

U.S. Insight: M&A Transactions Involving Companies that have Obtained PPP Loans and Employee Retention Credits – Significant IRS Guidance

As part of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), Congress created Employee Retention Credits (“ERCs”). An ERC is a refundable tax credit against certain employment taxes equal to 50 percent of the “qualified wages” (up to \$10,000 per employee) an eligible employer pays to employees after March 12, 2020, and before January 1, 2021. In addition, the CARES Act authorized Paycheck Protection Program loans (“PPP loans”) under which qualified businesses could obtain forgivable loans.

An entity that has received a PPP loan is ineligible for ERCs. In general, entities under common control are aggregated for purposes of determining the eligibility for both PPP loans and ERCs.

The mutual exclusiveness of the PPP loans and ERCs has created considerable uncertainty in situations where an entity that has claimed ERCs acquires a target entity that has obtained a PPP loan. The issue raised is whether the combination of the entities disqualifies the PPP loan, the ERCs, or both the PPP loan and the ERCs. This issue commonly arise in M&A transactions following the enactment of the CARES Act and has given rise to significant uncertainty in connection with the negotiation and execution of M&A transactions.

On November 16, 2020, the IRS released guidance which clarifies whether an entity’s ability to claim ERCs is impacted by its acquisition of a target entity that obtained a PPP loan. It should be noted that the November 16th guidance does not address the impact of an acquisition on the target’s eligibility for PPP loan forgiveness.

In general, the IRS guidance clarifies a number of issues, including:

- I. The acquiring entity remains eligible for ERCs claimed for qualified wages paid to its employees before the closing date. That is, ERCs claimed by the acquiring entity with respect to its employees should not be subject to recapture due to the entity’s acquisition of a target entity that received a PPP loan.
- II. The acquiring entity should generally remain eligible to claim ERCs for qualified wages paid to its employees on or after the closing date.

- III. The target entity may be precluded from claiming ERCs after the closing date depending on the (1) the form of the acquisition and (2) the status of the PPP loan.
- a. If the acquiring entity (x) purchases the stock (or other equity interests) of a target entity and (y) prior to the transaction closing date, the PPP loan is still outstanding and the target entity has not submitted a forgiveness application with an interest-bearing escrow account in accordance to the Small Business Administration guidance issued on October 2, 2020, the target entity cannot claim ERCs for any wages paid to any of its employees before or after the closing date.
 - b. If the acquiring entity (x) purchases the assets of the target entity and (y) assumes the PPP loan obligation, the acquiring entity cannot claim ERCs for qualified wages paid to the former employees of the target entity after the closing date.

The November 16 IRS guidance is arguably unclear whether a stock acquisition treated as an assets purchase pursuant to Section 338(h)(10) of the Internal Revenue Code, an acquisition of a disregarded entity, or an acquisition of a qualified S corporation subsidiary should be treated as a stock or an asset acquisition for the purpose of these rules.

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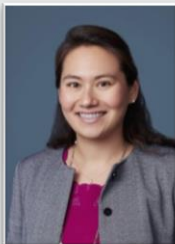
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