



Financial Aid Expected for Struggling Nonprofits: The HEROES Act and Accessing PPP Loans

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The week of May 11, 2020, the Democrats in the House of Representatives introduced a bill – the Health and Economic Recovery Omnibus Emergency Solutions Act (“HEROES Act”) – that would provide the next round of stimulus funds. The HEROES Act comes on the heels of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), and has been referred to as a Democratic-messaging bill. Senate Republicans have said it will not pass their chamber. Nonetheless, it contains significant economic support for nonprofits that are currently shut out of the Paycheck Protection Program (“PPP”) loans administered by the Small Business Administration (the “SBA”).

PPP Loans Currently Limited to 501(c)(3)s

As noted in our series of *eAlerts* on PPP loans, in order to be eligible for a PPP loan under the CARES Act, a business must (among other things) be one of the following:

- A small business under existing SBA regulations; or
- A business, a 501(c)(3) nonprofit, a 501(c)(19) veterans organization or a tribal business that employs not more than 500 employees or the number of employees in the size standard applicable to the business’ industry.

The SBA has updated its eligibility criteria to allow religious organizations exempt under 501(c)(3) of the Internal Revenue Code to apply for PPP loans, despite their exclusion from past SBA loan programs. The CARES Act shut out a significant portion of the nonprofit sector from accessing relief under the PPP. According to one review of the nonprofit sector, as of 2017, approximately 78% of nonprofits were 501(c)(3)s. This means approximately 22% of nonprofits (or in raw numbers, some 500,000 organizations) are ineligible for a PPP loan. That omission did not go unnoticed.

Follow Up to CARES Act

A month after the CARES Act was enacted, a bipartisan group of senators, led by Senators Cassidy (R-LA) and Manchin (D-WV), wrote to Senate leadership requesting that local chambers of commerce and other 501(c)(6) organizations be included in the next round of PPP funding. They stated such funding was necessary “to ensure that local chambers of commerce and other 501(c)(6) organizations can continue to support small businesses at this precarious moment for our country.”

Proposed Changes to the PPP Under the HEROES Act Affecting the Nonprofit Sector (and Other Businesses Generally)

In response, the House Democrats have unveiled the HEROES Act. The HEROES Act addresses the issue identified by the bipartisan group of senators more broadly by proposing to expand PPP eligibility to all types of nonprofits, regardless of their tax-exempt classification under Section 501(c) of the Internal Revenue Code. This would include both the 501(c)(6) trade associations identified in the Senate letter, as well as 501(c)(4) social welfare organizations, 501(c)(5) labor and agricultural organizations and any other “501(c)s.”

In addition, the HEROES Act proposes the following amendments to the PPP aimed at the nonprofit sector:

- Removal of the 500 employee cap, effectively allowing larger 501(c)(3) charities that were previously ineligible to apply for a PPP loan;
- Explicit allocation of 25% of new funding for nonprofits of all types; and
- Further allocation of the funding set aside for nonprofits evenly between large nonprofits (those with more than 500 employees) and small to mid-size ones (those with less than 500 employees).

The HEROES Act also proposes a number of changes to the PPP that, if passed, will have a sweeping effect on all borrowers generally, regardless of for profit vs. nonprofit status. These changes include:

- Extending the covered period from June 30, 2020 to December 31, 2020;
- Establishing a minimum maturity on PPP loans of five years;
- Amending the PPP loan forgiveness criteria by, among other things, extending the eight-week period to 24 weeks, eliminating the 75/25 rule on use of loan proceeds and creating a safe harbor for borrowers who cannot rehire within the prescribed timeframe; and
- Excluding the cost of compensation to any lobbyist registered under the Lobbying Disclosure Act as an eligible PPP expense, per an amendment to the HEROES Act.

Whether all of these changes will be passed into law remains to be seen. However, given the bipartisan support to extend PPP eligibility to all nonprofits generally, there is a good chance that this aspect of the HEROES Act will likely become law. The House of Representatives is set to vote on the bill on May 15, 2020.

If PPP Eligibility is Extended to All Nonprofits Generally, What Might Nonprofits Expect?

Assuming that PPP is extended to all nonprofits generally, what might you expect to encounter as part of the SBA loan process if you're a 501(c)(4) or 501(c)(6)? Based on our experience thus far with PPP loans, here are the key takeaways about the PPP that you should bear in mind:

- Categories of Eligible Expenses: The proceeds of a PPP loan may only be used to cover the cost of payroll, insurance premiums, employee compensation (with some limits for employees with salaries over \$100,000 and exclusions for non-U.S. based employees), rent, utilities and interest on mortgage payments and other debt

incurred prior to February 15, 2020.

- Maximum Amount of PPP Loan: The maximum amount of PPP loan that may be borrowed is capped at \$10 million or 2.5 times the average monthly payroll for the applicant, whichever is greater. One thing that may be particularly relevant to nonprofits is that payments to independent contractors are *excluded* when calculating an applicant's average monthly payroll costs.
- Eligibility Rules: Nonprofits should scrutinize their eligibility for a PPP loan in light of the CARES Act, PPP Frequently Asked Questions ("FAQS") issued by the SBA and all SBA Interim Final Rules issued to date. In particular, nonprofits should note that any applicant for a PPP loan will be required to certify in good faith that "current economic uncertainty makes the loan necessary to support...ongoing business operations." In determining eligibility for a PPP loan, a nonprofit needs to take into account current economic business activity and must assess its ability to access sources of liquidity sufficient to support its ongoing business operations in a manner that is not detrimental to the business. See here for further discussion on this aspect of the eligibility rules.

In addition to the eligibility requirements in the CARES Act, FAQs and Interim Final Rules, the SBA also has a list of eligible and ineligible entities for its programs, and we expect (for the most part) the list to remain intact for nonprofits under the PPP. As we saw with the CARES Act's carve out for faith-based nonprofits, there may be some carve outs for other types of 501(c)s. One area where we expect the SBA rules to go unchanged is that entities that are "primarily engaged in political or lobbying activities" will remain ineligible for a PPP loan (see 13 CFR 120-110(r)), especially in light of the HEROES Act's proposed exclusion of registered lobbyists' compensation from eligible PPP expenses, as mentioned above. The SBA recently defended this rule in litigation, and won at the district court level, so we don't anticipate any changes that would apply to other 501(c)s. (Of course, under tax exemption rules, an entity engaged primarily in political activity would be a 527 political organization or political committee, but many 501(c)(4)s and 501(c)(6)s permissibly have lobbying as their primary purpose.) Because the SBA rules were written with business entities in mind, we expect some small tweaks – like the faith-based nonprofit one – if the SBA starts issuing PPP loans to other types of nonprofits.

- Loan Forgiveness: The amount of loan forgiveness depends, in part, on the total amount spent during the covered period (currently defined in the CARES Act as the eight-week period following the first disbursement of the loan) on eligible payments – i.e., the sum of payroll costs and certain overhead expenses (e.g., interest payments on mortgage obligations, rent payments on lease agreements and utility payments). Furthermore, unless the elimination of the 75/25 rule proposed under the HEROES Act is passed, **at least 75% of the amount forgiven must be attributable to payroll costs**. The amount that may be forgiven is decreased if the nonprofit has laid off employees or reduced compensation paid to employees with salaries of more than \$100,000 per annum by more than 25% during the covered period. Note, the CARES Act has not spelled out many of the details surrounding the loan forgiveness rules and we are still waiting for further guidance from the SBA on this aspect of the PPP.
- Keep a Thorough Written Record: The SBA has stated it will audit loans in excess of \$2 million to verify eligibility for a PPP loan. Given this and the uncertainty surrounding many aspects of the PPP, nonprofits should document and save a written record of not only their PPP loan application, but also all articles, FAQs, internet searches, PDF guidance, advice, notes, emails, drafts and other materials upon which the nonprofit relied in order to prepare its application. These resource materials are useful contemporaneous evidence to help explain what the board of the nonprofit understood at the time it applied for the loan. It also can help the board remember years later if an issue arises.

In sum, there is much to be decided regarding PPP and its availability to nonprofits beyond 501(c)(3)s. However, given that one of the "pushes" in the HEROES Act is to broaden the reach of the PPP to the entire

nonprofit sector, there is good reason to believe that some form of relief may become available. We expect any supplemental funding to be disbursed and claimed quickly, so now is the time for nonprofits to start planning to apply for a PPP loan so they can act quickly if the HEROES Act, or some form of it, becomes law.

This article is not intended to be an exhaustive summary of the PPP or the information contained in the HEROES Act, the CARES Act, the Interim Final Rules or FAQs. Readers are encouraged to click on the links above and visit the SBA's website for more complete and up-to-date information regarding the PPP.