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IRS Issues Favorable Guidance Addressing Certain Risks of Paycheck Protection Program Loans in M&A Transactions

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In a COVID-19: Paycheck Protection Program Loans May Lead to Unanticipated Costs in Certain M&A Transactions resource dated May 29, 2020, we identified a potential obstacle in M&A transactions involving companies benefitting from two different types of relief under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)—the Paycheck Protection Program (PPP) and the Employee Retention Credit (ERC). That obstacle no longer exists due to very favorable informal guidance issued by the Internal Revenue Service (IRS) on November 16, 2020.

BACKGROUND

The PPP and the ERC are mutually exclusive relief programs designed to encourage employers to retain their workforces during the COVID-19 pandemic. The interplay between the two created significant concern that if a company claiming (or planning to claim) the ERC acquired a PPP loan recipient, the buyer (and all its affiliates) might lose their ERC eligibility and have to repay any previously claimed credits. The IRS guidance issued on November 16, 2020, came in the form of revised FAQs about the interaction between the ERC and PPP rules. Under this guidance, buyers remain eligible for the ERC and, as long as the target's PPP loan has been satisfied before the closing or is not assumed by the buyer, the target effectively gets a clean slate and also becomes eligible to claim the ERC after the closing.

The guidance draws distinctions between transactions that are purchases of the target's equity interests (Stock Deals) and transactions that are purchases of some or all of the target's assets (Asset Deals).

Stock Deals.

- *Satisfied PPP Loan*. If, at closing, the target has already satisfied its PPP loan (whether through repayment or forgiveness) or submitted a forgiveness application to the Small Business Administration (SBA) and established an escrow, the ERC eligibility of the buyer and its pre-closing affiliates will not be affected by the acquisition and, if otherwise eligible, even the target can claim the ERC for wages paid after the closing.
- *Unsatisfied PPP Loan*. If, at closing, the target's PPP loan has not been satisfied (and no forgiveness application has been submitted and no escrow established), the ERC eligibility of the buyer and its pre-closing affiliates will not be affected by the acquisition, but the target will remain ineligible for the ERC after the closing.

Asset Deals.

- *No Assumption of PPP Loan.* A buyer that acquires the assets of a PPP loan recipient but does not assume its loan will not lose its ERC eligibility after the closing and, if otherwise eligible, can even claim the ERC for former employees of the PPP loan recipient.
- *Assumption of PPP Loan.* A buyer that acquires the assets of a PPP loan recipient and assumes its loan will not lose its ERC eligibility after the closing with respect to its employees (and those of its affiliates), but cannot claim the ERC for former employees of the PPP loan recipient.

CONCLUSION

As a technical matter, the IRS guidance is informal and nonbinding. Practically, however, the guidance removes the uncertainty lurking around these issues since the CARES Act was enacted. Buyers no longer have to worry about losing ERC eligibility, and targets no longer have to worry that their PPP loans will diminish their value by putting a buyer's ERC eligibility at risk.

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