

The CARES Act: Helping the Nonprofit Sector Care for Communities During COVID-19

Nonprofits now have a number of options to navigate doing business in the midst of COVID-19.

On March 27, 2020, President Donald J. Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), intended to help stimulate the economy in light of the COVID-19 pandemic that has shut down operations and threatened the sustainability of businesses and organizations across the United States, including those in the nonprofit community. This *Client Alert* provides a high-level overview of provisions of the CARES Act that may be relevant to nonprofits seeking to determine whether they can continue to operate, keep employees on payroll, and otherwise find a way to weather the storm.

Paycheck Protection Program Loans

Section 501(c)(3) organizations¹ with 500 or fewer employees² with a principal place of residence in the United States may be eligible for Small Business Administration (SBA) loans under the Paycheck Protection Program³ (PPP) designed to help employers maintain their payrolls.

Loans under the PPP are made at a 1% interest rate for a two-year term in amounts of up to the lesser of (a) a formula based on 2.5 times the organization's average total monthly payments for payroll costs⁴ (up to prorated annual compensation of \$100,000⁵ per person) incurred during the prior one-year period⁶ plus any outstanding EIDLs (as defined below) to be refinanced,⁷ or (b) \$10 million. The federal government will guarantee these loans through December 31, 2020; personal guarantees and collateral are not required. There is no prepayment penalty, and organizations can defer payment of principal and interest for six months. Note, however, that taking out a loan under this program makes the organization ineligible for other payroll tax credits, as described more fully below.

Eligible organizations must have been in operation on February 15, 2020, and have had employees for whom they paid salaries and payroll taxes. PPP loan proceeds must be used for operational costs, including payroll, interest payments on mortgages, rent, utilities, certain group healthcare benefits, and interest on debt incurred prior to February 15, 2020. Borrowers must spend at least 75% of the loan proceeds on payroll costs.⁸ Applicants must provide good faith certifications regarding a number of conditions, including but not limited to the following: (1) the current economic uncertainty makes a loan

request necessary to support ongoing operations; (2) PPP loan proceeds will be used to retain workers and maintain payroll or make mortgages, lease, and utility payments; and (3) between February 15, 2020 and December 31, 2020, applicants have not applied for or obtained another loan under the PPP for the same purpose and duplicative of amounts applied for or received.

All or a portion of these loans plus any accrued interest may be forgiven on a tax-free basis under circumstances generally related to the retention and/or rehiring of employees within a specific timeframe.⁹ Forgiveness may be made on loans of up to the total amount spent during an eight-week period after the origination date of the loan¹⁰ on:

- Payroll costs
- Interest on any mortgage incurred prior to February 15, 2020
- Rent on any lease in force prior to February 15, 2020
- Utilities for which services began prior to February 15, 2020

Not more than 25% of the loan forgiveness amount may be attributable to non-payroll costs. Note that forgiveness will be made with respect to the use of loan proceeds for a narrower range of expenses than are eligible under the PPP.

Many Section 501(c)(3) organizations will be subject to the not more than 500 employee limit, although organizations with more than 500 employees working in certain industries may be eligible if the organization meets the SBA's size standard for the industry. The not more than 500 employee limit extends to both part-time and temporary employees,¹¹ and affiliation rules apply that require organizations to aggregate the number of employees of affiliated entities. Entities are generally considered to be affiliates if one organization controls or has the power to control the other, or if a third party controls or has the power to control both, regardless of whether the control is actually exercised. Control may be affirmative or negative (e.g., the power to prevent a quorum or otherwise block action by the board of directors). Control may also arise through equity ownership under a variety of circumstances, and a Section 501(c)(3) organization would need to analyze the application of the rules regarding control on this basis with respect to its taxable subsidiaries.

The SBA traditionally considers the totality of the circumstances for purposes of evaluating affiliation, and factors such as management, previous relationships or ties, and contractual relationships may be relevant. Certain types of organizations are exempt from the affiliation rules, including entities owned by Indian Tribes, Alaska native corporations, native Hawaiian organizations, and community development corporations.¹² An exemption from the affiliation rules also applies with respect to the relationship of any church, convention or association of churches, or other faith-based organization, or entity, to any other person, group, organization, or entity that is based on a sincere religious teaching or belief or otherwise constitutes a part of the exercise of religion.

Congress appropriated \$349 billion for loans under this program, which ends on June 30, 2020. Small businesses and other types of entities are also eligible, and applicants can apply through approved third-party lenders. While the CARES Act contains a "Sense of the Senate" clause stating that the SBA should issue guidance to ensure processing and disbursement of these loans to organizations in underserved and rural markets, the SBA has not yet issued such guidance and banks are already accepting and processing applications.

Economic Injury Disaster Loans

Section 501(c)(3) organizations and other Section 501(c) organizations may be eligible for disaster-relief loans and emergency grants through the SBA's Economic Injury Disaster Loan (EIDL) program.

The CARES Act eases the process for “private nonprofit organizations” to obtain EIDLs at a 2.75% interest rate in amounts of up to \$2 million, with the amount based on the organization’s economic injury (as determined by the SBA), subject to certain modifications and waivers. The CARES Act does not define private nonprofit organizations, but the SBA’s application defines these organizations to include nongovernmental organizations with an IRS determination letter under Section 501(c), and faith-based organizations.¹³ Organizations that are primarily engaged in political or lobbying activities have been traditionally ineligible for the EIDL program, and the application for the COVID-19-related EIDLs asks applicants to check that they are not “in the business of lobbying.”

Proceeds of the loans may be used to pay expenses that could have been met had the disaster not occurred, such as:

- Working capital to carry out business until normal operations can resume
- Limited expenses necessary to alleviate the specific economic injury
- Paid sick leave
- Payroll
- Mortgage
- Other related expenses

Lenders may provide an advance of up to \$10,000, payable within three days of an application, which does not have to be repaid even if the loan application is denied. If an applicant receives an EIDL advance but is subsequently approved for a PPP loan, the advance amount is reduced from the amount of the loan eligible for forgiveness under the PPP.

EIDLs are available to tax-exempt organizations located in an area affected by a disaster that have suffered a substantial economic injury¹⁴ as a result of the disaster, and that do not own property subject to a federal judgment lien.¹⁵ Determinations may be based solely on the applicant’s credit score or an alternative method to determine ability to repay. Certain requirements will be waived for EIDLs made before December 31, 2020, including requirements to provide personal guarantees of up to \$200,000, to have been in business for at least one year (provided the applicant was in business before January 31, 2020), and to demonstrate that credit cannot be obtained elsewhere. Existing collateral requirements appear to apply. The program does not offer loan forgiveness.

Although not entirely clear, a Section 501(c) organization could possibly apply for a loan under the PPP as well as an EIDL, provided the loans are not used for the same purposes. More clearly, however, a Section 501(c) organization that obtained an EIDL from January 31, 2020 through April 3, 2020 could apply for a PPP loan for the same purpose but would need to refinance the EIDL with the PPP loan.

Congress appropriated \$10 billion for the expansion of the EIDL program. Organizations can apply for EIDLs directly on the SBA website.

Loans for Larger Nonprofits

Larger nonprofits with 500 to 10,000 employees may be eligible for low-interest loans to support ongoing operations through the Federal Reserve's program available to "mid-sized" businesses (Mid-Sized Business Program) established pursuant to Title IV of the CARES Act.

Although additional details of the Mid-Sized Business Program, beyond those set forth in the statute, have yet to be released by the Federal Reserve, the CARES Act provides that the US Department of the Treasury "shall endeavor to seek the implementation of a [Federal Reserve] program or facility ... that provides financing to banks and other lenders that make direct loans to eligible businesses including, to the extent practicable, nonprofit organizations, with between 500 and 10,000 employees." The interest rate of any such direct loans shall not exceed 2% per year, and repayment of principal and interest will not be due or payable within the first six months after the borrower receives the direct loan. Eligible business applicants must make a number of good-faith certifications (as described in Latham's related [Client Alert](#)). Title IV of the CARES Act prohibits the principal amount of any loan — made to an eligible borrower pursuant to a program or facility established by the Federal Reserve, including the Mid-Sized Business Program — to be reduced through loan forgiveness. The reduction or forgiveness of interest amounts, however, is not specifically prohibited in the statute.

Employee Retention Incentives

The CARES Act offers some additional economic incentives for Section 501(c) employers to retain employees during 2020.

First, Section 501(c) employers generally may be eligible for a refundable payroll tax credit of 50% of qualified employee wages up to \$10,000 per employee paid during the calendar quarters running from March 13, 2020 through December 31, 2020. Tax-exempt employers only qualify (1) for the period of time they fully or partially suspended operations due to a COVID-19-related government shutdown order, or (2) for the period of time (a) beginning with the first calendar quarter after December 31, 2019 for which their gross receipts declined by at least 50% from the same calendar quarter during the previous year and (b) ending during the next calendar quarter for which their gross receipts are more than 80% of gross receipts for the same calendar quarter during the previous year.

For employers that averaged more than 100 full-time employees during 2019, the credit is determined by the amount of qualified wages paid for time that the employee is not providing services. Employers that averaged 100 or fewer full-time employees during 2019 can receive the credit for qualified wages paid to any employee, regardless of whether the employee is providing services. Nonprofits receiving loans under the PPP are ineligible for this refundable payroll tax credit. In addition, certain rules apply that prevent an employer from receiving other tax credits or benefits for the same wages used to claim the employee retention credit.

Second, nonprofit employers may defer payment of the employer portion of Social Security taxes due from March 25, 2020 through December 31, 2020, with half of the payment due at the end of 2021 and the remaining half due at the end of 2022. Organizations that have had loans under the PPP forgiven are ineligible for this deferral.

Unemployment Benefits

For nonprofits that cannot retain certain employees during 2020, the CARES Act expands unemployment benefits for individuals experiencing job losses and furloughs.

The CARES Act provides enhanced unemployment benefits to covered individuals, many of whom might otherwise not be eligible. The enhanced benefits include up to 39 weeks of unemployment insurance for certain COVID-19-related qualifying reasons.

Donor Incentives

Donors to Section 501(c)(3) organizations have new incentives for charitable giving in 2020, which could help facilitate fundraising efforts.¹⁶

Individual taxpayers who do not itemize deductions can now deduct up to \$300 as an above-the-line deduction for charitable contributions made in 2020. Individual taxpayers who itemize deductions can deduct up to 100% (as opposed to 60%) of their adjusted gross income (computed without regard to any net operating loss (NOL) carryback under Section 172) of charitable contributions of cash made in 2020. Corporate taxpayers may deduct up to 25% (as opposed to 10%) of taxable income for charitable contributions of cash made in 2020; charitable contributions of food inventory may be deducted in an amount of up to 25% (as opposed to 15%) of the taxable income (in the case of C corporations).¹⁷ Contributions to most private nonoperating foundations as well as supporting organizations and donor-advised funds do not qualify for these enhanced charitable contribution limits. Taxpayers must elect to apply these enhanced charitable contribution limits.

Unrelated Business Taxable Income

The CARES Act introduces some potential changes to the calculation of unrelated business taxable income (UBTI).

For tax-exempt organizations that pay the unrelated business income tax, the CARES Act potentially modifies the calculation of UBTI by allowing a five-year carryback for NOLs generated in 2018, 2019, and 2020, and temporarily removing the 80% taxable income offset limitation for NOLs until 2021. The CARES Act also includes a provision allowing for quicker recovery of alternative minimum tax refunds, and it modifies the Section 163(j) business interest deduction limitation by increasing the 30% general cap to a 50% general cap on net business interest for any taxable year beginning in 2019 or 2020.

If you have questions about this *Client Alert*, please contact one of the Latham contacts below or the Latham lawyer with whom you normally consult:

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For tax-exempt organizations interested in resources for pro bono support, please see one of Latham's pro bono partner organizations:	
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Boston	Lawyers Clearinghouse
Chicago	Chicago Lawyers' Committee for Civil Rights
Houston	Texas Rio Grande Legal Aid C-BAR
Los Angeles	Public Counsel Legal Aid Foundation of Los Angeles
New York	Lawyers Alliance for New York
Orange County	Public Law Center
San Diego	San Diego Volunteer Lawyer Program
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Endnotes

- ¹ All Section references are to the Internal Revenue Code of 1986, as amended.
- ² Section 501(c)(3) organizations may also be eligible if they have more than 500 employees but less than the employee-based size standard established by the SBA for the industry in which the organization operates, if applicable.
- ³ This loan program also is available to Section 501(c)(19) veterans organizations but not other types of tax-exempt organizations.
- ⁴ Payroll costs consist of compensation to employees whose principal place of residence is in the United States in the form of salary, wages, commissions, or similar compensation; payment for vacation, parental, family, medical, or sick leave; allowances for separation or dismissal; payments for the provision of employee benefits consisting of group health coverage, including insurance premiums, and retirement; and the payment of state and local taxes assessed on compensation of employees. Guidance issued by the US Department of the Treasury and the SBA clarify that an employer cannot include in its calculation of payroll costs compensation paid to independent contractors.
- ⁵ The exclusion of compensation in excess of \$100,000 annually only applies to cash compensation and does not apply to benefits to an employee, including employer retirement contributions, other employee benefits, and payment of state and local taxes. See PPP Loans Frequently Asked Questions, available at <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.
- ⁶ The time period to calculate "payroll costs" will be the applicant's choice of either the previous 12 months or calendar year 2019. See PPP Loans Frequently Asked Questions, available at <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.
- ⁷ Special rules apply to seasonal employers and employers that are not in business from February 15, 2019 until June 30, 2019. In addition, EIDLs made between January 31, 2020 and April 3, 2020 may be refinanced through the PPP.
- ⁸ This requirement was not in the original text of the CARES Act but was added to the requirements by guidance issued by the US Department of the Treasury and an SBA Interim Final Rule, Docket No. SBA-2020-0015, available at <https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf>.
- ⁹ Forgiveness also will be subject to reduction in accordance with special rules related to the reduction of employees.

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- ¹⁰ According to the US Department of the Treasury, the eight-week period for forgiveness “begins on the date the lender makes the first disbursement of the PPP loan to the borrower. The lender must make the first disbursement of the loan no later than ten calendar days from the date of loan approval.” PPP Loans Frequently Asked Questions, available at <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.
- ¹¹ Organizations calculate the number of employees by looking back to the average number of employees for each pay period for the previous 12 months.
- ¹² These include exemptions for (1) businesses in the Accommodation and Food Services industries with 500 or fewer employees; (2) franchises approved on the SBA’s Franchise Directory; and (3) small businesses that receive financial assistance from a Small Business Investment Company.
- ¹³ The application also includes within its definition that an organization has received satisfactory evidence from the State that the non-revenue producing organization or entity is a nonprofit entity organized or doing business under State law, or that the organization is exempt from federal income tax under Section 501(d) or 501(e).
- ¹⁴ “Substantial economic injury” means that a business concern is unable to meet its obligations as they mature or to pay its ordinary and necessary operating expenses. Loss of anticipated profits or a drop in sales is not considered substantial economic injury for this purpose. See 13 C.F.R. Section 123.300(a).
- ¹⁵ On April 3, 2020, the SBA published in the Federal Register an Administrative Declaration of Economic Injury Disasters for the Entire United States and U.S. Territories, which means that organizations located anywhere in the United States and U.S. Territories are eligible for an EIDL if they satisfy the other criteria. See 85 Fed. Reg. 19052 (April 3, 2020).
- ¹⁶ These limits are subject to the amount of any other charitable contribution deductions that a taxpayer may take, although the normal five-year carryforward rule applies.
- ¹⁷ A different income measure is used for deductions taken by other types of entities.