

Larry's Tax Law

## **Love Thy Landlord – Prepayment of Rent with PPP Loan Proceeds May Not Be a Good Idea**

By Larry Brant and Peter Evalds on 5.21.20 | Posted in Federal Law, Legislation, Tax Planning

In addition to worrying about keeping their business afloat these days, businesses are focusing on whether their Paycheck Protection Program (“PPP”) loan will be forgiven. Without loan forgiveness, many of these businesses will not survive. Consequently, the stakes are high!

The eligibility requirements for PPP loan forgiveness are complex. As we [discussed previously](#), in large part, loan forgiveness is based on the borrower using the loan proceeds within the eight-week period immediately following receipt of the loan on specified expenses, including payroll and rent.

Some landlords have been generous enough to reduce or even abate rent for a period (e.g., three months) to assist the tenant in salvaging its business. Consequently, these businesses may have little or no rent to pay during the eight-week period. If a business owner asks the landlord for advice on what to do in this situation, the landlord will likely say:

### **Love thy landlord – pay me anyway!**

Whether the prepayment of rent (or the payment of rent for a period preceding the eight-week period) applies for purposes of the loan forgiveness computation under the PPP is likely a question being pondered by many businesses and their advisors.

#### Background

As [previously discussed](#), the CARES Act created the PPP under which the Small Business Administration (the “SBA”) is authorized to make up to \$349 billion (subsequently increased to \$659 billion) in forgivable loans to small businesses to enable them to meet payroll costs, benefits, rent and utility payments.

Section 1106(b) of the CARES Act provides that an eligible recipient of a PPP loan is eligible for debt forgiveness in an amount equal to the sum of certain “costs incurred and payments made” (“Eligible Costs”) during the eight-week period beginning on the date of the loan’s origination (the “Covered Period”).

Eligible Costs include “payment on any covered rent obligation.” For this purpose, a “covered rent obligation” is defined as “rent obligated under a leasing agreement in force before February 15, 2020.”

The SBA has not yet issued formal guidance with respect to the payment of “covered rent obligations.” The U.S. Department of the Treasury (the “Treasury”) [recently stated](#), however, that the SBA will issue “regulations and guidance” soon with respect to PPP loan forgiveness applications.

The [instructions to the SBA’s Loan Forgiveness Application](#) direct applicants to “[e]nter the amount of business rent or lease payments ... during the Covered Period, pursuant to lease agreements in force before February 15, 2020.” The instructions further provide that the following “nonpayroll” costs are eligible for forgiveness: “covered rent obligations: business rent or lease payments pursuant to lease agreements for real or personal property in force before February 15, 2020 (‘business rent or lease payments’).” In order to be eligible for forgiveness, such “nonpayroll” costs must be “paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date, even if the billing date is after the Covered Period.” So, the instructions would lead us to believe that rent for a period prior to the Covered Period (i.e., late rent) that is paid during the Covered Period is includable in the forgiveness computation. As discussed below, caution is advised. The statute clearly says the payment has to be both incurred and paid during the Covered Period. Also, the instructions provide that rent for the Covered Period that is paid on the next scheduled due date that falls after the Covered Period, is includable in the forgiveness computation. Again, the instructions go beyond the express terms of the statute. Caution is warranted.

#### Prepaid Rent

*So, is prepaid rent an Eligible Cost?* The answer likely depends on when the rent was paid and to which period it relates.

There are a lot of variations of prepaid rent. At least two likely common scenarios come to mind: (i) rent paid before the Covered Period for the Covered Period; and (ii) rent paid during the Covered Period for periods following the Covered Period.

#### **1. Rent Paid Before the Covered Period for the Covered Period**

*Is rent paid before the Covered Period for the Covered Period an Eligible Cost?*

Rent that was prepaid before the Covered Period, but which relates to the Covered Period probably does **not** qualify for inclusion in the forgiveness computation.

Some practitioners and commentators have suggested that the SBA's loan forgiveness application instructions may reasonably be read to allow forgiveness with respect to this variation of prepaid rent. **Pause for cause!** We do not concur with that conclusion.

First and foremost, in this situation, the rent is **not** being paid from the loan proceeds. At the time of payment, the loan did not exist. The statute speaks expressly in terms of the loan proceeds being used for Eligible Costs. A borrower cannot use the loan proceeds before receiving them from the bank!

Second, the rent is not being paid during the Covered Period. Rather, it is paid before the Covered Period.

The statute provides that costs must be both **incurred** and **payments must be made** during the Covered Period in order to qualify for inclusion in the loan forgiveness computation. Congress' use of the conjunction "and" means that both requirements must be met in order for amounts to apply for forgiveness purposes.

As noted above, the loan forgiveness application instructions provide (contrary to the express language of the statute) that amounts incurred in the Covered Period but paid on or before the next billing date (even if after the Covered Period) are includable in the forgiveness computation. The situation contemplated by that reference in the instructions is narrow. The reference is most likely limited to the following situation: (i) the rent for a month is due on the 15<sup>th</sup> of the month but covers that entire calendar month, (ii) the Covered Period ends on the 10<sup>th</sup> of the month, and (iii) the rent is actually paid on the due date (i.e., the 15<sup>th</sup>). Per the instructions, the amount of rent paid that relates to the Covered Period (through the 10<sup>th</sup> of the month), notwithstanding the fact that it is paid after the Covered Period, is includable in the forgiveness computation. Again, this conclusion is contrary to the statutory language. Whether a court would enforce its application could be debatable.

PPP guidance has been a moving target. To date, the guidance is far from complete. Consequently, the best approach in this situation (unless and until the SBA and/or Treasury provide contrary guidance) is to exclude payments of rent made prior to the Covered Period from the forgiveness computation.

## **2. Rent Paid During the Covered Period for Periods Following the Covered Period**

*Is rent paid during the Covered Period for periods following the Covered Period an Eligible Cost?*

The instructions to the SBA Loan Forgiveness Application provide that eligible amounts include amounts paid in the Covered Period. However, as discussed above, the statute requires rent both to be **paid** and **incurred** during the Covered Period. For that reason, the best approach in this situation (unless and until the SBA and/or Treasury provide contrary guidance) is to exclude

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payments of rent made during the Covered Period for periods following the Covered Period from the forgiveness computation.

### Conclusion

We suspect that few businesses will have the ability during these challenging times to prepay rent. For those that can and do prepay rent, however, caution is advised. Except for the limited situation discussed above and referenced in the SBA Loan Forgiveness Application instructions, rent prepayments (and for that matter, other expense prepayments) are not likely includable in the loan forgiveness computation. The SBA and/or Treasury will hopefully soon address the issue of expense prepayment in written guidance.

**Tags:** Business, business real estate, CARES Act, Commercial Real Estate, commercial tenants, Coronavirus, Covered Period, COVID-19, Department of the Treasury, forgivable loans, landlord, Paycheck Protection Program, prepayment, Prepayment of Rent, real estate, rent, small business, Taxpayer, Treasury