

PPP Loan Guidance When There's a Change of Control

By Jonathan Moore, CPA, CM&AA, Partner

When it comes to merger and acquisition activity, 2020 may very well become the year of “two halves.” After a significant decrease in M&A activity as a result of the pandemic in the first half of the year, we're now seeing a notable increase in deals. According to *Mergermarket*, M&A activity in the U.S. declined 65% in deal value from Q1 to Q2 and roughly 45% in number of deals. More recently, between Q2 and Q3, M&A activity increased by 400% in deal value, with 1,036 deals totaling \$402 billion.

With M&A activity on the rise, it's important that buyers and sellers familiarize themselves with potential restrictions to a change in ownership and the related requirements of PPP Borrowers if a merger or combination of entities is contemplated or in the works.

PPP Loan Restrictions

With over 5 million companies receiving Paycheck Protection Program (PPP) loans (of these, more than 650,000 received loans exceeding \$150,000 according to the U.S. Treasury), Buyers and Sellers contemplating a transaction were unsure how to address these loans, which resulted in different approaches. Adding to the confusion were different interpretations by Lenders and advisors of language in the PPP loan application regarding “change of ownership” restrictions.

On October 2, 2020, the Small Business Administration (SBA) issued a [Procedural Notice](#) providing guidance concerning the required procedures for changes of ownership of an entity that has received PPP funds. Included in the Notice is clarification that there are no restrictions on a change of ownership **if**:

- Prior to closing the sale or transfer, the Borrower has either repaid the PPP note in full **or** completed the loan forgiveness process.
- The SBA has remitted funds to the PPP Lender in full satisfaction of the PPP note **or** the PPP Borrower has repaid the portion of the loan that was not forgiven.

Definition of “Change of Ownership”

The SBA defines a change of ownership when the following occurs (in one or more transactions since the PPP loan was approved):

- At least 20% of the common stock or other ownership interest of the PPP Borrower is sold or otherwise transferred, including to an affiliate or an existing owner of the entity;
- The PPP Borrower sells or otherwise transfers at least 50% of the fair market value of its assets;
- A PPP Borrower is merged with or into another entity.

Required Notifications and Approvals

The PPP Borrower must notify the PPP Lender in writing of any contemplated change in ownership and provide the PPP Lender with a copy of the proposed agreements or other documents that would effectuate the transaction prior to the closing of any change in ownership.

When the PPP note is not fully satisfied, the PPP Lender may approve the change of ownership without prior approval of the SBA in these cases:

- The sale or other transfer is of 50% or less of the common stock or other ownership interest of the PPP Borrower; **or**
- For sales of 50% or more of the stock **or** 50% or more of the fair market value of the PPP Borrower's assets, the PPP Borrower completes a forgiveness application reflecting its use of all of

the PPP loan proceeds and submits it with any required supporting documentation to the PPP Lender, and an interest-bearing escrow account controlled by the PPP Lender is established with funds equal to the outstanding balance of the PPP loan. After the forgiveness process, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest.

SBA prior approval is required for sales exceeding 50% or more of the stock or assets if a PPP Borrower is unable to establish the required escrow account. In addition, the PPP Lender must include the following information when submitting a request to the appropriate SBA Loan Services center:

- Reason why the PPP Borrower cannot fully satisfy the PPP note or fund the escrow;
- Details of the transaction;
- Copy of the PPP note;
- Any letter of intent and the purchase or sales agreement setting forth the responsibilities of the PPP Borrower, Seller, and Buyer;
- Disclosure about the Buyer's existing PPP loan (if any); and
- List of all owners of 20% or more of the Buyer.

The SBA will review and provide a determination within 60 calendar days of receiving a completed request and may require additional measures as a condition of its approval. Noteworthy in an asset transaction is the SBA's requirement that the Buyer assume all of the PPP Borrower's obligations, including responsibility for compliance with the PPP loan terms. The assumption of these obligations will need to be included in the purchase and sale agreement or submitted to the SBA in a separate assumption agreement.

Continuing Obligations

Even if the transaction is structured as a stock sale or merger, the PPP Borrower will remain subject to all obligations under the PPP Loan. Furthermore, the SBA stated it will have recourse against the original owners for any unauthorized use of PPP funds by the new owners.

If a purchaser or new owner has a separate PPP loan, the SBA noted that the PPP Borrower and the new owner are responsible for segregating and delineating PPP funds and expenses for each Borrower and demonstrating compliance with PPP requirements with respect to both PPP loans.

Snapshot of SBA Notice

While not providing all of the answers, the SBA Notice does clarify these important matters:

- Sellers do not have to accelerate the forgiveness application process, especially if they are still expending funds on qualified expenditures in the 24-week covered period.
- More than one PPP Loan may be outstanding after the completion of a transaction.
- Buyer's will be required to assume the PPP Borrower's obligations with the SBA in a transaction structured as an asset sale (i.e., 50% or more of the fair market value of the assets). As a result, Sellers should expect additional indemnifications and, likely, an escrow of sales proceeds.
- PPP lenders may approve a change of ownership without prior SBA approval in certain situations.

Contact Us

For assistance in understanding these and any other rules related to the PPP loan, please reach out to your PKF O'Connor Davies team members, or email us at LoanForgiveness@pkfod.com. We are here to help.

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