

## **CLIENT ALERT - CORONAVIRUS (COVID 19) PAYCHECK PROTECTION PROGRAM UPDATE**

Dear Clients and Friends:

The U.S. Small Business Administration (“SBA”) published a new Interim Final Rule (“IFR”) regarding the Paycheck Protection Program (“PPP”) earlier this week, which provides additional guidance and clarity regarding certain payroll and non-payroll costs that are eligible for loan forgiveness. In particular, this new IFR addresses (1) limitations on the applicability of the owner-employee compensation rule; (2) how having tenants, subtenants and/or common spaces affects the forgiveness of rent and mortgage interest payments; (3) whether household expenses may be forgivable for borrowers who work from home; and (4) whether rent payments to related parties are eligible for forgiveness.

This Client Alert provides a summary of this new IFR. This information is not legal advice and may not be suitable for all client situations. As always, if you would like specific legal assistance with respect to the PPP program or any other matters, please do not hesitate to contact your HH&K attorney.

### **Limitations on the Applicability of the Owner-Employee Compensation Rule**

Prior SBA guidance established different caps on forgivable compensation for owner-employees and non-owner employees and the difference was significant for borrowers electing to use the 24-week loan forgiveness period. For borrowers utilizing the 8-week loan forgiveness period, the maximum amount of employee wages for which a borrower can receive forgiveness is \$15,385 per employee (i.e. \$100,000 x 8/52) and for owner-employees, forgiveness is further limited to 8/52 of 2019 net profit, up to a maximum of \$15,385 per owner-employee. For borrowers utilizing the 24-week loan forgiveness period, the cap on forgivable wages for non-owner employees is \$46,154 per employee (i.e. \$100,000 x 24/52), while the cap for owner-employees is limited to 2.5 months’ worth (2.5/12) of 2019 net profit (up to a \$20,833 maximum) per owner-employee.

In the new IFR, the SBA provides that **owner-employees with less than a 5% ownership stake in a C-Corporation or S-Corporation are not subject to the owner-employee compensation caps.** The SBA has stated that the purpose of the owner-employee compensation rule is to prevent owners from receiving a windfall from the PPP. In the new IFR, the SBA recognizes that owner-employees who own a small percentage of a business likely have no meaningful ability to influence decisions over how PPP loan proceeds are allocated and, accordingly, the SBA determined that this exception was consistent with the intent of the owner-employee compensation rule.

### **Effect of Tenants, Sub-tenants and Common Spaces on Loan Forgiveness Amount**

The new IFR further clarifies the PPP loan forgiveness rules by providing that the amount of loan forgiveness requested for non-payroll costs (1) may not include any amounts attributable to the business operations of a tenant or sub-tenant of the PPP borrower and (2) can only include the borrower’s share of any common or shared spaces. The SBA provided the following examples to illustrate how this rule is applied in practice:

(a) Where a borrower rents an office building for \$10,000 per month and sub-leases out a portion of the building to other businesses for a total of \$2,500 per month, only \$7,500 per month is eligible for loan forgiveness under the PPP.

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(b) Where a borrower has a mortgage on an office building of which it occupies 75% and leases 25% to other businesses, only 75% of the fair market value of the mortgage interest is eligible for loan forgiveness under the PPP.

(c) Where a borrower shares a rented space with another business, the borrower must prorate rent and utility payments in the same manner as it did on its 2019 tax filings (or expected 2020 tax filings if it is a new business) in order to determine the amount that is eligible for loan forgiveness under the PPP.

While the limitation on rent and utility expenses is common sense, many borrowers may not have considered that the same limitations apply to mortgage interest. This new IFR makes it clear that a borrower that owns its building and subleases space to or shares space with another party must similarly pro-rate its mortgage interest expenses when seeking loan forgiveness.

### **Limits on Forgiveness of Household Expenses**

The new IFR confirms that when a borrower works out of its home, the borrower may only include the share of covered expenses that were deductible on the borrower's 2019 tax filings (or expected 2020 tax filings if the borrower's business is new) to determine the amount that is eligible for loan forgiveness under the PPP.

### **Limits on Forgiveness of Rent Payments to Related Parties**

The new IFR confirms that rent payments to a related party are eligible for loan forgiveness, but it places limits on the amount eligible for forgiveness and places certain conditions on the eligibility of such payments. The amount of rent or lease payments to a related party that are eligible for forgiveness is limited to the amount of mortgage interest owed on the property during the loan forgiveness period that is attributable to the space being rented by the borrower. In other words, it is likely that 100% of a borrower's rent payments will not be eligible for forgiveness if it leases property from a related party. In addition, in order for these costs to be eligible for forgiveness, both the lease and the mortgage must have been entered into prior to February 15, 2020.

The SBA further clarified that any common ownership between the business and the property owner makes the property owner a related party for these purposes. When applying for loan forgiveness, any borrowers that are including rent/lease payments to related parties must also provide mortgage interest documentation to their lender to evidence that the rent/lease payments for which the borrower is seeking forgiveness meet these limitations.

It is also important to note that while rent or lease payments to a related party may be eligible for forgiveness (with the foregoing limitations), mortgage interest payments to a related party are not.

### **Contact Your HH&K Attorney for Legal Guidance**

This information is not legal advice and may not be suitable for all client situations. This Client Alert provides general information regarding the PPP program and does not outline all of the important considerations related thereto. We anticipate that the terms of the PPP program may continue to evolve as the SBA releases additional guidance. This Client Alert is not a substitute for legal guidance regarding program details and how those may be applicable to your business. As always, if we can be of assistance during this difficult time, please do not hesitate to contact your HH&K attorney.

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