

Think You're Over 500 Employees? Don't Stop Yet – PPP Eligibility is Still Possible

Employers are anxious to take advantage of the Paycheck Protection Program (“PPP”) loans available under the Coronavirus Aid Relief and Economic Security Act (“CARES Act”), which offer forgivable loans to employers who maintain payroll for an eight-week period after obtaining the funds.

Eligibility for a PPP loan is, in broad strokes, available to employers with fewer than 500 employees. In addition, businesses that are “affiliated” with other businesses are generally combined to constitute an “affiliated group” and such affiliation can put the total number of employees over 500.

But business leaders who assume that the analysis ends there could be missing out on the opportunity to participate in the program. It is important to consider some of the options that can allow eligibility for business that appear to be disqualified at first glance.

Who's Your Affiliate?

If your business is connected with other businesses via common ownership or management or in certain other ways, then you will need to undertake an analysis of which other businesses will be deemed an “affiliate” under the Small Business Administration (“SBA”) rules for business loans. Your business will be considered together with all of its “affiliates” for purposes of meeting the employee and size tests that determine PPP eligibility.

CARES Act Exclusions. The text of the CARES Act, however, provides some immediate clarity for certain businesses. The Act provides three general exceptions to the affiliation rules:

- Most franchises are exempt from being affiliated with other franchisees.
- Restaurants and places of accommodation (primarily hotels and motels) will be eligible on the basis of a single physical location and will not be affiliated with other locations of the same chain.
- Businesses that are connected with a type of investor classified as a Small Business Investment Company will not be affiliated with other companies with the same investor.

Less Restrictive Rules Apply. If you don't fall into one of those three exceptions, you may have started looking at the SBA's [Small Business Compliance Guide: Size and Affiliation](#). And you would be in the right place – mostly.

On page 3, the SBA notes that its primary set of “affiliation” rules (13 C.F.R. §121.103) applies *except* for “Business Loans.” Since the PPP loans are “Business Loans” for purposes of the SBA statutory authority, you will instead find the applicable regulations at 13 C.F.R. §121.301(f). This means you can ignore some of the more detailed sections of the Compliance Guide – but it is important to know which ones!

These affiliation rules **will** apply for purposes of PPP applications:

- Affiliation based on equity ownership;
- Affiliation based on stock options, convertible rights or similar contractual ownership arrangements;
- Affiliation based on common management;
- Affiliation based on “identity of interest” – which includes the economic interests of persons closely related to ownership;
- Affiliation of a newly organized concern with the entity of which it is an offshoot; and
- The “totality of the circumstances” test that can apply affiliation even if no one factor is alone sufficient to result in affiliation.

In addition to the specific exclusions in the CARES Act, these affiliation rules **do not** apply for purposes of PPP applications since they do not apply to SBA “Business Loans”:

- Affiliation based only on economic contractual relationships (as opposed to agreements related to ownership);
- Affiliation based on participation in a joint venture;
- Affiliation based on a contractor-subcontractor relationship;
- Affiliation based on a license agreement.

Be aware, of course, that any one of the “affiliation” tests can result in a finding of affiliation. And you will certify your application based on your understanding of the “affiliated group” that applies to your business.

Can We Dis-Affiliate? You may find that the SBA will consider you “affiliated” with another business and the result is that your “affiliated group” will likely not qualify for a PPP loan. Is there a way out? Yes ... depending on how flexible your ownership structure may be.

The initial guidance from the SBA and the U.S. Treasury on PPP loans recognized the potential for “affiliation” rules to disqualify some businesses with investors such as venture capital firms, private equity firms or owners of larger business concerns.

The guidance only expressly applied to “minority shareholders,” and permits a minority investor to “irrevocably” “waive” or “relinquish” rights that give rise to affiliation and render such investor “no longer an affiliate” for purposes of the SBA rules.

Can a “majority shareholder” or other person or business deemed to be an “affiliate” similarly “waive” or “relinquish” rights and thus dis-affiliate? The guidance does not state so expressly, but other SBA materials indicate that a business that dis-affiliates prior to the application could be considered “no longer an affiliate”

The SBA Compliance Guide states that for a receipts-based test, receipts of a former affiliate are excluded if the affiliation ceased before the date used for determining size. There is an identical statement for employee-based determinations. The date referred to appears to be the date upon which your business self-certifies as eligible for a PPP loan.

In theory, then, if your business is in a position to dis-affiliate in order attain PPP eligibility, it can do so and treat the dis-affiliated entity as “no longer an affiliate” on its application.

Such a dis-affiliation may provide a means to keep your business under the 500-employee limit, but it must be done in a proper, legally binding manner.

Still Over 500? There Are Still Options!

Your business still may not find a way under the 500-employee limit due to affiliation that cannot be waived or eliminated. Or it may just have more than 500 employees even without any affiliation. Is all hope of a PPP loan gone? Not yet!

The SBA Business Loan requirements offer two other ways to qualify despite being an employer or part of an affiliated group that has more than 500 employees.

Industry Size Standard. PPP eligibility is based on status as a “small business concern” under SBA guidelines. As an alternative, employers that would not be a “small business concern” under the SBA rules are eligible anyway if they have fewer than 500 employees.

This also works the other direction, however. Businesses (or affiliated groups) with more than 500 employees can nevertheless be eligible if the “industry size standard” can be met.

Each industry with a North American Industry Classification System (“NAICS”) code is assigned an “industry size standard” by the SBA. The full table is available [here](#). The standard is based on either “annual receipts” or “average employment” for a given industry. A business engaged in more than one industry may need to rely on the code applicable to its “primary function.”

If your business qualifies as a “small business concern” under the industry size standard, then it will be eligible for a PPP loan regardless of number of employees.

Alternative Size Standard. Finally, if your business or affiliated group is over 500 employees and does not meet the industry size standard, you still may make it under the “alternative size standard” originally adopted in the Small Business Jobs Act of 2010 and set forth at 15 U.S.C. §632(a)(5).

The “alternative size standard” is designed to open the door to businesses that otherwise would be eliminated from consideration for SBA loans.

To satisfy the “alternative size standard,” your business must meet *both* prongs of a two-part test:

- (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.

An applicant who can certify as to both prongs of the “alternative size standard” will be eligible as a “small business concern” even if the other tests are not met.

The Treasury has instructed PPP lenders that they do not need to conduct their own due diligence as to PPP eligibility. Instead, lenders are to rely on self-certification of the applicant.

The application asks the borrower to certify that “the information provided in this application and the information provided in all supporting documents and forms is true and accurate in all material respects.” Further, the applicant acknowledges that: “knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law.”

Therefore, applicants seeking to qualify under the alternative options stated above should consider the legal implications of making such a certification before submitting an application on that basis.

Vandenack Weaver attorneys can help businesses make those determinations when considering eligibility. Call us at 402-504-1300 or submit a request for a consultation through our website at www.vwattys.com.