

SBA CHANGES PPP LOAN FORGIVENESS RULES FOR 5% OWNER-EMPLOYEES OF CORPORATIONS AND FOR CERTAIN NONPAYROLL COSTS

On August 24, the Small Business Administration (SBA) issued an [Interim Final Rule](#) (IFR) that, for the first time, sets a de minimis rule for Paycheck Protection Program (PPP) loan forgiveness for owner-employees who own less than 5% of a corporation. The IFR also provides additional guidance on PPP loan forgiveness of certain nonpayroll costs. The IFR is effective immediately.

New Rule for 5% Owners of Corporations

SBA guidance on PPP loan repayment from May and June capped the amount of loan forgiveness for owner-employee payroll compensation and attempted to explain what that meant for different types of entities – with different results for C corporations, S corporations, limited liability companies (LLCs), general partnerships, and sole proprietorships. But the earlier guidance did not set forth any exceptions based on the owner-employee's percentage of ownership.

Under the new IFR, any individual with a less than 5% ownership stake in a PPP borrower that is a C corporation or S corporation is now exempt from the special PPP owner-employee compensation rules when determining the amount of their compensation that is eligible for PPP loan forgiveness. Less than 5% corporate owner-employees can now use the more favorable nonowner rules for payroll costs to be forgiven.

The new IFR creates different results based on the PPP borrower's choice of entity. In issuing the de minimis ownership rule for C and S corporation owners, the SBA said that the exemption was intended "to cover owner-employees who have no meaningful ability to influence decisions over how loan proceeds are allocated."

Accordingly, borrowers may want to revisit their PPP loan forgiveness application to increase payroll costs for owner-employees who own less than 5% of a corporation.

Insight

The new IFR did not address LLCs, partnerships or sole proprietorships, so the 5% owner exception appears to be limited only to corporations for the time being. The owners of LLCs taxed as partnerships might

not be covered. Regardless, not all partners are treated as owner-employees because earlier guidance applied the owner-employee rules only to general partners.

New Nonpayroll Cost Rules

The IFR sets out new limits for PPP loan forgiveness on rent payments and mortgage interest payments made to "related parties." The IFR says: "Any ownership in common between the business and the property owner is a related party for these purposes." So the typical controlled group, affiliated service group or common control rules (including family or other attribution rules) do not apply in determining if the parties are related for PPP loan forgiveness of nonpayroll costs. Now, rent or lease payments to related parties qualify for forgiveness only if (1) the payments don't exceed the amount of mortgage interest owed on the property during the covered period that is attributable to space rented by the business, and (2) the lease and mortgage were entered into before February 15, 2020. The IFR also says that mortgage interest payments made to a related party are not eligible for PPP loan forgiveness.

Finally, the new IFR says that nonpayroll amounts attributable to a business operation of a tenant or subtenant of a PPP borrower are not eligible for forgiveness.

Insights

Many businesses pay rent to their owners that don't have a mortgage on the property. Nothing in the CARES Act or prior IFRs hinted at these new limitations based on a landlord-tenant or related party relationship, so many borrowers likely included those amounts in their expected PPP forgiveness calculations.

Accordingly, borrowers may want to revisit the PPP loan forgiveness documentation to eliminate (1) rent paid to related parties that exceeds the interest on the property's mortgage, (2) any nonpayroll expense that is reimbursed by a sublease tenant, and (3) mortgage interest payments to a related party.