Stephen L. Gordon
+1-212-474-1704
gordon@cravath.com

Andrew W. Needham
+1-212-474-1440
aneedham@cravath.com

Eric W. Hilfers
+1-212-474-1352
ehilfers@cravath.com

Lauren Angelilli
+1-212-474-1016
langelilli@cravath.com

Jennifer S. Conway
+1-212-474-1316
jconway@cravath.com

J. Leonard Teti II
+1-212-474-1896
lteti@cravath.com

Christopher K. Fargo
+1-212-474-1236
cfargo@cravath.com

Jonathan J. Katz
+1-212-474-1538
jkatz@cravath.com

Kara L. Mungovan
+1-212-474-1954
kmungovan@cravath.com

Paycheck Protection Program Loans May Lead to Unanticipated Costs in Certain M&A Transactions

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Two mutually exclusive programs under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) designed to encourage workforce retention during the COVID-19 pandemic—the Paycheck Protection Program and the Employee Retention Credit—clash in the case of an M&A deal involving a buyer that has received one benefit and a target that has received the other. This scenario could result in unanticipated costs in the form of lost tax benefits due to an acquisition, even a very small one.

BACKGROUND

The Paycheck Protection Program (PPP) is the Small Business Administration's forgivable loan program designed to provide small businesses with a direct incentive to keep workers on their payrolls over the eight-week period after the loan is originated. The Employee Retention Credit is a payroll tax credit for certain wages paid between March 13 and December 31, 2020, by an employer of any size that has experienced significant disruption to its business due to the pandemic. A company that receives a PPP loan cannot claim the Employee Retention Credit, regardless of when the loan is received and whether it is repaid in full or forgiven (with a limited exception for loans repaid by May 18, 2020). Furthermore, ineligibility extends to all subsidiaries of the PPP loan recipient as well as all other affiliates linked by at least fifty percent (50%) common ownership or control (referred to herein as affiliates).

ISSUES IN M&A TRANSACTIONS

If a buyer that has claimed (or is planning to claim) the Employee Retention Credit acquires a company that has received a PPP loan, the buyer and all its affiliates may become ineligible for the Employee Retention Credit and may have to repay any credits they have already claimed. The same issue exists if the buyer (or one of its affiliates) is a PPP loan recipient and the acquired company (or one of its affiliates) could otherwise benefit from the Employee Retention Credit. The size of the PPP loan does not matter, and the issue appears to exist even if the loan is repaid in full after May 18, 2020, but before the closing. The value of the Employee Retention Credit may be very significant and, therefore, the loss of the credit could make certain transactions much less attractive.

UNANSWERED QUESTIONS

The CARES Act was adopted quickly and under extreme pressure, so there are many unanswered questions about how it applies. The Internal Revenue Service (IRS) has released several rounds of frequently asked questions (FAQs) intended to clarify eligibility for the Employee Retention Credit but, to date, no FAQs have addressed the consequences of M&A activity involving a PPP loan recipient. Based on the language of the CARES Act and the IRS FAQs, eligibility to claim the Employee Retention Credit is clearly at risk with respect to wages paid by the buyer and its affiliates after the acquisition of a PPP loan recipient (unless the loan was repaid by May 18, 2020). There may also be a risk of losing the credit for wages paid prior to the closing, though that is less clear.

SUGGESTED ACTIONS

Companies that are considering M&A transactions should take into account the interplay between PPP loans and the Employee Retention Credit early in connection with reviewing a potential transaction. There may be some ability to structure a transaction to avoid the risks associated with a PPP loan (for example, by purchasing assets, rather than stock), but changes in transaction structure often have many other implications that need to be considered. In addition, since most PPP loan recipients are small companies,[1] the transaction price may fall below a threshold necessitating extensive internal review or the use of outside counsel, so companies that have claimed (or may claim) the Employee Retention Credit should be especially careful about requiring internal communication in connection with acquisitions of any size. At this time, many companies are still evaluating their eligibility for the Employee Retention Credit and its potential value (which may depend, in part, on the extent to which businesses remain closed due to the pandemic), so the consequences of losing eligibility may not be clear until the future.

New York
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019-7475
+1-212-474-1000

London
CityPoint
One Ropemaker Street
London EC2Y 9HR
+44-20-7453-1000

www.cravath.com

1 PPP loan recipients must certify to the SBA in the loan application that, due to current economic uncertainty, the loan is necessary to support their ongoing operations, and as such, tend not to be large companies. Additionally, PPP loan recipients, together with their affiliates, may not exceed certain employee-count thresholds, which vary by industry.