WINSTON & STRAWN LLP

CLIENT ALERT

Application of the CARES Act to Non-Profit Organizations

MARCH 31, 2020

On Friday, March 27, 2020, the President signed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act" or the "Act") into law. The CARES Act includes a number of provisions applicable to non-profit organizations, including: (1) establishment of paycheck protection loans, (2) expanded eligibility for non-profit organizations to apply for Small Business Administration ("SBA") disaster- assistance loans, (3) opportunities for larger non-profit organizations to apply for relief under the new Exchange Stabilization Fund ("ESF") program at the Department of the Treasury, (4) expanded unemployment benefits and related provisions, and (5) various tax provisions that benefit non-profit organizations.

Loans and Direct Funding

The CARES Act provides significant funding to non-profit organizations through (i) the establishment of the Paycheck Protection Program ("PPP"), (ii) access to Economic Injury Disaster Loans ("EIDL"), and (iii) the creation of an ESF directing the Treasury to provide assistance to mid-sized non-profit organizations.

- **Paycheck Protection Program ("PPP") Loans (emergency SBA 7(a) loans)**

The Act expands the existing SBA 7(a) loan program by establishing a new PPP loan program, which makes federally backed forgivable loans of up to $10 million available to qualifying non-profit organizations.

Eligibility: A non-profit organization is eligible for PPP loans if it: (i) was in operation on February 15, 2020, (ii) is either tax-exempt under Section 501(c)(3) or a tax-exempt veterans organization under Section 501(c)(19) of the *Internal Revenue Code*, (iii) has employees [1] for whom it paid salaries and payroll taxes, and (iv) employs fewer than 500 [2] employees. A non-profit organization that receives a PPP loan, however, is ineligible for the payroll tax credits (discussed below).

Loan Process: PPP loans will be made by lenders who are currently approved as 7(a) lenders or who are approved by the SBA and the Treasury Department to become PPP lenders. PPP lenders are only required to consider whether an applicant (i) was in operation on February 15, 2020, and (ii) either had employees for whom it paid salaries and payroll taxes or paid independent contractors. Applicants are not required to show that credit is unavailable elsewhere or demonstrate repayment ability. They are also not required to provide a personal guarantee or pledge any collateral. However, they must certify that a PPP loan is necessary to support their ongoing operations because of the uncertainty of current economic conditions. PPP loans are non-recourse loans backed by a 100% guaranty from the SBA.

Maximum Amount: Eligible non-profit organizations can receive PPP loans of up to the lesser of $10 million or 2.5 *times* the average monthly payroll costs (excluding the prorated portion of any annual compensation above $100,000 for an individual) during the one-year period before the loan is made. The definition of "payroll costs" under the PPP does *not* include the following expenses: (i) compensation of an individual employee in excess of an annual salary of $100,000, as prorated for the covered period, (ii) taxes imposed or withheld under chapters 21, 22, or 24 of the *Internal Revenue Code* during the covered period, (iii) any compensation of an employee whose principal place of residence is outside of the United States, (iv) qualified sick-leave wages for which a credit is allowed under Section 7001 of the Families First Coronavirus Response Act ("FFCRA"), or (v) qualified family leave wages for which a credit is allowed under section 7003 of the FFCRA. The PPP loans bear interest at a maximum rate of 4% and mature no later than 10 years after determination of the amount, if any, to be forgiven, as described below.

Authorized Uses: The proceeds of the PPP loans may be used for the following purposes: payroll costs (excluding the prorated portion of any compensation above $100,000 per year for any individual), group health care benefits and insurance premiums, employee compensation, mortgage interest payments, rent, utilities, and interest on debt incurred prior to February 15, 2020.

Loan Repayment and Forgiveness: The payment of principal, interest, and fees on PPP loans can be deferred for at least six months and up to one year. The amount of the proceeds of PPP loans that is used for payroll costs (excluding the prorated portion of any compensation above $100,000 per year for any individual), and mortgage interest, rent, and utility payments during the eight-week period after the PPP loan is made is eligible for forgiveness. However, the amount forgiven is reduced proportionally based on failure to maintain the average number of full-time equivalent employees compared to the period from either February 15, 2019, through June 30, 2019, or January 1, 2020, through February 29, 2020, as selected by the borrower. Further, although amounts forgiven will not constitute cancellation of indebtedness income for federal tax purposes, an employer whose PPP loan is forgiven will be ineligible for the payroll tax deferral (discussed below).

- **Economic Injury Disaster Loans ("EIDL")**

The Act appropriates an additional $10 billion to the EIDL program. The EIDL program offers disaster assistance loans ("Disaster Loans") to eligible non-profit organizations that have suffered substantial economic injury in a declared disaster area. The Disaster Loans are issued directly by the SBA (rather than local financial institutions).

Eligibility: "Private non-profit organizations" are eligible to receive the Disaster Loans, including any entity exempt under Section 501(c), trade associations, advocacy organizations, unions, and social clubs otherwise excluded under the PPP, in addition to certain organizations tax-exempt under 501(d) (apostolic organizations) or 501(e) (cooperative hospital service organizations). The loan applicant must have been in business prior to January 31, 2020. For Disaster Loans to be issued prior to December 31, 2020 due to COVID-19, the SBA will waive (i) any rules related to the personal guarantee on advances and Disaster Loans below $200,000 and (ii) the requirement that a business not have credit available elsewhere.

Maximum Amount: The SBA will lend up to $2,000,000 for each Disaster Loan at a maximum interest rate of 2.75% for eligible non-profit organizations.

Advance: Disaster Loan applicants may receive an advance of up to $10,000. The borrower or an applicant, even if such applicant is denied a Disaster Loan, is not required to repay any advance amount. If an applicant that receives an advance is also approved for a PPP loan, then the advance amount shall be reduced from the loan forgiveness amount for a PPP loan for payroll costs. The SBA is required to pay the advance within three days after the SBA receives the EIDL application if the applicant certifies, under the penalty of perjury, that it is eligible to receive the Disaster Loan.

Authorized Uses: The Disaster Loans may be used to pay paid sick leave to employees unable to work due to the direct effect of COVID-19, payroll, debts (including but not limited to mortgage payments), rent, and increased costs due to disrupted supply chains.

How the PPP loan and Disaster Loan programs will work in practice remains an open question, but the CARES Act requires the SBA to draft implementing regulations within 15 days under emergency rulemaking authority.

- **Exchange Stabilization Fund ("ESF")**

The Act establishes an ESF of $500 billion, and directs the Secretary of the Treasury to set aside $454 billion to implement a program or facility that provides financing to banks and lenders that make loans to eligible businesses, including, to the extent practicable, non-profit organizations and other mid-sized businesses with between 500 and 10,000 employees.

Eligibility: The applicant must be an "eligible business" (*i.e.*, a U.S. business that has not received adequate economic relief in the form of loans or loan guarantees provided under the Act). In other words, an eligible business would not have received a Disaster Loan or PPP loan. As previously noted, non-profit organizations between 500 and 10,000 employees are expressly eligible. Additionally, any eligible borrower under this program must certify, among other things, that:

- the uncertainty of economic conditions makes the loan request necessary to support ongoing operations;
- the funds it receives will be used to retain at least 90% of the recipient's workforce at full compensation and benefits until September 30, 2020;
- the recipient intends to restore not less than 90% of its workforce that existed as of February 1, 2020, and to restore all compensation and benefits to workers no later than four months after the termination of the public health emergency in response to COVID-19;
- the recipient will not abrogate collective bargaining rights and will remain neutral in union organizing efforts during the term of the loan; and
- the recipient will not outsource or offshore jobs for the term of the loan and two years after completing repayment of the loan.

Maximum Amount: The Act does not indicate a maximum loan amount, but such loans would be subject to an annualized interest rate no higher than 2% per annum, and no principal or interest would be due for at least the first six months.

The Act also grants the Board of Governors of the Federal Reserve System the authority to establish a Main Street Lending Program or other similar program or facility (including any program in which the Treasury makes a loan, loan guarantee, or other investment) that supports lending to small and mid-sized businesses on terms and conditions as the Board of Governors may set consistent with the relevant provisions of the Federal Reserve Act.

Tax Provisions that Benefit Non-Profit Organizations

The Act also provides stimulus through various tax provisions that benefit non-profit organizations.

- **Payroll Tax Credits**

The Act's provisions include a refundable tax credit to eligible employers equal to 50% of qualified wages paid to employees during a calendar quarter, up to the first $10,000 of wages per employee paid from March 13, 2020 through December 31, 2020. The tax credit is applied against the employer's Social Security payroll tax obligations for any calendar quarter, with any excess credit being refundable to the employer.

An eligible employer expressly includes any organizations described in Section 501(c). However, employers that receive a PPP loan are not eligible for the payroll tax credit.

The definition of qualified wages eligible for the 50% credit depends on the size of the employer. For eligible employers that had on average 100 or fewer full-time equivalent employees in 2019, all employee wages qualify for the credit during the period in which the employer remains an eligible employer. Wages include an employer contribution to a group health insurance plan to the extent that they are excludable from an employee's gross income.

- **Payroll Tax Deferral**

  The Act grants employers a deferral for the payment of their portion of Social Security payroll taxes with respect to wages paid on or after March 27, 2020 and before January 1, 2021. Specifically, 50% of an employer's Social Security payroll taxes otherwise due would not be due until December 31, 2021, with the remaining 50% deferred until December 31, 2022. The payroll tax-deferral provisions would not apply to non-profit organizations that take advantage of a loan forgiveness provision of the Act relating to PPP loans.

- **Student Loan Payments**

  The CARES Act provides a much sought-after change to permit employers to pay employees up to $5,250 per year on a tax-free basis for student loan debt expenses incurred while employed with an employer maintaining a written program pursuant to *Internal Revenue Code* Section 127. For the first time, employers will be permitted to assist employees with already incurred student loan debt. Specifically, *Internal Revenue Code* Section 127 is amended to effectively provide that payments up to $5,250 made before January 1, 2021, by an employer either to the employee or to a lender of principal and/or interest on qualified education loans will not be taxable to the employee. Employees may not receive both a loan payment and a deduction on interest paid on such debt.

- **Modification of Limitations on Charitable Deductions**

  For individual taxpayers who itemize deductions, the Act removes the cap on charitable deductions for donations made in cash to public charities (including private operating foundations, but not private foundations or donor-advised funds) during 2020, if the taxpayer so elects. The Act also provides for an "above-the-line" charitable deduction of up to $300 for 2020 for individuals who do not itemize deductions. For corporate donors, the Act increases the existing 10% taxable income limitation to 25% of taxable income (determined without regard to certain deductions). This increase includes corporate donations of food, which are typically limited to a deduction of 15% of taxable income.

Employment Provisions

- **Expansion of Unemployment Insurance**

  Through a patchwork of federal and state programs, the Act extends unemployment benefits to individuals (including workers who would not otherwise ordinarily be entitled to unemployment benefits, such as self-employed individuals or gig workers, individuals without a sufficient work history to qualify for benefits, and individuals who have previously exhausted their benefit entitlement), who are unemployed, partially unemployed, or unable or unavailable to work because of any one of a litany of COVID-19-related reasons enumerated in the Act.

  - The amount of unemployment benefits equals the amount that would be calculated under state law (with a minimum equal to 50% of the average weekly payment of regular compensation in the state), *plus* (through July 31, 2020) an additional $600 per week, representing a potential windfall for individuals whose regular compensation is below that amount.

  - The normal one-week waiting period for benefits has been waived.

- The duration for such unemployment assistance is up to 39 weeks (up from the normal 26 weeks in most states), between January 27, 2020 and December 31, 2020.
- Excluded from these benefits are (i) individuals who have the ability to telework with pay; and (ii) individuals who are receiving paid sick leave or other paid-leave benefits.

- **Short-Time Compensation**

  The Act provides federal financial support for states that have or create "short-time compensation" programs through the end of 2020. Short-time compensation programs provide benefits to employees who have not been furloughed or laid off but whose hours have been reduced. Currently, about half of the states offer some form of short-time compensation.

- **Amendment to New Paid-Leave Mandates**

  While the FFCRA, which was enacted on March 18, 2020, in response to the COVID-19 crisis imposed certain expanded paid-leave requirements on employers and provided corresponding payroll tax credits to those with less than 500 employees, the CARES Act lowers the maximum amount that employers must pay for paid sick and family leave to $511 per day ($200 per day if the leave is for caring for a family member or child) for up to 10 days per employee in each calendar quarter.

- **Self-Funded Non-Profit Organizations**

  501(c)(3) non-profit organizations have the ability to either be a self-insured employer (*i.e.,* reimburse a state for unemployment benefits paid to a former employee) or, like most, pay into a state unemployment trust fund. The Act transfers federal funds into state unemployment insurance trust funds in an amount equal to 50% of the benefits claimed by terminated employees from such funds between March 13, 2020, and December 31, 2020. This will allow states to reimburse 50% of the payments made by their self-insuring non-profit organizations for the unemployment benefits claimed by their former employees during that window. For example, if a self-insured non-profit organization's former employee receives $2,000 in unemployment benefits from the state, the non-profit organization would normally be required to reimburse the state for $2,000. However, the Act provides that the non-profit organization may be reimbursed for half of this amount (*i.e.*, $1,000).

Conclusion

Like all organizations, non-profit organizations face challenging decisions as they respond to the COVID-19 crisis. The CARES Act contains a number of provisions that non-profit organizations should consider, both for the organization itself and its employees, as they navigate these difficult times.

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[1] This includes full-time and part-time employees, and those employed on any other basis, such as independent contractors.

[2] An entity with more than 500 employees may still qualify for a PPP loan if it: (a) has fewer than the SBA small business threshold for number of employees in the industry it operates in (see table here), or (b) operates in food services or hospitality industry (NAICS industry code beginning with "72"), has multiple physical locations, and employs fewer than 500 employees at each physical location.

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