

PPP Issues: Disclosure Forms and the Impact of PPP Loans on Transactions

November 24, 2020



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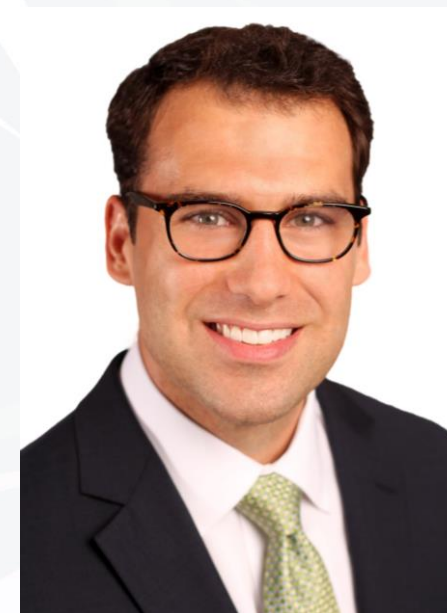
TODAY'S PANELISTS



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Attendees may submit questions at any time using the Q&A function. Panelists will address questions at the end of the formal presentation if time permits.

Additionally, all attendees will be emailed a link to a recording of the webinar, a pdf of the presentation, and a listing of speaker biographies and contact information.

Today's presentation is not:

- Legal advice
- The final word on today's topics – updates will be continuously provided via herbein.com

Before taking any action, you should review this material with internal and/or external advisors.

In order to be eligible for Continuing Professional Education (CPE) for certified public accountants, participants:

- Must be logged in for the entirety of the program.
- Answer at least 3 questions during the hour.

Unfortunately, we are unable to grant CPE in cases where technical difficulties prevent the participants to meet the requirements listed above.

Have you already applied for loan forgiveness:

- Yes
- No
- Didn't receive PPP loan
- Not sure

PAYCHECK PROTECTION PROGRAM (PPP) TIMELINE



On October 31, 2020, the U.S. Small Business Administration (“SBA”) published a Notice in the Federal Register seeking approval from the Office of Management and Budget for the collection of information through, among other forms, SBA Form 3509 (Loan Necessity Questionnaire – For-Profit Borrowers) and SBA Form 3510 (Loan Necessity Questionnaire – Non-Profit Borrowers).

These Paycheck Protection Program (“PPP”) Loan Necessity Questionnaires “will be used by SBA loan reviewers to evaluate the good-faith certification that you made on your PPP Borrower Application...that economic uncertainty made the loan request necessary.” Both Loan Necessity Questionnaire forms – one for for-profit borrowers and one for non-profit borrowers – state that SBA is “reviewing these loans to maximize program integrity and protect taxpayer resources,” emphasizing, if there was any doubt, that SBA intends to search for and investigate possible fraud, waste, and abuse in the PPP.

- Pressed for more detail regarding the meaning of “economic uncertainty,” SBA responded in its Frequently Asked Questions (“FAQ”) No. 31 only that PPP loan Borrowers needed to “make such certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that was not significantly detrimental to the business.”
- Borrowers were warned that it would be “unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.”

In FAQ No. 39, SBA informed borrowers that it would review all PPP loans in excess of \$2 million following the lender's submission of the borrower's loan forgiveness application. However it did not offer any further criteria for the term "economic uncertainty."

For-profit and non-profit borrowers that received PPP loans of \$2 million or more are required to complete and submit, along with required supporting documentation, to their lenders.

Questionnaires need to be provided to the borrower by the bank, and the borrower has 10 business days from receipt of the form to submit the information.

Eligible “for-profit borrowers” include the following:

- sole proprietors,
- partnerships,
- C-corporations,
- S-corporations,
- limited liability companies,
- independent contractors,
- eligible self-employed individuals,
- Tribal businesses, and
- electric and telephone cooperatives exempt from federal income taxation under section 501(c)(12) of the Internal Revenue Code.

Eligible “non-profit borrowers” includes the following:

- 501(c)(3) non-profits,
- 501(c)(19) veteran’s organizations;
- non-profit hospitals owned by governmental entities if they are described in Internal Revenue Code (“IRC”) §501(c)(3)(or otherwise adhere to the parameters of IRC §501(c)(3) and rely on the income exclusion under IRC §115) and receive less than 50 percent of their funding from state or local government sources, exclusive of Medicaid; and
- churches, and integrated auxiliaries of churches that meet the requirements of IRC §501(c)(3)(even if they have not applied to the IRS to receive recognition of tax-exempt status).

Who has provided the most assistance through the PPP loan process?

- Attorney
- Banker
- Accountant
- SBA
- All of the above
- Didn't get a PPP Loan

PPP Loan Necessity Questionnaire (For-Profit Borrowers)

The For-Profit Loan Necessity Questionnaire includes two sections

- One entitled, “Business Activity Assessment” and
- Second entitled, “Liquidity Assessment.”

The instructions state that “you must include supporting documentation” and also that “SBA may request additional supporting documentation as part of the loan review.”

The Business Activity Assessment for-profit borrowers consists of eight questions, some of which have multiple sub-parts, and requests detailed information and supporting documentation related mainly to:

- **GROSS REVENUE**
- **MANDATORY SHUT DOWN**
- **VOLUNTARY SHUT DOWN** and
- **NEW CAPITAL IMPROVEMENT PROJECTS**

The Liquidity Assessment consists of 13 questions, some of which have multiple sub-parts, and requests detailed information and supporting documentation related mainly to:

- **CASH ON HAND**
- **CAPITAL DISTRIBUTIONS**
- **PREPAID OUTSTANDING DEBT**
- **COMPENSATION TO OWNERS OR EMPLOYEES OF MORE THAN \$250,000**
- **LISTING ON NATIONAL SECURITIES EXCHANGE**
- **PUBLIC COMPANY OWNERSHIP OF 20% OR MORE**
- **BOOK VALUE**
- **SUBSIDIARY STATUS**
- **PRIVATE EQUITY OWNERSHIP OF 20% OR MORE**
- **AFFILIATE OF FOREIGN, STATE-OWNED ENTERPRISE**
- **OTHER CARES ACT FUNDS**

The Non-Profit Loan Necessity Questionnaire also includes a “Non-Profit Activity Assessment” and a “Liquidity Assessment.” They are tailored to non-profit borrowers and request such information:

- The borrower’s gross receipts from gifts, grants, contributions and similar amounts, as well as its expenses in Q2 of 2019 and 2020 (or Q1 of 2020 if borrower did not exist in 2019).
- In the non-profit “Liquidity Assessment,” the 11 questions add an extra layer of specificity.
- Question No. 8 asks, “Does Borrower provide health care services?” and, if the answer is yes, includes several more questions.
- Question No. 10 asks, “Did Borrower directly receive any funds from any CARES Act program other than PPP, excluding tax benefits?” and, if the answer is yes, the borrower must provide the funding amount and the program name or funding source for those funds.

Both Questionnaires require the borrower to certify, “that the information provided in this questionnaire and in all supporting documentation is true and correct in all material respects” and that the borrower makes this certification “after reasonable inquiry of people, systems, and other information available to Borrower.” The borrower also must certify that he or she “understands that knowingly making a false statement to obtain a guaranteed loan or forgiveness of an SBA-guaranteed loan is punishable under the law... by imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000.”

SBA is expecting a very quick turn-around of these very complicated Loan Necessity Questionnaires. Once a company receives the questionnaire from the lender, it has only ten business days to complete and submit the form to the lender. And, within five days of receiving the completed form with all required responses, supporting documentation, signatures, and certifications, the lender is required to upload the form to SBA's PPP Forgiveness Platform, and separately input the responses to each question into the web form available in the platform (an arduous chore for the lenders).

It is critical that PPP recipients of loans with an original principal amount of \$2 million or greater complete the Questionnaires with supporting documentation, etc., within the ten-business day window to respond. Failure to complete the form and provide the required supporting documentation may result in SBA determining that the company was ineligible for the PPP loan, the PPP loan amount, or any forgiveness amount claimed, and SBA may seek repayment of the loan – or worse –pursue other available remedies. Companies would be well advised to start the process of answering these questionnaires before being faced with an unusually short ten business day deadline in the coming weeks and months.

For those going through transactions, have you been through forgiveness and escrow process yet?

- Yes – as a seller
- Yes – as a buyer
- Not yet – as a seller
- Not yet – as a buyer
- Not currently in a PPP-affected transaction



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Successfully Addressing PPP Loans in M&A Transactions

November 24, 2020

Tyler M. Smith, Esq., *Partner*

SBA Loan Servicing Guidelines and Procedural Notice 5000-20057

- Existing SBA loan servicing guidelines provided that SBA lenders must obtain the prior approval of SBA before issuing consent to certain transactions.
 - Servicing and Liquidation Actions 7(a) Lender Matrix available at:
 - https://www.sba.gov/sites/default/files/2020-02/Unilateral_Action_Matrix_for_7a_Loan_Servicing-Liquidation_V-15.pdf
- “Change in Ownership of Borrower” remained undefined.
- Procedural Notice 5000-20057 identifies mandated procedures for effectuating “changes of ownership” of an entity that has received Paycheck Protection Program (“PPP”) funds.
 - Procedural Notice available at:
 - <https://www.sba.gov/sites/default/files/2020-10/5000-20057-508.pdf>



Procedural Notice 5000-20057 and “Change of Ownership”

1. At least 20 percent of the ownership interest of PPP Borrower is sold or otherwise transferred, whether in one or more transactions, including to an affiliate or an existing owner of the entity;
2. PPP Borrower sells or otherwise transfers at least 50 percent of its assets in one or more transactions; or
3. PPP Borrower is merged with or into another entity



“Change of Ownership” Situational Procedures

Situation 1: PPP Note Is Fully Satisfied

No restrictions or approvals on change of ownership if, prior to closing, PPP Borrower has:

- a. Repaid the PPP note in full; or
- b. Completed the loan forgiveness process in accordance with the PPP requirements and
 - i. SBA has remitted funds to PPP Lender in full satisfaction of the PPP Note; or
 - ii. PPP Borrower has repaid any remaining balance on the PPP loan.



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“Change of Ownership” Situational Procedures

Situation 2: Ownership Interest Sale or Merger and PPP Note Is Not Fully Satisfied

1. PPP Lender Consent Required (but not SBA Approval) if:
 - a. 50% or less of ownership interest sold*; or
 - b. PPP Borrower:
 - i. submits forgiveness application; and
 - ii. establishes interest-bearing escrow account controlled by PPP Lender equal to the outstanding balance of the PPP loan.
2. PPP Borrower remains subject to all PPP loan obligations. If new owners use PPP funds for unauthorized purposes, SBA has recourse against the owners for the unauthorized use.
3. PPP Lender Notice Requirements to SBA.

*All transfers occurring since date of approval of PPP Loan are aggregated.



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“Change of Ownership” Situational Procedures

Situation 3: Asset Sale and PPP Note Is Not Fully Satisfied

1. PPP Lender Consent Required (but not SBA Approval) if:
 - a. PPP Borrower :
 - i. submits forgiveness application; and
 - ii. establishes interest-bearing escrow account controlled by PPP Lender equal to the outstanding balance of the PPP loan.
2. PPP Lender Notice Requirements to SBA.



“Change of Ownership” Situational Procedures

Situation 4: All Other Scenarios

1. PPP Lender Consent and SBA Approval Required
2. PPP Lender Notice Requirements, including (without limitation):
 - a. the reason that the PPP Borrower cannot fully satisfy the PPP Note;
 - b. letter of intent and the purchase or sale agreement; and
 - c. a list of all owners of 20 percent or more of the purchaser.
3. SBA will review and provide a determination within 60 calendar days of receipt of a complete request



“Change of Ownership” Special Scenario

SBA Approval of Asset Sale:

1. SBA approval of sale of 50% or more of the assets of PPP Borrower will be conditioned on purchaser assuming all of PPP Borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms.
2. Must include appropriate language in the purchase agreement regarding the purchaser's assumption of PPP Borrower's obligations under the PPP loan.



Clarifying Items

1. PPP Loan Documents Silent (or less stringent) on Change of Control:
 - a. Procedural Notice provides that PPP Borrower must notify the PPP Lender in writing of the transaction prior to closing and provide copy of the proposed agreements
2. Regardless of any change of ownership, PPP Borrower remains responsible for:
 - a. Performance of PPP loan obligations;
 - b. Certifications made in connection with the PPP loan application;
 - c. Compliance with all other PPP requirements; and
 - d. Obtaining, preparing, and retaining all required PPP forms and supporting documentation and providing those materials to the PPP Lender or to SBA.



Practical Seller/Borrower Considerations

1. Contact Lender Promptly if Contemplating M&A Transaction
2. Become Familiar with PPP- and non-PPP loan documents
3. Begin Forgiveness Application Process
4. Approval Timelines
5. Inquire with Lender about Escrow Procedures



Practical Buyer Considerations

1. Diligence Seller/Borrower
2. Force Repayment, Await Forgiveness, Escrow?
3. Representations, Indemnities, Covenants in Purchase Agreement
4. Presence of Buyer's own PPP Loans



Avoid Foot-Faults

1. End of Year Estate Planning
 - a. Political Considerations and Potential Reduction in Lifetime Gift Tax Exemption
2. Equity Incentive Plans

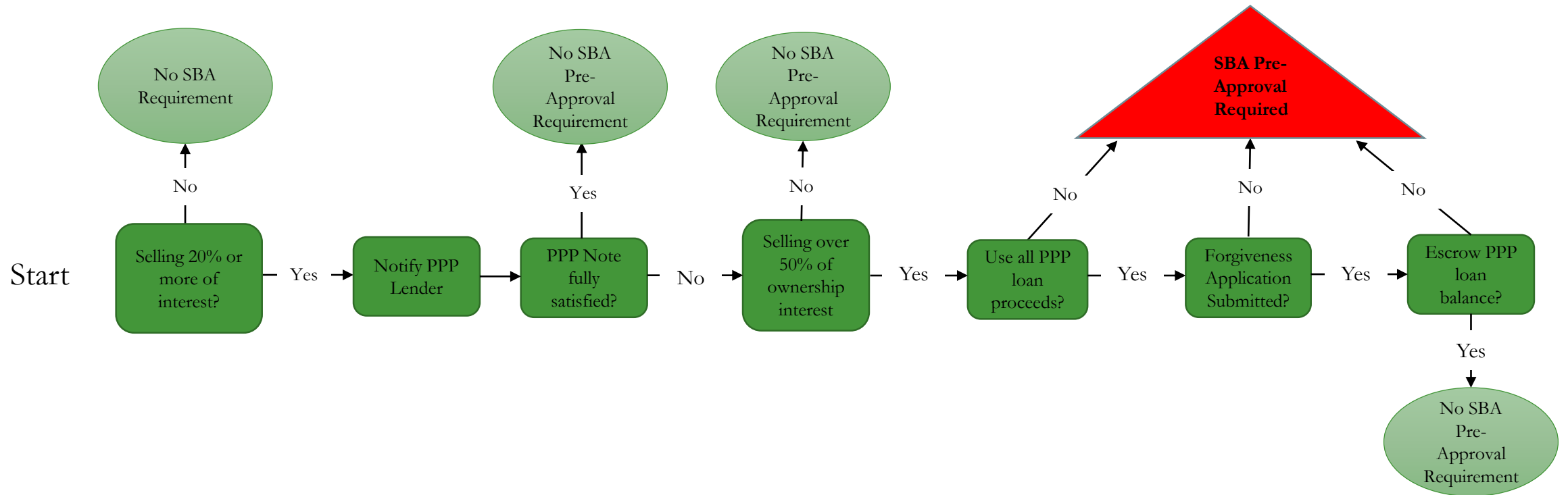


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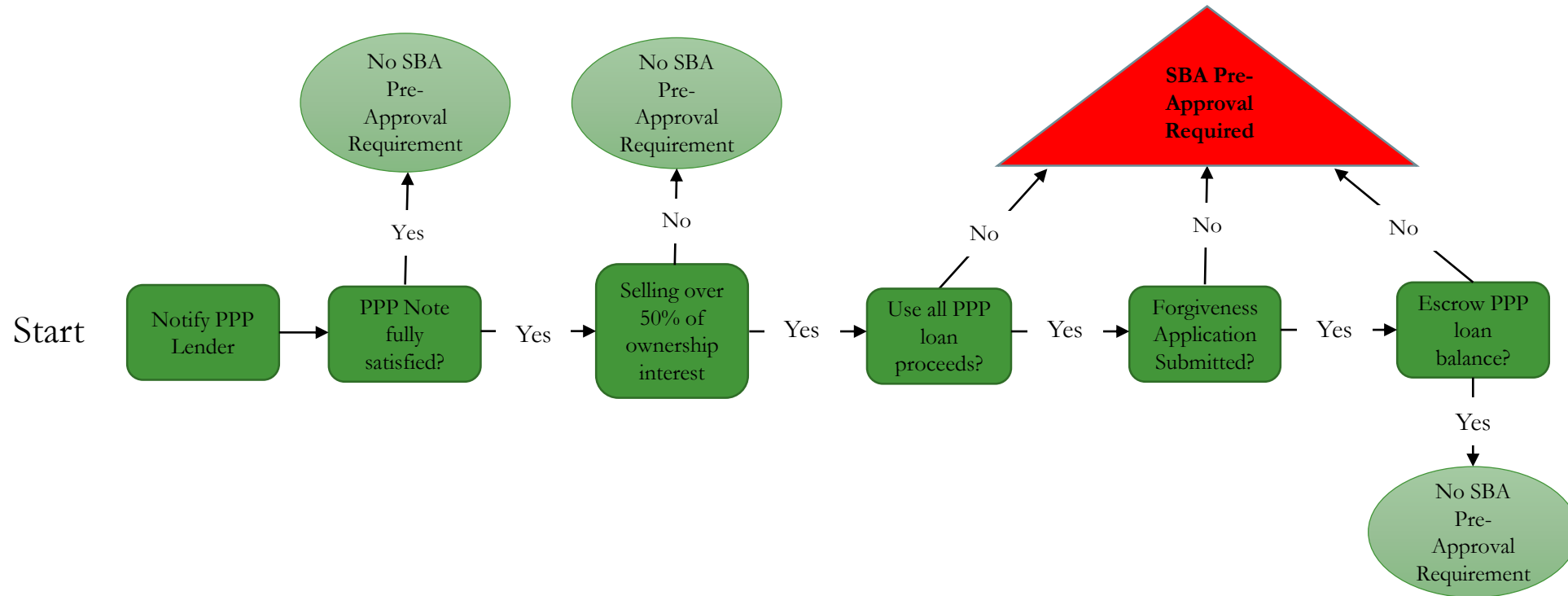
PPP notwithstanding, do you expect your company's level of transactions in 2021 to:

- Increase
- Decrease
- Stay same
- No transactions planned

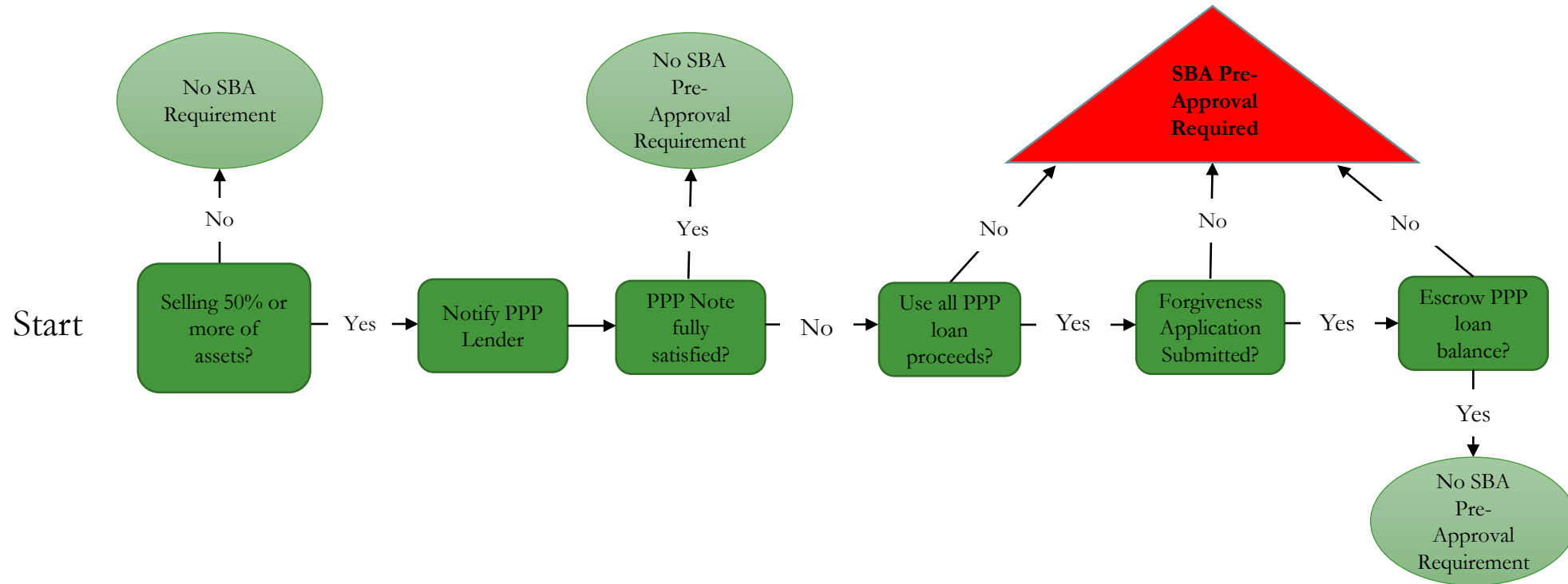
Flow Chart: Sale of Ownership Interest



Flow Chart: Merger



Flow Chart: Sale of Assets



Contact

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Do you have any questions that would require a follow-up consultation with either or our speakers?

- Yes – David Peritz
- Yes – Tyler Smith
- Yes - both
- No



Question & Answer

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1. If forgiveness is granted in 2021 will it be recognized in 2021? DEP
2. Do we have to file anything for the EIDL loan? DEP
3. What is the impact on tax liability if you receive EIDL, PPP, assuming forgiveness and Montco Grant? DEP
4. When is the best time to fill my forgiveness application. DEP
5. Where do I start to prepare for my forgiveness filling. DEP