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New Payment Protection Program Rule Regarding Foreign Affiliates Complicates Eligibility Analysis for Borrowers

On May 18, 2020, the Small Business Administration (the “SBA”) published a new Interim Final Rule (the “New Foreign Affiliate Rule”) under the Paycheck Protection Program (the “PPP”), addressing the treatment of foreign affiliates when calculating a PPP borrower’s eligibility based on employee count. The New Foreign Affiliate Rule purports to clarify prior guidance issued by the SBA in the Frequently Asked Questions published from time to time on the U.S. Department of the Treasury’s website (the “FAQs”). Borrowers should review the New Foreign Affiliate Rule and consider whether it impacts their eligibility determinations under the PPP.

Noting that there is uncertainty among certain market participants, the New Foreign Affiliate Rule states that when determining whether a borrower has more than 500 employees, the borrower must include **all** employees of its domestic **and** foreign affiliates (except where the PPP expressly states that affiliation rules do not apply). The SBA has said that the New Foreign Affiliate Rule is intended to clarify the guidance in FAQ number 44 published on May 5, 2020, but the new guidance appears to be directly contrary to SBA’s guidance provided by FAQ number 3 published on April 6, 2020. FAQ number 3 states that a business is eligible for a PPP loan if it “has 500 or fewer employees whose principal place of residence is in the United States.” Many applicants likely calculated the number of employees of their affiliates by including only employees whose principal place of residence is in the United States on the basis of this now superseded guidance.

The New Foreign Affiliate Rule may lead to anomalous results, such as the following:

- A company has 715 employees worldwide, but only 480 that have a principal place of residence in the United States, and no affiliates. Prior to May 5, 2020, this company would be under the safe harbor described below, and this business would have been eligible under the guidance in FAQ number 3. However, under the New Foreign Affiliate Rule, this company would not be eligible on or after May 5, 2020.
- Another company has one affiliate. The company and its affiliate have a combined 501 employees worldwide. This company has 400 employees, all of whom have a principal place of residence in the United States and its affiliate has 101 employees, all of whom do not have a principal place of residence in the United States. This company is not eligible for a PPP loan on or after May 5, 2020, based on the New Foreign Affiliate Rule.

To the relief of some borrowers, the SBA has mitigated the impact of this new guidance by granting a safe harbor to borrowers who applied for a PPP loan prior to May 5, 2020. Those borrowers will not be found to be ineligible for a PPP loan based on their exclusion of non-U.S. employees from the 500-employee calculation if the borrower and its affiliates had no more than 500 employees whose principal place of residence is in the United States. The New Foreign Affiliate

Rule points to FAQ number 44, which was published on May 5, 2020, and states that an applicant must count all of its employees and the employees of its U.S. and foreign affiliates for purposes of the PPP's size standard.

Borrowers that applied for a PPP loan on or after May 5, 2020 should reassess their employee count to the extent that it excluded any foreign employees of it or its affiliates on the basis of the guidance in the New Foreign Affiliate Rule.

The New Foreign Affiliate Rule also notes that the SBA's prior guidance regarding employees whose principal place of residence is in the United States remains applicable to a borrower's calculation of payroll costs for purposes of determining the PPP loan amount and the calculation of loan forgiveness—*i.e.*, **only** the payroll costs for U.S. resident employees are eligible for inclusion in these calculations.

We are available to assist our clients in assessing the impact of the New Foreign Affiliate Rule on their eligibility for a PPP loan.

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