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## INSIGHT: Confusion for ‘Owner-Employees’ Remains—How Are Owner-Employees Treated for the FTE Ratio in a PPP Loan Forgiveness Application?



By LEWIS HOROWITZ AND ERIC KODESCH

For reasons known only to the Small Business Administration (SBA), it continues to attempt to treat “owner-employees” in the same manner as sole proprietors and partners for purposes of loan forgiveness under the paycheck protection program (PPP). Despite recent efforts by the SBA to relax the impacts of this flawed policy, unintended consequences continue to manifest, including one from a glitch in the PPP loan forgiveness application form with respect to the FTE ratio.

We’ve been [critical](#) of the limitations invented by the SBA with respect to PPP loan forgiveness for “owner-employees” as SBA attempts to extend forgiveness limitations applicable to sole proprietors and partners to owner-employees. However, as we noted in this [article](#), the PPP loan regime treats owner-employees differently from sole proprietors and partners in many regards, including the ability of sole proprietors and partners to receive PPP loan proceeds as tax-free compensation. Such key differences undermine the logic of extending the treatment of sole proprietors and partners to owner-employees.

As we described in May, in the [14th interim final rule](#) (IFR) for PPP loans, the SBA formalized the [restrictions](#) it (but not Congress) chose to impose on this undefined category of employees of businesses with PPP loans. (Although the SBA has still not provided a definition for the term “owner-employee,” it generally appears that the term means employee shareholders of C corporations and S corporations, including LLCs taxed as such. So far at least, neither indirect ownership nor attribution rules apply.)

In the [18th IFR](#) and the [instructions](#) to the regular PPP loan forgiveness [application](#), the SBA capped the forgivable cash compensation paid to an owner-employee of a business using a 24-week covered period at \$20,833, rather than the \$46,154 that applies to other employees. In a recent [article](#), we applauded the SBA for providing a *de minimis* ownership threshold (5%) for this special cap. (We believe the threshold is too low. However, it limits the maximum impact of the special cap to \$506,420 ( $20 * (\$46,154 - 20,833)$ )—absent the *de minimis* threshold, a business with 100 employees with nominal stock ownership could lose over \$2.5 million in loan forgiveness that they were reasonably expecting.) Although the *de minimis* threshold provides relief for one flaw of the owner-employee limitations, others remain—for example, the impact of owner-employees on the FTE ratio.

The 24-week covered period for PPP loan forgiveness has not ended yet for any business with a PPP loan. Although the SBA has stated that businesses can apply for forgiveness before the end of the 24-week covered period, we described in this [article](#) how it may not be possible, as a practical matter, for a business to submit a forgiveness application before the end of its 24-week covered period. Still, with the SBA opening its PPP loan [“forgiveness portal”](#) for banks, and banks expected to start accepting PPP loan forgiveness applications soon (if they have not already), businesses are starting to put together drafts of the PPP loan forgiveness applications. For the regular forgiveness application, this requires calculating the business’s FTE ratio.

As a reminder, PPP loan forgiveness is capped at the least of three amounts:

1. The principal amount of the PPP loan.
2. Payroll costs paid or incurred during the covered period divided by 60 percent.
3. The sum of forgivable payments over the covered period less the amount for the statutory reduction in forgiveness because of a reduction in compensation, all multiplied by the business's FTE ratio.

As we previously [described](#), the SBA's favorable interpretations for whether a business has reduced an employee's compensation, and the calculation of the FTE ratio, will generally prevent these provisions from reducing PPP loan forgiveness. Nonetheless, the application requires computation for both, so businesses still have to do the math. The FTE ratio is a fraction where the numerator is the average weekly FTEs of each employee during the covered period and the denominator is the average weekly FTEs of each employee during the "reference period" (generally, Feb. 15, 2019, to June 30, 2019, or Jan. 1, 2020, to Feb. 29, 2020, as chosen by the business).

Conceptually, the FTE ratio is fairly simple (although there is some complication because neither reference period is an exact number of weeks, unlike the covered period). Of course, the devil is in the details. Here, those details are how you calculate the FTE ratio on the forgiveness application:

- The numerator of the FTE ratio (average weekly FTEs of each employee during the covered period) derives from Table 1 and Table 2 of the PPP Schedule A Worksheet. Table 1 lists the information, including average FTEs during the covered period, for employees who received compensation at an annualized rate of \$100,000 or less for all pay periods in 2019. Table 2 lists the information, including average FTEs during the covered period, for employees who received compensation at an annualized rate of more than \$100,000 for all pay periods in 2019. Importantly, the instructions provide: "Do not include any independent contractors, **owner-employees**, self-employed individuals, or partners" in either Table 1 or Table 2. (Emphasis added.) Therefore, the application apparently excludes the average weekly FTEs of owner-employees from the numerator of the FTE ratio.

- The denominator of the FTE ratio (average weekly FTEs of each employee during the reference period) is listed on line 11 of PPP Schedule A. Although the instructions for line 11 provide limited guidance, they indicate that the denominator includes "each employee," with no exclusions. Accordingly, some might conclude that the denominator includes the average weekly FTEs of owner-employees even though those same people are excluded from the numerator. (Because sole proprietors and partners are not employees, they would be excluded from the denominator.)

Under such reading, there is a mismatch, with owner-employees excluded from the numerator of the FTE ratio, but included in the denominator. But mechanically following the forgiveness application leads to an unfair result that has no statutory basis or logical justification. Congress never mentioned "owner-employees" in the CARES Act or the PPPFA, let alone a calculation of an FTE ratio that punishes business for having owner-employees. Further, the law defines the numerator of the FTE ratio as "the average number of full-time equivalent **employees** per month employed by the eligible recipient during the covered period." CARES Act Section 1106(d)(2)(A)(i) (emphasis added).

Businesses may find cold comfort with this detailed explanation of a flaw in the PPP loan forgiveness application. Instead, businesses with owner-employees completing the application understandably want a solution that fixes this problem. The SBA needs to provide guidance, including a correction to the application and instructions. In the meantime, businesses should consider the following:

1. Take the position that employees with an ownership interest below the 5% threshold are not "owner-employees" for any purposes. Under this reasonable interpretation of the *de minimis* test discussed above, the business can include these employees in Table 1 or Table 2, as applicable. Although logical, this interpretation does not follow the literal language of the IFR that created the threshold, which describes the threshold in terms of not applying "the owner-employee compensation rule" to "owner-employees with less than a 5% ownership stake in a C- or S-Corporation." Still, it seems unlikely that the SBA could successfully challenge, or a court would strike, an interpretation that leads to a logical and reasonable result. Although this approach should help many forgiveness applications, it does not solve the problem for businesses with owner-employees with more than 5% ownership in the business.

2. Include owner-employees in Table 1 or Table 2, as applicable, but inserting \$0 for the cash compensation. The application already has a specific spot (Line 9 of PPP Schedule A) for the compensation of owners, including owner-employees. Further, the SBA likely excluded owner-employees from Table 1 and Table 2 to avoid double counting this compensation. Including the average weekly FTEs of employee-owners in Table 1 or Table 2 also gets to the logically appropriate result. However, listing \$0 of compensation may raise questions or create problems, especially for businesses submitting the application electronically through a portal created by the bank.

3. Exclude owner-employees from the denominator of the FTE ratio. This would be consistent with the SBA's general policy of treating owner-employees in the same manner as sole proprietors and partners. However, it contradicts the law, which defines the denominator of the FTE ratio as "the average number of full-time equivalent **employees** per month employed by the eligible recipient during" the reference period. CARES Act Section 1106(d)(2)(A)(ii)(I)(aa), (I)(bb), and (II) (emphasis added).

The SBA went beyond its statutory authority when it created the owner-employee compensation rule and imposed limits on forgivable compensation paid to owner-employees. Then Congress expanded the covered period from 8 to 24 weeks and the SBA *sua sponte* decided that the rule it previously created would be too generous so it reduced forgiveness by up to \$25,321 per owner-employee. Recognizing the error of its way, the SBA then provided *de minimis* relief for owner employees with less than 5% ownership. As we continue to work through the forgiveness application, we see that the SBA's treatment of owner-employees also produces an intellectually unjustified result for the calculation of the FTE ratio. We hope that the SBA will fix this problem that it created. Otherwise, affected businesses may have to resort to litigation to get the right result.

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