

New Interim PPP Rules Address Owner-Employee Compensation, Sub-Tenants, and Rent Payments to a Related Party

Hinshaw Alert | 3 min read

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The Small Business Administration (SBA) and the U.S. Department of the Treasury issued a new interim Paycheck Protection Program (PPP) rule on August 24, 2020. The rule covers changes involving owner-employee compensation, sub-tenants, and rent payments to a related party. We explore these new interim rules below.

Owner-Employee Compensation

The [current rules](#) place a limit on the amount of loan forgiveness for payroll compensation attributable to an owner-employee. There is no exception in the rule based on the owner-employee's percentage of ownership. The rule caps the amount of loan forgiveness for payroll compensation attributable to an owner-employee for:

- 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
- all other borrowers, at 2.5 months' worth of 2019 compensation or \$20,833 per individual, whichever is less.

Under the new rule, compensation paid to individuals who own less than 5% of the PPP borrower that is an S-corporation or a C-corporation is not subject to the owner-employee compensation forgiveness limits mentioned above. The Agencies indicated that this exemption is being adopted for owner-employees who, in reality, have no meaningful ability to influence decisions over how loan proceeds are allocated.

Shareholders owning 5% or less of an S-corporation or a C-corporation will qualify for forgiveness for up to \$46,154—assuming the PPP borrower is using a 24 week Covered Period—as well as amounts payable for health insurance and retirement plan contributions.

Although the new rule does not directly state this, it should also apply to an LLC that is, for tax purposes, treated like an S-corporation or a C-corporation. Notably, this rule does not apply to partners in a partnership.

Eligibility of Certain Nonpayroll Costs for Loan Forgiveness: Sub-Tenants

The new rule also addresses nonpayroll costs attributable to tenants or sub-tenants. The Agencies stated that the amount of loan forgiveness requested 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 following examples illustrate this rule:

Example 1: A borrower rents an office building for \$10,000 per month and subleases 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 uses and 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 tenants. For instance, 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.

Rent Payments to a Related Party

The Agencies also placed limits on the forgiveness of rent payments to related parties. Such costs may be forgiven as long as:

- 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
- the lease and the mortgage were entered into before February 15, 2020.

Any ownership in common between the business and the property owner is a related party for these purposes. No threshold has been set to determine what constitutes ownership in common.

The borrower must provide its lender with mortgage interest documentation to substantiate these payments. While rent or lease payments to a related party may be eligible for forgiveness, mortgage interest payments to a related party are not eligible for forgiveness. This new rule will also prohibit a borrower who owns its building in a separate entity without any mortgage from receiving any forgiveness for rent paid to this entity.

The Agencies believe 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 the structure of the business.

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