

(UPDATE) PPP Eligibility: Counting Non-U.S. Employees of Foreign Affiliates

The Paycheck Protection Program (PPP), as enhanced by the Paycheck Protection Program and Health Care Enhancement Act, authorizes up to \$659 billion in forgivable loans to eligible small businesses to help pay their employees during the COVID-19 crisis. Under the Interim Final Rules as published in the Federal Register and effective on April 15, 2020 (“Initial Interim Final Rules”), a business will be eligible, among other potential grounds for eligibility, if, combined with its affiliates, it “has 500 or fewer employees whose principal place of residence is within the United States.”

For many entities, the question becomes how is the number of employees calculated for eligibility purposes. This requires application of various regulations and guidance with respect to what employees are counted, including with respect to when employees of related entities must be aggregated under “affiliation” rules.¹ An issue of particular uncertainty relates to businesses that have fewer than 500 employees residing in the United States, but that have employees, or affiliated employees, which, if aggregated, would result in more than 500 employees worldwide. Does the business have to count employees “whose principal place of residence” is not within the United States?

This issue has been the source of considerable confusion, to the point where even the SBA admits they’ve been unclear. Ultimately it appears the SBA has switched their position in the middle of the program.

The Initial Interim Financial Rule seemed straightforward since it specifically limited the standard to employees “whose principal place of residence is within the United States.” This limiting language was repeated in multiple sources of SBA guidance and further rule releases, including in the SBA released Frequently Asked Questions (FAQs) published on April 6, which generally clarified that a business does not have to qualify as a “small business concern” as defined under the Small Business Act in order to participate if “the business has 500 or fewer employees *whose principal residence is in the United States.*”

¹ The Initial Interim Final Rules provide some notable exceptions to the affiliation rules, including for the accommodation and food services sector.

In early May, however, the SBA began to shift position, without directly addressing the issue. On May 5, the SBA released FAQ #44, which addresses the application of the SBA's affiliation rules with regard to counting the employees of foreign and U.S. affiliates. It says, "For purposes of the PPP's 500 or fewer employee size standard, an applicant must count all of its employees and the employees of its U.S. *and foreign affiliates*, absent a waiver of or an exception to the affiliation rules."

After FAQ #44, there was debate about how to interpret this seemingly inconsistent guidance. Some commentators read the reference in FAQ # 44 to "foreign affiliates" to mean that an applicant must include worldwide employees of foreign affiliates, and that the SBA, in considering eligibility, will disregard the reference in the original rule that would otherwise limit counting to U.S.- resident employees.

On the other hand, FAQ # 44, on its own, could have been read consistently with previous statements that employees will only be counted if they reside in the United States. For example, when it says that all employees of foreign and U.S. affiliates must be counted, it could mean that if a U.S. company has employees that reside in the U.S., and a foreign affiliate of that U.S. company has employees that reside in the U.S., those two sets of U.S. residing employees must be counted together. This position arguably was a reasonable, if not stronger, interpretation. Where possible, guidance should be read as consistent with, not contradictory to, the rules, and FAQs are not afforded as great a weight of authority as the Interim Final Rules. Furthermore, FAQ #44 does not specifically address the question of employees not resident in the United States – it is about affiliation. The SBA may just have left out the additional residency language inadvertently since that was not the core issue of the question. If the SBA was going to completely break with previously clear explicit statements, the argument would go that they would have to make a clear statement to that effect.

To alleviate the confusion, on May 18, 2020, the SBA came out with a new Interim Final Rule ("New Foreign Employee Rule") which directly states that for purposes of eligibility under the 500 or fewer employee size standard, the applicant must include the U.S. and foreign employees of itself and its affiliates. The New Foreign Employee Rule technically does not come into effect until published in the Federal Register, but since it is publicly available, it should be followed immediately.

Notably, however, the story doesn't completely (or clearly) end there either. The New Foreign Employee Rule itself admits "Some market participants have indicated that there may be uncertainty regarding whether PPP applicants must include employees of foreign affiliates in their employee counts,

because SBA has previously issued guidance stating that an entity is eligible for a PPP loan if it has 500 or fewer employees *whose principal place of residence is in the United States*. See 85 FR 20811, 20812 (April 15, 2020).” The New Foreign Employee Rules further go on to say “[A]s an exercise of enforcement discretion due to reasonable borrower confusion based on SBA guidance (which was later resolved through a clarifying FAQ on May 5, 2020), SBA will not find any borrower that applied for a PPP loan prior to May 5, 2020 to be ineligible based on the borrower’s exclusion of non-U.S. employees from the borrower’s calculation of its employee headcount if the borrower (together with its affiliates) had no more than 500 employees whose principal place of residence is in the United States. Such borrowers shall not be deemed to have made an inaccurate certification of eligibility solely on that basis.”

What about PPP applications between the May 5 safe harbor and the May 18 release of the New Foreign Employee Rule? Since the May 5, 2020 release of FAQ #44 was the first time the SBA gave any indication of including non-U.S. resident employees, it is unclear how that release “resolved” the issue as the SBA suggests. Before May 5, there was no issue - it was clear that only employees residing in the U.S. would be counted based on the explicit language continuously repeated by the SBA. The fact that the SBA published an entire Interim Final Rule two weeks after FAQ #44 also seems to support the argument that FAQ #44 was not the source of clarification, but of confusion. In a previously published FAQ #17, the SBA had stated “Borrowers and lenders may rely on the laws, rules, and guidance available at the time of the relevant application. However, borrowers whose previously submitted loan applications have not yet been processed may revise their applications based on clarifications reflected in these FAQs.” There is a reasonable argument that before the New Foreign Employee Rules on May 18, the guidance available at the time still suggested eligibility was based solely on U.S. resident employees.

Therefore, it is now clear that after May 18, borrowers and their affiliates must have fewer than 500 employees worldwide to be eligible for the PPP program. Borrowers who applied prior to May 5, however, based on having fewer than 500 employees in the United States will not be subject to enforcement pursuant to the SBA’s explicit safe harbor. There is a lack of clarity with respect to borrowers who applied for PPP relief between May 5 (the end of the safe harbor) and May 18 (the public announcement of the New Foreign Employee Rule), as well as the availability of loan forgiveness for the previously applied for loans. Those who have questions resulting from this remaining uncertainty should seek additional guidance from legal counsel.

If we can be of assistance and to discuss various options and specific situations, please feel free to contact any of the Buchalter Corporate Attorneys.



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