



**Laurie Rogers**

Of Counsel  
303.473.2866  
Boulder  
LSRogers@hollandhart.com



**Timothy Crisp**

Partner  
303.295.8000  
Denver, Salt Lake City, Santa Fe  
TSCrisp@hollandhart.com

# Paycheck Protection Program: Eligibility and Affiliation Rules

**Insight — 04/09/2020**

On the heels of the Paycheck Protection Program (PPP) Interim Final Rule issued on April 2, 2020, the Treasury Department and the Small Business Administration (SBA) released additional PPP guidelines in the form of FAQs on April 6, 2020.

The additional guidance helps clarify key provisions of the CARES Act surrounding eligibility requirements for a PPP loan and the applicable SBA affiliation rules.

## Three Methods of Eligibility

- 500 or fewer employees, including employees of affiliates.
- Meeting the SBA size standard corresponding to a business's primary industry. A size standard is stated in number of employees or average annual receipts (depending on the business's industry) and represents the largest size that a business (including subsidiaries and affiliates) may be to remain classified as a small business for the PPP loan.
  - Use the SBA's Table of Small Business Size Standards to determine the largest your business can be to qualify as a small business.
- Meeting both tests in the SBA's "Alternative Size Standard" as of March 27, 2020.
  - Maximum tangible net worth of the business is not more than \$15 million; and
  - Average net income after federal income taxes (excluding carry-over losses) for the two fiscal years before the date of the application is not more than \$5 million.

## SBA Affiliation Rules

To determine a business's eligibility for a PPP loan using the employee headcount or average annual revenue tests, a business must count both its average annual receipts or employees (as the case may be) and those of all of its domestic and foreign affiliates. Generally, affiliation exists when one business controls or has the power to control another business or when a third-party business controls or has the power to control both businesses. Control arises through ownership, management, or other relationships between the businesses. Some examples of affiliation include:

- *Affiliation through ownership.* A business is an affiliate of an entity

that owns or has the power to control more than 50 percent of the concern's voting equity. In general, options and warrants exercisable for, and debt instruments convertible into, voting equity will be counted as though they were exercised or converted. Control can occur through outright ownership or the right to vote the equity, such as through a voting trust. Affiliation can also arise from negative controls, including where a minority shareholder or LLC member has the ability to prevent a quorum or block action by the board of directors, shareholders, managers or members. If a minority shareholder or member gives up those rights, the minority shareholder/member would not be an affiliate.

- *Affiliation based on management.* Affiliation arises where the CEO, President, senior officers, partners, or managing members of the business also control the management of one or more other concerns. It also arises where an individual or business controls the board of the borrower and the board of another business.
- *Affiliation based on identity of interest.* Two or more individuals or businesses with an identity of interest may be affiliates. Individuals or businesses with substantially identical business or economic interests may be affiliates. Examples include close relatives who operate businesses in similar industries in the same area, common investments, and economic dependence. The SBA has previously held such identity of interest often exists between a business owner and their spouse, children, parents and in-laws.
- Other affiliation rules apply, including exceptions to affiliation coverage.

If your company is a parent or a subsidiary of another company, or if its management controls other entities, then your company likely has affiliates. This means that in addition to counting the number of employees or annual receipts in your business, you also need to count the employees or annual receipts of each affiliate. PPP eligibility and affiliation rules can be complex.

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*We encourage you to visit Holland & Hart's Coronavirus Resource Site, a consolidated informational resource offering practical guidelines and proactive solutions to help companies protect their business interests and their workforce. The dynamic Resource Site is regularly refreshed with new topics and updates as the COVID-19 outbreak and the legal and regulatory responses continue to evolve. Sign up to receive updates and for upcoming webinars.*