COVID-19: AFFILIATION & AGGREGATION CONSIDERATIONS FOR THE PAYCHECK PROTECTION PROGRAM AND THE EMPLOYEE RETENTION CREDIT

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Tax Alert

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Many businesses have been evaluating their eligibility for various benefits in the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Two popular incentives include the Paycheck Protection Program (PPP) and the Employee Retention Credit (ERC). The rules and requirements for each form of assistance differ, including the number of employees, qualified wages and expenses, the ability to keep employees on payroll, and the reasons for claiming the assistance. To further complicate matters, the PPP and ERC provisions in the CARES Act each include affiliation and aggregation rules, taking into account both domestic and foreign related parties, that must be considered when determining numerous thresholds that affect a business' eligibility for each incentive. Exacerbating the complexity, the affiliation and aggregation rules differ between the PPP and the ERC. Businesses are not eligible to claim the ERC if they receive a PPP loan.

This alert provides an overview of the affiliation and aggregation rules for the PPP and ERC, respectively, highlighting notable differences and considerations businesses should understand prior to taking advantage of either. Additional information on COVID-19-related legislation and tax guidance can be found here.

AFFILIATION AND AGGREGATION RULES UNDER THE CARES ACT

Paycheck Protection Program

Generally speaking, an entity is eligible for a PPP loan if it and its affiliated entities have 500 or fewer employees in the aggregate. The affiliation rules under the PPP are derived from existing Small Business Association (SBA) regulations, which is not surprising since the PPP is based on the SBA 7(a) loan regime. As established by the SBA, whether businesses are affiliated is based on (1) ownership, including the ability to prevent a quorum or block certain actions by the board of directors or shareholders (i.e., negative control); (2) stock options, convertible securities, and agreements to merge; (3) common management; and (4) identity of interest. In general the affiliation rules under the SBA are broader and more likely to sweep in multiple entities as “affiliated” compared to the IRS rules governing the ERC. The SBA rules focus on the ability to control or influence rather than on the actual exercise of control.

Some types of businesses can avoid an affiliation analysis. The CARES Act waives the affiliation rules for certain restaurant and accommodation businesses with no more than 500 employees at each location, certain

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businesses operating as a franchise, and other businesses that received financial assistance from a Small Business Investment Company.

Other applicants that must navigate the affiliation rules often find themselves engaging in a difficult analysis. Although the SBA and the Department of Treasury (Treasury) have issued multiple Interim Final Rules[1] and FAQs[2] that explain how the affiliation rules apply, complex rules and conflicting guidance have resulted in many questions and left some businesses uncertain on whether they qualify for a PPP loan, particularly when foreign parties are involved. For example, companies, together with their affiliates, that have 500 or fewer employees are eligible for a PPP loan. The first two IFRs and SBA FAQ #3 appeared to state that only "employees whose principal place of residence is in the United States" need to be counted for purposes of the 500 employee threshold. As such, many applicants did not include employees of foreign affiliates (whose principal places of residence were outside the United States) in determining their employee counts. However, SBA FAQ #44 (as of May 5, 2020) and another IFR (dated May 18, 2020) clarify that an affiliates' employees regardless of their principal place of residence count toward the 500 employee threshold. Due to the apparent inconsistency in guidance, the SBA created a safe harbor and stated that applicants that submitted an application prior to May 5 will not be subject to the revised standard. Despite providing some comfort for prior applicants, the safe harbor also resulted in disparate treatment among businesses with foreign affiliates depending on when they applied for a PPP loan.[3]

Employee Retention Credit

Aggregation rules under the ERC are derived from existing IRC provisions. Per the CARES Act, all (1) employees and members of the same controlled group of corporations, (2) employees of trades or businesses (whether or not incorporated) which are under common control, and (3) employees and members of an affiliated service group, are treated as a single employer for purposes of the ERC. In general, the aggregation rules under the ERC are more form-driven than those of the SBA and are focused on employer status and actual voting control to determine whether the business is a single employer.

On April 29, 2020, the IRS published FAQs[4] providing guidance for determining which entities are considered single employers under the aggregation rules for purposes of the ERC and how those rules apply for purposes of determining certain thresholds and eligibility for the ERC, including:

- Whether the employer has a trade or business that was fully or partially suspended due to governmental orders related to COVID-19;
- >Whether the employer has a significant decline in gross receipts;
- Whether the employer has more than 100 full-time employees for purposes of determining "Qualified Wages"; and
- Whether the employer is precluded from claiming the ERC if any member of its aggregated group receives a PPP loan.

CONCLUSION

Taxpayers contemplating the PPP and the ERC must realize that the affiliation and aggregation rules for each benefit are not consistent. The PPP affiliation rules focus more on the power to control and the ERC rules focus

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more on the actual exercise of control. It is important to understand the applicable rules for each incentive so businesses do not inadvertently exclude applicable affiliated entities which they have some power to control or influence (or which have the ability to control or influence them) and potentially claim a benefit to which they are not entitled.

For a deeper discussion on how these affiliation and aggregation rules are applied for purposes of the PPP and ERC, and how choosing one or the other might affect your business, please reach out to one of the authors of this alert and/or refer to our CARES Act Tax Summary Guide found at our K&L Gates HUB COVID-19 resource page.

FOOTNOTES

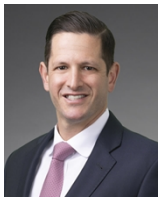
[1] Small Business Administration: IFR "Business Loan Program Temporary Changes; Paycheck Protection Program" (85 FR 20811, effective April 15, 2020), available here; Small Business Administration: IFR Supplement "Business Loan Program Temporary Changes; Paycheck Protection Program", Affiliate Rules for Paycheck Protection Program (85 FR 20817, effective April 15, 2020), available here; Small Business Administration, IFR "Business Loan Program Temporary Changes; Paycheck Protection Program – Treatment of Entities with Foreign Affiliates" (dated May 18, 2020), available here.

[2] Paycheck Protection Program Loans Frequently Asked Questions (FAQs) (As of May 19, 2020), available here.

[3] Small Business Administration, IFR "Business Loan Program Temporary Changes; Paycheck Protection Program – Treatment of Entities with Foreign Affiliates" (dated May 18, 2020), available here.

[4] The IRS has posted a disclaimer on its website stating that the FAQs were not included in the Internal Revenue Bulletin and cannot be relied upon as legal authority.

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