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CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS

PPP: New IFR on Owner-Employees, Related Party Rent, Nonpayroll Costs

Earlier this week the SBA issued an Interim Final Rule (IFR) on forgiveness issues related to owner-employee compensation and on nonpayroll costs, including new limitations on related party rent. Click here https://home.treasury.gov/system/files/136/PPP--IFR--Treatment-Owners-Forgiveness-Certain-Nonpayroll-Costs.pdf

Owner compensation:

- *Less than 5% corporate owners treated the same as non-owners*: Owner compensation is subject to caps on payroll compensation eligible for forgiveness. A new exemption was added for C- or S-Corporation owner-employees with less than a 5% ownership stake; these owners will no longer be subject to the owner-employee compensation rule. The guidance notes that this exemption is intended to cover owner-employees who have no meaningful ability to influence decisions over how loan proceeds are allocated.
    - *No mention was made of partners or partnerships, so presumably any amount of ownership interest in a partnership still subjects the compensation of the partner to the owner compensation caps.*

Nonpayroll costs:

- *Related party rent, new limitations*: Several new limitations were added on related party rent. Beyond the normal rule that leases and mortgages must have been entered into prior to February 15, 2020, the following additional limitations apply:
    - Loan forgiveness for rent or lease payments to a related party are limited to the amount of mortgage interest owed on the property during the Covered Period that is attributable to the space being rented by the business.
        - *No examples are given in the guidance. An example would be: Operating company ("OpCo") pays rent of $20k a month to a related entity that owns the property ("PropCo.") Assume total rent that would normally be eligible for forgiveness over the Covered Period was $120k. Also assume that only $80k of mortgage interest was paid by PropCo to its lender (a third party bank) for the property it rents out to OpCo over that same period. Under the new limitation, OpCo's rent eligible for forgiveness related to this lease would be limited to $80k. Presumably, related party equipment rent would be treated the same way.*
    - The borrower must provide its lender with mortgage interest documentation to substantiate these payments.
    - No double-dipping - the related party itself would not also be eligible to request forgiveness for this amount (mortgage interest.)
        - *Following the example above, PropCo would not be allowed to claim the same mortgage interest in its forgiveness application. For most business structures, this will not be an issue as PropCo was likely not eligible to apply for a PPP loan in the first place.*

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  - ANY ownership in common between the business and the property owner is a related party for these purposes.
  - Mortgage interest payments to a related party are not eligible for forgiveness.
  - The guidance indicates that PPP loans are intended to help businesses cover certain nonpayroll obligations that are owed to third parties, not payments to a business's owner that occur because of how the business is structured. This is meant to maintain equitable treatment between a business owner that holds property in a separate entity and one that hold the property in the same entity as its business operations.

- *Shared expenses and expenses of home-based businesses*: Loan forgiveness for nonpayroll costs may not include any amount attributable to the business operation of a tenant or sub-tenant of the PPP borrower or, for home-based businesses, household expenses. The guidance gives four examples:
  - Example 1: A borrower rents an office building for $10,000 per month and subleases out a portion of the space to other businesses for $2,500 per month. Only $7,500 per month is eligible for loan forgiveness.
  - Example 2: A borrower has a mortgage on an office building it operates out of, and it leases out a portion of the space to other businesses. The portion of 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. As an illustration, if the leased space represents 25% of the fair market value of the office building, then the borrower may only claim forgiveness on 75% of the mortgage interest.
  - Example 3: A borrower shares a rented space with another business. 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 if a new business, the borrower's expected 2020 tax filings.
  - Example 4: A borrower works out of his or her home. When determining the amount of nonpayroll costs that are eligible for loan forgiveness, the borrower may include only the share of covered expenses that were deductible on the borrower's 2019 tax filings, or if a new business, the borrower's expected 2020 tax filings.

Please contact us if you have any questions on loan forgiveness or need assistance – we are happy to help!