

April 30, 2021 | Business, Corporate & Securities, Insights

How to Navigate the SBA Rules on a “Change of Ownership”

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Even as borrowers from the second round of Paycheck Protection Program (“PPP”) funding continue to receive and utilize funds and submit forgiveness applications to their PPP lenders, many such borrowers are again contemplating transactions that range from complete sales of their companies to partial transfers of equity. The question becomes what transactions are subject to SBA rules and what consents are required from the SBA.

[SBA Procedural Notice 5000-20057](#), effective October 2, 2020 (the “SBA Notice”), still controls what transactions qualify as a “change of ownership” of the PPP borrower and what approvals must be obtained. “Change of ownership” is defined in the SBA Notice as the (i) sale or transfer of at least 20% of the ownership interests of the PPP borrower, in one or more transactions, including to an affiliate or an existing owner of the PPP borrower, (ii) sale or transfer at least 50% of the PPP borrower’s assets, in one or more transactions or (iii) the merger by the PPP borrower with or into another entity.

Two notable aspects that may surprise some borrowers: (1) A change of ownership as low as 20% of the total equity of the PPP borrower triggers the rules under the SBA Notice, including if that transfer is to an existing owner in the company and (2) it doesn’t matter that the PPP borrower is the survivor of the merger.

If the contemplated transaction would constitute a change of ownership of the PPP borrower, and the PPP loan is not fully satisfied by repayment in full or approval of a forgiveness application, the transaction may require the prior consent of the PPP lender, and possibly also the SBA.

The SBA’s prior consent to the change of ownership transaction of the PPP borrower will be required in all circumstances where the PPP borrower has not yet submitted an application for forgiveness.

The SBA’s prior consent to the change of ownership transaction of the PPP borrower will not be required if the sale or transfer of equity is 50% or less of the total equity of the PPP borrower or if less than 50% of the PPP borrower’s assets are sold or transferred. If the



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transfer or sale of equity is more than 50% or the sale of assets is equal to or greater than 50%, consent of the SBA will not be required if the PPP borrower (1) submits a completed forgiveness application to its PPP lender and (2) deposits the outstanding amount of the PPP loan with the PPP lender in an interest-bearing account. In our experience with several major lenders, two years' worth of interest was required in addition to the principal amount.

Once the forgiveness application has been processed, all funds from the escrow account will be released, first to pay back any unforgiven amounts of the PPP loan, with the remainder distributed to the PPP borrower to an account designated at the time the escrow was formed. Therefore, if the entire amount of the PPP loan was forgiven, the entire amount of the escrow account will be released back to the PPP borrower. For planning purposes, most banks will require the escrow account to be opened by the PPP borrower in its name and not that of a third party, so that the funds are released back directly to the PPP borrower. This means that if the PPP borrower entity was acquired through equity sale or merger, provision should be made in the purchase agreement that would require the amounts released from the PPP loan escrow account to be further distributed by the buyer to the sellers, unless the parties negotiate to allow the buyer to retain those amounts.

A note of caution for buyers of entities with PPP loans outstanding. If the buyer has a PPP loan outstanding and the target also has a PPP loan outstanding, the buyer is responsible for segregating and delineating funds and expenses for each PPP loan and providing documentation to demonstrate compliance with PPP requirements for each of the PPP loans.

We are happy to answer any questions that you may have or assist in reviewing your proposed change of ownership transaction and the steps that will be required under applicable SBA guidance. Please reach out to the [author of this post](#) or any member of the Rich May team that you are currently working with.

Disclaimer: This summary is provided for educational and information purposes only and is not legal advice. Any specific questions about these topics should be directed to attorney [Arvid von Taube](#).