

Treasury Issues Interim Regulations on Affiliation Rules Under Payroll Protection Program

On Friday, April 3, 2020 the Small Business Administration (SBA) issued an interim rule on its affiliation rules to further implement the Payroll Protection Program (PPP) under the Coronavirus Aid, Relief and Economic Security Act (CARES Act). This rule becomes effective upon publication in the Federal Register.

Under existing law, the SBA may, under certain circumstances, factor in an applicant's affiliated companies when determining whether a company qualifies as a "small business." The SBA has a specific set of rules that explain when another person, business, or entity is considered an "affiliate" for size purposes. The CARES Act already waived the SBA's affiliation rules for businesses in the restaurant and hospitality sectors for purposes of PPP eligibility. The new rule has no effect on these statutory waivers, which remain in full force and effect. The new rule, however, provides additional relief to faith-based organizations from the SBA's affiliation rules.

The SBA confirmed in the rule that, in most cases, a borrower will be considered together with its affiliates for purposes of determining eligibility for the PPP. The rule exempts otherwise qualified faith-based organizations from the SBA's affiliation rules where the application of the affiliation rules would substantially burden those organizations' religious exercise.

The SBA determined this exemption was required, or at a minimum authorized, by the Religious Freedom Restoration Act, which provides that the "[g]overnment shall not substantially burden a person's exercise of religion" unless the government can "demonstrate[] that application of the burden" to the person is both "in furtherance of a compelling governmental interest" and "the least restrictive means of furthering that compelling governmental interest." In this case, the SBA determined that a number of faith-based organization would otherwise qualify for the PPP but for their affiliation with other entities as part of their religious practice. Thus, application of the affiliation rules would in the SBA's view impose a substantial burden and deny these groups an important benefit, i.e., participation in the PPP.

Under the new rule, the SBA's affiliation rules, do not apply to the relationship of any church, convention or association of churches, or other faith-based organization or entity to any other person, group, organization, or entity that is based on a sincere religious teaching or belief or otherwise constitutes a part of the exercise of religion. This includes any relationship to a parent or subsidiary and other applicable aspects of organizational structure or form.

The SBA further clarified that a faith-based organization seeking loans under the PPP may rely on a reasonable, good faith interpretation in determining whether its relationship to any other person, group, organization, or entity is exempt from the affiliation rules under this provision, and SBA will not assess, and will not require participating lenders to assess, the reasonableness of the faith-based organization's determination.

While the SBA had indicated that further guidance on application of its affiliation rules to the PPP were forthcoming in an interim rule issued earlier this week, many believed the SBA could potentially relax its affiliation rules more broadly. For example, the new rule leaves concerns of private equity and venture capital firms unaddressed, who have called upon the SBA to waive its affiliation rules so that businesses in their portfolios would qualify for the loans and not have their employees counted in aggregate. The new rule confirms the affiliation rules apply to nonprofit organizations as well. Whether there will be any further relief for any of these or other industries remains to be seen, but for now this means businesses will be subject to the SBA's general affiliation rules other than: (1) those classified under NAICS Sector 72 (Accommodation and Food Service), (2) any business concern operating as a franchise that is assigned a franchise identifier



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code by the administration; (3) 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); and (4) any faith-based organization as set forth above.

For those businesses not exempt from the SBA's affiliation rules, affiliation is generally all about control. SBA's affiliation rules look to whether one firm has the power to control another, or a third firm has the power to control both. Control may arise through ownership, management, or other relationships or interactions between the parties. It does not matter if control is exercised, so long as the power to control exists.

SBA will consider the totality of the circumstances when determining whether affiliation exists and may find affiliation based on the totality of the circumstances even though no single factor alone may be sufficient to constitute affiliation. If SBA determines that affiliation exists, then SBA will count the receipts, employees, or other measure of size for the concern whose size is at issue combined with the receipts, employees, or other measure of size for all of its domestic and foreign affiliates.

Please contact your Cozen O'Connor relationship attorney or a member of our Small Business team if you have questions or would like additional information.