



LEGAL UPDATE Mar 29, 2020

# **Nonprofit Guide to the CARES Act (Including Those Loans You've Been Hearing About to Cover Payroll and That Don't Need to Be Paid Back)**

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The Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) became law on March 27, 2020, and is designed to assist nearly every facet of the American economy, including the charitable sector. One highlight is the Paycheck Protection Program, which generally makes loans available to certain tax-exempt organizations to cover 2.5 months of payroll costs. The loans are later completely or partially forgiven depending on the borrower maintaining staff levels and limiting compensation reductions for the 8-week period after getting the loan. Essentially, the federal government is looking to provide funds to nonprofits and other businesses to cover payroll through the end of June in an effort to avoid millions of people making new unemployment claims and losing their employer-sponsored health and other benefits. The program falls under the aptly titled, “Keeping American Workers Paid and Employed Act.” (For the nonprofit folks, think of it as the receipt of a restricted grant agreement—do x, y, and z, and you get to keep the money—otherwise, you’ll need to pay some or all of it back.)

This Nonprofit Guide to the CARES Act summarizes provisions applicable to nonprofits and tax-exempt organizations, large and small. The CARES Act provides numerous opportunities for existing nonprofit and tax-exempt organizations to reduce the stress that COVID-19 may cause on their finances, whether through loans, grants, or tax credits.

The following provisions and their implications for nonprofits are addressed[1]:

- **Paycheck Protection Program.** Loans to 501(c)(3) and 501(c)(19) tax-exempt organizations with up to 500 employees. These low-interest Small Business Administration (SBA) loans, generally for two and a half months of payroll costs, may be forgiven entirely if the borrower limits salary reductions to no more than 25% and maintains staffing levels for eight weeks after getting the loan.
- **Economic Injury Disaster Loans.** SBA disaster lending program for loans of up to \$2 million with interest set at 2.75% for nonprofits (and grants of a quick \$10,000). Payments of principal and interest may be deferred for up to four years.
- **Reimbursements for “Reimbursable Employers”.** This benefit is for nonprofits that have elected to be “reimbursable employers” (you are probably not one of these, and if you are, you know who you are) for purposes of state unemployment insurance taxes.
- **Payroll Tax Credit.** The employee retention payroll tax credit is a benefit for organizations that don’t get Paycheck Protection Program loans.
- **Industry Stabilization Fund.** Loans to nonprofits with 500 to 10,000 employees (e.g., hospitals and universities) at 2% interest and no payments due for the first six months.

## Paycheck Protection Program

Title I of the CARES Act is the Keeping American Workers Paid and Employed Act, which establishes the Paycheck Protection Program (the Program). Congress has appropriated \$349 billion for the Program. The details follow below, but if you are a 501(c)(3) or 501(c)(19) organization with 500 or fewer employees, your next steps may be to:

1. Gather documentation as to your average monthly payroll costs and, with that, calculate your maximum loan amount (generally 2.5 times the average monthly payroll cost).
2. Figure out how much of that maximum you will spend on Permitted Uses (including making payroll and paying rent) within eight weeks of receiving the loan (that’s the amount that can be forgiven). If you’ll use it all, consider requesting the maximum amount. Remember, if you borrow more than you end up spending on Permitted Uses in eight weeks, you can, without prepayment penalties, repay the outstanding/unforgiven balance.

3. Get your applications in **now**.

## **Eligibility**

A nonprofit organization generally may participate in the Program only if it:

1. was in existence on March 1, 2020,
2. is either (a) an organization that is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the Code) or (b) a war veterans' organization exempt under section 501(c)(19) of the Code, and
3. has 500 or fewer full and/or part-time employees (there are exceptions to this cap).

## **Loan Amount**

The available loan size is based on the nonprofit's "payroll costs" and is capped at \$10,000,000. If the organization was in business from February 15, 2019, to June 30, 2019, the maximum loan is equal to 2.5 times the average monthly payroll costs during the 1-year period before the date of the loan. If the organization was not in business from February 15, 2019, to June 30, 2019, the maximum loan is equal to 2.5 times the average monthly payroll costs between January 1, 2020, and February 29, 2020. Seasonal employers have a couple of different options. Also, if the organization took out an Economic Injury Disaster Loan (discussed below) after January 31, 2020, it may be able to refinance that loan into a Program loan (effectuated by adding that amount to the foregoing Program loan amount calculation, but the cap remains \$10 million).

"Payroll costs" include the sum of payment of any compensation with respect to employees that is a: (1) salary, wage, commission or similar compensation; (2) payment for vacation, parental, family, medical, or sick leave; (3) allowance for dismissal or separation; (4) payment required for the provisions of group health care benefits, including insurance premiums; (5) payment of any retirement benefit; and (6) payment of state or local tax assessed on the compensation of employees.

"Payroll costs" do not include: (1) the compensation of an individual employee in excess of an annual salary of over \$100,000, prorated for the covered period;<sup>[2]</sup> (2) taxes imposed or withheld under chapters 21 (FICA), 22 (Railroad Retirement Tax), and 24 (payroll taxes) of the Code; (3) compensation of employees whose principal place of

residence is outside of the United States; (4) qualified sick and family leave for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act.

Example 1. A 501(c)(3) was in business from February 15, 2019, to June 30, 2019. During the 1-year period before the date the loan will be made, the 501(c)(3) employed one hundred (100) individuals, each of whom cost the organization \$60,000 per year in total payroll costs (salary, benefits, etc.). The maximum loan amount for this nonprofit is \$1,250,000, calculated as follows: The average total monthly payments by the applicant for payroll costs incurred during the 1-year period before the loan date is \$500,000 ( $\$60,000/12 = \$5,000 \times 100$  employees).  $\$500,000 \times 2.5 = \$1,250,000$ .

Example 2. Same facts as above, except that the 501(c)(3) employs ninety-five (95) individuals, each of whom cost the organization \$60,000 per year in total payroll costs (salary, benefits, etc.), and five officers, each of whom cost the organization \$150,000 per year in total, including \$130,000 of compensation to each of those five officers. The maximum loan amount for this nonprofit is \$1,312,500, calculated as follows: The average total monthly payments by the applicant for payroll costs incurred during the 1-year period before the loan date is \$525,000 ( $\$60,000/12 = \$5,000 \times 95$  employees = \$475,000, plus  $\$120,000/12$  ( $\$150,000$  less the  $\$30,000$  of compensation in excess of a  $\$100,000$  annual salary) =  $\$10,000 \times 5$  officers =  $\$50,000$ ).  $\$525,000 \times 2.5 = \$1,312,500$ .

## **Permitted Uses of Loan Proceeds**

The loan proceeds may only be used for (1) payroll; (2) employer group health care benefits; (3) interest on mortgage obligations; (4) rent; (5) utilities; and (6) interest on other debt incurred before February 15, 2020 (collectively, Permitted Uses). The loan may not be used to prepay mortgage interest or for the payment of principal on a mortgage.

## **Loan Terms**

The interest rate on Program loans may not exceed 4%. The maximum loan term is ten years. There is no loan fee or prepayment fee and the usual SBA 7(a) loan collateral and guarantee requirements are waived. The loans do not need to be repaid for at least six months, but repayment may be deferred up to one year based on guidance to be issued by the SBA within 30 days after the date of enactment of the Act. The loans are

nonrecourse, except to the extent that the proceeds are used for unpermitted purposes.

## **Where can I get a Program loan? How do I apply?**

Try giving your banker a call and ask for an application. The SBA does not lend money—instead, it sets guidelines for loans to be made by its partnering lenders. All current SBA 7(a) lenders are eligible to issue Program loans. A list of the 100 most active SBA 7(a) lenders includes many familiar names—see the link below.<sup>[3]</sup> The Department of the Treasury may authorize new lenders, including non-bank lenders.

Loan underwriting is delegated to these participating banks and financial institutions, without going through normal SBA channels. Underwriting is based on the impact COVID-19 has had on the organization, not its ability to repay the loan. An eligible tax-exempt organization must make a good faith certification:

- that the uncertainty of current economic conditions makes the loan request necessary to support ongoing operations,
- acknowledging that funds will be used only for Permitted Uses (see above), and
- that the organization does not have another Program loan pending and has not received a loan under the Program for the same purpose—a duplicative amount.

## **Timing**

The goal is to issue a determination on each application within 2 to 3 weeks after receiving a complete application and to make an initial disbursement within five (5) days of receiving signed loan closing documents.

## **Loan Forgiveness (the Cherry on Top)**

Borrowers are eligible to have loan amounts completely forgiven to the extent that the amounts borrowed are used for Permitted Uses during the 8-week period after receiving the loan. The amount of loan forgiveness may not exceed the principal amount of the loan (you'll still owe the accrued interest even if the loan is completely forgiven), and the loan forgiveness is subject to reduction if there is a reduction in the organization's number of employees or a reduction in wages through June 30, 2020.

# Reduction Based on Reduction in Number of Employees

The loan forgiveness reduction for a reduction in the number of employees generally is calculated by taking the amount spent on Permitted Uses during the 8-week period after getting the loan (expected to be the full loan amount) and multiplying it by the percentage of employees you still have vs. what you used to have (e.g., you recently had 100 people on staff, and during the 8-week period after getting the loan, you only have 80, so only 80% of the loan is forgiven).

Specifically, the loan forgiveness amount is reduced by multiplying the amount spent on Permitted Uses (up to the full loan amount) during the “covered period”—the 8-week period after getting the loan, by the quotient obtained by dividing (1) the average number of full-time equivalent (FTE) employees per month employed by the organization in the eight week period beginning on the date of the loan origination by, at the organization’s election, (a) the average number of full-time equivalent employees per month employed from February 15, 2019, to June 30, 2019; or (b) the average number of full-time equivalent employees per month employed by the organization from January 1, 2020, to February 29, 2020. The average number of full-time equivalent employees for a month is determined by calculating the average number of full-time equivalent employees for each pay period within a month.

So, the loan forgiveness reduction for a reduction in employees is as follows:

$$\begin{array}{r}
 \text{Avg. \# of FTE in the 8-week} \\
 \text{period after loan origination} \\
 \\
 \text{Amount spent on Permitted Uses} \\
 \mathbf{X} \quad \underline{\hspace{10em}} \\
 \\
 \text{Avg. \# of FTE employees from} \\
 \mathbf{2/15/19 to 6/30/19}
 \end{array}$$

Alternatively, the organization may elect to calculate the formula using FTE averages from January and February of 2020 in the denominator, as follows:

$$\begin{array}{r}
 \text{Avg. \# of FTE in the 8-week} \\
 \text{period after loan origination} \\
 \\
 \text{Amount spent on Permitted Uses} \\
 \mathbf{X} \quad \underline{\hspace{10em}} \\
 \\
 \text{Avg. \# of FTE employees from} \\
 \mathbf{1/1/2020 to 2/29/2020}
 \end{array}$$

# Reduction in Loan Forgiveness Relating to Salary and Wage Cuts

The loan forgiveness amount is also reduced by the amount of any reduction in total salary or wages of any employee during the 8-week period following the origination of the loan, that is in excess 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the loan was originated. Note that this reduction does not apply to salary reductions to employees who received, during any single pay period during 2019, wages or salary at an annualized rate of more than \$100,000.

So, with respect to those with six-figure salaries, their wages may be cut by more than 25% without reducing the loan forgiveness amount. For employees making \$100,000 or less, reductions to salary and wages beyond 25% cuts will begin to reduce the loan forgiveness amount, dollar for dollar.

### **Exception for Rehiring Employees and Restoring Salary Cuts**

If an organization reduced its staff or salaries between February 15, 2020, and thirty (30) days after March 27 (the enactment of the Act), the amount of loan forgiveness for which the organization is eligible will not be reduced according to the formulas above if the organization, not later than June 30, 2020, eliminates the reduction, as compared to February 15, 2020, in the number of full-time equivalent employees and/or salary of 1 or more employees.

### **Loan Forgiveness Application**

Loan forgiveness is not automatic. The tax-exempt organization will need to submit an application to the lender that is servicing the loan that includes:

- documentation verifying the number of full-time equivalent employees on payroll and pay rates;
- state income, payroll, and unemployment insurance filings;
- documentation, including cancelled checks, payment receipts, transcripts of accounts, or other document verifying payments on covered mortgage and lease obligations and utility payments;
- certification from an authorized representative that the documentation is true and correct and the amount for which the forgiveness is requested was used for Permitted Uses; and

- any other documentation the SBA Administrator requires.

No forgiveness is permitted without providing the above documentation. The lender is required to issue a decision on the loan forgiveness application within 60 days of its submission.

## **Tax Treatment of Cancellation of Debt**

The CARES Act specifically provides that amounts forgiven under the Paycheck Protection Program are excluded from gross income. In other words, it is statutorily excluded from UBTI. It is unclear how the loan forgiveness may be treated for purposes of Form 990 reporting. For public charities relying on the public support test under section 170(b)(1)(A)(vi) of the Code, it appears reasonable to characterize the amount as a grant received from a governmental unit and not subject to the 2% limit on public support (i.e., it may all count as public support).

## **Emergency Economic Injury Disaster Loans and Grants**

For all of 2020, the CARES Act provides expands the availability of Economic Injury Disaster Loans (EIDLs) under section 7(b)(2) of the Small Business Act to “private nonprofit organizations” (in addition to small business concerns). EIDLs are intended to pay for expenses that could have been met had the disaster not occurred, including payroll and other operating expenses.

## **Economic Injury Disaster Loans**

### **Eligibility**

Eligible entities include Employee Stock Ownership Plans (ESOPs) and, for 2020 only, small agricultural cooperatives and “private nonprofit organizations.” “Private nonprofit organization” is not defined for purposes of EIDLs, but under the Paycheck Protection Program (see above), “nonprofit organization” is limited to 501(c)(3) tax-exempt organizations. It is unclear whether other types of nonprofit organizations are eligible for EIDLs, such as 501(c)(4) social welfare organizations, 501(c)(6) trade associations, etc.

### **Maximum Loan Amount**



The maximum loan amount is \$2 million.

## **Loan Terms**

The loan proceeds may only be used for expenses that could have been met had the disaster not occurred, such as payroll and other operating expenses. The loans are for up to 30 years and the interest rate for nonprofit organizations is 2.75%. Principal and interest may be deferred for up to four years.

## **Underwriting**

EIDLs do not require personal guarantees for advances of loans of less than \$200,000. Applicants need to have been operating on January 31, 2020. There is no requirement that an applicant show that it cannot obtain credit elsewhere or for the applicant to prove that it has the ability to repay the loan. The loan may be approved based solely on the applicant's credit score (no tax return is required) or the SBA may approve the loan using alternative methods.

## **Repayment**

EIDLs are not eligible for loan forgiveness and must be repaid according to the terms of the loan.

## **Application**

Eligible nonprofit entities may apply for a EIDL at a local [SBA District Office](#) or online at <https://disasterloan.sba.gov/ela/>.

## **\$10,000 Emergency Grants**

An EIDL applicant may request that up to \$10,000 of the amount it has applied for be given as a grant, which the SBA is required to pay within three days after the SBA receives the EIDL application provided that the applicant certifies, under the penalty of perjury, that it is an eligible entity, i.e., an ESOP, small agricultural cooperative, or private nonprofit organization.

## **Permitted Uses of Grant Funds**

The funds can be used for any allowable purpose, including but not limited to, (1) providing sick leave to employees unable to work due to the direct effects of COVID-19; (2) maintaining payroll to retain employees during business disruptions or substantial slowdowns; (3) meeting increased costs to obtain materials due to interrupted supply chains; (4) making rent or mortgage payments; (5) and repaying other obligations that cannot be met.

## **Repayment**

The grant does not have to be repaid even if the EIDL application is denied.

## **Self-Insured Nonprofits and Unemployment**

Nonprofits and government entities have the ability to either be a reimbursable employer (i.e., reimburse a state for unemployment benefits paid to a former employee) or, like most, pay into a state unemployment trust fund. It is uncommon for nonprofits to choose to be a reimbursable employer and the vast majority elect the certainty of paying a set amount into the state unemployment trust fund and knowing that this is the extent of their unemployment tax liability (rather than the uncertainty of reimbursing the state an undetermined amount later for amounts paid to a former employee by the state unemployment insurance trust fund).

The CARES Act provides that nonprofits that have chosen to be reimbursable employers may be reimbursed for one-half of the amounts paid into a state unemployment trust fund between March 13, 2020, and December 31, 2020.

For example, if a “reimbursable employer” nonprofit organization’s former employee receives \$5,000 in unemployment benefits from the state, the organization would normally be required to reimburse the state for the \$5,000. However, the CARES Act provides that the federal government may reimburse the nonprofit organization for half of this amount, i.e., \$2,500.

## **Employee Retention Payroll Tax Credit**

The CARES Act provides certain employers in operation at any point in 2020, including “tax-exempt organizations”, with an employee retention payroll tax credit.

## **Eligibility**

All of the tax-exempt 501(c) organizational types (e.g., 501(c)(3), 501(c)(4), 501(c)(5), 501(c)(6), etc.) are eligible for the employee retention payroll tax credit if (1) its operations were fully or partially suspended due to a governmental order that limited commerce, travel, or group meetings (for commercial, social, religious or other purposes) due to COVID-19, i.e., a shutdown order; (2) its gross receipts declined by more than 50% when compared to the same quarter in a prior year; and (3) the organization has not received a Payroll Protection Program loan.

## **Credit Amount**

The credit is a refundable payroll tax credit equal to 50% of “qualified wages.” For eligible employers with more than 100 employees, those are wages paid to an employee even though the employee is unable to work due to a full or partial suspension of operations due to a governmental “stay at home” or other order. For eligible employers with 100 or fewer employees, “qualified wages” include all wages paid whether the employer is open for business or subject to a shutdown order. Qualified wages includes health plan expenses.

## **Industry Stabilization Fund (Low Interest Loans for Nonprofits with 500 to 10,000 Employees)**

The CARES Act creates a \$500 billion Industry Stabilization Fund (the Fund), \$454 billion of which has been allocated to “nonprofit organizations” and businesses (other than airlines, air cargo companies, and national security businesses) that have between 500 and 10,000 employees (deemed “mid-sized businesses”). The Treasury Department and the Federal Reserve will implement a special Federal Reserve facility that provides financing to the banks and other lenders that will make these loans.

These loans from the Fund may prove beneficial to large nonprofit employers, including hospitals and universities.

## **Loans**

The loans will be subject to annualized interest rates of no more than 2% per year. No principal or interest is due on the loans for at least the first six months after the loan is made.

## **Eligibility**

Notably, the term “nonprofit organizations” is not defined for purposes of the Fund, so it is unclear whether nonprofits other than those exempt from tax under section 501(c)(3) of the Code are eligible.

## **Loan Applications, and the Strings Attached**

The Act provides that the Secretary of the Treasury shall publish procedures for application and minimum requirements for making loans and providing loan guarantees. Eligible nonprofit organizations applying for direct loans under this program will be required to certify, among other things, that:

- the uncertainty of economic conditions makes the loan request necessary to support ongoing operations;
- funds received will be used to retain at least 90% of the recipient’s workforce, at full compensation and benefits, through September 30, 2020;
- the recipient intends to restore not less than 90% of its February 1, 2020, workforce and to restore all compensation and benefits to the workers no later than four months after the termination date of the public health emergency declared by the Secretary of Health and Human Services in response to COVID-19;
- the recipient is created/organized and domiciled in the United States with significant operations and a majority of employees located/based in the United States;
- the recipient will not outsource or offshore jobs for the term of the loan plus an additional two years;
- the recipient is not a debtor in a bankruptcy proceeding;
- the recipient will not abrogate existing collective bargaining agreements for the term of the loan plus an additional two years; and
- the recipient will remain neutral in any union organizing effort for the term of the loan.

## **Loan Forgiveness**

Unlike the Paycheck Protection Program loans, loans from the Fund are not eligible for forgiveness.

# Conclusion

The CARES Act provides numerous opportunities for existing nonprofit and tax-exempt organizations to reduce or at least stall some of the financial stress that COVID-19 have created. Tax-exempt organizations and nonprofits should consult with their attorneys and financial advisors to discuss the loans, grants, tax credits, and other opportunities provided by the Act.

[1] For charitable donors, we will be issuing a separate Alert covering the tax-deductible charitable contribution enhancements provided by the CARES Act.

[2] This means that, for anyone making six figures, the total monthly “payroll cost” for their salary is capped at \$8,333.33 (\$100k / 12), and each such employee’s monthly average salary adds another \$20,833.33 (\$8,333.33 x 2.5) toward the maximum available loan amount.

[3] <https://www.sba.gov/article/2020/mar/02/100-most-active-sba-7a-lenders>

# Authors



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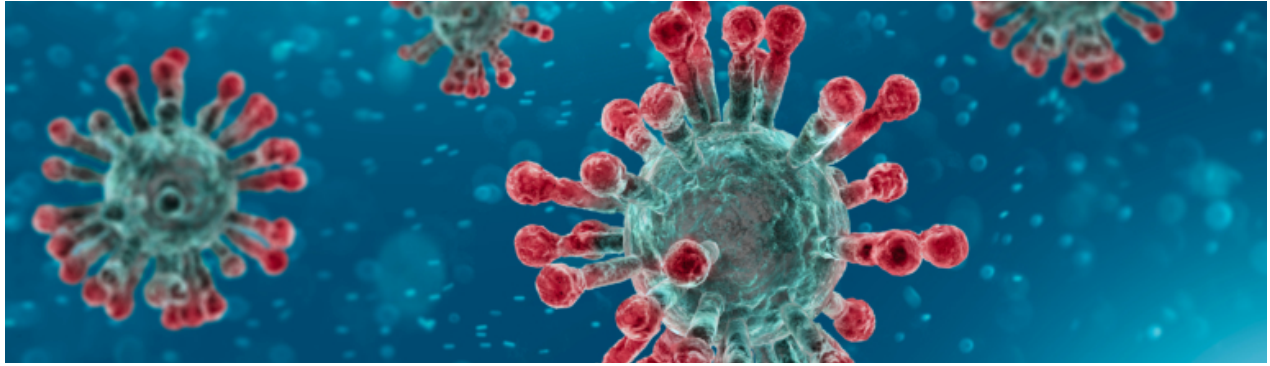
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