

How the Paycheck Protection Loan Program Applies to Nonprofit Organizations

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The Coronavirus Aid, Relief, and Economic Security (CARES) Act, passed on March 27, 2020, creates a new Paycheck Protection Loan program (PPLP) administered by the Small Business Administration (SBA).¹ The program is designed to provide small businesses, including nonprofits, with immediate access to cash to allow them to survive the disruption caused by the COVID-19 pandemic. There are no restrictions on eligibility for faith-based organizations, including churches.

The PPLP will:

- Provide up to \$10 million in the form of a government-guaranteed loan to be used for payroll, group health benefits, mortgage interest payments, rent payments, utilities, interest on any debt obligations incurred before February 15, 2020, and any other use permitted under 15 U.S.C. 636(a).
- Permit the deferral of loan payments for no less than six months and not more than 12 months from the date of application for deferral.
- Permit loan forgiveness based on the retention of employees.
- Provide for a 10-year loan repayment schedule for any portion of the loan that is not forgiven.

Below, we describe eligibility for the program, limits on loan amounts, permissible uses for the loan proceeds, and the opportunity for loan payment deferral and loan payment forgiveness.

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Who may apply for a Paycheck Protection Loan?

Eligible participants include:

- Small business concerns as described by SBA regulations in existence on February 15, 2020;
- Business concerns, **nonprofit organizations**, veterans organizations, and certain tribal business concerns in existence on February 15, 2020 that employ not more than the greater of (a) 500 employees, or (b) a number of employees specified by the SBA for the industry in which the entity operates;
- In the case of business concerns in the accommodation and food service industry, any such business concern that employs fewer than 500 employees per physical location; and
- Eligible sole proprietors and independent contractors.

Eligible nonprofit organizations include any organization exempt from income tax under section 501(c)(3). This includes churches, religious nonprofits, Christian schools, and higher education institutions. It does not include organizations exempt from tax under sections 501(c)(4) or 501(c)(6).

Which employees count in computing the number of employees for the 500-employee limit?

The CARES Act requires that the employer count all employees hired on a full-time, part-time, or other basis. The CARES Act does not appear to permit a full-time

equivalency computation for this purpose, although subsequent regulations may clarify this point.

Who is an eligible self-employed individual?

An eligible self-employed individual is an individual who (a) regularly carries on a trade or business, and (b) would be entitled to receive paid leave during the taxable year pursuant to the [Emergency Paid Sick Leave Act](#) if the individual were an employee of an employer (other than himself or herself).

How is the maximum loan amount computed?

The maximum loan amount allowed is the lesser of (a) \$10 million and (b) 2.5 times the average total monthly payroll costs incurred during the one-year period before the date on which the loan is made *plus* the outstanding balance of any Emergency Injury Disaster Loan made by the SBA on or after January 31, 2020 and before the date Paycheck Protection Loans are made available.

Please see below for special rules for seasonal employers and eligible employers that had not yet begun business during the period of February 15, 2019 through June 30, 2019.

In the case of employees, payroll costs include compensation payments such as:

- Salary, wages, commissions, or other similar compensation;
- Payment of cash tips or their equivalent;
- Payments for vacation, parental, family, medical, or sick leave;
- Any allowance for dismissal or separation;
- Payments for group health care benefits, including insurance premiums;
- Payment of any retirement benefit; or
- Payment of any state or local tax assessed on employee compensation.

Payroll costs for employees do not include:

- Compensation in excess of \$100,000 paid to any one individual;
- FICA tax, Medicare tax, RRTA tax, or federal unemployment tax;
- Compensation to an employee whose principal place of residence is outside the United States;
- Payments for qualified sick leave wages paid for which a credit was allowed under the Families First Coronavirus Response Act (FFCRA); and

- Payments for qualified family leave wages paid for which a credit was allowed under the FFCRA.

Note that the exclusion of compensation paid to employees whose principal place of residence is outside the United States will exclude compensation paid to most missionaries on a foreign field of service.

In the case of self-employed individuals, payroll costs include compensation or income that is a wage, commission, income, net earnings from self-employment, or similar compensation that does not exceed \$100,000 in one year, prorated for the period between February 15, 2020 and June 30, 2020.

Special rule for seasonal employers

Seasonal employers may compute their maximum loan amount as the lesser of (a) \$10 million and (b) 2.5 times the average total monthly payroll costs incurred for the period beginning either February 15, 2019 or March 1, 2019 and ending on June 30, 2019 *plus* the outstanding balance of any Emergency Injury Disaster Loan made by the SBA on or after January 31, 2020 and before the date Paycheck Protection Loans are made available.

Special rule for eligible employers that had not yet begun business during the period of February 15, 2019 through June 30, 2019

Upon request, an employer that was not in business during the period of February 15, 2019 through June 30, 2019 may compute its maximum loan amount as the lesser of (a) \$10 million and (b) 2.5 times the average total monthly payroll costs incurred during the period beginning on January 1, 2020 and ending on February 29, 2020, *plus* the outstanding balance of any Emergency Injury Disaster Loan made by the SBA on or after January 31, 2020 and before the date Paycheck Protection Loans are made available.

What rate of interest will apply to a Paycheck Protection Loan?

The maximum rate of interest that may apply to a Paycheck Protection Loan is 4%.

For what purposes may the loan proceeds be used?

The Paycheck Protection Loan proceeds may be used:

- For any allowable purpose under SBA loan programs;
- To cover payroll costs (see the definition of payroll costs above);
- To pay group health benefits, including insurance premiums;

- To pay employee salaries, commissions, or similar compensation;
- To pay mortgage interest payments (but not principal payments, including prepayment of principal);
- To pay rent;
- To pay utilities;
- To pay interest on any other obligation incurred before February 15, 2020; and
- To refinance an Emergency Injury Disaster Loan made between January 31, 2020 and the date on which Paycheck Protection Loans are made available.

When is documentation required?

Sole proprietors, self-employed individuals, and independent contractors must provide sufficient documentation to demonstrate their eligibility. This includes, but is not limited to:

- Payroll tax filings filed with the IRS;
- Income and expenses from their sole proprietorship;
- Forms 1099-MISC; and
- Such other documentation as is required by the SBA and the Secretary of Commerce.

When will Paycheck Protection Loans be available?

By definition, a Paycheck Protection Loan must be made between February 15, 2020 and June 30, 2020. At this time, it is unclear how long lenders will take to release loan funds.

What criteria must a lender consider when evaluating a Paycheck Protection Loan applicant?

The CARES Act identifies a number of criteria lenders must consider to determine if an applicant is an eligible borrower. These factors include:

- Whether the applicant was in operation on February 15, 2020; and
- Whether the applicant had employees for whom it paid salaries and payroll taxes or paid independent contractors as reported on Form 1099-MISC.

In addition, an applicant must make a good faith certification that:

- The loan is necessary to support the applicant's ongoing operations due to the uncertainty of current economic conditions;

- The loan proceeds will be used to retain workers and maintain payroll, or to make mortgage payments, lease payments, and utility payments;
- The applicant has no other Paycheck Protection Loan Application pending; and
- During the period beginning February 15, 2020 and ending December 31, 2020, the applicant has not received Paycheck Protection Loan proceeds for the same purpose and duplicative of amounts applied for or received under another Paycheck Protection Loan.

Further, sole proprietors, self-employed individuals, and independent contractors must provide sufficient documentation to demonstrate their eligibility. This includes, but is not limited to:

- Payroll tax filings filed with the IRS;
- Income and expenses from their sole proprietorship;
- Form 1099-MISC; and
- Such other documentation as is required by the SBA and the Secretary of Commerce.

What loan payment deferment options are available?

For any applicant that was in operation on February 15, 2020 and has a Paycheck Protection Loan application approved after the enactment of the CARES Act, deferment of the payment of interest principal and fees is required for a period of not less than six months and not more than one year. The SBA Administrator is charged with determining the actual length of the deferral period.

What options exist for loan forgiveness?

A portion of the Paycheck Protection Loan up to 100% may be forgiven. The loan forgiveness amount is determined by first computing the amount of payments made for payroll costs, mortgage interest payments, rent payments, and utility payments for the eight-week period following the origination of the Paycheck Protection Loan. This amount is then multiplied by two factors: (1) a headcount reduction factor; and (2) a salary and wage reduction amount. In addition, the loan forgiveness amount must be reduced by an Economic Injury Disaster Loan advance received by the borrower.

Computation of the headcount reduction factor

To compute the headcount reduction factor:

1. Compute the number of full-time equivalent (FTE) employees per month employed during the eight-week period beginning on the loan origination date.

2. Divide the result, at the borrower's discretion, by either:
 - a. The average number of FTE employees per month employed by the borrower between February 15, 2019 and June 30, 2019; or
 - b. The average number of FTE employees per month employed by the borrower between January 1, 2020 and February 29, 2020.

If the employer is a seasonal employer, the denominator of the factor is the average number of FTE employees per month employed by the borrower between February 15, 2019 and June 30, 2019.

To compute the average number of FTE employees, calculate the average number of FTE employees for each pay period that falls within a month.

Note that the CARES Act does not describe how part-time employee hours are to be converted to FTE employee hours. Elsewhere in the Act where there is a reference to computing the average number of FTE employees, there is a cross-reference to the computation used to determine whether an employer meets the 50 FTE employee threshold for classification as an Applicable Large Employer under the Employer Shared Responsibility payment requirements of the Affordable Care Act. It remains to be seen whether this standard will be adopted for Paycheck Protection Loan forgiveness purposes.

Computation of the salary and wage reduction amount

To compute the salary and wage reduction factor:

1. Determine which employees, if any, experienced a salary or wage reduction during the eight-week period beginning on the loan origination date that is in excess of 25% of the employee's total salary or wages during the most recent full quarter of employment prior to the loan origination date. In making this determination, exclude any employee who received an amount of salary or wages during any pay period during 2019 which exceeded \$100,000 at an annualized rate of pay.
2. For each such employee, compute the amount by which the salary and wage reduction exceeds 25%.
3. The sum of the amounts computed in the preceding step is the salary and wage reduction amount.

Exception to the application of the headcount reduction factor and salary and wage reduction amount

There is an important exception to the application of the headcount reduction factor and salary and wage

reduction amount where an employer rehires employees or restores the salary and wages of affected employees.

The headcount reduction exception factor applies where, during the period beginning on February 15, 2020 and ending on April 26, 2020 (the date 30 days after enactment of the CARES Act), there is a headcount reduction that is eliminated by no later than June 30, 2020.

Similarly, the salary and wage reduction amount exception applies where, during the period beginning on February 15, 2020 and ending on April 26, 2020 (the date 30 days after enactment of the CARES Act), there is a salary and wage reduction for one or more employees as compared to February 15, 2020, which is eliminated by not later than June 30, 2020.

The two exceptions operate independently of one another. Therefore, an employer may qualify for either exception, neither exception, or both.

Finally, for taxable borrowers, forgiven amounts are excludable from gross income for tax purposes. Any amounts that are not forgiven will be repayable over a 10-year period that begins on the date the borrower applies for loan forgiveness.

What documentation must a borrower provide a lender to obtain loan forgiveness?

A borrower must submit an application for loan forgiveness that includes:

- Documentation verifying the number of FTE employees on the payroll and their rates of pay at the relevant dates described above. This documentation may include payroll tax filings filed with the IRS and income, payroll, and unemployment insurance filings filed with state authorities.
- Documentation such as canceled checks, payment receipts, and account statements or transcripts showing mortgage payments, rent payments, and utility payments.
- A certification by an officer as to the truthfulness of the information submitted and certifying the loan proceeds were used to retain employees, make mortgage interest payments, make rent payments, make utility payments, or used for some combination of these purposes.
- Any other document the SBA Administrator determines is necessary.

Loan forgiveness is prohibited if a borrower fails to comply with these documentation requirements.

Other Loan Features

Paycheck Protection Loans are 100% guaranteed by the federal government. They do not require personal guarantees or collateral. No prepayment penalty may apply. They are made by and administered by banks, savings and loans, and credit unions.

What should you do next?

If you think your organization may benefit from a Paycheck Protection Loan, there are several steps you can begin to take now:

1. Begin a dialog with your bank regarding the application process;
2. Begin to accumulate the payroll information necessary to determine the maximum loan amount;
3. Prepare the required certification (or at least confirm you can make the certification on a form provided by the lender);
4. Prepare a forecast of amounts you will spend on payroll costs, mortgage interest payments, rent payments, and utility payments for the eight weeks following the origination of the Paycheck Protection Loan; and
5. Look at the various other forms of relief [in the CARES Act](#) and [the Families First Coronavirus Response Act](#) to determine what combination of relief is your best option.

What else should you know?

This is a complex loan program. Expect the SBA and lenders to be flying blind for several weeks as the application process is designed, forms are created, and regulations and other guidance are created.

Please contact us online or at info@capincrouse.com with any questions about the PPLP, CARES Act, or how we can help your organization navigate this challenging time.

ⁱ A Paycheck Protection Loan is authorized under Section 7(a) of the Small Business Act. Accordingly, it is among a class of SBA loans known as "7(a) loans."

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