Gesmer Updegrove LLP

ClientUpdate

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New Guidance On PPP Loans And Recent Changes To Employment Taxes

PPP Loan Foregiveness

On August 24, 2020 the SBA and U.S. Treasury Department issued new guidance on two important expenses that may or may not be forgiven under the Payment Protection Program ("PPP").

Owner-Employee Compensation

For all C and S corporations if an employee owns less than 5% of corporate equity 100% of such employee's compensation is eligible for forgiveness. If an employee owns 5% or more of corporate equity, is self-employed or a general partner his/her compensation that will be forgiven is capped. If the employer uses the 8 week covered period, forgivable compensation for the 5%+ owner-employee is the lesser of 8 weeks' of 2019 compensation, or $15,385. If the employer uses the 24 week covered period, forgivable compensation for the 5%+ owner-employee is the lesser of 2.5 months of 2019 compensation, or $20,833.

It is unclear whether equity ownership is based on an "issued" basis, or a "fully diluted" basis. The new guidance focuses on an equity owner's ability to control the employer. If an employee holds options or convertible securities, and cannot exert control through such securities, it is unlikely the unissued securities will be included in the 5% ownership threshold.

The owner-employee compensation rules do not apply to LLCs or other business entities.

Owner-Occupied Rent and Mortgage Interest

If a PPP borrower's landlord is a related entity forgivable rent is limited to the mortgage interest owed by the landlord during the covered period, so long as the lease was entered into prior to February 15, 2020. Related entities include a corporate parent, and entities with any common ownership. The borrower's forgiveness application must include evidence of the landlord's mortgage. If the landlord has no mortgage none of the borrower's rent is eligible for forgiveness.

If a PPP borrower subleases some of its space, rent paid by the subtenant is deducted from the borrower's rent that may be forgiven. For example, if the borrower's rent during the covered period is

$15,000, and it collects $9,000 from a sub-tenant, the borrower's forgivable rent is capped at $6,000.

If a borrower owns its space/building it may seek forgiveness of interest paid on its mortgage during the covered period. If there is no mortgage there is no rent or interest that can be forgiven.

If a borrower owns its building, and leases part of the space, the mortgage interest that qualifies for forgiveness is limited to the portion of the building occupied by the borrower.

If a borrower works from home occupancy costs that may be forgiven are limited to the home office deduction reported on the borrower's 2019 tax return. If it is a new business the amount that may be forgiven is the expected deduction to be reported on the borrower's 2020 tax return.

Changes To Social Security Taxes For The Remainder Of 2020

Starting today, September 1, 2020, certain payroll taxes will be deferred pursuant to an executive order signed by the President on August 8, 2020. Payroll taxes consist of two parts, Social Security (12.4%) and Medicare (2.9%). Each tax is equally split between employer and employee. The Executive Order only pertains to the Social Security tax, only applies to the employee's share (6.2%), and only applies to employees earning less than $4,000 in a bi-weekly pay-period ($104,000 annually). The deferral is not a tax "holiday." Rather it is a tax "hiatus." From September 1st through December 31st the deferred amount is paid to the employee. Beginning January 1, 2021, the employer must ratably withhold the deferred amount from the employee's wages through April 30, 2021. As a result, employees covered by this tax change can expect a boost in take-home pay for the remainder of 2020. Barring an act of Congress the windfall will gradually be clawed back in its entirety during the first four months of 2021.

This advisory is for information purposes only, and does not constitute legal advice. If you would like to discuss to discuss the SBA's recent guidance, or have any questions on PPP or EIDL loans or the social security tax deferral, please contact Joe Laferrera, Aaron Kriss, or Sean Gilligan at (617) 350-6800, or email them at joe.laferrera@gesmer.com, aaron.kriss@gesmer.com, or sean.gilligan@gesmer.com.


Joe Laferrera


Aaron Kriss


Sean Gilligan