
CARES Act and Affiliation Rules for Paycheck Protection Program

When do groups of related for-profit businesses or affiliates fall outside of the “500 or fewer employees” threshold?

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Overview.

The CARES Act, signed into law March 27, 2020, created a Paycheck Protection Program (“PPP”) within the U.S. Small Business Administration’s (“SBA”) loan program commonly referred to as the “Section 7(a) loan program”. Generally, business concerns with 500 or fewer employees may qualify as eligible recipients of a PPP loan. Some business concerns may have related or affiliated entities whose employees must be aggregated with the concern for purposes of determining whether or not the business concern, together with any “affiliates”, meets the 500 or less employee threshold to qualify for a PPP loan. The CARES Act contains specific waivers for certain affiliation rules contained in the SBA regulatory scheme.

This article addresses the affiliation rules set forth in the CARES Act and the SBA regulations and interim rules, as well as guidance provided by other government agencies, such as the Department of Treasury.

All emphasis added, unless otherwise indicated.

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1. CARES Act – Eligibility, Generally.

The CARES Act, signed into law March 27, 2020, created a Paycheck Protection Program (“PPP”) within the U.S. Small Business Administration’s loan program commonly referred to as the “Section 7(a) loan program”. Eligibility for a PPP loan is described as follows:

During the covered period [defined as February 15, 2020 through June 30, 2020], in addition to small business concerns, any business concern, nonprofit organization, veterans organization, or Tribal business concern described in section 31(b)(2)(C) shall be eligible to receive a covered loan if the business concern, nonprofit organization, veterans organization, or Tribal business concern employs not more than the greater of—

- (I) 500 employees; or
- (II) if applicable, the size standard in number of employees established by the Administration for the industry in which the business concern, nonprofit organization, veterans organization, or Tribal business concern operates.

15 U.S.C. § 636(a)(36)(D)(i)- 7(a)(36)(D)(i)(II), as added by the [CARES Act](#); pages 8 of 335.

2. CARES Act – Affiliation Rules and Waiver.

The CARES Act waives certain affiliation rules contained in section 121.103 of title 13, Code of Federal Regulations with respect to certain businesses:

(iv) WAIVER OF AFFILIATION RULES.—During the covered period, the provisions applicable to affiliations **under section 121.103** of title 13, Code of Federal Regulations, or any successor regulation, are waived with respect to eligibility for a covered loan for—

- (I) any business concern with not more than 500 employees that, as of the date on which the covered loan is disbursed, is assigned a North American Industry Classification System code beginning with 72;
- (II) any business concern operating as a franchise that is assigned a franchise identifier code by the Administration; and
- (III) any business concern that receives financial assistance from a company licensed under section [301 of the Small Business Investment Act of 1958 \(15 U.S.C. 681\)](#) [Small Business Investment Company].

(v) EMPLOYEE.—For purposes of determining whether a business concern, nonprofit organization, veterans organization, or Tribal business concern . . . employs not more than 500 employees under clause (i)(I) [eligibility, generally, for a paycheck protection program loan], the term ‘employee’ includes individuals employed on a full-time, part-time, or other basis.

(vi) AFFILIATION.— The provisions applicable to affiliations under section 121.103 of title 13, Code of Federal Regulations, or any successor thereto, shall apply with respect to a nonprofit organization and a veterans organization in the same manner as with respect to a small business concern.

See 15 U.S.C. § 636(a)(36)(D)(iv)-(vi), as added by the [CARES Act](#), pages 8-9 of 335.

As noted above, the CARES Act applies (and then waives) certain affiliation requirements for certain veterans organizations and nonprofit organizations, including religious organizations. See [SBA FAQs regarding Participation of Faith-Based Organizations in the PPP and EIDL Loan](#)

[Program](#) (Question 6: *Is my faith-based organization disqualified from any SBA loan programs because it is affiliated with other faith-based organizations, such as a local diocese?*).

This article focuses on business concerns that are not nonprofit organizations.

3. NAICS Code 72 – Accommodation and Food Services.

Businesses designated under North American Industry Classification System code beginning with 72 are within the Accommodation and Food Services categories. See [U.S. Census Bureau NAICS Code information](#).

4. Affiliation - SBA Interim Final Rule, *Business Loan Program Temporary Changes; PPP*.

As noted above, the CARES Act waiver of affiliation rules applies to: (I) any business concern with not more than 500 employees that is assigned a NAICS code beginning with 72; (II) any business concern operating as a franchise that is assigned a franchise identifier code by the SBA; (III) any business concern that receives financial assistance from a Small Business Investment Company; and (IV) certain veterans organizations and nonprofit organizations. And, the waiver applies only to the affiliation rules contained in section 121.103 of the regulations.

According to SBA Interim Final Rule issued on April 3, 2020:

- “In most cases, a borrower will be considered together with its affiliates for purposes of determining eligibility for the PPP. Under SBA rules, entities may be considered affiliates based on factors including stock ownership, overlapping management, and identity of interest. 13 CFR § 121.301.”
- “An entity generally is eligible for the PPP if it, combined with its affiliates, is a small business as defined in section 3 of the Small Business Act (15 U.S.C. 632), or (1) has 500 or fewer employees whose principal place of residence is in the United States or is a business that operates in a certain industry and meets applicable SBA employee-based size standards for that industry, and (2) is a tax-exempt nonprofit organization . . . , a tax-exempt veterans organization . . . , a Tribal business concern . . . , or any other business concern.”

See [SBA Interim Final Rule](#), at pages 4-5; see [13 C.F.R. § 121.103](#) (*How does SBA determine affiliation?*).

5. SBA Borrower Application Form 2483.

The Borrower Application Form, SBA Form 2483, released by the SBA on April 2, 2020, requires applicants to list other businesses with which they have common management. See [SBA Form 2483](#) (Including, “Is the Applicant or any owner of the Applicant an owner of any other business, or have common management with, any other business? If yes, list all such businesses and describe the relationship on a separate sheet identified as addendum A.”).

6. Affiliation – SBA, in Consultation with the Department of Treasury.

On April 8, 2020 and then again on April 13, 2020, the SBA, in consultation with the Department of Treasury, issued a *Paycheck Protection Program Loans Frequently Asked Questions* (the “SBA/DoT FAQs”). The SBA/DoT FAQs address the affiliation rules under the CARES Act. Importantly, the SBA/DoT FAQs document does not carry the force and effect of law independent of the CARES Act and regulations on which the FAQs document is based. In any event, the SBA/DoT FAQs document provides as follows in regard to affiliation:

Question: Are small business concerns (as defined in section 3 of the Small Business Act, 15 U.S.C. 632) required to have 500 or fewer employees to be eligible borrowers in the PPP?

Answer: No. Small business concerns can be eligible borrowers even if they have more than 500 employees, as long as they satisfy the existing statutory and regulatory definition of a “small business concern” under section 3 of the Small Business Act, 15 U.S.C. 632. A business can qualify if it meets the SBA employee-based or revenue-based size standard corresponding to its primary industry. . . .

Additionally, a business can qualify for the Paycheck Protection Program as a small business concern if it met both tests in SBA’s “alternative size standard” as of March 27, 2020 [the date the CARES Act was enacted]: (1) maximum tangible net worth of the business is not more than \$15 million; and (2) the average net income after Federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than \$5 million.

A business that qualifies as a small business concern under section 3 of the Small Business Act, 15 U.S.C. 632, may truthfully attest to its eligibility for PPP loans on the Borrower Application Form, unless otherwise ineligible.

[See [SBA/DoT, Paycheck Protection Program Loans Frequently Asked Questions, issued April 13, 2020](#) and [SBA/DoT, Paycheck Protection Program Loans Frequently Asked Questions, issued April 8, 2020](#)].

7. 13 C.F.R. § 121.301 -- *What size standards and affiliation principles are applicable to financial assistance programs?*

As noted above, the principles set forth in [13 C.F.R. § 121.301](#) (titled *What size standards and affiliation principles are applicable to financial assistance programs?*) are specifically referenced by the SBA in its Interim Final Rule issued on April 2, 2020. Except where waived by the CARES Act, those principles are used to determine the size of a particular business concern for purposes of qualifying the applicable business for the Paycheck Protection Program.

Section 121.301 provides, in relevant part, as follows:

- (a) For Business Loans . . . and for Disaster Loans (other than physical disaster loans), an applicant business concern must satisfy two criteria:
- (1) The size of the applicant alone (without affiliates) must not exceed the size standard designated for the industry in which the applicant is primarily engaged; and
 - (2) The size of the applicant combined with its affiliates must not exceed the size standard designated for either the primary industry of the applicant alone or the primary industry of the applicant and its affiliates, which ever is higher. These size standards are set forth in [§ 121.201](#).

See [13 C.F.R. § 121.301\(a\)-\(a\)\(2\)](#) (What size standards and affiliation principles are applicable to financial assistance programs?).

See also [id. at § 121.201](#) (What size standards has SBA identified by North American Industry Classification System codes?).

8. Principles of “Affiliation” – SBA Guide and 13 C.F.R. § 121.301(f)-(f)(8).

The SBA’s [Small Business Compliance Guide: Size and Affiliation](#) (the “SBA Guide”) helps explain the general affiliation rules in a fairly easy-to-read manner. *The SBA Guide is not the law, but it is instructive and should be very helpful to many.*

Subsection (f) of [Section 121.301](#) of the SBA regulations provides a list of eight principles that are used to determining the size and affiliation for purposes of business loans through the SBA. Notably, the SBA may consider all connections between the concern and a possible affiliate. Even though no single factor is sufficient to constitute affiliation, the SBA may find affiliation where there is “clear and convincing evidence based on the totality of the circumstances”. See 13 C.F.R. § 121.301(f)(6).

A truncated version of Subsection (f) is as follows:

Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists. Affiliation under any of the circumstances described below is sufficient to establish affiliation for applicants for SBA’s Business Loan, Disaster Loan, and Surety Bond Programs. For this rule, the Business Loan Programs consist of the 7(a) Loan Program[.] . . . The Disaster Loan Programs consist of Physical Disaster Business Loans, Economic Injury Disaster Loans[.] . . . The following principles apply for the Business Loan, Disaster Loan, and Surety Bond Guarantee Programs:

- (1) ***Affiliation based on ownership.*** . . .
- (2) ***Affiliation arising under stock options, [etc.].*** . . .
- (3) ***Affiliation based on management.*** . . .
- (4) ***Affiliation based on identity of interest -*** . . .
- (5) ***Affiliation based on the newly organized concern.*** . . .
- (6) ***Affiliation based on totality of the circumstances.*** In determining whether affiliation exists, SBA may consider all connections between the concern and a possible affiliate. Even though no single factor is sufficient to constitute affiliation, SBA may find affiliation . . . where there is clear and convincing evidence based on the totality of the circumstances[.] . . .
- (7) ***Affiliation based on franchise agreements.*** . . .
- (8) ***Determining the concern's size.*** In determining the concern's size, SBA counts the receipts, employees (§ 121.201), or the **alternate size standard** (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.
- (9) ***Exceptions to affiliation.*** For exceptions to affiliation, see 13 CFR 121.103(b).

See [13 C.F.R. § 121.301\(f\)-\(f\)\(9\)](#).

9. "Alternative Size Standard" - 13 C.F.R. § 121.301(f)(8).

Subsection (f)(8) of Section 121.301 of the SBA regulations provides that, in determining a business concern's size, the "SBA counts the receipts, employees ([§ 121.201](#)), **or the alternate size standard** (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit." See 13 C.F.R. § 121.301(f)(8).

The SBA/DoT FAQs issued on April 8, 2020, states that a business *can* qualify as a small business concern under the PPP **if the concern meets both tests** in SBA's "**alternative size standard**" as of **March 27, 2020**: **"(1)** maximum tangible net worth of the business is not more than \$15 million; **and (2)** the average net income after Federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than \$5 million."

The current "alternative size standard" was established under the Small Business Jobs Act of 2010 and is contained in [15 U.S.C. § 632a\(a\)\(5\)-\(a\)\(5\)\(B\)\(ii\)](#).

The Small Business Size Regulations are contained in Title 13, part 121 of the Code of Federal Regulations. See [13 C.F.R. §§ 121.101-1206](#).

10. Closing Thoughts.

Under the CARES Act, business concerns with 500 or fewer employees may qualify as eligible recipients of a PPP loan. Some business concerns may have related or affiliated entities whose employees must be aggregated with the concern for purposes of determining whether or not the business concern, together with any “affiliates”, meets the 500 or less employee threshold. The CARES Act waives the affiliation [under section 121.103](#) of title 13, Code of Federal Regulations, but only as to three specific subsets of business concerns.

According to the SBA’s Interim Final rule, a borrower will, in most instances, be considered together with its affiliates for purposes of determining eligibility. In the SBA Interim Final rule, the SBA specifically cites 13 C.F.R. § 121.301 for purposes of determining affiliation, and that regulation contains a list of eight principles used to determine whether an affiliation exists for purposes of 7(a) business loans.

The SBA/DoT FAQs suggests that a business concern *can* qualify for a Paycheck Protection Program loan if the business meets the “alternative size standard” as of March 27, 2020. However, the SBA is not restricted to considering only the principle of “alternative size standard” when determining whether an affiliation exists. *See and compare* [13 C.F.R. § 121.301\(f\)](#) (stating that “Affiliation under any of the circumstances described below [in subsections (f)(1)-(8)] is sufficient to establish affiliation for applicants for SBA’s Business Loan), *with id.* at § 121.301(f)(8) (stating that “In determining the concern’s size, SBA counts the receipts, [employees \(§ 121.201\)](#), or the [alternate size standard](#) (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.”).

A business concern *may* qualify for a PPP loan if the business meets the “alternative size standard” and the SBA decides to use the alternate size standard. However, that principle is but one principle in a list of eight principles prescribed by the SBA regulations set forth in 13 C.F.R. § 121.301(f) for determining whether or not an affiliation exists for purposes of 7(a) business loans. Perhaps the SBA and the Department of Treasury intends to relax the other principles set forth in 13 C.F.R. § 121.301(f), but the SBA/DoT FAQs do not carry the force and effect of law upon which the FAQs are based, being the CARES Act and establish regulations.

The “alternative size standard” may provide PPP loan opportunity to affiliated companies who may have thought that they were ineligible based on the number of employees of their affiliated entities. However, prospective borrowers should use caution in relying *solely* on the “alternative size standard”, but perhaps that may be the one avenue for some business concerns to obtain a favorable qualification determination for a PPP loan.