

April 7, 2020

The CARES Act – Considerations for Tax-Exempt Organizations

In response to COVID-19, a number of significant legislative and administrative steps have been taken to, among other things, ameliorate the impact of the crisis on individuals, businesses, and tax-exempt organizations. At the federal level, the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act), a ~\$2 trillion stimulus package, was enacted on March 27, 2020. The CARES Act includes a number of provisions that will or may impact organizations that are exempt under section 501(c)(3) of the Internal Revenue Code of 1986 (the Tax Code)—including certain amendments to the Tax Code designed to provide financial aid to such organizations—the more significant of which are highlighted below.

I. Incentives for Charitable Donations

The CARES Act relaxes the limitations on the tax deductibility of charitable contributions made by individuals and corporations. In this way, the new legislation is intended to enhance the incentive for, and thereby to enhance the level of, charitable giving. This relaxation applies for charitable giving during 2020.

Under the CARES Act, individuals who do not itemize deductions are permitted to deduct up to \$300 of qualified charitable contributions made in cash during the 2020 calendar year; prior to the CARES Act, no such deduction was permitted for those non-itemizers. Individuals who itemize deductions are now permitted to fully deduct qualified contributions; prior to the new legislation, the deductibility of charitable gifts by such itemizers was limited to 60% of the taxpayer's adjusted gross income. Corporate taxpayers are permitted under the CARES Act to deduct qualified contributions of up to 25% of their taxable income; previously, a corporate taxpayer could only deduct as much as 10% of its taxable income.

A qualified contribution includes donations made to organizations described in section 170(b)(1)(A) of the Tax Code, and excludes donations made to either new or existing donor advised funds (as defined in section 4966(d)(2) of the Tax Code), or to organizations described in section 509(a)(3) of the Tax Code (i.e. public charity supporting organizations). Thus, while these relaxed rules apply to most section 501(c)(3) organizations that qualify as public charities, there are certain public charities—like certain supporting organizations and organizations that house and maintain donations in donor advised funds—that are excluded.

II. Tax Relief Provisions

Employee retention credit for employers subject to closure due to COVID-19. The CARES Act allows certain eligible employers, including section 501(c)(3) organizations, a refundable credit against the employer-portion of social security taxes in an amount equal to 50% of up to \$10,000 of “qualified wages” paid after March 12, 2020 and before January 1, 2021, up to a maximum credit of \$5,000 per employee.

To be eligible, a tax-exempt organization having operations during the 2020 calendar year must either (i) have its operations (which do not have to constitute a trade or business) fully or partially suspended during a calendar quarter of 2020 due to orders from a governmental authority limiting commerce, travel, or group meetings due to COVID-19, or (ii) have a 50% reduction in revenue during a calendar quarter when compared to the same calendar quarter of the prior year.

For employers with no more than 100 employees, “qualified wages” are wages, including the cost of certain employer provided health care, paid during a period in which the employer experiences a COVID-19-related suspension of operations or decline in gross receipts. For larger employers, such wages are qualified only if they are paid to an employee who is not providing services. “Qualified wages” are limited to \$10,000 per employee and are subject to further limitations in the case of a large employer. Importantly, employers that receive a Paycheck Protection Program loan under the CARES Act are not eligible for this credit.

An eligible employer may be reimbursed for the credit by reducing its required payroll tax deposits, and may apply for an advance payment for any excess amount on Form 7200 (*Advance Payment of Employer Credits Due to COVID-19*). Guidance as to the manner to take advantage of this credit is [available here](#).

Delay of payment of employer payroll taxes. The CARES Act permits employers, including section 501(c)(3) organizations, to defer payment of the employer-portion of social security taxes from March 27, 2020 until the end of 2020. If deferred, 50% of such taxes are due on December 31, 2021, and the remaining 50% are due on December 31, 2022. No election is required for an employer to benefit from this provision. While eligible employers—including section 501(c)(3) organizations—may be entitled to this deferral, many with adequate cash on hand are considering whether to make these employer payroll tax payments at their “normal” time so as to avoid the potential disruption (and consequences of failure to pay) when the payments become due under the new law. In general, an organization that participates in the Paycheck Protection Program loan program (described below) will not be eligible for deferral of employer payroll tax payments.

Modifications for net operating losses. The CARES Act modifies rules relating to the use of net operating losses (NOLs), which may benefit certain section 501(c)(3) organizations with unrelated business taxable income (UBTI). Under prior law, NOLs generated after 2017 could not be carried back to prior years, and could only offset up to 80% of a taxpayer’s taxable income if carried forward; these limits on use of NOLs applied for organizations in determining their liability in respect of UBTI.

Under the CARES Act, NOLs generated in taxable years beginning after December 31, 2017 and before January 1, 2021 may be carried back to the five taxable years preceding the tax year in which the loss arose. In addition, for these losses (generated in the 2017-2020 periods), the CARES Act allows use of 100% of such losses to be applied to offset income in any tax period beginning before January 1, 2021.

In computing UBTI, section 512(b)(6) allows a section 501(c)(3) organization to deduct NOLs under section 172. Thus, this newly permitted expanded use and carryback of NOLs may present an opportunity for a section 501(c)(3) organization with UBTI. Organizations should remain mindful, however, that other constraints on the use of NOLs to offset UBTI remain in effect; for example, the determination of NOLs available to offset UBTI is made only with reference to income and deductions otherwise included in the UBTI computation, and (effective for tax years beginning after December 31,

2017) the deductions and losses from one trade or business may not offset the UBTI from a separate trade or business.

Tax-exempt organizations should review their prior year Form 990-Ts and consider whether they wish to amend the forms to utilize any available NOLs to reduce the amount of UBTI for prior years and claim a refund.

III. Funding Opportunities – Overview

The CARES Act provides significant funding opportunities to section 501(c)(3) organizations. Availability of the funds and the process for obtaining such funds depends in significant part on a tax-exempt organization's tax classification under section 501(a) of the Tax Code and whether the organization meets the applicable requirements. The new law broadens access to loans—some of which may be partially forgivable—through the Small Business Administration (SBA) by establishing Paycheck Protection Program loans and expanding the Economic Injury Disaster Loans (EIDL Program) to certain tax-exempt organizations. In addition to the funding opportunities through the SBA, tax-exempt organizations may also be eligible under the mid-size loan program (Mid-Size Loan Program) for emergency grants as part of the industry stabilization fund program.

While many of these opportunities also serve for-profit businesses, the CARES Act expressly provides that tax-exempt organizations are eligible. The following high-level summary generally notes the applicability to tax-exempt organizations:

- The Paycheck Protection Program applies to “charitable non-profits” under section 501(c)(3) and veterans’ organizations under 501(c)(19), each with 500 or fewer employees;
- The EIDL Program applies to “private non-profit organizations” and excludes certain charitable organizations; and
- The Mid-Size Loan Program applies to “nonprofit organizations” with 500-10,000 employees.

The EIDL Program allows small businesses and non-profits to borrow up to \$2 million, and an advance of up to \$10,000 may be forgiven. The interest rate for nonprofits is 2.75%. Borrowers under the EIDL Program can apply directly to the SBA [here](#).

Details of the Mid-Size Loan Program have not been announced. Features and conditions of the Paycheck Protection Program are provided below.

IV. Paycheck Protection Program

The Paycheck Protection Program (PPP) loan program established by the CARES Act allows qualifying small businesses to obtain low-interest loans up to \$10 million. The government steps in to guarantee the loan, so no collateral or personal guarantee by the owner is required. Fees also are waived. Most importantly, the law allows lenders to defer payments for up to 6 months, and the indebtedness can be forgiven for the amounts used by the small business for qualifying payroll, benefits, rent, mortgage payments, and utilities during the covered period. The maximum loan amount is the lesser of:

(A) 2.5 times average total monthly payroll costs incurred in the one-year period before the loan is made (or for seasonal employers the average monthly payroll costs for the 12 weeks beginning on February 15, 2019, or from March 1, 2019 to June 30, 2019) (or for businesses that were not in existence during the period from February 15, 2019 to June 30, 2019, 2.5 times the average total monthly payroll payments from January 1, 2020 to February 29, 2020);

PLUS the outstanding amount of any loan made under the SBA's Disaster Loan Program between January 31, 2020 and the date on which such loan may be refinanced as part of this new program;

OR

(B) \$10 million.

Participating lenders began accepting applications for the PPP Loan Program on April 3 using [this form](#). Borrowers can search for a participating lender using the SBA's lender locator tool [available here](#).

Eligibility of Nonprofits for PPP Loans. A nonprofit entity is eligible for a PPP loan if it, combined with its affiliates, has 500 or fewer employees and is a tax-exempt organization described in section 501(c)(3) of the Tax Code, a tax-exempt veterans organization described in section 501(c)(19) of the Tax Code, or a Tribal business concern described in section 31(b)(2)(C) of the Small Business Act. Prior to the CARES Act, nonprofit organizations were not eligible for SBA loans under section 7(a) of the Small Business Act. The CARES Act subjects most borrowers – including most nonprofits – to the SBA's existing affiliation rules. Importantly, on April 3, 2020, the SBA and the Treasury Department released an advance copy of a second interim final rule that exempts otherwise qualified faith-based organizations from the SBA's affiliation rules where the application of the affiliation rules would substantially burden those organizations' religious exercise ([available here](#)).

Application of the SBA affiliation rules. The SBA's affiliation rules apply to most nonprofits (except for faith-based organizations) in the same way they do for for-profit companies. Unfortunately, the affiliation rules were designed for for-profit companies, so in some cases the rules do not easily fit nonprofits. A borrower will be considered together with its affiliates for purposes of determining whether the aggregate number of employees exceeds 500, which is the ceiling for eligibility for a PPP loan. Under existing SBA rules (13 CFR § 121.301), entities may be considered affiliates based on factors including common ownership, overlapping management, and identity of interest. Entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists. Most criteria for affiliation described in SBA regulations apply to for-profit companies and would not typically arise for nonprofits, but the factors SBA would consider include the following:

- **Affiliation based on management.** Affiliation arises where the CEO or President of the applicant concern (or other officers, managing members, or partners who control the management of the concern) also controls the management of one or more other concerns. Affiliation also arises where a single individual, concern, or entity that controls the Board of Trustees or management of one concern also controls the Board or management of one of more other concerns. Affiliation also arises where a single individual, concern or entity controls the management of the applicant concern through a management agreement.
- **Affiliation based on identity of interest.** Affiliation arises when there is an identity of interest between close relatives, with identical or substantially identical business or economic interests (such as where the close relatives operate concerns in the same or similar industry in the same geographic area).

- **Affiliation based on ownership.** This basis for affiliation likely would not apply to most nonprofit organizations, although it could arise in a situation where an organization has both for-profit and nonprofit entities.
- **Affiliation arising under stock options, convertible securities, and agreements to merge.** This basis for affiliation likely would not apply to most nonprofit organizations. SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the power to control a concern. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised. Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered agreements in principle and are thus not given present effect.

Exemption from affiliation rules for religious organizations. Under the second interim final rule, the relationship of a faith-based organization to another organization is not considered an affiliation if the relationship is based on a religious teaching or belief or otherwise constitutes a part of the exercise of religion. According to the rule, “the exemption is required, or at a minimum authorized,” by the Religious Freedom Restoration Act (RFRA) (P.L. 103-141), which provides that the “[g]overnment shall not substantially burden a person’s exercise of religion” unless the government can “demonstrate[] that application of the burden” to the person is both “in furtherance of a compelling governmental interest” and “the least restrictive means of furthering that compelling governmental interest.” The rules states that the SBA does not have a compelling interest in denying emergency assistance to faith-based organizations that are facing the same economic hardship to which the CARES Act responded and who would be eligible for PPP but for their faith-based organizational and associational decisions.

In applying for a loan under the PPP, a faith-based organization may explain in an addendum to the application that any relationship that may pertain to affiliation (e.g., ownership of, ownership by, or common management with any other organization) is entitled to the exemption set forth in the second interim final rule. SBA will not assess, and will not require participating lenders to assess, the reasonableness of the faith-based organization’s good faith determination that the exemption applies.

Exemption from affiliation rules for other organizations. In the for-profit sector, the CARES Act exempts three categories of borrowers from application of the affiliation rules: (a) hotels and restaurants with less than 500 employees per location; (b) registered franchises; and (c) a business that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act.

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V. Filing Deadlines

Separate from the CARES Act but also of relevance to certain section 501(c)(3) organizations is that the Internal Revenue Service, pursuant to Notice 2020-18, has extended the filing deadline for Form 990-T (*Exempt Organization Business Income Tax Return*) in certain cases. If such form was due to be filed April 15th, the deadline has been extended to July 15th; however, as of the date of this notice, the filing deadline for Form 990-T’s due to be filed on May 15th has not changed, and filing obligations for Form 990 (*Return of Organization Exempt from Tax*) do not appear to have been affected (more information is [available here](#)).

Note that states and localities may also take legislative steps—which could be of significance to section 501(c)(3) organizations—that are not addressed in this notice.

If you have questions concerning the contents of this alert, or would like more information, please speak to your regular contact at Weil or to any of the following:

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