



BUSINESS SIZE REQUIREMENTS AND AFFILIATION RULES FOR SBA LOAN ELIGIBILITY UNDER THE CARES ACT

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The recently-enacted Coronavirus Aid, Relief, and Economic Security (CARES) Act provides, among other relief measures, \$349 billion in forgivable loans under a new economic relief program under the Small Business Administration (SBA) known as the Paycheck Protection Program (PPP) in order to incentivize small businesses to retain and/or re-hire workers. The CARES Act also provides that applicants for an Economic Injury Disaster Loan (EIDL), a separate SBA loan program which has been available since before the CARES Act upon a disaster declaration, may request an emergency advance, which need not be repaid, of up to \$10,000 (EIDL Grants). Please refer to the previous discussion of the PPP and EIDL SBA programs, updated as of April, by clicking [here](#).

Eligibility for the SBA relief programs under the CARES Act may seem straightforward, but the existing size requirements and affiliation rules for SBA programs reveal otherwise. These factors may be important for clients such as private equity, family offices, venture capital portfolio companies, real estate investment or management companies, angel investors, businesses owned by close relatives, businesses with management agreements, and others due to the variety of business relationships in which the SBA may find affiliation. Thus, it is important for businesses who desire to apply for SBA relief programs under the CARES Act to evaluate their eligibility for such programs in light of the existing size requirements and affiliation rules applicable to other SBA programs.

1. What are the size eligibility requirements for SBA loans?

Even prior to the CARES Act, a business's eligibility for SBA loan programs depended, in part, on whether such business meets the SBA's criteria for a "small business concern." Under the SBA regulations, a "small business concern" is defined as a business entity which:

- a) is organized for profit, has a place of business located in the U.S., and either (i) operates primarily in the U.S. or (ii) makes a significant contribution to the U.S. economy by paying taxes or using American products, materials, or labor; and
- b) falls within the particular size standard, determined in accordance with the North American Industrial Classification System (NAICS) Code applicable to such business, which are based either on a business's average number of employees or its average annual receipts. A table of the SBA size standards matched to NAICS codes can be found [here](#).

Employee-Based Size Standards. When the NAICS size standard applicable to a business is based on the number of employees, such business must determine the average number of employees of the business – *including* the number of employees of its domestic and foreign affiliates – by calculating the sum obtained by adding together the number of employees in each of the pay periods during the preceding 12 calendar months and then dividing such sum by the number of pay periods in the preceding 12 calendar months.

For example, assume B is a business subject to an employee-based size standard and it pays its employees monthly. Its number of employees in each of the preceding pay periods during the preceding 12 calendar months (April 2019 to March 2020) was as follows:

4/2019 5/2019 6/2019 7/2019 8/2019 9/2019 10/2019 11/2019 12/2019 1/2020 2/2020 3/2020

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B's number of employees would be calculated as follows: The sum of the employees in each pay period during the preceding 12 calendar month (4,895), divided by the number of pay periods during the preceding 12 calendar month (12) is about 407.92 employees.

Note that the SBA counts all individuals employed on a full-time, part-time or other basis as well as employees from temp agencies.

Annual Receipts-Based Size Standards. For a business with an annual receipts-based size standard, the amount of "annual receipts" is the sum of the business's "total income" plus "cost of goods sold" (as such terms are used on IRS tax return forms). A sole proprietorship would substitute the "total income" with "gross income" in calculating its annual receipts. If a business has been in existence for three or more years, its annual receipts are calculated as the sum of its annual receipts over the most recently completed three fiscal years, divided by three.

2. How are the SBA size eligibility requirements applied under the CARES Act?

Paycheck Protection Program Loans (PPP Loans). Congress expanded the SBA loan size eligibility requirements for PPP Loans under the CARES Act. The PPP provides that, during the covered period (February 15 through June 30), “*in addition to small business concerns*, any business concern, nonprofit organization, veterans organization, or Tribal business” shall be eligible to receive a PPP Loan if such business concern or organization employs not more than the greater of:

- a) 500 employees, or
- b) the number of employees permitted under the applicable employee-based size-standard, if any, for such business's industry.

Additionally, PPP Loans are available to:

- sole proprietorships, independent contractors, and self-employed individuals; and
- businesses in the accommodation and food service industries with NAICS codes beginning with 72 (e.g., restaurants and hotels) with more than one physical location, so long as they employ fewer than 500 employees at each location.

PPP Loans will clearly be available to businesses that meet employee-based size standards set forth above. However, the “in addition to small business concerns” language in the criteria described above leaves an open question as to whether a business with more than 500 employees would be eligible if it otherwise constitutes a “small business concern” under an **annual receipts-based** size standard. We expect the SBA will likely clarify this point soon as it continues to issue guidance and regulations for PPP Loans. **Importantly, unless an exception applies, a business must also evaluate the size of each of its affiliated companies when determining its own size.** Please see Question #3 below for more detail on this point.

According to recent SBA and Treasury guidance, participating lenders may begin processing PPP Loan applications from (i) small businesses and sole proprietors as soon as **April 3** and (ii) independent contractors and self-employed individuals as soon as **April 10**. You can find a sample form of the application [here](#).

EIDLs and EIDL Grants. The EIDL program is available only to organizations which were small businesses or private non-profit organizations at the time that the declared disaster (here, the COVID-19 pandemic) commenced. An applicant is a small business eligible for EIDL loans and grants if it meets both of the following criteria:

- a) the size of the applicant – *without* taking into account its affiliates – must not exceed the size standard designated for the industry in which the applicant primarily conducts business; **and**
- b) the size of the applicant – *together* with its affiliates – must not exceed the size standard designated for either (i) the primary industry of the applicant *alone*, **or** (ii) the primary industry of the applicant *and its affiliates*, whichever is higher.

3. How do the affiliation rules work in determining eligibility for sba loans under the cares act?

The affiliation rules are convoluted and not addressed very well on the brief [sample application](#). Whether a portfolio company of a private equity or venture capital firm is affiliated with its sponsor or with other portfolio companies will depend on the particular facts and circumstances and whether the existing affiliation standards will apply. If such standards are applied consistent with prior interpretation (we don't yet know the answer to this), it may limit the ability of private equity or venture capital portfolio companies to access these funds, which would seem to be contrary to the policy behind the CARES Act. Our recommendation is to mention the concern directly to your banker. Please let us know if you need assistance identifying a banker who is familiar with the PPP loans.

Essentially, if the SBA determines that existing affiliation standards will apply, a business determining its size will have to identify and include the annual receipts or the number of employees of its affiliates when determining whether it meets the applicable size standard, unless an exception applies, such as provisions in the CARES Act waiving the affiliation rules in certain circumstances. Under the CARES Act, the affiliation rules are waived for:

- Any business in the accommodation and food service industries with an NAICS code beginning with 72 (e.g., a restaurant, hotel, etc.) which has not more than 500 employees as of the date on which the loan is disbursed;
- Any business which operates as a franchise and has been assigned an SBA franchise identifier code; and
- Any business that receives financial assistance from a Small Business Investment Company (SBIC).

Absent any applicable exception, the SBA commonly considers percentage ownership, minority rights under the operating agreement, and relationships among the parties as relevant factors. We have provided a summary of such factors below.

Affiliation based on Ownership. If an individual, concern, or entity that owns or has the power to control more than 50% or more of another concern's voting equity. For example, suppose B is determining its size under an employee-based size standard. If C owns 50 percent or more of A's and B's voting equity, B must include the number of employees of A, B, and C in determining how many employees B will be deemed to employ. Please note that, because Z controls company Y, Y also is affiliated with every other business that company Z controls.

Alternatively, a party whose stock options allow its equity interests in a business to meet or exceed 50% will be deemed to be a 50% owner and to hold control of such business, even if the options are not exercised.

Finally, in the case of business of which no individual, concern or entity is found to control 50% or more of the voting equity, the SBA will deem the board of directors, president, CEO or any other party(ies) who have management authority over such business to be in control.

Affiliation based on Management. If the management of one business concern also controls another business concern, those businesses will be affiliates for size purposes. This is true if management of the applicant is controlled through a management agreement.

Affiliation based on Identity of Interest. If two or more firms are economically dependent on each other through close business relationships or have identical or substantially identical business or economic interests, the SBA may find such firms to be affiliates. For example, the SBA may find affiliation between businesses where close relatives operate similar businesses. The SBA may also find affiliation where a substantial portion of multiple concerns in the same or related industries are owned by the same individuals or firms, or among similar business which share resources, equipment, locations, or employees.

Affiliation and Angel Investor. A minority shareholder may be deemed to be in control if that individual or entity has the ability to prevent a quorum or otherwise impede the majority's ability to conduct day-to-day business operations (i.e., more than the ability to block extraordinary actions like dissolution or liquidation of the company).

The above summary is intended to be brief and to highlight some of the potential issues which may arise under existing size requirements and affiliation rules. Although the Treasury and SBA will likely issue additional guidance soon, businesses that are considering taking advantage of the SBA programs available under the CARES Act should contact their lenders as soon as possible to express their interest.

If you have questions or would like to discuss further, please contact [Trey DeLoach](#), [Nikki Gibson](#), Ed McQueen or Ira Perez.

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William "Trey" A. DeLoach, III