgage interest owed on the property

Finally, the IFR states that rent payments to a related party are only eligible for loan forgiveness if (1) the amount of loan forgiveness requested for rent or lease payments to a related party is no more than the amount of mortgage interest owed on the property during the covered period that is attributable to the space being rented by the business, AND (2) the lease and mortgage were entered into prior to February 15, 2020. The IFR states, "The borrower must provide its lender with mortgage interest documentation to substantiate these payments." However, the IFR clarifies that mortgage interest payments to a related party are not eligible for loan forgiveness.

The IFR defines "related party" for these purposes to mean any ownership in common between the borrower and the property owner.

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